Report of the Actuarial Function Holder of

The Prudential Assurance Company Limited

on the proposed transfer of certain with-profits annuity business

from

Equitable Life Assurance Society

to

The Prudential Assurance Company Limited

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REPORT OF THE ACTUARIAL FUNCTION HOLDER OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED

The following is the report by D J Belsham, the Actuarial Function Holder of The Prudential Assurance Company Limited (PAC), to the Directors of PAC on the proposed transfer of certain with-profits annuity business from the Equitable Life Assurance Society (ELAS) to PAC.

1. INTRODUCTION

1.1 The purpose of this report is to review the proposed transfer of certain with-profits annuity business from ELAS to PAC (the "Transfer"). The Transfer will take effect by means of an insurance business transfer scheme (the "Scheme") under Part VII of the Financial Services and Markets Act 2000.

1.2 In this report, I have considered the Transfer primarily from the perspective of the policyholders of PAC. However, where appropriate, I have also commented on the implications of the Transfer for the transferring ELAS policyholders.

1.3 I am a Fellow of the Institute of Actuaries, having qualified in 1988, and hold a certificate issued by the Institute of Actuaries to act as a Life Actuary (including with-profits). I have been the PAC Appointed Actuary, and subsequently the PAC Actuarial Function Holder, since 1998. I am a Director of PAC, and a shareholder in PAC's ultimate owner, Prudential plc. Disclosure of my interests is provided in the Report & Accounts of The Prudential Assurance Company Limited.

1.4 Gerry Gallagher, the With-Profits Actuary of PAC, has reviewed this report and has provided a certificate indicating his agreement with the content insofar as it relates to the treatment of PAC's with-profits policyholders.

1.5 Tim Bateman, the Actuarial Function Holder and With-Profits Actuary of ELAS, is reporting on the proposed transfer from the perspective of the ELAS policyholders.

1.6 Steve Sarjant of Watson Wyatt Limited has been retained by PAC and ELAS to produce a report on the terms of the Scheme in the capacity of Independent Expert, and his appointment has been approved by the FSA. A copy of this report will be provided to Steve Sarjant who has had the opportunity to review various drafts of it.

1.7 This report is structured as follows:

- Section 2 sets out information on the current operation of PAC
- Section 3 sets out the financial position of PAC at 31 December 2006
- Section 4 sets out details of the proposed Transfer
- Section 5 sets out the impact of the Transfer on the financial position of PAC, assuming that the Transfer took place at 31 December 2006
- Section 6 sets out the impact of the Transfer on the transferring ELAS policyholders
- Section 7 sets out the impact of the Transfer on PAC policyholders
- Section 8 sets out my conclusions.

2. INFORMATION ON THE PRUDENTIAL ASSURANCE COMPANY LIMITED

2.1 Company information

2.1.1 PAC is a proprietary company, the shares of which are wholly owned by its immediate parent company, Prudential plc.

2.1.2 PAC's principal activity is long-term insurance business, which is written in the company's long-term fund; PAC also conducts some general insurance business, which is written in the company's shareholder fund.

2.1.3 PAC's long-term business consists of:

(i) life and annuity, pensions, permanent health, and linked long-term business, which is carried on in the Ordinary Branch; and

(ii) life business which is carried on in the Industrial Branch. The Industrial Branch was closed to new business on 1 January 1995.

The company's long-term business includes conventional with-profits, accumulating with-profits, non-linked non-profit and linked business. PAC's long-term business is predominantly with-profits, and is transacted mainly in the UK.

2.1.4 The company's UK business consists of:

(i) business written directly in PAC,

(ii) business transferred into PAC from the Scottish Amicable Life Assurance Society (SALAS) on 30 September 1997 and from Scottish Amicable Life plc (SAL) on 31 December 2002, and

(iii) business reassured into PAC from other insurance subsidiaries of Prudential plc, including Prudential (AN) Limited (PANL).

2.1.5 PAC also contains business written outside of the UK, comprising:

(i) business written by branches of PAC in Hong Kong, France and Malta, and

(ii) business reassured into PAC by other insurance subsidiaries of Prudential plc, including Prudential International Assurance plc (PIA), or by other external insurers.

2.1.6 Some of PAC's property-linked business is reassured to the internal linked funds of other life assurance companies, including other Prudential group companies, while most of PAC's non-profit and index-linked annuities in payment are reassured to Prudential Annuities Limited (a wholly-owned subsidiary of the PAC long-term fund) or Prudential Retirement Income Limited (which is owned by the shareholder fund of PAC).

2.1.7 New business in the UK is currently distributed primarily through intermediaries, business to business or direct to the customer. However, substantial volumes of business have also historically been distributed through the company's own salesforce.

2.1.8 The PAC long-term fund is divided into four sub-funds to facilitate the management of the various risk-bearing and profit-sharing arrangements that apply.

The Prudential Assurance Company Limited (PAC)					
Shareholder Fund		Long-Term Fund			
General Insurance Fund	Other	With-Profits Sub-Fund (WPSF) “90:10”	Defined Charge Participating Sub-Fund (DCPSF) “100:0”	Scottish Amicable Insurance Fund (SAIF) “100:0”	Non-Profit Sub-Fund (NPSF) “0:100”

This diagram does not indicate relative sizes

These sub-funds are described in section 2.2 below.

2.2 Long term fund structure

2.2.1 PAC's Articles of Association provide for the Directors to identify the profits arising on different blocks of business, and (within certain constraints) to attribute those profits between policyholders and shareholders. These powers have been applied, and the profits emerging in PAC's long-term business fund are identified and allocated as follows:-

2.2.1.1 With-Profits Sub-Fund (WPSF)

The With-Profits Sub-Fund (WPSF) consists mainly of with-profits business, which comprises:

(i) business written by PAC, both Ordinary Branch (including Hong Kong and Malta) and Industrial Branch,

(ii) business written by Scottish Amicable Life plc (SAL), and transferred into PAC, and

(iii) business written by Prudential (AN) Limited (PANL), and reassured into PAC.

The WPSF also contains a small amount of non-profit business, which consists of:

(i) the non-profit (including unit-linked business) written by PAC that is not allocated by the Directors to the Non-Profit Sub-Fund (see section 2.2.1.4 below), and

(ii) certain types of business originally written by the Scottish Amicable Life Assurance Society and now contained in the Scottish Amicable Account.

The WPSF contains the PAC inherited estate, which consists of assets in the fund over and above the amounts that the company would expect to pay out over time to existing policyholders as claim values (see section 2.7 below).

Divisible profit arising in the WPSF, including profit that arises on the non-profit business in the WPSF, is divided between with-profits policyholders and shareholders. The Articles of Association permit up to 5% of the divisible profit to be transferred to a common contingency fund before the balance is divided between policyholders and shareholders. The proportion of divisible profit attributable to with-profits policyholders in the WPSF is defined by the Articles of Association as being at least 90%, with the balance attributable to shareholders. For virtually all business, the policyholders' proportion is currently 90%. Thus the WPSF is a "90:10" fund.

2.2.1.2 Defined Charge Participating Sub-Fund (DCPSF)

The Defined Charge Participating Sub-Fund (DCPSF) consists solely of the accumulated investment content of premiums paid in respect of Defined Charge Participating business, which comprises:

(i) business reassured into PAC from Prudential International Assurance plc (PIA) or other companies, and

(ii) business written through PAC's French branch (between 1 January 2001 and 31 December 2003).

Defined Charge Participating business is defined as with-profits business on which policyholders incur only the charges stated explicitly in the policy (which include an annual management charge on the assets held within the DCPSF). These charges accrue to the Non-Profit Sub-Fund (NPSF), which bears all expenses; hence the shareholders receive any profits or losses arising from the difference between the charges and expenses on this business.

A bonus smoothing account for this business is maintained in the inherited estate within the WPSF. The bonus smoothing account is credited or debited as appropriate with any difference between claim payments made from the DCPSF and the relevant policies' underlying asset shares. It is intended that these smoothing transfers should generate no net gain to either sub-fund over the long term.

The profit in the DCPSF arises solely from investment performance, and is entirely attributable to DCPSF policyholders i.e. the DCPSF is a "100:0" fund.

2.2.1.3 Scottish Amicable Insurance Fund (SAIF)

The Scottish Amicable Insurance Fund (SAIF) is a closed sub-fund that contains the bulk of the business originally written by the Scottish Amicable Life Assurance Society (SALAS) and acquired by PAC on 30 September 1997. The balance of SALAS's business was transferred to the WPSF and is allocated to the Scottish Amicable Account (SAA). The with-profits investment element of SAA policies (i.e. the accumulation of premiums less charges) is invested in SAIF, and is thus managed with all other SAIF with-profits policies.

SAIF also contains the SAIF inherited estate. This inherited estate consists of assets in the fund over and above the amounts that the company would normally expect to pay out over time to SAIF and SAA policyholders, if the fund had remained open to new business. Under the terms of the SALAS Scheme, the SAIF inherited estate will be distributed to the SAIF and SAA with-profits policyholders as an addition to the with-profits benefits arising in SAIF.

SAIF is provided with financial support from the WPSF by means of the Scottish Amicable Capital Fund (SACF), in return for an annual charge. SACF is treated as part of the free assets of SAIF for the purposes of setting SAIF's bonus and investment policy. However, SACF remains in the WPSF and does not form part of the SAIF inherited estate. SACF cannot exceed 15 per cent of the with-profits fund in SAIF, and will reduce in size as the SAIF fund reduces as a result of policyholder pay-outs. SACF would be used to fund any final deficit in the SAIF bonus smoothing account, which is managed in accordance with the SAIF Principles of Financial Management set out in the Scheme that transferred SALAS into PAC, and could in extremis be required to meet the cost of guarantees arising on policies in SAIF.

The Scheme which transferred SALAS into PAC states that the Scottish Amicable Funds (i.e. SAIF and SACF) must be managed in accordance with specified SAIF Principles of Financial Management (PFM). These Principles include the over-arching provision that the Scottish Amicable Funds should be managed in a sound and prudent fashion, and provide a framework for setting bonus and investment policy for the Scottish Amicable Funds on a basis that is fair to both SAIF and SAA policyholders and other PAC policyholders.

The whole of the profit arising in SAIF, including profits or losses on its non-profit business, will be allocated to with-profits policyholders in SAIF and SAA i.e. SAIF is a "100:0" fund.

2.2.1.4 Non-Profit Sub-Fund (NPSF)

The Non-Profit Sub-Fund (NPSF) consists of such non-profit and unit-linked business as has been explicitly allocated to this sub-fund by the Directors.

It also includes all Defined Charge Participating business other than its investment content (which is allocated to the DCPSF). Therefore, all charges in respect of DCPSF business are credited to the NPSF, and the NPSF bears all of the associated expenses.

All the profit of the NPSF is attributable to shareholders i.e. the NPSF is a "0:100" fund.

2.2.2 The PAC Board has the right to amend the company's Articles of Association, and the Articles will be amended as required in order to incorporate the business that is transferred from ELAS.

2.3 Management of PAC

2.3.1 The PAC Board is responsible for the management of the company's long-term business, including its exposure to risk.

2.3.2 In managing risk, the PAC Board is responsible for:

(i) determining the company's risk appetite. This, in conjunction with the company's available working capital, determines the company's risk capacity from time to time, and

(ii) managing the overall risk level of the company and the long-term fund, including its four sub-funds, having regard to that risk capacity.

2.3.3 In order to ensure that the company's operations remain within its risk capacity, the Board manages the types and volumes of new business accepted, and sets the bonus and investment policy of its with-profits business, having regard to the available capital in the long-term fund. The company's investment policy, bonus policy and available capital (or inherited estate) are described in sections 2.5-2.7 below.

2.4 Governance arrangements for with-profits business

2.4.1 As noted in section 2.3 above, the PAC Board is responsible for the management of the company's with-profits business, including its investment and bonus distribution policy. In addition, the SALAS Scheme established the Scottish Amicable Board to be responsible for the management (including investment and bonus policy) of the Scottish Amicable Funds.

2.4.2 Industry-wide regulatory requirements changed with effect from 31 December 2004 and, as a consequence, the PAC Board appointed:

(i) an Actuarial Function Holder, who provides the PAC Board with all actuarial advice,

(ii) a With-Profits Actuary, with the specific duty to advise the Board on the reasonableness of how discretion has been exercised in applying the company's Principles and Practices of Financial Management (PPFM), and how any conflicting interests have been addressed, and

(iii) a With-Profits Committee of independent individuals.

2.4.3 The company prepares an annual report to with-profits policyholders setting out how it has complied with the PPFM.

2.4.4 The With-Profits Committee has the duty to report to the Board, providing an assessment of compliance with the PPFM and how any conflicting rights have been addressed. If the Committee wishes to make a statement to with-profits policyholders in addition to the company's annual report described above, the company will make that report available.

2.5 Investment management

2.5.1 The PAC Board is responsible for setting the investment strategy of the company and, as noted it paragraph 2.3.3 above, it manages this strategy as part of the management of the overall risk level of the company and the long-term fund.

2.5.2 For linked and non-linked non-profit contracts, a policy of close matching of assets to liabilities is maintained. This approach reduces the need for these classes of business to rely on the working capital of the long-term fund for solvency support.

2.5.3 For with-profits business, the company's investment strategy is to seek to secure the highest total return (allowing for the effect of taxation and investment expenses) whilst:

(i) maintaining an acceptable overall risk level (having regard to the currency, nature and outstanding duration of the liabilities) for the long-term fund,

(ii) maintaining an appropriate and broad mix of suitable investments, and

(iii) protecting appropriately the relative interests of all groups of policyholders.

2.5.4 The company seeks to include all with-profits policies in a common asset pool wherever it is appropriate for them to share a common investment policy. The major asset pools are currently as follows:

- For most WPSF policies, assets are held within the main WPSF asset pool. The asset mix of this asset pool at 31 December 2006 was as follows:

Equities	53%
Property	15%
Fixed interest	25%
Other	7%

- The PAC inherited estate may have a different asset mix to that of the assets backing with-profits policies. This is to help meet guarantees and maintain regulatory solvency in adverse market conditions. Within the inherited estate, the Scottish Amicable Capital Fund (SACF), is required to maintain an asset mix as close as possible to that of the with-profits assets in the Scottish Amicable Insurance Fund (SAIF).

- For SAIF policies, most assets (including the SAIF inherited estate) are held within the main SAIF asset pool. The benchmark asset mix for SAIF's main pool differs from that of the WPSF's main pool to reflect the relative strength of the two sub-funds.

- For the Defined Charge Participating Sub-Fund (DCPSF), there are three asset pools relating to liabilities denominated in Sterling, the Euro and the US Dollar.

2.5.5 A stochastic asset/liability model is used to identify the range of asset mixes for each with-profits asset pool that would be consistent with the risk appetite of the fund. The company selects from that range an appropriate strategic asset mix for the pool, consisting of a diversified portfolio of assets which is intended to maximise the expected long-run investment return, subject to the risk level and liquidity needs of the asset pool. The stochastic model allows for all types of investment risk, including mis-matching risk, market risk and credit risk.

2.5.6 The resulting investment policy for with-profits business is to invest in a highly diversified portfolio of UK and overseas assets. This policy aims to avoid large losses connected with default or bankruptcy of an individual company and also generates country diversification. The assets may include any available assets which enhance the risk/return balance; they will consist mainly of exchange-traded equity and bond investments, but may also include less liquid investments such as direct property or private equity and debt. In the context of the current financial strength and the positive cash flow characteristic of the with-profits sub-funds, liquidity is not a major issue. The investments will not contain shares in Prudential plc, but may contain shares in subsidiary companies.

2.5.7 All assets of the WPSF, SAIF and the DCPSF would normally be available to be traded. The only exception is Prudential Annuities Limited (PAL), a subsidiary company of the WPSF which was set up to enable greater focus to be placed on the management and profitability of pensions annuity business. PAL has no significant impact on the investment freedom of the WPSF. Profits and losses from business written in PAL between 1 January 2000 and 30 June 2004 are reflected in WPSF asset shares as miscellaneous surplus as and when they arise.

2.5.8 In setting the investment policies for the with-profits asset pools, the directors do not rely on assets held outside the relevant pool except that:

(i) the investment policies for the WPSF with-profits asset pools have regard to the PAC inherited estate, and the availability of shareholder resources as described in paragraph 2.7.5 below

(ii) the DCPSF investment policy relies on an appropriate proportion of the PAC inherited estate, and

(iii) the investment policy for SAIF relies on the solvency support provided by SACF to pursue an investment policy appropriate to an open fund i.e. higher real (equity and property) assets than would otherwise be appropriate for a closed fund.

2.6 Bonus policy

2.6.1 The PAC Board is responsible for setting the company's bonus policy and, as noted in paragraph 2.3.3 above, it manages this policy as part of the management of the overall risk level of the company and the long-term fund.

2.6.2 The main objectives of the company's bonus distribution policy are:

(i) to give each with-profits policyholder a return on the premiums paid reflecting the return on the underlying investments over the time the policyholder has held the policy, smoothing the peaks and troughs of investment performance, and

(ii) to ensure that with-profits policyholders in each sub-fund receive a fair share of the profits distributed from that sub-fund by way of bonus additions to their policies.

2.6.3 To retain flexibility in the company's investment policy and to protect the ongoing solvency of the fund, for most types of with-profits product the company aims to keep a substantial proportion of pay-out values in non-guaranteed form (i.e. payable as final bonus) and determines regular bonus rates accordingly.

Rates of regular bonus are determined for each type of policy primarily by targeting them on a prudent proportion of the long-term expected future investment return on the underlying assets. The expected future investment return is reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholders' transfers. However, the rates declared may differ by product type, or by date of payment of the premiums or date of issue of the policy, if the accumulated annual bonuses are particularly high or low relative to a prudent proportion of the achieved investment return.

When target bonus levels change, the PAC Board has regard to the overall financial strength of the long-term fund when determining the length of time over which it will seek to achieve the amended prudent target bonus level.

In normal investment conditions, we expect changes to regular bonus rates to be gradual over time and changes are not expected to exceed 1% p.a. over any year. However, the Directors retain the discretion whether or not to declare a regular bonus each year, and there is no limit on the amount by which regular bonus rates can change.

2.6.4 Pay-out values are set by reference to the earnings of the underlying investments, except where guaranteed minimum benefits increase the total amount payable.

In order to meet this objective, pay-out values are targeted on the asset shares of sample policies or groups of sample policies.

These asset shares are calculated by accumulating the premiums paid (less allowance for expenses and charges) at the actual rates of investment return earned on the underlying assets over the lifetime of the policy (allowing for the effect of tax on the investment returns and of tax relief on expenses for life business), making appropriate allowance for miscellaneous profits and losses.

2.6.5 Final bonus rates are set so that in normal investment conditions pay-out values change only gradually over time.

In normal circumstances we expect most policy pay-out values to move within specified guidelines, although some larger changes may occur to balance pay-out values between different policies. Greater flexibility may be required in certain circumstances, for example following a significant rise or fall in market values (either sudden or over a period of years), and in such situations the PAC Board may decide to vary the standard bonus smoothing limits to protect the overall interests of policyholders. Such a situation arose in February 2003 when pay-out values on most equivalent policies were reduced by amounts greater than the normal limits.

At each bonus declaration date, 90% of all payouts in the period covered by the declaration are expected to fall in the range 80-120% of specimen asset shares. However any substantial movement in the market value of the assets of the relevant with-profits fund may take a significant proportion of pay-out values outside the target range. This may lead to a mid-year bonus declaration to bring more pay-out values within the target range.

Our intention is that smoothing profits and losses should balance out over time, so that in the long run with-profits policyholders in each sub-fund, or within a product group with a specific smoothing account, neither gain nor lose as a result of our smoothing policy. The accumulative cost of smoothing and guarantees is monitored. The short-term cost of smoothing is constrained only by the impact that smoothing costs have on the risk level of the fund and hence the security of continuing policyholders.

2.7 Inherited estate

2.7.1 An inherited estate is the amount of money in the long-term fund in excess of the amounts that the company expects to pay out to meet its obligations to existing policyholders. These latter amounts are equal to the with-profits policyholders' accumulated asset shares, plus any additional payments that may be required by way of smoothing or to meet guarantees.

2.7.2 There are two inherited estates in Prudential's long-term fund, the PAC inherited estate (in the WPSF) and the Scottish Amicable Insurance Fund inherited estate (in SAIF).

2.7.3 The PAC inherited estate represents the major part of the working capital of Prudential's long-term fund, and is available to support both current and future business. It has arisen over many years from a number of sources and, like the whole of the with-profits funds, belongs to the company. The company seeks to manage the PAC inherited estate so that it continues to provide adequate working capital for the future security and ongoing solvency of the long-term fund.

2.7.4 The PAC Board manages the overall business having regard to the size of the PAC inherited estate. This reflects the inherited estate's role as the working capital of the long-term fund which largely determines the risk capacity of the fund.

2.7.5 If the size of the inherited estate relative to the liabilities of the long-term fund became significantly smaller or significantly larger, the Board would take the appropriate action at that time. There is no specific target for the size of the PAC inherited estate. A significant reduction in the PAC inherited estate as a proportion of the WPSF would be likely to lead to changes in the investment and bonus policies for the affected with-profits business, such that the overall risk level of the company was substantially unaltered.

2.7.6 The Directors decide how the PAC inherited estate is used to support the with-profits business. Neither policyholders nor shareholders can have any expectation that they will receive any distribution of the inherited estate in the normal course of events, other than through the normal process of smoothing and meeting guarantees in adverse investment conditions.

2.7.7 The PAC inherited estate currently supports the with-profits business in the WPSF by:

(i) providing the benefits associated with smoothing and guarantees,

(ii) permitting investment flexibility for the fund's assets, and

(iii) meeting the regulatory capital requirements, which demonstrate solvency.

Transfers to or from the PAC inherited estate occur every year as part of the normal process of smoothing pay-out values; larger transfers from the inherited estate may occur as a result of meeting guarantees in adverse investment conditions.

The PAC inherited estate is also used to support business in other sub-funds in return for an appropriate charge; for example it supports SAIF and the Defined Charge Participating Sub-Fund (DCPSF) in return for a yearly charge.

2.7.8 The PAC inherited estate may also be used for any other purposes as considered appropriate by the Directors. This may include absorbing the costs of significant events, such as fundamental change in PAC's long-term business and the cost of providing redress for past mis-selling, without affecting the bonus and investment policies of existing policyholders. The costs of fundamental change may include investment in new technology, redundancy and restructuring costs, cost overruns on new and existing business, regulatory and legal change and the funding of other appropriate activities related to long-term insurance, including acquisitions.

2.7.9 Currently, the PAC inherited estate bears the following costs:

(i) the additional tax payable by the long-term fund as a result of the distribution to shareholders of their part of the WPSF divisible profit,

(ii) expenses written-off so that the total deductions from asset shares are expected to equal the policy specific charges illustrated for new business at point of sale, and

(iii) in respect of business issued by Scottish Amicable Life plc, any cost of shareholder transfer in excess of the difference between the level of charge deducted and level of expenses incurred.

These items will continue to be charged to the PAC inherited estate only for as long as the security of the fund remains satisfactory.

2.7.10 The PAC inherited estate has also borne the costs associated with the PAC personal pensions mis-selling review. So that the resulting reduction in the inherited estate would have no adverse impact on policyholder pay-out values, Prudential stated in 1998 that deducting personal pensions mis-selling costs from the inherited estate would not impact the company's bonus or investment policy for WPSF policies. The company gave an assurance that if this unlikely event were to occur, it would make available support to the long-term fund from shareholder resources for as long as the situation continued, so as to ensure that WPSF policyholders were not disadvantaged.

The assurance was designed to protect both existing WPSF policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing. This review was completed on 30 June 2002 and consequently the assurance has not applied to new WPSF business issued since 1 January 2004.

The assurance will continue to apply to any WPSF policy in force as at 31 December 2003, both for premiums paid before 1 January 2004 and for subsequent regular premiums.

The maximum amount of capital support available under the terms of the assurance will reduce over time as the company pays claims on the policies covered by the assurance. It reduces to the extent that the current asset share value of such policies remaining in force falls below the asset share value at 31 December 2003 of all policies then covered by the assurance, adjusted for the net investment return earned on the PAC inherited estate since that date.

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

2.8 Proposed Reattribution of the Inherited Estate

2.8.1 Prudential announced on 15 March 2007 that it is exploring the possibility of a reattribution of the PAC inherited estate. Prudential has believed for many years that it would be beneficial if there was greater clarity as to the status of the PAC inherited estate. Reattribution will, however, only proceed if this is in the interests of both policyholders and shareholders.

3. FINANCIAL POSITION OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED

3.1 Under the UK regulatory regime for insurers, PAC is required to determine its Pillar I solvency on a "twin peaks" basis. This requires the company to carry out two separate solvency calculations, referred to as the regulatory and realistic peaks, for each of its with-profits funds, and to hold sufficient capital to cover whichever calculation proves to be the more onerous. At 31 December 2006, the realistic peak was the more onerous for each of the WPSF, the DCPSF and SAIF.

3.2 The transferring ELAS policyholders will rely principally for their security on the inherited estate of the WPSF. This inherited estate currently provides support for business in the WPSF, the DCPSF and SAIF, and the realistic solvency position of each of these funds at 31 December 2006 (and at 31 December 2005) was as follows:

WPSF

	31 December 2006 £m	31 December 2005 £m
Assets		
Regulatory value of assets	76,133	72,135
Adjustment for shares in subsidiaries	361	396
Future profits on NP business	448	666
Total assets	76,942	73,197
Liabilities		
With-profits benefit reserve	62,713	59,888
Past miscellaneous surplus attributable to asset shares	47	
Planned enhancements to asset shares	362	369
Planned deductions for guarantees	(1,165)	(1,105)
Other planned deductions from asset shares	(94)	(67)
Future cost of guarantees	1,278	1,398
Future costs of smoothing	184	481
Future cost of financial options	47	52
Other liabilities	1,514	1,069
Realistic value of current liabilities	3,436	3,132
Total liabilities	68,322	65,218
Free assets	8,619	7,979
Risk Capital Margin (RCM)	1,818	1,795
Surplus assets	6,801	6,184
RCM cover	4.7x	4.4x

DCPSF

	31 December 2006 £m	31 December 2005 £m
Assets		
Regulatory value of assets	1,575	1,307
Total assets	1,575	1,307
Liabilities		
With-profits benefit reserve	1,574	1,302
Planned deductions for guarantees	(61)	(40)
Future cost of guarantees	31	13
Other liabilities	30	27
Realistic value of current liabilities	1	5
Total liabilities	1,575	1,307
Free assets	-	-
Risk Capital Margin (RCM)	-	-
Surplus assets	-	-
RCM cover	-	-

SAIF

	31 December 2006		31 December 2005	
	Internal presentation £m	FSA presentation £m	Internal presentation £m	FSA presentation £m
Assets				
Regulatory value of assets	14,321	14,321	14,354	14,354
Future profits on NP business	323	323	451	451
Total assets	14,644	14,644	14,805	14,805
Liabilities				
With-profits benefit reserve	12,483	12,483	12,609	12,609
Planned enhancements to asset shares	205	1,104	198	895
Planned deductions for guarantees	(328)	(328)	(332)	(332)
Future cost of guarantees	84	84	175	175
Future costs of smoothing	(83)	(83)	68	68
Future cost of financial options	561	561	619	619
Other liabilities	210	210	134	134
Realistic value of current liabilities	612	612	638	638
Total liabilities	13,745	14,644	14,108	14,805
Free assets	899	-	697	-
Risk Capital Margin (RCM)	526	-	645	-
Surplus assets	373	-	52	-
RCM cover	1.7x	-	1.1x	-

Note: Under the FSA requirements and Actuarial guidance, all of the free assets of SAIF must be included in the published balance sheet as a liability (as a future enhancement to asset shares) since they are expected to ultimately be distributed to policyholders. A more meaningful presentation of the financial position of SAIF is also shown above (internal presentation).

3.3 It can be seen that the WPSF was in a very strong financial position at 31 December 2006, its Risk Capital Margin (RCM) being covered 4.7 times by capital within the sub-fund.

3.4 The zero surplus assets in the DCPSF reflect the fact that the DCPSF contains the asset shares of DCPSF business, and that these asset shares are expected to be distributed to policyholders over the outstanding lifetime of the business in force. The DCPSF thus contains no free assets.

3.5 The zero surplus assets shown for the FSA representation of SAIF reflect the fact that the inherited estate of SAIF is expected to be distributed to policyholders over the outstanding lifetime of the business in force. The free assets of SAIF are therefore included as a liability (under future enhancements). A more meaningful presentation of the financial strength of SAIF is also shown (internal presentation), which identifies the free assets separately. This shows that SAIF had 1.7 times cover for its RCM at 31 December 2006, before allowing for any additional support available from SACF.

3.6 Under the FSA's Pillar II solvency framework, PAC is also required to hold sufficient capital to cover its Individual Capital Assessment (ICA) and Individual Capital Guidance (ICG). The capital held by the company comfortably covered these requirements at 31 December 2006.

4. THE PROPOSED TRANSFER

4.1 Background

4.1.1 In December 2006, PAC was invited to participate in a tender process regarding the possible transfer of the ELAS with-profits annuity business to a third party. PAC was successful in this tender process and, as a result, PAC and ELAS entered into a Business Transfer Agreement on 14 March 2007 (the 'Agreement'). This Agreement set out the terms and conditions under which the ELAS with-profits annuity business would be transferred to PAC, together with details of how the business would be dealt with both before and after the date of transfer.

4.2 Rationale for the proposed transfer

4.2.1 The rationale for the proposed transfer from an ELAS perspective is as follows:

(i) The proposed transfer will give the transferring ELAS with-profits annuitants exposure to the Prudential with-profits fund, which is one of the largest and strongest in the UK and which has a greater bonus earning potential than the current ELAS with-profits fund.

(ii) ELAS has a significant exposure to the risk that annuitant longevity will improve at a faster rate than currently anticipated. The proposed transfer removes this risk, to the extent that it arises in connection with the transferring business.

(iii) The proposed transfer will allow ELAS to focus its attention on identifying an attractive strategy for its remaining with-profits policyholders.

4.2.2 The proposed transfer is also consistent with PAC's core competencies and business strategy reflecting, in particular, the company's expertise in:

(i) the management of with-profits business,

(ii) the management of annuities business, and

(iii) the management of Part VII transfers.

4.3 Business being transferred

The business being transferred from ELAS to PAC under the Scheme comprises approximately 66,000 with-profits annuity benefits (the 'Transferring Policies'). The transferring business comprises mainly UK pension business, but also includes small proportions of purchased life annuities and overseas annuities.

The annuities being transferred are currently operated by ELAS as follows:

(i) The annuities have a "guaranteed income" and a "non-guaranteed income" attaching to them, and the income received by the policyholder in any policy year is the greater of these two amounts.

(ii) The initial amount of the guaranteed income on each policy was determined having regard to an interest rate which reflected the combined effect of:

- the guaranteed interest rate (the "GIR"), typically 3.5% per annum for policies issued before 1 July 1996, and 0% per annum for policies issued after that date, and

- an Anticipated Bonus Rate (the "ABR") which was fixed for each individual policy at the date the policy was written.

The effect of the GIR was to increase the level guaranteed income payable throughout the term of the policy, while the effect of the ABR was to produce a higher initial guaranteed income which would reduce in each subsequent year.

Other than for certain so-called 'Low Start' policies, which in effect have a negative ABR, the ABR varies between 0% and 7.5% depending on the individual policy.

Before allowing for any reversionary (guaranteed) bonuses, the guaranteed income reduces each year by the ABR. This guaranteed income is then increased by any reversionary bonus declared in the year.

(iii) The non-guaranteed income is intended to represent the amount of annuity that can be afforded, based on the policy's asset share, after allowing for reductions to payments due to the combined effect of the ABR and the GIR relevant to each policy, and based on assumptions about the future mortality experience of policyholders.

(iv) If the investment return, net of charges, allocated to a with-profits annuity in the form of bonus exceeds the combined effect of the GIR and ABR, the non-guaranteed income will increase, but if it falls short of the combined effect of the GIR and ABR, the non-guaranteed income will reduce. Many with-profits annuities were taken out in times of higher interest rates and have relatively high ABRs. These policyholders have been experiencing falling incomes in the current lower interest rate environment.

(v) Since 2000, all distributions of surplus have been made in non-guaranteed form, and ELAS has indicated that there is no expectation of any further reversionary bonus being awarded in the near to medium term.

(vi) Currently, deductions are made from asset shares for expenses and guarantees at rates of 1% per annum and 0.5% per annum respectively.

(vii) Following the House of Lords' ruling on guaranteed annuity rate policies in 2000, a reduction in non-guaranteed policy benefits for policies issued before 20 July 2000 is being phased in over time. Annual reductions of 1% per annum were applied in 2000 and 2001 and of 0.5% per annum in 2005, 2006 and 2007. Further reductions of 0.5% per annum are planned for 2008, 2009 and 2010.

Around 98% of the Transferring Policies (by value) are affected by these reductions.

(viii) ELAS operates a conservative investment policy as a result of its solvency position and its need for liquidity. The Society accordingly invests mainly in fixed interest securities (both gilts and corporate bonds) and is unlikely to be able to alter this policy unless its financial strength increases significantly.

This strategy is helpful in reducing risk, and in helping to maintain solvency. It shields with-profits policyholders from the worst effects of falling stock markets, but also limits the returns that will be achieved in rising stock markets.

The mix of assets backing with-profits policies in ELAS as at 31 December 2006 was as follows:

Equities	3%
Fixed interest	78%
Property	12%
Other	7%

4.4 Allocation of assets and liabilities

It is intended that the Transferring Policies (along with the associated assets and liabilities) will transfer from ELAS to PAC at 11.59 p.m. on 31 December 2007, or such other time and date as may be agreed by PAC and ELAS and approved by the Court (the 'Effective Date').

An initial payment (the "WPA Allocated Amount") will be made from ELAS to PAC on the Effective Date by means of a transfer of suitable assets.

The assets and liabilities associated with the Transferring Policies will, in general, be allocated to the DCPSF within PAC's long term fund. However certain assets and liabilities will be allocated to the WPSF. These comprise:

(i) Guaranteed Liabilities

The Guaranteed Liabilities comprise any guaranteed income payments made after the Effective Date, insofar as they exceed the non-guaranteed income that would otherwise be payable, before the application of smoothing.

(ii) Mortality Assets/Liabilities

Mortality Liabilities are defined as any liability relating to adverse longevity experience in excess of the amount that can be charged to policyholder asset shares under the Scheme. Likewise, Mortality Assets are defined as any corresponding asset that arises as a result of favourable longevity experience.

(iii) Up-front Guarantee Charge

The Up-front Guarantee Charge represents an amount to cover the cost (including the associated cost of capital) of meeting the Guarantee Liabilities, after deduction of the present value of expected future charges in respect of investment guarantees.

(iv) Mortality Premium

The Mortality Premium represents an amount to cover the cost (including the associated cost of capital) arising in connection with the Mortality Assets/Liabilities.

The WPA Allocated Amount, net of the Up-front Guarantee Charge and Mortality Premium will be allocated to the DCPSF, and will constitute the "Aggregate Initial Asset Shares" of the Transferring Policies at the Effective Date.

4.5 Determination of the Transferring Assets

The methods of determining the WPA Allocated Amount, the Up-front Guarantee Charge and the Mortality Premium have been agreed between PAC and ELAS, and are set out in the Scheme. In summary:

- The WPA Allocated Amount will be determined as the sum of the with-profits benefit reserve, the excess of the future cost of guarantees over the value of planned future deductions (using the ELAS asset mix at the Effective Date), and a share of the working capital of ELAS. These calculations will be based on methodologies that are consistent with ELAS's reporting to the FSA.

- The Up-front Guarantee Charge will be determined as the market consistent cost of the investment guarantees, less the market consistent value of future charges in respect of those guarantees (using the PAC target asset mix at the Effective Date). These calculations will be performed using the ELAS stochastic model, and the results will then be adjusted to reflect the compromise agreed by PAC and ELAS in order to allow for differences between the PAC and ELAS stochastic models and assumptions.

- The Mortality Premium will be £17m, adjusted to reflect movements in Aggregate Initial Asset Shares between 31 December 2006 and the Effective Date, as calculated using the ELAS model.

On the Effective Date, the assets transferred to the WPSF and DCPSF will be based on estimates of these items, as agreed between ELAS and PAC in advance. These estimates will be based on calculations at 30 June 2007, rolled forward to the Effective Date using a methodology agreed between ELAS and PAC.

Final amounts will be calculated after the Effective Date, based on policy data at that date, and adjusting payments will be made as necessary between ELAS and the WPSF, and ELAS and the DCPSF, allowing for interest earned between the Effective Date and the date of the adjustment.

4.6 Management of the Transferring Policies

The Scheme contains provisions covering the financial management of the transferring business by PAC after the Effective Date. These provisions include the following:

4.6.1 Bonus and asset shares

(i) the Transferring Policies will be allocated to, and form a new bonus series within, the PAC DCPSF

(ii) on the Effective Date, the Transferring Policies will have the same level of guaranteed and non guaranteed income as applied immediately prior to the Effective Date

(iii) until a new bonus rate is declared by PAC, the rate declared immediately prior to the Effective Date by ELAS will continue to apply

(iv) the asset shares attaching to the Transferring Policies will be maintained separately (in the DCPSF), and bonuses will be declared by PAC with the aim of fully distributing the achieved returns on the underlying investments over the lifetime of the Transferring Policies, allowing for smoothing of the peaks and troughs of investment performance, and for PAC's expectations of future mortality

(v) the asset mix backing the Transferring Policies will be identical to the asset mix of the main WPSF asset pool, and the investment return applied each year to the asset shares of the Transferring Policies will be the same as is credited to equivalent PAC with-profits policies which are backed by that asset pool. (For the avoidance of doubt, this investment return will be calculated after allowing for costs associated with the purchase, sale, maintenance or development of assets; it will, however, be calculated before any deduction for explicit investment fees, which are borne by the PAC NPSF.)

4.6.2 Bonus smoothing

(i) after the Effective Date, the level of non-guaranteed income on a transferring policy will be amended at each policy anniversary to reflect the combined effect of the ABR and the GIR applicable to the policy, and the levels of non-guaranteed bonuses declared by PAC

(ii) in normal conditions, bonus smoothing will operate to ensure that the amount of annuity payable (before allowing for guarantees) can only fall or rise within certain limits. The upper smoothing limit can be altered with the approval of the PAC With-Profits Committee

(iii) smoothing will operate to ensure that the objective of gradual rather than erratic changes in annuity income is achieved

(iv) a smoothing account will be set up in the WPSF. This will reflect the differences (positive or negative) between the smoothed annuity income payments and the unsmoothed annuity income level

(v) the smoothing account will be adjusted by the investment return earned on the main WPSF asset pool, less the charges described in 4.6.5 below, and will be managed with the on-going aim that it should tend to zero, subject to the need for short term smoothing

(vi) in exceptional circumstances, for example following a significant fall or rise in market values (either sudden or over a period of years), the company may vary the bonus smoothing limits described in (ii) above in order to protect the overall interests of all PAC policyholders. In making such a change, the company must apply the same principles as it would for other PAC policies, taking into account the balance on the ELAS bonus smoothing account.

4.6.3 Guarantees

(i) after the effective date, the level of guaranteed income on a transferring policy will be amended at each policy anniversary to reflect the level of ABR applicable to the policy, and any guaranteed bonuses declared by PAC.

(ii) the Scheme provides that the WPSF should meet the cost of any guaranteed income payments, insofar as they exceed the non guaranteed income before the application of smoothing.

4.6.4 Mortality experience

(i) to the extent that actual annuity payments are less than or more than expected in any calendar year, because of heavier or lighter mortality than expected, any profit or loss will fall to the WPSF

(ii) the Scheme has provisions which allow PAC to alter its view on expected future mortality and, within certain limits, to vary future annuity payments accordingly, subject to the approval of the company's With-Profits Committee

(iii) in giving such approval, the With-Profits Committee must be satisfied that the new expectation of future mortality is a best estimate, taking into account the historic and expected future mortality experience of the Transferring Policyholders

(iv) the cost or benefit of any change in expected future mortality can be charged to asset shares of the Transferring Policies in the DCPSF, but only up to a prescribed limit, equivalent to a 0.5% per annum compound future charge/enhancement to asset shares. The cost or benefit of any mortality basis change in excess of this limit will be charged/credited to the WPSF.

4.6.5 Charges

(i) the Scheme allows PAC to make certain limited charges against the asset shares of the Transferring Policies

(ii) charges of 1% per annum will be made in respect of expenses, and these charges will be transferred from the DCPSF to the NPSF

(iii) charges of up to 0.5% per annum will be made in respect of the expected cost of investment guarantees, and these charges will be transferred from the DCPSF to the WPSF

(iv) the Scheme states that no other charges beyond those described above can be made against the Transferring Policies e.g. in respect of investment management, transaction expenses or capital support. However, the Scheme does allow deductions to be made against the asset shares of the Transferring Policies in the following limited circumstances:

- where there was a shortfall in the amount transferred to Prudential by ELAS, or

- where Prudential has made a loss in connection with the transfer and Prudential's With-Profits Committee agree that it is proper for all or part of such loss to be charged against the Transferring Policies

(v) the Scheme allows equivalent charges to be made (and transferred to the NPSF or WPSF as appropriate) against the balance (positive or negative) on the Smoothing Account in the WPSF.

4.6.6 Review of guarantee charges

(i) if the proportion of the WPSF's assets targeted to be held in equities and property is reduced by a material amount (defined as a reduction below a percentage which is an integral multiple of 5), then this reduction must be referred to the PAC With-Profits Committee, who will consider if the guarantee charges should be reduced as a result

(ii) the PAC With-Profits Committee, under certain defined circumstances, can also increase the guarantee charge (up to a maximum of 0.5% per annum) if it has previously been reduced below its maximum level

(iii) any review of the ongoing charges for guarantees on PAC's with-profits policies will also include a review of the guarantee charge for the Transferring Policies, and any reduction in charges as a result of such a review will be applied on a consistent basis. Any changes to the guarantee charge for the Transferring Policies must be referred to the PAC With-Profits Committee.

4.6.7 Deferred cost policies

The Scheme requires PAC to reduce the bonuses that would otherwise be declared on certain "deferred cost policies" by 0.5% for 2008, 2009 and 2010. This replicates what ELAS would otherwise do in the absence of the Scheme.

4.6.8 Relaxation of Scheme

The Scheme has provisions whereby, if the realistic liabilities of the remaining policies fall below a minimum amount of £100m increased annually by reference to the retail prices index, then PAC has the option to terminate the Scheme. In this event, any positive amount remaining in the bonus smoothing account will be distributed amongst the then remaining annuity policies by way of an enhancement to non-guaranteed income in a way considered fair by the PAC With-Profits Committee.

4.6.9 Purchased life annuities

Approximately 2% (by value) of the Transferring Policies are purchased life annuities. These are treated as non-pensions business for tax purposes. The ELAS practice was to declare the same bonuses for all policies, regardless of tax treatment, and to allow for differential tax treatment in the relevant pricing bases (the rates for purchased life annuities business included a loading for the capitalised value of future tax on investment return).

Following the transfer, PAC will continue to declare the same bonus rates for all policies (before reductions for Deferred Cost Policies) irrespective of tax treatment and the cost of future tax on investment return will continue to be borne by all of the Transferring Policies. To take account of the fact that the remaining policyholders of ELAS will no longer be exposed to that tax liability, there will be a (small) increase in the amount available for augmentation of benefit (as described in section 4.7 below), equal to the capitalised value of the future tax expected to have been borne.

4.7 Benefit augmentation

As noted in section 4.5 above, final amounts in relation to the Transferring Assets will be agreed some time after the Effective Date. As a result, the Transferring Policyholders may receive a benefit augmentation. Any such augmentation is not expected to be significant.

The augmentation will take the form of an increase in non-guaranteed income, and will take effect from a date to be determined, but expected to be in mid-2008 (the Income Uplift Date). The assets to be transferred from ELAS to the PAC DCPSF will be calculated assuming the benefit increase had taken place on 31 December 2007. To the extent that actual income payments in the period prior to the Income Uplift Date are lower than they would have been had the increase applied from 31 December 2007, an (implicit) adjustment will be made to the bonus rate for the 2008 calendar year. This will ensure that the transferring policyholders receive the full benefit of the assets transferred in respect of the augmentation.

Guaranteed income levels will not be increased. As a result, those policyholders who are currently receiving income at the guaranteed minimum level may not experience an immediate income increase. However, the increase to non-guaranteed income will increase the likelihood that, over time, income levels may increase above the guaranteed minimum level.

There is a possibility that the amount available to be applied to any uplift could be negative. Although this is unlikely it may occur because of, for example, significant adverse movements in the value of the ELAS with-profit fund around the time of the transfer. In this extreme event, the Scheme allows for future bonus levels and, if necessary, amounts of non guaranteed income to be reduced.

4.8 Excluded policies

The Scheme allows for the possibility that certain policies may have to be excluded from the transfer due to the inability to comply with certain requirements as detailed in the Scheme (for example, if it transpires that the "state of commitment" of a particular annuity is in an EEA state whose regulator has objected to the Scheme). If such policies exist, the Scheme provides for a reassurance agreement to be entered into, and for the excluded policies to then be reassured from the Effective Date to PAC on a basis intended to replicate the financial effects of a transfer of such policies to PAC. No further amount will be payable by ELAS.

4.9 Costs

The Scheme allows that each of ELAS and PAC will pay its own costs under the transfer. The Agreement states that any reasonable costs directly incurred for the Independent Expert and Counsel will be shared equally.

4.10 Indemnities

The Scheme specifically does not transfer certain liabilities from ELAS to PAC. These excluded liabilities include mis-selling and any liabilities associated with a breach of policy terms (including in respect of policies whose proceeds were used to pay the premium for the Transferring Policies) or other regulatory requirements. ELAS has provided a limited indemnity to PAC to the extent that should any such liability be transferred to PAC and a claim subsequently arise, then ELAS will indemnify PAC against certain associated costs.

4.11 PAC Reattribution of the inherited estate

The Scheme specifies that the Transferring Policies will have no interest in any possible future reattribution or distribution of the inherited estate of the WPSF.

4.12 Amendment of policies

ELAS has certain policies ('Multi-Segment' policies) where some of the benefits are with-profits annuities and some of the benefits are not with-profits annuities. As part of the Scheme, these policies will be split such that ELAS and PAC are each a party to the policies in their capacity as insurer. The allocation of liabilities will be as follows:

(i) PAC will become contractually liable for that part of the contract providing the benefits being transferred, and

(ii) ELAS will continue to be the insurance provider for any benefits not being transferred under the Scheme.

4.13 Taxation

The implementation of the Scheme is conditional on PAC and ELAS obtaining certain tax confirmations from the relevant taxation authorities. These confirmations are expected to be received. The Scheme does, however, make provision for the requirement for any such confirmation to be waived by PAC and ELAS on the agreement of both companies.

4.14 Administration

Post the Effective Date, the administration of the Transferring Policies will transfer from HBOS to PAC.

Arrangements will be put in place as part of the Scheme to ensure that the administration of the Multi-Segment policies is appropriately carried out. ELAS will be responsible (to the exclusion of PAC) for any part of a Multi-Segment policy not transferring and PAC will be responsible for any part of such a policy which is transferred. Neither party may amend a Multi-Segment policy in such a way that it affects the other without the other party's written consent.

4.15 Jersey and Guernsey policies

Transferring Policies issued by ELAS in Jersey and Guernsey will not be transferred by the Scheme, but will be the subject of equivalent schemes approved under the relevant arrangements in those jurisdictions. Where such policies are transferred to PAC, they will be treated as though they had been transferred by the Scheme.

4.16 Charge for WPSF solvency support

As a result of the Scheme, the PAC inherited estate will be providing solvency support for the transferring liabilities in the DCPSF. In compensation for this, the WPSF will receive a capital charge of 0.14% per annum of asset shares from the NPSF. This is not covered by the Scheme, but will be included in PAC's Principles and Practices of Financial Management (PPFM).

4.17 Amendment of PAC Articles

As part of the Agreement, PAC has agreed that the assets being transferred from ELAS to PAC to back the asset shares of the transferring policies will be co-invested with the main asset pool in the WPSF, and that the transferred annuities will get the same rate of return as other equivalent with-profits policies invested in the WPSF.

A change will be required to PAC's Articles of Association to put this agreement into effect. This amendment will be made in November 2007, assuming a positive outcome of the ELAS EGM which is expected to take place in October 2007.

4.18 Amendment of PAC PPFM

PAC's PPFM will be amended to be consistent with the Principles of Financial Management described in the Scheme.

5. FINANCIAL IMPACT OF THE PROPOSED TRANSFER ON THE PAC LONG-TERM FUND

5.1 The impact of the proposed transfer on the PAC long-term fund has been modelled assuming that the transfer occurred at 31 December 2006.

5.2 The effect on the Pillar I (Peak 2) solvency position of the WPSF and DCPSF is shown below (the position of SAIF is unchanged).

5.3 As noted in Section 4.7 above, the final amounts in relation to any benefit augmentation will only be agreed some time after the Effective Date. The final amount is not expected to be significant.

The possible financial effect of any augmentation on PAC has been estimated and is shown in the report of the Independent Expert. However since the effect of any augmentation will not be material for PAC, and given that any amount calculated before the transfer is only an estimate, the figures shown in this Section 5 do not make any allowance for augmentation.

WPSF at 31 December 2006

	Before Scheme £m	Scheme[1] £m	After Scheme £m
Assets			
Regulatory value of assets	76,133	77 [2]	76,210
Adjustment for shares in subsidiaries	361	-	361
Future profits on NP business	448	-	448
Total assets	76,942	77	77,019
Liabilities			
With-profits benefit reserve	62,713	-	62,713
Past miscellaneous surplus attributable to asset shares	47	-	47
Planned enhancements to asset shares	362	-	362
Planned deductions for guarantees	(1,165)	(64)	(1,229)
Other planned deductions from asset shares	(94)	-	(94)
Future cost of guarantees	1,278	137	1,415
Future costs of smoothing	184	-	184
Future cost of financial options	47	-	47
Other liabilities	1,514	-	1,514
Realistic value of current liabilities	3,436	-	3,436
Total liabilities	68,322	73	68,395
Free assets	8,619	4	8,623
Risk Capital Margin (RCM)	1,818	165	1,983
Surplus assets	6,801	(161)	6,640
RCM cover	4.7x	-	4.3X

Note: [1] Figures exclude the effect of any potential augmentation

[2] Excludes charge for capital receivable from the NPSF of £18m

DCPSF at 31 December 2006

	Before Scheme £m	Scheme[1] £m	After Scheme £m
Assets Regulatory value of assets	 1,575	 1,733	 3,308
Total assets	1,575	1,733	3,308
Liabilities With-profits benefit reserve Planned deductions for guarantees Future cost of guarantees Other liabilities Realistic value of current liabilities	 1,574 (61) 31 30 1	 1,733 - - - -	 3,307 (61) 31 30 1
Total liabilities	1,575	1,733	3,308
Free assets	-	-	-
Risk Capital Margin (RCM)	-	-	-
Surplus assets	-	-	-

Note: [1]Figures exclude the effect of any potential augmentation

5.4 It can be seen that the assets and liabilities of the DCPSF are both increased by £1,733m, this amount being equal to the aggregate asset shares of the transferring policies. The surplus on the DCPSF remains at zero since the transferring asset shares are expected to be distributed to the transferring policyholders over the remaining lifetime of the business.

5.5 The assets of the WPSF are increased by £77m, this amount being made up of:

£60m in respect of the Up-front Guarantee Charge, and
£17m in respect of the Mortality Premium.

The WPSF will also receive planned deductions for guarantees of £64m, representing the present value of future charges in respect of investment guarantees, and be liable for the future cost of guarantees of £137m, which represents the market consistent cost of the investment guarantees.

The overall impact of the Up-front Guarantee Charge, the present value of future charges in respect of investment guarantees and the future cost of guarantees, is a loss of £13m. This reflects the compromise agreed between PAC and ELAS in determining the Up-front Guarantee Charge, as described in section 4.5 above.

Other impacts of the Scheme on the WPSF are:

(i) the Mortality Assets/Liabilities described in section 4.4.

(ii) the potential losses that could arise from the bonus smoothing described in section 4.6.2, and

(iii) the charge for solvency support that will be received from the NPSF, as described in section 4.16.

Mortality and smoothing are expected to have a neutral impact over time on a market consistent basis, and hence have no impact on the realistic balance sheet of the WPSF at the Effective Date.

The capital charge payable by the NPSF is not valued for the purpose of Pillar I (Peak 2) reporting since it is not an admissible asset under FSA rules. Including this item of £18m, which is appropriate when considering this transaction on a fully realistic basis, would result in an overall change in free assets as a result of the Scheme of £22m.

It can be seen that the WPSF remains in a very strong financial position, its RCM being covered 4.3 times by capital within the sub-fund.

5.6 The ICA of the PAC long-term fund has also been recalculated assuming that the transfer occurred at 31 December 2006, and this calculation shows that the capital of the long-term fund continues to comfortably cover the revised ICA.

5.7 As noted in section 2.3 above, the PAC long-term fund is operated to ensure that its risk profile remains within the company's risk appetite. Analysis shows that, after allowing for the transfer to have occurred at 31 December 2006, the company's financial position remains within risk appetite.

6. IMPACT OF THE PROPOSED TRANSFER ON TRANSFERRING ELAS POLICYHOLDERS

In assessing the proposed transfer, I have considered the effect of the Scheme on the security of the contractual benefits and the reasonable benefit expectations of the transferring ELAS policyholders.

6.1 Security of contractual benefits

The security of the transferring policyholders' contractual benefits will depend primarily on the solvency support provided by the inherited estate in the WPSF. The data in sections 3 and 5 above shows that PAC's WPSF and its long-term fund as a whole were very well capitalised at 31 December 2006 (both before and after the proposed transfer), and the management of risk in PAC described in section 2.3 is designed to ensure insofar as possible that this will remain the case in future.

In view of the strength of the PAC long term fund, and the way in which it is operated, I believe that the security of the transferring policies contractual benefits will be enhanced by the proposed Scheme. Additional security will be provided by the assets of the PAC shareholder fund, which would also ultimately be available to help meet guaranteed benefits in the event of insolvency.

6.2 Reasonable benefit expectations

The income received by the transferring policyholders in any year will be the higher of the guaranteed income and the non-guaranteed income.

6.2.1 Guaranteed income

On the Effective Date, the transferring policyholders will receive the same level of guaranteed income as was being paid immediately prior to that date. The contractual terms of the transferring policies will also remain unchanged, and this will ensure that transferring policyholders' guaranteed income will continue to be adjusted by any GIR and ABR in the same way as it would have been in ELAS.

No reversionary bonus additions have been made to the transferring policies since 2000, and ELAS has indicated that there is no expectation of any further reversionary bonus being added in the near to medium term. As at 31 December 2006, around 37% (by value) of the Transferring Policies had guarantees that were "in the money" (i.e. the guaranteed income exceeded the non-guaranteed income) whereas, as described in section 2.6.3, PAC aims to keep a substantial proportion of pay-out values in non-guaranteed form. The Scheme places no obligations on PAC to declare any reversionary bonuses, and it is therefore unlikely that any reversionary bonuses will be added to the transferring policies in PAC. Future reversionary additions might, however, be made in the event of sustained, favourable investment performance.

6.2.2 Non-guaranteed income

On the Effective Date, the transferring policyholders will receive the same level of non-guaranteed income as was being paid immediately prior to that date, and will continue to benefit from the same bonus structure as is currently applied by ELAS. At the first bonus declaration (1st April 2008) after the Effective Date, PAC will need to adjust the non-guaranteed income to reflect the actual aggregate asset shares transferred from ELAS. This adjustment will reflect the investment return earned by ELAS for the 2007 calendar year, and the resulting bonus rates may thus be expected to be very similar to those which would have applied in the absence of a transfer.

Thereafter, the benefit prospects of the transferring policyholders will reflect:

(i) the achieved investment returns on the backing assets

(ii) the smoothing of non-guaranteed income

(iii) charges for expenses

(iv) charges for guarantees

(v) mortality experience.

6.2.2.1 Achieved investment returns

The asset mix backing the Transferring Policies will be identical to the asset mix of the main WPSF asset pool, and the investment return applied each year to the asset shares of the Transferring Policies will be the same as is credited to equivalent PAC with-profits policies which are backed by that asset pool. Comparison of the asset mixes of ELAS and the main PAC with-profits asset pool shows that PAC has a substantially larger proportion of its assets invested in equities and property (this proportion being known as the "equity backing ratio"). Although not guaranteed, I believe that these assets offer the prospect of higher long term expected returns, which will enhance the bonus prospects of the transferring policyholders.

6.2.2.2 Smoothing of non-guaranteed income

Smoothing will be operated with the objective of distributing the transferring policyholders' asset shares over time, while avoiding erratic changes in annuity income from year to year. Given the high equity backing ratio, and the consequent potential volatility in investment returns, I believe the smoothing approach provides a valuable benefit to the transferring policyholders. The smoothing applied to the Transferring Policies will follow the principles described in the Scheme and the PAC PPFM. In view of the requirement in the Scheme that the bonus smoothing account should be managed with the on-going aim that it should tend to zero, the degree of smoothing may differ from that applied to other business in the WPSF.

6.2.2.3 Charges for expenses

Charges for expenses will be maintained at the level currently being applied by ELAS, and will be guaranteed by PAC to remain at 1% per annum in future. In the absence of any indication from ELAS that the charge is expected to reduce in future, I believe that the certainty offered by the PAC guarantee provides a valuable benefit to policyholders.

6.2.2.4 Charges for guarantees

Charges for guarantees will also be maintained at the level currently being applied by ELAS, and will be guaranteed by PAC not to increase above 0.5% p.a. in future, irrespective of whether the underlying guarantees actually bite. The value of the guarantees is being met, in part, by an initial payment from ELAS to the PAC WPSF, and the transferring policyholders will thus, in future, be paying only part of the actual cost incurred by PAC in providing the guarantees. This position will be maintained in future by the Scheme provisions for reviewing the charges in the event of a change in

PAC's equity backing ratio. I therefore believe the arrangements in relation to guarantee charges provide a valuable benefit to the transferring policyholders.

6.2.2.5 Mortality experience

Bonuses will be declared each year with the aim of distributing the accumulated asset shares over the remaining lifetime of the Transferring Policies, allowing for smoothing and for PAC's expectations of future mortality. The unsmoothed annuity payments will be charged against asset shares in the DCPSF.

The Scheme has provisions which allow PAC to alter its view on expected future mortality and, within certain limits, to vary future annuity payments accordingly, subject to the approval of the company's With-Profits Committee. The cost/benefit of any change in expected future mortality can be charged to policyholder asset shares in the DCPSF, but only up to a prescribed limit, equivalent to a 0.5% per annum compound future charge/enhancement to asset shares. The cost or benefit of any mortality basis change in excess of this limit will be charged/credited to the WPSF.

The transferring policyholders are currently exposed to the risk that unforeseen improvements in annuitant mortality will reduce the levels of their annuities. I understand that this risk is shared with other ELAS policyholders, so that the transferring policyholders would only bear around 23% of any losses arising. Under the proposed arrangements, the transferring policyholders will meet 100% of any losses (or profits) that arise from changes in expected future mortality, subject to the impact not exceeding 0.5% p.a. of asset shares. The charge to provide this cap and collar is being met by an initial payment from ELAS, and the transferring policyholders will thus, in future, be receiving a valuable guarantee at no charge to their asset shares.

6.3 Other considerations

6.3.1 With regards to administration, the transferring policyholders will, in general, be serviced from the same systems as existing PAC policyholders. Therefore, the service provided to transferring policyholders is, in general, expected to be equivalent to that experienced by existing PAC policyholders.

There are approximately 1000 annuities where the annuity is paid in a currency other than sterling, and it is anticipated that the administration of these policies will be outsourced to a third party who is able to provide an appropriate quality of service for these more complex cases.

6.3.2 Certain interim arrangements will apply in the 3 month period following 31 December 2007 in order to ensure fair treatment of policyholders with policy anniversaries in the period 1 January to 31 March 2008. For the affected policies, interim bonuses will be applied for the period from 1 January 2007 through to the policy anniversary in 2008, and these interim bonus rates will be determined with regard to both ELAS's bonus rates for the 2007 calendar year, and Prudential's best estimate of the interim bonus rate that it will announce for transferring policies having a policy anniversary in April 2008.

6.3.3 As noted in section 2.8 above, PAC is currently exploring the possibility of a reattribution of the PAC inherited estate. The transferring policyholders will have no interest in any such reattribution, but will benefit from the protections afforded to all policyholders in the event of such a transaction. I am therefore satisfied that the transferring policyholders will not be materially adversely affected by any future reattribution.

6.3.4 Several areas of the Scheme require specific approval to be given by the PAC With-Profits Committee. These have been highlighted to the Committee, and the Committee's terms of reference will be revised accordingly, assuming a positive outcome of the ELAS EGM in October 2007.

6.4 Conclusion

The ELAS Actuarial Function Holder and With-Profits Actuary has also reviewed the proposed scheme and concluded that the implementation of the Scheme will be of benefit to all classes of ELAS with-profits policyholders and there will be no material adverse effect from the scheme for any class of ELAS policyholder. In addition, the increased investment flexibility that Prudential is able to provide will enhance the bonus earning prospects for the transferring policyholders.

I concur with this assessment insofar as it relates to the policyholders transferring from ELAS.

7. IMPACT OF THE PROPOSED TRANSFER ON PAC POLICYHOLDERS

In order to assess the impact of the proposed Scheme on PAC policyholders, I have considered firstly its impact on each sub-fund of the PAC long-term fund, and then its impact on policyholders' security and benefit expectations.

7.1 DCPSF

The aggregate asset shares of the transferring policies will be allocated to the DCPSF on the Effective Date. The Transferring Policies will form a new bonus series, and the asset shares will be distributed to the transferring policyholders over the outstanding lifetime of the business. The Transferring Policies will therefore not have any direct impact on the other business of the DCPSF.

7.2 WPSF

Bonuses will be declared each year with the aim of distributing the accumulated asset shares over the remaining lifetime of the Transferring Policies, allowing for smoothing and for PAC's expectations of future mortality. The unsmoothed annuity payments will be charged against asset shares in the DCPSF, and the WPSF will bear any profits/losses that arise due to:

(i) smoothing,

(ii) guarantees, and

(iii) mortality experience.

7.2.1 Smoothing

The WPSF will bear any profits or losses that arise due to the smoothing of annuity payments during the outstanding lifetime of the transferring business. These profits or losses will be monitored in a Smoothing account.

As indicated in section 4.6.8, the Scheme requires that any positive amount in the bonus smoothing account on the termination of the Scheme must be distributed to the transferring policies. Such an eventual outcome would leave the WPSF in a neutral position.

It is, however, possible that the bonus smoothing account will be negative on the termination of the scheme either because of normal fluctuations in the account or because of sustained adverse investment conditions. This outcome would result in a loss to the WPSF.

The WPSF is not receiving any direct compensation for this risk. In order to mitigate the risk, PAC will therefore seek to ensure that, when the Scheme is terminated, the bonus smoothing account is as close to zero as possible.

This will be facilitated by:

(a) the active management of the bonus smoothing account over time, within the constraints described in section 4.6.2 above, and

(b) the fact that PAC can choose the optimum time at which to terminate the Scheme, once the criterion described in section 4.6.8 above is met.

In order to protect the interests of the WPSF it will, in particular, be important to flex the lower normal smoothing limit in the event of adverse investment experience.

Given the flexibility permitted to PAC to manage smoothing, I believe that the risk of material loss to the WPSF is minimal.

7.2.2 Guarantees

The WPSF will meet the Guaranteed Liabilities in respect of the Transferring Policies, and is therefore exposed to the risk of falls in the market value of the backing assets.

In order to compensate for this risk, the WPSF will receive an initial payment from ELAS on the Effective Date, plus an on-going charge of up to a maximum of 0.5% per annum of asset shares.

The charge for investment guarantees has been calculated on a market consistent basis, which automatically includes a market-related profit loading. As noted in section 4.5 above, the ELAS and PAC modelling produced slightly different estimates of the market consistent cost due to differences in the stochastic models and the economic assumptions used. However, I believe that the agreed charge represents a fair price for the risk being borne by the WPSF.

7.2.3 Mortality

The unsmoothed annuity payments charged against asset shares in the DCPSF will, in general, reflect PAC's expectations of future mortality. The WPSF will, however, bear any profits or losses that arise due to:

(i) actual annuity payments being less than or more than expected in any calendar year because of heavier or lighter mortality than expected, and

(ii) any worsening or improvement in PAC's expectations of future mortality which fall outside the range that can be charged against asset shares.

The cumulative impact of item (i) is likely to be small, since PAC monitors its emerging mortality experience closely, and actual experience in any year should therefore differ from expectations only due to statistical fluctuations in the number of deaths. The WPSF is therefore primarily exposed to the risk under (ii) that the transferring annuitants will on average live longer than expected, and that expected mortality experience falls outside the range that can be charged against asset shares.

The premium charged by PAC for accepting this risk has been calculated allowing for both a best estimate of, and the uncertainty surrounding, the expected mortality experience for this group of policyholders. Based on PAC's views of current and future mortality, the analysis carried out shows that the Mortality Premium will be sufficient to generate a profit in around 70% of outcomes. In my view, the premium therefore represents a fair market price for the risk being transferred.

7.2.4 Other liabilities

The WPSF is at risk should any liabilities emerge from the transferring business which have not been properly costed or otherwise allowed for. This risk is mitigated by the due diligence performed on the business to be transferred prior to agreeing to the transfer. In addition, prior to the Effective Date, a 'data cleansing' exercise will have been carried out on the data records that will be transferred to PAC to allow proper servicing and payment of the correct annuities. Finally, the Agreement and Scheme provide various warranties and indemnities relating to, for example, compliance with laws and regulations, tax and the accuracy of the ELAS records. In particular, the Scheme specifically excludes the transfer to PAC of any liabilities in respect of mis-selling or other regulatory breaches which occurred prior to the Effective Date, including in respect of the policies whose proceeds were used to pay the premium on the transferring policies.

7.2.5 Capital support

In addition to bearing the risks and rewards described in sections 7.2.1-7.2.4 above, the PAC inherited estate will be providing solvency support for the transferring liabilities in the DCPSF.

In compensation for this, and in accordance with PAC's existing practice as described in 2.7.7 above, the WPSF will receive a capital charge of 0.14% per annum of asset shares from the NPSF, with a present value on a market consistent basis of £18m. I believe that this is a reasonable charge given that the WPSF is already receiving compensation directly for the market and mortality risks that it is bearing.

7.3 NPSF

The NPSF will meet all of the expenses incurred in implementing the Scheme and in administering the transferring business. It will also bear all of the corresponding operational risk.

In compensation for this, the NPSF will receive the expense charge of 1% per annum of asset shares.

The NPSF is expected to make a profit from the Scheme, and hence I do not believe that the NPSF is adversely affected by the Scheme.

7.4 SAIF

SAIF relies on capital support from SACF, which forms part of the inherited estate in the WPSF. SACF remains fully available to SAIF post the Effective Date; hence I do not believe that SAIF is adversely affected by the Scheme.

7.5 Policyholder security and reasonable benefit expectations

The security and benefit expectations of PAC policyholders in the WPSF, the DCPSF and SAIF depend primarily on the solvency support provided by the inherited estate of the WPSF. As described in section 7.2 above, the inherited estate is receiving a fair market price for the risks being transferred, and is therefore not being impaired in any way by the proposed transfer. The inherited estate thus remains fully available to provide solvency support to both PAC and the transferring ELAS policyholders.

The data in sections 3 and 5 above shows that PAC's WPSF and its long-term fund as a whole were very well capitalised at 31 December 2006 (both before and after the proposed transfer), and the management of risk in PAC described in section 2.3 is designed to ensure insofar as possible that this will remain the case in future. In view of the strength of the PAC long term fund, and the way in which it is operated, I believe that the security and benefit expectations of PAC policyholders will not be materially affected by the Scheme.

As noted in section 2.8 above, PAC is currently exploring the possibility of a reattribution of the PAC inherited estate. This is not a normal benefit expectation of PAC policyholders but, if the reattribution does proceed, PAC with-profits policyholders' interests will be protected since the transferring policyholders have no interest in any such reattribution or distribution.

The security of PAC policyholders in the NPSF depends on the availability of shareholder capital support. As described in section 7.3 above, the proposed transfer is expected to give rise to profits in the NPSF, and should therefore at least maintain the security of existing PAC policyholders.

7.6 Other considerations

7.6.1 As noted above, the transfer is not expected to have any material adverse impact on PAC with-profits policyholders. It will, at the margin, benefit policyholders since the transfer of additional policies should contribute to the company's overheads and spread costs over a wider population. The increase in funds under management will also help to contain investment management fees given the higher volumes of assets being traded.

7.6.2 The PAC Board, the PAC With-Profits Committee and the PAC With-Profits Actuary have all considered the terms of the Scheme, and concluded that the Scheme will not have any material adverse impact on PAC policyholders.

7.7 Communication with policyholders

As noted above, I do not expect the transfer of ELAS business to have a material adverse impact on the benefits of the PAC policyholders, or to adversely affect their reasonable benefit expectations. Given that the transfer will have no material adverse effect on PAC policyholders, to limit the cost of the transaction, PAC will apply to the Court for a waiver from the requirement to send all its policyholders formal notice of the Scheme. However, notice of the transfer will be placed in the national press and Prudential's and Equitable's website and this notice will include details of how to obtain copies of all relevant documentation, including the Scheme. I consider the request for the waiver and the means of advising PAC policyholders to be both fair and reasonable.

8. CONCLUSION

I have reviewed the scheme from the perspective of the PAC policyholders and am satisfied that

(i) the security of PAC's existing policyholders will not be materially altered by the Scheme.

(i) the reasonable expectations of the PAC policyholders will not be adversely affected by the Scheme.

D J Belsham FIA
PAC Actuarial Function Holder
29 August 2007