Registered Number SC047842

Prudential Retirement Income Limited

Annual Report and Financial Statements
For the year ended 31 December 2014

Prudential Retirement Income Limited

Incorporated and registered in Scotland Registered Number SC047842
Registered Office: Craigforth, Stirling, Scotland, FK9 4UE

Contents **Page**

Prudential Retirement Income Limited

Directors

J Hunt (Chairman)
D J Belsham (Resigned 7 July 2014)
H A Hussain
J Warburton
T Naidu (Appointed 17 October 2014)
D Pender (Appointed 13 February 2015)

Secretary

Prudential Group Secretarial Services Limited

Auditor

KPMG LLP, London

Prudential Retirement Income Limited

Strategic report for the year ended 31 December 2014

Principal activity

The principal activity of Prudential Retirement Income Limited (the Company) is the writing of pension annuity long term insurance business. This will continue in 2015.

Business review

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

With effect from 31 December 2008, the Company entered into an arrangement with The Prudential Assurance Company Limited (PAC) to reinsure 15% of all its non-profit annuity business on a quota share basis. This arrangement allows for all of the reinsurance premiums to be deposited back to the Company. With effect from 31 December 2014, the proportion of business reinsured under this quota share arrangement was increased from 15% to 20%. On a UK GAAP basis the reinsurance results in a loss on the quota share arrangement is £235m (2013: loss of £28m). Part of this increased loss results from the increase to the quota share percentage, increasing the profit transfer by £100m, while economic conditions over 2014 have led to higher investment gains on surplus assets, increasing the profit transfer by approximately £100m. There is an equal and offsetting profit in PAC from accepting this business.

The UK market continues to be heavily influenced by an unprecedented level of regulatory and legislative change. The significant reforms of the pensions industry announced by the UK Government, including removal of the requirement to purchase a pension annuity from April 2015, have resulted in an increasing proportion of customers deferring the decision to convert their pension savings into retirement income. The increased flexibility afforded by these reforms should ultimately help create an environment where more people are encouraged to save. The changes have also opened up opportunities for us to meet customer needs for alternative retirement solutions, including income drawdown.

The Company remained in a satisfactory financial position as at 31 December 2014.

Performance and measurement

The following table sets out the key performance indicators for the Company

Key Performance Indicators	2014 £m	2013 £m
Profit on ordinary activities before tax	**570**	293
Shareholder funds	**3,292**	2,847
Dividends paid	**Nil**	Nil

The profits during 2014 have mainly arisen from profits on new business written in the year, investment returns on assets in excess of technical provisions, and favourable credit experience over the year.

The assets and liabilities of the Company have increased during 2014 both as a result of a reduction in the yield on the underlying assets and as a result of new business single premiums of £2.3bn (2013: £1.3bn). This is partially offset by the payment of annuities.

Strategic report for the year ended 31 December 2014 (continued)

Market review and strategy

During 2014, the Company has maintained its market leadership in annuities, where it has continued to obtain value from PAC's internal vesting pension book. This has been supported by the Company's partnership deals with insurers such as Royal London. The Company now has approximately 1,040,000 annuities in payment.

The Company's strategy in the wholesale market is to participate selectively in bulk annuity and back book buyouts, where the Company is able to win business based on its financial strength, superior track record as well as its extensive annuitant mortality risk assessment capabilities. The Company will

maintain a strict focus on value, only participating in transactions that generate an acceptable rate of return.

The UK life and pensions industry continues to undergo significant change. The announcement by the UK Chancellor in the 2014 Budget to remove compulsory annuitisation and introduce new pension freedoms from April 2015 has been described as a once in a 100-year change. The Company is supportive of this change and more generally of policy initiatives that will help encourage people to save in greater numbers and more often, particularly in an environment where there is a significant savings gap. Simultaneously, a shift in how customers view retirement is being witnessed. The distinction between accumulating funds and then using them to provide an income in retirement is no longer clear-cut. Further opportunities are expected to be created in the savings and investment market with demand for financial advice increasing and customers engaging more frequently with their providers.

These new developments represent major changes to the way business is conducted in a number of areas of the markets in which the Company operates in the UK, and impact not only insurance and investments providers, but also distributors and consumers.

The introduction of new regulations in the form of pension freedoms will allow new ways for customers to secure an income in retirement. Most notably the removal of compulsory annuitisation has created new and exciting opportunities that play to the Company's strengths. Against the backdrop of a changing regulatory environment, the Company's strong product capability, financial strength, reputation and experience provides a very solid foundation for it to enable customers to save and invest today for the outcomes they wish to achieve in the future.

Risk & uncertainties

As a provider of insurance services, the Company's business is the managed acceptance of risk. The Company is a wholly owned subsidiary of the Prudential Group and is subject to the Group's internal control and risk management processes as detailed in the Group Governance Manual and Group Risk Framework. The control procedures and systems established within the Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. As such they provide strong but 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 management, risk oversight and independent assurance.

The Company's results and financial condition are exposed to both financial and non-financial risks. The key risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. The Company's exposure to financial risk through its financial assets and liabilities is provided in detail in Note 9 of the notes to the financial statements.

Risk & uncertainties (continued)

Financial risks

The Company is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The key financial risk factors affecting the Company are market risk, credit risk and insurance risk.

The local economic and investment outlook has improved, but the ongoing wider economic uncertainty 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. Interest rates in the US, UK and the Eurozone remain close to historic lows and it remains to be seen how the markets and the economy as a whole adjust in the medium term.

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

The Company is exposed to market risk through its investments in property assets and mismatch between asset and liability interest rates and inflation exposures. The Company manages these risks by having limits in place for property investments and closely matching its asset and liability cashflows.

(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 which arises mainly from the corporate bond holdings backing the annuity business. Corporate borrowers continue to experience a challenging business environment and volatile profits and cash flows. This principally impacts 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 2014 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 (e.g. 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 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.

Risk & uncertainties (continued)

Financial risks (continued)

(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 and expense experience.

The Company is exposed to significant levels of insurance risk. Insurance risk arises mainly in the form of longevity risk, which is the risk that the Company's (current and deferred) annuity customers live longer than allowed for 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 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 will have an impact on the Company's results.

The Company is also exposed to expense risk which is the risk of actual expenses exceeding the assumptions in pricing and reserving bases. If the actual expenses exceed these assumptions, the Company's operating results could be adversely impacted.

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, longevity trends, 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.

Non-financial risk

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

Risk & uncertainties (continued)

Non-Financial risk (continued)

(a) Business environment risk (continued)

Business environment risk is the risk of exposures to forces in the external environment that could significantly change the fundamentals that drive the business's overall objectives and strategy.

The material regulatory and legal change risks currently faced by the Company 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 has now been agreed. This 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 has been 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 Directive, which is 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) has given rise to new requirements and regulatory expectations of the Company. This includes an increase in thematic review activity, the impact of additional & conflicting compliance demands and the implications from the FCA's new powers and competition objective. This has been evidenced through the recent FCA thematic review of annuities and subsequent market study of the entire retirement market to assess competition.

- Distribution within the market is continually evolving following the implementation of the Retail Distribution Review bringing new business implications as a result and Auto Enrolment / National Employment Savings Trust (NEST) where there is a potential impact on existing business due to amalgamation of deferred pots or automatic switching of funds to their new employers scheme, with NEST becoming the home for most small pension pots.

- 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.

Risk & uncertainties (continued)

Non-Financial risk (continued)

(a) Business environment risk (continued)

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

- The retirement market in the UK is currently undergoing significant legislative change affecting the Company's chosen markets and product offerings. This creates an uncertain environment affecting the Company's ability to sell its products and its continued profitability.

- 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 outsourcing arrangements and medium term degradation of cost benefits arising from wage and cost inflation.

- In April 2016, the Scottish Parliament will be able under the Scotland Act 2012 to set their own rates of income tax which could impact the company given it has a significant number of employees and policyholders that would be impacted by any such changes.

The uncertain economic environment and low interest rates may reduce consumer confidence and their propensity to buy retirement products.

(b) Strategic risk

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

The strategic importance of retirement 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 for this business. The concentration leaves the 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. This places strategic reliance on the performance of these organisations.

(c) Conduct risk

Conduct Risk is the risk of loss arising from the approach taken by firms in their relationship with customers.

The Company puts customers' needs at the heart of its business and provides financial products and services to its customers. In so doing, the Company aims to uphold a reputation built over 160 years, for acting responsibly and with integrity in supporting customers while respecting the laws and regulations, traditions and cultures within which it operates, as well as meeting internationally accepted standards of responsible business conduct.

The Company is exposed to increased regulatory scrutiny in several areas including value for money, treatment of existing versus new customers, product profitability, behavioural economics and mis-selling.

Risk & uncertainties (continued)

Non-Financial risk (continued)

(d) 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.

The Company's activities involve processing annuities in payment and as a result it is exposed to the risks of data integrity and transaction processing errors. Further, because of the nature of much of the Company's business, accurate records have to be maintained for significant periods. The Company is therefore exposed to data security risk potentially resulting in regulatory breaches, complaints and brand damage.

The Company outsources several inter-company and intra-group operations, including investment management, customer-facing functions, support and IT activities. The Company is therefore reliant upon the operational processing performance of its outsourcing partners, and their performance is monitored carefully.

The Company's systems and processes incorporate controls which are designed to manage the operational risks associated with its activities as any weakness in the administration systems, finance systems and processes or actuarial reserving process could have an impact on its results during the effected period.

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.

(e) 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 and other global regulatory developments

The European Union (EU) has developed 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, having been adopted by the Council of the European Union in April 2014, amended 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.

Prudential Retirement Income Limited

Strategic report for the year ended 31 December 2014 (continued)

Solvency II and other global regulatory developments (continued)

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 the results 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.

Following adoption of the Omnibus II Directive, Solvency II will be implemented on 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-late 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 remain to be clarified and the capital position of the Company, is sensitive to these outcomes. There is a risk that the effect of the measures finally adopted could be adverse for the Company, including potentially a significant increase in the capital required to support its business and the Company may be placed at a competitive disadvantage to other European and non-European financial services groups. The Company, as part of the wider Group, is actively participating in shaping the outcome through its involvement in industry bodies and trade associations, including the Pan-European Insurance Forum, Chief Risk Officer and Chief Financial Officer Forums, together with the Association of British Insurers and Insurance Europe.

Having assessed the requirements of Solvency II, the Company has a well established implementation programme to manage the required work across the Company. The Company 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. The Company is in constant and ongoing dialogue with the PRA regarding potential outcomes, the approval process for the internal model, and also the range of available actions to ameliorate the impacts of transitioning to the new solvency 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 and subsequent guidance papers these additional policy measures will include enhanced group-wide supervision, effective resolution measures of the group in the event of failure, loss absorption, and higher loss absorption capacity. These additional measures will be phased in over a period from 2015 to 2019.

Strategic report for the year ended 31 December 2014 (continued)

Solvency II and other global regulatory developments (continued)

ComFrame is also being developed by the IAIS to provide common global requirements for the supervision of insurance groups. The framework is designed to outline a set of common global principles and standards for group supervision and may increase the focus of regulators in some jurisdictions. One of the framework's key components is an Insurance Capital Standard (ICS) which would be expected to form the group solvency capital standard under ComFrame. In December 2014, the IAIS issued a comprehensive consultation paper on ICS and a quantitative field test is planned during 2015, which will be followed by another consultation in December 2015. Further field testing exercises are planned until 2018 to assess the impact 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
Prudential Group Secretarial Services Limited
Company Secretary
27 March 2015

Prudential Retirement Income Limited

Directors' report for the year ended 31 December 2014

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.

Company Registration Number

The Company Registration number is SC047842.

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 demonstrate the Group's CR commitments and principles to its stakeholders and provide clarity to it's 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

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

Directors' report for the year ended 31 December 2014 (continued)

Results and dividends

The state of affairs of the Company at 31 December 2014 is shown in the balance sheet on pages 20 and 21. The profit and loss account appears on pages 18 and 19. No dividend for 2014 is proposed (2013: £Nil).

Share Capital

No ordinary shares were issued by the Company during the year (2013: Nil). There have been no other changes in the Company's share capital during 2014 (2013: Nil).

Directors

The present directors are shown on page 2. Mr Belsham resigned on 7 July 2014 and Ms Naidu was appointed on 17 October 2014. Since the year end Mr Pender has been appointed as a Director, effective 13 February 2015. There have been no further changes since the year end.

Disclosure of information to auditors

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 they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Auditor

Due to an internal reorganisation within KPMG, KPMG Audit Plc resigned as auditor with effect from 6 October 2014. To fill this casual vacancy, the directors approved the appointment of KPMG LLP, an intermediate parent of KPMG Audit Plc, as auditor of the Company, on 28 November 2014.

An ordinary resolution of the Company for the re-appointment of KPMG LLP as auditor of the Company will be proposed to the members of the Company in accordance with Section 485(4)(a) 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 permit 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 2014 and remain in force.

Prudential Retirement Income Limited

Directors' report for the year ended 31 December 2014 (continued)

On behalf of the Board of directors.

S D Windridge
Prudential Group Secretarial Services Limited
Company Secretary
27 March 2015

Prudential Retirement Income Limited

Statement of directors' responsibilities in respect of the Strategic report, 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 judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis 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 its 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

27 March 2015

Independent Auditor's report to the members of Prudential Retirement Income Limited

We have audited the financial statements of Prudential Retirement Income Limited for the year ended 31 December 2014 set out on pages 18 to 51. 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 15, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2014 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

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

Prudential Retirement Income Limited

Independent Auditor's report to the members of Prudential Retirement Income Limited (continued)

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Robert Lewis

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

27 March 2015

Prudential Retirement Income Limited

Profit and Loss Account for the year ended 31 December 2014

Long Term Business - Technical Account	Note	**2014 £m**	2013 £m
Gross premiums written	2(a)	**2,316**	1,322
Outward reinsurance premiums		**(1,931)**	(306)
Earned premiums, net of reinsurance		**385**	1,016
Investment income	3	**1,471**	1,379
Unrealised gains/(losses) on investments		**2,660**	(940)
		4,131	439
Claims incurred, net of reinsurance			
Claims paid		**(1,231)**	(1,175)
Change in other technical provisions, net of reinsurance			
Long term business provision, net of reinsurance	13	**(1,012)**	241
Technical provision for linked liabilities, net of reinsurance	13	**(1,145)**	(86)
		(2,157)	155
Net operating expenses			
Acquisition costs	8	**(38)**	(45)
Administrative costs		**(24)**	(18)
Investment expenses and charges		**(691)**	(68)
		(753)	(131)
Tax attributable to the long term business		**(83)**	(38)
Balance on the technical account – long term business		**292**	266

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 22 to 51 form an integral part of these financial statements.

Prudential Retirement Income Limited

Profit and Loss Account for the year ended 31 December 2014 (continued)

Non-Technical Account	Note	**2014 £m**	2013 £m
Balance on the long term business technical account		**292**	266
Tax attributable to balance on the long term business technical account		**83**	38
Investment income	3	**105**	29
Unrealised gains/(losses) on investments		**94**	(36)
Investment expenses and charges		**(4)**	(4)
Profit on ordinary activities before tax		**570**	293
Tax on profit on ordinary activities	5(a)	**(125)**	(37)
Profit for the financial year	13	**445**	256

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

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

Reconciliation of movement in Shareholders' Funds

Year ended 31 December 2014

	2014 £m	2013 £m
Shareholders' capital and reserves at beginning of year	**2,847**	2,591
Retained profit for the financial year	**445**	256
Shareholders' capital and reserves at end of year	**3,292**	2,847

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 22 to 51 form an integral part of these financial statements.

Prudential Retirement Income Limited

Balance sheet as at 31 December 2014

ASSETS	Note	2014 £m	2013 £m
Investments			
Land and buildings	9	**957**	855
Loans to group undertakings	10	**1,233**	1,307
Other financial investments	9	**24,316**	21,135
		26,506	23,297
Assets held to cover linked liabilities	12	**4,721**	3,576
Reinsurers' share of technical provisions			
Long term business provision	13	**4,434**	2,951
Technical provision for linked liabilities	13	**1,205**	631
		5,639	3,582
Debtors			
Debtors arising out of reinsurance operations		**1**	4
Debtors arising out of direct insurance operations		**-**	40
Other debtors	15	**29**	35
		30	79
Other assets			
Cash at bank and in hand	19	**182**	139
Prepayments and accrued income			
Accrued interest and rent		**413**	399
Total assets	2(b)	**37,491**	31,072

The accounting policies and notes on pages 22 to 51 form an integral part of these financial statements.

Prudential Retirement Income Limited

Balance sheet as at 31 December 2014 (continued)

LIABILITIES	Note	2014 £m	2013 £m
Capital and reserves			
Called up share capital	20	**858**	858
Profit and loss account	13	**2,434**	1,989
Total shareholders' funds		**3,292**	2,847
Technical provisions			
Long term business provision	13	**21,768**	19,273
Claims outstanding	13	**5**	4
Technical provisions for linked liabilities	13	**5,926**	4,207
Provision for other risks and charges			
Deferred tax	16	**195**	219
Creditors			
Derivative liabilities	9	**287**	188
Creditors arising out of reinsurance operations		**1**	1
Deposits from ceding undertakings		**4,755**	3,135
Amounts owed to credit institutions		**836**	727
Other creditors including taxation and social security	17	**426**	471
		6,305	4,522
Total liabilities		**37,491**	31,072

The financial statements on pages 18 to 51 were approved by the board of directors on 27 March 2015.

H A Hussain
Director

The accounting policies and notes on pages 22 to 51 form an integral part of these financial statements.

Notes to the financial statements for the year ended 31 December 2014 (continued)

1. Accounting Policies

(a) Changes to accounting policies

In 2014 there have been no changes to accounting policies arising from changes to, or new Financial Reporting Standards.

(b) Basis of preparation

The financial statements have been prepared in accordance with Part 15 of the Companies Act 2006 and Schedule 3 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The financial statements comply with applicable accounting standards and the 2005 ABI SORP, updated on 21 December 2006, and have been prepared under the historical cost accounting rules, modified to include the revaluation of investments.

The Company has not presented a capital position statement with supporting disclosures under FRS 27 on the basis that the Company is more than 90 per cent owned within a group and the Company is included in the publicly available Prudential Group financial statements which provide information on a group basis complying with this requirement. The process for setting assumptions and determining liabilities, as required to be disclosed by FRS 27, is described in Note 14 of the financial statements (together with key assumptions).

The directors have a reasonable expectation that the Company will be able to continue in operational existence for the foreseeable future and thus continue to adopt the going concern basis of accounting in preparing the financial statements.

In assessing the going concern of the Company, the directors have also considered the implementation of Solvency II on 1 January 2016. The Company continues to work with the regulators to assess the implications, however, the new regime is under development with material areas requiring further clarification before the impacts can be fully assessed. There is a risk that under some scenarios, the level of capital required to support the business could increase and, in these circumstances, management have a range of measures available to them to continue operating as a going concern. These options may include reliance on intra-group support arrangements or the potential use of transitional measures the use of which is subject to regulator approval.

This conclusion has been based upon the following: the Company is a subsidiary within the Prudential Group and it, its parent company and the ultimate parent company are continuing to trade 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 11), generates positive cashflows and has very low debt-financing. In addition consideration has also been given to the Company's performance, the market in which it operates, its strategy and risks and uncertainties, as set out in the Business Review on page 3, the management of financial risk as set out in Note 9, including its exposure to liquidity risk and credit risk.

(c) Long term business

Under FRS 26, the measurement basis of assets and liabilities of long term business contracts is dependent upon the classification of the contracts as either insurance contracts, if the level of insurance risk is significant, or investment contracts if the risk is insignificant. The Company's contracts are all classed as insurance contracts.

1. Accounting Policies (continued)

(c) Long term business (continued)

Annuity considerations are accounted for when due. Annuities are accounted for when the annuity becomes due for payment. Surrenders are accounted for when paid. Death claims and all other claims are accounted for when notified. Index linked annuity business has been disclosed as linked for the purposes of these financial statements. Investment income and realised and unrealised investment gains attributable to long term business are credited to the long term business technical account.

The costs of acquiring new business, principally commission and certain costs associated with policy issue and underwriting, which are not matched by policy charges, are written off in the year in which they are incurred.

(d) Investments

(i) *Land and Buildings*
Land and buildings are valued annually by a number of different professional external valuers on a Market Value basis, as defined in the Appraisal and Valuation Manual issued by the Royal Institute of Chartered Surveyors, in particular Practice Statement 3.2. No depreciation is provided on land and buildings held for investment purposes, in accordance with Statement of Standard Accounting Practice 19, Accounting for Investment Properties.

On a historical cost basis buildings are depreciated over 40 years. Leasehold buildings are depreciated over 40 years or if the lease is less than 40 years over the length of the lease.

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

(iii) *Unrealised gains and losses on investments*
Unrealised gains and losses on investments represent the difference between the change in the value of investments held at the balance sheet date and the reversal of unrealised investment gains and losses recognised in earlier accounting periods in respect of investment disposals.

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

(iv) *Financial investments at fair value through profit and loss*
This comprises assets designated by management as fair value through profit and loss on inception and derivatives which are deemed to be held for trading. These investments are valued at fair value with all changes thereon being recognised in the profit and loss account.

The Company uses bid prices to value its quoted financial investments. Actively traded investments without quoted prices are valued using external broker bid prices.

Notes to the financial statements for the year ended 31 December 2014 (continued)

Accounting Policies (continued)

(d) Investments (continued)

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 9 (a) on pages 29 to 35.

(v) *Loans and receivables*

This comprises investments that have fixed or determinable payments and are not designated as fair value through profit and loss or available-for-sale. These investments include loans secured by mortgages, deposits and other unsecured loans and receivables. These investments are carried at amortised cost using the effective interest method and subject to impairment reviews. The Company measures the amount of the impairment loss by comparing the amortised cost with the present value of its estimated future cash flows discounted at the original effective interest rate.

(e) Long term business provision

The long term business provision is determined by the Company's directors based on advice from the Company's Actuarial Function Holder, who determined the provision using recognised actuarial methods, with due regard to the actuarial principles laid down in Directive 2002/83/EC.

It is calculated initially on a statutory solvency basis to comply with the reporting requirements under the Financial Services and Markets Act 2000. The valuation is then modified to remove certain resilience, contingency and other reserves required by the Prudential Sourcebook for Insurers and the General Prudential Sourcebook issued by the Prudential Regulation Authority.

The technical provisions are the discounted value of future claim payments, adjusted for investment expenses and future administration costs. Claim payments allow for the effects of mortality in line with the bases set out in Note 14. These bases have been derived from an analysis of recent population and internal mortality experience and make allowance for improvements in mortality in the future. The assumptions also seek to take into account the impact of anti-selection.

The interest rates used for discounting claim payments are derived from the yield on the assets held and make allowance for potential defaults on those assets (see Note 14). Long-term rates of default appropriate to the assets held have been set based on an investigation into historic rates of default by credit rating, term to redemption and security. An additional short-term default provision is held to reflect market conditions at the valuation date.

(f) Cash Flow Statement

The Company has availed itself of the exemption from preparing a cash flow statement allowed under section 5(a) of FRS 1, "Cash Flow Statements", on the grounds that it is a wholly owned subsidiary of Prudential plc which publishes a consolidated cash flow statement incorporating the cash flows of the Company.

Notes to the financial statements for the year ended 31 December 2014 (continued)

1. Accounting Policies (continued)

(g) Taxation

Tax is charged on all taxable profits arising in the accounting period.

Except where otherwise required by accounting standards, full provision for deferred tax without discounting is made for all timing differences which have arisen but not reversed at the balance sheet date.

(h) Foreign Currencies

The accounts are presented in pounds sterling which is also the Company's functional currency. Foreign currency revenue transactions are translated at the rate applied at the time of execution. Monetary foreign currency assets and liabilities are translated at year end exchange rates. Exchange differences are included in the profit and loss account.

(i) 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.

2. Segmental analysis

(a) Gross premiums written

	2014 £m	2013 £m
Pension annuities:		
- Level and fixed increasing	**1,031**	1,200
- Index linked	**1,285**	122
	2,316	1,322
Comprising:		
External direct premiums:		
- Immediate annuities	**1,806**	437
- Deferred annuities	**(1)**	1
	1,805	438
External reinsurance accepted:		
- Immediate annuities	**81**	132
Reinsurance from a related party:		
- Immediate annuities	**430**	752
Total	**2,316**	1,322

All premiums are single premium business. All business is written in the United Kingdom. Group pension schemes included in premiums are £1,711m (2013: £274m).

Notes to the financial statements for the year ended 31 December 2014 (continued)

(b) Assets attributable to the long term business fund

Of the total assets shown on page 20, £35,644m (2013: £29,582m) is attributable to the long term business fund.

(c) Reinsurance premium

The outward reinsurance premium for the year included the impact of increasing the quota share to The Prudential Assurance Company from 15% to 20% of all liabilities on 31 December 2014.

3. Investment income

	Long term business technical account		Non technical account	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Income from land and buildings	**81**	70	-	-
Income from debt securities	**1,071**	1,048	**36**	34
Income from mortgage loans and other loans	**12**	10	**1**	-
Income from deposits with credit institutions	**1**	1	**1**	-
Income from other investments	**86**	87	**6**	5
Profits / (losses) on the realisation of investments other than derivatives	**220**	163	**61**	(10)
	1,471	1,379	**105**	29

4. Staff costs

The Company has no employees (2013: Nil). Included within net operating expenses are amounts paid in return for management services provided to the Company by other group companies.

5. Tax on profit on ordinary activities

(a) Analysis of charge in the period

	2014 £m	2013 £m
Current Tax		
UK Corporation tax on gains of the period	**149**	97
	149	97
Deferred Tax		
Origination and reversal of timing differences	**(24)**	(60)
Tax on profits on ordinary activities	**125**	37

Notes to the financial statements for the year ended 31 December 2014 (continued)

5. Tax on profit on ordinary activities (continued)

(b) Factors affecting tax charge for the period

The reduction in the UK corporation tax rate to 21% from 1 April 2014 and the further reduction to 20% from 1 April 2015 have been reflected in the financial statements for the year ended 31 December 2014.

	2014 £m	2013 £m
Profit on ordinary activities before tax	**570**	293
Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 21.5% (2013: 23.25%)	**123**	68
Effects of		
Timing differences		
- Effect of life tax transitional adjustment	**26**	29
Current tax charge for the period	**149**	97

6. Auditor's remuneration

Fees payable to KPMG LLP (KPMG) for the audit of the Company's accounts and the Company's reporting pack for the Parent's consolidated accounts were £71,300 (2013: £70,000). Fees payable to KPMG for other services pursuant to legislation, including the audit of the regulatory return were £30,400 (2013: £30,000).

7. Directors' emoluments

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

	2014 £	2013 £
Aggregate emoluments and non-pension benefits	**492,562**	408,024

During the year five (2013: seven) directors were entitled to shares under the Prudential's main long term incentive scheme. One director is entitled to retirement benefits under the defined benefit scheme and two directors participated in the defined contribution scheme.

The aggregate of emoluments and amounts receivable under long term incentive schemes of the highest paid director included in the above figure was £232,381 (2013: £115,931). During the year the highest paid director did not exercise any share options but did receive shares under a long term incentive scheme.

8. Acquisition costs

Included within the total for acquisition costs are commissions of £7m (2013: £13m).

Notes to the financial statements for the year ended 31 December 2014 (continued)

9. Investments

	Cost		Current Value	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Freehold land and buildings	**460**	461	**513**	497
Leasehold land and buildings	**409**	309	**444**	358
Derivative assets	**13**	29	**352**	199
Equity securities	-	10	-	1
Debt securities and other fixed income securities	**19,296**	18,449	**22,861**	19,923
Loans secured by mortgages	**361**	182	**361**	182
Other loans	**3**	3	**3**	3
Deposits with credit institutions	**739**	827	**739**	827
	21,281	20,270	**25,273**	21,990

The change in current value of investments included in the profit and loss account was a profit of £2,143m (2013: loss of £1,026m) analysed between a profit of £2,048m (2013: loss of £990m) included in the Long term business technical account and a profit of £95m (2013: loss of £36m) included in the Non-technical account. The change in current value of £2,048m (2013: loss of £990m) included a gain of £6m (2013: gain of £16m) in respect of land and buildings, a gain of £1,895m (2013: loss of £944m) in respect of debt securities, a gain of £9m in respect of equity securities (2013: £Nil) and a gain of £138m (2013: loss of £62m) in respect of derivatives.

Amounts included in the above ascribed to listed investments:

	Current Value	
	2014 £m	2013 £m
Equity securities	-	1
Debt securities and other fixed income securities	**20,395**	18,523
	20,395	18,524

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

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

	Freehold and leasehold land and buildings	
	2014 £m	2013 £m
At cost	**869**	770
Aggregated depreciation	**(123)**	(106)
Net book value based on historical cost	**746**	664

Prudential Retirement Income Limited

Notes to the financial statements for the year ended 31 December 2014 (continued)

9. Investments (continued)

(a) Financial instruments

(i) Designation and fair values

All financial assets of the Company are designated as either fair value through profit and loss or loans and receivables. Financial liabilities are designated as either fair value through profit and loss or amortised cost.

2014	Fair value through profit and loss	Loans and receivables	Total carrying value	Fair value
		£m		
Financial Assets:				
Deposits with credit institutions	-	739	739	739
Equity securities	-	-	-	-
Debt securities	22,861	-	22,861	22,861
Loans:				
Loans secured by mortgages	-	361	361	386
Other loans	-	3	3	3
Derivative assets	352	-	352	352
Accrued investment income	-	410	410	410
Other debtors	-	29	29	29
Debtors arising out of reinsurance operations	-	1	1	1
Cash at bank and in hand	-	182	182	182
Assets held to cover linked liabilities	4,721	-	4,721	4,721
	27,934	1,725	29,659	29,684

	Fair value through profit and loss	Amortised cost	Total carrying value	Fair value
		£m		
Financial Liabilities:				
Deposits from ceding undertakings	-	4,755	4,755	4,755
Creditors arising out of reinsurance operations	-	1	1	1
Other creditors	-	1,162	1,162	1,162
Derivative liabilities	287	-	287	287
	287	5,918	6,205	6,205

9. Investments (continued)

(a) Financial instruments (continued)

(i) Designation and fair values (continued)

2013	Fair value through profit and loss	Loans and receivables	Total carrying value	Fair value
		£m		
Financial Assets:				
Deposits with credit institutions	-	827	827	827
Equity securities	1	-	1	1
Debt securities	19,923	-	19,923	19,923
Loans:				
Loans secured by mortgages	-	182	182	190
Other loans	-	3	3	3
Derivative assets	199	-	199	199
Accrued investment income	-	399	399	399
Other debtors	-	35	35	35
Debtors arising out of reinsurance operations	-	4	4	4
Debtors arising out of direct insurance operations	-	40	40	40
Cash at bank and in hand	-	139	139	139
Assets held to cover linked liabilities	3,576	-	3,576	3,576
	23,699	1,629	25,328	25,336

	Fair value through profit and loss	Amortised cost	Total carrying value	Fair value
		£m		
Financial Liabilities:				
Deposits from ceding undertakings	-	3,135	3,135	3,135
Creditors arising out of reinsurance operations	-	1	1	1
Other creditors	-	1,130	1,130	1,130
Derivative liabilities	188	-	188	188
	188	4,266	4,454	4,454

As at 31 December 2014 no convertible bonds (2013: £Nil) were included in debt securities. There were no convertible bonds included in borrowings (2013: £Nil).

For financial liabilities designated as fair value through profit and loss there was no material impact on profit from movements in credit risk during 2014 and 2013.

9. Investments (continued)

(a) Financial instruments (continued)

(ii) Determination of fair values

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

The fair values of the financial instruments for which fair valuation is required under UK GAAP are determined by the use of current market bid prices for quoted investments, or by using quotations from independent third-parties, such as brokers and pricing services or by using appropriate valuation techniques. Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades and financial investments for which markets are no longer active as a result of market conditions e.g. market illiquidity. The valuation techniques used include comparison to recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used priority is given to publicly available prices from independent sources, when available but overall, the source of pricing is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date.

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

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

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

The fair value of borrowings is based on quoted market prices, where available.

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

9. Investments (continued)

(a) Financial instruments (continued)

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

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

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

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

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

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

The nature of the Company's operations in the UK mean that a significant proportion of the assets backing non-linked shareholder backed business are held in corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using third party broker quotes in the UK either directly or via third parties such as IDC or Bloomberg. Such assets have generally been classified as level 2 as the nature of broker quotations means that it does not strictly meet the definition of a level 1 asset. However these valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £19,363m (2013: £17,191m), £2,345m (2013: £1,415m) are valued internally. The majority of such securities use matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring a specified liquidity premium. The significance of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

Notes to the financial statements for the year ended 31 December 2014 (continued)

9. Investments (continued)

(a) Financial instruments (continued)

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

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

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

Of the £170m (2013: £60m) level 3 items which support non-linked shareholder-backed business Nil% (2013: Nil%) of the total assets net of derivative liabilities backing this business are valued externally, all are internally valued. Internal valuations, which represent only 4% for levels 1 to 3 (2013: 3%) of the total assets net of derivative liabilities supporting non-linked shareholder-backed business, are inherently more subjective than external valuations.

If the value of all level 3 investments backing non-linked shareholder-backed business was varied by 10%, the change in valuation would be £17m (2013: £1.6m), which would reduce or increase shareholders' equity by this amount before tax.

2014	Level 1	Level 2	Level 3	Total
		£m		
Debt securities	4,572	18,140	149	22,861
Other investments (including derivative assets)	-	352	-	352
Assets held to cover linked liabilities	1,107	4,169	-	5,276
Derivative liabilities	-	(287)	-	(287)
Total financial investments, net of derivative liabilities:	**5,679**	**22,374**	**149**	**28,202**
Percentage of total	**20.1%**	**79.4%**	**0.5%**	**100%**

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

Notes to the financial statements for the year ended 31 December 2014 (continued)

9. Investments (continued)

(a) Financial instruments (continued)

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

2013	Level 1	Level 2	Level 3	Total
		£m		
Equity securities	-	-	1	1
Debt securities	2,673	17,191	59	19,923
Other investments (including derivative assets)	-	199	-	199
Assets held to cover linked liabilities	813	2,864	-	3,677
Derivative liabilities	-	(188)	-	(188)
Total financial investments, net of derivative liabilities:	3,486	20,066	60	23,612
Percentage of total	14.8%	85.0%	0.2%	100%

Reconciliation of movements in level 3 financial instruments measured at fair value

The following table reconciles the value of level 3 financial instruments at 1 January 2014 to that presented at 31 December 2014. 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.

2014	At 1 Jan 2014	Total gains in long-term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2014
				£m			
Equity securities	**1**	**2**	**-**	**(3)**	**-**	**-**	**-**
Debt securities	**59**	**2**	**-**	**(33)**	**149**	**(28)**	**149**
Total financial investments net of derivative liabilities	**60**	**4**	**-**	**(36)**	**149**	**(28)**	**149**

9. Investments (continued)

(a) Financial instruments (continued)

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

2013	At 1 Jan 2013	Total gains in long-term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2013
				£m			
Equity securities	1	-	-	-	-	-	1
Debt securities	-	-	-	-	59	-	59
Total financial investments net of derivative liabilities	1	-	-	-	59	-	60

Of the total gain of £4m (2013: £Nil) in the period, £4m (2013: £Nil) gain relates to level 3 financial instruments not held at the end of the year, £2m (2013: £Nil) relates to debt securities and £2m (2013: £Nil) relates to equity securities.

Transfers between level 1 and level 2

There have been no significant transfers between level 1 and level 2 during 2014 and 2013.

(iv) Interest income and expense

The interest income on financial assets not at fair value through profit and loss was £13m for the year ended 31 December 2014 (2013: £11m).

There is no interest expense on financial liabilities not at fair value through profit and loss for the year ended 31 December 2014 (2013: £Nil).

(b) Market risk

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

Market risk comprises four types of risk, namely:

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

Notes to the financial statements for the year ended 31 December 2014 (continued)

9. Investments (continued)

(b) Market Risk (continued)

The financial assets covering the Company's liabilities are subject to market risk. The liabilities for annuity contracts are subject to market risk arising from changes in the returns of the attaching assets. Except mainly to the extent of any minor asset/liability duration mismatch, and exposure to credit risk, the sensitivity of the Company's annuity business' results to market risk for movements in the carrying value of liabilities and covering assets is broadly neutral on a net basis.

The principal items affecting the results of the Company are mortality experience and assumptions and credit risk.

(i) Interest rate risk

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

2014	Fair value interest rate risk	Cash flow interest rate risk	Not directly exposed to interest rate risk	Total
		£m		
Financial Assets:				
Deposits with credit institutions	-	739	-	739
Debt securities	22,568	144	149	22,861
Loans:				
Loans secured by mortgages	361	-	-	361
Other loans	3	-	-	3
Derivative asset	315	-	37	352
Cash at bank and in hand	-	-	182	182
	23,247	883	368	24,498

	Fair value interest rate risk	Amortised cost	Not directly exposed to interest rate risk	Total
		£m		
Financial Liabilities:				
Derivative liabilities	287	-	-	287
	22,960	883	368	24,211

9. Investments (continued)

(b) Market Risk (continued)

(i) Interest rate risk (continued)

2013	Fair value interest rate risk	Cash flow interest rate risk	Not directly exposed to interest rate risk	Total
		£m		
Financial Assets:				
Deposits with credit institutions	-	827	-	827
Equity securities	-	-	1	1
Debt securities	19,685	163	75	19,923
Loans:	182	-	-	182
Loans secured by mortgages				
Other loans	3	-	-	3
Derivative asset	169	-	30	199
Cash at bank and in hand	-	-	139	139
	20,039	990	245	21,274

	Fair value interest rate risk	Amortised cost	Not directly exposed to interest rate risk	Total
		£m		
Financial Liabilities:				
Derivative liabilities	184	-	4	188
	19,855	990	241	21,086

(ii) Maturity analysis of derivatives

The net derivative position as at the 31 December 2014 was an asset of £65m (2013: asset of £11m).

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

	2014 £m	2013 £m
Derivative assets	**352**	199
Derivative liabilities	**(287)**	(188)
Net Derivative position	**65**	11

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

9. Investments (continued)

(b) Market Risk (continued)

(iii) Sensitivity to interest rate movement

The close matching by the Company of assets of appropriate duration to its annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and UK GAAP is not the same, with contingency reserves and some other margins for prudence within the assumptions required under the PRA regulatory solvency basis not included for UK GAAP reporting purposes. As a result UK GAAP's shareholders' funds are higher than regulatory capital and therefore more sensitive to interest rate risk.

The estimated sensitivity of the shareholder-backed business to a movement in interest rates of 1% and 2% as at 31 December 2014 and 2013 are as follows:

2014

	Fall of 2%	**Fall of 1%**	**Rise of 1%**	**Rise of 2%**
		£m		
Carrying value of debt securities and derivatives	**9,941**	**4,350**	**(3,487)**	**(6,338)**
Long term business provision	**(8,556)**	**(3,803)**	**3,085**	**5,619**
Related tax effects	**(277)**	**(109)**	**80**	**144**
Net sensitivity of profit after tax and shareholders' funds	**1,108**	**438**	**(322)**	**(575)**

2013

	Fall of 2%	Fall of 1%	Rise of 1%	Rise of 2%
		£m		
Carrying value of debt securities and derivatives	7,608	3,405	(2,811)	(5,166)
Long term business provision	(6,682)	(2,986)	2,446	4,473
Related tax effects	(185)	(84)	73	139
Net sensitivity of profit after tax and shareholders' funds	741	335	(292)	(554)

(iv) Currency risk

As at 31 December 2014, the Company held 3% (2013: 4%) and 58% (2013: 67%) of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency, Sterling.

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

(v) Other Price Risk – Equities and Property

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

9. Investments (continued)

(b) Market Risk (continued)

(v) Other Price Risk – Equities and Property (continued)

2014	**A decrease of 20%**	**A decrease of 10%**
	£m	
Pre-tax profit	**(191)**	**(96)**
Related current tax effects	**38**	**20**
Net sensitivity of profit after tax and shareholders' equity	**(153)**	**(76)**

2013	A decrease of 20%	A decrease of 10%
	£m	
Pre-tax profit	(171)	(85)
Related current tax effects	34	17
Net sensitivity of profit after tax and shareholders' equity	(137)	(68)

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

In the equity and property risk sensitivity analysis shown above the Company has, for 2014, considered the impact of an instantaneous 20 per cent fall in equity and property markets. If equity and property markets were to fall by more than 20 per cent, the Company believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Company would be able to put in place mitigating management actions.

(c) Derivatives and Hedging

The Company uses various derivative arrangements in order to assist in the matching of contractual liabilities.

Currency swap agreements involve the exchange of payments in different currencies over the life of the agreement. The Company enters into currency swap transactions to hedge foreign currency risk on overseas investments. Interest rate and inflation swap agreements involve the exchange of fixed and floating payments over the life of the agreements without an exchange of the underlying principal amount. The Company has entered into credit default swap arrangements predominantly in respect of sovereign government debt obligations.

The swap agreements are accounted for on a market value basis, consistent with the assets and liabilities hedged. All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual group entities, of which the Company is one, and relevant counterparties in place under each of these market master agreements.

Prudential Retirement Income Limited

Notes to the financial statements for the year ended 31 December 2014 (continued)

9. Investments (continued)

(d) Credit Risk

(i) Debt securities and other fixed income securities

The following table summarises by the rating, the securities held by the Company as at 31 December 2014 and 2013:

	Total 2014 £m	Total 2013 £m
S&P – AAA	**3,038**	2,527
S&P – AA+ to AA-	**3,197**	2,843
S&P – A+ to A-	**5,961**	5,550
S&P – BBB+ to BBB-	**3,742**	3,527
S&P – Other	**182**	198
	16,120	14,645
Moody's – Aaa	**373**	392
Moody's –Aa1 to Aa3	**2,104**	1,537
Moody's –A1 to A3	**1,123**	829
Moody's – Baa1 to Baa3	**293**	281
Moody's - Other	**26**	4
	3,919	3,043
Fitch	**198**	134
Other	**2,624**	2,101
Total debt securities	**22,861**	19,923

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 2014 which are not externally rated, £1,800m (2013: £1,297m) were internally rated AAA to A-, £697m (2013: £722m) were internally rated BBB to B- and £127m (2013: £82m) were unrated.

In 2011, S&P withdrew its ratings of debt securities issued by a number of sovereigns. Where these are no longer available, Moody's ratings have been used.

The Company's exposure to the eurozone sovereigns of Portugal, Italy, Ireland, Greece and Spain (PIIGS) is £61m (2013: £51m). The Company's exposure to banking operations in these eurozone countries is £67m (2013: £79m). The Company has no exposure in Greece (2013: £Nil).

(ii) Loans and receivables

Of the total loans and receivables held £Nil (2013 £1m) are past their due date but have not been impaired. Of the total past due but not impaired, £Nil (2013: £1m) are less than 1 year past their due date. The Company expects full recovery of these loans and receivables. In accordance with accounting policy, impairment reviews were performed for loans and receivables. During the year ended 31 December 2014, no impairment losses (2013: £Nil) were recognised for loans and receivables.

9. Investments (continued)

(iii) Securities lending and reverse repurchase agreements

The Company has entered into securities lending (including repurchase agreements) whereby blocks of securities are loaned to third parties, primarily major brokerage firms. The amounts above the fair value of the loaned securities required to be held as collateral by 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 2014, the Company had lent £1,169m (2013: £828m) of securities and held collateral under such agreements of £1,212m (2013: £858m). Of this amount £62m (2013: £167m) related to another group company.

At 31 December 2014, the Company had entered into reverse repurchase transactions, under which it purchased securities and had taken on the obligation to resell the securities for the purchase price, amounting to £1,015m (2013: £676m), together with accrued interest. Of this amount £Nil (2013: £Nil) related to another group company.

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

(iv) Collateral under derivative transactions

At 31 December 2014, the Company had lent £77m (2013: £85m pledged) for liabilities and held collateral of £228m (2013: £335m) in respect of over-the-counter derivative transactions.

(v) Reinsurer's share of technical provisions

Of the reinsurer's share of technical provisions at 31 December 2014 of £5,639m (2013: £3,582m), 2% (2013: 2%) of the balance relates to companies outside of the Prudential Group and of these 100% (2013: 100%) of the balance were from reinsurers with S&P's rating of AA+ and above, based on the ratings at the date of signing these financial statements.

(e) Risk management

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

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

The Company uses derivatives to facilitate efficient portfolio management or to reduce investment risk. The most widely used derivatives by the Company are interest rate, currency and inflation-linked swaps.

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

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.

Notes to the financial statements for the year ended 31 December 2014 (continued)

9. Investments (continued)

(e) Risk management (continued)

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.

The primary market risk that the Company faces is interest rate risk because most of its assets are investments that are bonds, mortgages or cash deposits, the values of which are subject to interest rate risk. The Company has some liabilities that contain guaranteed returns which generally will be supported by fixed income investments.

Credit risk

Credit risk is the risk of loss to the Company 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'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, although solvent on a balance sheet basis, does not have sufficient cash resources available to meet it's obligations as they fall due or can secure them only at excessive cost. The Company writes solely annuity business, which cannot be surrendered. Therefore liquidity risk is mitigated by cashflow matching the maturity profile of investments with the expected regular annuity payments.

10. Loans to group undertakings

	Cost		Current Value	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Loans to group undertakings	**1,233**	1,307	**1,233**	1,307

During 2014 the Company received loan repayments of £108m (2013: £Nil) which related to loans to The Prudential Assurance Company. No new loan agreements were entered into during 2014 (2013: £57m) Of the total loans, £Nil (2013: £57m) is to be repaid within one year and £1,233m (2013: £1,250m) have no set term.

Prudential Retirement Income Limited

Notes to the financial statements for the year ended 31 December 2014 (continued)

11. Capital requirements and management

Regulatory capital requirements apply at both an individual Company level and at the Prudential Group level, of which the Company is a part, for life assurance and investment management business. The Prudential Group, of which the Company is a part, is currently subject to the solvency requirements of the Insurance Groups Directive (IGD) as implemented by the PRA. Under the IGD a continuous parent company solvency test is applied: under this test the surplus capital held in each of the regulated subsidiaries, including the Company, is aggregated with the free assets of non-regulated subsidiaries.

From this total, Prudential Group borrowings are deducted, other than subordinated debt issues which qualify as capital.

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

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

The Insurance Prudential Sourcebook also contains rules on Individual Capital Assessments. Under these rules and the rules of the General Prudential Sourcebook all insurers must assess for themselves the amount of capital needed to back their business. If the 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.

The available capital of £2,786m (2013: £2,143m) reflects the excess of regulatory basis assets over liabilities of the fund, before deduction of the capital resources requirement of £1,008m (2013: £851m).

The capital resources requirement for this Company broadly reflects a formula which, for active funds, equates to a percentage of regulatory reserves plus a percentage of death strains.

	2014	2013
	£m	£m
Shareholders' equity		
Held outside long term funds:		
Net assets	**2,231**	1,478
Total	**2,231**	1,478
Held in long term funds	**1,061**	1,369
Total shareholders' equity	**3,292**	2,847
Adjustments to regulatory basis	**(506)**	(704)
Total available capital resources on regulatory bases	**2,786**	2,143

Notes to the financial statements for the year ended 31 December 2014 (continued)

12. Assets held to cover linked liabilities

	Cost		Current Value	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Assets held to cover linked liabilities	**4,465**	3,397	**4,721**	3,576

The change in current value of assets held to cover linked liabilities included in the Long term business technical account was a gain of £611m (2013: gain of £49m).

13. Reserves and policyholder liabilities (net of reinsurance)

	Claims outstanding	Technical provision for linked liabilities	Long term business provision	Profit and loss account
			£m	
Balance at 1 January 2014	4	3,576	16,322	1,989
Movement in technical provisions for the year	-	1,145	1,012	-
Profit and loss account	1	-	-	445
Balance at 31 December 2014	5	4,721	17,334	2,434

14. Long term business provisions

The Company's liabilities are for contracts that provide individual immediate and bulk immediate and deferred annuities.

The immediate annuities are either fixed, where annuity payments are guaranteed from the outset, or inflation linked. These products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump sum capital payment. No surrender value is available under any of these products.

The deferred annuities are also either fixed or inflation linked, both during deferment and in payment.

The primary risks to the Company are therefore mortality, investment and credit risk.

The Company's fixed-increase annuities may incorporate automatic increases in annuity payments by fixed amounts over the policyholder's life. The Company's inflation linked annuity contracts provide for a regular annuity payment which changes periodically based on the change in UK inflation, which:

(i) for the majority of contracts is measured by the Retail Price Index (RPI) and
(ii) for some contracts are subject to pre-defined minima and maxima.

For bulk annuity business, the Company manages the assets and accepts the liabilities of a company pension scheme, to the extent to which they are funded, usually when it is wound up by the employer.

14. Long term business provisions (continued)

The provisions are the present value of the annuity payments and expenses. The calculation of the provisions requires a number of actuarial assumptions regarding future experience to be made. The assumptions are set by the Directors having regard to actuarial advice and based on analysis of relevant past and current data and information on anticipated future trends.

The key assumptions made at 31 December 2013 and 31 December 2014 are shown below.

Mortality

Mortality assumptions are set in light of recent population and internal experience. The mortality assumptions used are percentages of standard actuarial mortality tables. The percentages of the standard table used are selected according to the source of business. Where annuities have been sold on an enhanced basis to impaired lives an adjustment is made, either through an addition to the age or through an explicit mortality loading set by the underwriters.

The mortality assumptions also include an allowance for expected future improvements in longevity. For males, these future mortality improvements are in line with Prudential's own calibration of the CMI 2012 mortality model, with a long term improvement rate of 2.25% p.a. For females, the future mortality improvements are in line with Prudential's own calibration of the CMI 2012 mortality model, with a long term improvement rate of 1.5% p.a. Compared with the core CMI mortality model, Prudential's calibration:

(a) blends period improvements between ages 60 to 80 to the long term improvement rate over a 15 year period (compared with a 20 year period in the core CMI model), and

(b) assumes that cohort improvements dissipate over a 30 year period, or by age 90 if earlier (compared with a 40 year period, or by age 100 if earlier, in the core CMI model).

(c) zeroizes the negative cohort improvement feature for years of birth on or after 1948.

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

	2014		2013	
	Males	Females	Males	Females
In payment:	91% - 95% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2012 model, with a long term improvement rate of 2.25% p.a.	84% - 98% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2012 model, with a long term improvement rate of 1.50% p.a.	91% - 96% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2012 model, with a long term improvement rate of 2.25% p.a.	84% - 98% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2012 model, with a long term improvement rate of 1.50% p.a.
In deferment:	AM92 - 4 years	AF92 - 4 years	AM92 - 4 years	AF92 - 4 years

14. Long term business provisions (continued)

Interest rate

The valuation interest rates comply with the requirements of Rule 1.2.33R of the Prudential Sourcebook for Insurers except that:

- additional margins for prudence required in setting the valuation interest rate for the valuation of liabilities for statutory solvency purposes have been removed;
- the Company is required, by an order issued under section 138A of the Financial Services and Market Act 2000, to calculate the valuation rate of interest by reference to the aggregate yield on the assets rather than the market weighted gross redemption yield which is normally required by the Valuation Rules.

The valuation interest rates are adjusted to reflect investment management expenses and the risk of default on the assets.

The investment management expenses are reviewed annually and reflect the Company's costs.

The credit risk assumption is also reviewed annually and reflects the assets actually held. The assumption about the future level of defaults is 46 basis points per annum (43 basis points per annum at 31 December 2013), which is able to cover a significantly adverse credit situation.

Credit risk provisions

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

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

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

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

14. Long term business provisions (continued)

Credit risk provisions (continued)

The allowance for credit risk comprises:

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

The weighted components of the bond spread over swap rates for fixed and linked annuity business at 31 December 2014 and 31 December 2013, based on the asset mix at the relevant balance sheet date are shown below.

31 December 2014	**Pillar 1 regulatory basis (bps)**	**Adjustment from regulatory to IFRS basis (bps)**	**IFRS (bps)**
Bond spread over swap rates note (i)	**143**	-	**143**
Credit risk allowance			
Long-term expected defaults note (ii)	**14**	-	**14**
Additional provisions note (iii)	**44**	**(12)**	**32**
Total credit risk allowance	**58**	**(12)**	**46**
Liquidity premium	**85**	**12**	**97**

31 December 2013	Pillar 1 regulatory basis (bps)	Adjustment from regulatory to IFRS basis (bps)	IFRS (bps)
Bond spread over swap rates note (i)	133	-	133
Credit risk allowance			
Long-term expected defaults note (ii)	15	-	15
Additional provisions note (iii)	47	(19)	28
Total credit risk allowance	62	(19)	43
Liquidity premium	71	19	90

Notes

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

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

14. Long term business provisions (continued)

Credit risk provisions (continued)

Movement in the credit risk allowance for the year ended 31 December 2014

The movement during 2014 of the average basis points allowance on Pillar 1 regulatory and IFRS bases are as follows:

	Pillar 1 Regulatory basis	IFRS
	(bps) Total	(bps) Total
Total allowance for credit risk at 31 December 2013	62	43
Credit rating changes	1	1
Asset trading	(1)	(1)
New business	(3)	(2)
Other	(1)	5
Total allowance for credit risk at 31 December 2014	58	46

In 2010 and prior periods, surplus from favourable default experience was retained within short-term allowances for credit risk on both the Pillar 1 and IFRS bases. For full years 2011, 2012 and 2013 the retention of such surpluses continued to be applied under IFRS but not under Pillar 1. At 31 December 2014, surplus experience is not retained in either the IFRS or Pillar I credit risk allowances.

Overall the movement has led to the credit allowance for Pillar 1 purposes to be 41% (2013: 47%) of the bond spread over swap rates. For IFRS purposes it represents 32% (2013: 32%) of the bond spread over swap rates.

The reserve for credit risk allowance at 31 December 2014 on a Pillar 1 regulatory basis was £2.0bn (2013: £1.7bn) and on an IFRS basis was £1.6bn (2013: £1.2bn).

Expenses

An allowance is made for expenses. This allowance is reviewed annually following an investigation into the Company's costs.

Other assumptions

A number of other, less financially significant, actuarial assumptions are made in calculating the provisions, including the likely marital status of joint-life policyholders on death and the future rates of escalation of certain benefits.

Notes to the financial statements for the year ended 31 December 2014 (continued)

15. Debtors

Other Debtors	2014 £m	2013 £m
Amounts due from group undertakings	**28**	34
Due from Stockbrokers	**1**	1
	29	35

16. Provision for deferred tax

	2014 £m	2013 £m
Life tax transitional arrangements	**195**	219
Undiscounted provision for deferred tax	**195**	219

	2014 £m	2013 £m
Deferred tax liability at start of year	**219**	279
Deferred tax (credit) in profit and loss account	**(24)**	(60)
Deferred tax liability at end of year	**195**	219

The UK Government made substantial changes to the rules relating to the taxation of life insurance companies, effective from 1 January 2013. A deferred tax liability has been recognised for the adjustment that arises on transition to the new regime. This adjustment is required to be spread and taxed over a 10 year period.

17. Creditors

Other creditors including taxation and social security	2014 £m	2013 £m
Amounts owed to group undertakings	**226**	295
Taxation	**99**	68
Other creditors	**101**	108
	426	471

Included within amounts owed to group undertakings at 31 December 2014 was an amount of £220m (2013: £213m), which represents two contingent loans (including interest) repayable to The Prudential Assurance Company Limited. During the year a repayment of £79m (2013: £Nil) was made in respect of these loans.

17. Creditors (continued)

Loan repayments are contingent upon surplus arising and are made after the end of each financial year as a specified percentage of the lesser of the Company's Pillar I surplus and the Company's Pillar II surplus which emerged over that period. If either surplus arising amount is negative, no repayments need be made in respect of that financial year.

Any repayment obligations crystallise on the last day of the financial year to which the surplus arising relates. The loans may be prepaid by the Company upon prior notice.

All other creditors of £200m (2013: £176m) are payable within a period of five years.

18. Guarantees and Commitments

At present, the Company has not provided any guarantees or commitments to third parties that have been entered into in the normal course of business. From time to time the Company may enter into these arrangements, however the Director's do not consider the amounts to be significant.

19. Bank current accounts

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

20. Called up share capital

The total number of issued and fully paid shares at the year end was 837,700,000 (2013: 837,700,000) ordinary shares and 20,000,000 (2013: 20,000,000) preference shares.

The 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 Preference Shares may not be redeemed otherwise than at the option of the Company.

The 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 Preference Shares or in relation to any other matter which will have detrimental effect upon the rights of the Preference Shares.

21. Charges

In the normal course of business certain reinsurance liabilities were secured by a floating charge, ranking these liabilities equally with amounts due under unsecured direct (non-reassurance) policies, over the long term insurance assets of the Company. Amounts secured by charges of this nature were £8,685m and £470m (2013: £7,638m and £446m) representing individual liabilities to one customer.

22. Related party transactions

The Company has taken advantage of the exemption under paragraph 3(c) of Financial Reporting Standard Number 8 from disclosing transactions with other subsidiary undertakings of the Prudential Group. There were no other transactions with related parties.

23. Immediate and ultimate parent company

The immediate parent company is The Prudential Assurance Company Limited. The ultimate parent company is Prudential plc, which is the only parent company which prepares group financial statements. Copies of these financial statements can be obtained from the Company Secretary, Laurence Pountney Hill, London, EC4R 0HH.