Registered No: 15454

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Annual Report and Financial Statements for the Year Ended 31 December 2012

Final
Dated 25 March 2013

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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

Registered office: Laurence Pountney Hill, London EC4R 0HH

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THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Directors

Mr T C Thiam - Chairman
Mr N A Nicandrou – Deputy Chairman
Ms W Au (Independent Non-Executive Director)
Mr D J Belsham
Mr A M Crossley
Mr R A Devey
Mr H A Hussain
Mr F A O'Dwyer

Secretary

Miss S D Windridge

Auditor

KPMG Audit Plc, London

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012

Principal activity

The principal activity of the Company in the course of 2012 was transacting long-term insurance business in the United Kingdom. The Company also owns several insurance subsidiary undertakings and a branch in Hong Kong that transact insurance business in the United Kingdom and overseas. These activities will continue in 2013. The Company has established a branch in Poland to transact insurance business and this branch became operational in March 2013.

The Company itself is a wholly owned subsidiary undertaking of another company registered in England and Wales and therefore group financial statements and a group business review are not prepared. Accordingly, the financial statements and the following business review present information about the Company as an individual undertaking and are not consolidated.

Business review

Market review and strategy

The Company's long-term products consist of life insurance, pension products and pension annuities. In common with other UK long-term insurance companies, the Company's products are structured as either with-profits (or participating) products, or non-participating products including annuities in payment and unit-linked products. Depending upon the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies. With-profits policies are supported by the with-profits sub-fund and can be single or regular premium. The return to shareholders on virtually all with-profits products is in the form of a statutory transfer to the Company's shareholders' funds which is analogous to a dividend from the Company's long-term fund and is dependent upon the level of bonuses credited or declared on policies in that year. There are two types of bonuses – "annual" and "final". Annual bonuses are declared once a year, and are determined as a prudent proportion of the long-term expected future investment return on the underlying assets. Once credited, annual bonuses are guaranteed in accordance with the terms of the particular product. In contrast, "final" bonuses are only guaranteed until the next bonus declaration, and are primarily determined on the actual investment return achieved, smoothed over the life of the policy. With-profits policyholders currently receive 90 per cent of the distribution from the with-profits sub-fund as bonus additions to their policies and shareholders receive 10 per cent as a statutory transfer. On 31 August 2011 the majority of the annuities previously reinsured to Prudential Annuities Limited (PAL), a subsidiary of the Company, was recaptured by the Company's with-profits fund. On 31 October 2012 PAL, which is closed to new business, reassured its entire book of business to the Company, except for a small number of policies that had already been reassured to an external reinsurance company. PAL's business is entirely made up of non-profit pension annuities.

The Scottish Amicable Insurance Fund (SAIF) is a closed sub-fund that contains the bulk of the business originally written by the Scottish Amicable Life Assurance Society and acquired by the Company on 30 September 1997. Under the terms agreed at the time of the purchase, the SAIF inherited estate will be distributed to with-profits policyholders as an addition to the with-profits benefits arising in SAIF. The SAIF policyholders therefore receive 100 per cent of the distribution from the sub-fund as bonus additions to their policies.

The defined charge participating sub-fund (DCPSF) forms part of the Company's long-term fund and comprises the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France, the defined charge participating with-profits business reassured into the Company from both Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd and the with-profits annuity business transferred to the Company from the Equitable Life Assurance Society on 31 December 2007. All profits in this fund accrue to policyholders in the DCPSF.

There is a substantial volume of non-participating business in the with-profits sub-fund; profits from this business accrue to the with-profits sub-fund. The Company also writes non-participating business, the profit on which accrues solely to shareholders, and this business is written in the Company's non-profit sub-fund.

The Life & Pensions market in the UK is mature and highly regulated. Significant regulatory change occurred in 2012 with the implementation of the Retail Distribution Review, Gender Neutral Pricing and Auto-enrolment for company pension schemes. These new regulations represent a major change to the way business is conducted in many areas of the markets in which the Company operates in the UK, and

impact not only insurance and investments providers, but also distributors and consumers. It is inevitable that regulatory change of this scale and scope creates a period of uncertainty before the shape of the new long-term competitive landscape becomes more evident.

The UK market is also characterised by an ageing population and a concentration of wealth in the 50+ age group, many of whom have built up substantial pension funds in employer-sponsored schemes. These customers require help to convert wealth into sustainable lifetime income. For the next generation of savers, the responsibility for retirement provision has shifted substantially away from Government and employers towards the individual. These customers are typically under-funded for retirement and helping them accumulate savings constitutes a significant opportunity for long-term savings and retirement income providers, at a time when the ability of the state to intervene is significantly diminished.

The Company's longevity experience, multi-asset investment capabilities, long-standing trusted brand and financial strength mean that it is favourably positioned to help consumers translate their accumulated wealth into dependable retirement income through its range of market leading with-profits and annuity products.

The Company focuses on those areas of the market where it is able to bring superior value to its customers and where it enjoys a competitive advantage. The performance of the Company's With-Profits Fund in 2012 has allowed bonuses to be declared which mean the policyholders should see year-on-year increases of between 3.5 per cent and 6.5 per cent in accumulating with-profits policy values and total bonus payments are expected to top £2.0bn in 2013.

The Company's ability to deliver value to its customers and the resulting market franchise allowed the Company to achieve another strong performance in 2012 despite the challenging economic environment and competitive conditions that prevailed in the UK marketplace.

The Company is growing its individual annuity business, building on a robust pipeline of internal vestings from maturing individual and corporate pensions policies.

Onshore bonds sales were up 28 per cent on 2011, including with-profits bond sales which increased by 34 per cent. The PruFund range made up 75 per cent of with-profits bond sales, with 35 per cent higher sales than 2011. PruFund continues to be popular with consumers, providing smoothed returns and a range of optional guarantees, which offer a degree of security against potential market falls in a post-crisis environment where investors have become much more risk-averse. Although the demand for guarantees remains high, the increase in PruFund sales is based entirely on the non-guaranteed version of the product, which is attractive to those customers who are prepared to accept some risk to their capital but still want to benefit from the smoothing offered by a with-profit product.

The Retail Distribution Review (RDR), one of a number of current reforms to the UK regulatory framework, was implemented on 31 December 2012. It means that financial advisers can no longer be paid commission for recommending investment products. This is likely to lead to some short-term dislocation in the market as consumers adjust to paying fees for advice and adviser firms adapt their business models for the new rules. While the Company has prepared its business for the post-RDR regulatory environment, it is expected that this transition phase will impact the Company's sales of investment bonds in 2013.

Corporate pensions sales were 19 per cent lower than the same period last year. Sales in 2011 were particularly high due to new defined contribution members joining the Company's schemes following closure of a number of defined benefit schemes operated by existing clients. The Company continues to focus on securing new members and incremental business from its current portfolio of corporate pensions customers rather than acquiring new corporate pensions schemes where market pricing is currently unattractive. The Company remains the largest provider of Additional Voluntary Contribution plans within the public sector where it now provides schemes for 68 of the 99 public sector authorities in the UK.

Sales of other products, principally individual pensions, PruProtect and offshore bonds were 12 per cent higher than 2011. Individual pensions sales (including income drawdown) were 11 per cent higher, reflecting increased demand for the Flexible Retirement Plan among advisers and their clients.

In the Wholesale market, the Company's aim is to continue to participate very selectively in bulk and back-book buyouts using its financial strength, superior investment track record and annuitant mortality risk assessment and servicing capabilities. The Company will continue to maintain a very strict focus on

value and only participate in capital-efficient transactions that meet its strict return on capital requirements.

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

Performance and measurement

The following table sets out the key performance indicators for the Company. These are considered to be the key metrics for the Company as these are the measures by which the Company's management monitor the performance of the business.

Key Performance Indicators	**2012**	**2011**	**Change**
	£m	**£m**	**%**
Profit on ordinary activities before tax	459	480	(4%)
Shareholder funds	4,740	4,179	13%
APE sales	1,782	1,066	67%
Available capital on the Financial Services Authority (FSA) regulatory bases:			
With-profits, Scottish Amicable Insurance Fund, Defined Charge Participating Sub-fund	7,047	6,055	16%
Non-profit sub-fund	205	181	13%

Profit on Ordinary Activities before Tax

The results of the Company for the year as set out on pages 17 to 19 show a profit on ordinary activities before tax of £459m (2011: £480m), 4% lower than in 2011.

The 2012 long-term business results are £417m, £25m lower than in 2011; £56m lower in the UK and £31m higher in the Hong Kong branch. In the UK, profits attributable to the with-profits business are £21m lower than in 2011 due to a change in tax rate and a fall in the annual bonus rates. In the UK, the profit attributable to the non-profit sub-fund business is £35m lower than in 2011. This is primarily due to lower profits from protection and life business; partially offsetting these losses are higher profits from linked pensions business and increased profits from the quota share reinsurance with Prudential Retirement Income Limited (PRIL); since 31 December 2008 the Company has had a reinsurance arrangement with PRIL to accept 15% of PRIL's non-profit annuity business on a quota share basis, which allows all of the reinsurance premiums to be deposited back to PRIL. This has resulted in a profit of £77m (2011: £59m) in the Company, with an equal and offsetting loss in PRIL. In the Hong Kong branch profits are £31m higher than in 2011 mainly due to the growth of in-force business and a lower reserve strengthening for the year compared to 2011.

Profit arising from the shareholder funds is £4m higher than in 2011 at £42m mainly because the 2011 result was reduced by a one-off loss of £10m arising on the liquidation of Prudential (AN) Limited. This favourable movement in 2012 has been partially offset by the commission received on Prudential-branded General Insurance products being £7m lower than in 2011, at £33m, as the book of business originally transferred to Churchill in 2004 is decreasing as expected.

Shareholders' Funds

The shareholders' funds of the Company total £4,740m (2011: £4,179m). The increase of £561m, after taking account of dividends paid to Prudential plc of £245m and exchange adjustments of £6m, is due to profit after tax of £376m, and an increase in the revaluation of investments in subsidiaries and one associate owned by the shareholder funds of £436m.

APE Sales

Sales on an APE basis (Regular Premiums plus 1/10th Single Premiums) are £1,782m up 67 per cent from £1,066m in 2011. This increase is primarily due Prudential Annuities Limited (PAL), a subsidiary of the Company, reassuring almost its entire book of business to the Company on 31 October 2012. The premium paid was £5,944m which was equal to the value of the transferring business, as measured on the prudent statutory basis ('Pillar 1, Peak 1'). Without this one-off transaction sales on an APE basis would have been £1,188m, up 11 per cent from 2011. The increase is mainly due to demand for the Company's onshore bonds, sales of which are up 28 per cent on 2011 and in particular with-profits bond sales are up by 34 per cent. The Company's PruFund range made up 75 per cent of total with-profits bond sales with 35 per cent higher sales than in 2011. In addition sales on individual pensions, protection and offshore bonds are up 12 per cent on 2011, partially offset by sales of corporate pensions products which are 19 per cent lower than in 2011. In Hong Kong sales are up 13 per cent on 2011 mainly due to increased sales of with-profits and health and protection products driven by successful customer promotions and new product offerings launched in 2012.

Available Capital

The strength and performance track record of the Company's With-Profits Fund is widely recognised. The combined financial strength and investment performance track record of the Company's With-Profits Fund continues to provide a key source of non-price differentiation in a competitive market. With-profits customers benefit from the security of the Company's large inherited estate, valued at £7bn at the year-end on a regulatory realistic basis, which provides a high degree of protection against adverse market movements. The Fund continues to provide customers with solid returns and to out-perform the FTSE All-Share Index over medium to long-term horizons. Over the last 15 years, the Fund has delivered a cumulative investment return of 184.3 per cent on investments covering policyholder liabilities. This compares favourably with other with-profits funds and the FTSE All-Share Index total return of 106.5 per cent over the same period. This performance shows that investing in a strong with-profits fund can produce good returns for cautious investors, in spite of the combined pressures of volatile market conditions and UK interest rates remaining at historically low levels.

The available capital in the Company's non-profit sub-fund is £205m (2011: £181m).

The Company's available capital position is covered further in Note 34 on page 74.

As at the date of signing the accounts, the Company's long-term fund is rated Aa2 by Moody's, AA by Standard & Poor's and AA by Fitch.

Risks & uncertainties

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

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

The Company's results and financial condition is exposed to both financial and non-financial risks from its long-term with-profits and non-profits business and from the underlying business within its investments in a number of subsidiary and associate companies, the value of which can be affected by certain risks factors. The key risk factors, mentioned below, should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

Financial risks

The Company is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The financial risk factors affecting the Company include market risk, credit risk, insurance risk and liquidity risk. Further information on the financial risk management objectives and

policies of the Company and the exposure of the Company to the financial risk factors is given in note 31 on page 50, note 33 (C) on page 70 and in note 33 (E) on page 73.

The current uncertainty in local and international economic and investment climates has increased financial risks and this could adversely affect the Company's business and profitability. Since 2008 the Company has had to operate against a challenging background of periods of significant volatility in global capital and equity markets, interest rates, liquidity, and the broader economic environment. Government interest rates have also fallen to historic lows in the US and the UK.

The global financial markets have experienced and continue to experience significant uncertainty brought on, in particular, by concerns over European sovereign debt, as well as concerns about a general slowing of global demand reflecting an increasing lack of confidence among consumers, companies and governments. Upheavals in the financial markets may affect general levels of economic activity, employment and customer behaviour. For example, insurers may experience an elevated incidence of lapses, or surrenders of policies, and some policyholders may choose to defer or stop paying insurance premiums. The demand for insurance products may also be adversely affected. If sustained, this environment is likely to have a negative impact on the insurance sector over time and may consequently have a negative impact on the Company's business and profitability. New challenges related to market fluctuations and general economic conditions may continue to emerge.

A significant part of the Company's profit is related to bonuses for policyholders declared on its with-profits products, which are broadly based on historic and current rates of return on equity, property and fixed income securities, as well as the Company's expectations of future investment returns. This profit could be lower in a sustained low interest rate environment.

(a) 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 and/or volatility of market prices of assets and liabilities and changes in interest rates and exchange rates.

Market risk is one of the largest risks for the Company. The key areas of the business impacted by market risk are the non-profit annuity business, the present value of expected future shareholder transfers from the with-profits business, the lifetime mortgage book transferred from a subsidiary company and currency risk on the value of the business in the Hong Kong branch. The current uncertainty in local and international economic and investment climates has increased market risk and this could adversely affect the Company's business and profitability, principally through the following:

- Investment impairments or reduced investment returns, as a result of market volatility, could impair the Company's ability to write significant volumes of new business, which would have a negative impact on the Company's assets under management and profit;

- The asset and liability mismatch risk and the risk of insolvency has increased due to historically low interest rates. The company manages this risk by appropriate matching of its assets and liabilities.

(b) Credit risk

Credit risk is the risk of loss to the Company 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 is exposed to significant credit risk. The credit risk arises mainly from the corporate bond holdings in the non-profit annuity and with-profits business. The global financial crisis has exacerbated credit risk as corporate borrowers are experiencing a challenging business environment and volatile profits and cashflows. This has impacted credit risk through the following:

- Increased risk of credit losses through defaults and widening of credit spreads on corporate bonds. This is a material risk for the Company and is managed by careful management of the corporate bond portfolio and having appropriate concentration and credit rating limits in place;

- The Company, in the normal course of business enters into a variety of transactions with counterparties, including reinsurance and derivative transactions. Failure of any of these counterparties to discharge their obligations, or where adequate collateral is not in place (e.g. in case of reinsurance counterparties), could have an adverse impact on the Company's results. The Company manages reinsurance counterparty risk by diversifying its reinsurance exposures across a number of counterparties, and by having minimum counterparty credit rating limits and maximum concentration limits in place. Derivative counterparty risk is largely mitigated by careful counterparty selection and adequate collateralisation arrangements.

(c) Insurance risk

Insurance risk is the risk of loss or of adverse change in the value of insurance liabilities of the Company, resulting from changes in the level, trend or volatility of a number of insurance risk drivers. This includes adverse longevity, mortality, morbidity, persistency and expense experience.

The Company is exposed to significant insurance risk. Insurance risk arises mainly from the annuity business in the form of longevity risk, which is the risk that the Company's (current and deferred) annuity customers live longer than expected in the Company's current pricing and reserving assumptions, and as a result future reserving and capital assumptions are changed. The Company conducts rigorous research into longevity risk, using data from its annuitant portfolio. As part of its pension annuity pricing and reserving policy, the Company assumes that current rates of mortality continue to improve over time at levels based on the Company's calibration of the Continuous Mortality Investigations (CMI) 2011 mortality projection model as published by the Institute and Faculty of Actuaries. If mortality improvement rates significantly exceed the improvement assumed, the Company's operating results could be adversely affected. Also any major medical breakthrough (for example in the treatment of cancer or other life-threatening diseases) that would require the Company to strengthen its longevity assumptions will have an impact on the Company's results.

The other insurance risks run by the Company are expense risk, persistency risk and mortality/morbidity risk. These risks are less material than the market, credit and longevity risks.

- Expense risk is the risk of the actual expenses exceeding the assumptions in pricing and reserving and is relevant to all lines of business. The Company makes assumptions about future expected levels of expenses for each line of business and uses these in pricing and calculating reserves. If the actual expenses exceed these assumptions, the Company's operating results could be adversely impacted.

- Persistency is the assumption that the Company makes about future expected levels of the rates of early termination of products by its customers. The Company's persistency assumptions reflect the recent past experience for each relevant line of business including any expected trends in future persistency rates. If the actual levels of future persistency are significantly lower than assumed (that is, policy termination rates are significantly higher than assumed), the Company's results of operations could be adversely affected. This risk is only relevant to the non-annuity business in the Company.

- Mortality and morbidity risks relate to assumptions around the expected number of deaths or illnesses used in pricing and calculating reserves. These are relevant for those lines of business where the customer payoff is dependant on a death or illness. An example is the impact of epidemics or other events that cause a large number illnesses and/or deaths. Significant influenza epidemics have occurred three times in the last century, but the likelihood, timing, or the severity of future epidemics cannot be predicted. The effectiveness of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Company's loss experience. If the actual mortality or morbidity rates are significantly higher than those assumed in pricing and reserving, then the Company would make a loss on certain lines of business which could be offset by potential gains on other lines of business due to the natural diversification between longevity and mortality risks.

In common with other industry participants, the profitability of the Company's businesses ultimately depends on a mix of factors including investment performance and impairments, mortality and morbidity trends, policy surrender rates, unit cost of administration and new business acquisition expense.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

(d) Liquidity risk

Liquidity risk is the risk that the Company, although solvent on a balance sheet basis, does not have sufficient cash resources available to meet its obligations as they fall due, or can secure them only at excessive cost.

Liquidity risk is not a material risk for the Company. This risk is managed through careful management of bank balances, cash-flow forecasting, appropriate fund management (to ensure that assets are not unduly concentrated in less liquid investments) and detailed cash-flow matching for the annuity business. Specific arrangements are also in place to manage liquidity in the linked funds, particularly property funds where the underlying assets are relatively illiquid. As a result all of the Company's insurance funds have substantial volumes of readily realisable assets.

Non-financial risk

The Company is exposed to business environment, strategic, operational and group risk.

(a) Business environment risk

Business environment risk is the exposure to forces in the external environment that could significantly change the fundamentals that drive the Company's overall strategy.

The Company conducts its business subject to regulation and the associated regulatory risks, and is therefore exposed to changes in laws, and regulations that affect the products and markets in which it operates.

Changes in government policy, legislation (including tax) or regulatory interpretation applying to UK insurance companies may be applied retrospectively, may adversely affect the Company's product range, distribution channels, capital requirements and, consequently, reported results and financing requirements. Regulators in jurisdictions in which the Company operates may change the level of solvency capital required to be held or could introduce possible changes in the regulatory framework for pension arrangements, retirement income and investments, or the regulation of selling practices and solvency requirements.

The material regulatory and legal change risks currently faced are:

- Solvency II - The EU is harmonising the solvency framework for insurance companies across Europe based on the concept of three pillars — minimum capital requirements, supervisory review of firms' risk management system, and enhanced disclosure requirements. This will cover valuations, the treatment of insurance groups and companies, the definition of capital and the level of capital required. A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies, and may allow the Company to make use of its internal economic capital models, if approved by the relevant supervisory authority. Although the Solvency II Directive was formally approved by the Economic and Financial Affairs Council in November 2009 the Solvency II implementation date has been postponed from 1st January 2014 and the new date is yet to be confirmed. Discussions are on-going with the European Parliament, the European Commission and the Council for the European Union to agree the Omnibus II Directive and to develop the detailed rules that will complement the high-level principles of the Directive, referred to as 'implementing measures'. Agreement to the Omnibus II Directive is not currently scheduled to be finalised until late 2013 while the implementing measures cannot be finalised until after Omnibus II. There is significant uncertainty regarding the final outcome of this process. As a result there is a risk that the effect of the measures finally adopted could be adverse for the Company, including potentially a significant increase in capital required to support its business and that the Company may be placed at a competitive disadvantage to other European and non-European financial services groups. (Further details on Solvency II are on page 11);

- The split of regulation in the UK in 2013 between the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) may give rise to new requirements and regulatory expectations for the Company;

- The new business implication resulting from the implementation in 2013 of the new distribution arrangements resulting from the Retail Distribution Review and requirements for compulsory Open Market Options being provided for vesting pension business;

- The annuities market in the UK is highly competitive affecting the Company's ability to sell its products and its continued profitability. Gender Neutral Pricing introduced from the end of 2012, and the growth in more selective annuity providers focusing on impaired life annuities, may increase the Company's exposure to anti-selection risk in the future;

- Any further changes or modification to Financial Reporting Standards, or adoption of International Financial Reporting Standards (IFRS) may require a change in the reporting basis of future results, or a restatement of reported results;

- Changes in tax legislation could affect the Company's financial condition and results of operations.

The market for UK financial services is highly competitive with several factors affecting the Company's ability to sell its products and its continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historic bonus levels, developing demographic trends and customers' appetite for certain savings products.

Changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or the Company's financial condition but could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties.

The Company's principal competitors in the life insurance market include many of the major retail financial services companies including, in particular, Aviva, Legal & General, Lloyds Banking Group and Standard Life. The Company believes competition will intensify in response to consumer demand, technological advances, the impact of consolidation, regulatory actions and other factors. The Company's ability to generate an appropriate return depends significantly upon its capacity to anticipate and respond appropriately to these competitive pressures.

The uncertain economic environment may reduce consumer confidence and their propensity to buy savings products and also adversely impact investment returns, and/or interest rates and hence their decision to annuitise. The customer demographics and the employment and retirement preferences are changing and this may lead to individuals deferring their retirement; that could alter the profile of pension maturities in the future, such that it does not materialise in line with the projections planned.

(b) Strategic risk

Strategic risk is the risk of ineffective, inefficient or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Company's capabilities.

The strategic focus on with-profits and annuity products means the Company is dependent on being able to continue to deliver profitable volumes from these lines of business and that unplanned regulatory or legal changes do not adversely impact customer or advisor behaviour. The concentration leaves the Company's UK business at risk to a significant change in its business model arising from future regulatory developments.

(c) Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events.

The Company is exposed to operational risk in the ordinary course of its business and as a result may be subject to unplanned costs, regulatory fines or legal actions and disputes in relation to contracts or a course of conduct taken. These legal actions and disputes may relate specifically to the Company's businesses and operations or may be issues that are common to companies that operate in the Company's markets. Although the Company believes it has adequately provisioned for the potential costs of litigation and regulatory matters, no assurance can be provided that such reserves are

sufficient. Given the large or indeterminate amounts of damages sometimes sought, and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could, from time to time, have an adverse effect on the Company's results of operations or cash flows.

The Company operates in a mature and highly regulated environment where the pace of regulatory change has intensified making regulatory compliance a key risk, particularly from mis-selling or misleading customers. In addition to the level of change experienced, regulatory relationships have become more intrusive particularly around product development, distribution processes, complaint handling and breach management. There has been an increase in fines and regulatory sanctions imposed on firms.

The Company's activities involve processing a large number of complex transactions across numerous and diverse long term insurance products. As a result it is exposed to the risks of data integrity and transaction processing errors. The Company's operating model is to outsource several activities both intra-group and externally, including investment management, a significant part of its customer-facing functions as well as some IT functions. The Company is therefore reliant upon the operational processing performance of its outsourcing partners, and their performance is monitored carefully.

Further, because of the long-term nature of much of the Company's business, accurate records have to be maintained securely for significant periods.

The Company's systems and processes incorporate controls which are designed to manage and mitigate the operational risks associated with its activities as any weakness in the administration and finance systems and pricing and reserving processes could impact operations or the financial results. The Company has not identified any operational risk events in 2012, which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.

(d) Group risk

Group risk is the risk associated with being part of a group, particularly as a result of contagion.

Being a member of a group can provide significant advantages for the Company in terms of diversification of risk, financial strength, technical expertise and management experience. It can also give rise to risks; if a guarantee of financial support given by the parent were removed, or from particular transactions arising from an impaired parent or affiliate within the group. The independent capitalisation of the Company as well as the risk management processes and internal control mechanisms within the Company ensure group risk is appropriately managed.

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.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

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.

The Prudential plc Board discusses the Group's performance in the areas of social and environmental management at least once a year and also reviews and approves the Group's corporate responsibility report and strategy on an annual basis.

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. 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 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 are intended to be aligned more closely with economic capital methodologies and may allow Prudential to make use of internal economic capital models if approved by the Financial Services Authority (FSA) or other relevant supervisory authority.

Representatives from the European Parliament, the European Commission and the Council of the European Union are currently discussing the Omnibus II Directive which, once approved, will amend certain aspects of the original Solvency II Directive. In addition the European Commission is continuing to develop, in consultation with stakeholders including industry, the detailed rules that will complement the high-level principles in the Solvency II Directive, referred to as 'implementing measures'. The Omnibus II Directive is not currently scheduled to be finalised until late 2013, while the implementing measures cannot be finalised until after Omnibus II.

There is a significant uncertainty regarding the final outcome from this process. In particular, the Solvency II rules relating to the determination of the liability discount rate remain unclear and the capital position of the Prudential Group, of which the Company is a part, is sensitive to these outcomes. With reference to the liability discount rate, solutions to remove artificial volatility from the balance sheet have been suggested by policymakers as the regulations continue to evolve. These solutions are continuing to be considered by policymakers as part of the process to reach agreement on the Omnibus II Directive. There is a risk that the effect of the measures finally adopted could be adverse for the Prudential Group and the Company, including potentially that a significant increase in capital may be required to support its business and that the Prudential Group and the Company 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 and Insurance Europe (formerly known as the Comité Européen des Assurances).

The delays in finalising the Omnibus II Directive and implementing measures are expected to result in a deferral of the Solvency II implementation date for firms beyond the previously anticipated date of 1 January 2014. At this stage, it remains unclear exactly when Solvency II will come into force, although a deferral until 1 January 2016 or beyond appears likely.

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. The Prudential Group is continuing its preparations to adopt the regime when it eventually arrives and is undertaking in parallel an evaluation of the possible actions to mitigate its effects. The Prudential Group regularly reviews its range of options to maximise the strategic flexibility of the Group. This includes consideration of optimising the Group's domicile as a possible response to an adverse outcome on Solvency II.

Over the coming months the Prudential Group will remain in regular contact with the FSA as it continues to engage in the 'pre-application' stage of the approval process for the internal model. In addition, the Prudential Group also expects to engage in the initial stage of the FSA's proposed 'Individual Capital Adequacy Standards Plus (ICAS+)' regime, which will ultimately enable its UK insurance entities to leverage the developments made in relation to the Solvency II internal model for the purpose of meeting existing ICAS regime.

Currently there are also a number of other prospective global regulatory developments which could impact the way in which the Prudential Group and the Company is supervised. These include the work of the Financial Stability Board (FSB) on Globally Systemically Important Financial Institutions (G-SIFIs) and the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) being developed by the International Association of Insurance Supervisors (IAIS).

As part of a global initiative to identify G-SIFIs, in May 2012, the IAIS published proposed assessment methodology for designating Globally Systemically Important Insurers (G-SIIs). For those groups that are designated by the FSB as G-SII then additional policy measures including enhanced supervision and higher loss absorbency requirements could be proposed. Further detail of the proposals is expected during 2013 and implementation is likely to be over a period of years. Furthermore, the FSA is considering the designation of Domestically Systemically Important Insurer (DSII) for those UK insurers that are significant in UK terms. It is not yet clear what the impact of this designation may be.

ComFrame is also being developed by the IAIS to provide common global requirements for supervision of insurance groups. The framework is designed to develop common principles for supervision and so may increase the focus of regulators in some jurisdictions. It is also possible that some prescriptive requirements, including group capital, could be proposed. Further clarity on ComFrame is expected during the second half of 2013.

Retail Distribution Review

The FSA's review of the retail distribution marketplace called the Retail Distribution Review ('RDR') came into force on the 31st December 2012. The changes contained in the review are designed to encourage greater levels of transparency, professionalism and sustainability within the industry, with the prime aim of increasing consumers' confidence in the industry and providing a more economically viable business model for Product Providers and Intermediaries. The Company supports the aims of the RDR and believes that this provides an opportunity to put in place a framework that will better align the interests of consumers, advisers and providers.

The changes implemented improve the clarity with which firms describe their services to customers and the role of advisers, particularly with regards to remuneration. The advice market is split between independent and restricted advice, which is the new label to describe any adviser not providing a full independent advice service. This is supported by specific disclosure of status both in writing and orally at point of sale which includes the exact nature of the service if restricted advice is to be provided. Commissions traditionally paid by product providers to advisers has be replaced by 'Adviser Charging' with prescriptive rules aimed at ensuring consumers have total clarity on the cost of advice services. The changes have significantly increased the requirements for firms to be able to describe themselves as independent. As a result, it is widely expected that the popularity of restricted advice models will grow and that a return of provider-led direct to consumer advice models is likely over the next 3-5 years.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

The new rules apply to all products within the FSA's definition of "Retail investment products" with similar changes introduced in the group pensions marketplace. Advisers will continue to be able to be remunerated by commission for pure protection business.

Subsidiary and associate undertakings and branches

Particulars of the Company's principal subsidiary and associate undertakings at 31 December 2012 are shown on page 46 in note 17. The Company has branches outside the United Kingdom in Hong Kong and in Poland. The Polish branch became operational in March 2013.

With-profits governance

The Company produces an annual report, which is available on request, setting out how it has complied with its Principles and Practices of Financial Management (PPFM).

The Board has established a With-Profits Committee (WPC), made up of three members (each of whom is external and independent of the Company). The WPC provides the Board with an independent assessment of the way in which the Company manages its with-profits business, its compliance with the PPFM, and how the Company balances the rights and interests of policyholders and shareholders in relation to its with-profits funds. The WPC has the right, if it wishes, to make a statement to with-profits policyholders in addition to the Company's report described above.

The Company has a With-Profits Actuary who has the specific duty to advise the Board on the application of discretion in relation to with-profits business; and an Actuarial Function Holder who will provide the Board with all other actuarial advice. Both of these are Financial Services Authority approved roles.

Post balance sheet events

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

Accounts

The state of affairs of the Company at 31 December 2012 is shown in the balance sheet on pages 21 and 22. The profit and loss account appears on pages 17 to 19.

Share Capital

There have been no changes in the Company's share capital during 2012 as shown on page 49 in note 24.

Dividends

An interim dividend of £245.5m (2011: £223.4m) was declared on 1 May 2012, of which a dividend of £216.0m (2011: £223.4m) on the ordinary shares was paid on 4 May 2012 and the remaining £29.5m was satisfied by a reduction in the balance outstanding on the loan from the Company to Prudential plc, resulting in the release of £245.5m from the retained profit and reserves of the Company. The directors have not declared a final dividend on the ordinary shares for 2012 (2011: £Nil).

No dividend was paid on the A preference shares during 2012 (2011: £9,623). No dividend was paid on any other preference shares.

Payment policy

It is the policy of the Company to agree terms of payment when orders for goods or services are placed and to pay in accordance with those terms. This policy was strengthened in 2009 by signing up to the Prompt Payment Code, launched in December 2008 by the UK Department for Business, Enterprise and Regulatory Reform. In 2012, the Company's trade creditor days, based on the ratio of amounts which were owed to trade creditors at the year end to the aggregate of the amounts invoiced by trade creditors during the year, were 22 days (2011: 22 days).

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

Directors

The present directors are shown on page 1. Mr H A Hussain was appointed a director on 15 March 2012 and Ms W Au was appointed a director on 18 May 2012. There have been no further changes.

Political and Charitable Donations

During 2012 the Hong Kong branch made donations of £57,425 (2011: £47,369). This is broken down as follows: Education £44,004; Social and Welfare £10,574 and Staff Volunteering £2,847. No donations were made by the Hong Kong branch for political purposes in 2012 or 2011. In the UK, no charitable or political donations were made in 2012 or 2011.

Disclosure to auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Financial instruments

The Company is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The financial risk factors affecting the Company include market risk, credit risk and liquidity risk. Information on the financial risk management objectives and policies of the Company and the exposure of the Company to the financial risk factors is given in note 33 (E) on page 73. Further information on the use of derivatives by the Company is provided in note 33 (C) on page 70.

Auditor

The directors re-appointed KPMG Audit Plc as auditor of the Company on 20 June 2012. An ordinary resolution of the Company for the re-appointment of KPMG Audit Plc as auditor of the Company will be proposed to the members of the Company in accordance with Section 485(4) of the Companies Act 2006.

Directors' and officers' protection

Prudential plc has arranged appropriate insurance cover in respect of legal action against directors and senior managers of companies within the Prudential Group. In addition, the Articles of Association of the Company provide for the directors, officers and employees of the Company to be indemnified in respect of liabilities incurred as a result of their office. Prudential plc also provides protections for directors and senior managers of companies within the Group against personal financial exposure they may incur in their capacity as such. These include qualifying third party indemnity provisions (as defined by the relevant Companies Act) for the benefit of directors of Prudential plc, including, where applicable, in their capacity as a director of the Company and other companies within the Group. These indemnities were in force during 2012 and remain in force.

On behalf of the Board of directors.

S D Windridge
Secretary
25 March 2013

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

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

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

A M Crossley
Director
25 March 2013

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED

We have audited the financial statements of The Prudential Assurance Company Limited for the year ended 31 December 2012 set out on pages 17 to 77. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 15, 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 Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

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 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following 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 the information and explanations we require for our audit.

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

25 March 2013

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2012

Note	**General Business Technical Account**	**2012 £m**	2011 £m
2b	Gross premiums written	**42**	37
	Outward reinsurance premiums	**(5)**	(4)
	Premiums written, net of reinsurance	**37**	33
	Change in the provision for unearned premiums		
	Gross amount	**(2)**	(1)
	Earned premiums, net of reinsurance	**35**	32
	Claims paid		
	Gross amount	**(22)**	(27)
	Reinsurers' share	**5**	12
	Claims paid, net of reinsurance	**(17)**	(15)
	Change in provision for claims		
	Gross amount	**4**	5
	Reinsurers' share	**(5)**	(6)
	Net of reinsurance	**(1)**	(1)
	Claims incurred, net of reinsurance	**(18)**	(16)
5	Net operating expenses	**(16)**	(14)
2b	**Balance on the general business technical account**	**1**	2
	Analysis:		
	Continuing operations	**1**	2
9	Operations in run-off	**-**	-
		1	2

Profit and Loss Account for the year ended 31 December 2012 (continued)

Note	Long-term Business Technical Account	2012 £m	2011 £m
2a	Gross premiums written	**14,074**	6,610
	Outward reinsurance premiums	**(1,088)**	(1,098)
11	Recaptured reinsurance premiums	**-**	7,650
	Earned premiums, net of reinsurance	**12,986**	13,162
3	Investment income	**9,710**	8,133
	Unrealised gains (losses) on investments	**743**	(3,984)
	Claims paid		
	Gross amount	**(10,374)**	(9,658)
	Reinsurers' share	**865**	978
	Claims paid, net of reinsurance	**(9,509)**	(8,680)
	Change in provision for claims		
	Gross amount	**13**	(63)
	Reinsurers' share	**1**	1
	Claims incurred, net of reinsurance	**(9,495)**	(8,742)
	Change in long-term business provision		
	Gross amount	**(10,919)**	(2,628)
	Reinsurers' share	**1,104**	1,540
11	Recaptured reinsurance	**-**	(7,316)
		(9,815)	(8,404)
	Change in technical provision for linked liabilities	**(639)**	533
	Change in other technical provisions, net of reinsurance	**(10,454)**	(7,871)
5	Net operating expenses	**(1,201)**	(1,011)
6	Investment expenses and charges	**(279)**	(293)
7	Tax attributable to the long-term business	**(502)**	(56)
12	Actuarial and other gains/(losses) on pension schemes	**60**	(25)
	Transfer (to) from the fund for future appropriations	**(1,242)**	1,018
	Balance on the long-term business technical account	**326**	331

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

Profit and Loss Account for the year ended 31 December 2012 (continued)

Note	**Non-Technical Account**	2012 £m	2011 £m
	Balance on the general business technical account	1	2
	Balance on the long-term business technical account	326	331
7	Tax credit attributable to the balance on the long-term business technical account	91	111
2a	Balance on the long-term business technical account before tax	417	442
3,10	Investment income	47	21
	Other income	34	38
	Other charges	(40)	(23)
	Total profit on other activities	41	36
	Profit on ordinary activities before tax	459	480
7	Tax on profit on ordinary activities	(83)	(146)
	Profit for the financial year	376	334

Except for the valuation of investments, there is no material difference between the results for the current year and the previous year as described in the profit and loss account and the results on an unmodified historical cost basis. Accordingly, given the exemptions provided to insurance companies in FRS 3.31A, a note of the historical cost profits and losses for the year is not given.

Statement of Total Recognised Gains and Losses for the year ended 31 December 2012

Note		2012 £m	2011 £m
	Profit for the financial year	**376**	334
	Other recognised gains and losses:		
25	Increase in surplus on revaluation of investments in shareholder subsidiaries and associate	**436**	456
	Exchange adjustments	**(6)**	2
	Total recognised gains relating to the financial year	**806**	792

Reconciliation of Movement in Shareholders' Funds for the year ended 31 December 2012

	2012 £m	2011 £m
Total recognised gains relating to the financial year	**806**	792
Dividends	**(245)**	(223)
Net movement in shareholders' funds	**561**	569
Shareholders' funds at beginning of year	**4,179**	3,610
Shareholders' funds at end of year	**4,740**	4,179
Included in Shareholders' funds are aggregate net foreign exchange differences as follows:		
Aggregate net foreign exchange differences included in opening Shareholders' funds	**(7)**	1
Net foreign exchange differences for the year	**1**	1
Aggregate net foreign exchange differences included in closing Shareholders' funds	**(6)**	2

Balance sheet as at 31 December 2012

Note	Assets	2012 £m	2011 £m
15	Intangible assets		
	Licence	**73**	84
	Distribution rights	**100**	117
		173	201
	Investments		
16	Land and buildings	**6,270**	6,329
17	Investments in group undertakings and participating interests	**6,225**	6,042
18	Other financial investments	**92,991**	88,360
	Deposits with ceding undertakings	**7,306**	2,853
		112,792	103,584
19	Assets held to cover linked liabilities	**12,531**	10,199
20	Reinsurers' share of technical provisions		
	Provision for unearned premiums	**2**	2
	Long-term business provision	**8,117**	7,035
	Claims outstanding	**99**	104
	Technical provisions for linked liabilities	**4,621**	4,075
		12,839	11,216
	Debtors		
	Debtors arising out of direct insurance operations		
	Policyholders	**52**	49
	Intermediaries	**18**	19
	Debtors arising out of reinsurance operations	**49**	12
21	Other debtors	**1,167**	1,250
		1,286	1,330
	Other assets		
22	Tangible assets	**6**	7
26	Cash at bank and in hand	**934**	1,242
		940	1,249
	Prepayments and accrued income		
	Accrued interest and rent	**740**	788
	Deferred acquisition costs		
	General business	**6**	7
	Long-term business	**184**	182
	Accrued external dividends receivable	**37**	80
	Other prepayments and accrued income	**126**	107
		1,093	1,164
	Total assets (excluding pension asset)	**141,654**	128,943
12	Pension asset (net of related deferred tax)	**73**	86
23	**Total assets (including pension asset)**	**141,727**	129,029

Balance sheet as at 31 December 2012 (continued)

Note	Liabilities	2012 £m	2011 £m
	Capital and reserves		
24	Share capital	**330**	330
25	Revaluation reserve	**1,841**	1,405
25	Other reserves	**536**	536
25	Profit and loss account	**2,033**	1,908
2c	Shareholders' funds – equity interests	**4,740**	4,179
	Fund for future appropriations	**10,598**	9,363
	Technical provisions		
	Provision for unearned premiums	**21**	20
31	Long-term business provision	**103,376**	94,759
	Claims outstanding	**523**	544
8	Equalisation provision	**1**	1
	Unearned revenue provision	**39**	42
	Total technical provisions	**103,960**	95,366
	Technical provisions for linked liabilities	**17,152**	14,274
	Provisions for other risks and charges		
7	Deferred taxation	**527**	525
	Other	**30**	13
		557	538
	Creditors		
	Creditors arising out of direct insurance operations	**173**	99
	Creditors arising out of reinsurance operations	**50**	143
	Amounts owed to credit institutions	**70**	56
	Other borrowings not owed to credit institutions	**126**	232
27	Other creditors including taxation and social security	**4,178**	4,645
28	Preference shares	**1**	1
		4,598	5,176
	Accruals and deferred income	**122**	133
	Total liabilities	**141,727**	129,029

The accounts on pages 17 to 77 were approved by the Board of directors on 25 March 2013.

A M Crossley
Director

Notes on the financial statements

1. Accounting Policies

A. Basis of Preparation

The financial statements are prepared in accordance with Part 15 of the Companies Act 2006 and Schedule 3 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. The financial statements comply with applicable accounting standards (UKGAAP) and the ABI SORP, and have been prepared under the historical cost accounting rules, modified to include the revaluation of investments.

As the Company is a wholly owned subsidiary undertaking of another company registered in England and Wales, group financial statements are not prepared. Accordingly, the financial statements present information about the Company as an individual undertaking and are not consolidated.

The Company has taken advantage of the exemption under FRS1 (Revised) 'Cash flow statements' from preparing a cash flow statement. The Company has not presented all the supporting disclosures required under FRS 27 'Life Assurance' on the basis that the Company is more than 90 per cent owned within a group and the Company is included in the publicly available Prudential plc group financial statements which provide information on a group basis complying with this requirement.

The directors have a reasonable expectation that the Company will be able to continue in operational existence for the foreseeable future and thus continue to adopt the going concern basis of accounting in preparing the financial statements. This conclusion has been based upon the following: the Company is a subsidiary within the Prudential Group and it and its parent company, which is also the ultimate parent company, are continuing to trade profitably and there are no plans for liquidation, the Company has a healthy solvency margin, well in excess of the Minimum Capital Requirement (MCR) and Enhanced Capital Requirement (ECR) (Note 34 on page 74), is supported by its inherited estate (Note 32 on page 55), generates positive cashflows and has very low debt-financing. In addition consideration has also been given to the Company's performance, the market in which it operates, its strategy and risks and uncertainties, as set out in the Business Review on pages 2 to 12, the management of financial risk as set out in note 33, including its exposure to liquidity risk and credit risk.

As set out in Note 25, the opening balances in respect of the Revaluation reserve and Profit and Loss Account reserve have been adjusted. There has been no impact on the profit or the net assets for the current period as a result of this amendment.

B. Change in Accounting Policies

In 2012, the Company adopted "Amendments to FRS29 (IFRS 7) - Financial Instruments: Disclosures - Disclosures - Transfers of Financial Assets", which had no material impact on the financial statements of the Company.

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.

C. Long-term Business

The measurement basis of assets and liabilities of long-term business contracts is dependent upon the classification of the contracts under FRS 26 as either insurance contracts, if the level of insurance risk is significant, or investment contracts if the risk is insignificant. A further distinction is made between investment contracts with and without discretionary participation features. Discretionary participation features represent the contractual right to receive additional profit-sharing benefits as a supplement to guaranteed benefits. The Company's insurance contracts and investment contracts with discretionary participation features are primarily with-profits and other protection type or annuity policies. The investment contract without discretionary participation features classification applies primarily to certain unit-linked and similar contracts written by the Company. Insurance contracts and investment contracts with discretionary participation features are accounted for under previously applied UKGAAP, as set out in the ABI SORP. Investment contracts without discretionary participation features are accounted for as financial liabilities under FRS 26 and, where relevant the provisions of the ABI SORP in respect of the attaching investment management features of the contracts. FRS 26 applies a different accounting treatment to these contracts

Notes on the financial statements (continued)

1. Accounting Policies (continued)

than that previously applied primarily in respect of deferred acquisition costs, deferred income reserves and provisions for future expenses commonly called "sterling reserves" (see below).

A further feature is that investment contracts without discretionary participation features are closer in nature to a deposit style arrangement between the investors and the Company. Premiums and withdrawals for these contracts are recorded within the balance sheet as a movement on the investors' liability and the long-term business technical account reflects the fee income, expenses and taxation on the contracts. The provisions for investment contracts without discretionary participation features are included in Technical Provisions for Linked Liabilities in the balance sheet.

Technical account treatment:

Premiums and annuity considerations for conventional with-profit policies and other protection type life insurance and annuity policies are accounted for when due. For unit-linked business and unitised with-profit policies, premiums are accounted for when the liabilities arising from the premiums are created. Premiums exclude any taxes or duties based on premiums. Pensions annuity contracts that vest during the year are included in claims incurred and premium income at the annuity purchase price.

Claims paid include maturities, annuities, surrenders and death. Maturity claims are accounted for on the policy maturity date. Annuity claims are accounted for when the annuity becomes due for payment. Surrenders are accounted for when paid and death claims when notified.

Under FRS 26, the accounting treatment for investment contracts without discretionary participation features reflects the deposit nature of the arrangement with premiums and claims reflected as deposits and withdrawals taken directly to the balance sheet as a movement on the investors' liability with the long-term technical account reflecting fee income, expenses and taxation on these contracts.

The costs of acquiring new non-profit insurance contracts, principally commission and certain costs associated with policy issue and underwriting, which are not matched by policy charges are capitalised and amortised against margins in future revenues on the related insurance contracts for non-profit business to the extent that the amounts are recoverable out of margins.

Under FRS 26, for the investment contracts without discretionary participation features, only the incremental, directly attributable acquisition costs relating to the securing of investment management element of the contracts can be capitalised and amortised in line with related revenue. If these contracts involve up-front charges, this income is also deferred and amortised through the technical account in line with contractual service provision.

Sterling reserves, as defined above, are not permitted to be recognised under FRS 26 for investment contracts.

Bonus additions made to policies are included in the change in the long-term business provision or, where the policy is no longer in force, in claims incurred.

Profits comprise actuarial surpluses allocated to shareholders adjusted, other than for with-profits business, for the deferral of acquisition costs and movements in the shareholders' interest in reserves held within long-term funds. For with-profits business, unappropriated surplus is carried forward in the fund for future appropriations and no allocation is made to the shareholders. There is no deferral of acquisition costs for with-profits business.

The fund for future appropriations comprises amounts arising in relation to participating policies and other non-linked policies, the allocation of which to policyholders or to shareholders has not been determined at the balance sheet date.

The assumptions used to calculate the long-term business provisions are described in note 31.

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

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

1. Accounting Policies (continued)

The FSA realistic value of liabilities is calculated as:

(i) a with-profits benefits reserve (WPBR) plus
(ii) future policy related liabilities (FPRL) plus
(iii) the realistic current liabilities of the fund

The WPBR is the main component of the product related liability, and is mainly determined using a retrospective asset share calculation.

Asset shares are calculated by rolling up the premiums paid, less expenses and charges using the actual investment returns earned on the with-profits fund. The assumptions used within the asset share calculations are consistent with those that are actually used to determine policyholders' bonuses. A number of adjustments are made to reflect future expected policyholder benefits and other outgoings. For certain classes of business including conventional with-profits whole life, industrial branch and many pension contracts (which have capped charges) a prospective bonus reserve valuation is performed instead, valuing future claims and expenses using the expected future bonus rates.

The FPRL includes a market consistent valuation of the costs of guarantees, options and smoothing. This is determined using stochastic modelling. The FPRL also includes other liabilities such as tax on shareholder transfers and enhancements to policy benefits arising from the distribution of surplus from non-profit business written within the with-profits fund or from the Company's subsidiary, Prudential Annuities Limited (PAL). For the Scottish Amicable Insurance Fund (SAIF), the FSA realistic liability calculation requires that all of the surplus within the fund is distributed to policyholders and therefore the FPRL is increased up to the point where the fund has no working capital.

The FSA realistic value of liabilities is adjusted in accordance with FRS 27 to remove the present value of shareholder transfers and related tax. Shareholder transfers are recognised as a liability for the purposes of FSA regulatory returns but, for accounting purposes under FRS 27, shareholders' transfers are recognised only on declaration, consistent with the current basis of financial reporting.

The reported assets include the Company's interest in its subsidiary, PAL, adjusted from the value reported in the FSA realistic balance to reflect differences in the provisioning and capital requirements between the accounting and FSA realistic basis.

Under FSA reporting, the assets include the present value of future profits of PAL and of non-profit business written within the with-profit funds. Under FRS 27 these items are not recognised. Similarly, that part of these future profits which is included in the FSA FPRL is excluded under FRS 27.

D. General Business

General insurance business is accounted for on an annual accounting basis.

Premiums are accounted for when risks are assumed. Premiums are shown gross of commission and exclude any taxes or duties based on premiums. In determining the result, the proportion of premiums written relating to periods of risk beyond the year end is carried forward to subsequent accounting periods as unearned premiums, calculated on a daily basis, so that earned premiums relate to risks carried during the accounting period. A similar treatment is applied to acquisition expenses.

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

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

Notes on the financial statements (continued)

1. Accounting Policies (continued)

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

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

E. Reinsurance

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

F. Investments

Investment income and realised and unrealised gains or losses in respect of long-term business are included in the long-term business technical account. Other investment income and realised gains or losses and, except in respect of the Company's shareholder investments in subsidiaries and its associate, unrealised gains or losses are included in the non-technical account.

Realised gains or losses are determined as the difference between net proceeds on disposal and the purchase price. Movements in unrealised gains or losses comprise the change in the value of investments held at the balance sheet date and the reversal of unrealised investment gains and losses recognised in earlier accounting periods in respect of investment disposals.

The Company's shareholder investments in entities that undertake insurance business, and also the investment in the entity that undertakes mortgage lending and administration, are shown at current values using embedded values as determined in accordance with the European Embedded Value principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on European Embedded Value Disclosures issued in October 2005. Investments in other subsidiaries are valued at net asset value. The movement in values is taken to the revaluation reserve, other than a permanent diminution in value, which is taken to the non-technical account. Investments in participating interests are carried at fair value.

Under FRS 26, upon initial recognition financial investments are recognised at fair value. Subsequently, the Company is permitted, subject to specific criteria, to designate its investments as either financial investments at fair value through profit and loss, financial investments held on an available-for-sale basis, financial investments held to maturity, or loans and receivables. The Company holds financial investments on the following bases:

(i) Financial investments at fair value through profit and loss – this comprises assets designated by management as fair value through profit and loss on inception and derivatives which 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. An analysis of net gains/losses is disclosed separately in note 3 on page 32 and note 18 on page 47.

(ii) The Company uses bid prices to value its quoted financial investments. Actively traded investments without quoted prices are valued using external broker bid prices. If there is no active established market for an investment, the Company applies an appropriate valuation technique such as discounted cash flow technique. Further information on valuation techniques is provided in note 33 (A) on pages 58 to 59.

(iii) Loans and receivables – these comprise investments that have fixed or determinable payments and are not designated as fair value through profit and loss or available-for-sale. These investments include loans secured by mortgages, deposits and loans to policyholders and other unsecured loans and receivables. These investments are carried at amortised cost using the effective interest method and subject to impairment reviews. The Company measures the amount of the impairment loss by comparing the amortised cost with the present value of its estimated future cash flows discounted at the original effective interest rate. Certain mortgage loans of the Company have been designated at fair value through profit and loss as this loan portfolio is managed and evaluated on a fair value basis and these are included within loans in the balance sheet.

Notes on the financial statements (continued)

1. Accounting Policies (continued)

The Company uses derivatives for the purpose of efficient portfolio management or the reduction in investment risk. In so doing, the Company obtains cost effective and efficient exposure to various markets and to manage exposure to interest rate, currency, credit and other business risks. The Company designates as a fair value hedge certain fixed to floating rate swaps which hedge the fair value exposure to interest rate movements of certain of the Company's operational borrowings. Movements in the fair value of the hedging instruments are recorded in the long term technical account. All derivatives that are not designated as hedging instruments are carried at fair value with movements in fair value being recorded in the long term technical account.

Properties are valued annually, by a number of different professional external valuers, at market value as defined in the Appraisal and Valuation Manual issued by the Royal Institute of Chartered Surveyors in particular Practice statement 3.2. In accordance with SSAP 19, no depreciation is provided on investment properties as the directors consider that to depreciate them would not give a true and fair view.

In accordance with the provisions of Schedule 3, paragraph 76 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, there is a requirement to show the net book value on a historical cost basis of properties in a note to the accounts. For this purpose properties are depreciated over forty years. Leasehold properties are depreciated over forty years, or if the lease is less than forty years, over the length of the lease.

G. Financial Liabilities

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

The Company holds financial liabilities on the following bases:

(i) Financial liabilities at fair value through profit and loss – these comprise derivatives, investment contracts without discretionary participation features and certain creditors. Derivative liabilities and certain creditors are valued at fair value with all changes thereon being recognised in the profit and loss account. An analysis of net gains/losses is disclosed separately in note 3 on page 32 and note 18 on page 47. Investment contracts without discretionary participation features are covered in section C above.

(ii) Financial liabilities that are not valued at fair value through profit and loss and are not investment contracts with discretionary participation features are mainly creditors shown at settlement value. The Company also has some operational borrowings where it has chosen to designate as a fair value hedge certain fixed to floating rate swaps which hedge the fair value exposure to interest rate movements of these borrowings.

(iii) Investment contracts with discretionary participation features. The accounting policy is covered in section C above.

H. Tax

Tax is charged on all taxable profits arising in the accounting period. The UK HM Revenue & Customs rules for taxing long-term business are significantly different to those applying to non-insurance companies and the different classes of business written by the Company are themselves subject to distinct rules. Furthermore the tax calculations are performed using data from the regulatory returns submitted to the FSA rather than the financial statements. There may be significant and complex differences between the regulatory and accounting bases.

The UK Government has made substantial changes to the rules relating to the taxation of life insurance companies, effective from 1 January 2013. Until the end of 2012, shareholders' taxable profits are calculated using regulatory surplus as a starting point, with appropriate deferred tax adjustments for UK GAAP. Beginning in 2013, under new life tax rules, taxable profits will be calculated using accounting profit or loss as a starting point.

Notes on the financial statements (continued)

1. Accounting Policies (continued)

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 Currency

Foreign currency revenue transactions are translated at average exchange rates for the year. Monetary foreign currency assets and liabilities are translated at year end exchange rates. Exchange differences on long-term business and on net investments in foreign enterprises less matching borrowings are taken to reserves. Other exchange differences are included in the profit and loss account.

J. Tangible Assets

Tangible assets, principally fixtures and fittings, building improvements, computer equipment and software development expenditure, are capitalised and depreciated by equal annual instalments over their estimated useful lives. Fixtures and fittings and building improvements are depreciated over ten years, computer hardware over five years and software over three years.

K. Pension Costs

The Company applies the requirements of FRS 17 'Retirement Benefits' as amended December 2006. The Prudential Group operates a number of defined contribution and defined benefit pension schemes and a portion of these defined benefit pension schemes' surplus or deficits is attributed to the Company. Further details are disclosed in note 12. Contributions in respect of defined contribution schemes are recognised when incurred.

The assets and liabilities of the defined benefit pension schemes of the Prudential Group are subject to a full triennial actuarial valuation using the projected unit method. Estimated future cash flows are discounted at a high quality corporate bond rate, adjusted to allow for the difference in duration between the bond index and the pension liabilities where appropriate, to determine its present value. The Prudential Staff Pension Scheme (PSPS) is the largest defined benefit scheme and accounts for 86% of the underlying scheme liabilities of the Prudential Group's defined benefit schemes under FRS 17. The difference between the fair value of the scheme assets and the actuarial value of the scheme liabilities is a surplus or deficit on the scheme. The Company's share of pension surplus is recognised to the extent that the Company is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme.

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

The actuarial gains and losses which arise from assumptions, the difference between actual and expected investment return on the scheme assets, and experience gains and losses on liabilities are recognised in the long-term technical account. Actuarial gains and losses also include adjustment for unrecognised pension surplus as described above.

Notes on the financial statements (continued)

1. Accounting Policies (continued)

L. Intangible Assets

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

Intangible assets include a licence, which represents the value of an agreement with a fellow subsidiary company for the use of certain Scottish Amicable assets, which is being amortised over a period of 20 years to 30 September 2017, on a basis consistent with the revenue stream from the agreement.

Intangible assets also include distribution rights which relate to facilitation fees paid in relation to the bancassurance partnership arrangements in Asia, in respect of the Company's Hong Kong branch, for the bank distribution of insurance products for a fixed period of time, being the term of the contract. The distribution rights amounts are amortised on the basis to reflect the pattern in which the distribution rights' future economic benefits are expected to be consumed by the Company by reference to new business levels.

M. Dividend Policy

Interim and final dividends are recognised in the period in which they are declared to the extent that they are unconditional on any future events. Dividends declared after the balance sheet in respect of the prior reporting period are treated as a non-adjusting event.

N. Share-based Payments

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

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

Notes on the financial statements (continued)

2. Segmental analysis

(a) Long-term business

Premiums and profit	**Gross premiums written**		**Balance on the technical account before tax**	
	2012 £m	2011 £m	**2012 £m**	2011 £m
United Kingdom (*)	**12,149**	4,998	**354**	410
Hong Kong	**1,675**	1,421	**63**	32
France	**250**	191	**-**	-
	14,074	6,610	**417**	442

New business	**Regular premiums**		**Single premiums**	
	2012 £m	2011 £m	**2012 £m**	2011 £m
United Kingdom (*)	**228**	273	**11,453**	4,352
Hong Kong	**371**	324	**156**	179
France	**-**	-	**222**	161
	599	597	**11,831**	4,692

Single premiums include UK Department of Work and Pensions rebates business and increments under existing group pension schemes. Regular premiums are determined on an annualised basis.

New business premiums include those contracts excluded from premium income in the 2012 technical account under FRS26 and the ABI SORP (as amended in December 2006). These are investment contracts without discretionary participation features and carry no significant insurance risk.

(*) On 31 October 2012 Prudential Annuities Limited (PAL), a subsidiary of the Company, reassured its entire book of business to the Company, except for a small number of policies that had already been reassured to an external reinsurance company. PAL's business is entirely made up of non-profit pension annuities. The single premium paid was £5,944m which was equal to the value of the transferring business, as measured on the prudent statutory basis ('Pillar 1, Peak 1'). The Company immediately deposited back the assets received by way of the premium with PAL.

Analysis of premium income	**2012 £m**	2011 £m
Gross written premiums:-		
Direct	**7,638**	6,207
Reinsurance accepted	**6,436**	403
	14,074	6,610
Analysis of gross direct premiums:-		
Individual business	**7,066**	5,650
Group contracts	**572**	557
	7,638	6,207
Regular premiums	**2,529**	2,324
Single premiums	**5,109**	3,883
	7,638	6,207
Participating contracts	**6,073**	4,843
Non-participating contracts	**723**	571
Linked long-term contracts (excluding investment contracts without discretionary participation features)	**842**	793
	7,638	6,207
United Kingdom	**5,963**	4,786
Hong Kong	**1,675**	1,421
France	**-**	-
	7,638	6,207

Notes on the financial statements (continued)

2. Segmental analysis (continued)

Net reinsurance income

Net reinsurance income in respect of long-term business for the year ended 31 December 2012 was £1,426m (2011: £1,586m).

(b) General business

Premiums and underwriting result		Gross premiums written 2012 £m	Gross premiums written 2011 £m	Underwriting result 2012 £m	Underwriting result 2011 £m
Continuing operations	Hong Kong	**42**	37	**1**	2
Operations in run-off	United Kingdom	**-**	-	**-**	-
		42	37	**1**	2

Analysis of technical account	Gross Premiums Written 2012 £m	Gross Premiums Written 2011 £m	Gross Premiums Earned 2012 £m	Gross Premiums Earned 2011 £m	Gross Claims Incurred 2012 £m	Gross Claims Incurred 2011 £m	Gross Operating Expenses 2012 £m	Gross Operating Expenses 2011 £m	Reinsurance Balance 2012 £m	Reinsurance Balance 2011 £m
Motor -other classes	**2**	2	**2**	2	**1**	4	**1**	2	**(1)**	3
Marine, aviation and transport	**-**	-	**-**	-		-	**-**	-	**-**	-
Fire and other damage	**5**	5	**5**	5	**1**	1	**3**	2	**-**	-
Other (*)	**35**	30	**33**	29	**16**	17	**13**	11	**(3)**	-
	42	37	**40**	36	**18**	22	**17**	15	**(4)**	3

* Other business is primarily health, protection and employers' liability insurance.

The geographical analyses of long-term and general business premiums are based on the territory of the operating unit assuming the risk. Premiums by territory of risk are not materially different.

(c) Shareholders' funds

Shareholders' funds relate to the following countries:

	Shareholders' funds 2012 £m	Shareholders' funds 2011 £m
United Kingdom	**4,523**	4,003
Hong Kong	**217**	176
Total	**4,740**	4,179

Notes on the financial statements (continued)

3. Investment income

	Long-term business		Non-technical account	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Income from:				
Group undertakings	**553**	922	**(32)**	(30)
Other investments				
Land and buildings	**428**	413	**-**	-
Listed investments	**3,043**	2,956	**-**	-
Unlisted investments	**183**	156	**-**	-
Other investments	**279**	274	**80**	61
	4,486	4,721	**48**	31
(Losses) on loans and receivables	**(58)**	(37)	**-**	-
Gains (losses) on the realisation of investments at fair value through profit and loss other than derivatives	**4,886**	3,325	**-**	(10)
Gains (losses) on the realisation of derivatives – see note 33	**482**	93	**-**	-
Exchange losses	**(118)**	(23)	**(1)**	-
Fees for policy administration and asset management services arising from unit-linked investment contracts	**32**	54	**-**	-
	9,710	8,133	**47**	21

4. Bonuses

Bonuses added during the year are included in the change in the long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses was £2,582m (2011: £2,737m).

5. Net operating expenses

	Long-term business		General business	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Depreciation	**4**	4	**-**	-
Acquisition costs	**709**	581	**11**	11
Change in deferred acquisition costs	**(6)**	(2)	**1**	-
Administrative expenses	**471**	411	**4**	3
Amortisation of licence and distribution rights (Note 15)	**23**	17	**-**	-
	1,201	1,011	**16**	14

Acquisition costs include commissions in respect of long-term direct insurance business of £483m (2011: £407m) and general direct insurance business of £12m (2011: £10m). Administrative expenses are principally recharged from Prudential Distribution Limited, a service company within the Prudential Group.

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

6. Investment expenses and charges

	Long-term business		Non-technical account	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Investment management expenses	**249**	270	**-**	-
Interest on bank borrowings	**30**	23	**-**	-
	279	293	**-**	-

Notes on the financial statements (continued)

7. Tax

From April 2012, the standard corporation tax rate for the UK changed from 26% to 24%. A further reduction in the standard corporation tax rate to 23% from April 2013 has also been enacted. Deferred tax at the end of 2012 has been provided at the relevant rates of 23%, as the temporary differences are expected to reverse at that rate, and at 20% where the liability/asset is subject to the policyholder tax rate. The effect of this change on the deferred tax liabilities at 31 December 2012 is £24m.

The Chancellor has proposed a further reduction to the UK corporation tax rate to 20% by 2015 however this is not reflected in the financial statements for the year ended 31 December 2012 as it has not yet been substantively enacted.

The UK Government has made substantial changes to the rules relating to the taxation of life insurance companies, effective from 1 January 2013. Until the end of 2012, shareholders' taxable profits are calculated using regulatory surplus as a starting point, with appropriate deferred tax adjustments for UKGAAP. Beginning in 2013, under new life tax rules, taxable profits will be calculated using accounting profit or loss as a starting point.

At the end of 2012, a deferred tax liability is recognised for the transitional adjustment that arises from the difference in retained UKGAAP profits and taxed surplus which is required to be spread and taxed over a 10 year period.

The effect of these changes is reflected in the financial statements for the year ended 31 December 2012 but has no material impact on the company's net assets.

a) Tax charged (credited)	**Long-term funds**		**Shareholders' Profits**	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Current Tax				
UK corporation tax	**568**	368	**3**	11
Double tax relief	**(17)**	(11)	**-**	-
Overseas tax	**44**	38	**-**	-
Adjustments in respect of prior year	**(85)**	(22)	**(20)**	21
Total current tax	**510**	373	**(17)**	32
Deferred tax				
Origination and reversal of timing differences	**(1)**	(314)	**2**	-
Effect of changes in tax rate on closing balances	**-**	-	**-**	-
Adjustments in respect of prior year	**-**	-	**-**	-
Total deferred tax	**(1)**	(314)	**2**	-
Shareholders' attributable tax in respect of the long-term business				
Current	**-**	-	**63**	89
Deferred	**-**	-	**28**	22
Total shareholders' attributable tax	**-**	-	**91**	111
Tax allocated to non-technical account	**(7)**	(3)	**7**	3
Tax charge on profit on ordinary activities	**502**	56	**83**	146

Notes on the financial statements (continued)

b) Factors affecting tax charge for the period

	2012 £m	2011 £m
Profit on ordinary activities before tax	**459**	480
Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 24.5 per cent (2011: effective rate of 26.5 per cent)	**112**	127
Permanent differences	**2**	(1)
Adjustment to current tax in respect of previous periods	**(25)**	31
Different tax bases of long-term insurance (current tax)	**8**	(42)
Effect of short term timing differences	**(41)**	-
Effect of overseas tax	**(3)**	6
Gains not taxable	**-**	3
Current tax charge for the period	**53**	124

c) Balance Sheet

	Attributable to Long-term funds		Attributable to Shareholders' funds	
	2012 £m	2011 £m	2012 £m	2011 £m
Provision for Deferred Tax				
Accelerated capital allowances	**(1)**	(1)	**-**	-
Policy reserves	**-**	126	**-**	-
Short term timing differences	**(3)**	(31)	**(1)**	(3)
Unrealised gains	**506**	517	**-**	-
Deferred acquisition costs	**(104)**	(83)	**-**	-
Life transitional arrangements	**130**	-	**-**	-
Undiscounted provision for deferred tax liability (deferred tax asset)	**528**	528	**(1)**	(3)
Deferred tax liability (deferred tax asset) at start of the period	**528**	844	**(3)**	(3)
Deferred tax charged in technical/ non-technical account for the period	**-**	(316)	**2**	-
Deferred tax liability (deferred tax asset) at end of the period	**528**	528	**(1)**	(3)

The deferred tax liability relating to the pension asset attributable to the Company of £5m (2011: £6m) has been netted off against the pension asset on the balance sheet. The movement in this deferred tax liability has been included in the tax charge within the technical account.

8. Equalisation provision

An equalisation provision has been established in accordance with the requirements of the Prudential Sourcebook for Insurers. The provision, which is in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date, is required by Schedule 3 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 to be included within technical provisions in the balance sheet, notwithstanding that it does not represent a liability at the balance sheet date. This has had the effect of reducing shareholders' funds by £1m (2011: £1m). There has been no movement in the equalisation provision during the year (2011: Nil). An IBNR (Incurred but not reported) provision has been maintained.

9. Operations in run-off

Operations in run-off comprise UK personal and commercial lines of general insurance business. All the business is fully reinsured and as such there is no profit or loss arising. The business reinsured is mostly UK employers' liability and public liability business.

10. Acquisition and disposal of subsidiaries and participating interests

There were no acquisitions or disposals in 2012.

On 8 July 2011 Prudential (AN) Limited went into liquidation. After taking into account the cost of £28m the carrying value on liquidation was £18m giving rise to a realised loss of £10m reported in "Investment Income" in the Non-Technical Account. Prior to liquidation, movements in the value of this company, were taken to the revaluation reserve.

There were no acquisitions or other disposals during 2011.

11. Transfers of Business

There have been no transfers of business into the Company during 2012.

On 31 August 2011 the majority of the annuities previously reinsured from the Company to Prudential Annuities Limited (PAL), a subsidiary of the Company, were recaptured by the Company. The recapture premium was equal to the value of the transferring business, as measured on the prudent statutory basis ('Pillar I, Peak 1') and hence assets of this value were transferred from PAL to the Company on this date. The recapture of the internally vested annuity business by the with-profit sub-fund totalled £7,650m and is shown as "Recaptured reinsurance premiums" in the Long-term Business Technical Account and an amount of £7,316m is shown as "Recaptured reinsurance" in the change in long-term business provision in the Long-term Business Technical Account.

12. Information on staff and pension costs

The average number of persons employed by the Company during the year was:	**2012**	2011
United Kingdom	**13**	15
Hong Kong	**927**	850
	940	865

The majority of employees in the UK are employed by Prudential Distribution Limited, a service company within the Prudential Group.

The costs of employment were:	**2012 £m**	2011 £m
Wages and salaries	**57**	45
Social security and pension costs	**3**	2
	60	47

Defined Benefit Pension Schemes

The majority of staff employed by the Prudential Group in the UK are members of the Prudential Group's pension schemes. The largest scheme is the Prudential Staff Pension Scheme (PSPS). This scheme is primarily a defined benefit scheme but no employees with employment offers after 31 July 2003 are eligible for membership of the defined benefit section of the Scheme. At 31 December 2012, on the FRS 17 'Retirement Benefits' (FRS 17) basis of valuation, the underlying PSPS liabilities account for 86% (2011: 86%) of the aggregate liabilities of the Prudential Group's defined benefit schemes. There is also a smaller defined benefit scheme, Scottish Amicable Pension Scheme (SAPS).

Notes on the financial statements (continued)

For the purposes of preparing consolidated financial statements, the Prudential Group applies IFRS basis accounting including IAS 19 'Employee Benefits' (IAS 19). However, individual company accounts of the parent, Prudential plc and the Company continue to apply UKGAAP including FRS 17. The FRS 17 disclosures are aligned with IAS 19. The Prudential Group applies IFRIC 14, interpretation guidance to IAS 19 with the effect of derecognising all or a substantial portion of the Prudential Group's interest in PSPS surplus and recognising an additional liability for the deficit funding obligation where applicable for PSPS in the Group financial statements.

For both schemes, the projected unit method was used for the most recent full actuarial valuations. Defined benefit schemes are generally required to be subject to full actuarial valuation every three years to assess the appropriate level of funding for schemes having regard to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. The last completed actuarial valuation of PSPS was as at 5 April 2011. This valuation was finalised in the first half of 2012 and demonstrated the Scheme to be 111 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's statutory funding objective. As a result of this valuation, future contributions into the scheme have been reduced to the minimum level of contributions required under the scheme rules effective from July 2012.

Excluding expenses, the contributions fell to approximately £6m per annum from the £50m per annum paid previously. The new contributions are only for ongoing service of current employees. No deficit type funding is required. Deficit funding for PSPS, where applicable, as applied in 2011, is apportioned in the ratio 70/30 between the Company's with-profits fund and Prudential plc following detailed consideration in 2005 of the sourcing of previous contributions. Employer contributions for ongoing service of current employees have been apportioned in the ratio relevant to current activity. In 2012, total contributions for the year, including expenses, were £36m (2011: £54m).

The last completed actuarial valuation of SAPS was at 31 March 2011. This valuation was finalised in the second half of 2012 and demonstrated the scheme to be 85 per cent funded. Based on this valuation, it was agreed with the Trustees of the scheme that the existing level of deficit funding of £13.1m per annum will continue to be paid into the scheme over the next six years to eliminate the actuarial deficit.

For SAPS, it is estimated that approximately 50% of the FRS 17 deficit is attributable to the Company's with-profits sub-fund. The remaining shareholders' share of the deficit of SAPS is borne by Prudential Financial Services Limited, a fellow subsidiary undertaking of the Prudential Group.

Corporate Governance

The rules of the defined benefit section of PSPS, a final salary scheme, specify that, in exercising its investment powers, the Trustee's objective is to achieve the best overall investment return consistent with the security of the assets of the scheme. In doing this, consideration is given to the nature and duration of the scheme's liabilities. The Trustee sets the benchmark for the asset mix, following analysis of the liabilities by the Scheme's Actuary and, having taken advice from the Investment Managers, then selects benchmark indices for each asset type in order to measure investment performance against a benchmark return.

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

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

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

Notes on the financial statements (continued)

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

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

	2012	2011
	%	%
Price inflation:		
Retail Price Index (RPI)	2.7	2.9
Consumer Price Index (CPI)	2.0	1.9
Rate of increase in salaries	2.7	2.9
Rate of increase of pensions in payments:		
PSPS		
Guaranteed - LPI (Max 5%)	2.5	2.5
Guaranteed - LPI (Max 2.5%)	2.5	2.5
Discretionary	2.5	2.5
SAPS	2.7	2.9
Rate used to discount scheme liabilities	4.4	4.7

Long-term expected rates of return	**Prospectively for 2013**	**2012**	2011
	%	%	%
Equities	6.70	6.80	8.20
Bonds	2.80	3.00	4.60
Properties	5.50	5.55	6.90
Other assets	2.00	2.00	4.75
Weighted average long-term expected rate of return	2.90	3.10	5.10

The long-term expected rates of return have been determined after applying due consideration to the requirements of paragraph 54 of FRS 17, in particular, taking account of the values of the assets.

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality. The 2012 and 2011 specific allowance is in line with custom calibration of the 2009 mortality model from the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries ("CMI").

The tables used for PSPS immediate annuities in payment at 31 December 2012 and 2011 were:

Male: 108.6 per cent PNMA 00 with improvements in line with a custom calibration of the CMI's 2009 mortality model, with a long-term mortality improvement rate of 1.75 per cent per annum; and
Female: 103.4 per cent PNFA 00 with improvements in line with a custom calibration of the CMI's 2009 mortality model, with a long-term mortality improvement rate of 1.00 per cent per annum.

The assumed life expectancies on retirement at age 60, based on the mortality table used was:

	2012		2011	
	Years		Years	
	Male	Female	Male	Female
Retiring today	28.1	29.1	27.8	29.0
Retiring in 20 years' time	30.6	31.2	30.5	31.1

The mean term of the current PSPS liabilities is around 17 years.

Using external actuarial advice provided by the professionally qualified actuaries, Towers Watson for the valuation of PSPS and Xafinity Consulting for SAPS, the most recent full valuations have been updated to 31 December 2012 applying the principles prescribed by FRS 17.

Notes on the financial statements (continued)

The combined assets and liabilities of PSPS and SAPS were:

	31 Dec 12 £m	%	31 Dec 11 £m	%	31 Dec 10 £m	%
Equities	244	4	378	6	728	13
Bonds	5,725	83	5,826	84	4,096	71
Properties	290	4	297	4	205	3
Other assets	642	9	403	6	748	13
Total value of assets	6,901	100	6,904	100	5,777	100
Present value of underlying scheme liabilities	5,801		5,371		5,438	
Underlying surplus (deficit) in the schemes	1,100		1,533		339	

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

	2012 £m	2011 £m	2010 £m
Attributable to the Company's with-profits fund	78	92	57

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

	2012 £m	2011 £m	2010 £m
With-profits fund	73	86	53

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

Underlying scheme assets and liabilities of PSPS and SAPS

The change in the present value of scheme liabilities and the change in the fair value of the scheme assets of PSPS and SAPS are as follows:

	2012 £m	2011 £m
Present value of scheme liabilities at beginning of year	5,371	5,438
Current service cost	27	29
Past service cost *	106	(264)
Interest cost	252	285
Employee contributions	1	1
Actuarial losses	281	106
Benefit payments	(237)	(224)
Present value of scheme liabilities at end of year	5,801	5,371

	2012 £m	2011 £m
Fair value of scheme assets at beginning of year	6,904	5,777
Expected return on scheme assets	222	293
Employee contributions	1	1
Employer contributions**	56	73
Actuarial gains	(45)	984
Benefit payments	(237)	(224)
Fair value of scheme assets at end of year	6,901	6,904

* The past service cost in 2012 of £106m 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 £264m related to the effect of the change of the basis of indexation from Retail Price Index to Consumer Price Index.

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

Notes on the financial statements (continued)

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

	2012 £m	2011 £m
Pension (charge) credit		
Operating (charge) credit:		
Current service cost	(27)	(29)
Past service cost	(106)	264
	(133)	235
Finance income (expense):		
Interest on pension scheme liabilities	(252)	(285)
Expected return on pension scheme assets	222	293
	(30)	8
Total pension (charge) credit of the schemes	(163)	243
Of which the following amounts have been attributed to the Company:		
With-profits fund	(105)	20

The pension (charge) credit relating to PSPS attributable to the Company is related to the surplus recognised on the balance sheet of the Company. In 2011, an amount of £151m was applied to extinguish the negative past service cost attributable to the Company's with-profits fund from the unrecognised portion of the pension surplus at 31 December 2011. No adjustment was made to the pension (charge) credit in 2012 relating to the unrecognised portion of the PSPS surplus.

Actuarial gains (losses)	**2012 £m**	2011 £m	2010 £m	2009 £m	2008 £m
Actual less expected return on scheme assets * ((1%), 14%, 5%, 2%, (6%) of pension scheme assets)	(45)	984	296	91	(325)
Experience gains (losses) on scheme liabilities (0%, 6%, 0%,1%, 3% of the present value of scheme liabilities)**	(19)	317	(1)	62	148
Changes in assumptions underlying the present value of scheme liabilities	(262)	(423)	(398)	(475)	250
Total actuarial (losses) gains of the schemes ((6%),16%, (2%), (7%), 2% of the present value of the scheme liabilities)	(326)	878	(103)	(322)	73
Of which the following amounts have been attributed to the Company:					
With-profits fund	60	(25)	(45)	(55)	(287)
Shareholders' funds***	-	-	-	-	2
	60	(25)	(45)	(55)	(285)

* The total actual return on scheme assets for both PSPS and SAPS is a net gain of £177m (2011: net gain of £1,277m) of which a net gain of £119m (2011: net gain of £885m) relates to the amounts attributable to the Company's with-profits fund.

** The experience gains on scheme liabilities in 2011 of a gain of £317m related mainly to the 'true up' reflecting improvements in data consequent upon the 2011 triennial valuations of PSPS and SAPS. Similarly, the experience gains in 2008 of a gain of £148m related mainly to the 'true-up' reflecting improvements in data consequent upon the 2008 triennial valuation of PSPS.

*** The shareholders' share of the deficit of SAPS was previously borne by the Company's shareholders' funds but was transferred to Prudential Financial Services Limited from 2009.

The actuarial gains (losses) relating to PSPS attributable to the Company's with-profits fund are related to the surplus (deficit) recognised on the balance sheet of the Company. In 2012, the actuarial gains attributable to the Company's with-profits fund included a credit of £282m (2011: a charge of £633m) for

Notes on the financial statements (continued)

the adjustment to the unrecognised portion of the PSPS surplus which has not been applied against the pension (charge) credit. Since the shareholders' profit in respect of the Company's with-profits fund is a function of the actuarially determined surplus for distribution, the overall profit and loss account result is not directly affected by the level of pension cost or other expenses relating to the with-profits fund. The amounts of pension charge of £105m (2011: credit of £20m) and actuarial gains of £60m (2011: actuarial losses of £25m) attributable to the Company's with-profits fund are included in the technical account and reflected in the transfer to or from the fund for future appropriations.

Total employer contributions expected to be paid into PSPS and SAPS for the year ending 31 December 2013 amounts to £31m, reflecting the annual accrual cost and deficit funding (SAPS only), and expenses.

The table below shows the sensitivity of the underlying PSPS and SAPS liabilities at 31 December 2012 of £5,226m (2011: £4,844m) and £575m (2011: £527m) to changes in discount rates, inflation rates and mortality rate assumptions.

Assumption	**Change in assumption**	**Impact on PSPS and SAPS scheme liabilities on FRS17 basis**
2012		
Discount rate	Decrease by 0.2% from 4.4% to 4.2%	Increase scheme liabilities by: PSPS 3.3% SAPS 4.9%
Discount rate	Increase by 0.2% from 4.4% to 4.6%	Decrease scheme liabilities by: PSPS 3.1% SAPS 4.6%
Rate of inflation	RPI: Decrease by 0.2% from 2.7% to 2.5% CPI: Decrease by 0.2% from 2.0% to 1.8% with consequent reduction in salary increases	Decrease scheme liabilities by: PSPS 0.6% SAPS 4.2%
Mortality rate	Increase life expectancy by 1 year	Increase scheme liabilities by: PSPS 2.6% SAPS 2.2%

Assumption	Change in assumption	Impact on PSPS and SAPS scheme liabilities on FRS17 basis
2011		
Discount rate	Decrease by 0.2% from 4.7% to 4.5%	Increase scheme liabilities by: PSPS 3.3% SAPS 4.9%
Discount rate	Increase by 0.2% from 4.7% to 4.9%	Decrease scheme liabilities by: PSPS 3.1% SAPS 4.6%
Rate of inflation	RPI: Decrease by 0.2% from 2.9% to 2.7% CPI: Decrease by 0.2% from 1.9% to 1.7% with consequent reduction in salary increases	Decrease scheme liabilities by: PSPS 0.6% SAPS 4.1%
Mortality rate	Increase life expectancy by 1 year	Increase scheme liabilities by: PSPS 2.7% SAPS 2.1%

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

Notes on the financial statements (continued)

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

Defined Contribution Pension Schemes

The Company operates defined contribution schemes in Hong Kong. The cost of these contributions was £2.3m (2011: £1.9m). £0.4m was outstanding at 31 December 2012 (2011 £0.3m).

Share-based payments

The Company maintains a number of main share award and share option plans relating to Prudential plc shares, which are described below.

(i) Group Performance Share Plan, previously Restricted Share Plan

The Group Performance Share Plan (GPSP) is the incentive plan in which all executive directors and other senior executives within the Group can participate. This scheme was established as a replacement for the Restricted Share Plan (RSP) under which no further awards could be made after March 2006. Awards are granted either in the form of a nil cost option, conditional right over shares, or such other form that shall confer to the participant an equivalent economic benefit, with a vesting period of three years. The performance measure for the awards is that Prudential's Total Shareholder Return (TSR) outperforms an index comprising of peer companies. Vesting of the awards between each performance point is on a straight-line sliding-scale basis. Participants are entitled to the value of reinvested dividends that would have accrued on the shares that vest. Beginning in 2010, newly issued shares have been used in settling the awards that vest and are released.

The RSP was, until March 2006, the Group's long-term incentive plan for executive directors and other senior executives designed to provide rewards linked to shareholder return. Each year participants were granted a conditional option to receive a number of shares. There was a deferment period of three years, at the end of which the award vested to an extent that depended on the performance of the Group's shares including notional reinvested dividends and on the Group's underlying financial performance. After vesting, the option may be exercised at zero cost at any time, subject to closed period rules, in the balance of a 10-year period. Shares are purchased in the open market by a trust for the benefit of qualifying employees.

(ii) Business Unit Performance Plan

The Business Unit Performance Plan (BUPP) is an incentive plan created to provide a common framework under which awards would be made to senior employees in the UK and Asia, including the chief executive officers. Awards under this plan were based on growth in shareholder capital value on the European Embedded Value (EEV) basis with performance measured over three years. All awards made are settled in shares after vesting. Participants are entitled to receive the value of reinvested dividends over the performance period for those shares that vest. The growth parameters for the awards are relevant to each region, and vesting of the awards between each performance point is on a straight-line sliding-scale basis. Beginning in 2010, newly issued shares will be used in settling the awards that vest and are released. The BUPP awards for the UK are based on the same relative TSR measure applied to GPSP awards. As a result, awards made under the UK BUPP reflect those TSR conditions applied to GPSP awards.

(iii) Savings related options

The Company participates in share option schemes satisfied by the issue of new shares: UK-based executive directors and eligible employees are eligible to participate in the Prudential HM Revenue & Customs (HMRC)-approved UK savings related share option scheme (SAYE scheme) and the Asia-based executive directors and eligible employees can participate in the equivalent International SAYE scheme.

Notes on the financial statements (continued)

The options are normally exercisable during the six month period following either the third or fifth anniversary of the start of the relevant savings contract. No options may be granted under the schemes if the grant would cause the number of shares which have been issued, or which remain issuable pursuant to options granted in the preceding 10 years under the scheme and other share option schemes operated by the Company, or which have been issued under any other share incentive scheme of the Company, to exceed 10 per cent of the Company's ordinary share capital at the proposed date of grant.

(iv) Share Incentive Plan

UK-based executive directors and employees are also eligible to participate in the Company's HMRC-approved Share Incentive Plan, which allows all UK-based employees to purchase shares of Prudential plc (partnership shares) on a monthly basis out of gross salary. For every four partnership shares bought, an additional matching share is awarded, purchased on the open market. Dividend shares accumulate while the employee participates in the plan. Partnership shares may be withdrawn from the scheme at any time. If the employee withdraws from the plan within five years, the matching shares are forfeit, and if within three years, dividend shares are forfeit.

(v) Long-term Incentive Plan

The Prudential Corporation Asia Long-Term Incentive Plan (PCA LTIP) is an incentive plan created in 2008 for senior employees and chief executive officers. Awards under the PCA LTIP will vest after three years subject to the employee being in employment at the time of vesting without any performance conditions. Awards will be discretionary and on a year-by-year basis determined by Prudential's full year financial results and the employee's contribution to the business. All awards will be in Prudential shares except for countries where share awards are not feasible due to securities and/or tax reasons, where awards will be replaced by the cash value of the shares that would otherwise have been transferred.

(vi) Other Share awards

In addition, there are other share awards, including the Prudential Corporation Deferred Bonus Plan and other arrangements. There are no performance conditions attaching to these deferred bonus plans, and awards vest in full subject to the individual being employed by the Company at the end of the vesting period. The other arrangements relate to various awards that have been made without performance conditions to individual employees, typically in order to secure their appointment or ensure retention.

Movements in share options outstanding under the Company's share-based compensation plans relating to Prudential plc shares during 2012 and 2011 were as follows:

	2012		2011	
Options outstanding (including conditional options)	**Number of options**	**Weighted average exercise price £**	Number of options	Weighted average exercise price £
Beginning of year:	**249,217**	**4.96**	199,606	3.36
Granted	**217,083**	**6.29**	86,026	4.66
Exercised	**(90,849)**	**2.95**	(8,524)	4.74
Forfeited	**(27,380)**	**4.96**	(11,498)	3.18
Cancelled	**(3,862)**	**4.66**	(10,234)	3.20
Lapsed	**(295)**	**5.51**	(6,159)	5.58
End of year	**343,914**	**5.44**	249,217	3.72
Options immediately exercisable, end of year	**5,349**	**4.25**	577	4.96

The weighted average share price of Prudential plc for the year ended 31 December 2012 was £7.69 compared to £6.86 for the year ended 31 December 2011.

Notes on the financial statements (continued)

Movements in share awards outstanding under the Group's share-based compensation plans relating to Prudential plc shares at 31 December 2012 and 2011 were as follows:

Awards outstanding	**2012 Number of awards**	2011 Number of awards
Beginning of year:	**830,955**	763,090
Granted	**401,370**	247,654
Exercised	**(371,077)**	-
Forfeited	**-**	-
Expired	**(9,867)**	(179,789)
End of year	**851,381**	830,955

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2012.

2012		Outstanding		Exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise prices £	Number exercisable	Weighted average exercise prices £
Between £0 and £1	-	-	-	-	-
Between £1 and £2	-	-	-	-	-
Between £2 and £3	42,072	1.92	2.88	-	-
Between £3 and £4	-	-	-	-	-
Between £4 and £5	90,483	2.37	4.63	5,349	4.25
Between £5 and £6	-	-	-	-	-
Between £6 and £7	211,359	3.51	6.29	-	-
	343,914	3.02	5.44	5,349	4.25

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2011.

2011		Outstanding		Exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise prices £	Number exercisable	Weighted average exercise prices £
Between £0 and £1	-	-	-	-	-
Between £1 and £2	-	-	-	-	-
Between £2 and £3	128,876	1.57	2.88	-	-
Between £3 and £4	-	-	-	-	-
Between £4 and £5	120,046	3.20	4.61	282	4.38
Between £5 and £6	295	0.00	5.51	295	5.51
Between £6 and £7	-	-	-	-	-
	249,217	2.36	3.72	577	4.96

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

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

2012 Weighted average fair value			2011 Weighted average fair value		
GPSP £	**SAYE Options £**	**Awards £**	GPSP £	SAYE Options £	Awards £
5.00	**2.27**	**7.70**	4.10	2.63	5.87

Notes on the financial statements (continued)

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

	2012		2011	
	GPSP	**SAYE Options**	GPSP	SAYE Options
Dividend yield (%)	-	**3.63**	-	3.33
Expected volatility (%)	**23.70**	**34.32**	28.80	63.65
Risk-free interest rate (%)	**0.36**	**0.37**	1.13	0.83
Expected option life (years)	-	**3.17**	-	3.27
Weighted average exercise price (£)	-	**6.29**	-	4.66
Weighted average share price (£)	**6.64**	**8.26**	7.34	6.06

Compensation costs for all share-based compensation plans are determined using the Black-Scholes model, the Monte Carlo model or other market consistent valuation methods. Share options and awards granted by the parent company are valued using the share price at the date of grant. Share options and awards granted by the Company are valued using the share price at the balance sheet date. The compensation costs for all awards and options are recognised in net income over the plans' respective vesting periods. The Black-Scholes model is used to value all options and awards other than GPSP and BUPP, for which the Monte Carlo model is used in order to allow for the impact of the TSR performance conditions. These models are used to calculate fair values for share options and awards at the grant date or balance sheet date, as appropriate, based on the quoted market price of the stock at the measurement date, the amount, if any that the employees are required to pay, the dividend yield, expected volatility, risk-free interest rates and exercise prices.

For the SAYE options, the expected volatility is based on the market implied volatilities for Prudential shares as quoted on Bloomberg. This change (from an estimate based on historic volatility) brings the methodology into line with the approach used to determine the volatility for the GPSP and UK BUPP awards. The Prudential specific at-the-money implied volatilities are adjusted to allow for the different term and discounted exercise price on SAYE options by using information on the volatility surface of the FTSE 100.

Risk free interest rates are UK gilt rates with projections for three and five year terms to match corresponding vesting periods. Dividend yield is determined as the average yield over a period of 12 months up to and including the date of the grant. For GPSP, volatility and correlation between Prudential and an index constructed from a simple average of TSR growth of 10 companies is required. For grants in 2012, an average index volatility and correlation of 32% and 76%, respectively were used. Changes to the subjective input assumptions could materially affect the fair value estimate.

The total share-based payment expense recognised in the non-technical account for 2012 is £3.9m (2011: £0.9m) of which £0.1m (2011: £0.1m) is accounted for as equity-settled and £3.8m (2011: £0.8m) is accounted for as cash-settled.

13. Directors' emoluments

	2012 £	2011 £
Aggregate emoluments	**3,025,714**	2,788,463
Aggregate amounts receivable (excluding shares) under long term incentive schemes	-	-
Excess retirement benefits:		
Current directors	**279,360**	241,753
Past directors	-	-
Other cash payments	-	-
	3,305,074	3,030,216
Highest Paid Director:		
Aggregate emoluments and amounts receivable (excluding shares) under long term incentive schemes	**1,364,140**	1,108,303

Notes on the financial statements (continued)

No directors (2011: two) exercised share options during the year. Four directors (2011: four) were entitled to shares under Prudential's main long-term incentive scheme and one director (2011: one) was entitled to retirement funds under defined benefit schemes. The highest paid director did not exercise any share options but did receive shares under long-term incentive schemes. The highest paid director in 2011 did not exercise any share options and did not receive shares under long-term incentive schemes.

14. Auditors' remuneration

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

	2012 £m	2011 £m
Audit services:		
Fees payable to KPMG for the audit of the Company's accounts	**2.3**	2.4
Non-audit services:		
Fees payable to KPMG and its associates for other services:		
Audit of the Company's subsidiaries, pursuant to legislation	**0.1**	0.1
Other services pursuant to legislation, including the audit of the regulatory return	**0.4**	0.3
Tax Compliance services	**0.1**	0.1
Tax Advisory services	**-**	-
Other assurance services	**-**	-
Corporate finance services	**-**	-
	2.9	2.9

15. Intangible assets

	Distribution Rights £m	Licence £m	Total £m
Cost:			
At 1 January 2012	137	174	311
Exchange differences	(6)	-	(6)
At 31 December 2012	**131**	**174**	**305**
Amortisation:			
At 1 January 2012	20	90	110
Exchange differences	(1)	-	(1)
Provided in the year in the long-term business technical account	12	11	23
At 31 December 2012	**31**	**101**	**132**
Net book value at 31 December 2012	**100**	**73**	**173**
Net book value at 31 December 2011	117	84	201

The charge for amortisation for the year ended 31 December 2011 was £17m charged to the long-term business technical account.

The licence represents the value of an agreement, which commenced in 1997, with a fellow subsidiary company for the use of certain Scottish Amicable assets, which is being amortised over a period of 20 years to 30 September 2017, on a basis consistent with the revenue stream from the agreement. Under this basis, the amortisation commenced in the year 2000, when the benefits from the agreement first started to arise, with the intention of the licence being fully amortised by 30 September 2017.

The distribution rights relate to facilitation fees paid in relation to the bancassurance partnership arrangements in Asia for the bank distribution of insurance products for a fixed period of time, being the term of the contract. The distribution rights amounts are amortised on the basis to reflect the pattern in which the distribution rights' future economic benefits are expected to be consumed by the Company by reference to new business levels.

There have been no impairments during the year (2011: £Nil).

Notes on the financial statements (continued)

16. Land and buildings

	2012 £m	2011 £m
Current value		
Freeholds	**3,927**	3,926
Leaseholds with a term of over 50 years	**1,949**	2,025
Leaseholds with a term of less than 50 years	**394**	378
	6,270	6,329
Cost	**4,896**	4,835

The value of land and buildings occupied by the Company amounted to £100m (2011: £92m).

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

Freehold and leasehold land and buildings

	2012 £m	2011 £m
At cost	**4,896**	4,835
Aggregate depreciation	**(1,700)**	(1,579)
Net book value based on historical cost	**3,196**	3,256

17. Investments in group undertakings and participating interests

	Cost		**Current value**	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Shares in group undertakings				
Long-term fund investments	**1,520**	1,499	**2,457**	2,711
Shareholder investments	**1,160**	1,160	**3,008**	2,572
	2,680	2,659	**5,465**	5,283
Debt securities issued by, and loans to group undertakings – long term funds	**760**	759	**760**	759
Total	**3,440**	3,418	**6,225**	6,042

The following is a list of the principal subsidiary undertakings of the Company at 31 December 2012, all wholly owned; a full list of all the Company's subsidiaries is filed annually at Companies House:

		Class of shares held	Principal Activity	Country of Incorporation
	Prudential Retirement Income Limited	Ordinary shares £1 Preference shares £1	Pension annuities	Scotland
*	Prudential Annuities Limited	Ordinary shares £1	Pension annuities	England and Wales
	Prudential European Assurance Holdings plc Note: Prudential European Assurance Holdings plc is the holding company of Prudential International Assurance plc, a company registered in the Republic of Ireland, the principal activity of which is life and pensions business.	Preference shares £1	Financial Services Holding Company	Scotland
	Prudential Pensions Limited	Ordinary shares £1	Pensions	England and Wales
	Prudential Lifetime Mortgages Limited	Ordinary shares £1 Preference shares £1	Mortgage lending and administration	Scotland

* Owned by the long-term fund.

Notes on the financial statements (continued)

The Company has one associate at 31 December 2012:

	Class and proportion of shares held	Principal Activity	Country of Incorporation
Prudential Health Holdings Limited	A ordinary shares £1 25% holding	Private medical insurance	England and Wales

18. Other financial investments

	Cost		Carrying value	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Shares and other variable yield securities and units in unit trusts	**26,874**	24,009	**32,886**	30,253
Debt securities and other fixed income securities	**41,872**	42,986	**46,152**	46,683
Derivative assets	**340**	464	**1,533**	1,216
Loans secured by mortgages	**1,870**	1,605	**2,095**	1,885
Loans to policyholders secured by insurance policies	**90**	87	**90**	87
Other loans	**867**	979	**772**	903
Deposits with credit institutions	**9,463**	7,333	**9,463**	7,333
	81,376	77,463	**92,991**	88,360

The change in carrying value of other financial investments included in the Profit and Loss account was a gain of £795m (2011: £2,595m loss) analysed between a gain of £795m (2011: £2,595m loss) included in the Long-term business technical account and £Nil (2011: £Nil) included in the Non-technical account. The change in carrying value of £795m (2011: £2,595m loss) included a loss of £136m (2011: £3,889m loss) in respect of equity securities, a gain of £614m (2011: £1,540m gain) in respect of debt securities, a gain of £331m (2011: £373m loss) in respect of derivatives and a loss of £14m (2011: £127m gain) in respect of other financial instruments.

	Carrying value	
Amounts included in the above relating to listed investments:	**2012 £m**	2011 £m
Shares and other variable yield securities and units in unit trusts	**27,744**	25,587
Debt securities and other fixed income securities	**43,540**	44,423
	71,284	70,010

The table below analyses the derivative positions of the Company:

	2012 £m		2011 £m	
	Fair value assets	**Fair value liabilities**	Fair value assets	Fair value liabilities
Derivative financial instruments held to manage interest rate and currency profile:				
Interest rate swaps	**135**	**224**	127	204
Cross currency swaps	**156**	**67**	123	214
Currency exchange forward contracts	**1,097**	**830**	508	431
Bond futures	**9**	**49**	33	199
Credit Default Swaps	**4**	**1**	33	6
Derivative financial instruments held to manage market risk and efficient investment management:				
Equity options	**128**	**-**	386	-
Equity futures	**4**	**9**	6	12
Total return swaps	**-**	**-**	-	5
Total	**1,533**	**1,180**	1,216	1,071

The nature of the derivative financial instruments, used by the Company in 2012, are similar to those used in 2011 and their use is disclosed in note 33.

Notes on the financial statements (continued)

19. Assets held to cover linked liabilities

	Cost		Current value	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Assets held to cover linked liabilities (net of reinsurance)	**11,633**	9,139	**12,531**	10,199

20. Reinsurers' share of technical provisions

The reinsurers' share of the long-term business provision relates mainly to cessions to Prudential Retirement Income Limited, a subsidiary of the Company. The reinsurers' share of the technical provisions for linked liabilities relates mainly to cessions to Prudential Pensions Limited.

21. Other debtors

	2012 £m	2011 £m
Amounts owed by fellow subsidiaries and holding company	**704**	721
Amounts owed by subsidiary companies	**304**	309
Tax recoverable	**45**	118
Other	**114**	102
	1,167	1,250

22. Tangible fixed assets

	Computer Equipment £m	Fixtures & Fittings £m	Total £m
Cost:			
At 1 January 2012	10	45	55
Exchange differences	-	(1)	(1)
Additions	2	1	3
Disposals	-	-	-
At 31 December 2012	**12**	**45**	**57**
Depreciation:			
At 1 January 2012	8	40	48
Exchange differences	-	(1)	(1)
Provided in the year	2	2	4
Disposals	-	-	-
At 31 December 2012	**10**	**41**	**51**
Net book value at 31 December 2012	**2**	**4**	**6**
Net book value at 31 December 2011	2	5	7

The charge for depreciation for the year ended 31 December 2011 was £4m.

23. Assets attributable to the long-term business fund

Of the total amount of assets shown in the balance sheet on page 21, £136,611m (2011: £124,514m) is attributable to the long-term business fund.

Notes on the financial statements (continued)

24. Share capital

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

The A Preference Shares (see note 28) issued shall be redeemed by the Company without notice on 8 May 2016. The premium payable on redemption amounts to 28.08p, which is increased by the percentage of the RPI from a date 30 days prior to the first issue of any preference shares to a date 30 days prior to redemption. The A Preference Shares carry the right to receive an index linked cumulative preferential dividend, payable annually. The A Preference Shares carry no voting rights except if a resolution is proposed abrogating, varying or modifying any of the rights or privileges of the holders of the A Preference Shares, but carry preferential rights in priority to other shareholders to payment on a return of capital in the event of the winding up of the Company.

The B Preference Shares issued carry the right to receive a non-cumulative preferential dividend which shall accrue at the rate of two pence per annum. The B Preference Shares may not be redeemed otherwise than at the option of the Company at any time after the fifth anniversary of the date of issue of such B Preference Share. The B Preference Shares carry no voting rights except if a resolution is proposed in relation to (i) the winding up of the Company, a voluntary arrangement with creditors of the Company or proposed receivership, administrative receivership or administration of the Company; or (ii) an alteration of the rights of the B Preference Shares or in relation to any other matter which will have detrimental effect upon the rights of the B Preference Shares.

25. Shareholders' reserves

	Revaluation reserve	Other reserves	Profit and loss account	Total
	£m	£m	£m	£m
Balance at 1 January 2012 (*)	1,405	536	1,908	3,849
Exchange adjustments	-	-	(6)	(6)
Profit for the financial year	-	-	376	376
Dividends	-	-	(245)	(245)
Revaluation of subsidiaries and associate	436	-	-	436
Balance at 31 December 2012	**1,841**	**536**	**2,033**	**4,410**

	2012 £m	2011 £m
Analysis of profit and loss account:		
Distributable retained profit (*)	**1,678**	1,663
Undistributable retained profit	**355**	245
Total (*)	**2,033**	1,908

* 2011 corresponding amounts have been adjusted to increase the Revaluation reserve and decrease the Profit and Loss Account reserve by £223m to reflect an altered treatment in respect of a former subsidiary company.

26. Bank current accounts

Under the terms of the Company's arrangements with the Prudential Group's main UK banker, the bank has a right of set-off between credit balances (other than those of long term business funds) and all overdrawn balances of those Group undertakings with similar arrangements.

Notes on the financial statements (continued)

27. Other creditors including taxation and social security

	2012 £m	2011 £m
Amounts owed to fellow subsidiaries and holding company	**119**	46
Amounts owed to subsidiary companies	**1,497**	1,355
Tax	**253**	359
Derivative liability (see note 18)	**1,180**	1,071
Other creditors	**1,129**	1,814
	4,178	4,645

28. Preference shares

	2012 £m	2011 £m
A preference shares of £1 each – see note 24	**1**	1

29. Ultimate parent company

The ultimate and immediate parent company is Prudential plc, which is the parent company that prepares group accounts. Copies of these accounts can be obtained from the Company Secretary, Laurence Pountney Hill, London EC4R 0HH.

30. Related party transactions

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

During 2012, in respect of the Company's associate (Prudential Health Holdings Limited), no capital injection was made (2011: £4m). £41m (2011: £33m) was recharged to the Company from Prudential Health Services Limited for services provided in respect of the PruProtect product underwritten by the Company. £Nil (2011: £Nil) of interest was recharged by the Company to Prudential Health Services Limited in respect of the use of negative reserves in the Company's balance sheet for PruProtect. An agreement was entered into on 3 September 2007 which allows the Company to borrow from Prudential Health Holdings Limited up to an aggregate amount of £250m. The loan amount is principally linked to the emergence of regulatory losses arising in respect of all income and costs associated with selling and underwriting the Flexible Protection Plan and PruProtect Plan. The loan is to be repaid as regulatory surpluses arise in the future. In 2012 the Company borrowed £Nil (2011: £5m) under this arrangement.

31. Long-term business provision

The principal valuation methods and bases adopted for the main relevant classes of business which are not reinsured are as follows:

Business in With-Profits Sub-Fund, SAIF and Defined Charge Participating Sub-Fund

The overarching principle in assumption setting is that realistic provisions are established using best estimate assumptions, taking into account the firm's regulatory duty to treat its customers fairly.

Assumptions are required in three areas, namely:

(i) Retrospective assumptions,
(ii) Prospective assumptions, and
(iii) Stochastic modelling assumptions relating to the economic asset model and management actions.

Retrospective assumptions

Retrospective assumptions are required for the accumulation of past asset shares up to the valuation date. These assumptions are determined by reference to actual past experience primarily in relation to investment returns, expenses and miscellaneous surplus. The assumptions include past expense write-

Notes on the financial statements (continued)

offs and enhancements to asset shares, and are as used when calculating specimen asset shares for the purpose of bonus setting.

The 2012 year end Investment Return for asset shares is:

Return	With-Profits Sub Fund	High Reversionary Bonus fund (held within the With-Profits Sub-Fund)	PruFund Cautious Fund (held within the With-Profits Sub-Fund)	SAIF
Gross return	10.43%	12.61%	9.85%	9.73%
Net return	8.78%	10.35%	8.02%	8.16%

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

Prospective assumptions

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

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

Expense assumptions have been taken as the level of expenses incurred during 2012.

The mortality assumption has been set to the realistic component of the statutory basis. This means that for a given business class, the margin for adverse deviations (MAD) has been removed from the corresponding statutory assumption.

The table below shows the mortality bases used for the valuation at 31 December 2012:

Product	Mortality Table (M/F)	Age Rating Years	Multiplier % (M/F)
Prudence Bond	AM92 / AF92	-1/-1	100 / 100
PSA / PIB	AM92 / AF92	-0.5/-0.5	100 / 100
Personal Pensions	AM92 / AF92	-1/-1	100 / 100
Ordinary Branch assurances	AM92 / AF92	-0.5/-0.5	100 / 100
Industrial Branch	PAC 78 WL (Internal Table)	+0 / +0	70 / 70
With-Profit Deferred Annuities	AM92 / AF92	-1/-1	100 / 100
SAIF Conventional With-Profits	AM92 / AF92	+1 / +1	70 / 70
SAIF/ex-SAL Accumulating With-Profits Life	AM92 / AF92	+1 / +1	70 / 70

For persistency, the assumptions for most products are based on those used for European Embedded Value calculations. The persistency assumptions used to value the cost of options and guarantees are reduced by a 10% margin to make an allowance for the impact of policyholders' group actions in extreme market scenarios.

Stochastic asset model economic calibration and management actions

The cost of options, guarantees and smoothing are assessed on a market consistent basis, so that the reserves held are equal to the theoretical cost of hedging the guarantees in the market. In the absence

of a deep, liquid market these costs are assessed using a "market consistent" model, with a market consistent calibration.

In order to value the Company's guarantees and options, the stochastic asset/liability model projects the with-profits liabilities forward over the next 40 years for 5,000 separate economic scenarios.

The risk free rate was assumed to be the long term gilt rate.

Separate asset models are used for the risk free rate, UK equities, overseas equities, corporate bonds, property and real interest rates. Where appropriate securities or derivatives are traded, it has been demonstrated that the model is able to closely reproduce these prices. Where this is not the case (for example for property and corporate bonds) expert judgement has been applied. Allowance has also been made for the correlation of investment returns between different asset classes.

The cost of guarantees, options and smoothing is very sensitive to the bonus, market value reduction and investment policies that the Company will employ under varying investment conditions. The stochastic modelling incorporates several management actions to protect the fund in adverse investment scenarios. These management actions are consistent with the PPFM and the obligation to treat customers fairly.

Other non-linked business

Provisions are predominantly calculated by the net premium valuation method. Discount rates are derived from the returns available on appropriate investments and, for equity and property assets, are based on expected income and/or earnings with no allowance for potential future capital growth. Allowance is made as follows for the risk that some or all of the anticipated future income will not be received:

(a) For equity and property assets the income is restricted where necessary to ensure that no individual holding had a yield in excess of the annual yield on the Merrill Lynch over 10 years corporate bond index, less a risk margin.

(b) For fixed interest securities, aggregate bond asset yields have been adjusted to allow for potential defaults within the non-linked and index-linked asset portfolios respectively.

The following discount and mortality bases were used:

	Interest Rate %	Actuarial Mortality Table Reference*
UK (excluding Scottish Amicable Insurance Fund)		
Term assurances - life business	3.00	AM/AF92+1
Term assurances - pensions business	4.00	AM/AF92+1
Immediate annuity - Fixed	3.40-3.74	99% PCMA00 + CMI_2011_PRU_M[2.25]
Immediate annuity - Linked	0.36-0.48	89% PCMA00 + CMI_2011_PRU_F[1.50]**
Scottish Amicable Insurance Fund		
Term assurances - life business	2.25	AM/AF92+1
Term assurances – pensions business	2.75	AM/AF92+1

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

** CMI_PRU_2011_M[X] and CMI_PRU_2011_F[Y] are the male and female improvement rates produced by Prudential's internal calibration of the 2011 CMI model, with long term rates of X% and Y%.

Notes on the financial statements (continued)

Linked business in the Non-Profit Sub-Fund and Scottish Amicable Insurance Fund

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

Discount Rate	3.50% gross
Fund Growth	5.00% gross
Mortality	AM/AF92+1 plus 1/3 AIDS "R6A" for most contracts
Administration Expenses	£29 to £219 p.a. depending on the product type
Expense Inflation	3.50% p.a.

Compared with the 2012 valuation the assumptions regarding administration expenses have been revised to allow for actual and forecast costs.

Linked business in the With-Profit Sub-Fund

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

Discount Rate	4.00% gross
Fund Growth	5.00% gross
Mortality	AM/AF92 -3 years
Administration Expenses	£34 to £226 p.a. depending on the product type
Expense Inflation	3.50% p.a.

Compared with the 2012 valuation the assumptions regarding administration expenses have been revised to allow for actual and forecast costs.

Other long-term business provisions

Additional provisions have been established, the most significant being for the potential costs and expenses of compensating the Company's pension policyholders under the FSA review of pension opt-outs and transfer cases, for the potential costs of compensating endowment mortgage policyholders and for the potential cost of meeting annuity rate guarantees at vesting.

32. Contingencies and Related Obligations

Consistent with FRS 12 'Provisions, contingent liabilities and contingent assets', appropriate provision has been made in the financial statements where the Company either has an obligation, or it is probable that it has an obligation, arising from the events or activities described below, where a reliable estimate of the obligation can be made, but not for contingent liabilities which are discussed below.

Pension Mis-selling Review

The pensions review by the UK insurance regulator (the Financial Services Authority (FSA) of past sales of personal pension policies required all UK life insurance companies to review their cases of potential mis-selling and record a provision for the estimated costs. The Company met the requirement of the FSA to issue offers to all cases by 30 June 2002.

At 31 December 2012, the pension mis-selling provision was £306m (2011: £362m). The table below summarises the change in the pension mis-selling provision for the year ended 31 December 2012.

Notes on the financial statements (continued)

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Balance at start of the period	362	314
Changes to actuarial assumptions and method of calculation	(10)	97
Discount unwind	1	1
Redress paid to policyholders	(45)	(49)
Payment of administrative costs	(2)	(1)
Balance at end of the period	306	362

The pension mis-selling provision at 31 December 2012 of £306m is stochastically determined on a discounted basis. The average discount rate implied in the movement in the year is 2.3 per cent (2011: 2.6 per cent).

Provisions in respect of the costs associated with the review have been included in the change in long-term technical provisions in the Company's long-term technical account and the transfer to or from the fund for future appropriations has been determined accordingly.

The directors believe that, based on current information, the provision, together with future investment return on the assets backing the provision, will be adequate to cover the costs of pension mis-selling including administration costs. Such provision represents the best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased.

The costs associated with the pension mis-selling review have been met from the inherited estate. Accordingly, these costs have not been charged to the asset shares used in the determination of policyholder bonus rates. Hence policyholders' payout values have been unaffected by pension mis-selling.

Mortgage Endowment Products Review

In common with several other UK insurance companies, the Company used to sell low-cost endowment products related to repayment of residential mortgages. At sale, the initial sum assured is set at a level such that the projected benefits, including an estimate of the annual bonus receivable over the life of the policy, will equal or exceed the mortgage debt. The FSA is concerned that the maturity value of some of these products will be less than the mortgage debt because of a decrease in expected future investment returns since these products were sold. The FSA has worked with insurance companies to devise a programme whereby the companies write to customers indicating whether they may have a possible shortfall and outline the actions that the customers can take to prevent this possibility.

The Company is exposed to mortgage endowment products in respect of policies issued by Scottish Amicable Life plc (SAL) and policies issued by Scottish Amicable Life Assurance Society (SALAS) and transferred into the Scottish Amicable Insurance Fund (SAIF). Technical provisions of £1m in the non-profit sub-fund and £12m in SAIF were held at 31 December 2012 to cover potential compensation in respect of mortgage endowment product mis-selling claims. As SAIF is a separate sub-fund of the Company's long-term business fund, wholly attributable to the policyholders of the fund, this provision has no impact on shareholders.

In addition, the Company's main with-profits fund paid compensation of £1m in respect of mortgage endowment products mis-selling claims in the year ended 31 December 2012 and held a technical provision of £20m at 31 December 2012 in respect of further compensation. In line with the time limit prescribed by the FSA and the ABI, impacted customers have three years to lodge a mis-selling complaint from the date they receive their first "red" letter indicating that there is a high risk their mortgage endowment may not achieve its projected final value.

Guaranteed Annuities

The Company used to sell guaranteed annuity products in the UK and held a technical provision of £47m at 31 December 2012 within the main with-profits fund to honour guarantees on these products.

Notes on the financial statements (continued)

The Company's main exposure to guaranteed annuities in the UK is through the Scottish Amicable Insurance Fund (SAIF) and a technical provision of £371m was held in SAIF at 31 December 2012 to honour the guarantees. As SAIF is a separate sub-fund of the Company's long-term business fund, wholly attributable to the policyholders of the fund, this provision has no impact on shareholders.

Guarantees and Commitments

During 2012 the Company agreed to guarantee the funding obligation that Prudential Distribution Limited (PDL), a service company within the Prudential Group and principal employer, and other participating employers have to the Scottish Amicable Pension Scheme. The funding obligation arises from the deficit in this pension scheme. Payment under the guarantee would be exercised should PDL fail to meet its funding obligation. The guarantee expires on 1 September 2018.

The Company also provides, from time to time, other guarantees and commitments to third parties entered into in the normal course of business but the directors do not consider that the amounts involved are significant.

Inherited Estate

The assets of the with-profits sub-fund (WPSF) within the long-term fund of the Company comprise the amounts that it expects to pay out to meet its obligations to existing policyholders and an additional amount used as working capital. The amount payable over time to policyholders from the WPSF is equal to the policyholders' accumulated asset shares plus any additional payments that may be required by way of smoothing or to meet guarantees. The balance of the assets of the WPSF is called the 'inherited estate' and has accumulated over many years from various sources.

The inherited estate, as working capital, enables the Company to support with-profits business by providing the benefits associated with smoothing and guarantees, by providing investment flexibility for the fund's assets, by meeting the regulatory capital requirements that demonstrate solvency and by absorbing the costs of significant events or fundamental changes in its long-term business without affecting the bonus and investment policies. The size of the inherited estate fluctuates from year to year depending on the investment return and the extent to which it has been required to meet smoothing costs, guarantees and other events.

Support of Long-term Business Funds by Shareholders' Funds

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

In 1997, the business of Scottish Amicable Life Assurance Society, a mutual society, was transferred to the Company. In effecting the transfer, a separate sub-fund, the Scottish Amicable Insurance Fund (SAIF), was established within the Company's long-term business fund. This sub-fund contains all the with-profits business and all other pension business that was transferred. No new business has been or will be written in the sub-fund and the sub-fund is managed to ensure that all the invested assets are distributed to SAIF policyholders over the lifetime of the SAIF policies. With the exception of certain amounts in respect of the unitised with-profits life business, all future earnings arising in SAIF are retained for SAIF policyholders. Any excess (deficiency) of revenue over expense within SAIF during a period is offset by a change in the SAIF technical provisions (no FFA is shown for SAIF in 2012 because technical provisions are set at a level at which the realistic working capital is zero). Shareholders have no interest in the profits of SAIF but are entitled to the investment management fees paid on this business.

SAIF with-profits policies contain minimum levels of guaranteed benefit to policyholders. In addition, as mentioned earlier in this note, certain pensions products have guaranteed annuity rates at retirement.

Notes on the financial statements (continued)

Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations of the policyholders of SAIF, the Company's long-term fund would be liable to cover any such deficiency in the first instance. The directors believe that the probability of either the Company's long-term fund or the Company's shareholders' funds having to contribute to SAIF is remote.

There is an obligation of the Company's shareholder funds to support the Polish branch to meet any excess of initial funding provided by the Company's with-profits fund over the product charges received. The main trigger for this support is considered to be closure to new business, although there is also a time trigger setting a date by which the financing should be recovered through future charges. As the branch has not yet started trading, at 31 December 2012, the Company's exposure is limited to the initial set up costs.

33. Financial assets and liabilities

A. Financial instruments – designation and fair values

All financial assets of the Company are designated as either fair value through profit and loss or loans and receivables. Financial liabilities are designated as either fair value through profit and loss, amortised cost or investment contracts with discretionary participation features accounted for under FRS 26 and the ABI SORP as described in the Accounting Policies section.

2012	Fair value through profit and loss £m	Loans and receivables £m	Total carrying value £m	Fair value £m
Financial Assets				
Deposits with credit institutions	-	9,463	9,463	9,463
Equity securities and portfolio holdings in unit trusts	30,734	-	30,734	30,734
Debt securities and other fixed income securities (note i)	46,152	-	46,152	46,152
Loans (note ii):	226	2,731	2,957	3,189
Other investments (note iii)	2,152	-	2,152	2,152
Derivative assets	1,533	-	1,533	1,533
Assets held to cover linked liabilities	12,531	-	12,531	12,531
Deposits with ceding undertakings	-	7,306	7,306	7,306
Debtors arising out of direct insurance ops	-	70	70	70
Debtors arising out of reinsurance ops	-	49	49	49
Accrued investment income	-	903	903	903
Other debtors	-	1,122	1,122	1,122
Cash at bank and in hand	-	934	934	934
Total	**93,328**	**22,578**	**115,906**	**116,138**

	Fair value through profit and loss £m	Amortised cost £m	ABI SORP/ FRS26 £m	Total carrying value £m	Fair value £m
Financial Liabilities					
Amounts owed to credit institutions	-	70	-	70	70
Other borrowings not owed to credit institutions (note iv)	-	126	-	126	126
Investment contracts with discretionary participation features (note v)	-	-	33,560	33,560	-
Investment contracts without discretionary participation features	6,508	-	-	6,508	6,508
Creditors arising out of direct insurance operations	-	173	-	173	173
Creditors arising out of reinsurance operations	-	50	-	50	50
Other creditors	258	2,487	-	2,745	2,745
Derivative liabilities	1,180	-	-	1,180	1,180
Total (note v)	**7,946**	**2,906**	**33,560**	**44,412**	**10,852**

2011	Fair value through profit and loss £m	Loans and receivables £m	Total carrying value £m	Fair value £m
Financial Assets				
Deposits with credit institutions	-	7,333	7,333	7,333
Equity securities and portfolio holdings in unit trusts	27,876	-	27,876	27,876
Debt securities and other fixed income securities (note i)	46,683	-	46,683	46,683
Loans (note ii):	279	2,596	2,875	2,799
Other investments (note iii)	2,377	-	2,377	2,377
Derivative assets	1,216	-	1,216	1,216
Assets held to cover linked liabilities	10,199	-	10,199	10,199
Deposits with ceding undertakings		2,853	2,853	2,853
Debtors arising out of direct insurance ops	-	68	68	68
Debtors arising out of reinsurance ops	-	12	12	12
Accrued investment income	-	975	975	975
Other debtors	-	1,132	1,132	1,132
Cash at bank and in hand	-	1,242	1,242	1,242
Total	**88,630**	**16,211**	**104,841**	**104,765**

	Fair value through profit and loss £m	Amortised cost £m	ABI SORP/ FRS26 £m	Total carrying value £m	Fair value £m
Financial Liabilities					
Amounts owed to credit institutions	-	56	-	56	56
Other borrowings not owed to credit institutions (note iv)	-	232	-	232	232
Investment contracts with discretionary participation features (note v)	-	-	29,443	29,443	-
Investment contracts without discretionary participation features	5,802	-	-	5,802	5,802
Creditors arising out of direct insurance operations	-	99	-	99	99
Creditors arising out of reinsurance operations	-	143	-	143	143
Other creditors	281	2,934	-	3,215	3,215
Derivative liabilities	1,071	-	-	1,071	1,071
Total (note v)	**7,154**	**3,464**	**29,443**	**40,061**	**10,618**

Notes

(i) As at 31 December 2012, £420m (2011: £473m) of convertible bonds were included in debt securities. There were no convertible bonds included in borrowings.

(ii) Loans and receivables are reported net of allowance for loan losses of £95m (2011: £76m).

(iii) Other investments include participation in various investment funds and limited liability property partnerships.

(iv) As at 31 December 2012, £126m (2011: £232m) of loan repayable, contingent on regulatory surplus emerging, was included in "Other borrowings not owed to credit institutions".

(v) It is impractical to determine fair value of investment contracts with discretionary participation features due to the lack of a reliable basis to measure such features.

(vi) For financial liabilities designated as fair value through profit and loss there was no material impact on profit from movements in credit risk during 2012 and 2011.

Determination of fair value

The fair values of the financial assets and liabilities as shown in the table above have been determined on the following bases.

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

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

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

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

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

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

The table below includes financial instruments carried at fair value analysed by level of the FRS29 defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

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

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

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

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

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

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £41,608m (2011: £39,946m), £2,785m (2011: £2,147m) 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.

Notes on the financial statements (continued)

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

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

At 31 December 2012 the Company held £2,408m (2011: £2,278m), 3% (2011: 3%) of the fair valued financial instruments, within level 3. Of these amounts £2,407m (2011: £2,277m) was held by the Company's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments. Total level 3 assets represented 3% (2011: 3%) of the total assets of the participating funds at 31 December 2012.

Notes on the financial statements (continued)

	31 December 2012			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
With-profits				
Equity securities and portfolio holdings in unit trusts	27,045	2,678	430	**30,153**
Debt securities	3,652	39,043	70	**42,765**
Other investments (including derivative assets)	105	1,290	1,907	**3,302**
Derivative liabilities	(58)	(742)	-	**(800)**
Total financial investments, net of derivative liabilities	**30,744**	**42,269**	**2,407**	**75,420**
Percentage of total	**41%**	**56%**	**3%**	**100%**
Unit-linked				
Assets held to cover linked liabilities	8,562	71	-	**8,633**
Total financial investments net of derivative liabilities	8,562	71	-	**8,633**
Investment contract without discretionary participation features held at fair value	-	(6,508)	-	**(6,508)**
Total	**8,562**	**(6,437)**	-	**2,125**
Percentage of total	**403%**	**(303%)**	-	**100%**
Non-linked shareholder-backed				
Equity securities and portfolio holdings in unit trusts	497	84	-	**581**
Debt securities	822	2,565	-	**3,387**
Loans at FVTPL	-	226	-	**226**
Other investments (including derivative assets)	-	382	1	**383**
Derivative liabilities	-	(380)	-	**(380)**
Total financial investments, net of derivative liabilities	**1,319**	**2,877**	**1**	**4,197**
Percentage of total	**31%**	**69%**	-	**100%**
Company total				
Equity securities and portfolio holdings in unit trusts	27,542	2,762	430	**30,734**
Debt securities	4,474	41,608	70	**46,152**
Loans at FVTPL	-	226	-	**226**
Other investments (including derivative assets)	105	1,672	1,908	**3,685**
Assets held to cover linked liabilities	8,562	71	-	**8,633**
Derivative liabilities	(58)	(1,122)		**(1,180)**
Total financial investments, net of derivative liabilities	**40,625**	**45,217**	**2,408**	**88,250**
Investment contract without discretionary participation features held at fair value	-	**(6,508)**	-	**(6,508)**
Total	**40,625**	**38,709**	**2,408**	**81,742**
Percentage of total	**50%**	**47%**	**3%**	**100%**

Notes on the financial statements (continued)

	31 December 2011			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**
With-profits				
Equity securities and portfolio holdings in unit trusts	25,025	2,214	323	**27,562**
Debt securities	5,763	37,650	107	**43,520**
Other investments (including derivative assets)	250	1,351	1,847	**3,448**
Derivative liabilities	(211)	(725)	-	**(936)**
Total financial investments, net of derivative liabilities	**30,827**	**40,490**	**2,277**	**73,594**
Percentage of total	**42%**	**55%**	**3%**	**100%**
Unit-linked				
Assets held to cover linked liabilities	8,079	80	-	**8,159**
Total financial investments net of derivative liabilities	8,079	80	-	**8,159**
Investment contract without discretionary participation features held at fair value	-	(5,802)	-	**(5,802)**
Total	**8,079**	**(5,722)**	-	**2,357**
Percentage of total	**343%**	**(243%)**	-	**100%**
Non-linked shareholder-backed				
Equity securities and portfolio holdings in unit trusts	229	85	-	**314**
Debt securities	867	2,296	-	**3,163**
Loans at FVTPL	-	279	-	**279**
Other investments (including derivative assets)	4	140	1	145
Derivative liabilities	-	(135)	-	**(135)**
Total financial investments, net of derivative liabilities	**1,100**	**2,665**	**1**	**3,766**
Percentage of total	**29%**	**71%**	-	**100%**
Company total				
Equity securities and portfolio holdings in unit trusts	25,254	2,299	323	**27,876**
Debt securities	6,630	39,946	107	**46,683**
Loans at FVTPL	-	279	-	**279**
Other investments (including derivative assets)	254	1,491	1,848	**3,593**
Assets held to cover linked liabilities	8,079	80	-	**8,159**
Derivative liabilities	(211)	(860)	-	**(1,071)**
Total financial investments, net of derivative liabilities	**40,006**	**43,235**	**2,278**	**85,519**
Investment contract without discretionary participation features held at fair value	-	**(5,802)**	-	**(5,802)**
Total	**40,006**	**37,433**	**2,278**	**79,717**
Percentage of total	**50%**	**47%**	**3%**	**100%**

Notes on the financial statements (continued)

Assets held to cover linked liabilities, shown in the table, only covers those assets which are required to be disclosed under the provisions of FRS29 'Financial Instruments' for the fair value hierarchy. There are a further £3,898m (2011: £2,040m) of assets which comprise the total assets held to cover linked liabilities, which consist mainly of cash at bank, other debtors and property.

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 2012 to that presented at 31 December 2012. 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.

Transfers out of level 3 include debt securities reclassifications from level 3 to level 2 which reflect improving liquidity during the period.

	At 1 Jan 2012	Total gains or (losses) in long-term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2012
	£m	£m	£m	£m	£m	£m	£m
With-profits							
Equity securities and portfolio holdings in unit trusts	323	16	198	(94)	-	(13)	**430**
Debt securities	107	26	1	(54)	-	(10)	**70**
Other investments (including derivative assets)	1,847	91	226	(257)	-	-	**1,907**
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	2,277	133	425	(405)	-	(23)	**2,407**
Total	**2,277**	**133**	**425**	**(405)**	**-**	**(23)**	**2,407**
Non-linked shareholder-backed							
Equity securities and portfolio holdings in unit trusts	-	-	-	-	-	-	-
Debt securities	-	-	-	-	-	-	-
Other investments (including derivative assets)	1	-	-	-	-	-	**1**
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	1	-	-	-	-	-	**1**
Total	**1**	**-**	**-**	**-**	**-**	**-**	**1**
Company total							
Equity securities and portfolio holdings in unit trusts	323	16	198	(94)	-	(13)	**430**
Debt securities	107	26	1	(54)	-	(10)	**70**
Other investments (including derivative assets)	1,848	91	226	(257)	-	-	**1,908**
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	2,278	133	425	(405)	-	(23)	**2,408**
Total	**2,278**	**133**	**425**	**(405)**	**-**	**(23)**	**2,408**

Of the total profits of £133m (2011: profit of £135m) in the period, £52m (2011: profit of £76m) relates to Level 3 financial instruments still held at the end of the year, which can be analysed as a loss of £10m (2011: £9m profit) for equity securities, a loss of £23m (2011: £3m profit) for debt securities and a profit of £85m (2011: £64m profit) for other investments.

Notes on the financial statements (continued)

	At 1 Jan 2011 £m	Total gains or (losses) in long-term technical account £m	Purchases £m	Sales £m	Transfers into level 3 £m	Transfers out of level 3 £m	At 31 Dec 2011 £m
With-profits							
Equity securities and portfolio holdings in unit trusts	395	14	55	(107)	-	(34)	323
Debt securities	246	40	211	(351)	-	(39)	107
Other investments (including derivative assets)	1,583	81	417	(178)	-	(56)	1,847
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	2,224	135	683	(636)	-	(129)	2,277
Total	2,224	135	683	(636)	-	(129)	2,277
Non-linked shareholder-backed							
Equity securities and portfolio holdings in unit trusts	-	-	-	-	-	-	-
Debt securities	1	-	-	(1)	-	-	-
Other investments (including derivative assets)	-	-	1	-	-	-	1
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	1	-	1	(1)	-	-	1
Total	1	-	1	(1)	-	-	1
Company total							
Equity securities and portfolio holdings in unit trusts	395	14	55	(107)	-	(34)	323
Debt securities	247	40	211	(352)	-	(39)	107
Other investments (including derivative assets)	1,583	81	418	(178)	-	(56)	1,848
Derivative liabilities	-	-		-	-	-	-
Total financial investments net of derivative liabilities	2,225	135	684	(637)	-	(129)	2,278
Total	2,225	135	684	(637)	-	(129)	2,278

Transfers between level 1 and level 2

During 2012, there were no transfers from level 1 to level 2 (2011: £824m) and £245m of transfers from level 2 to level 1 (2011: £1m). These transfers relate to certain investment funds held by the Company's with-profit sub-fund which arose to reflect the change in the observability of the inputs used in valuing these funds.

Interest income and expense

The interest income on financial assets not at fair value through profit and loss was £179m for the year ended 31 December 2012 (2011: £148m).
The interest expense on financial liabilities not at fair value through profit and loss was £19m for the year ended 31 December 2012 (2011: £20m).

B. Market Risk

The financial assets and liabilities attaching to the Company's life assurance business are, to varying degrees, subject to market risk that may have a material effect on the profit or loss and shareholders' funds.

Market risk is the risk that the fair value or future cash flows of a financial instrument or, in the case of liabilities of insurance contracts, their carrying value will fluctuate because of changes in market prices.

Market risk comprises four types of risk, namely:

- Interest rate risk: due to changes in market interest rates,
- Liquidity risk: inability to meet payment of obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates
- Currency risk: due to changes in foreign exchange rates, and
- Other price risk: due to fluctuations in market prices (other than those arising from interest rate risk or currency risk).

With-profits business
The shareholder results of the Company's with-profits business are sensitive to market risk only through the indirect effect of investment performance on declared policyholder bonuses. The investment assets of the Company's with-profits fund are subject to market risk. However, changes in their carrying value, net of the related changes to asset-share liabilities of with-profit contracts, affect the level of funds for future appropriations, which is accounted for as a liability, movements in its value do not affect shareholders' profit or shareholders' funds.

The shareholder results of the Company's with-profits fund correspond to the shareholders' share of the cost of bonuses declared on the with-profits business. This currently corresponds to one-ninth of the cost of bonuses declared.

Investment performance is a key driver of bonuses, and hence the shareholders' share of cost of bonuses. Due to the 'smoothed' basis of bonus declaration the sensitivity to investment performance in a single year is low relative to movements in the period to period performance. However, over multiple periods it is important.

SAIF
SAIF is a ring-fenced fund in which, apart from asset management fees, shareholders have no interest. Accordingly, the Company's profit and shareholders' funds are insensitive to the direct effects of market risk attaching to SAIF's assets and liabilities.

Shareholder-backed non-profit sub-fund
The Company's non-profit sub-fund principally comprises annuity business previously written by Scottish Amicable Life, annuity business accepted from the quota share reinsurance arrangement with Prudential Retirement Income Ltd, credit life, unit-linked and other non-participating business. The financial assets covering the liabilities for those types of business are subject to market risk. The liabilities for annuity contracts are subject to market risk arising from changes in the returns of the attaching assets. Except mainly to the extent of any minor asset/liability duration mismatch, and exposure to credit risk, the sensitivity of the Company's non-profit sub-fund's annuity business' results to market risk for movements in the carrying value of liabilities and covering assets is broadly neutral on a net basis.

The liabilities of the unit-linked business change in line with the matching linked assets. Amounts under unit-linked contracts are generally repayable on demand and the Company is responsible for ensuring there is sufficient liquidity within the asset portfolio to enable liabilities to unit-linked policyholders to be met as they fall due. Other liabilities of the Company's non-profit sub-fund are broadly insensitive to market risk.

The principal items affecting the results of the Company's non-profit sub-fund are mortality and credit experience.

Notes on the financial statements (continued)

Interest rate risk

The following table shows an analysis of the classes of financial assets and liabilities and their direct exposure to interest rate risk. Each applicable class of the Company's assets or liabilities are analysed between those exposed to fair value interest rate risk, cash flow interest rate risk and those with no direct interest rate risk exposure.

2012	**Fair value interest rate risk**	**Cash flow interest rate risk**	**Not directly exposed to interest rate risk**	**Total**
	£m	**£m**	**£m**	**£m**
Financial Assets				
Deposits with credit institutions	1	9,462	-	9,463
Debt securities and other fixed income securities	42,882	3,270	-	46,152
Loans	2,132	825	-	2,957
Derivative asset	255	-	1,278	1,533
Cash at bank and in hand	-	934	-	934
	45,270	**14,491**	**1,278**	**61,039**
Financial Liabilities				
Amounts owed to credit institutions	-	70	-	70
Other borrowings not owed to credit institutions	-	126	-	126
Investment contracts without discretionary participation features	-	-	6,508	6,508
Derivative liabilities	293	-	887	1,180
	293	**196**	**7,395**	**7,884**

2011	**Fair value interest rate risk**	**Cash flow interest rate risk**	**Not directly exposed to interest rate risk**	**Total**
	£m	**£m**	**£m**	**£m**
Financial Assets				
Deposits with credit institutions	1	7,332	-	7,333
Debt securities and other fixed income securities	44,078	2,605	-	46,683
Loans	2,003	872	-	2,875
Derivative asset	619	-	597	1,216
Cash at bank and in hand	-	1,242	-	1,242
	46,701	12,051	597	59,349
Financial Liabilities				
Amounts owed to credit institutions	-	56	-	56
Other borrowings not owed to credit institutions	-	232	-	232
Investment contracts without discretionary participation features	-	-	5,802	5,802
Derivative liabilities	884	-	187	1,071
	884	288	5,989	7,161

Notes on the financial statements (continued)

Liquidity Analysis

(i) Contractual maturities of financial liabilities

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

2012	**1 year or less**	**After 1 year to 5 years**	**After 5 years to 10 years**	**After 10 years to 15 years**	**After 15 years to 20 years**	**Over 20 years**	**No stated maturity**	**Total un-discounted cashflows**	**Total carrying value**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Financial Liabilities									
Amounts owed to credit institutions	9	61	-	-	-	-	-	70	70
Other borrowings not owed to credit institutions	126	-	-	-	-	-	-	126	126
	135	**61**	**-**	**-**	**-**	**-**	**-**	**196**	**196**

2011	**1 year or less**	**After 1 year to 5 years**	**After 5 years to 10 years**	**After 10 years to 15 years**	**After 15 years to 20 years**	**Over 20 years**	**No stated maturity**	**Total un-discounted cashflows**	**Total carrying value**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Financial Liabilities									
Amounts owed to credit institutions	11	45	-	-	-	-	-	56	56
Other borrowings not owed to credit institutions	105	136	-	-	-	-	-	241	232
	116	181	-	-	-	-	-	297	288

ii) Maturity analysis of derivatives and investment contracts

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

2012	**Total carrying value**	**1 year or less**	**After 1 to 3 years**	**After 3 to 5 years**	**After 5 years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Net derivative position	**353**	**353**	**-**	**-**	**-**	**353**

2011	**Total carrying value**	**1 year or less**	**After 1 to 3 years**	**After 3 to 5 years**	**After 5 years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Net derivative position	145	145	-	-	-	145

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

	2012	2011
	£m	£m
Derivative assets	**1,533**	1,216
Derivative liabilities	**(1,180)**	(1,071)
Net derivative position	**353**	145

Notes on the financial statements (continued)

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

The table below shows the maturity profile for investment contracts on an undiscounted basis to the nearest billion. This maturity profile has been based on the cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing the European Embedded Value (EEV) basis results.

	1 year or less	After 1 year to 5 years	After 5 years to 10 years	After 10 years to 15 years	After 15 years to 20 years	Over 20 years	Total un-discounted value	Total carrying value
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
2012								
Life assurance investment contracts	**4**	**15**	**14**	**11**	**8**	**9**	**61**	**40**
2011								
Life assurance investment contracts	3	13	14	11	9	11	61	35

This table has been prepared on an undiscounted basis and accordingly the amounts shown for life assurance investment contracts differ from those included in the balance sheet. Durations of long-term business contracts, covering both insurance and investment contracts, on a discounted basis are included below.

Durations of long-term business contracts on a discounted basis:

With the exception of most unitised with-profit bonds and other whole of life contracts the majority of the contracts of the Company have a contract term. However, in effect, the maturity term of contracts reflects the earlier of death, maturity, or lapsation. In addition, with-profit contracts include projected future bonuses based on current investment values. The actual amounts payable will vary with future investment performance of SAIF and the WPSF. Instead the Company uses cash flow projections of expected benefit payments. The following table shows the maturity profile of the cash flows used for insurance contracts i.e. those containing significant insurance risk, and investment contracts, which do not contain significant insurance risk:

2012	With-profits business			Other			PAL Business		
	Insurance contracts	Investment contracts	Total	Insurance contracts	Investment contracts	Total	Insurance contracts	Insurance contracts reinsured	Total
	%	%	%	%	%	%	%	%	%
0-5 years	45	39	43	35	27	30	33	26	30
5-10 years	24	25	24	25	23	24	25	22	24
10-15 years	13	17	15	17	17	17	18	17	18
15-20 years	8	11	10	10	12	11	12	13	12
20-25 years	5	6	5	6	9	8	7	9	8
Over 25 years	5	2	3	7	12	10	5	13	8

2011	With-profits business			Other			PAL Business		
	Insurance contracts	Investment contracts	Total	Insurance contracts	Investment contracts	Total	Insurance contracts	Insurance contracts reinsured	Total
	%	%	%	%	%	%	%	%	%
0-5 years	46	35	40	34	27	31	33	25	29
5-10 years	24	25	25	25	22	23	25	22	24
10-15 years	13	18	16	18	18	18	18	18	18
15-20 years	8	13	10	11	12	11	12	13	12
20-25 years	5	7	6	6	9	8	7	9	8
Over 25 years	4	2	3	6	12	9	5	13	9

Notes:

(i) The cash flow projections of expected benefit payments used in the maturity profile table above are from in-force business and exclude the value of future new business, including vesting of internal pension contracts.

(ii) Benefit payments do not reflect the pattern of bonuses and shareholder transfers in respect of the with-profits business.

(iii) Investment contracts under Other comprise unit-linked and similar contracts.

(iv) For business with no maturity term included within the contracts, for example with-profits investment bonds such as Prudence Bond, an assumption is made as to likely duration based on prior experience.

Sensitivity to interest rate movement

As described above, the net exposure to interest rate movement for the Company is very substantially ameliorated by virtue of the close matching of assets with appropriate duration to the liabilities.

The close matching by the Company of assets of appropriate duration to its non-profit sub fund's annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and UKGAAP 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 UKGAAP reporting purposes. As a result UKGAAP's shareholders' funds are higher than regulatory capital and therefore more sensitive to interest rate risk.

The estimated sensitivity of the shareholder-backed business to a movement in interest rates of 1% and 2% as at 31 December 2012 and 2011 are as follows:

	2012				2011			
	Fall of 1% £m	Rise of 1% £m	Fall of 2% £m	Rise of 2% £m	Fall of 1% £m	Rise of 1% £m	Fall of 2% £m	Rise of 2% £m
Carrying value of debt securities and derivatives	457	(369)	1,050	(677)	399	(329)	901	(606)
Long term business provision	(390)	323	(866)	593	(333)	277	(737)	511
Related tax effects	(15)	11	(42)	19	(16)	13	(41)	23
Net sensitivity of profit after tax and shareholders' funds	52	(35)	142	(65)	50	(39)	123	(72)

Currency Risk

As at 31 December 2012 the Company held 34% and 3% (2011: 35% and 4%) of its financial assets and financial liabilities, respectively in currencies, mainly US dollar and Euro, other than the functional currency of the relevant business unit.

The financial assets, of which 82% (2011: 82%) are held by the with-profit fund, allow the fund to obtain exposure to foreign equity markets.

The financial liabilities, of which 83% (2011: 83%) are held by the with-profit fund, mainly relate to investment contracts with discretionary participation features.

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

Other Price Risk – Equities and Property

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

	2012		2011	
	Decrease of 20% £m	Decrease of 10% £m	Decrease of 20% £m	Decrease of 10% £m
Pre-tax profit	(158)	(79)	(114)	(57)
Related deferred tax effects	36	18	28	14
Net sensitivity of profit after tax and shareholders' funds	(122)	(61)	(86)	(43)

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

C. Derivatives and Hedging

The Company uses derivatives for the purpose of efficient portfolio management or the reduction in investment risk. In so doing, the Company obtains cost effective and efficient exposure to various markets and to manage exposure to interest rate, currency, credit and other business risks.

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

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

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

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

The total fair value balances of derivative assets and liabilities are shown in note 18.

There are hedging arrangements in place for the liabilities. In addition to some product/purpose specific arrangements, the main objective of the hedging arrangement is to broadly match a proportion of the market consistent liabilities and hence protect the Pillar II solvency of the with-profits business against adverse market movements. A benchmark of theoretical equity put options and interest rate exposure representing the liabilities has been determined, based on characteristics of the with-profits liability. The company deals in an appropriate amount of hedging instruments so that movements in the instruments held reflect movements in the benchmark put options representing the liabilities.

The actual and required hedging positions are monitored at least monthly, and the 1-month Value at Risk between the assets and benchmark is calculated. If this amount is significant, then an assessment

is made as to whether or not to address the balance, and how much to rebalance. Automatic rebalancing is triggered if the monthly Value at Risk position of the main hedge is greater than £100m.

The Company has chosen to designate as a fair value hedge certain fixed to floating rate swaps which hedge the fair value exposure to interest rate movements of certain of the Company's operational borrowings. The fair value of the derivatives designated as fair value hedges above at 31 December 2012, were an asset of £0.3m (2011: an asset of £3.3m). Movements in the fair value of the hedging instruments of a net loss of £3.0m (2011: net loss of £1.2m) and the hedged items of a net gain of £3.0m (2011: net gain of £1.2m) are recorded in the long term technical account in respect of the fair value hedges above.

D. Credit risk

Debt Securities and Other Fixed Income Securities

The following table summarises by rating the securities held by the Company as at 31 December 2012 and 2011.

	With-profits sub fund £m	**Other funds £m**	**Total 2012 £m**	With-profits sub fund £m	Other funds £m	Total 2011 £m
S&P – AAA	4,565	426	4,991	5,520	513	6,033
S&P – AA+ to AA-	4,682	324	5,006	5,469	329	5,798
S&P – A+ to A-	11,698	924	12,622	11,218	853	12,071
S&P – BBB+ to BBB-	10,646	663	11,309	10,469	545	11,014
S&P – Other	2,467	40	2,507	2,727	25	2,752
	34,058	2,377	36,435	35,403	2,265	37,668
Moody's – Aaa	2,610	638	3,248	2,529	603	3,132
Moody's – Aa1 to Aa3	420	112	532	219	55	274
Moody's – A1 to A3	427	44	471	496	45	541
Moody's – Baa1 to Baa3	580	32	612	572	39	611
Moody's – Other	186	8	194	169	7	176
	4,223	834	5,057	3,985	749	4,734
Fitch – AAA	51	-	51	6	-	6
Fitch – AA+ to AA-	-	-	-	-	-	-
Fitch – A+ to A-	145	19	164	164	18	182
Fitch – BBB+ to BBB-	18	-	18	17	-	17
Fitch – Other	22	1	23	18	-	18
	236	20	256	205	18	223
Other	4,248	156	4,404	3,928	130	4,058
Total debt securities and other fixed income securities	42,765	3,387	46,152	43,521	3,162	46,683

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

Where no external ratings are available internal ratings produced by the Prudential Group's asset management operations, which are prepared on a comparable basis to external ratings, are used where possible. Of the total debt securities held at 31 December 2012 which are not externally rated, £1,434m (2011: £1,176m) were internally rated AAA to A-, £2,228m (2011: £2,206m) were internally rated BBB+ to B- and £725m were internally rated as below B- or unrated (2011: £544m). The majority of the unrated debt security investments were held by the Company's with-profits fund and relate to convertible debt and other investments which are not covered by rating analysts nor have an internal rating attributed to them. The remaining £17m of debt securities relate to government bonds and corporate bonds held by the Hong Kong branch which do not have UK ratings.

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.

As detailed in section B the primary sensitivity of profit or loss and shareholders' equity of the Company relates to non-linked shareholder-backed business which covers the "other funds" in the table above.

Excluded from the table above is £560m (2011: £562m) of assets backing unit-linked and index-linked contracts which are included within assets held to cover linked liabilities. The holders of these contracts bear the credit risk arising from these assets.

The Company's exposure to the eurozone sovereigns of Portugal, Italy, Ireland, Greece and Spain (PIIGS) is £92m (2011: £86m) with £90m (2011: £85m) in the with-profits fund and £2m (2011: £1m) in the shareholder funds. The Company's exposure to banking operations in these eurozone countries is £88m (2011: £118m) with £70m (2011: £72m) in the with-profits fund and £18m (2011: £46m) in the shareholder funds. The Company has no exposure in Greece in 2012 or 2011.

Loans and receivables

In accordance with accounting policy, impairment reviews were performed for loans and receivables. During the year ended 31 December 2012, impairment losses of £19m (2011: £46m) were recognised for loans and receivables.

Of the total loans and receivables held £14m (2011: £2m) are past their due date but have not been impaired. 96% (2011: 98%) of the loans and receivables that are past due but not impaired are less than one year past their due date for 2012. The Company expects full recovery of these loans and receivables.

Financial assets that would have been past due or impaired had the terms not been renegotiated amounted to £Nil (2011: £Nil).

Securities lending and reverse repurchase agreements

The Company has entered into securities lending (including repurchase agreements) whereby blocks of securities are loaned to third parties, primarily major brokerage firms. The amounts above the fair value of the loaned securities required to be held as collateral by the agreements, depend on the quality of the collateral, calculated on a daily basis. The loaned securities are not removed from the Company's balance 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 2012, the Company had lent £1,869m (2011: £5,064m) of securities and held collateral under such agreements of £1,954m (2011: £5,311m).

At 31 December 2012, 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, £557m (2011: £1,165m), together with accrued interest.

Collateral and pledges under derivative transactions

At 31 December 2012, the Company had pledged £193m (2011: £243m) for liabilities and held collateral of £458m (2011: £544m) in respect of over-the-counter derivative transactions.

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

Reinsurer's share of technical provisions

The majority of the reinsurers' share of technical provisions relate to cessions to subsidiaries of the Company. See note 20.

Of the reinsurer's share of technical provisions at 31 December 2012 of £12,839m (2011: £11,216m), 6% (2011: 7%) of the balance relates to companies outside of the Prudential Group and of this 62% (2011: 23%) of the balances were from reinsurers with S&P's rating of AA- and above, based on the ratings at the time of signing these financial statements.

E. Risk Management

The Company's business involves the acceptance and management of risk. The Company has in place a risk management process, which is undertaken in accordance with the Group Risk Framework.

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

The Company uses derivatives to facilitate efficient portfolio management or to reduce investment risk. The most widely used derivatives by the Company are exchange traded futures and currency forwards.

The Company also uses over-the-counter swaps (including total return swaps), options, swaptions and warrants.

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 except as described in note C above.

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 and/or volatility of market prices of assets and liabilities.

The primary market risks that the Company faces are equity risk and interest rate risk because most of its assets are investments that are either equity type of investments and subject to equity price risk, or bonds, mortgages or cash deposits, the values of which are subject to interest rate risk. The amount of risk borne by the Company's shareholders depends on the extent to which its customers share the investment risk through the structure of the Company's products.

The split of the Company's investments between equity investments and interest-sensitive instruments depends principally on the type of liabilities supported by those investments and the amount of capital the Company has available. This mix of liabilities allows the Company to invest a substantial portion of its investment funds in equity and property investments that the Company believes produce greater returns over the long term. On the other hand the Company has some liabilities that contain guaranteed returns which generally will be supported by fixed income investments.

Credit risk

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

Liquidity risk

Liquidity risk is the risk that the Company may be unable to meet payment of obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates. Liquidity management in the Company seeks to ensure that, even under adverse conditions, the Company has access to the funds necessary to cover surrenders, withdrawals and maturing liabilities.

In practice, most of the Company's assets are marketable securities. This, combined with the fact that a large proportion of the liabilities contain discretionary surrender values or surrender charges, reduces the liquidity risk.

34. Capital Requirements and Management

Regulatory capital requirements apply at both an individual company level and at the Prudential Group level, of which the Company is a part, for life assurance and investment management business. The Prudential Group is currently subject to the solvency requirements of the Insurance Groups Directive (IGD) as implemented by the FSA. Under the IGD a parent company continuous solvency test is applied. Under this test the surplus unrestricted capital held in each of the regulated subsidiaries, including the Company, is aggregated with the free assets of non-regulated subsidiaries. From this total, Prudential Group borrowings are deducted, other than subordinated debt issues which qualify as capital.

In addition to obligations under subsidiary and Prudential Group regulatory requirements, the Prudential Group applies an economic framework to its management of capital. Economic capital provides a realistic and consistent view of the Group's capital requirements, allowing for diversification benefits.

At the Company level, the FSA rules which govern the prudential regulation of insurance form part of the Prudential Sourcebook for Insurers, the General Prudential Sourcebook and Interim Prudential Sourcebook for Insurers. Overall, the net requirements of the General Prudential Sourcebook are intended to align the capital adequacy requirements for insurance business more closely with those of banking and investment firms and building societies, for example, by addressing tiers of capital, rather than looking at net admissible assets. An insurer must hold capital resources equal at least to the Minimum Capital Requirement (MCR).

The Prudential Sourcebook for Insurers also contains rules on Individual Capital Assessments. Under these rules and the rules of the General Prudential Sourcebook all insurers must assess for themselves the amount of capital needed to back their business. If the FSA views the results of this assessment as insufficient, it may draw up its own Individual Capital Guidance for a firm, which can be superimposed as a requirement.

With-Profits Sub-Fund, SAIF and Defined Charge Participating Sub-Fund

Under FSA rules, insurers with with-profits liabilities of more than £500m must hold capital equal to the higher of the MCR and the Enhanced Capital Requirement (the "ECR"). The ECR is intended to provide a more risk responsive and "realistic" measure of a with-profit insurers capital requirements, whereas the MCR is broadly speaking equivalent to the previous required minimum margin under the Interim Prudential Sourcebook and satisfies the minimum EU Standards.

Determination of the ECR involves the comparison of two separate measurements of the firm's resources requirement, which the FSA refers to as the "twin peaks" approach. The two separate peaks are:

(i) the requirement comprised by the mathematical reserves plus the "Long-Term Insurance Capital Requirement" (the "LTICR"), together known as the "regulatory peak"; and

(ii) a calculation of the "realistic" present value of the insurer's expected future contractual liabilities together with projected "fair" discretionary bonuses to policyholders, plus a risk capital margin, together known as the "realistic peak".

Available capital of the WPSF and SAIF and DCPSF of £7.0bn (2011: £6.1bn) represents the excess of assets over liabilities on the FSA realistic basis. Unlike the previously discussed FRS 27 basis, realistic liabilities on the regulatory basis include the shareholders' share of future bonuses. These amounts are shown before deduction of the risk capital margin (RCM) which is £1.5bn (2011: £2.0bn) at 31 December 2012.

The FSA's basis of setting the RCM is to target a level broadly equivalent to a Standard & Poor's credit rating of BBB and to judge this by ensuring there are sufficient assets to absorb a 1 in 200 year event. The RCM calculation achieves this by setting rules for the determination of margins to cover defined stress changes in asset values and yields for market risk, credit risk and termination risk for with-profits policies.

Notes on the financial statements (continued)

The Company has discretion in its management actions in the case of adverse investment conditions. Management actions encompass, but are not confined to, investment allocation decisions, levels of reversionary bonuses, crediting rates and total claim values. To illustrate the flexibility of management actions, rates of regular bonus are determined for each type of policy primarily by targeting them at a prudent proportion of the long-term expected future investment return on the underlying assets. The expected future investment return is reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholders' transfers. However, the rates declared may differ by product type, or by date of payment of the premiums or date of issue of the policy, if the accumulated annual bonuses are particularly high or low relative to a prudent proportion of the achieved investment return.

When target bonus levels change, the Company's board has regard to the overall financial strength of the long-term fund when determining the length of time over which it will seek to achieve the amended product target bonus level.

In normal investment conditions, the Company expects changes to regular bonus rates to be gradual over time and changes are not expected to exceed one per cent per annum over any year. However, discretion is retained as to whether or not a regular bonus is declared each year, and there is no limit on the amount by which regular bonus rates can be changed.

As regards smoothing of maturity and death benefits, in normal circumstances the Company does not expect most pay-out values on policies of the same duration to change by more than 10 per cent up or down from one year to the next, although some larger changes may occur to balance pay-out values between different policies. Greater flexibility may be required in certain circumstances, for example following a significant rise or fall in market values (either sudden or over a period of years) and in such situations the Company's board may decide to vary the standard bonus smoothing limits to protect the overall interests of policyholders.

For surrender benefits, any substantial fall in the market value of the assets of the with-profits sub-fund would lead to immediate changes in the application of Market Value Reductions (MVRs) for accumulating with-profits policies, firstly to increase the size of MVRs already being applied and, secondly, to extend the range of policies for which an MVR is applied.

Non-Profit Sub-Fund

The available capital of £205m (2011: £181m) reflects the excess of regulatory basis assets over liabilities of the Company. The regulatory capital resources requirement of £444m (2011: £400m) is covered in part (as is permitted by the FSA Regulations) by assets in the shareholder funds. The available capital and capital resources requirement is monitored during the year. In addition, a realistic assessment of available capital and capital requirements sufficient to cover a 1 in 200 year event is undertaken. Additional capital is sought from the parent company as necessary.

The capital requirement required by regulation was maintained during the year.

Notes on the financial statements (continued)

The Company's capital position for life assurance business with reconciliations to shareholders' funds is shown below. Available capital for each fund is determined by reference to the FSA regulations at 31 December 2012 and 2011.

31 December 2012	SAIF £m	WPSF and DCPSF £m	Total with-profits fund £m	Non-profit sub-fund £m	Total life assurance £m	Shareholders' funds £m	Company total £m
Shareholders' funds							
Held outside long-term funds							
Net assets	-	-	-	-	-	4,007	4,007
Goodwill	-	-	-	-	-	-	-
Total	-	-	-	-	-	4,007	4,007
Held in long-term funds (note i)	-	-	-	733	733	-	733
Total shareholders' funds	-	-	-	733	733	4,007	4,740
Adjustments to regulatory basis							
Funds for future appropriation (note ii)	-	10,531	10,531	67	10,598		
Shareholders' share of realistic liabilities	-	(2,469)	(2,469)	-	(2,469)		
Deferred acquisition costs of non-participating business and intangible assets (distribution rights and licence) not recognised for regulatory reporting purposes	-	(76)	(76)	(281)	(357)		
Adjustment from FRS17 basis pension surplus attributable to WPSF to pension liability for regulatory purposes	-	(107)	(107)	-	(107)		
Valuation difference on PAL between UKGAAP basis and regulatory basis	-	(215)	(215)	-	(215)		
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) (note iii)	-	(617)	(617)	(314)	(931)		
Total adjustments	-	7,047	7,047	(528)	6,519		
Total available capital resources of life assurance businesses on FSA regulatory bases	-	7,047	7,047	205	7,252		

Notes on the financial statements (continued)

31 December 2011	SAIF £m	WPSF and DCPSF £m	Total with-profits fund £m	Non-profit sub-fund £m	Total life assurance £m	Shareholders' funds £m	Company total £m
Shareholders' funds							
Held outside long-term funds							
Net assets	-	-	-	-	-	3,651	3,651
Goodwill	-	-	-	-	-	-	-
Total	-	-	-	-	-	3,651	3,651
Held in long-term funds (note i)	-	-	-	528	528	-	528
Total shareholders' funds	-	-	-	528	528	3,651	4,179
Adjustments to regulatory basis							
Funds for future appropriation (note ii)	-	9,286	9,286	77	9,363		
Shareholders' share of realistic liabilities	-	(2,394)	(2,394)	-	(2,394)		
Deferred acquisition costs of non-participating business and intangible assets (distribution rights and licence) not recognised for regulatory reporting purposes	-	(89)	(89)	(294)	(383)		
Adjustment from FRS17 basis pension surplus attributable to WPSF to pension liability for regulatory purposes	-	(107)	(107)	-	(107)		
Valuation difference on PAL between UKGAAP basis and regulatory basis	-	(644)	(644)	-	(644)		
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) (note iii)	-	3	3	(130)	(127)		
Total adjustments	-	6,055	6,055	(347)	5,708		
Total available capital resources of life assurance businesses on FSA regulatory bases	-	6,055	6,055	181	6,236		

Notes

(i) The term shareholders' funds held in long-term funds refers to the excess of assets over liabilities attributable to shareholders of funds which are required by law to be maintained with segregated assets and liabilities.

(ii) Other adjustments to shareholders' funds and funds for future appropriation include amounts for the value of non-participating business for with-profits funds, deferred tax, admissibility and other items measured differently on the regulatory basis.

(iii) Insurance business accounted for as financial instruments under FRS26.

35. Litigation

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