Notes on the parent company financial statements

1 Nature of operations
Prudential plc (the Company) is a parent holding company. The Company together with its subsidiaries (collectively, the Group) is an international financial services group with its principal operations in the UK, the US and Asia. The Group operates in the UK through its subsidiaries, primarily The Prudential Assurance Company Limited, Prudential Annuities Limited, Prudential Retirement Income Limited, M&G Investment Management Limited and, prior to disposal, Egg Banking plc. On 29 January 2007 the Company announced that it had entered into a binding agreement to sell its Egg banking business to Citi, as described in note 4. On 1 May 2007, the Company completed the sale. In the US, the Group's principal subsidiary is Jackson National Life Insurance Company. In Asia, the Group's main operations are in Hong Kong, Malaysia, Singapore and Taiwan.

The Company is responsible for the financing of each of its subsidiaries.

2 Basis of preparation
The financial statements of the Company, which comprise the balance sheet and related notes, are prepared in accordance with Section 226 of, and Schedule 4 to, the Companies Act 1985, which apply to companies generally. The Company has taken advantage of the exemption under Section 230 of the Companies Act 1985 from presenting its own profit and loss account.

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

The Company has not prepared a cash flow statement on the basis that its cash flow is included within the cash flow statement in the consolidated financial statements. The Company is also exempt under the terms of FRS 8 from disclosing related party transactions with entities that are part of the Group or investees of the Group.

FRS 29, 'Financial Instruments: Disclosures' which replaces the disclosure requirements of FRS 25, 'Financial Instruments: Disclosure and Presentation' became effective in 2007. Similar to the treatment adopted for FRS 25, the Company has taken advantage of the exemption within FRS 29, from the requirements of this standard on the basis that the Company is included in the publicly available consolidated financial statements of the Group that include disclosures that comply with IFRS 7, 'Financial Instruments: Disclosures', which is equivalent to FRS 29.

An amendment to FRS 26, 'Financial Instruments: Recognition and Measurement' which brings recognition and derecognition requirements of IAS 39, 'Financial Instruments: Recognition and Measurement' into FRS 26 became effective in 2007. The amendment applies only to financial assets and liabilities. The relevant requirements of FRS 5, 'Reporting the Substance of Transactions' continue to apply to the recognition and derecognition of non-financial assets. The adoption of this amendment to FRS 26 did not have an impact on the balance sheet or profit and loss account of the Company.

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

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

Derivatives
Derivative financial instruments are used to reduce or manage interest rate and currency exposures. The Company's policy is that amounts at risk through derivative transactions are covered by cash or by corresponding assets. Derivative financial instruments are carried at fair value with changes in fair value included in the profit and loss account.

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

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

3 Significant accounting policies continued

Dividends

Dividends are recognised in the period in which they are declared. Dividends declared after the balance sheet date in respect of the prior reporting period are treated as a non-adjusting event.

Where scrip dividends are issued, the value of such shares, measured as the amount of the cash dividend alternative, is credited to reserves and the amount in excess of the nominal value of the shares issued is transferred from the share premium account to retained profit.

Share premium

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

Foreign currency translation

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

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

Tax

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

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

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

Pensions

The Company assumes a portion of the pension surplus or deficit of the Group's largest pension scheme, the Prudential Staff Pension Scheme (PSPS). Further details are disclosed in note 8. The Company applies the requirements of FRS 17 (as amended in December 2006) to its portion of PSPS surplus or deficit.

A pension surplus or deficit is recorded as the difference between the present value of the scheme liabilities and the fair value of the scheme assets.

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

The aggregate of the actuarially determined service costs of the currently employed personnel and the unwind of the discount on liabilities at the start of the period, less the expected investment return on the scheme assets at the start of the period, is recognised in the profit and loss account.

Actuarial gains and losses as a result of the changes in assumptions, the difference between actual and expected investment return on scheme assets and experience variances are recorded in the statement of total recognised gains and losses.

4 Investments of the Company

	2007 £m	
	Shares in subsidiary undertakings	Loans to subsidiary undertakings
At beginning of year	6,085	2,841
Transfer from a subsidiary undertaking	1,754	–
Additional investment in subsidiary undertakings	38	–
Disposal of Egg Banking plc	(575)	–
Transfer to a subsidiary undertaking	(151)	151
Net repayment of loans	–	(183)
At end of year	7,151	2,809

On 29 January 2007, the Company announced that it had entered into a binding agreement to sell Egg Banking plc to Citi. Under the terms of the agreement, the consideration payable to the Company by Citi was £575 million cash, subject to adjustments to reflect any change in net asset value between 31 December 2006 and completion, and the carrying value of the Company's investment at 31 December 2006 was reduced to £575 million. On 1 May 2007, the Company completed the sale.

5 Subsidiary undertakings

The principal subsidiary undertakings of the Company at 31 December 2007, all wholly owned except PCA Life Assurance Company Limited, were:

	Main activity	Country of incorporation
The Prudential Assurance Company Limited	Insurance	England and Wales
Prudential Annuities Limited*	Insurance	England and Wales
Prudential Retirement Income Limited (PRIL)*	Insurance	Scotland
M&G Investment Management Limited*	Investment management	England and Wales
Jackson National Life Insurance Company*	Insurance	US
Prudential Assurance Company Singapore (Pte) Limited*	Insurance	Singapore
PCA Life Assurance Company Limited* (99% owned)	Insurance	Taiwan

* Owned by a subsidiary undertaking of the Company.

Each subsidiary has one class of ordinary shares and operates mainly in its country of incorporation, except for PRIL which operates mainly in England and Wales.

6 Borrowings

	Core structural borrowings 2007 £m	Core structural borrowings 2006 £m	Other borrowings 2007 £m	Other borrowings 2006 £m	Total 2007 £m	Total 2006 £m
Core structural borrowings:						
£249m 5.5% Bonds 2009	248	248	–	–	248	248
€500m 5.75% Subordinated Notes 2021 note i	365	335	–	–	365	335
£300m 6.875% Bonds 2023	300	300	–	–	300	300
€20m Medium-Term Subordinated Notes 2023 note ii	15	13	–	–	15	13
£250m 5.875% Bonds 2029	249	249	–	–	249	249
£435m 6.125% Subordinated Notes 2031	427	427	–	–	427	427
US$1,000m 6.5% Perpetual Subordinated Capital Securities note iii	485	484	–	–	485	484
US$250m 6.75% Perpetual Subordinated Capital Securities note iv	124	125	–	–	124	125
US$300m 6.5% Perpetual Subordinated Capital Securities notes iv,v,vi	150	149	–	–	150	149
Total core structural borrowings	2,363	2,330	–	–	2,363	2,330
Other borrowings: vii						
Commercial paper	–	–	2,422	2,017	2,422	2,017
Floating Rate Notes 2007	–	–	–	5	–	5
Medium-Term Notes 2008	–	–	48	–	48	–
Medium-Term Notes 2010	–	–	7	10	7	10
Total borrowings	2,363	2,330	2,477	2,032	4,840	4,362
Borrowings are repayable as follows:						
Within 1 year or on demand	–	–	2,470	2,022	2,470	2,022
Between 1 and 5 years	248	248	7	10	255	258
After 5 years	2,115	2,082	–	–	2,115	2,082
	2,363	2,330	2,477	2,032	4,840	4,362
Recorded in the balance sheet as:						
Subordinated liabilities note viii	1,566	1,533				
Debenture loans	797	797				
	2,363	2,330				

Notes

i The €500 million 5.75 per cent borrowings have been swapped into borrowings of £333 million with interest payable at six month £Libor plus 0.962 per cent.

ii The €20 million Medium-Term Subordinated Notes were issued at 20-year Euro Constant Maturity Swap (capped at 6.5 per cent). These have been swapped into borrowings of £14 million with interest payable at three month £Libor plus 1.2 per cent.

iii Interest on the US$1,000 million 6.5 per cent borrowings was swapped into floating rate payments at three month US$Libor plus 0.80 per cent. In January 2008, this was swapped back into fixed rate payments at 6.5 per cent.

iv The US$250 million 6.75 per cent borrowings and the US$300 million 6.5 per cent borrowings can be converted, in whole or in part, at the Company's option and subject to certain conditions, on any interest payment date falling on or after 23 March 2010 and 23 March 2011 respectively, into one or more series of Prudential preference shares.

v Interest on the US$300 million 6.5 per cent borrowings was swapped into floating rate payments at three month US$Libor plus 0.0225 per cent. In January 2008, this was swapped back into fixed rate payments at 6.5 per cent.

vi In 2006, hedge accounting under FRS 26 was applied for the US$300 million borrowings at the Group consolidated level only. For 2007 onwards, hedge accounting is also applied at the Company level.

vii These borrowings support a short-term fixed income securities programme.

viii The interests of the holders of the Subordinated Notes and the Subordinated Capital Securities are subordinate to the entitlements of other creditors of the Company.

7 Derivative financial instruments

The table below analyses the fair value of derivatives of the Company at 31 December:

	2007 £m		2006 £m	
	Fair value assets	Fair value liabilities	Fair value assets	Fair value liabilities
Derivative financial instruments held to manage interest rate and currency profile:				
Interest rate swaps	8	17	12	27
Cross-currency swaps	2	1	5	2
Inflation-linked swap	–	82	–	67
Forward foreign currency contracts	–	44	–	4
Total	10	144	17	100

The change in fair value of the derivative financial instruments of the Company was a gain before tax of £13 million (2006: £131 million).

The Company has a US$1,000 million fair value hedge in place which hedges the interest exposure on the US$1,000 million 6.5 per cent perpetual subordinated capital securities. In addition, in 2007 the Company designated a US$300 million fair value hedge which hedges the interest exposure on the US$300 million 6.5 per cent perpetual subordinated capital securities.

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

8 Pension scheme financial position

The majority of UK Prudential staff are members of the Group's pension schemes. The largest scheme is the Prudential Staff Pension Scheme (PSPS) which is primarily a closed defined benefit scheme. At 31 December 2007, on the FRS 17, 'Retirement Benefits' basis of valuation, PSPS accounted for 87 per cent (2006: 88 per cent) of the liabilities of the Group's defined benefit schemes.

For the purpose of preparing consolidated financial statements, the Group applies IFRS basis accounting including IAS 19, 'Employee Benefits'. However, the individual accounts of the Company continue to follow UK GAAP. In 2006, the Company early adopted the amendment to FRS 17 issued in December 2006 which aligned the FRS 17 disclosures with IAS 19.

At 31 December 2005, the allocation of surpluses and deficits attaching to PSPS between the Company and the unallocated surplus of the Prudential Assurance Company's (PAC) with-profits funds was apportioned in the ratio 30/70 between the Company and the PAC with-profits fund following detailed consideration of the sourcing of previous contributions. This ratio was applied to the base deficit position at 1 January 2006 and for the purpose of determining the allocation of the movements in that position up to 31 December 2007. The FRS 17 service charge and ongoing employer contributions are allocated by reference to the cost allocation for current activity.

Defined benefit schemes are generally required to be subject to full actuarial valuation every three years to assess the appropriate level of funding for schemes having regard to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. PSPS was last actuarially valued as at 5 April 2005 using the projected unit method. This valuation demonstrated the scheme to be 94 per cent funded, with a shortfall of actuarially determined assets to liabilities of six per cent, representing a deficit of £243 million.

The valuation as at 5 April 2005 was accompanied by changes to the basis of funding for the scheme from 2006 onwards. Deficit funding amounts designed to eliminate the actuarial deficit over a 10-year period are being made. Based on this valuation, total contributions to the scheme for deficit funding and employer contributions for ongoing service for current employees were expected to be of the order of £70 to 75 million per annum over a 10-year period. In 2007, total contributions for the year, including expenses and augmentations, were £82 million (2006: £137 million). The 2006 amount reflected the increased level of contributions for ongoing service and deficit funding backdated to 6 April 2005.

Notes on the parent company financial statements
continued

8 Pension scheme financial position continued

Using external actuarial advice provided by the professionally qualified actuaries, Watson Wyatt Partners, for the valuation of PSPS, the most recent full valuations have been updated to 31 December 2007 applying the principles prescribed by FRS 17.

The key assumptions adopted were:

	2007 %	2006 %
Price inflation	3.3	3.0
Rate of increase in salaries	5.3	5.0
Rate of increase in pension payments for inflation:		
Guaranteed (maximum 5%)	3.3	3.0
Guaranteed (maximum 2.5%)	2.5	2.5
Discretionary	2.5	2.5
Rate used to discount scheme liabilities	5.9	5.2

Long-term expected rate of return

	Prospectively for 2008 %	2007 %	2006 %
Equities	7.5	7.5	7.1
Bonds	5.5	4.9	4.5
Properties	6.75	6.8	6.4
Other assets	5.5	5.0	4.5
Weighted average long-term expected rate of return	6.2	5.9	6.1

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

Further details on the PSPS scheme, including mortality assumptions, are shown in note I1 'Staff and Pension Plans' of the notes on the financial statements of the Group.

The assets and liabilities of PSPS were:

	31 Dec 2007		31 Dec 2006		31 Dec 2005	
	Value £m	%	Value £m	%	Value £m	%
Equities	1,278	26.1	1,346	28.3	2,293	52.1
Bonds	1,134	23.2	2,077	43.8	1,490	33.9
Properties	545	11.2	580	12.2	539	12.3
Other assets	1,932	39.5	745	15.7	75	1.7
Total value of assets	4,889	100.0	4,748	100.0	4,397	100.0
Present value of scheme liabilities	4,361		4,607		4,776	
Surplus (deficit) in the scheme	528		141		(379)	
Allocated as:						
Attributable to the PAC with-profits fund	365		93		(265)	
Attributable to the Company	163		48		(114)	
	528		141		(379)	
After deducting deferred tax, the amounts reflected in the balance sheet of the Company are:	117		34		(80)	

8 Pension scheme financial position continued

The change in the present value of the scheme liabilities and the change in the fair value of the assets is as follows:

	2007 £m	2006 £m
Present value of scheme liabilities, beginning of year	4,607	4,776
Service costs	39	47
Interest	234	226
Employee contributions	2	1
Actuarial gains	(314)	(249)
Benefit payments	(207)	(194)
Present value of scheme liabilities, end of year	4,361	4,607

	2007 £m	2006 £m
Fair value of scheme assets, beginning of year	4,748	4,397
Expected return on scheme assets	276	266
Employee contributions	2	1
Employer contributions*	82	137
Actuarial (losses) gains	(12)	141
Benefit payments	(207)	(194)
Fair value of scheme assets, end of year	4,889	4,748

*The contributions include deficit funding and ongoing contributions.

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

	2007 £m	2006 £m
Pension credit (charge)		
Operating charge:		
Service costs	(39)	(47)
Finance income (expense):		
Interest on scheme liabilities	(234)	(226)
Expected return on scheme assets	276	266
	42	40
Total pension credit (charge)	3	(7)
Less: amount attributable to the PAC with-profits fund	(15)	(6)
Pension charge attributable to the Company	(12)	(13)

8 Pension scheme financial position continued

	2007 £m	2006 £m	2005 £m	2004 £m
Actuarial gains (losses):				
Actual less expected return on scheme assets (0% (2006: 3%) (2005: 11%) (2004: 3%) of assets)	(12)	141	500	104
Experience (losses) gains on scheme liabilities (0% (2006: 0%) (2005: 0%) (2004: 1%) of liabilities)	(10)	17	–	(25)
Changes in assumptions underlying the present value of scheme liabilities	324	232	(405)	(128)
Total actuarial gains (7% (2006: 8%) (2005: 2%) (2004: (1)%) of the present value of the scheme liabilities)	302	390	95	(49)
Less: amount attributable to PAC with-profits fund	(211)	(272)	(66)	39
	91	118	29	(10)
Less: additional losses on change of estimate of allocation of opening PSPS deficit between the Company and the PAC with-profits fund	–	–	(59)	–
Actuarial gains (losses) attributable to the Company	91	118	(30)	(10)

The total actual return on scheme assets for PSPS was £264 million (2006: £407 million).

The actuarial gains before tax of £91 million (2006: £118 million) attributable to the Company are recorded in the statement of total recognised gains and losses. Cumulative actuarial gains as at 31 December 2007 amount to £234 million (2006: £143 million).

The additional loss of £59 million in 2005 reflected the changed estimate of allocation in the deficit of PSPS from a ratio of 20/80 between the Company and the PAC with-profits fund prior to 2005 to a ratio of 30/70 from 2005 onwards.

Total employer contributions expected to be paid into the PSPS defined benefit scheme for the year ending 31 December 2008 amount to £75 million.

9 Share capital and share premium

The authorised share capital of the Company at both 31 December 2007 and 31 December 2006 was £220 million (divided into 4,000,000,000 ordinary shares of 5 pence each and 2,000,000,000 sterling preference shares of 1 pence each) and US$20 million (divided into 2,000,000,000 US dollar preference shares of 1 cent each) and €20 million (divided into 2,000,000,000 Euro preference shares of 1 cent each). None of the preference shares has been issued. A summary of the ordinary shares in issue is set out below:

	2007		
Issued shares of 5 pence each fully paid	Number of shares	Share capital £m	Share premium £m
At beginning of year	2,444,312,425	122	1,822
Shares issued under share option schemes	803,818	–	6
Shares issued in lieu of cash dividends	24,900,997	1	175
Transfer to retained profit in respect of shares issued in lieu of cash dividends	–	–	(175)
At end of year	2,470,017,240	123	1,828

At 31 December 2007, there were options subsisting under share option schemes to subscribe for 9,017,442 (2006: 10,722,274) shares at prices ranging from 266 pence to 695 pence (2006: 266 pence to 715 pence) and exercisable by the year 2014 (2006: 2013). In addition, there were 2,037,220 (2006: 4,113,481) conditional options outstanding under the Restricted Share Plan exercisable at nil cost within a 10-year period. No further options will be issued under the Restricted Share Plan which has been replaced by the Group Performance Share Plan. There were 3,485,617 (2006: 1,623,637) conditional options outstanding under the Group Performance Share Plan exercisable at nil cost within a 10-year period. Further information on the Group's employee share options is given in note I2 'Share-based payments' of the notes on the financial statements of the Group.

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

The loss after tax of the Company for the year was £17 million (2006: profit of £834 million). After dividends of £426 million (2006: £398 million), actuarial gains net of tax in respect of the pension scheme of £66 million (2006: £83 million) and a transfer from the share premium account of £175 million (2006: £75 million) in respect of shares issued in lieu of cash dividends, retained profit at 31 December 2007 amounted to £1,166 million (2006: £1,368 million).

A reconciliation of the movement in shareholders' funds of the Company for the years ended 31 December 2007 and 2006 is given below:

	2007 £m	2006 £m
(Loss) profit for the year	(17)	834
Dividends	(426)	(398)
	(443)	436
Actuarial gains recognised in respect of the pension scheme net of related tax (note 8)	66	83
New share capital subscribed (note 9)	182	336
Net movement in shareholders' funds	(195)	855
Shareholders' funds at beginning of year	3,312	2,457
Shareholders' funds at end of year	3,117	3,312

11 Other information

a Information on directors' remuneration is given in the directors' remuneration report section of this Annual Report and note I3 'Key management remuneration' of the notes on the financial statements of the Group.

b Information on transactions of the directors with the Group is given in note I5 'Related party transactions' of the notes on the financial statements of the Group.

c The Company employs no staff.

d Fees payable to the Company's auditor for the audit of the Company's annual accounts were £0.1 million (2006: £0.1 million). In addition, the Company paid fees for other services of £0.2 million (2006: £0.6 million), which were wholly for services relating to corporate finance transactions.

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

12 Post balance sheet events

A final dividend of 12.30 pence per share was proposed by the directors on 13 March 2008. Subject to shareholders' approval, the dividend will be paid on 20 May 2008 to shareholders on the register at the close of business on 11 April 2008. The dividend will absorb an estimated £304 million of shareholders' funds. A scrip dividend alternative will be offered to shareholders. There have been no other significant events affecting the Company since the balance sheet date.