Registered No: 15454

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Annual Report and Accounts 2002

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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

Registered office: 142 Holborn Bars, London EC1N 2NH

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THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Directors

J W Bloomer (Chairman)
D J Belsham
N A Berkett
P A J Broadley
R J Field
T J W Tookey
G M Wood

Secretary

R Walker

Auditors

KPMG Audit Plc, London

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2002

Principal activity and business review

The principal activity of the Company is transacting long-term insurance business in the United Kingdom and overseas. The general insurance business operation in the United Kingdom was sold to Winterthur Swiss Insurance Company and Churchill Management Limited, its UK subsidiary on 4 January 2002. On 31 December 2002 the business of Scottish Amicable Life plc transferred into the Company following a part VII transfer under the Financial Services and Markets Act 2000. The Company also owns subsidiary undertakings and branches that transact insurance business in the United Kingdom and overseas. These activities will continue in 2003.

Subsidiary undertakings and branches

Particulars of the Company's principal subsidiary undertakings at 31 December 2002 are shown on *page 21 in note 15. At 31 December 2002 the Company had branches outside the United Kingdom in* Hong Kong and France.

Accounts

The state of affairs of the Company at 31 December 2002 is shown in the balance sheet on pages 9 and 10. The profit and loss account appears on pages 5 to 7.

Dividends

An interim dividend was declared for 2002 of £380m (2001: Nil). The directors have not declared a final dividend for 2002 (2001:Nil).

Payment policy

The Company does not follow any code or standard on payment practice with its suppliers but it is the policy of the Company to agree terms of payment when orders for goods or services are placed and to pay in accordance with those terms. Trade creditor days, based on the ratio of trade creditors at the year end to the amounts invoiced by trade creditors during the year, were 22 days (2001: 22 days).

Directors

The present directors are shown on page 1.

Mr A R Cook resigned as a director on 28 June 2002. Mr N A Berkett and Mr T J W Tookey were appointed directors of the Company on 15 July 2002 and 2 September 2002 respectively and in accordance with the Articles of Association retire at the Annual General Meeting and offer themselves for election. Mr M J Moores resigned as a director on 2 September 2002. Mr K S Lerche-Thomsen resigned as a director on 5 September 2002. There were no other changes during the year.

Directors' interests

Of the directors in office at the end of the year, Mr J W Bloomer, Mr P A J Broadley and Mr G M Wood were also directors of Prudential plc, the immediate and ultimate holding company of the Company and their interests are shown in the annual report and accounts of that company.

The other directors in office at the end of the year had interests in shares of 5p each in Prudential plc as follows:

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2002 (continued)

Directors' interests (continued)

(a) in shares, including shares awarded under the Prudential Share Participation Plan and shares allocated under the Prudential Restricted Share Plan:

	1.1.2002	31.12.2002
D J Belsham	53,918	56,085
R J Field	77	96

(b) under the Prudential Restricted Share Plan, in which shares are held in trust and represent the maximum award that can be allocated if the performance requirements of the Plan are met:

	1.1.2002 or at date of *appointment if later*	31.12.2002
D J Belsham	28,921	34,262
N A Berkett	-	10,873
R J Field	11,275	27,765
T J W Tookey	-	4,959

(c) in options to subscribe for shares under the Prudential Savings-Related Share Option Scheme:

	1.1.2002 or at date of appoint-ment if later	Granted in 2002	Exercised in 2002	Cancelled in 2002	31.12.2002
D J Belsham	1,564	1,169	-	-	2,733
N A Berkett	-	2,731	-	-	2,731
R J Field	3,022	5,130	-	3,022	5,130
T J W Tookey	-	4,747	-	-	4,747

The above directors in office at the end of the year also had interests in the 50p shares of Egg plc, a listed subsidiary of Prudential plc as follows:

	1.1.2002	31.12.2002
D J Belsham	1,410	1,410

Except as stated above, none of the directors in office at the end of the year:

(a) had any interest in shares in, or debentures of, any group company either at the beginning of the year or at their later date of appointment or at the end of the year; or (b) was granted or exercised any right to subscribe for shares in, or debentures of, any group company during the year or, if appointed during the year, since the date of their appointment up to the end of the year.

Employees

The following information is given in respect of the employees of the Company in the United Kingdom. The policy towards employees overseas is the same but the practical application of the policy varies according to local requirements.

Equal Opportunity

The Company recognises, respects and values difference and diversity. Its equal opportunities policy is to be fair, responsible and caring in all aspects of our business. The Company seeks to ensure all employees and applicants to its businesses are given equal opportunity in all aspects of employment to ensure that the Company's businesses attract, retain and promote the best available talent. All the businesses work to embed these principles in all aspects of their management practices and to ensure that this is evident to employees in their day to day work. It is the Company's policy to give full and fair consideration and encouragement to the employment of applicants with suitable aptitudes and abilities, and to continuing the employment of staff who become disabled, and to provide training and career development opportunities to disabled employees.

Employee Involvement

The Company has effective communication channels through which employees' views can be sought on issues which concern them. Throughout the Company there is close consultation between management and other employees on appropriate matters of concern, with a view to keeping employees informed about the progress of the Company's business and the economic factors affecting it. Communication with employees is achieved in a number of ways, including staff briefings and through the Prudential's intranet site. Prudential's European Employee Forum provides an opportunity for elected staff representatives to consult with senior management on strategic European business issues. Each Prudential business in Europe is represented on the Forum. In 2002 employees were again invited to participate in the Prudential Savings-Related Share Option Scheme. The scheme has now been operating for over 19 years.

The trustees of each of the Company's UK pension schemes include individuals elected by the members of those schemes.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

On behalf of the Board of directors

R Walker

R Walker
Secretary
21 March 2003

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2002

Note	General Business Technical Account		2002 £m	2001 £m
1b	Gross premiums written			
		Continuing operations	**19**	17
		Discontinued operations	**330**	390
			349	407
8	Outward reinsurance premiums		**(336)**	(339)
	Premiums written, net of reinsurance		**13**	68
	Change in the gross provision for unearned premiums		**40**	(26)
	Change in the provision for unearned premiums, reinsurers' share		**(7)**	158
8	Earned premiums, net of reinsurance		**46**	200
	Claims paid			
		Gross amount	**(236)**	(266)
		Reinsurers' share	**215**	8
	Claims paid, net of reinsurance		**(21)**	(258)
	Change in provision for claims			
		Gross amount	**7**	37
		Reinsurers' share	**(7)**	158
		Net of reinsurance	**-**	195
	Claims incurred, net of reinsurance		**(21)**	(63)
	Change in other technical provisions, net of reinsurance		**-**	1
4	Net operating expenses (includes re-engineering costs of nil (2001 £7m)		**(39)**	(101)
7	Change in the equalisation provision		**7**	(2)
1b	**Balance on the general business technical account**		**(7)**	35
	Analysis:			
	Continuing operations		**1**	1
8	Discontinued operations		**(8)**	34
			(7)	35

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Profit and Loss Account for the year ended 31 December 2002 (continued)

Note	Long-term Business Technical Account	2002 £m	2001 £m
1a	Gross premiums written	**6,440**	6,540
	Outward reinsurance premiums	**(1,430)**	(1,058)
	Earned premiums, net of reinsurance	**5,010**	5,482
2	Investment income	**4,375**	6,610
	Claims paid		
	Gross amount	**(7,510)**	(6,982)
	Reinsurers' share	**985**	928
	Claims paid, net of reinsurance	**(6,525)**	(6,054)
	Change in provision for claims		
	Gross amount	**15**	36
	Reinsurers' share	**-**	1
	Claims incurred, net of reinsurance	**(6,510)**	(6,017)
	Long-term business provision		
	Gross amount	**1,115**	(3,963)
	Reinsurers' share	**596**	623
		1,711	(3,340)
	Technical provision for linked liabilities	**53**	38
	Change in other technical provisions, net of reinsurance	**1,764**	(3,302)
4	Net operating expenses (includes re-engineering costs of £29m (2001 £154m)	**(977)**	(1,300)
5	Investment expenses and charges	**(292)**	(319)
	Unrealised losses on investments	**(9,332)**	(8,963)
6	Tax attributable to the long-term business	**715**	357
	Transfer from the fund for future appropriations	**5,580**	7,758
	Balance on the long-term business technical account	**333**	306

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

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Profit and Loss Account for the year ended 31 December 2002 (continued)

Note	Non-Technical Account	2002 £m	2001 £m
	Balance on the general business technical account	(7)	35
	Balance on the long-term business technical account	333	306
6	Tax credit attributable to the balance on the long-term business technical account	98	133
1a	Balance on the long-term business technical account before tax	431	439
2	Investment income	313	59
	Unrealised losses on portfolio investments	(216)	(47)
28	Other income	167	5
13	Amortisation of goodwill	(33)	(33)
	Other charges	(20)	(3)
1c	Total profit (loss) on other activities	211	(19)
8	Discontinued activities - profit on sale of UK general insurance operations	322	-
9	Profit on disposal of subsidiary undertaking	92	-
	Profit on ordinary activities before tax	1,049	455
6	Tax on profit on ordinary activities	(117)	(129)
	Profit for the financial year	932	326
	Dividends		
	Interim paid	(380)	-
		(380)	-
22	**Retained profit for the financial year**	552	326

There is no material difference between the results for the current year and the previous year as described in the profit and loss account and the results on an unmodified historical cost basis. Accordingly, a note of the historical cost profits and losses for the year is not given.

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Statement of Total Recognised Gains and Losses for the year ended 31 December 2002

Note		2002 £m	2001 £m
	Profit for the financial year	**932**	326
	Other recognised gains and losses:		
22	(Decrease) increase in surplus on revaluation of investments in shareholder subsidiaries and associate undertaking	**(292)**	114
	Exchange adjustments	**(2)**	-
	Total recognised gains relating to the financial year	**638**	440

Reconciliation of Movement in Shareholders' Funds for the year ended 31 December 2002

Note		2002 £m	2001 £m
	Profit for the financial year	**932**	326
	Dividends	**(380)**	-
	Increase on issue of shares	**-**	1
22	*(Decrease) increase in surplus on revaluation of investments* in shareholder subsidiaries and associate undertaking	**(292)**	114
	Exchange adjustments	**(2)**	-
	Net movement in shareholders' funds	**258**	441
	Shareholders' funds at beginning of year	**2,197**	1,756
	Shareholders' funds at end of year	**2,455**	2,197

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Balance sheet as at 31 December 2002

Note	Assets	2002 £m	2001 £m
13	Intangible assets		
	Licence	**173**	180
	Goodwill	**163**	196
		336	376
	Investments		
14	Land and buildings	**10,164**	9,910
15	Investments in group undertakings and participating interests	**2,808**	2,936
16	Other financial investments	**57,783**	66,105
		70,755	78,951
17	Assets held to cover linked liabilities	**5,064**	330
18	Reinsurers' share of technical provisions		
	Provision for unearned premiums	**157**	164
	Long-term business provision	**7,589**	6,576
	Claims outstanding	**196**	206
	Technical provisions for linked liabilities	**1,419**	3,772
		9,361	10,718
	Debtors		
	Debtors arising out of direct insurance operations		
	Policyholders	**201**	210
	Intermediaries	**2**	2
	Debtors arising out of reinsurance operations	**14**	18
19	Other debtors	**726**	371
		943	601
	Other assets		
	Tangible assets	**39**	48
	Cash at bank and in hand	**374**	554
		413	602
	Prepayments and accrued income		
	Accrued interest and rent	**560**	539
	Deferred acquisition costs		
	General business	**2**	29
	Long-term business	**1,347**	1,331
	Other prepayments and accrued income	**11**	17
		1,920	1,916
20	**Total assets**	**88,792**	93,494

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Balance sheet as at 31 December 2002 (continued)

Note	Liabilities	2002 £m	2001 £m
	Capital and reserves		
21	Share capital	**76**	76
22	Revaluation reserve	**450**	742
22	Other reserves	**535**	535
	Profit and loss account		
	Distributable	**1,203**	559
	Non-distributable	**191**	285
22		**1,394**	844
	Shareholders' funds - equity interests	**2,455**	2,197
23	Fund for future appropriations	**7,683**	13,249
	Technical provisions		
	Provision for unearned premiums	**162**	202
30	Long-term business provision	**69,044**	69,274
24	Claims outstanding	**751**	764
7	Equalisation provision	**33**	40
	Other technical provisions	**-**	2
	Total technical provisions	**69,990**	70,282
	Technical provisions for linked liabilities	**6,483**	4,102
29	Deposits received from reinsurers	**70**	-
29	Value of future margins relating to advances from reinsurers	**(70)**	-
	Provisions for other risks and charges		
6	Deferred taxation	**775**	1,860
	Creditors		
	Creditors arising out of direct insurance operations	**61**	259
	Creditors arising out of reinsurance operations	**185**	336
25	Other creditors including taxation and social security	**1,160**	1,209
		1,406	1,804
	Total liabilities	**88,792**	93,494

The accounts on pages 5 to 29 were approved by the Board of directors on 21 March 2003.

J W Bloomer
Chairman

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Accounting Policies

A. Basis of Preparation

The financial statements are prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985. The financial statements comply with applicable accounting standards and the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 1998, and have been prepared under the historical cost accounting rules, modified to include the revaluation of investments.

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

The Company has taken advantage of the exemption under FRS1 (Revised) from preparing a cash flow statement.

B. Long-term Business

(i) Premiums and annuity considerations are accounted for when due. For unit linked business, premiums are accounted for when the liabilities arising from the premiums are created. Premiums exclude any taxes or duties based on premiums. Pensions annuity contracts that vest during the year are included in claims incurred and premium income at the annuity purchase price.

(ii) Maturity claims are accounted for on the policy maturity date. Annuities are accounted for when the annuity becomes due for payment. Surrenders are accounted for when paid and death claims when notified.

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

(iv) The costs of acquiring new insurance contracts, principally commission and certain costs associated with policy issue and underwriting, which are not matched by policy charges are amortised against margins in future revenues on the related insurance contracts.

(v) Investment income and realised and unrealised investment gains attributable to long-term business are credited to the long-term business technical account.

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

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

(viii) For accumulating with-profits business the calculation of the long-term business provision is described in note 30 of the financial statements. One element of the calculation is a gross premium bonus reserve valuation under which future reversionary bonuses are added to the guaranteed liabilities existing at the valuation date. The provision is then calculated as the present value of future policyholder benefits plus the present value of future expenses. An addition is made in respect of future premiums if this produces a higher provision. The assumptions to which the estimation of the long-term business provision is particularly sensitive are the assumed future reversionary bonuses, the interest rate used to discount the provision, the assumed future per policy expenses and the assumed future mortality experience of policyholders.

Accounting Policies (continued)

For traditional with-profits and other non-linked business the net premium valuation method has been used to calculate the long-term business provision. The net premium is calculated such that it would be exactly sufficient at the outset of the policy to provide only for the discounted value of the original guaranteed death and maturity benefits. The provision is then calculated by subtracting the present value of future net premiums from the present value of future benefits (including bonuses added up to the valuation date) using a prudent discount rate. The assumptions to which the estimation of the long-term business provision is particularly sensitive are the interest rate used to discount the provision and the assumed future mortality experience of policyholders. These are disclosed in note 30 of the financial statements.

C. General Business

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

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

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

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

(v) An equalisation provision has been established in accordance with the requirements of the Insurance Companies (Reserves) Act 1995 in order to reduce the impact of claims volatility.

(vi) Investment income and investment gains earned on assets matching general business provisions and related solvency capital are credited to the non-technical account.

(vii) Transactions in respect of discontinued general business operations are accounted for within the general business technical account.

(viii) Certain long-tail liabilities in respect of discontinued operations with mean terms of settlement of at least four years are discounted to take account of the extended settlement period.

D. Investments

(i) Investment income and realised and unrealised gains in respect of long-term business are included in the long-term business technical account. Other investment income and realised gains and, except in respect of shareholder investments in subsidiaries and associates, unrealised gains are included in the non-technical account.

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

(ii) Shareholder investments in subsidiaries and associates that undertake long-term business are shown at current values using the achieved profits basis shareholders' funds. Investments in other subsidiaries are valued at net asset value. The movement in values is taken to the revaluation reserve. Investments in participating interests are carried at fair value.

(iii) Other investments are shown at market value. Properties are valued annually by the Prudential group's qualified surveyors or by professional external valuers at market value. In accordance with SSAP 19, no depreciation is provided on investment properties as the *directors consider that to depreciate them would not give a true and fair view.* Depreciation is only one of the factors reflected in the valuations and the amount that might otherwise have been shown cannot reasonably be separately identified or quantified. For unlisted securities, market value is estimated by the directors.

E. Tax

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.

F. Foreign Currencies

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

G. Tangible Assets

Tangible assets, principally computer equipment, software development expenditure and fixtures and furniture, are capitalised and depreciated by equal annual instalments over their estimated useful lives.

H. Pension Costs

Charges in respect of employers' contributions to defined benefit schemes are calculated on a basis that spreads the costs over the service lives of scheme members. Contributions in respect of defined contribution schemes are recognised when incurred.

I. Intangible Assets

Intangible assets, including goodwill representing the excess of the fair value of the consideration given over the fair value of the separable net assets acquired, is capitalised in the balance sheet at cost and amortised through the profit and loss account on a straight line basis over its useful economic life. The gain or loss on subsequent disposal of a subsidiary or associated undertaking will include any attributable unamortised goodwill.

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Accounting Policies (continued)

J Financial reinsurance

Reinsurance covering the financing of initial expenses is shown as a liability and the value of future margins out of which the financing will be repaid is shown in the balance sheet as an asset of an equal amount using a linked presentation. Under the terms of the reinsurance contracts, the Company is under no obligation to repay the liability to the reinsurer to the extent that the actual level of margins is insufficient.

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Notes on the accounts

1. **Segmental analysis**

(a) Long-term business

Premiums and profit	**Gross premiums written**		**Balance on the technical account before tax**	
	2002 £m	2001 £m	**2002 £m**	2001 £m
United Kingdom	**5,942**	6,203	**429**	442
Hong Kong	**395**	294	**8**	6
France	**103**	43	**(6)**	(9)
	6,440	6,540	**431**	439

New business	**Regular premiums**		**Single premiums**	
	2002 £m	2001 £m	**2002 £m**	2001 £m
United Kingdom	**171**	174	**3,650**	3,411
Hong Kong	**74**	59	**143**	89
France	**-**	-	**103**	43
	245	233	**3,896**	3,543

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

Analysis of premium income	**2002 £m**	2001 £m
Gross written premiums:-		
Direct	**5,908**	6,120
Reinsurance accepted	**532**	420
	6,440	6,540
Analysis of gross direct premiums:-		
Individual business	**5,006**	5,232
Group contracts	**902**	888
	5,908	6,120
Regular premiums	**2,423**	2,879
Single premiums	**3,485**	3,241
	5,908	6,120
Participating contracts	**5,536**	5,870
Non-participating contracts	**156**	121
Linked long-term contracts	**216**	129
	5,908	6,120
United Kingdom	**5,477**	5,783
Hong Kong	**395**	294
France	**36**	43
	5,908	6,120

Net reinsurance income/expenditure

Net reinsurance income in respect of long-term business for the year ended 31 December 2002 was (£92m) (2001 £274m).

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Notes on the accounts (continued)

1. **Segmental analysis (continued)**

(b) **General business**

Premiums and underwriting result		Gross premiums written **2002 £m**	Gross premiums written 2001 £m	Underwriting result **2002 £m**	Underwriting result 2001 £m
Continuing operations	Hong Kong	**19**	17	**1**	1
Discontinued operations	United Kingdom	**330**	390	**(8)**	34
		349	407	**(7)**	35

Analysis of technical account	Gross premiums written **2002 £m**	Gross premiums written 2001 £m	Gross premiums earned **2002 £m**	Gross premiums earned 2001 £m	Gross claims incurred **2002 £m**	Gross claims incurred 2001 £m	Gross operating expenses **2002 £m**	Gross operating expenses 2001 £m	Reinsurance balance **2002 £m**	Reinsurance balance 2001 £m
Motor										
-third party liability	**2**	2	**1**	2	**1**	1	**-**	-	**-**	(1)
-other classes	**68**	82	**75**	73	**50**	61	**6**	16	**(18)**	(34)
Marine, aviation and transport	**-**	-	**-**	-	**3**	-	**1**	2	**-**	-
Fire and other damage	**264**	272	**271**	272	**167**	153	**15**	71	**(97)**	33
Other	**15**	51	**42**	34	**8**	14	**10**	13	**(20)**	(13)
	349	407	**389**	381	**229**	229	**32**	102	**(135)**	(15)

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

Notes on the accounts (continued)

1. Segmental analysis (continued)

(c) Net assets and shareholders' other income and funds

A segmental analysis of the technical provisions net of reinsurance is set out below which provides a more useful indication than net assets of the assets supporting the business.

Technical provisions (net of reinsurance)	Long-term business		General business	
	2002 £m	2001 £m	2002 £m	2001 £m
United Kingdom	65,869	62,614	172	214
Other countries	1,057	824	14	14
Total	66,926	63,438	186	228

Long-term business technical provisions include the transfer of the liabilities of Scottish Amicable Life plc.

Shareholders' other income and shareholders' funds, taking into account the location of business operations of subsidiaries, relate to the following countries:-

Shareholders' other income and funds	Shareholders' other income		Shareholders' funds	
	2002 £m	2001 £m	2002 £m	2001 £m
United Kingdom	197	(35)	1,739	1,416
Singapore	-	-	584	438
Malaysia	13	14	-	218
Taiwan	1	2	78	78
Other countries	-	-	54	47
	211	(19)	2,455	2,197

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Notes on the accounts (continued)

2. Investment income

	Long-term business		Non-technical account	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Income from:				
Group undertakings	**8**	1	**93**	7
Other investments				
Land and buildings	**770**	751	**-**	-
Listed investments	**2,398**	2,338	**11**	15
Unlisted investments	**141**	113	**-**	-
Other investments	**228**	271	**11**	13
Transfer of Scottish Amicable Life plc long term business net assets	**64**	-	**-**	-
	3,609	3,474	**115**	35
Gains on the realisation of investments	**243**	2,988	**198**	24
Exchange gains	**523**	148	**-**	-
	4,375	6,610	**313**	59

3. Bonuses

Bonuses added during the year are included in the change in the long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses was £2,955m (2001 £3,483m).

4. Net operating expenses

	Long-term business		General business	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Depreciation	**15**	10	**-**	2
Acquisition costs	**529**	562	**6**	50
Change in deferred acquisition costs	**69**	102	**27**	(13)
Administrative expenses	**357**	619	**6**	62
Amortisation of license	**7**	7	**-**	-
	977	1,300	**39**	101

Acquisition costs include commissions in respect of long-term direct insurance business of £208m (2001 £148m) and general direct insurance business of £13m (2001 £26m).

Administrative expenses include re-engineering costs of £29m (2001 £154m) in the long-term business technical account and nil (2001 £7m) in the general business technical account.

5. Investment expenses and charges

	Long-term business		Non-technical account	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Investment management expenses	**264**	285	**-**	-
Interest on bank borrowings	**28**	34	**-**	-
	292	319	**-**	-

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the accounts (continued)

6. Tax

a) Tax (credited)/charged to long-term business technical account and non-technical account	Attributable to long-term funds		Attributable to shareholders' profits	
	2002 £m	2001 £m	2002 £m	2001 £m
Current Tax				
UK corporation tax	283	320	66	25
Double tax relief	(18)	(27)	(4)	(1)
Overseas tax	32	32	4	1
Prior year adjustments	13	26	15	(14)
Total current tax	310	351	81	11
Deferred tax				
Origination and reversal of timing differences	(1,025)	(708)	(62)	(15)
Total deferred tax	(1,025)	(708)	(62)	(15)
Shareholders' attributable tax	-	-	98	133
Tax (credit)/charge on profit on ordinary activities	(715)	(357)	117	129

b) Factors affecting tax charge for the period	2002 £m	2001 £m
Profit on ordinary activities before tax	1,049	455
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30.00% (2001 30.00%)	315	137
Tax credit attributable to the balance on the long-term business technical account	(98)	(133)
Permanent differences	12	(1)
Deferred tax recognised in period	62	17
Adjustment to current tax in respect of previous periods	15	(15)
Difference between realised gains and capital gains tax basis	(3)	-
Franked investment income	(25)	(5)
Amortisation of goodwill not tax effective	10	10
Prior year underprovision	-	2
Difference in tax rates	(19)	(3)
Utilisation of capital losses against profits on sale of UK GI business	(97)	-
Non taxable sale of subsidiary	(28)	-
Non-taxable transfer of assets and liabilities from Scottish Amicable Life plc	(68)	-
No deferred tax provided on losses	2	
Other	3	2
Current tax charge for the period	81	11

c) Balance Sheet	Attributable to long-term funds		Attributable to shareholders' funds	
	2002 £m	2001 £m	2002 £m	2001 £m
Provision for Deferred Tax				
Accelerated capital allowances	(11)	(20)	(1)	(2)
Policy reserves	24	-	-	-
Short term timing differences	15	-	1	7
Unrealised gains	752	1,805	-	57
Deferred acquistion costs	(5)	13	-	-
Undiscounted provision for deferred tax liability	775	1,798	-	62
Deferred tax liability at start of the period	1,798	2,506	62	77
Deferred tax (credited) in technical/ non-technical account for the period	(1,025)	(708)	(62)	(15)
Transfer from Scottish Amicable Life plc	2	-	-	-
Deferred tax liability at end of the period	775	1,798	-	62

Notes on the accounts (continued)

7. Equalisation provision

An equalisation provision has been established in accordance with the requirements of the Insurance Companies (Reserves) Act 1995. The provision, which is in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date, is required by Schedule 9A of the Companies Act 1985 to be included within technical provisions in the balance sheet, notwithstanding that it does not represent a liability at the balance sheet date. This has had the effect of reducing shareholders' funds by £33m (2001 £40m). The movement in the equalisation provision during the year resulted in a increase in the general business technical account result and the profit before taxation of £7m (2001 decrease of £2m).

8. Discontinued activities

The Company completed the transfer of its UK general insurance business operations to Winterthur Swiss Insurance Company and Churchill Management Limited, its UK subsidiary on 4 January 2002 for a consideration of £353m. After allowing for the costs of sale and other related items, the profit on sale was £322m before tax.
Discontinued operations comprise this business and commercial lines general insurance business closed in 1992 and now in run off.
The profit and loss account includes the following amounts in respect of these operations:

	2002 £m	2001 £m
Premiums earned, net of reinsurance	34	190
Claims incurred, net of reinsurance		
Claims paid	(15)	(248)
Change in provision for claims	-	188
Total	(15)	(60)
Net operating expenses	(34)	(96)
Change in the equalisation provision	7	-
Technical result	(8)	34
Investment return	8	(34)
Operating profit before tax	-	-

9. Disposal of subsidiary

The Company's investment in the Malaysia life operation was transferred at achieved profits value of £223m to Prudential Corporation Holdings Limited, a fellow subsidiary, in November 2002. After taking into account cost of £131m the profit on disposal was £92m.

10. Information on staff

The average number of persons employed by the Company during the year was:	2002	2001
United Kingdom	5,114	7,443
Hong Kong	480	288
	5,594	7,731

The costs of employment were:	2002 £m	2001 £m
Wages and salaries	174	222
Social security costs	13	20
Other pension costs (see below)	17	20
	204	262

The Company's main pension scheme is the Prudential Staff Pension Scheme which covers 97% of members in all Company schemes. As employees of other Group companies are members of these schemes it is not possible to identify the share of the fund surplus in each scheme which is specifically attributable to the Company. This scheme is of the defined benefit type with scheme assets held in separate trustee administered funds and was last valued as at 5 April 2002 by Watson Wyatt Partners. Particulars of this scheme are shown in the accounts of the parent company, Prudential plc. £0.8m (2001 £0.7m) of the pension costs related to overseas schemes.

11. Directors' emoluments

Directors' emoluments amounted to £2,531,000 (2001 £2,564,000). Two (2001 three) director's exercised share options during the year. Ten (2001 eleven) directors were entitled to shares under Prudential's main long term incentive scheme and to retirement benefits under defined benefit schemes. Three (2001 five) directors, being subject to the earnings cap, were also entitled to retirement benefits under money purchase schemes. However, the Company only bears the cost in the case of two (2001 three) directors which totalled £165,851 (2001 £153,000) of which £120,488 (2001 £56,000) relates to the highest paid director. The highest paid director's emoluments were £596,000, his accrued pension at the end of the year was £3,000 and he did not exercise any share options but did receive shares under long-term incentive schemes. The highest paid director in 2001 received emoluments of £734,000, his accrued pension at the end of the year was £1,000 and he did not exercise any share options but did receive shares under long-term incentive schemes.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the accounts (continued)

12. Auditors' remuneration

Fees payable to KPMG Audit Plc (KPMG) in respect of the statutory audit were £0.6m (2001 £0.5m). Fees payable to KPMG and its associates in respect of other work were £1.3m (2001 £9.6m)

13. Intangible assets

	Goodwill £m	Licence £m	Total £m
Balance at beginning of year	196	180	376
Amortised in year			
Charged to non-technical account	(33)	-	(33)
Charged to the long-term business technical account	-	(7)	(7)
Balance at end of year	163	173	336

The goodwill arose on the purchase by the Company of the Scottish Amicable Life Assurance Society on 30 September 1997 and is being amortised from 1 January 1998 over a period of 10 years.

The licence primarily represents the value of an agreement with a fellow subsidiary company for the use of certain Scottish Amicable assets, which is being amortised over a period of 20 years to 30 September 2017, on a basis consistent with the revenue stream from the agreement. Under this basis, the amortisation commenced in the year 2000, when the benefits from the agreement first started to arise. The licence also includes £25m in respect of the estimated net present value of income from current service agreements which are being amortised from 1 January 1998 over a period of 10 years.

14. Land and buildings

	2002 £m	2001 £m
Current value		
Freeholds	6,063	5,909
Leaseholds with a term of over 50 years	3,930	3,897
Leaseholds with a term of less than 50 years	171	104
	10,164	9,910
Cost	6,998	6,760

The value of land and buildings occupied by the Company amounted to £102m (2001 £129m).

15. Investments in group undertakings and participating interests

	Cost		Current value	
	2002 £m	2001 £m	2002 £m	2001 £m
Shares in group undertakings				
Long-term fund investments	846	795	1,448	1,193
Shareholder investments	706	816	1,117	1,520
	1,552	1,611	2,565	2,713
Participating interests				
Other participating interests	24	24	24	48
Loans to group undertakings				
Long-term fund loans	219	175	219	175
Total	1,795	1,810	2,808	2,936

The principal subsidiary undertakings of the Company at 31 December 2002, all wholly owned:

		Class of shares held	Principal activity	Country of incorporation
	The Prudential Assurance Company Singapore (Pte) Limited	Ordinary shares S$1	Insurance	Singapore
	Prudential Pensions Limited	Ordinary shares £1	Pensions	England and Wales
*	Prudential Annuities Limited	Ordinary shares £1	Pension annuities	England and Wales

* owned by the long-term fund

Other participating interests comprise:

	Class of shares held	Proportion held	Country of incorporation
Life Assurance Holding Corporation Limited	Ordinary shares 1p	15.3%	England and Wales

Life Assurance Holding Corporation Limited is not listed on a recognised investment exchange and is a holding company for companies that transact long-term insurance business.

Notes on the accounts (continued)

16. Other financial investments

	Cost		Current value	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Shares and other variable yield securities and units in unit trusts	**24,136**	24,899	**29,506**	40,116
Debt securities and other fixed income securities	**25,231**	23,095	**25,679**	23,374
Loans secured by mortgages	**66**	73	**76**	79
Loans to policyholders secured by insurance policies	**94**	104	**94**	104
Other loans	**72**	87	**90**	101
Deposits with credit institutions	**2,338**	2,331	**2,338**	2,331
	51,937	50,589	**57,783**	66,105

Amounts included in the above ascribable to listed investments:	**2002 £m**	2001 £m
Shares and other variable yield securities and units in unit trusts	**28,510**	39,291
Debt securities and other fixed income securities	**22,610**	20,725
	51,120	60,016

17. Assets held to cover linked liabilities

	Cost		Current value	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Assets held to cover linked liabilities (see note 28)	**5,697**	262	**5,064**	330

Assets held of cover linked liabilities have increased as a result of the transfer of the business of Scottish Amicable Life plc to the company.

18. Reinsurers' share of technical provisions

The reinsurers' share of the long-term business provision relates mainly to cessions to Prudential Annuities Limited, a subsidiary of the Company. The reinsurers' share of the technical provisions for linked liabilities relates mainly to cessions to other group companies. The reinsurers' share of the general insurance business technical provision relates mainly to cessions to Winterthur Swiss Insurance Company in connection with the sale of the Company's UK General Insurance operations during the year.

19. Other debtors

	2002 £m	2001 £m
Amounts owed by fellow subsidiaries	**500**	140
Amounts owed by subsidiary companies	**9**	11
Tax recoverable	**113**	49
Other	**104**	171
	726	**371**

20. Assets attributable to the long-term business fund

Of the total amount of assets shown in the balance sheet on page 9, £85,775m (2001 £90,310m) is attributable to the long-term business fund.

21. Share capital

The Company's authorised share capital is £1,087,500,000 comprising 350,000,000 ordinary shares of 25p each, of which 298,388,254 shares have been issued and fully paid and 1,000,000,000 Preference Shares of £1 each, of which 1,000,000 shares have been issued and fully paid. The Preference Shares issued shall be redeemed by the Company without notice on 8 May 2016 and carry the right to receive an index linked cumulative preferential dividend, payable annually. The Preference Shares carry no voting rights but carry preferential rights in priority to other shareholders to payment on a return of capital in the event of the winding up of the Company.

22. Shareholders' reserves

	Revaluation reserve	Other reserves	Profit and loss account	Total
	£m	£m	£m	£m
Balance at 1 January 2002	742	535	844	2,121
Exchange adjustments	-	-	(2)	(2)
Revaluation of subsidiaries	(292)	-	-	(292)
Retained profit for the year	-	-	552	552
Balance at 31 December 2002	450	535	1,394	2,379

The profit and loss account includes £181m (2001 £60m) held within the long-term business fund and £10m (2001 £225m) of unrealised appreciation on shareholder portfolio investments. These amounts are non-distributable.

Notes on the accounts (continued)

23. Fund for future appropriations

	2002 £m	2001 £m
Prudential Assurance Company with-profits fund	**7,246**	11,435
Scottish Amicable Insurance Fund (SAIF)	**437**	1,814
	7,683	13,249

The SAIF fund for future appropriations comprises amounts which are attributable, but not allocated, to SAIF policyholders.

24. Claims outstanding

To take account of the extended settlement period, discounting has been applied to certain asbestos, pollution and health hazard claims of the discontinued commercial lines general business operations. The discount rate is 4% per annum with the projected settlement periods ranging from 5 to 12 years depending on the claim category. The overall effect of discounting is to reduce the liabilities at 31 December 2002 by £10m (2001 £9m).

25. Other creditors including taxation and social security

	2002 £m	2001 £m
Amounts owed to fellow subsidiaries	**116**	240
Amounts owed to subsidiary companies	**303**	332
Tax	**300**	259
Other creditors	**441**	378
	1,160	1,209

26. Ultimate parent company

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

27. Related party transactions

The Company has taken advantage of the exemption under Paragraph 3(c) of Financial Reporting Standard 8 from disclosing transactions with other subsidiary undertakings of the Prudential group.

28. Transfer of Scottish Amicable Life plc

On 31 December 2002 the business of Scottish Amicable Life plc ('SAL') transferred into the Company following a Part VII transfer under the Financial Services and Markets Act 2000. The business transferred into the non-profit sub fund of the long-term business fund. Under the terms of the transfer scheme, assets to the value of £160.8m were transferred from the SAL long term fund into the other than long term fund of the Company, this amount is included in 'other income' in the non-technical account.

29. Financial reinsurance

The assets and liabilities relating to Financial Reinsurance treaties have been transferred from Scottish Amicable Life plc ('SAL') at 31 December 2002.

In December 2000, SAL entered into a reinsurance arrangement under which £125m of unit linked liabilities were ceded to the reinsurer. This was accounted for as a reduction in unit linked liabilities and credited to other technical income. Under the terms of the agreement, reassured amounts that become due to policyholders will be met out of future margins arising on the business in force at the time the reinsurance was effected. The reduction in unit linked liabilities under the agreement at 31 December 2002 was £75.9m and is included in the balance sheet within the reinsurer's share of technical provision for linked liabilities.

As security for the reinsurance agreement, the reinsurer made a loan back to the Company. The outstanding balance on the loan of £47.9m is included in other creditors. Under the reinsurance treaty it is possible that additional contingent liabilities may arise. At the 31 December 2002 the amount of such contingent liabilities was £23.6m.

There were also two financial reinsurance agreements relating to regular premium linked business and mortgage protection business. Sums received under these contracts together with interest are repayable out of margins on the business written that will emerge in the future. The balance outstanding at 31 December 2002 was £46.2m.

The reinsurance treaties have been included in the balance sheet as deposits from reinsurers and the value of future margins relating to these advances has been established as an asset using a linked presentation.

30. Long-term business provision

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

Accumulating with-profits business

The provision has been taken as the lower of:
- the accumulated fund or the value at the bid price of the notional number of units allocated to policyholders, in both cases excluding terminal bonus, and
- the surrender or transfer value which, having regard to policyholders' reasonable expectations, would be payable at the valuation date,

or, if greater, the value of the guaranteed liabilities excluding terminal bonus calculated on a gross premium bonus reserve method.

For the purpose of calculating the liability using the bonus reserve method, future reversionary bonuses are assumed to fall from current levels to zero in steps of 1.5% per year. Other elements of the basis are shown in the following table:

	Interest Rate %	Administration Expenses £ per annum	Actuarial Mortality Table Reference
UK (excluding Scottish Amicable Insurance Fund)			
Assurances	3.20	10.50 to 26.00	AM/AF92+1
Pension business – individual	4.00	22.50 to 34.69	AM92+1(m),-3(f)
Pension business – corporate:			
(i) With 2.5% p.a. guarantee	4.00	49.25 to 241.12	AM/AF92-3
(ii) With 4.75% p.a. guarantee	5.00	49.25 to 241.12	AM/AF92-3
(iii) Without guarantee	4.00	22.50 to 241.12	AM/AF92-3
Scottish Amicable Insurance Fund			
Assurances:			
(i) Home Purchaser Series 2 & 3	3.20	17.50	85% AM/AF80
(ii) Other	3.20	17.50	AM/AF92+1 plus 1/3 AIDS "R6A"
Pension business:			
(i) With guarantee	4.875	22.50 to 58.50	AM/AF92+1 plus 1/3 AIDS "R6A"
(ii) Without guarantee	4.00	22.50 to 58.50	AM/AF92+1 plus 1/3 AIDS "R6A"
Hong Kong			
Assurances	3.75	US$8.00	HKA93
Pension business:			
(i) Hong Kong $ guarantee fund	5.00	US$560.00	HKA93
(ii) Capital guarantee fund	0.00	US$560.00	HKA93
(iii) 3% guarantee fund	3.00	US$560.00	HKA93
(iv) 5% guarantee fund	5.00	US$560.00	HKA93
Other Overseas Business			
Direct written business	3.00	€76.88	TD8890(m),TV8890(f)
Reassurance accepted:			
(i) Euro denominated	3.00		
(ii) Sterling denominated	4.00		
(iii) US dollar denominated	4.00		

Traditional with-profits and other non-linked business

Provisions are calculated by the net premium valuation method on the following bases:

	Interest Rate %	Actuarial Mortality Table Reference
UK (excluding Scottish Amicable Insurance Fund)		
Ordinary branch with-profits assurances	3.00	AM/AF92+1
Industrial branch with-profits assurances	3.00	A1967/70+1
With-profits retirement annuities:		
(i) in deferment	5.00	AM92-3(m),-7(f)
(ii) in possession	4.50	70% PMA/PFA92(c=2003)
Term assurances - life business	3.00	AM/AF92+1
Term assurances - pensions business	4.00	AM/AF92+1
Scottish Amicable Insurance Fund		
With-profits assurances	3.00	AM/AF92+1 plus 1/3 AIDS "R6A"
With-profits retirement annuities:		
(i) Flexipension in deferment	5.00	AM/AF92-3
(ii) Flexipension in possession	4.00	70% PMA/PFA92(c=2003)
(iii) Other in deferment	4.50	AM/AF92+1 plus 1/3 AIDS "R6A"
(iv) Other in possession	4.00	70% PMA/PFA92(c=2003)
Term assurances - life business	3.00	AM/AF92+1 plus 1/3 AIDS "R6A"
Term assurances - pensions business	4.00	AM/AF92+1 plus 1/3 AIDS "R6A"
Annuities in payment	5.00	70% PMA/PFA92(c=2003)
Hong Kong		
With-profits assurances	3.75	AM/AF92
Non-profit assurances	3.75	AM/AF92

For retirement annuities, the interest rate used is adjusted where appropriate to allow for mortality improvements during deferment and for expenses.

For with-profits business, the net premium valuation has made explicit provision only for vested bonuses, including those vesting following the valuation at 31 December 2002.

Linked business

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

Discount Rate	4.0% gross, 3.2% net
Fund Growth	4.5% gross, 3.6% net
Mortality	AM/AF92+1 plus 1/3 AIDS "R6A" for most contracts
Expenses	£7.00 - £95.00 depending on the product type

Other long-term business provisions
Additional provisions have been established, the most significant being for the potential costs and expenses of compensating the Company's pension policyholders under the FSA review of pension opt-outs and transfer cases, for the potential cost of meeting annuity rate guarantees at vesting or on maturity of policies and for additional expenses, not otherwise catered for in the basic net premium valuation, of running off the industrial branch business.

31. Contingencies and Related Obligations

Consistent with FRS 12, "Provisions, contingent liabilities and contingent assets", appropriate provision has been made in the financial statements where the Company has an obligation arising from the events or activities described below but not for contingent liabilities.

Pension Mis-selling Review

(a) Provisions in respect of the costs associated with the pensions mis-selling review have been included in the change in the long-term technical provision in the Company's profit and loss account. Within the long-term technical provisions, the transfer from the FFA has been determined accordingly. The directors believe that, based on current information, the pension mis-selling provision, together with future investment return on the assets backing the provision, will be adequate to cover the costs of pension mis-selling as well as the costs and expenses of the Company's pension review unit established to identify and settle such cases. Such provision presents the best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased.

The calculation of the pension mis-selling provision is dependent upon a number of assumptions and requirements provided by the FSA. The costs associated with the pensions mis-selling review have been met from the inherited estate. Given the strength of the with-profits fund, the directors believe that charging the costs to the inherited estate will not have an adverse effect on the level of bonuses paid to policyholders or on their reasonable expectations. In the unlikely event of this proving not to be the case, an appropriate contribution to the with-profits fund would be made from the shareholders' funds.

In view of the uncertainty, it is not practicable to estimate the level of any potential contribution. The following is a summary of the changes in the pension mis-selling liability, including internal and external legal and administrative costs, for the years ended 31 December 2002 and 31 December 2001:

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
Balance at start of the year	1,065	1,475
Changes to actuarial assumptions and method of calculation	(50)	(89)
Discount unwind	53	89
Redress to policyholders	(292)	(273)
Payments of administrative costs	(46)	(137)
Balance at end of the year	730	1,065

Free Standing Additional Voluntary Contribution Business Review

(b) The review requires companies to identify relevant investors and contact them with an offer to review their individual case. The Company met an interim deadline set by the FSA of 90% of cases completed by 30 June 2002 and also the deadline for 100% completion by 31 December 2002. As a result of the review, the Company held a provision of £3m at 31 December 2002, (2001: £42m).

Mortgage Endowment Products Review

(c) The FSA issued a report in March 2001 raising concerns regarding Scottish Amicable Life plc ('SAL')'s conduct of sales of mortgage endowment products by its appointed representatives and in March 2003 it fined the Company £750,000 in respect of cases where advisers did not place appropriate emphasis on identifying whether a customer was prepared to take the risk that their mortgage might not be repaid at the end of the term. A provision of £25m was made in 2001 in the long term fund of SAL for cases that may require redress. The business of SAL (including the provision) transferred to the Company at 31 December 2002 and the directors are satisfied the current provision (£21m) continues to be adequate. SAL withdrew from the mortgage endowment product market in April 2001 and disbanded its network of appointed representatives in October 2001.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED
Notes on the accounts (continued)

Guaranteed Annuities

(d) The Company formerly sold guaranteed annuity products in the UK and held a provision of £46m at 31 December 2002, (2001: £34m), within the main with-profits fund to honour guarantees on these products. The Company's main exposure to guaranteed annuities in the UK is through the Scottish Amicable Insurance Fund ("SAIF") and a provision of £744m was held in SAIF at 31 December 2002, (2001: £758m) to honour annuity and other guarantees. SAIF is a separate sub-fund of the Company's long-term business fund. Accordingly, this provision has no impact on shareholders.

Guarantees and Commitments

(e) The Company has guaranteed up to £17.4m of a £100m loan issued by the Royal Bank of Scotland to Pension Advisors Support Systems (PASS) to assist independent financial advisors with their review of pension transfers and opt outs. Any amounts payable under this guarantee are recoverable from SAIF, and therefore there is no impact on shareholders.

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

Other Matters

Inherited Estate in the main with-profits fund.

(f) The inherited estate is the assets of the main with-profits fund within the long-term fund of the Company, less non-participating liabilities, the policyholder asset shares aggregated across with-profits policies and any additional amounts expected at the valuation date to be paid to in-force policyholders in the future in respect of smoothing costs and guarantees. The inherited estate is thus the assets in the main with-profits fund in excess of what the Company expects to pay to policyholders and other creditors.

The Company believes that it would be beneficial if there were to be greater clarity as to the status of the inherited estate. With that in mind, it has been considering the principles that would apply to any re-attribution of the inherited estate to either policyholders or shareholders. Discussions have been held with the FSA to this end. The Company has not considered or discussed any actual distribution as its current expectation is that, for the foreseeable future, the entire inherited estate will need to be retained within the long-term fund to provide working capital. Accordingly in the light of current market conditions, the amount and timing of any re-attribution of the estate remains very uncertain.

Shareholder Support of Long-term Business Funds

(g) As a proprietary insurance company, the Company is liable to meet its obligations to policyholders even if the assets of the long-term funds are insufficient to do so. The assets, represented by the Fund for Future Appropriations, in excess of amounts expected to be paid

for future terminal bonuses and related shareholder transfers ("excess assets") in the long-term funds could be materially depleted over time, by, for example, a significant or sustained equity market downturn, significant fundamental strategic change costs, or material increases in the pensions misselling provision. In the unlikely circumstance that the depletion of the excess assets within the long-term fund was such that the Company's ability to satisfy policyholders' reasonable expectations was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders' funds to the long-term funds to provide financial support.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED
Notes on the accounts (continued)

(h) Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the Company's long-term fund would be liable to cover any such deficiency. At 31 December 2002, the excess of SAIF assets over guaranteed benefits was £437m. Due to the quality and diversity of the assets in SAIF, the aforementioned amount of the excess of assets over guaranteed benefits and the ability of the company to vary future bonus rates in line with asset shares, the directors believe that the probability of either the Company's long-term fund or Prudential shareholders' funds having to contribute to SAIF is remote.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period.

In preparing those financial statements, the directors are required to:
- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- 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 proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. 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.

J W Bloomer
Chairman
21 March 2003

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

We have audited the financial statements on pages 5 to 29.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 Auditors

The directors are responsible for preparing the directors' report and, as described on page 30, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company is not disclosed.

Basis of Audit Opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2002 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London
21 March 2003