

Registered No: 15454

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Annual Report and Financial Statements for the Year Ended 31 December 2013

**Final
Dated 25 March 2014**

Strictly Confidential

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
Mr D J Belsham
Mr A M Crossley (resigned 6 June 2013)
Mr R A Devey (resigned 5 September 2013)
Ms J Hunt (appointed 1 October 2013)
Mr H A Hussain
Mr F A O'Dwyer (resigned 24 May 2013)
Mr M J Yardley (appointed 20 May 2013)

Secretary

Miss S D Windridge

Auditor

KPMG Audit Plc, London

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013

Principal activity

The principal activity of the Company in the course of 2013 was transacting long-term insurance business in the United Kingdom. Throughout 2013 the Company also owned several insurance subsidiary undertakings and branches in Hong Kong and Poland that transacted insurance business in the United Kingdom and overseas; the Polish branch became operational in March 2013. These activities will continue in 2014 with the exception of the activities of the Hong Kong branch which were transferred on 1 January 2014 to two new locally incorporated companies in Hong Kong, both subsidiaries of the Company, one providing life insurance and the other providing general insurance.

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, pensions 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, were 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.

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

The UK life and pensions industry has undergone considerable regulatory and market change in 2013 with the appointment of two new industry regulatory bodies, the phasing in of auto-enrolment for company pensions and the introduction of the voluntary ABI Code on Retirement Choices. The Financial Conduct Authority's (FCA) Thematic Review into the UK annuity market, which ran throughout 2013, concluded in February 2014 with the announcement that it was launching a further study to examine competition and choice in the retirement income market as a whole. The Company continues to support both regulatory and other initiatives to improve consumer experience and outcomes.

The review by the former regulator, the Financial Services Authority, of the retail distribution marketplace called the Retail Distribution Review ('RDR') came into force on 31 December 2012. One of the main aims of the RDR was to increase the level of professionalism within the financial advice market. The Company supports this aim.

The changes implemented increase the clarity with which advisory firms describe their services and charges. They stipulate that the adviser must be paid by the customer. Providers are no longer permitted to pay commission on new sales of retail investment products. Comparable rules have been introduced for group pensions business. Sales of protection business and general insurance can still attract commission. The changes have also significantly increased the requirements for firms who seek to describe themselves as independent.

The long term impact of the RDR remains uncertain but as expected FCA figures confirm that a drop in UK adviser numbers of around 20 per cent took place in the two year lead-up to RDR but then stabilised through 2013. The higher threshold to remain independent has seen an increased trend towards advisory firms moving to restricted advice models and the popularity of this model is expected to continue to grow. Typically these models see adviser firms limiting their range to smaller number of products and providers. The Company is well placed in such models with distribution agreements already in place with a number of major advice firms.

The implementation of the recommendations of the RDR has therefore changed the distribution landscape and providers, distributors, advisers and their clients continue to adjust to the new environment.

The Company continues to manage its UK business by focusing on its strengths in with-profits and individual annuities products. The combined financial strength and investment performance track record of the Company's UK With-Profits Fund provides a key source of differentiation in a competitive market. The performance of the Company's With-Profits fund in 2013 has allowed it to add an estimated £2.0bn to with-profits policies in the year and policyholders will typically see year-on-year increases of between 5.0 per cent and 8.0 per cent in accumulating with-profits policy values over the past year. Total bonus payments are expected to top £2.0bn in 2014.

The introduction of RDR has significantly impacted the timing of sales volumes in the UK retail investments markets over the last two years. For the Company, this resulted in very strong sales of onshore bonds in 2012, due to heightened activity prior to the implementation of RDR, while in 2013 volumes have returned to levels consistent with 2011, the last "undisturbed" year. Onshore bond sales were 23 per cent lower as a result.

In corporate pensions, the Company continues to focus on securing new members and incremental business from its current portfolio of customers and on additional voluntary contribution plans within the public sector, where the Company now provides schemes for 69 of the 99 public sector authorities in the UK (2012: 68 schemes).

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, extensive mortality risk assessment experience 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.

During 2013 the Company commenced sales operations in Poland, one of Europe's fastest-growing economies, which has an expanding middle class and high savings rates. The Company has made a good start to the business building an agency sales network of 481 financial planning consultants across 12 active branches. The agency sales network will continue to be rolled out to more major Polish cities and towns during 2014.

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

Throughout 2013 the Company's Hong Kong Branch has been a leading life insurer with strong brand recognition in the Hong Kong market. The branch has been dedicated to meeting the different needs of its customers by providing a comprehensive range of insurance services. The range of products includes life insurance, investment-linked, health and protection, general insurance and employee benefits products supported by outstanding customer strategy and service. Retirement and health have been two key strategic initiatives to help Hong Kong people lead financially secure lives and to meet customer needs for increased medical protection. Mainland China visitor business opportunities are also driving the continued growth of the Hong Kong branch. On 1 January 2014, the Hong Kong branch business was transferred to two new Hong Kong incorporated Prudential companies; Prudential Hong Kong Limited (PHKL) providing life insurance and Prudential General Insurance Hong Kong Limited (PGHK) providing general insurance. Both companies are wholly owned subsidiaries of the Company.

The Company along with the rest of the insurance industry, will work with the Government and regulators, following the 2013 Budget announcement, to ensure the new pensions system that emerges from the consultation period continues to serve the needs of British savers. The Company continues to believe in market-based solutions that give consumers choice and flexibility in the ways they save and draw down income in retirement. The Company has experience of working with many different structures to deliver positive outcomes for its customers. The Company welcomes the Government's commitment to close the savings and investment gap. The Company is well placed to continue to provide products that look after its customers' needs and in turn channel savings into long-term investment in the UK economy.

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	2013	2012	Change
	£m	£m	%
Profit on ordinary activities before tax	227	459	(51%)
Shareholders' funds	4,934	4,740	4%
APE sales	1,170	1,782	(34%)
Available capital on the Prudential Regulation Authority (PRA) regulatory bases:			
With-profits, Scottish Amicable Insurance Fund, Defined Charge Participating Sub-fund	8,009	7,047	14%
Non-profit sub-fund	252	205	23%

Profit on Ordinary Activities before Tax

The results of the Company for the year as set out on pages 18 to 20 show a profit on ordinary activities before tax of £227m (2012: £459m), 51% lower than in 2012.

The 2013 long-term business results are £363m, £54m lower than in 2012; £63m lower in the UK, a £3m loss, due to new business strain, in the newly-operational Polish branch and £12m higher in the Hong Kong branch. In the UK, profits attributable to the with-profits business are £21m lower than in 2012 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 £42m lower than in 2012. This is primarily due to lower profits from linked business and lower 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 £28m (2012: £77m) in the Company, with an equal and offsetting loss in PRIL. Partially offsetting these lower profits in the UK is an increase in profits from protection business. In the Hong Kong branch profits are £12m higher

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

than in 2012 as a result of the growth of in-force business from both with-profits and shareholder-backed business.

Profit arising from the shareholders' funds is £178m lower than in 2012 at a loss of £137m. During the year the Company put in place a partial equity hedge of the shareholder transfers expected to emerge from the Company's with-profits sub-fund. In 2013 there has been a total loss (realised and unrealised) of £105m on the hedge contracts. Unrealised losses on debt securities experienced in the long-term business funds have decreased the investment return transferred from the long-term funds to the shareholder fund by £55m. In addition the costs associated with the domestication of the Hong Kong branch, £35m in 2013, have contributed to the 2013 loss. The commission received on Prudential-branded General Insurance products is £4m lower than in 2012, at £29m, as the book of business is decreasing as expected. Partially offsetting these movements is the non-recurrence of the £16m no negative equity guarantee provision set up in 2012 for the shareholder-backed equity release business and other savings of £5m.

Shareholders' Funds

The shareholders' funds of the Company total £4,934m (2012: £4,740m). The increase of £194m, after taking account of dividends paid to Prudential plc of £231m and exchange adjustments of £8m, is due to profit after tax of £189m, and an increase in the revaluation of investments in subsidiaries, and one associate owned by the shareholder funds of £244m.

APE Sales

Sales on an APE basis (Regular Premiums plus 1/10th Single Premiums) are £1,170m down 34 per cent from £1,782m in 2012. During 2012 Prudential Annuities Limited (PAL), a subsidiary of the Company, reassured almost its entire book of business to the Company which increased APE by £594m. Without this one-off transaction in 2012 sales on an APE basis would have been £1,188m, and therefore 2013 sales on a comparative basis are down 2 per cent from 2012. The decrease is mainly due to a fall in demand for the Company's onshore bonds in the UK, sales of which are 23 per cent below 2012 due to the exceptionally strong comparative following the intensified activity prior to the implementation of RDR and are more consistent with 2011, a more normal year. The Company's PruFund range made up 74 per cent (2012: 75 per cent) of total with-profits bond sales in 2013. Partially offsetting the decrease in the UK is an increase in Hong Kong sales of 20 per cent on 2012 due to strong sales of with-profits business from agency and broker channels. This momentum was partly offset by reduced sales of linked products.

Available Capital

The combined financial strength and investment performance track record of the Company's With-Profits Fund provides 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 £8.0bn 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 178.3 per cent on investments covering policyholder liabilities. This compares favourably with other with-profits funds and the FTSE All-Share Index total return of 119.3 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 £252m (2012: £205m).

The Company's available capital position is covered further in Note 34 on page 75.

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

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

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. As such they can only provide reasonable and not absolute assurance against material misstatement or loss, and focus on optimising the levels of risk and reward with the aim of achieving the business objectives.

The Group Risk Framework requires all business units 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 taking and management, risk control and oversight and independent assurance.

The Company's results and financial condition are 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 51, note 33 (C) on page 71 and in note 33 (E) on page 74.

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. With historic low interest rates in the US, UK and the Eurozone and the unprecedented levels of quantitative easing in particular by the US, it remains to be seen how the markets and the economy as a whole adjusts as these actions are subsequently reversed.

The global financial markets have experienced and still continue to experience significant uncertainty brought on, in particular, by concerns over sovereign debt, as well as concerns about a general slowing of global demand reflecting an increasing lack of confidence among consumers, companies and governments, despite the actions of the central banks. 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. Any adverse impact on the current and expected future asset returns may impact the current and future levels of with-profits bonuses and is therefore likely to impact the Company's profitability.

(a) Market risk

Market risk is the risk of loss or adverse change in the financial condition of the Company, 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 and currency risk on the value of the business in the Hong Kong branch which will remain a risk following the transfer of this business to subsidiaries of the Company. 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:

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STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

- Investment impairments or reduced investment returns, as a result of market volatility, could result in direct losses and may also impair the Company's ability to write desired volumes of new business, which would, in turn, have a negative impact on the Company's assets under management and profitability;
- 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 debtors in the form of defaults, downgrades or widening of credit spreads.

The Company is exposed to significant levels of 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, although less significant in 2013 than in previous years due to market improvements, 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 cash deposit, reinsurance and derivative transactions. Failure of any of these counterparties to discharge their obligations, or where adequate collateral is not in place (in case of reinsurance counterparties), could have an adverse impact on the Company's results. The Company manages cash counterparty risk by using secured cash placements (such as reverse repos) and having counterparty concentration limits in place for unsecured cash deposits. Reinsurance counterparty risk is managed 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. These include adverse longevity, mortality, morbidity, persistency and expense experience.

The Company is exposed to significant levels of 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) 2012 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 would 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 actual expenses exceeding the assumptions in pricing and reserving bases 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

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

reserves. If the actual expenses exceed these assumptions, the Company's operating results could be adversely impacted. The nature of the contractual arrangement with the Company's principal outsourcer partially mitigates this risk.

- Persistency risk is the risk of actual persistency or customer retention levels being different to the Company's expectations. This risk can materialise if more or (for some lines of business) fewer customers opt for early termination of its products than anticipated. 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 different than assumed in reserving and capital calculations, the Company's operating results could be adversely affected. This risk is only relevant to the non-annuity lines of business written by 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 of 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 such an epidemic were to occur. If the actual mortality or morbidity rates were 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 asset impairments, mortality and morbidity trends, policy surrender rates, unit cost of administration and new business acquisition expense.

(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, conduct, operational and group risk.

(a) Business environment risk

Business environment risk is the risk that can arise as a result of changing external factors in the business environment and the impact on 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

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

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' assessments of risk, 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 its implementation was delayed pending agreement on a directive known as Omnibus II which, once adopted, will amend certain aspects of the Solvency II Directive. In November 2013, representatives from the European Parliament, the European Commission and the Council of the European Union reached an agreement on the Omnibus II Directive, which is currently expected to be adopted in early 2014. As a result, Solvency II is now expected to be implemented as of 1 January 2016, although the European Commission and the European Insurance and Occupational Pensions Authority (EIOPA) are continuing to develop the detailed rules that will complement the high-level principles of the Solvency II and Omnibus II Directives, which are not currently expected to be finalised until mid-2015. 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;
- 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. This may include an increase in thematic review activity, the impact of additional and conflicting regulatory demands and the implications from the FCA's new powers and competition objective;
- The new business implications resulting from the implementation of the Retail Distribution Review; requirements for compulsory Open Market Options being provided for vesting pension business (providing Open Market Options has been optional for some time but this has had a limited impact on customers switching); and Auto Enrolment / National Employment Savings Trust (NEST) where there is a potential impact on existing business due to the amalgamation of deferred pots or automatic switching of funds to their new employers scheme, with NEST becoming the home for most small pension pots;
- The annuities market in the UK is highly competitive affecting the Company's ability to sell its products and its continued profitability. Regulatory changes such as Gender Neutral Pricing implemented in 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. Potential implications resulting from increased regulatory, media and political focus on annuities and retirement provision in general and, in particular, the FCA's recently announced retirement income market study could in time potentially impact on sales volumes and margins;
- Given the outsourced nature of the Company's operating model, there is exposure to changes in the environment that affect the economics of these arrangements. Examples of this would include potential changes to VAT on the outsourcing arrangements and medium term degradation of cost benefits arising from wage and cost inflation;
- 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,

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

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 that can arise as a result of ineffective or inadequate business strategy decisions in relation to competitors, the market and consumers.

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.

The Company operates a largely outsourced operating model, with heavy dependence on both internal and external organisations. Outsourced activities include investment management, a significant part of the Company's customer-facing functions as well as some IT functions. This places strategic reliance on the performance of these organisations and as such their performance is monitored carefully.

(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, including exposure to computer viruses, attempts at unauthorised access and cyber-security attacks. 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 is

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

therefore exposed to data security risk potentially resulting in regulatory breaches, complaints and brand damage.

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 2013, which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.

As with any large organisation, the Company is affected by the risk of operational failures due to inadequate practices for the recruitment, development, management or retention of employees and contractors.

(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.

Solvency II

The European Union (EU) is developing a new prudential regulatory 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 although its implementation was delayed pending agreement on a directive known as Omnibus II which, once adopted, will amend certain aspects of the Solvency II Directive. 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 its internal economic capital models if approved by the Prudential Regulation Authority (PRA).

In November 2013, representatives from the European Parliament, the European Commission and the Council of the European Union reached an agreement on the Omnibus II Directive, which is currently expected to be adopted in early 2014. As a result, Solvency II is now expected to be implemented as of 1 January 2016, although the European Commission and the European Insurance and Occupational Pensions Authority (EIOPA) are continuing to develop the detailed rules that will complement the high-level principles of the Solvency II and Omnibus II Directives, which are not currently expected to be finalised until mid-2015.

There is significant uncertainty regarding the final outcome from this process. In particular, certain detailed aspects of the Solvency II rules relating to the determination of the liability discount rate for UK annuity business remains to be clarified and the capital position of the Group, of which the Company is a part, is sensitive to these outcomes. Further, the effective application of a number of key measures incorporated in the Omnibus II Directive, including the provisions for third-country equivalence, are expected to be subject to supervisory judgement and approval. There is a risk that the effect of the measures finally adopted could be adverse for the Group and the Company, including potentially a significant increase in the capital required to support its business and that the Group and the Company may be placed at a competitive disadvantage to other European and non-European financial services groups. The 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,

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

together with the Association of British Insurers and Insurance Europe.

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 coordinated centrally to achieve consistency in the understanding and application of the requirements. The Group is continuing its preparations to adopt the regime when it comes into force on 1 January 2016 and is undertaking in parallel an evaluation of the possible actions to mitigate its effects. Prudential regularly reviews its range of options to maximise the strategic flexibility of the Group. This includes consideration of optimising the Group's domicile as a possible response to an adverse outcome on Solvency II.

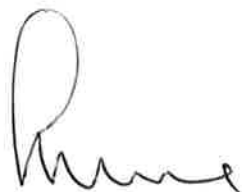
Over the coming months the Group will remain in regular contact with the PRA as it continues to engage in the 'pre-application' stage of the approval process for the internal model. In addition, the Group is engaged in the PRA's 'Individual Capital Adequacy Standards Plus (ICAS+)' regime, which is enabling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

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

In July 2013 the Financial Stability Board announced the initial list of nine insurance groups that have been designated as G-SIIs. This list included Prudential as well as a number of its competitors. The designation as a G-SII is likely to lead to additional policy measures being applied to the designated group. Based on a policy framework released by the IAIS concurrently with the initial list, these additional policy measures will include enhanced group-wide supervision. These additional measures will be phased in over a period from 2014 to 2019.

ComFrame is also being developed by the IAIS to provide common global requirements for the 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 currently expected that some prescriptive requirements, including group capital requirements will be included in the framework. A revised draft ComFrame proposal was released for consultation in October 2013. The IAIS will undertake a field testing exercise from 2014-2018 to assess the impacts of the quantitative and qualitative requirements proposed under ComFrame. ComFrame is expected to be implemented in 2019.

On behalf of the Board of directors.



S D Windridge
Secretary
25 March 2014

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2013

Introduction

None of the information required to be included in the Directors' Report under Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013) has been set out in the Company's Strategic Report.

Subsidiary and associate undertakings and branches

Particulars of the Company's principal subsidiary and associate undertakings at 31 December 2013 are shown on page 47 in note 17. At 31 December 2013 the Company had branches outside the United Kingdom in Hong Kong and in Poland.

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 five 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 Conduct Authority approved roles.

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 social value is created through the day-to-day operations. The Group provides customers with ways to help manage uncertainty and build a more secure future. In seeking to match the long-term liabilities the Group has towards its customers with similarly long-term financial assets, it provides capital that finances businesses, builds infrastructure and fosters growth in both developed and developing markets.

The Group's sustainable approach to business is reinforced by the Group-wide CR strategy. While the Group believes that CR is best managed on the ground by those closest to the customer and local stakeholders, the Group approach is underpinned by four global CR themes:

- Serving its customers: The Group aims to provide fair and transparent products that meets the customers' needs
- Valuing its people: The Group aspires to retain and develop highly engaged employees
- Supporting local communities: The Group seeks to make a positive contribution to its communities through long-term partnerships with charitable organisations that make a real difference
- Protecting the environment: The Group takes responsibility for the environment in which it operates

These themes provide clarity to the businesses as to how 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.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

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.

Post balance sheet events

With effect from 1 January 2014 the Hong Kong branch has been domesticated. The branch was transferred on 1 January 2014 to two new Hong Kong-incorporated companies, both subsidiaries of the Company, one providing life insurance and the other providing general insurance – Prudential Hong Kong Limited (PHKL) and Prudential General Insurance Hong Kong Limited (PGHK) respectively. Approximately £12.6bn of assets, £12.3bn of liabilities (including technical provisions of £10.2bn and £1.7bn of funds for future appropriations) and £0.3bn of shareholders' funds (for the excess assets of the transferred non-participating business) have been transferred. As part of the domestication a quota-share reinsurance arrangement, effective from 1 January 2014, has been put in place to reinsure non-profit annuities from the Company to PHKL.

Following the transfer of the Hong Kong branch operations to two newly incorporated wholly owned subsidiaries in 2014 the contributions from these operations will be reported in the profit and loss account within investment returns either as a dividend or as a change in the value of their operations rather than on a line by line basis. In the balance sheet there will be a reduction in the value of gross assets and liabilities as the 2014 balance sheet will only record the value of the Hong Kong operations in investments in subsidiaries and a corresponding value within shareholders equity as opposed to the gross assets and liabilities of the underlying insurance operations.

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

Accounts

The state of affairs of the Company at 31 December 2013 is shown in the balance sheet on pages 22 and 23. The profit and loss account appears on pages 18 to 20.

Share Capital

There have been no changes in the Company's share capital during 2013 as shown on page 50 in note 24.

Dividends

An interim dividend of £230.7m (2012: £245.5m) was declared on 26 June 2013, of which a dividend of £205.6m (2012: £216.0m) on the ordinary shares was paid on 27 June 2013 and the remaining £25.1m (2012: £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 £230.7m from the retained profit and reserves of the Company. The directors have not declared a final dividend on the ordinary shares for 2013 (2012: £Nil).

No dividend was paid on the A preference shares in 2013 (2012: £Nil). No dividend was paid on any other preference shares.

Directors

The present directors are shown on page 1. Messrs Devey, Crossley and O'Dwyer resigned on 5 September, 6 June and 24 May 2013 respectively. Ms Hunt was appointed on 1 October 2013 and Mr Yardley on 20 May 2013. There have been no further changes.

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.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2013 (continued)

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 74. Further information on the use of derivatives by the Company is provided in note 33 (C) on page 71.

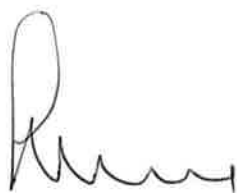
Auditor

KPMG Audit Plc was reappointed as auditor of the Company on 22 May 2013. Due to a legal reorganisation within KPMG, the specific entity being appointed for 2014 will be KPMG LLP rather than KPMG Audit Plc as currently. An ordinary resolution of the Company for the appointment of KPMG LLP as auditor of the Company will therefore 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 2013 and remain in force.

On behalf of the Board of directors.



S D Windridge
Secretary
25 March 2014

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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

The directors are responsible for preparing the Strategic Report and 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.



H A Hussain
Director
25 March 2014

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

INDEPENDENT AUDITOR'S 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 2013 set out on pages 18 to 78. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 16, 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 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 2013 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 Strategic Report and 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 2014

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2013

Note	<u>General Business Technical Account</u>	<u>2013 £m</u>	<u>2012 £m</u>
2b	Gross premiums written	47	42
	Outward reinsurance premiums	(5)	(5)
	Premiums written, net of reinsurance	<u>42</u>	<u>37</u>
	Change in the provision for unearned premiums		
	Gross amount	(2)	(2)
	Earned premiums, net of reinsurance	<u>40</u>	<u>35</u>
	Claims paid		
	Gross amount	(25)	(22)
	Reinsurers' share	6	5
	Claims paid, net of reinsurance	<u>(19)</u>	<u>(17)</u>
	Change in provision for claims		
	Gross amount	(45)	4
	Reinsurers' share	43	(5)
	Net of reinsurance	<u>(2)</u>	<u>(1)</u>
	Claims incurred, net of reinsurance	<u>(21)</u>	<u>(18)</u>
5	Net operating expenses	(18)	(16)
2b	Balance on the general business technical account	<u>1</u>	<u>1</u>
	<u>Analysis:</u>		
	Continuing operations	1	1
9	Operations in run-off	-	-
		<u>1</u>	<u>1</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2013 (continued)

Note	<u>Long-term Business Technical Account</u>	<u>2013 £m</u>	<u>2012 £m</u>
2a	Gross premiums written	7,532	14,074
	Outward reinsurance premiums	(937)	(1,088)
	Earned premiums, net of reinsurance	<u>6,595</u>	<u>12,986</u>
3	Investment income	7,096	9,710
	Unrealised (losses) gains on investments	(43)	743
	Claims paid		
	Gross amount	(10,607)	(10,374)
	Reinsurers' share	706	865
	Claims paid, net of reinsurance	<u>(9,901)</u>	<u>(9,509)</u>
	Change in provision for claims		
	Gross amount	(69)	13
	Reinsurers' share	(1)	1
	Claims incurred, net of reinsurance	<u>(9,971)</u>	<u>(9,495)</u>
	Change in long-term business provision		
	Gross amount	474	(10,919)
	Reinsurers' share	227	1,104
		<u>701</u>	<u>(9,815)</u>
	Change in technical provision for linked liabilities	(772)	(639)
	Change in other technical provisions, net of reinsurance	<u>(71)</u>	<u>(10,454)</u>
5	Net operating expenses	(1,114)	(1,201)
6	Investment expenses and charges	(303)	(279)
7	Tax attributable to the long-term business	(408)	(502)
12	Actuarial and other (losses) gains on pension schemes	(22)	60
	Transfer to the fund for future appropriations	(1,462)	(1,242)
	Balance on the long-term business technical account	<u>297</u>	<u>326</u>

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

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2013 (continued)

Note **Non-Technical Account**

	<u>2013 £m</u>	<u>2012 £m</u>
Balance on the general business technical account	<u>1</u>	<u>1</u>
Balance on the long-term business technical account	297	326
7 Tax credit attributable to the balance on the long-term business technical account	66	91
2a Balance on the long-term business technical account before tax	<u>363</u>	<u>417</u>
3 Investment income	(27)	47
33C Unrealised losses on investments	(92)	-
Other income	30	34
Other charges	(48)	(40)
Total (loss) profit on other activities	<u>(137)</u>	<u>41</u>
Profit on ordinary activities before tax	<u>227</u>	<u>459</u>
7 Tax on profit on ordinary activities	(38)	(83)
Profit for the financial year	<u>189</u>	<u>376</u>

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 2013

Note

	<u>2013 £m</u>	<u>2012 £m</u>
Profit for the financial year	189	376
Other recognised gains and losses:		
25 Increase in surplus on revaluation of investments in shareholder subsidiaries and associate	244	436
Exchange adjustments	(8)	(6)
Total recognised gains relating to the financial year	425	806

Reconciliation of Movement in Shareholders' Funds for the year ended 31 December 2013

	<u>2013 £m</u>	<u>2012 £m</u>
Total recognised gains relating to the financial year	425	806
Dividends	(231)	(245)
Net movement in shareholders' funds	194	561
Shareholders' funds at beginning of year	4,740	4,179
Shareholders' funds at end of year	4,934	4,740
Included in Shareholders' funds are aggregate net foreign exchange differences as follows:		
Aggregate net foreign exchange differences included in opening Shareholders' funds	(4)	(7)
Net foreign exchange differences for the year	(4)	1
Aggregate net foreign exchange differences included in closing Shareholders' funds	(8)	(6)

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Balance sheet as at 31 December 2013

Note	<u>Assets</u>	<u>2013 £m</u>	<u>2012 £m</u>
15	Intangible assets		
	Licence	59	73
	Distribution rights	88	100
		<u>147</u>	<u>173</u>
	Investments		
16	Land and buildings	6,315	6,270
17	Investments in group undertakings and participating interests	6,284	6,225
18	Other financial investments	93,475	92,991
	Deposits with ceding undertakings	6,949	7,306
		<u>113,023</u>	<u>112,792</u>
19	Assets held to cover linked liabilities	13,060	12,531
20	Reinsurers' share of technical provisions		
	Provision for unearned premiums	3	2
	Long-term business provision	8,334	8,117
	Claims outstanding	141	99
	Technical provisions for linked liabilities	4,991	4,621
		<u>13,469</u>	<u>12,839</u>
	Debtors		
	Debtors arising out of direct insurance operations		
	Policyholders	50	52
	Intermediaries	17	18
	Debtors arising out of reinsurance operations	9	49
21	Other debtors	1,301	1,167
		<u>1,377</u>	<u>1,286</u>
	Other assets		
22	Tangible assets	8	6
26	Cash at bank and in hand	1,238	934
		<u>1,246</u>	<u>940</u>
	Prepayments and accrued income		
	Accrued interest and rent	691	740
	Deferred acquisition costs		
	General business	5	6
	Long-term business	177	184
	Accrued external dividends receivable	39	37
	Other prepayments and accrued income	133	126
		<u>1,045</u>	<u>1,093</u>
	Total assets (excluding pension asset)	<u>143,367</u>	<u>141,654</u>
12	Pension asset (net of related deferred tax)	23	73
23	Total assets (including pension asset)	<u>143,390</u>	<u>141,727</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Balance sheet as at 31 December 2013 (continued)

Note	<u>Liabilities</u>	<u>2013 £m</u>	<u>2012 £m</u>
	Capital and reserves		
24	Share capital	330	330
25	Revaluation reserve	2,085	1,841
25	Other reserves	536	536
25	Profit and loss account	1,983	2,033
2c	Shareholders' funds – equity interests	<u>4,934</u>	<u>4,740</u>
	Fund for future appropriations	12,043	10,598
	Technical provisions		
	Provision for unearned premiums	22	21
31	Long-term business provision	102,865	103,376
	Claims outstanding	635	523
8	Equalisation provision	1	1
	Unearned revenue provision	34	39
	Total technical provisions	<u>103,557</u>	<u>103,960</u>
	Technical provisions for linked liabilities	18,051	17,152
	Provisions for other risks and charges		
7	Deferred taxation	682	527
	Other	49	30
		<u>731</u>	<u>557</u>
	Creditors		
	Creditors arising out of direct insurance operations	185	173
	Creditors arising out of reinsurance operations	36	50
	Deposits received from reinsurers	137	-
	Amounts owed to credit institutions	-	70
	Other borrowings not owed to credit institutions	74	126
27	Other creditors including taxation and social security	3,540	4,178
28	Preference shares	1	1
		<u>3,973</u>	<u>4,598</u>
	Accruals and deferred income	101	122
	Total liabilities	<u>143,390</u>	<u>141,727</u>

The accounts on pages 18 to 78 were approved by the Board of directors on 25 March 2014.



H A Hussain
Director

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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 75), is supported by its inherited estate (Note 32 on page 56), 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.

B. Change in Accounting Policies

In 2013 there have been no changes to accounting policies arising from changes to, or new Financial Reporting Standards.

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

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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.

Following the implementation of the Retail Distribution Review (RDR), policies sold on or after 1 January 2013 will no longer be eligible for deferred acquisition costs to be written against them. Therefore, the deferred acquisition costs will begin to run off as the in-force business starts to be weighted more towards post-RDR policies.

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 PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

1. Accounting Policies (continued)

The Company applies FRS 27, which impacts the basis of reporting for the with-profits business provisions. FRS 27 is underpinned by the PRA'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.

The PRA 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 PRA 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 PRA 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 PRA 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 PRA realistic balance to reflect differences in the provisioning and capital requirements between the accounting and PRA realistic basis.

Under PRA 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 PRA 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

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

1. Accounting Policies (continued)

to claims experience up to the end of the accounting period. No specific provision is made for major events occurring after this date.

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 33 and note 18 on page 48.
- (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 59 to 61.
- (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

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

1. Accounting Policies (continued)

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.

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 33 and note 18 on page 48. 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.
- (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.

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 were calculated using regulatory surplus as a starting point, with appropriate deferred tax adjustments for UK

Notes on the financial statements (continued)

1. Accounting Policies (continued)

GAAP. From 1 January 2013, taxable profits are calculated using accounting profit or loss as a starting point.

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' surpluses 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 84% 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.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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	
	2013 £m	2012 £m	2013 £m	2012 £m
United Kingdom (*)	4,936	12,149	291	354
Hong Kong	2,213	1,675	75	63
Poland	1	-	(3)	-
France	382	250	-	-
	7,532	14,074	363	417

New business

	Regular premiums		Single premiums	
	2013 £m	2012 £m	2013 £m	2012 £m
United Kingdom (*)	229	228	4,408	11,453
Hong Kong	431	371	326	156
Poland	1	-	-	-
France	-	-	355	222
	661	599	5,089	11,831

New business premiums include those contracts excluded from premium income in the 2013 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

	2013 £m	2012 £m
Gross written premiums:-		
Direct	6,969	7,638
Reinsurance accepted	563	6,436
	7,532	14,074
Analysis of gross direct premiums:-		
Individual business	6,532	7,066
Group contracts	437	572
	6,969	7,638
Regular premiums	2,834	2,529
Single premiums	4,135	5,109
	6,969	7,638
Participating contracts	5,195	6,073
Non-participating contracts	949	723
Linked long-term contracts (excluding investment contracts without discretionary participation features)	825	842
	6,969	7,638
United Kingdom	4,755	5,963
Hong Kong	2,213	1,675
Poland	1	-
France	-	-
	6,969	7,638

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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 2013 was £365m (2012: £1,426m).

(b) General business

<u>Premiums and underwriting result</u>		<u>Gross premiums written</u>		<u>Underwriting result</u>	
		<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
		<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Continuing operations	Hong Kong	47	42	1	1
Operations in run-off	United Kingdom	-	-	-	-
		<u>47</u>	<u>42</u>	<u>1</u>	<u>1</u>

<u>Analysis of technical account</u>	<u>Gross Premiums Written</u>		<u>Gross Premiums Earned</u>		<u>Gross Claims Incurred</u>		<u>Gross Operating Expenses</u>		<u>Reinsurance Balance</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Motor										
-other classes	2	2	2	2	-	1	1	1	(1)	(1)
Fire and other										
damage	6	5	5	5	1	1	3	3	(1)	-
Other (*)	39	35	38	33	69	16	15	13	47	(3)
	<u>47</u>	<u>42</u>	<u>45</u>	<u>40</u>	<u>70</u>	<u>18</u>	<u>19</u>	<u>17</u>	<u>45</u>	<u>(4)</u>

* 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:

	<u>Shareholders' funds</u>	
	<u>2013 £m</u>	<u>2012 £m</u>
United Kingdom	4,666	4,523
Hong Kong	267	217
Poland	1	-
Total	<u>4,934</u>	<u>4,740</u>

Notes on the financial statements (continued)

3. Investment income

	Long-term business		Non-technical account	
	<u>2013 £m</u>	<u>2012 £m</u>	<u>2013 £m</u>	<u>2012 £m</u>
Income from:				
Group undertakings	443	553	(40)	(32)
Other investments				
Land and buildings	372	428	-	-
Listed investments	2,937	3,043	-	-
Unlisted investments	189	183	-	-
Other investments	378	279	26	80
	<u>4,319</u>	<u>4,486</u>	<u>(14)</u>	<u>48</u>
Gains (losses) on loans and receivables	8	(58)	-	-
Gains on the realisation of investments at fair value through profit and loss other than derivatives	2,770	4,886	-	-
Gains (losses) on the realisation of derivatives – see note 33	138	482	(13)	-
Exchange losses	(184)	(118)	-	(1)
Fees for policy administration and asset management services arising from unit-linked investment contracts	45	32	-	-
	<u>7,096</u>	<u>9,710</u>	<u>(27)</u>	<u>47</u>

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 £2,443m (2012: £2,582m).

5. Net operating expenses

	Long-term business		General business	
	<u>2013 £m</u>	<u>2012 £m</u>	<u>2013 £m</u>	<u>2012 £m</u>
Depreciation	4	4	-	-
Acquisition costs	650	709	13	11
Change in deferred acquisition costs	4	(6)	1	1
Administrative expenses	431	471	4	4
Amortisation of licence and distribution rights (Note 15)	25	23	-	-
	<u>1,114</u>	<u>1,201</u>	<u>18</u>	<u>16</u>

Acquisition costs include commissions in respect of long-term direct insurance business of £433m (2012: £483m) and general direct insurance business of £12m (2012: £12m). 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	
	<u>2013 £m</u>	<u>2012 £m</u>	<u>2013 £m</u>	<u>2012 £m</u>
Investment management expenses	284	249	-	-
Interest on bank borrowings	19	30	-	-
	<u>303</u>	<u>279</u>	<u>-</u>	<u>-</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

7. Tax

From 1 April 2013, the standard corporation tax rate for the UK changed from 24% to 23%. Further reductions in the standard corporation tax rate to 21% from 1 April 2014 and to 20% from 1 April 2015 have also been enacted. Deferred tax at the end of 2013 has been provided at 20%, as the temporary differences are expected to reverse at that rate.

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 were calculated using regulatory surplus as a starting point, with appropriate deferred tax adjustments for UKGAAP. From 1 January 2013, taxable profits are calculated using accounting profit or loss as a starting point.

a) Tax charged (credited)	Long-term funds		Shareholders' Profits	
	2013 £m	2012 £m	2013 £m	2012 £m
Current Tax				
UK corporation tax	245	568	(23)	3
Double tax relief	(20)	(17)	-	-
Overseas tax	46	44	-	-
Adjustments in respect of prior year	(25)	(85)	1	(20)
Total current tax	246	510	(22)	(17)
Deferred tax				
Origination and reversal of timing differences	156	(1)	-	2
Effect of changes in tax rate on closing balances	-	-	-	-
Adjustments in respect of prior year	-	-	-	-
Total deferred tax	156	(1)	-	2
Shareholders' attributable tax in respect of the long-term business				
Current	-	-	103	63
Deferred	-	-	(37)	28
Total shareholders' attributable tax	-	-	66	91
Tax allocated to non-technical account	6	(7)	(6)	7
Tax charge on profit on ordinary activities	408	502	38	83

b) Factors affecting tax charge for the period

	2013 £m	2012 £m
Profit on ordinary activities before tax	227	459
Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 23.25 per cent (2012: effective rate of 24.5 per cent)	53	112
Permanent differences	1	2
Adjustment to current tax in respect of previous periods	2	(25)
Different tax bases of long-term insurance (current tax)	(2)	8
Effect of short term timing differences	18	(41)
Effect of overseas tax	5	(3)
Non-taxable income	(2)	-
Current tax charge for the period	75	53

Notes on the financial statements (continued)

c) Balance Sheet

	Attributable to Long-term funds		Attributable to Shareholders' funds	
	2013 £m	2012 £m	2013 £m	2012 £m
Provision for Deferred Tax				
Accelerated capital allowances	7	(1)	-	-
Short term timing differences	9	(3)	(1)	(1)
Unrealised gains	676	506	-	-
Deferred acquisition costs	(99)	(104)	-	-
Life transitional arrangements	90	130	-	-
Undiscounted provision for deferred tax liability (deferred tax asset)	<u>683</u>	<u>528</u>	<u>(1)</u>	<u>(1)</u>
Deferred tax liability (deferred tax asset) at start of the period	528	528	(1)	(3)
Deferred tax charged in technical/ non-technical account for the period	<u>155</u>	<u>-</u>	<u>-</u>	<u>2</u>
Deferred tax liability (deferred tax asset) at end of the period	<u>683</u>	<u>528</u>	<u>(1)</u>	<u>(1)</u>

The deferred tax liability relating to the pension asset attributable to the Company of £6m (2012: £5m) 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 (2012: £1m). There has been no movement in the equalisation provision during the year (2012: £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 material subsidiaries and participating interests

There have been no acquisitions or disposals in 2013. There were no acquisitions or disposals in 2012.

11. Transfers of Business

There have been no transfers of business into the Company during 2013 or 2012.

In 1 January 2014 the Hong Kong branch transferred to two new Hong Kong incorporated companies, both subsidiaries of the Company. See post balance sheet event note on page 14.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

12. Information on staff and pension costs

The average number of persons employed by the Company during the year was:	2013	2012
United Kingdom	11	13
Poland	68	-
Hong Kong	1,031	927
	1,110	940

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 in respect of UK, Poland or Hong Kong:	2013 £m	2012 £m
Wages and salaries	68	57
Social security and pension costs	3	3
	71	60

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 2013, on the FRS 17 'Retirement Benefits' (FRS 17) basis of valuation, the underlying PSPS liabilities account for 84% (2012: 86%) of the aggregate liabilities of the Prudential Group's defined benefit schemes. There is also a smaller defined benefit scheme, Scottish Amicable Staff Pension Scheme (SASPS).

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 and was finalised in 2012. This valuation demonstrated the scheme to be 111 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's funding objective. Based on this valuation, future contributions into the scheme were reduced to the minimum level of contributions required under the scheme rules effective from July 2012. Excluding expenses, the contributions are now payable at approximately £6m per annum for ongoing service of active members of the scheme. No deficit or other funding is required. Deficit funding for PSPS, where applicable, as applied prior to 2012, is apportioned in the ratio of 70/30 between the PAC 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 are apportioned in the ratio relevant to current activity.

The last completed actuarial valuation of the SASPS was as at 31 March 2011 and was finalised in 2012. This valuation demonstrated the scheme to be 85 per cent funded. Based on this valuation, it was agreed with the Trustees that the existing level of deficit funding of £13.1m per annum continues to be paid into the scheme until 31 December 2018, to eliminate the actuarial deficit.

For SASPS, 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 SASPS is borne by Prudential Financial Services Limited, a fellow subsidiary undertaking of the Prudential Group.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

Corporate Governance

The Company's UK pension schemes are regulated by 'The Pension Regulator' in accordance with the Pension Act 1995. Trustees have been appointed for each pension scheme and they have the ultimate responsibility to ensure that the scheme is managed in accordance with the Trust Deed & Rules. The Trustees are required by the Pension Regulator to be well conversant with the Trust Deed & Rules and to act in accordance with these Rules.

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 asset 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 Prudential Assurance Company, on the investment principles, but the ultimate responsibility for the investment of the assets of the scheme lies with the Trustee.

The investment policies and strategies for the SASPS which is also a final salary scheme, follow similar principles, but have different target allocations reflecting the particular requirements of the scheme.

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

	2013	2012
	%	%
Price inflation:		
Retail Price Index (RPI)	3.3	2.7
Consumer Price Index (CPI)	2.3	2.0
Rate of increase in salaries	3.3	2.7
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	3.3	2.7
Rate used to discount scheme liabilities	4.4	4.4

Long-term expected rates of return	Prospectively for 2014	2013	2012
	%	%	%
Equities	7.60	6.70	6.80
Bonds	3.80	2.80	3.00
Properties	6.40	5.50	5.55
Other assets	2.00	2.00	2.00
Weighted average long-term expected rate of return	3.90	2.90	3.10

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

The long-term expected rates of return have been determined after applying due consideration to the requirements 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 specific allowance made is in line with a custom calibration and has been updated in 2013 to reflect the 2011 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 2013 were:

Male: 112.0 per cent PNMA00 with improvements in line with a custom calibration of the CMI's 2011 mortality model, with a long-term mortality improvement rate of 1.75 per cent per annum; and
Female: 108.5 per cent PNFA00 with improvements in line with a custom calibration of the CMI's 2011 mortality model, with a long-term mortality improvement rate of 1.25 per cent per annum.

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

Male: 108.6 per cent PNMA00 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 PNFA00 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:

	2013 years		2012 years	
	Male	Female	Male	Female
Retiring today	27.9	29.5	28.0	29.1
Retiring in 20 years' time	31.5	32.8	30.6	31.2

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 SASPS, the most recent full valuations have been updated to 31 December 2013 applying the principles prescribed by FRS 17.

The combined assets and liabilities of PSPS and SAPS were:

	31 Dec 13		31 Dec 12		31 Dec 11	
	£m	%	£m	%	£m	%
Equities	384	6	315	5	378	6
Bonds	5,345	81	5,532	80	5,826	84
Properties	71	1	167	2	297	4
Other assets	804	12	887	13	403	6
Total value of assets	6,604	100	6,901	100	6,904	100
Present value of underlying scheme liabilities	5,993		5,801		5,371	
Underlying surplus (deficit) in the schemes	611		1,100		1,533	

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

	2013 £m	2012 £m	2011 £m
Attributable to the Company's with-profits fund	29	78	92

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

	2013 £m	2012 £m	2011 £m
With-profits fund	23	73	86

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

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:

	2013 £m	2012 £m
Present value of scheme liabilities at beginning of year	5,801	5,371
Current service cost	24	27
Past service cost *	3	106
Interest cost	250	252
Employee contributions	1	1
Actuarial losses	160	281
Benefit payments	(246)	(237)
Present value of scheme liabilities at end of year	5,993	5,801

	2013 £m	2012 £m
Fair value of scheme assets at beginning of year	6,901	6,904
Expected return on scheme assets	204	222
Employee contributions	1	1
Employer contributions**	31	56
Actuarial gains	(287)	(45)
Benefit payments	(246)	(237)
Fair value of scheme assets at end of year	6,604	6,901

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

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

	2013 £m	2012 £m
Pension charge		
Operating charge:		
Current service cost	(24)	(27)
Past service cost	(3)	(106)
	(27)	(133)
Finance income (expense):		
Interest on pension scheme liabilities	(250)	(252)
Expected return on pension scheme assets	204	222
	(46)	(30)
Total pension charge of the schemes	(73)	(163)
Of which the following amounts have been attributed to the Company:		
With-profits fund	(43)	(105)

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

The pension charge relating to PSPS attributable to the Company is related to the surplus recognised on the balance sheet of the Company. No adjustment was made to the pension charge in 2013 and 2012 relating to the unrecognised portion of the PSPS surplus.

Actuarial (losses) gains	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Actual less expected return on scheme assets * ((4%), (1%), 14%, 5%, 2% of pension scheme assets)	(287)	(45)	984	296	91
Experience (losses) gains on scheme liabilities (0%, 0%, 6%, 0%, 1% of the present value of scheme liabilities)**	(2)	(19)	317	(1)	62
Changes in assumptions underlying the present value of scheme liabilities	(158)	(262)	(423)	(398)	(475)
Total actuarial (losses) gains of the schemes ((7%), (6%), 16%, (2%), (7%) of the present value of the scheme liabilities)	(447)	(326)	878	(103)	(322)
Of which the following amounts have been attributed to the Company:					
With-profits fund	(22)	60	(25)	(45)	(55)

* The total actual return on scheme assets for both PSPS and SASPS is a net loss of £83m (2012: net gain of £177m) of which a net loss of £69m (2012: net gain of £119m) 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 SASPS.

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

The actuarial (losses) gains relating to PSPS attributable to the Company's with-profits fund are related to the surplus recognised on the balance sheet of the Company. In 2013, the actuarial losses attributable to the Company's with-profits fund included a credit of £281m (2012: a credit of £282m) for the adjustment to the unrecognised portion of the PSPS surplus which has not been applied against the pension charge. 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 £43m (2012: charge of £105m) and actuarial losses of £22m (2012: actuarial gains of £60m) 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 SASPS for the year ending 31 December 2014 amounts to £31m, reflecting the annual accrual cost and deficit funding (SASPS only), and expenses.

The table below shows the sensitivity of the underlying PSPS and SASPS liabilities at 31 December 2013 of £5,316m (2012: £5,226m) and £677m (2012: £575m) to changes in discount rates, inflation rates and mortality rate assumptions.

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Notes on the financial statements (continued)

Assumption	Change in assumption	Impact on PSPS and SASPS scheme liabilities on FRS17 basis
2013		
Discount rate	Decrease by 0.2% from 4.4% to 4.2%	Increase scheme liabilities by: PSPS 3.3% SASPS 5.0%
Discount rate	Increase by 0.2% from 4.4% to 4.6%	Decrease scheme liabilities by: PSPS 3.1% SASPS 4.7%
Rate of inflation	RPI: Decrease by 0.2% from 3.3% to 3.1% CPI: Decrease by 0.2% from 2.3% to 2.1% with consequent reduction in salary increases	Decrease scheme liabilities by: PSPS 0.7% SASPS 4.6%
Mortality rate	Increase life expectancy by 1 year	Increase scheme liabilities by: PSPS 2.7% SASPS 2.5%
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%

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 SASPS to the Company's with-profits fund as described above.

The amounts attributable to the Company's with-profits fund for both PSPS and SASPS 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 £2.6m (2012: £2.3m). £Nil was outstanding at 31 December 2013 (2012 £0.4m).

Notes on the financial statements (continued)

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) Prudential Long-term Incentive Plan (PLTIP)

The PLTIP is a new plan approved by Prudential shareholders in 2013. The PLTIP is a conditional share plan: the shares which are awarded will ordinarily be released to participants after three years to the extent that performance conditions have been met. If performance conditions are not achieved in full, the unvested portion of any award lapses and performance cannot be retested. The performance conditions attached to PLTIP awards are: Relative Total Shareholder Return (TSR) (50 per cent of award); and Group IFRS profit (50 per cent of award); or Business Unit IFRS profit (50 per cent of award). The performance conditions attached to each award is dependent on the role of the participants. The Relative TSR is measured over three years. The TSR is measured against a peer group of international insurers (currently 18) which are similar to Prudential in size, geographic footprint and products. IFRS profit is the three year cumulative IFRS operating profit assessed at Group or Business Unit level. Threshold and maximum achievement levels will be set at the beginning of the performance periods in line with the three year business plan.

(ii) 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. These schemes allow all eligible employees to save towards the exercise of options over Prudential plc shares with the option price set at the beginning of the savings period at a discount of up to 20 per cent of the market price.

In 2013 participants could elect to enter into savings contracts of up to £250 per month for a period of three or five years. At the end of this term, participants may exercise their options within six months and purchase shares. If an option is not exercised within six months, participants are entitled to a refund of their cash savings plus interest if applicable under the rules. Shares are issued to satisfy those options which are exercised. 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.

(iii) Share Incentive Plan

UK-based executive directors and employees are also eligible to participate in the Company's HMRC-approved Share Incentive Plan (SIP). In 2013 all UK-based employees were able to purchase shares of Prudential plc up to a value of £125 per month from their gross salary (partnership shares) through the SIP. For every four partnership shares bought, an additional matching share is awarded, purchased by Prudential 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, or leaves the Group, matching shares are forfeit.

Notes on the financial statements (continued)

(iv) Long-term Incentive Plan

The Prudential Corporation Asia Long-Term Incentive Plan (PCA LTIP) provides eligible employees with conditional awards. Awards are discretionary and on a year-by-year basis determined by Prudential's full year financial results and the employee's contribution to the business. Awards vest after three years subject to the employee being in employment. Vesting of awards may also be subject to performance conditions. All awards are made in Prudential shares, or American Depositary Receipts, 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.

(v) 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 attached to deferred share awards made under these arrangements.

(vi) Group Performance Share Plan (GPSP) and Business Unit Performance Plan (BUPP)

Prior to the approval of the PLTIP, the GPSP and the BUPP were the principal long-term incentive plans operated for executive directors and senior executives. The GPSP and BUPP are conditional share plans: the shares which were awarded will be released to participants to the extent that performance conditions have been met, over the three-year performance period. The performance measure for the awards is that Prudential's Total Shareholder Return (TSR) outperforms an index comprising of peer companies.

Movements in share options outstanding under the Company's share-based compensation plans relating to Prudential plc shares during 2013 and 2012 were as follows:

	2013		2012	
	Number of options	Weighted average exercise price £	Number of options	Weighted average exercise price £
Options outstanding (including conditional options)				
Beginning of year:	343,914	5.44	249,217	4.96
Granted	179,787	9.01	217,083	6.29
Exercised	(15,161)	4.46	(90,849)	2.95
Forfeited	(20,755)	5.81	(27,380)	4.96
Cancelled	(2,784)	8.75	(3,862)	4.66
Lapsed	(666)	9.01	(295)	5.51
End of year	484,335	6.75	343,914	5.44
Options immediately exercisable, end of year	1,295	4.61	5,349	4.25

The weighted average share price of Prudential plc for the year ended 31 December 2013 was £11.14 compared to £7.69 for the year ended 31 December 2012.

Movements in share awards outstanding under the Group's share-based compensation plans relating to Prudential plc shares at 31 December 2013 and 2012 were as follows:

	2013	2012
	Number of awards	Number of awards
Awards outstanding		
Beginning of year:	851,381	830,955
Granted	282,806	401,370
Exercised	(248,212)	(371,077)
Forfeited	(17,350)	-
Expired	-	(9,867)
End of year	868,625	851,381

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2013.

2013		Outstanding			Exercisable	
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise prices £	Number exercisable	Weighted average exercise prices £	
Range of exercise prices						
Between £0 and £1	-	-	-	-	-	-
Between £1 and £2	-	-	-	-	-	-
Between £2 and £3	40,700	0.92	2.88	-	-	-
Between £3 and £4	-	-	-	-	-	-
Between £4 and £5	70,005	1.58	4.63	1,295	4.61	-
Between £5 and £6	-	-	-	-	-	-
Between £6 and £7	197,355	2.46	6.29	-	-	-
Between £7 and £8	-	-	-	-	-	-
Between £8 and £9	-	-	-	-	-	-
Between £9 and £10	176,275	3.26	8.05	-	-	-
	484,335	2.63	6.75	1,295	4.61	

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	
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise prices £	Number exercisable	Weighted average exercise prices £	
Range of 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	-	-	-
Between £7 and £8	-	-	-	-	-	-
Between £8 and £9	-	-	-	-	-	-
Between £9 and £10	-	-	-	-	-	-
	343,914	3.02	5.44	5,349	4.25	

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:

2013			2012		
Prudential	Weighted average fair value		GPSP	Weighted average fair value	
LTIP/GPSP	SAYE Options	Awards		SAYE Options	Awards
£	£	£	£	£	£
7.41	2.95	11.07	5.00	2.27	7.70

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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:

	2013	SAYE Options	2012 GPSP	SAYE Options
	Prudential LTIP/GPSP			
Dividend yield (%)	-	2.73	-	3.63
Expected volatility (%)	23.60	23.97	23.70	34.32
Risk-free interest rate (%)	0.66	0.96	0.36	0.37
Expected option life (years)	-	3.23	-	3.17
Weighted average exercise price (£)	-	9.01	-	6.29
Weighted average share price (£)	11.80	11.85	6.64	8.26

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 the Prudential LTIP (TSR), 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 all options and awards, the expected volatility is based on the market implied volatilities for Prudential shares as quoted on Bloomberg. The Prudential specific at-the-money implied volatilities are adjusted to allow for the different terms 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 the Prudential LTIP (TSR) and GPSP (TSR), volatility and correlation between Prudential and a basket of 18 competitor companies is required. For grants in 2013, an average index volatility and correlation of 26% and 60%, respectively were used. Market implied volatilities are used for both Prudential and the components of the index. 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 2013 is £5.2m (2012: £3.9m) of which £0.2m (2012: £0.1m) is accounted for as equity-settled and £5.0m (2012: £3.8m) is accounted for as cash-settled.

13. Directors' emoluments

	2013 £	2012 £
Aggregate emoluments	2,029,324	3,025,714
Aggregate amounts receivable (excluding shares) under long term incentive schemes	-	-
Excess retirement benefits:		
Current directors	117,297	279,360
Past directors	158,626	-
Other cash payments	-	-
	<u>2,305,247</u>	<u>3,305,074</u>
Highest Paid Director:		
Aggregate emoluments and amounts receivable (excluding shares) under long term incentive schemes	<u>553,186</u>	<u>1,364,140</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

No directors (2012: nil) exercised share options during the year. Five directors (2012: four) were entitled to shares under Prudential's main long-term incentive scheme and one director (2012: 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 2012 did not exercise any share options but did 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:

	2013 £m	2012 £m
Audit services:		
Fees payable to KPMG for the audit of the Company's accounts	2.4	2.3
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	0.3	0.4
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 2013	131	174	305
Exchange differences	(2)	-	(2)
At 31 December 2013	129	174	303
Amortisation:			
At 1 January 2013	31	101	132
Exchange differences	(1)	-	(1)
Provided in the year in the long-term business technical account	11	14	25
At 31 December 2013	41	115	156
Net book value at 31 December 2013	88	59	147
Net book value at 31 December 2012	100	73	173

The charge for amortisation for the year ended 31 December 2012 was £23m 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 (2012: £Nil).

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

16. Land and buildings

	<u>2013 £m</u>	<u>2012 £m</u>
Current value		
Freeholds	3,556	3,927
Leaseholds with a term of over 50 years	2,354	1,949
Leaseholds with a term of less than 50 years	405	394
	<u>6,315</u>	<u>6,270</u>
Cost	<u>4,733</u>	<u>4,896</u>

The value of land and buildings occupied by the Company amounted to £112m (2012: £100m).

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

Freehold and leasehold land and buildings

	<u>2013 £m</u>	<u>2012 £m</u>
At cost	4,733	4,896
Aggregate depreciation	(1,818)	(1,700)
Net book value based on historical cost	<u>2,915</u>	<u>3,196</u>

17. Investments in group undertakings and participating interests

	<u>Cost</u>		<u>Current value</u>	
	<u>2013 £m</u>	<u>2012 £m</u>	<u>2013 £m</u>	<u>2012 £m</u>
Shares in group undertakings				
Long-term fund investments	1,508	1,520	2,199	2,457
Shareholder investments	1,194	1,160	3,286	3,008
	<u>2,702</u>	<u>2,680</u>	<u>5,485</u>	<u>5,465</u>
Debt securities issued by, and loans to group undertakings – long term funds	799	760	799	760
Total	<u>3,501</u>	<u>3,440</u>	<u>6,284</u>	<u>6,225</u>

The following is a list of the principal subsidiary undertakings of the Company at 31 December 2013, all wholly owned; a full list of all the Company's subsidiaries is filed annually at Companies House:

	<u>Class of shares held</u>	<u>Principal Activity</u>	<u>Country of Incorporation</u>
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	Preference shares £1	Financial Services Holding Company	Scotland
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.			
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.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

The Company has one associate at 31 December 2013:

	<u>Class and proportion of shares held</u>	<u>Principal Activity</u>	<u>Country of Incorporation</u>
Prudential Health Holdings Limited	A ordinary shares £1 25% holding	Holding Company of Private medical insurance group	England and Wales

Included in the long-term fund investments are a number investments in private property holding companies.

18. Other financial investments

	<u>Cost</u>		<u>Carrying value</u>	
	<u>2013 £m</u>	<u>2012 £m</u>	<u>2013 £m</u>	<u>2012 £m</u>
Shares and other variable yield securities and units in unit trusts	27,819	26,874	35,305	32,886
Debt securities and other fixed income securities	43,343	41,872	44,864	46,152
Derivative assets	73	340	929	1,533
Loans secured by mortgages	1,825	1,870	2,075	2,095
Loans to policyholders secured by insurance policies	95	90	95	90
Other loans	752	867	684	772
Deposits with credit institutions	9,523	9,463	9,523	9,463
	<u>83,430</u>	<u>81,376</u>	<u>93,475</u>	<u>92,991</u>

The change in carrying value of other financial investments included in the Profit and Loss account was a loss of £844m (2012: £795m gain) analysed between a loss of £752m (2012: £795m gain) included in the Long-term business technical account and £92m (2012: £Nil) included in the Non-technical account. The change in carrying value of £844m (2012: £795m gain) included a gain of £1,260m (2012: £136m loss) in respect of equity securities, a loss of £2,758m (2012: £614m gain) in respect of debt securities, a gain of £460m (2012: £331m gain) in respect of derivatives and a gain of £194m (2012: £14m loss) in respect of other financial instruments.

	<u>Carrying value</u>	
	<u>2013 £m</u>	<u>2012 £m</u>
Amounts included in the above relating to listed investments:		
Shares and other variable yield securities and units in unit trusts	27,141	27,744
Debt securities and other fixed income securities	41,784	43,540
	<u>68,925</u>	<u>71,284</u>

The table below analyses the derivative positions of the Company:

	<u>2013 £m</u>		<u>2012 £m</u>	
	<u>Fair value assets</u>	<u>Fair value liabilities</u>	<u>Fair value assets</u>	<u>Fair value liabilities</u>
Derivative financial instruments held to manage interest rate and currency profile:				
Interest rate swaps	88	229	135	224
Cross currency swaps	60	21	156	67
Currency exchange forward contracts	619	107	1,097	830
Bond futures	47	20	9	49
Credit Default Swaps	-	-	4	1
Derivative financial instruments held to manage market risk and efficient investment management:				
Equity options	35	-	128	-
Equity futures	80	8	4	9
Total	<u>929</u>	<u>385</u>	<u>1,533</u>	<u>1,180</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

The nature of the derivative financial instruments, used by the Company in 2013, are similar to those used in 2012. During 2013 a partial equity hedge of the shareholder transfers expected to emerge from the Company's with-profits sub-fund was set up. The use of derivatives is disclosed in note 33C.

19. Assets held to cover linked liabilities

	Cost		Current value	
	2013 £m	2012 £m	2013 £m	2012 £m
Assets held to cover linked liabilities (net of reinsurance)	11,497	11,633	13,060	12,531

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

	2013 £m	2012 £m
Amounts owed by holding company	744	569
Amounts owed by fellow subsidiaries	35	135
Amounts owed by subsidiary companies, associate and joint ventures	350	304
Tax recoverable	97	45
Other	75	114
	1,301	1,167

22. Tangible fixed assets

	Computer Equipment £m	Fixtures & Fittings £m	Total £m
Cost:			
At 1 January 2013	12	45	57
Additions	4	2	6
Disposals	-	(23)	(23)
At 31 December 2013	16	24	40
Depreciation:			
At 1 January 2013	10	41	51
Provided in the year	2	2	4
Disposals	-	(23)	(23)
At 31 December 2013	12	20	32
Net book value at 31 December 2013	4	4	8
Net book value at 31 December 2012	2	4	6

The charge for depreciation for the year ended 31 December 2012 was £4m.

23. Assets attributable to the long-term business fund

Of the total amount of assets shown in the balance sheet on page 22, £138,064m (Restated 2012: £136,726m) is attributable to the long-term business fund.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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 2013	1,841	536	2,033	4,410
Exchange adjustments	-	-	(8)	(8)
Profit for the financial year	-	-	189	189
Dividends	-	-	(231)	(231)
Revaluation of subsidiaries and associate	244	-	-	244
Balance at 31 December 2013	<u>2,085</u>	<u>536</u>	<u>1,983</u>	<u>4,604</u>

	<u>2013 £m</u>	<u>2012 £m</u>
Analysis of profit and loss account:		
Distributable retained profit	1,712	1,678
Undistributable retained profit	271	355
Total	<u>1,983</u>	<u>2,033</u>

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.

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Notes on the financial statements (continued)

27. Other creditors including taxation and social security

	<u>2013 £m</u>	<u>2012 £m</u>
Amounts owed to fellow subsidiaries and holding company	97	119
Amounts owed to subsidiary companies, associate and joint ventures	1,564	1,497
Tax	105	253
Derivative liability (see note 18)	385	1,180
Other creditors	1,389	1,129
	<u>3,540</u>	<u>4,178</u>

28. Preference shares

	<u>2013 £m</u>	<u>2012 £m</u>
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 2013, in respect of the Company's associate (Prudential Health Holdings Limited), no capital injection was made (2012: £Nil). £53m (2012: £41m) was recharged to the Company from Prudential Health Services Limited for services provided in respect of the PruProtect product underwritten by the Company. 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 2013 the Company repaid £13m (2012: £Nil) under this arrangement. At 31 December 2013 the outstanding balance was £74m (2012: £87m).

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-

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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 2013 year end Investment Return for asset shares is:

Return	With-Profits Sub Fund Main Asset Share 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	10.33%	8.62%	5.07%	9.13%
Net return	8.77%	7.27%	4.31%	7.76%

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 based upon the level of expenses incurred during 2013.

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 2013:

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.

Notes on the financial statements (continued)

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 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*
<u>UK (excluding Scottish Amicable Insurance Fund)</u>		
Term assurances - life business	3.00	AM/AF92+1
Term assurances - pensions business	4.00	AM/AF92+1
Immediate annuity - Fixed	3.85-4.09	99% PCMA00 + CMI_2012_PRU_M[2.25];
Immediate annuity - Linked	0.36-0.82	89% PCFA00 + CMI_2012_PRU_F[1.50]**
<u>Scottish Amicable Insurance Fund</u>		
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_2012_M[X] and CMI_PRU_2012_F[Y] are the male and female improvement rates produced by Prudential's internal calibration of the 2012 CMI model, with long term rates of X% and Y%.

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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	5.50% gross
Mortality	AM/AF92+1 plus 1/3 AIDS "R6A" for most contracts
Administration Expenses	£29 to £220 p.a. depending on the product type
Expense Inflation	4.00% p.a.

Compared with the 2013 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	5.50% gross
Mortality	AM/AF92 -3 years
Administration Expenses	£33 to £220 p.a. depending on the product type
Expense Inflation	4.00% p.a.

Compared with the 2013 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 Financial Services Authority (FSA), the UK insurance regulator at the time, 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.

Pension Mis-selling Review

The pensions review by the Financial Services Authority (FSA), the UK insurance regulator at the time, 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. Prudential met the requirement of the FSA (the UK insurance regulator at the time) to issue offers to all cases by 30 June 2002.

At 31 December 2013, the pension mis-selling provision was £286m (2012: £306m). The table below summarises the change in the pension mis-selling provision for the year ended 31 December 2013.

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Notes on the financial statements (continued)

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Balance at start of the period	306	362
Changes to actuarial assumptions and method of calculation	26	(10)
Discount unwind	1	1
Redress paid to policyholders	(46)	(45)
Payment of administrative costs	(1)	(2)
Balance at end of the period	286	306

The pension mis-selling provision at 31 December 2013 of £286m is stochastically determined on a discounted basis. The average discount rate implied in the movement in the year is 3.4 per cent (2012: 2.3 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.

In 1998, Prudential stated that deducting mis-selling costs from the inherited estate would not impact its bonus or investment policy and it gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged. The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing.

This review was completed on 30 June 2002. The assurance will continue to apply to any policy in force at 31 December 2003, both for premiums paid before 1 January 2004, and for subsequent regular premiums (including future fixed, retail price index or salary related increases and Department of Work and Pensions rebate business). The assurance has not applied to new business since 1 January 2004. New business in this context consists of new policies, new members to existing pension schemes plus regular and single premium top-ups, transfers and switches to existing arrangements. The maximum amount of capital support available under the terms of the assurance will reduce over time.

The bonus and investment policy for each type of with-profits policy is the same irrespective of whether or not the assurance applies. Hence removal of the assurance for new business has had no impact on policyholder returns.

Mortgage Endowment Products Review

Historically, 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, would equal or exceed the mortgage debt. The FSA (the UK regulator at the time) was concerned that the maturity value of some of these products would be less than the mortgage debt because of a decrease in expected future investment returns since these products were sold. The FSA (the UK regulator at the time) 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. This programme remains in place following the change in the regulatory regime.

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Notes on the financial statements (continued)

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 £0.8m in the non-profit sub-fund and £7.5m in SAIF were held at 31 December 2013 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 2013 and held a technical provision of £14.6m at 31 December 2013 in respect of further compensation. In line with the time limit prescribed by the FSA, the insurance regulator at that time, 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 £36m at 31 December 2013 within the main with-profits fund to honour guarantees on these products.

The Company's main exposure to guaranteed annuities in the UK is through the Scottish Amicable Insurance Fund (SAIF) and a technical provision of £381m was held in SAIF at 31 December 2013 to honour the guarantees.

Guarantees and Commitments

Since 2012 the Company has 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 other companies within the Group and 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

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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 2013 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. 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 Polish branch became operational in March 2013. The Company's inherited estate is contributing to the costs of establishing the branch. The inherited estate is expected to recoup this funding over time from charges levied, however, if experience is not as expected there is an obligation of the Company's shareholder funds to ensure the inherited estate will be repaid in full with interest.

Intra-group Capital Support Arrangements

Prudential plc and the Company have put in place intra-group arrangements to formalise circumstances in which capital support would be made available by Prudential plc (including in the scenarios referred to in Pension Mis-selling Review above). While it is considered unlikely that such support will be required, the arrangements are intended to provide additional comfort to the Company and its policyholders.

Following the domestication of the Hong Kong branch a series of intra-group capital support arrangements have been put in place:

- **New Business Support Commitment:**

For a period of three years from the transfer date capital support shall be provided from the Company's shareholders' fund to its with-profits fund to enable it to maintain the expectations of its with-profits policyholders as if the assets of the inherited estate had not been transferred to the new business sub-fund of PHKL. The maximum amount of support available is £270m. In the event that the Company has to provide capital support under this arrangement, Prudential plc shall, in turn, provide capital support to the Company to the extent that there are insufficient assets in the Company's shareholders' fund for it to provide the capital support required by the with-profits fund.

- **PHKL Pension Mis-selling Costs Assurance:**

The PHKL shareholder fund will provide capital support to enable PHKL to satisfy its obligations to manage its in-force sub-fund as if the Company's pension mis-selling costs had not been deducted from the PHKL inherited estate. The Company, in turn, will provide capital support from its shareholders' fund to PHKL to the extent that there are insufficient assets in the PHKL shareholders' fund to enable PHKL to support its obligations to its in-force sub-fund.

- **Capital Support from Prudential plc:**

Prudential plc will also provide capital support as necessary to PHKL and PGHK to support new business growth and to maintain solvency. These support arrangements meet a condition set by the Hong Kong regulator (amongst other matters) for its approval of the domestication of the Hong Kong branch.

There is an obligation of the Company's shareholder funds to support Prudential Financial Planning Ltd, another group company, which became operational in 2013. Part of the acquisition costs incurred in the early years of operation are to be spread over five years to reflect the period over which the benefit, in

Notes on the financial statements (continued)

terms of sales, would arise. Where the initial funding is provided by the Company's with-profits fund, it is subject to support from the shareholder funds that in the event of a closure during this period, the amortisation will be reversed and the shareholder will reimburse the consequent estate drain.

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.

2013	Fair value through profit and loss £m	Loans and receivables £m		Total carrying value £m	Fair value £m
Financial Assets					
Deposits with credit institutions	-	9,523		9,523	9,523
Equity securities and portfolio holdings in unit trusts	33,021	-		33,021	33,021
Debt securities and other fixed income securities (note i)	44,864	-		44,864	44,864
Loans (note ii):	250	2,604		2,854	3,124
Other investments (note iii)	2,284	-		2,284	2,284
Derivative assets	929	-		929	929
Assets held to cover linked liabilities	13,060	-		13,060	13,060
Deposits with ceding undertakings	-	6,949		6,949	6,949
Debtors arising out of direct insurance ops	-	67		67	67
Debtors arising out of reinsurance ops	-	9		9	9
Accrued investment income	-	863		863	863
Other debtors	-	1,204		1,204	1,204
Cash at bank and in hand	-	1,238		1,238	1,238
Total	94,408	22,457		116,865	117,135
	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	-	-	-	-	-
Other borrowings not owed to credit institutions (note iv)	-	74	-	74	74
Investment contracts with discretionary participation features (note v)	-	-	35,453	35,453	-
Investment contracts without discretionary participation features	6,976	-	-	6,976	6,976
Creditors arising out of direct insurance operations	-	185	-	185	185
Creditors arising out of reinsurance operations	-	36	-	36	36
Deposits received from reinsurers	-	137	-	137	137
Other creditors	259	2,791	-	3,050	3,050
Derivative liabilities	385	-	-	385	385
Total (note v)	7,620	3,223	35,453	46,296	10,843

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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

Notes

- (i) As at 31 December 2013, £461m (2012: £420m) 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 £68m (2012: £95m).
- (iii) Other investments include participation in various investment funds and limited liability property partnerships.
- (iv) As at 31 December 2013, £74m (2012: £126m) of loans 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 2013 and 2012.

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

Notes on the financial statements (continued)

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 disclosed value cannot 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 where applicable.

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 £39,072m (2012: £41,608m), £2,792m (2012: £2,785m) 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.

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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 2013 the Company held £2,580m (2012: £2,408m), 3% (2012: 3%) of the fair valued financial instruments, within level 3. Of these amounts £2,579m (2012: £2,407m) 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% (2012: 3%) of the total assets of the participating funds at 31 December 2013.

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	31 December 2013			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
With-profits				
Equity securities and portfolio holdings in unit trusts	28,649	3,140	517	32,306
Debt securities	4,851	36,464	61	41,376
Other investments (including derivative assets)	160	1,049	2,001	3,210
Derivative liabilities	(28)	(256)	-	(284)
Total financial investments, net of derivative liabilities	33,632	40,397	2,579	76,608
Percentage of total	44%	53%	3%	100%
Unit-linked				
Assets held to cover linked liabilities	9,339	5	-	9,344
Total financial investments net of derivative liabilities	9,339	5	-	9,344
Investment contract without discretionary participation features held at fair value	-	(6,976)	-	(6,976)
Total	9,339	(6,971)	-	2,368
Percentage of total	394%	(294%)	-	100%
Non-linked shareholder-backed				
Equity securities and portfolio holdings in unit trusts	640	75	-	715
Debt securities	880	2,608	-	3,488
Loans at FVTPL	-	250	-	250
Other investments (including derivative assets)	-	2	1	3
Derivative liabilities	-	(101)	-	(101)
Total financial investments, net of derivative liabilities	1,520	2,834	1	4,355
Percentage of total	35%	65%	-	100%
Company total				
Equity securities and portfolio holdings in unit trusts	29,289	3,215	517	33,021
Debt securities	5,731	39,072	61	44,864
Loans at FVTPL	-	250	-	250
Other investments (including derivative assets)	160	1,051	2,002	3,213
Assets held to cover linked liabilities	9,339	5	-	9,344
Derivative liabilities	(28)	(357)	-	(385)
Total financial investments, net of derivative liabilities	44,491	43,236	2,580	90,307
Investment contract without discretionary participation features held at fair value	-	(6,976)	-	(6,976)
Total	44,491	36,260	2,580	83,331
Percentage of total	53%	44%	3%	100%

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	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%

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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 £3,716m (2012: £3,898m) 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 2013 to that presented at 31 December 2013. 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 2013 £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 2013 £m
With-profits							
Equity securities and portfolio holdings in unit trusts	430	32	42	(70)	83	-	517
Debt securities	70	36	-	(53)	8	-	61
Other investments (including derivative assets)	1,907	202	122	(282)	52	-	2,001
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	2,407	270	164	(405)	143	-	2,579
Total	2,407	270	164	(405)	143	-	2,579
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	430	32	42	(70)	83	-	517
Debt securities	70	36	-	(53)	8	-	61
Other investments (including derivative assets)	1,908	202	122	(282)	52	-	2,002
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	2,408	270	164	(405)	143	-	2,580
Total	2,408	270	164	(405)	143	-	2,580

Of the total profits of £270m (2012: £133m profit) in the period, £233m (2012: £52m profit) relates to Level 3 financial instruments still held at the end of the year, which can be analysed as a profit of £30m (2012: £10m loss) for equity securities, a profit of £5m (2012: £23m loss) for debt securities and a profit of £198m (2011: £85m profit) for other investments.

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	At 1 Jan 2012 £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 2012 £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

Transfers between level 1 and level 2

During 2013, there were £3m of transfers from level 1 to level 2 (2012: £Nil) and £134m of transfers from level 2 to level 1 (2012: £245m). These transfers primarily 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 £180m for the year ended 31 December 2013 (2012: £179m).

The interest expense on financial liabilities not at fair value through profit and loss was £4m for the year ended 31 December 2013 (2012: £19m).

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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. During 2013 the Company entered into a partial equity hedge of the shareholder transfers expected to emerge from the with-profits sub-fund in order to mitigate this risk. 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.

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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.

2013	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	9,522	-	9,523
Debt securities and other fixed income securities	41,659	3,196	9	44,864
Loans	2,202	652	-	2,854
Derivative asset	194	-	735	929
Cash at bank and in hand	-	1,238	-	1,238
	44,056	14,608	744	59,408
Financial Liabilities				
Amounts owed to credit institutions	-	-	-	-
Other borrowings not owed to credit institutions	-	74	-	74
Investment contracts without discretionary participation features	-	-	6,976	6,976
Derivative liabilities	264	-	121	385
	264	74	7,097	7,435

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

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.

2013	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	-	-	-	-	-	-	-	-	-
Other borrowings not owed to credit institutions	7	67	-	-	-	-	-	74	74
	7	67	-	-	-	-	-	74	74
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

ii) Maturity analysis of derivatives and investment contracts

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

2013	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	544	544	-	-	-	544
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

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

	2013 £m	2012 £m
Derivative assets (Note 18)	929	1,533
Derivative liabilities (Note 18 and Note 27)	(385)	(1,180)
Net derivative position	544	353

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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
2013								
Life assurance investment contracts	5	16	16	13	10	8	68	42
2012								
Life assurance investment contracts	4	15	14	11	8	9	61	40

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:

2013	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	49	40	40	33	38	38	37	28	33
5-10 years	23	25	25	24	22	24	26	24	25
10-15 years	13	17	16	17	16	16	18	18	18
15-20 years	7	11	10	11	11	10	10	12	11
20-25 years	4	5	5	7	7	6	5	8	6
Over 25 years	4	2	4	8	6	6	4	10	7
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

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Notes on the financial statements (continued)

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 PRA 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 2013 and 2012 are as follows:

	2013				2012			
	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	438	(359)	994	(661)	457	(369)	1,050	(677)
Long term business provision	(380)	316	(843)	582	(390)	323	(866)	593
Related tax effects	(12)	9	(30)	16	(15)	11	(42)	19
Net sensitivity of profit after tax and shareholders' funds	46	(34)	121	(63)	52	(35)	142	(65)

Currency Risk

As at 31 December 2013 the Company held 40% and 2% (2012: 34% and 3%) 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% (2012: 82%) are held by the with-profit fund, allow the fund to obtain exposure to foreign equity markets.

The financial liabilities, of which 83% (2012: 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.

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Notes on the financial statements (continued)

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.

	2013		2012	
	Decrease of 20% £m	Decrease of 10% £m	Decrease of 20% £m	Decrease of 10% £m
Pre-tax profit	(185)	(92)	(158)	(79)
Related deferred tax effects	37	18	36	18
Net sensitivity of profit after tax and shareholders' funds	(148)	(74)	(122)	(61)

A 10% or 20% increase in their value would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above.

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. The Company purchases swaptions in order to manage the default risk on certain underlying assets and hence reduce the amount of regulatory capital held to support the assets.

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 subset of the market consistent liabilities and hence protect the Pillar II solvency of the with-profits business against adverse market movements. A benchmark of a theoretical replicating portfolio (comprising of equity put options and bucketed 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

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Notes on the financial statements (continued)

rebalance. Automatic rebalancing is triggered if the monthly Value at Risk position of the hedges exceed the agreed threshold.

Prior to 2013 the Company had chosen to designate as a fair value hedge certain fixed to floating rate swaps which hedged the fair value exposure to interest rate movements of certain of the Company's operational borrowings. These operational borrowings have now been repaid and the hedge has been closed out with a realised profit of £0.2m recorded in the long term technical account.

During the year the Company entered into a partial equity hedge of the shareholder transfers expected to emerge from the Company's with-profits sub-fund. The effect in 2013 is an unrealised loss of £92m and a realised loss of £13m charged to the non-technical account.

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 2013 and 2012.

	With-profits sub fund	Other funds	Total 2013	With-profits sub fund	Other funds	Total 2012
	£m	£m	£m	£m	£m	£m
S&P – AAA	4,231	336	4,567	4,565	426	4,991
S&P – AA+ to AA-	5,274	393	5,667	4,682	324	5,006
S&P – A+ to A-	10,260	924	11,184	11,698	924	12,622
S&P – BBB+ to BBB-	9,805	698	10,503	10,646	663	11,309
S&P – Other	2,557	69	2,626	2,467	40	2,507
	32,127	2,420	34,547	34,058	2,377	36,435
Moody's – Aaa	1,746	95	1,841	2,610	638	3,248
Moody's – Aa1 to Aa3	1,693	506	2,199	420	112	532
Moody's – A1 to A3	630	137	767	427	44	471
Moody's – Baa1 to Baa3	573	57	630	580	32	612
Moody's – Other	121	-	121	186	8	194
	4,763	795	5,558	4,223	834	5,057
Fitch – AAA	103	1	104	51	-	51
Fitch – AA+ to AA-	20	-	20	-	-	-
Fitch – A+ to A-	102	20	122	145	19	164
Fitch – BBB+ to BBB-	17	7	24	18	-	18
Fitch – Other	30	1	31	22	1	23
	272	29	301	236	20	256
Other	4,214	244	4,458	4,248	156	4,404
Total debt securities and other fixed income securities	41,376	3,488	44,864	42,765	3,387	46,152

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 2013 which are not externally rated, £1,727m (2012: £1,434m) were internally rated AAA to A-, £2,017m (2012: £2,228m) were internally rated BBB+ to B- and £714m were internally rated as below B- or unrated (2012: £725m). 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.

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.

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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 £678m (2012: £560m) 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 £69m (2012: £92m) with £67m (2012: £90m) in the with-profits fund and £2m (2012: £2m) in the shareholder funds. The Company's exposure to banking operations in these eurozone countries is £101m (2012: £88m) with £98m (2012: £70m) in the with-profits fund and £3m (2012: £18m) in the shareholder funds. The Company has no exposure in Greece in 2013 or 2012.

Loans and receivables

In accordance with accounting policy, impairment reviews were performed for loans and receivables. During the year ended 31 December 2013, impairment losses of £10m (2012: £46m) and reversal of impairment losses of £37m (2012: £27m) were recognised for loans and receivables.

Of the total loans and receivables held £5m (2012: £14m) are past their due date but have not been impaired. All (2012: 96%) of the loans and receivables that are past due but not impaired are less than one year past their due date for 2013. 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 (2012: £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 2013, the Company had lent £2,680m (2012: £1,869m) of securities and held collateral under such agreements of £2,772m (2012: £1,954m).

At 31 December 2013, 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. The fair value of the collateral held in respect of these transactions was £8,793m (2012: £7,662m).

Collateral and pledges under derivative transactions

At 31 December 2013, the Company had pledged £239m (2012: £193m) for liabilities and held collateral of £599m (2012: £458m) 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 2013 of £13,469m (2012: £12,839m), 6% (2012: 6%) of the balance relates to companies outside of the Prudential Group and of this 87% (2012: 62%) 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.

Notes on the financial statements (continued)

E. Risk Management

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

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.

Notes on the financial statements (continued)

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 Prudential Regulation Authority (formerly 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 PRA 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 PRA 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 PRA 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 PRA 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 £8.0bn (2012: £7.0bn) represents the excess of assets over liabilities on the PRA 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 £0.9bn (2012: £1.5bn) at 31 December 2013.

The PRA'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 £252m (2012: £205m) reflects the excess of regulatory basis assets over liabilities of the Company. The regulatory capital resources requirement of £458m (2012: £444m) is covered in part (as is permitted by the PRA 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.

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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 PRA regulations at 31 December 2013 and 2012.

31 December 2013							
	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	-	-	-	-	-	4,309	4,309
Goodwill	-	-	-	-	-	-	-
Total	-	-	-	-	-	4,309	4,309
Held in long-term funds (note i)	-	-	-	625	625	-	625
Total shareholders' funds	-	-	-	625	625	4,309	4,934
Adjustments to regulatory basis							
Funds for future appropriation (note ii)	-	11,989	11,989	54	12,043		
Shareholders' share of realistic liabilities	-	(3,112)	(3,112)	-	(3,112)		
Deferred acquisition costs of non-participating business and intangible assets (distribution rights and licence) not recognised for regulatory reporting purposes	-	(66)	(66)	(258)	(324)		
Adjustment from FRS17 basis pension surplus attributable to WPSF to pension liability for regulatory purposes	-	(54)	(54)	-	(54)		
Valuation difference on PAL between UKGAAP basis and regulatory basis	-	(195)	(195)	-	(195)		
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) (note iii)	-	(553)	(553)	(169)	(722)		
Total adjustments	-	8,009	8,009	(373)	7,636		
Total available capital resources of life assurance businesses on PRA regulatory bases	-	8,009	8,009	252	8,261		

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Notes on the financial statements (continued)

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 PRA regulatory bases	-	7,047	7,047	205	7,252		

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.