

Registered Number: SC047842

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**Annual Report and Financial Statements for the year ended 31 December  
2015**

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

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

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**PRUDENTIAL RETIREMENT INCOME LIMITED**

**Directors**

J Hunt (Chairman) (Resigned 2 November 2015)  
H A Hussain  
J Warburton (Resigned 7 April 2015)  
T Naidu  
D Pender (Appointed 13 February 2015, Resigned 8 December 2015)

**Secretary**

Prudential Group Secretarial Services Limited

**Auditor**

KPMG LLP, London

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2015**

#### Principal activity

The principal activity of Prudential Retirement Income Limited (the Company) is the writing of pension annuity long-term insurance business. Whilst this will continue in 2016, the impact of pensions freedom has resulted in a reduction in individual new business being written. In addition, the implementation of Solvency II has resulted in an increase in the capital resource requirements that are required to support the writing of longevity risk and these together have reduced the Company's appetite to write new individual business. The Company will continue to selectively participate in new bulk annuity deals.

#### Business review

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

With effect from 31 December 2008, the Company entered into an arrangement with The Prudential Assurance Company Limited (PAC) to reinsure 15% of all its non-profit annuity business on a quota share basis. This arrangement allows for all of the reinsurance premiums to be deposited back to the Company. With effect from 31 December 2014, the proportion of business reinsured under this quota share arrangement was increased from 15% to 20%. On a FRS101 basis the reinsurance results in a loss on the quota share arrangement was £110m (2014: loss of £235m). There is an equal and offsetting profit in PAC from accepting this business. On 1 January 2016 the quota share was increased from 20% to 100%.

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

The Company remained in a satisfactory financial position as at 31 December 2015.

#### Performance and measurement

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

<b>Key Performance Indicators</b>	<b>2015</b>	<b>2014</b>
	<b>£m</b>	<b>£m</b>
Gross Operating profit	<b>806</b>	326
Profit on ordinary activities before tax	<b>572</b>	570
Shareholder funds	<b>3,758</b>	3,292
Premiums	<b>1,199</b>	385
Available capital on the Prudential Regulatory (PRA) basis	<b>3,023</b>	2,786

#### Gross Operating profit

The operating profits in each year have arisen from the writing of new business in the year, including bulk purchases, investment management related profits, and favourable credit experience over the year. This result includes £339m from specific management actions undertaken in the second half of 2015 to position the balance sheet more efficiently under the new Solvency II regime, which are not expected to recur going forward.

Operating profit has increased during 2015 due to a number of factors. These include assumption changes for mortality, longevity, default rates and expenses and reductions in liabilities arising from new longevity swaps.

#### Profit on ordinary activities before tax

The profit on ordinary activities includes – in addition to the gross operating profit – the impact of a profit share payment to PAC for the reinsured business and also market driven impacts. Over 2014 falls in market yields increased the value of assets by more than the liabilities leading to additional profits. The reverse occurred over 2015.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

#### Shareholder funds

In the second half of 2015 and ahead of securing Solvency II internal model approval, a number of specific actions were taken to position the balance sheet more effectively under the new regime. These actions included extending the reinsurance of longevity risk to cover £8,573m (2014: £2,220m) of annuity liabilities on an IFRS basis by the end of 2015.

The assets and liabilities of the Company have increased during 2015 as a result of new business single premiums of £1.9bn (2014: £2.3bn), this includes bulk purchases. This is offset by the payment of annuities and impact of increase in yields on underlying assets and liabilities.

#### Premiums

Individual premiums of £293m (2014: £524m) have reduced in part due to the impact of pensions freedom reforms introduced in 2014. On 31 December 2014 the quota share with PAC was increased from 15% to 20% and a one off premium of £1,475m was paid in respect of this.

#### Available capital

The available capital of £3,024m (2014: £2,786m) reflects the excess of regulatory basis assets over liabilities of the fund. From 1 January 2016 available capital will be measured on a Solvency II basis. The Company's available capital position is covered further in Note 17 on page 25.

#### Market review and strategy

During 2015, the Company has maintained its market leadership in annuities, and has continued to obtain value from PAC's internal vesting pension book. This has been supported by the Company's partnership deals with insurers such as Royal London. The Company now has approximately 1,040,000 annuities in payment.

The Company's strategy in the wholesale market is to participate selectively in bulk annuity and back book buyouts, where the Company is able to win business based on its financial strength, superior investment track record, extensive mortality risk assessment experience and servicing capabilities. The Company will continue to maintain a strict focus on value, and only participate in capital-efficient transactions that meet its strict return on capital requirements.

When compared to 2012 the UK pensions industry today is almost unrecognisable. Three years of unprecedented regulatory change has resulted in a structural marketplace shift in how customers view retirement. The distinction between customers accumulating funds and then using them to provide an income in retirement is no longer as clear-cut as it once was. Customers are engaging more frequently with their providers and the demand for financial advice and guidance is increasing. Those companies who are well-known, financially strong and create products and services to match pensions freedom needs and expectations of customers are likely to succeed.

The impact of pensions freedom and the implementation of Solvency II has resulted in both a reduction in new individual business being written, as well as increase in the capital resource requirements to support the writing of longevity risk. These factors together have reduced the Company's appetite to write new individual business.

#### Risk & uncertainties

As a provider of insurance services, the Company's business is the managed acceptance of risk. The Company is a wholly owned subsidiary of the Prudential Group and is subject to the Group's internal control and risk management processes as detailed in the Group Governance Manual and Group Risk Framework. The control procedures and systems established within the Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. As such they provide strong but not absolute assurance against material misstatement or loss, and focus on optimising the levels of risk and reward with the aim of achieving the business objectives.

The Group Risk Framework requires all business units and functions within the Group, including the Company, to establish processes for identifying, evaluating and managing key risks. The risk management framework for the Company is approved by the Board and operates based on the concept of three lines of defence: risk management, risk oversight and independent assurance.

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

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

#### **Financial risks**

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

The local economic outlook for 2016 is relatively unchanged from the previous year, with modest growth expected over the year. The global outlook continues to be mixed with increased uncertainty arising from a slowdown in China and increased volatility across global markets. This could adversely affect the Company's business and profitability. Interest rates within the UK and Eurozone remain close to historic lows, whilst the US raised interest rates in 2015 for the first time in nine years. Expectations regarding future interest rate paths are varied and this reflects the increased uncertainty across the global markets generally.

Further information on the financial risk management objectives and policies of the Company and exposure of the Company to financial risk factors is given in Note 26 to the financial statements.

#### **Non-financial risk**

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

##### **(a) Business environment risk**

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

The Company conducts its business subject to regulation and is therefore exposed to changes in laws, and regulations that affect the products and markets in which it operates.

Changes in government policy, legislation (including tax), regulatory interpretation and accounting standards applying to UK insurance companies may be applied retrospectively, may adversely affect the Company's product range, distribution channels, capital requirements and consequently, reported results and financing requirements.

The material regulatory and legal change risks currently faced by the Company are:

- The European Union's Solvency II Directive came into effect on 1 January 2016. This measure of regulatory capital is more volatile than under the previous Solvency I regime and regulatory policy may evolve under the new regime. The European Commission will review elements of the Solvency II legislation from 2016 onwards including a review of the Long Term Guarantee measures by 1 January 2021.
- The UK Government has committed to holding a "remain/leave" referendum on EU membership which will be held on 23 June 2016. The possible withdrawal of the UK from the EU would have political, legal and economic ramifications for both the UK and the EU, although these are expected to be more pronounced in the UK.
- The International Association of Insurance Supervisors (IAIS) is developing ComFrame which is focused on the supervision of large and complex Internationally Active Insurance Groups (IAIGs). ComFrame will establish a set of common principles and standards designed to assist regulators in addressing risks that arise from insurance groups with operations in multiple jurisdictions. As part of this, work is underway to develop a global Insurance Capital Standard (ICS) that would apply to IAIGs. Once the development of the ICS has been concluded, it is intended to replace the Basic Capital Requirement as the minimum group capital requirement for G-SIIs. Further consultations on the ICS are expected over the coming years, and a version of the ICS is expected to be adopted as part of ComFrame in late 2019.
- The Company is subject to regulation by both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) which gives rise to increased thematic review activity, and additional regulatory demands and the implications from the FCA's competition objective.
- Following the Pension Freedom changes in April 2015, the retirement market in the UK is experiencing a material change that has impacted the Company's chosen markets and product offerings. Further pension reforms have been consulted and may happen in the future.
- Given the outsourced nature of the Company's operating model, there is exposure to changes in the environment that affect the economics of these arrangements. Examples of this would include potential changes to VAT on outsourcing arrangements and medium term degradation of cost benefits arising from wage and cost inflation.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

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

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

#### **(b) Strategic risk**

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

The strategic importance of long term savings and retirement products meant that the Company was dependent on being able to continue to deliver profitable volumes from these lines of business and that unplanned regulatory or legal changes would not adversely impact customer or advisor behaviour for this business. The risk has materialised and has impacted the ability of the Company to write new business.

The concentration of risk to further regulatory or legal changes still leaves the UK business at risk to a significant change in its business model arising from future regulatory developments impacting the remaining in-force book.

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

#### **(c) Conduct risk**

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

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

Exposure to conduct risk will arise from the impact on customers from the way the Company manages itself; the products and services provided; the response and management of the financial risks to which customers are exposed, through to the performance of the products they buy from the Company through intermediaries.

#### **(d) Operational risk**

*Operational risk is the risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events.*

The Company is exposed to operational risk in the ordinary course of its business and as a result may be subject to unplanned costs, regulatory fines or legal actions and disputes.

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

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

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

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

**PRUDENTIAL RETIREMENT INCOME LIMITED**


**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

(e) Group risk

*Group risk is the risk associated with being part of a group, particularly as a result of contagion.*

Being a member of the group can provide significant advantages for the Company in terms of diversification of risk, financial strength, technical expertise and management experience. It can also give rise to risks; if a guarantee of financial support given by the parent were removed, or from particular transactions arising from an impaired parent or affiliate of the group. The independent capitalisation of the Company as well as risk management processes and internal control mechanisms within the Company ensure group risk is appropriately managed.

On behalf of the Board of directors



R Banerjee  
On behalf of Prudential Group Secretarial Services Limited  
Company Secretary  
24 March 2016



## PRUDENTIAL RETIREMENT INCOME LIMITED

### **DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

Under IFRS, for both of these transactions the original assets remain on the PRIL balance sheet. The restructure was solely for the Solvency II matching adjustment requirements.

On 17 December 2015, notice was served to Prudential Assurance Company Limited (PAC) that no new business will be reinsured from PAC to PRIL with effect from 1 July 2016. The total premiums that would have been affected if this change had taken place during the year ended 31 December 2015 was £231m.

#### Accounts and dividends

The state of affairs of the Company at 31 December 2015 is shown in the balance sheet on pages 13 and 14. The statement of comprehensive income appears on pages 11 and 12. No dividend for 2015 is proposed (2014: £Nil).

#### Share capital

There were no changes in the Company's share capital during 2015 (2014: Nil).

#### Directors

The present directors are shown on page 1.

Mr Warburton resigned as a Director on 7 April 2015 and Ms Hunt resigned as a Director on 2 November 2015. Mr Pender was appointed as a Director on 13 February 2015 and resigned as a Director on 8 December 2015. There have been no further changes since the year end.

#### Disclosure to auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

#### Auditor

An ordinary resolution of the Company for the re-appointment of KPMG LLP as auditor of the Company will be proposed to the members of the Company in accordance with Section 485(4)(a) of the Companies Act 2006.

#### Directors' and officers' protection

Prudential plc has arranged appropriate insurance cover in respect of legal action against directors and senior managers of companies within the Prudential Group. In addition, the Articles of Association of the Company permit the directors, officers and employees of the Company to be indemnified in respect of liabilities incurred as a result of their office. Prudential plc also provides protections for directors and senior managers of companies within the Group against personal financial exposure they may incur in their capacity as such. These include qualifying third party indemnity provisions (as defined by the relevant Companies Act) for the benefit of directors of Prudential plc, including, where applicable, in their capacity as a director of the Company and other companies within the Group. These indemnities were in force during 2015 and remain in force.

On behalf of the Board of directors.



R Banerjee  
On behalf of Prudential Group Secretarial Services Limited  
Company Secretary  
24 March 2016

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

Incorporated and registered in Scotland. Registered Number SC047842

### **DIRECTOR'S REPORT FOR THE YEAR ENDED 31 DECEMBER 2015**

#### Introduction

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

#### Corporate responsibility

The Company is a wholly owned subsidiary within the Prudential Group and Corporate Responsibility (CR) is integral to the way the Group does business.

The Group, of which the Company is a part, has developed a Group Governance Framework which is underpinned by a Group Governance Manual and associated processes. This encompasses all key policies and procedures for example, the Group Code of Business Conduct.

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

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

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

These themes demonstrate the Group's CR commitments and principles to its stakeholders and provide clarity to its businesses, including the Company, on where they should focus their CR efforts and resources in the context of their individual markets.

The Prudential plc Board discusses the Group's performance in the areas of social and environmental management at least once a year and also reviews and approves the Group's corporate responsibility report and strategy on an annual basis.

#### Post balance sheet events

On 1 January 2016, the Company increased the proportion of business reassured under the quota share arrangement with PAC from 20% to 100%. An initial additional reinsurance premium of £23,228m has been deposited back from PRIL to PAC in respect of this increase in January 2016.

On 1 January 2016 the Company's assets were restructured to meet the Solvency II matching adjustment requirements.

Certain types of asset are not eligible for matching adjustment and restructures have taken place to resolve these issues:

- Investment properties have been replaced with debt securities issued by Prudential Real Estate Investments Limited, a new subsidiary wholly owned by the Company.
- Loans backed by equity release mortgages have been replaced with debt securities issued by Prudential Equity Release Mortgages Limited, a new subsidiary wholly owned by the Company.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

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

The directors are responsible for preparing the Strategic Report and Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS101 Reduced Disclosure Framework.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



H A Hussain  
Director  
24 March 2016

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PRUDENTIAL RETIREMENT INCOME LIMITED**

We have audited the financial statements of Prudential Retirement Income Limited for the year ended 31 December 2015 set out on pages 11 to 40. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS101 Reduced Disclosure Framework.

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

#### **Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibilities Statement set out on page 9, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

#### **Scope of the audit of the financial statements**

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

#### **Opinion on financial statements**

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2015 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

#### **Opinion on other matters prescribed by the Companies Act 2006**

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

#### **Matters on which we are required to report by exception**

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

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



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

24 March 2016

**PRUDENTIAL RETIREMENT INCOME LIMITED****STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2015**

<b>Long-term Business Technical Account</b>	Note	<b>2015 £m</b>	<b>2014 £m</b>
Gross premiums written	2(a)	<b>1,875</b>	2,316
Outward reinsurance premiums		<b>(676)</b>	(1,931)
Earned premiums, net of reinsurance		<u><b>1,199</b></u>	<u>385</u>
Investment income	3	<b>1,820</b>	1,471
Unrealised gains on investments	3	<b>(1,588)</b>	2,660
		<u><b>232</b></u>	<u>4,131</u>
Claims paid, net of reinsurance			
Gross claims paid		<b>(1,673)</b>	(1,575)
Claims paid – reinsurers share		<b>635</b>	344
		<u><b>(1,038)</b></u>	<u>(1,231)</u>
Change in other technical provisions, net of reinsurance			
Long-term business provision, net of reinsurance	16		
Gross amount		<b>712</b>	(2,495)
Reinsurers share		<b>(71)</b>	1,483
		<u><b>641</b></u>	<u>(1,012)</u>
Technical provision for linked liabilities, net of reinsurance	16		
Gross amount		<b>(542)</b>	(1,719)
Reinsurers share		<b>203</b>	574
		<u><b>(339)</b></u>	<u>(1,145)</u>
Net operating expenses			
Acquisition costs	5	<b>(35)</b>	(38)
Administrative costs		<b>(43)</b>	(24)
Investment expenses and charges	3	<b>(47)</b>	(691)
		<u><b>(125)</b></u>	<u>(753)</u>
Tax attributable to the long-term business	4(a)	<b>(105)</b>	(83)
<b>Balance on the long-term business technical account</b>		<u><b>465</b></u>	<u>292</u>

All of the amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 16 to 40 form an integral part of these financial statements.

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2015  
(continued)**

<b>Non-Technical Account</b>	<b>Note</b>	<b>2015 £m</b>	<b>2014 £m</b>
<b>Balance on the long-term business technical account</b>		<b>465</b>	292
Tax attributable to balance on the long-term business technical account		<u>105</u>	<u>83</u>
		<b>570</b>	<b>375</b>
Investment income	3	83	105
Unrealised gains on investments	3	(79)	94
Administrative costs		(1)	(1)
Investment expenses and charges	3	(1)	(3)
<b>Operating profit on ordinary activities before tax</b>		<b>572</b>	<b>570</b>
Tax on profit on ordinary activities	4(a)	(106)	(125)
<b>Profit and comprehensive income for the financial year</b>		<b>466</b>	<b>445</b>

All of the amounts above are in respect of continuing operations.

The accounting policies and notes on pages 16 to 40 form an integral part of these financial statements.

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**BALANCE SHEET AS AT 31 DECEMBER 2015**

<b>ASSETS</b>	Note	2015 £m	2014 £m
<b>Investments</b>			
Land and buildings	9	1,032	957
Loans to group undertakings	10	1,274	1,233
Other financial investments	9	<u>24,115</u>	<u>24,316</u>
		<u>26,421</u>	<u>26,506</u>
<b>Assets held to cover linked liabilities</b>	11	5,061	4,721
<b>Reinsurers' share of technical provisions</b>			
Long-term business provision	16	4,363	4,434
Technical provision for linked liabilities	16	<u>1,408</u>	<u>1,205</u>
		<u>5,771</u>	<u>5,639</u>
<b>Debtors</b>			
Other debtors	12	33	30
<b>Other assets</b>			
Cash at bank and in hand	13	226	182
Prepayments and accrued income		434	413
<b>Total assets</b>	14	<u>37,946</u>	<u>37,491</u>
<b>LIABILITIES</b>			
		2015 £m	2014 £m
<b>Capital and reserves</b>			
Called up share capital	15	858	858
Profit and loss account		<u>2,900</u>	<u>2,434</u>
<b>Total shareholders' funds</b>		<u>3,758</u>	<u>3,292</u>
<b>Technical provisions</b>			
Long-term business provision	16	21,056	21,768
Claims outstanding	16	<u>6</u>	<u>5</u>
		<u>21,062</u>	<u>21,773</u>
<b>Technical provisions for linked liabilities</b>	16	6,468	5,926
<b>Provision for other risks and charges</b>			
Deferred taxation	4(c)	160	195
<b>Creditors: amounts falling due within one year</b>			
Derivative liabilities		533	287
Creditors arising out of reinsurance operations		6	1
Creditors arising out of direct insurance operations		1	-
Deposits from ceding undertakings		4,584	4,755
Amounts owed to credit institutions		1,067	836
Taxation		90	99
Other creditors		164	101
Amounts owed to group undertakings	19	<u>53</u>	<u>6</u>
		<u>6,498</u>	<u>6,079</u>
<b>Creditors: amounts falling due after more than one year</b>			
Amounts owed to group undertakings	19	-	220
<b>Total liabilities</b>		<u>37,946</u>	<u>37,491</u>

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**BALANCE SHEET AS AT 31 DECEMBER 2015 (continued)**

The financial statements on pages 11 to 40 were approved by the board of directors on 24 March 2016. The accounting policies and notes on pages 16 to 40 form an integral part of these financial statements.



H A Hussain  
Director



**PRUDENTIAL RETIREMENT INCOME LIMITED**

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2015**

	<b>Share Capital</b>	<b>Profit &amp; Loss Account</b>	<b>Total</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Balance at 1 January 2014	858	1,989	2,847
<b>Total comprehensive income for the year</b>			
Profit	-	445	445
Other comprehensive income	-	-	-
Total comprehensive income for the year	-	445	445
Balance at 31 December 2014	<u>858</u>	<u>2,434</u>	<u>3,292</u>
<b>Balance at 1 January 2015</b>	<b>858</b>	<b>2,434</b>	<b>3,292</b>
<b>Total comprehensive income for the year</b>			
Profit	-	466	466
Other comprehensive income	-	-	-
Total comprehensive income for the year	-	466	466
<b>Balance at 31 December 2015</b>	<u><b>858</b></u>	<u><b>2,900</b></u>	<u><b>3,758</b></u>

The accounting policies and notes on pages 16 to 40 form an integral part of these financial statements.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

#### **1. Accounting Policies**

##### **A. Basis of preparation**

Prudential Retirement Income Limited is a Company incorporated and domiciled in the UK.

These financial statements present information about the undertaking as an individual and not about its group. The Company has taken advantage of the exemption not to prepare group financial statements under Section 400 of the Companies Act 2006, since it is included in the consolidated financial statements of Prudential plc, a Company registered in England and Wales.

These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (FRS101), Part 15 of the Companies Act 2006 and Schedule 3 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ("Adopted IFRSs"), but makes amendments where necessary in order to comply with Companies Act 2006 and has set out below where advantage of the FRS101 disclosure exemptions has been taken.

The immediate parent company is The Prudential Assurance Company Limited. The Company's ultimate parent undertaking, Prudential plc includes the Company in its consolidated financial statements. The consolidated financial statements of Prudential plc are prepared in accordance with IFRS and are available to the public. Copies of these accounts can be obtained from the Company Secretary, Laurence Pountney Hill, London EC4R 0HH.

In these financial statements, the Company has applied the exemptions available under FRS101 in respect of the following disclosures:

- a Cash Flow Statement and related notes;
- Comparative period reconciliations for share capital;
- Disclosures in respect of transactions between wholly owned subsidiaries within the Prudential Group;
- The effects of new but not yet effective IFRSs;
- An additional balance sheet for the beginning of the earliest comparative period following the retrospective change in accounting policy to adopt FRS101; and
- Disclosures in respect of the compensation of Key Management Personnel.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements and in preparing an opening FRS101 balance sheet at 1 January 2014 for the purposes of the transition to FRS101.

The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The table below sets out the areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements.

Critical accounting estimates and assumptions	Accounting policy/note reference
Classification of insurance and investment contracts	C
Measurement of long-term business provision	C and 18
Determination of fair value of financial investments	F and 24

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

The Company is a subsidiary within the Prudential Group and it, its parent company and the ultimate parent company are continuing to trade profitably and there are no plans for liquidation. The Company generates positive cashflows and has very low debt-financing. In addition consideration has also been given to the Company's performance, the market in which it operates, its strategy and risks and uncertainties, as set out in the Business Review in the Directors Report, the management of financial risk as set out in note 26, including its exposure to credit and liquidity risk which it carefully manages through cash-flow forecasting and fund management.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

In assessing the going concern of the Company, the directors have assessed the Company's current solvency position under Solvency II, which became effective on 1 January 2016, and considers the Company to have a healthy solvency margin.

#### **B. Changes to accounting policies**

In these financial statements, the Company has adopted FRS101 for the first time.

In the transition to FRS101, the Company has applied IFRS1 whilst ensuring that its assets and liabilities are measured in compliance with FRS101. The Company has made no measurement and recognition adjustments and as such there has been no impact on the previously reported financial position and financial performance of the Company.

#### **C. Long-term business provision**

Under IFRS4, the measurement basis of assets and liabilities of long-term business contracts is dependent upon the classification of the contracts as either insurance contracts, if the level of insurance risk is significant, or investment contracts if the risk is insignificant. The Company's contracts are all classed as insurance contracts.

As permitted by IFRS4, insurance contracts are accounted for under previously applied UK GAAP and therefore the modified statutory basis of reporting has continued to be applied.

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

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

The technical provisions are the discounted value of future claim payments, adjusted for investment expenses and future administration costs. Claim payments allow for the effects of mortality in line with the bases set out in Note 18. These bases have been derived from an analysis of recent population and internal mortality experience and make allowance for improvements in mortality in the future. The assumptions also seek to take into account the impact of anti-selection.

The interest rates used for discounting claim payments are derived from the yield on the assets held and make allowance for potential defaults on those assets (Note 18). Long-term rates of default appropriate to the assets held have been set based on an investigation into historic rates of default by credit rating, term to redemption and security.

#### **D. Reinsurance**

The Company seeks to reduce loss exposure by reinsuring certain levels of risk in various areas of exposure with other insurance companies or reinsurers.

The measurement of reinsurance assets is consistent with the measurement of the underlying direct insurance contracts. An asset or liability is recognised in the balance sheet representing premiums due to or payments due from reinsurers and the share of benefits and claims recoverable from reinsurers.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

#### **E. Classification of instruments issued by the Company**

Having adopted FRS101, IAS32 is being applied to financial instruments issued by the Company and are treated as equity only to the extent that they meet the following two conditions:

- (i) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company; and
- (ii) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company's exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

#### **F. Financial Instruments**

##### **Financial assets**

Under IAS39, upon initial recognition financial investments are recognised at fair value. The Company is permitted, subject to specific criteria, to designate its investments as either financial investments at fair value through profit and loss, financial investments held on an available-for-sale basis, financial investments held to maturity, or loans and receivables. The Company holds financial investments on the following bases:

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

The Company uses bid prices to value its quoted financial investments. Actively traded investments without quoted prices are valued using external broker bid prices. If there is no active established market for an investment, the Company applies an appropriate valuation technique such as discounted cash flow technique.

Land and buildings are held either to earn rental income or for capital appreciation or for both. In applying the fair value IAS 40 Investment Property: Investment properties are held at fair value - any gains or losses arising from changes in the fair value are recognised in the profit or loss in the period that they arise and no depreciation is provided in respect of investment properties applying the fair value model.

Land and buildings are valued annually by a number of different professional external valuers on a Market Value basis, as defined in the Appraisal and Valuation manual issued by the Royal Institute of Chartered Surveyors, in particular Practice Statement 3.2. No depreciation is provided on land and buildings held for investment purposes in accordance with IAS 40.

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

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

##### **Financial liabilities**

Financial liabilities are designated as either fair value through profit and loss or amortised cost.

The Company holds financial liabilities that are valued at amortised cost and creditors are shown at settlement value.

Derivative liabilities are valued at fair value with all changes thereon being recognised separately in the Statement of Comprehensive Income.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

#### **G. Revenue recognition**

Annuity premiums and payments are recognised when due. Surrenders are accounted for when paid. Death claims and all other claims are accounted for when notified. Index linked annuity business has been disclosed as linked for the purposes of these financial statements.

Investment income and realised and unrealised gains in respect of long-term business are included in the long-term business technical account. Other investment income and realised and 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.

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

#### **H. Taxation**

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity or other comprehensive income, in which case it is recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

#### **I. Foreign Currencies**

The accounts are presented in pounds sterling which is also the Company's functional currency. Monetary foreign currency assets and liabilities are translated at year end exchange rates. Foreign currency revenue transactions are translated at the rates ruling at the transaction dates, except for accrued revenue items that are translated at year end exchange rates. Exchange differences are included in profit or loss.

## PRUDENTIAL RETIREMENT INCOME LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)

#### 2. Analysis of premiums

##### (a) Gross premiums written

	2015 £m	2014 £m
<b>Pension annuities</b>		
- Level and fixed increasing	977	1,031
- Index linked	898	1,285
	<u>1,875</u>	<u>2,316</u>
<b>Comprising:</b>		
<b>External direct premiums:</b>		
- Immediate annuities	1,555	1,806
- Deferred annuities	-	(1)
	<u>1,555</u>	<u>1,805</u>
<b>External reinsurance accepted:</b>		
- Immediate annuities	76	81
<b>Reinsurance from a related party:</b>		
- Immediate annuities	244	430
<b>Total</b>	<u>1,875</u>	<u>2,316</u>

All premiums are single premium business. All business is written in the United Kingdom. Group pension schemes included in premiums are £1,506m (2014: £1,711m).

#### 3. Revenue and investment return

	Long-term business technical account		Non-technical account	
	2015 £m	2014 £m	2015 £m	2014 £m
Investment income				
Income from land and buildings	79	81	-	-
Income from debt securities	1,066	1,071	56	36
Income from mortgage loans and other loans	12	12	1	1
Income from deposits with credit institutions	1	1	-	1
Income from other investments	89	86	5	6
Gains on the realisation of investments at fair value through the profit and loss other than derivatives	591	216	14	61
Gains on the realisation of derivatives	(18)	4	7	-
	<u>1,820</u>	<u>1,471</u>	<u>83</u>	<u>105</u>
Unrealised gains on investments				
Land and buildings	66	6	-	-
Equity	-	9	-	-
Debt securities	(1,333)	1,895	(77)	94
Derivatives	(13)	138	(2)	-
Linked assets	(308)	612	-	-
	<u>(1,588)</u>	<u>2,660</u>	<u>(79)</u>	<u>94</u>
Investment expenses and charges				
Investment manager expenses	(21)	(18)	-	(1)
Interest payable	(26)	(673)	(1)	(2)
Total investment expenses and charges	<u>(47)</u>	<u>(691)</u>	<u>(1)</u>	<u>(3)</u>
<b>Total revenue and investment return</b>	<u>185</u>	<u>3,440</u>	<u>3</u>	<u>196</u>

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015  
(continued)**

**4. Tax on profit on ordinary activities**

**(a) Analysis of charge in the period**

	Long-term business technical account		Non-technical account	
	2015 £m	2014 £m	2015 £m	2014 £m
Current tax				
UK Corporation tax on profits of the period	<u>140</u>	<u>107</u>	<u>1</u>	<u>42</u>
	<u>140</u>	<u>107</u>	<u>1</u>	<u>42</u>
Deferred tax				
Origination and reversal of temporary differences	(24)	(24)	-	-
Impact of reduction in tax rate	(11)	-	-	-
<b>Tax charge on profit on ordinary activities</b>	<u>105</u>	<u>83</u>	<u>1</u>	<u>42</u>

**Analysis of shareholder tax:**

	2015 £m	2014 £m
Current tax	141	149
Deferred tax	(35)	(24)
<b>Total</b>	<u>106</u>	<u>125</u>

**(b) Factors affecting tax charge for the period**

In July 2015, the UK Government announced additional reductions in the main rate of corporation tax to 19% from 1 April 2017 and to 18% from 1 April 2020. These additional reductions are reflected in the above figures as the changes were substantively enacted at the balance sheet date.

Other than the effects of permanent differences and adjustments in respect of previous periods, it is not expected that the tax charge will deviate from that calculated by applying the standard rate of corporation tax to the profit before tax of the Company.

	2015 £m	2014 £m
Profit on ordinary activities before tax	572	570
Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 20.25% (2014: 21.5%)	116	123
Temporary difference		
- Effect of life tax transitional adjustment	25	26
<b>Total tax charge for the period</b>	<u>141</u>	<u>149</u>

**(c) Balance sheet**

	2015 £m	2014 £m
Provision for deferred tax		
Transitional adjustments	160	195
Undiscounted provision for deferred tax liability	<u>160</u>	<u>195</u>

	2015 £m	2014 £m
Deferred tax liability at start of year	195	219
Deferred tax (credited) in technical account for the year	(35)	(24)
<b>Deferred tax liability at end of year</b>	<u>160</u>	<u>195</u>

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

## PRUDENTIAL RETIREMENT INCOME LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)

#### 5. Acquisition costs

Included within the total for acquisition costs are commissions of £3m (2014: £7m).

#### 6. Staff costs

The Company has no employees (2014: Nil). Included within net operating expenses are amounts paid in return for management services provided to the Company by other group companies.

#### 7. Directors' emoluments

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

	2015 £	2014 £
Aggregate emoluments and non-pension benefits	<u>405,190</u>	<u>492,562</u>

During the year five (2014: five) directors were entitled to shares under the Prudential's main long-term incentive scheme. One director is entitled to retirement benefits under the defined benefit scheme and three directors participated in the defined contribution scheme.

The aggregate of emoluments and amounts receivable under long-term incentive schemes of the highest paid director included in the above figure was £171,814 (2014: £232,381). During the year the highest paid director did not exercise any share options but did receive shares under a long-term incentive scheme.

#### 8. Auditor's remuneration

	2015 £'000	2014 £,000
Audit of these financial statements	71	71
Other services pursuant to legislation including the audit of the regulatory return	30	30
	<u>101</u>	<u>101</u>

Amounts receivable by the Company's auditor and its associates in respect of services to the Company and its associates, have not been disclosed as the information is required instead to be disclosed on a consolidated basis in the consolidated financial statements of the Company's ultimate parent, Prudential plc.

#### 9. Investments

	Cost		Carrying Value	
	2015 £m	2014 £m	2015 £m	2014 £m
Freehold land and buildings	461	460	564	513
Leasehold land and buildings	413	409	468	444
Derivative assets	19	13	355	352
Debt securities and other fixed income securities	20,348	19,296	22,468	22,861
Loans secured by mortgages	257	361	257	361
Other loans	3	3	3	3
Deposits with credit institutions	1,032	739	1,032	739
	<u>22,533</u>	<u>21,281</u>	<u>25,147</u>	<u>25,273</u>



## PRUDENTIAL RETIREMENT INCOME LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)

Amounts included in the above ascribed to listed investments:

	Current Value	
	2015 £m	2014 £m
Debt securities and other fixed income securities	<u>20,106</u>	<u>20,395</u>
	<u>20,106</u>	<u>20,395</u>

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

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

	Freehold and leasehold land and buildings	
	2015 £m	2014 £m
At cost	874	869
Aggregated depreciation	(145)	(123)
<b>Net book value based on historical cost</b>	<u>729</u>	<u>746</u>

#### 10. Loans to group undertakings

	Cost		Carrying Value	
	2015 £m	2014 £m	2015 £m	2014 £m
Loans to group undertakings	<u>1,274</u>	<u>1,233</u>	<u>1,274</u>	<u>1,233</u>

During 2015 the Company received loan repayments of £214m (2014: £108m) which related to loans to The Prudential Assurance Company Limited and Prudential Lifetime Mortgages Limited. One new loan agreement with The Prudential Assurance Company Limited for £200m was entered into during 2015 (2014: £Nil). Of the total loans, £200m (2014: £Nil) is to be repaid within one year and £1,074m (2014: £1,233m) have no set term.

#### 11. Assets held to cover linked liabilities

	Cost		Carrying Value	
	2015 £m	2014 £m	2015 £m	2014 £m
Assets held to cover linked liabilities	<u>5,142</u>	<u>4,465</u>	<u>5,061</u>	<u>4,721</u>

#### 12. Other Debtors

	2015 £m	2014 £m
Debtors arising out of reinsurance operations	-	1
Amounts due from group undertakings	33	28
Due from stockbrokers	-	1
	<u>33</u>	<u>30</u>

#### 13. Bank current accounts

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

## PRUDENTIAL RETIREMENT INCOME LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)

#### 14. Assets attributable to the long-term business fund

Of the total assets shown on the balance sheet, £35,787m (2014: £35,644m) is attributable to the long-term business fund.

#### 15. Share capital

	2015 £m	2014 £m
Issued and fully paid		
837,700,000 ordinary shares (2014: 837,700,000) of £1 each	838	838
20,000,000 preference shares (2014: 20,000,000) of £1 each	20	20
	<u>858</u>	<u>858</u>

There has been no increase in the share capital in the year.

The Preference Shares issued carry the right to receive a non-cumulative preferential Dividend which shall accrue at the rate of two pence per annum. The Preference Shares may not be redeemed otherwise than at the option of the Company.

The Preference Shares carry no voting rights except if a resolution is proposed in relation to (i) the winding up of the Company, a voluntary arrangement with creditors of the Company or proposed receivership, administrative receivership or administration of the Company; or (ii) an alteration of the rights of the Preference Shares or in relation to any other matter which will have detrimental effect upon the rights of the Preference Shares.

#### 16. Policyholder liabilities (net of reinsurance)

	Claims outstanding £m	Technical provision for linked liabilities £m	Long-term business provision £m
<b>Balance at 1 January 2015</b>	<b>5</b>	<b>4,721</b>	<b>17,334</b>
Movement in technical provisions for the year			
Gross amount	-	542	(712)
Reinsurers'share	-	(203)	71
Profit and loss account	1	-	-
<b>Balance at 31 December 2015</b>	<u><b>6</b></u>	<u><b>5,060</b></u>	<u><b>16,693</b></u>

	Claims outstanding £m	Technical provision for linked liabilities £m	Long-term business provision £m
Balance at 1 January 2014	4	3,576	16,322
Movement in technical provisions for the year			
Gross amount	-	1,719	2,495
Reinsurers'share	-	(574)	(1,483)
Profit and loss account	1	-	-
<b>Balance at 31 December 2014</b>	<u><b>5</b></u>	<u><b>4,721</b></u>	<u><b>17,334</b></u>

The reinsurer's share of technical provisions for long-term business at 31 December 2015 is £5,771m (2014: £5,639m). Of this, 6% (2014: 2%) relates to companies outside of the Prudential Group and of these 100% (2014: 100%) of the balance were from reinsurers with S&P's rating of A and above, based on the ratings at 31 December 2015. The remaining 94% (2014: 98%) relates to reinsurance agreements with other Prudential Group companies. There are no gains or losses arising from these reinsurance agreements.

## PRUDENTIAL RETIREMENT INCOME LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)

#### 17. Capital requirements and management

Up to 31 December 2015, UK insurers, regulated by the PRA, had to hold capital resources equal at least to the Minimum Capital requirement (MCR) under the Solvency I basis. In addition the rules required insurers to perform Individual Capital Assessments. Under these rules insurers assessed for themselves the amount of capital needed to back their business. If the PRA viewed the results of this assessment as insufficient, it might draw up its own Individual Capital Guidance for a firm which could be superimposed as a requirement. These requirements were replaced by the Solvency II regime on 1 January 2016 which is discussed further in the Strategic Report.

The available capital of £3,023m (2014: £2,786m) reflects the excess of regulatory basis assets over liabilities of the fund, before deduction of the capital resources requirement of £998m (2014: £1,008m).

The capital resources requirement for this Company broadly reflects a formula which, for active funds, equates to a percentage of regulatory reserves plus a percentage of death strains. This excess of available capital over capital resources requirement is monitored during the year. In addition, a realistic assessment of available capital and capital requirements sufficient to cover a 1 in 200 year event is undertaken. Additional capital is sought from the parent company as necessary.

	2015 £m	2014 £m
<b>Shareholders' equity</b>		
Held outside long-term funds	2,054	2,231
Held in long-term funds	1,704	1,061
Total shareholder funds	3,758	3,292
<b>Adjustments to regulatory basis</b>		
Other adjustments to restate these amounts to a regulatory basis	(735)	(506)
Total available capital resources on a regulatory basis	3,023	2,786

Up until 31 December 2015, under the Solvency I basis, for the Company and all other UK long-term insurers, long-term business assets and liabilities must, by law, be maintained in funds separate from those for the assets and liabilities attributable to non-life insurance business or to shareholders. Only the 'established surplus', the excess of assets over liabilities in the long-term fund determined through a formal valuation, may be transferred so as to be available for other purposes.

The amounts retained within the Company are at levels which provide an appropriate level of capital strength in excess of the regulatory minimum.

The concept of long-term fund as described above for the UK was abolished under the Solvency II regime, which came into effect on 1 January 2016. The Company will be required to meet the new capital maintenance requirements. Further information on the Solvency II capital requirements is provided in the Strategic Report.

#### 18. Long-term business provision

Analysis of movements in insurance liabilities:

	2015 £m	2014 £m
<b>Balance at 1 January</b>	27,699	23,484
Premiums	1,786	2,457
Surrenders	(16)	(10)
Maturities/deaths	(1,780)	(1,630)
Assumption changes	(162)	13
Investment-related items and other movements	3	3,385
<b>Balance at 31 December</b>	27,530	27,699

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

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

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

## PRUDENTIAL RETIREMENT INCOME LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)

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

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

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

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

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

The key assumptions made at 31 December 2014 and 31 December 2015 are shown below.

#### **Mortality**

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

The mortality assumptions also include an allowance for expected future improvements in longevity. For males, these future mortality improvements are in line with Prudential's own calibration of the CMI 2014 mortality model, with a long-term improvement rate of 2.25% p.a. For females, the future mortality improvements are in line with Prudential's own calibration of the CMI 2014 mortality model, with a long-term improvement rate of 1.50% p.a. Compared with the core CMI mortality model, Prudential's calibration:

- (a) blends period improvements between ages 60 to 80 to the long-term improvement rate over a 15 year period (compared with a 20 year period in the core CMI model), and
- (b) assumes that cohort improvements dissipate over a 30 year period, or by age 90 if earlier (compared with a 40 year period, or by age 100 if earlier, in the core CMI model).
- (c) introduces a floor or minimum value equal to the long-term rate of improvements; and
- (d) includes an adjustment of 0.25% to the initial rates of improvement.

The impact of mortality assumption changes during the year was a reduction to liabilities of £207m. This included the impact of changing from CMI 2012 to CMI 2014.

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

	2015		2014	
	Males	Females	Males	Females
In payment:	93% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2014 model, with a long-term improvement rate of 2.25% p.a.	82% - 96% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2014 model, with a long-term improvement rate of 1.50% p.a.	91% - 95% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2012 model, with a long-term improvement rate of 2.25% p.a.	84% - 98% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2012 model, with a long-term improvement rate of 1.50% p.a.
In deferment:	AM92 - 4 years	AF92 - 4 years	AM92 - 4 years	AF92 - 4 years

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

#### **Interest rate**

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

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

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

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

The credit risk assumption is also reviewed annually and reflects the assets actually held. The assumption about the future level of defaults is 43 basis points per annum (46 basis points per annum at 31 December 2014), which is able to cover a significantly adverse credit situation.

#### **Credit risk provisions**

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

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

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

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

The allowance for credit risk comprises:

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

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015**  
(continued)

The weighted components of the bond spread over swap rates for fixed and linked annuity business at 31 December 2015 and 31 December 2014, based on the asset mix at the relevant balance sheet date are shown below.

		Pillar 1 regulatory basis (bps)	Adjustment from regulatory to IFRS basis (bps)	IFRS (bps)
<b>31 December 2015</b>				
Bond spread over swap rates	(a)	171	-	171
Credit risk allowance				
Long-term expected defaults	(b)	13	-	13
Additional provisions	(c)	42	(12)	30
Total credit risk allowance		55	(12)	43
Liquidity premium		116	12	128
		Pillar 1 regulatory basis (bps)	Adjustment from regulatory to IFRS basis (bps)	IFRS (bps)
<b>31 December 2014</b>				
Bond spread over swap rates	(a)	143	-	143
Credit risk allowance				
Long-term expected defaults	(b)	14	-	14
Additional provisions	(c)	44	(12)	32
Total credit risk allowance		58	(12)	46
Liquidity premium		85	12	97

**Notes**

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

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

Movement in the credit risk allowance for the year ended 31 December 2015

The movement during 2015 of the average basis points allowance on Pillar 1 regulatory and IFRS bases are as follows:

	Pillar 1 Regulatory basis (bps) Total	IFRS (bps) Total
Total allowance for credit risk at 31 December 2014	58	46
Credit rating changes	2	1
Asset trading	(2)	(2)
Other (including new business)	(3)	(2)
<b>Total allowance for credit risk at 31 December 2015</b>	<b>55</b>	<b>43</b>

In 2010 and prior periods, surplus from favourable default experience was retained within short-term allowances for credit risk on both the Pillar 1 and IFRS bases. For full years 2011, 2012 and 2013 the retention of such surpluses continued to be applied under IFRS but not under Pillar 1. For full years 2014 and 2015, surplus experience is not retained in either the IFRS or Pillar 1 credit risk allowances.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

Overall the movement has led to the credit allowance for Pillar 1 purposes to be 32% (2014: 41%) of the bond spread over swap rates. For IFRS purposes it represents 25% (2014: 32%) of the bond spread over swap rates.

The reserve for credit risk allowance at 31 December 2015 on a Pillar 1 regulatory basis was £1.9bn (2014: £2.0bn) and on an IFRS basis was £1.5bn (2014: £1.6bn).

#### **Expenses**

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

#### **Other assumptions**

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

#### **19. Amounts owed to group undertakings**

Included within this balance is a contingent loan (including interest) of £49m (2014: £220m) repayable to The Prudential Assurance Company Limited. During the year a repayment of £178m (2014: £79m) was made in respect of this loan. This loan was repaid in full in March 2016.

#### **20. Charges**

In the normal course of business certain reinsurance liabilities were secured by a floating charge, ranking these liabilities equally with amounts due under unsecured direct (non-reinsurance) policies, over the long-term insurance assets of the Company. Amounts secured by charges of this nature were £8,297m and £437m (2014: £8,685m and £470m) representing individual liabilities to one customer.

#### **21. Guarantees and Commitments**

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

#### **22. Related party transactions**

The Company has taken advantage of the exemption under paragraph 8(k) of FRS101 from disclosing transactions with other subsidiary undertakings of the Prudential Group. There were no other transactions with related parties.

#### **23. Immediate and ultimate parent company**

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

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015  
(continued)**

**24. Assets and liabilities**

**A. Assets and liabilities – classification and measurement**

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

2015	Fair value through profit and loss	Cost/ Amortised Cost/IFRS4 value	Total carrying value	Fair value where applicable
	£m	£m	£m	£m
Loans to group undertakings	-	1,274	1,274	1,274
Deposits with credit institutions	-	1,032	1,032	1,032
Debt securities	22,468	-	22,468	22,468
Loans:				
Loans secured by mortgages	-	257	257	294
Other loans	-	3	3	3
Derivative assets	355	-	355	355
Assets held to cover linked liabilities	5,061	-	5,061	5,061
Other debtors	-	33	33	33
Cash at bank and in hand	-	226	226	226
Accrued interest and rent	-	434	434	434
<b>Total financial assets</b>	<b>27,884</b>	<b>3,259</b>	<b>31,143</b>	

2015	Fair value through profit and loss	Cost/ Amortised Cost/IFRS4 value	Total carrying value	Fair value where applicable
	£m	£m	£m	£m
Derivative liabilities	533	-	533	533
Creditors arising out of reinsurance operations	-	6	6	6
Creditors arising out of direct insurance operations	-	1	1	1
Deposits from ceding undertakings	-	4,584	4,584	4,584
Amounts owed to credit institutions	-	1,067	1,067	1,067
Other creditors including taxation and social security	-	254	254	254
Amounts owed to group undertakings	-	53	53	53
<b>Total financial liabilities</b>	<b>533</b>	<b>5,965</b>	<b>6,498</b>	



**PRUDENTIAL RETIREMENT INCOME LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015**  
(continued)

2014	Fair value through profit and loss £m	Cost/Amortised Cost/IFRS4 value £m	Total carrying value £m	Fair value where applicable £m
Loans to group undertakings		1,233	1,233	1,233
Deposits with credit institutions	-	739	739	739
Debt securities	22,861	-	22,861	22,861
Loans:				
Loans secured by mortgages	-	361	361	386
Other loans	-	3	3	3
Derivative assets	352	-	352	352
Assets held to cover linked liabilities	4,721	-	4,721	4,721
Debtors arising out of reinsurance operations	-	1	1	1
Other debtors	-	29	29	29
Cash at bank and in hand	-	182	182	182
Accrued interest and rent	-	413	413	413
<b>Total financial assets</b>	<b>27,934</b>	<b>2,961</b>	<b>30,895</b>	

2014	Fair value through profit and loss £m	Cost/Amortised Cost/IFRS4 value £m	Total carrying value £m	Fair value where applicable £m
Derivative liabilities	287	-	287	287
Creditors arising out of reinsurance operations	-	1	1	1
Deposits from ceding undertakings	-	4,755	4,755	4,755
Amounts owed to credit institutions	-	836	836	836
Other creditors including taxation and social security	-	200	200	200
Amounts owed to group undertakings	-	226	226	226
<b>Total financial liabilities</b>	<b>287</b>	<b>6,018</b>	<b>6,305</b>	

As at 31 December 2015 no convertible bonds (2014: £Nil) were included in debt securities. There were no convertible bonds included in borrowings (2014: £Nil).

Derivative liabilities are deemed as fair value through profit and loss.

**B. Financial assets and liabilities – determination of fair value**

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

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

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

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

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

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

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

#### **Level 1, 2 and 3 fair value measurement hierarchy of financial instruments**

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

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

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

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

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

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

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £18,366m (2014: £18,140m), £2,284m (2014: £2,345m) are valued internally. The majority of such securities use matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring a specified liquidity premium. The significance of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

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

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

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015**  
(continued)

Of the £1,587m (2014: £1,451m) level 3 items which support non-linked shareholder-backed business 13% (2014: Nil%) of the total assets net of derivative liabilities backing this business are valued externally. Internal valuations, which represent 10% for levels 1 to 3 (2014: 4%) of the total assets net of derivative liabilities supporting non-linked shareholder-backed business, are inherently more subjective than external valuations.

If the value of all level 3 investments backing non-linked shareholder-backed business was varied by 10%, the change in valuation would be £159m (2014: £145m), which would reduce or increase shareholders' equity by this amount before tax.

2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Debt securities	3,898	18,366	204	22,468
Derivative assets	-	355	-	355
Assets held to cover linked liabilities	1,300	4,342	351	5,993
Land and buildings	-	-	1,032	1,032
Derivative liabilities	-	(533)	-	(533)
<b>Total financial investments, net of derivative liabilities:</b>	<b>5,198</b>	<b>22,530</b>	<b>1,587</b>	<b>29,315</b>
<b>Percentage of total</b>	<b>18%</b>	<b>77%</b>	<b>5%</b>	<b>100%</b>

2014	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Debt securities	4,572	18,140	149	22,861
Derivative assets	-	352	-	352
Assets held to cover linked liabilities	1,107	4,169	345	5,621
Land and buildings	-	-	957	957
Derivative liabilities	-	(287)	-	(287)
<b>Total financial investments, net of derivative liabilities:</b>	<b>5,679</b>	<b>22,374</b>	<b>1,451</b>	<b>29,504</b>
<b>Percentage of total</b>	<b>19%</b>	<b>76%</b>	<b>5%</b>	<b>100%</b>

Assets held to cover linked liabilities, shown in the table, only cover those assets which are required to be disclosed for the fair value hierarchy.

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

The following table reconciles the value of level 3 financial instruments at 1 January 2015 to that presented at 31 December 2015. Total gains and losses recorded in the long-term technical account in the period represents realised gains and losses, including interest and dividend income, unrealised gains and losses on financial instruments classified at fair value through profit and loss and foreign exchange movements on overseas investments. All these amounts are included within "investment income" and "unrealised gains (losses)" in the long-term technical account.

2015	At 1 Jan 2015	Total gains in long- term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2015
	£m	£m	£m	£m	£m	£m	£m
Debt securities	149	(11)	63	-	3	-	204
Land and buildings	957	81	-	(6)	-	-	1,032
Assets held to cover linked liabilities	345	-	6	-	-	-	351
<b>Total financial investments, net of derivative liabilities</b>	<b>1,451</b>	<b>70</b>	<b>69</b>	<b>(6)</b>	<b>3</b>	<b>-</b>	<b>1,587</b>

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

2014	At 1 Jan 2014	Total gains in long-term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2014
	£m	£m	£m	£m	£m	£m	£m
Equity securities	1	2	-	(3)	-	-	-
Debt securities	59	2	-	(33)	149	(28)	149
Land and buildings	855	3	99	-	-	-	957
Assets held to cover linked liabilities	339	-	6	-	-	-	345
Total financial investments, net of derivative liabilities	1,254	7	105	(36)	149	(28)	1,451

#### **Transfers between level 1 and level 2**

During 2015 there were £55m transfers between level 1 and 2 that related to debt securities.

#### **Exposure to sovereign debt and bank debt**

The Company's exposure to the eurozone sovereigns of Portugal, Italy, Ireland, Greece and Spain (PIIGS) is £54m (2014: £61m). The Company's exposure to banking operations in these eurozone countries is £46m (2014: £67m). The Company has no exposure in Greece (2014: £Nil).

#### **C. Market risk**

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

Market risk comprises three types of risk, namely:

- Interest rate risk: due to changes in market interest rates,
- Currency risk: due to changes in foreign exchange rates, and
- Other price risk: due to fluctuations in market prices (other than those arising from interest rate risk or currency risk).

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

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

#### **Interest rate risk**

##### **Interest income and expense**

The interest income on financial assets not at fair value through profit and loss was £14m for the year ended 31 December 2015 (2014: £14m).

There is no interest expense on financial liabilities not at fair value through profit and loss for the year ended 31 December 2015 (2014: £Nil).

## PRUDENTIAL RETIREMENT INCOME LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)

#### Sensitivity to interest rate movement

The close matching by the Company of assets of appropriate duration to its annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and FRS 101 is not the same, with contingency reserves and some other margins for prudence within the assumptions required under the PRA regulatory solvency basis not included for FRS101 reporting purposes. As a result FRS 101's shareholders' funds are higher than regulatory capital and therefore more sensitive to interest rate risk.

The estimated sensitivity of the shareholder-backed business to a movement in interest rates of 1% and 2% as at 31 December 2015 and 2014 are as follows:

2015	Fall of 2%	Fall of 1%	Rise of 1%	Rise of 2%
	£m	£m	£m	£m
Carrying value of debt securities and derivatives	9,753	4,326	(3,531)	(6,476)
Long-term business provision	(7,838)	(3,504)	2,871	5,251
Related tax effects	(345)	(148)	119	221
<b>Net sensitivity of profit after tax and shareholders' funds</b>	<b>1,570</b>	<b>674</b>	<b>(541)</b>	<b>(1,004)</b>
2014	Fall of 2%	Fall of 1%	Rise of 1%	Rise of 2%
	£m	£m	£m	£m
Carrying value of debt securities and derivatives	9,941	4,350	(3,487)	(6,338)
Long-term business provision	(8,556)	(3,803)	3,085	5,619
Related tax effects	(277)	(109)	80	144
<b>Net sensitivity of profit after tax and shareholders' funds</b>	<b>1,108</b>	<b>438</b>	<b>(322)</b>	<b>(575)</b>

#### Currency risk

As at 31 December 2015, the Company held 4% (2014: 3%) and 7% (2014: 6%) of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency, Sterling.

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

#### Other Price Risk – Equities and Property

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

2015	A decrease of 20% £m	A decrease of 10% £m
Pre-tax profit	(206)	(103)
Related current tax effects	37	19
<b>Net sensitivity of profit after tax and shareholders' equity</b>	<b>(169)</b>	<b>(85)</b>

**PRUDENTIAL RETIREMENT INCOME LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015**  
(continued)

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

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

In the equity and property risk sensitivity analysis shown above the Company has, for 2015, considered the impact of an instantaneous 20 per cent fall in equity and property markets. If equity and property markets were to fall by more than 20 per cent, the Company believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Company would be able to put in place mitigating management actions.

**D. Liquidity Risk**

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

**Liquidity Analysis**

**Contractual maturities of financial liabilities**

The following table sets out the contractual maturities and repricing dates for applicable classes of financial liabilities, excluding derivative liabilities and investment contracts, which are separately presented. The financial liabilities are included in the column relating to the contractual maturities and repricing dates at the undiscounted cash flows (including contractual interest payments) due to be paid assuming conditions are consistent with those of year end.

2015	1 year or less	No stated maturity	Total undiscounted cashflows	Total carrying value
<b>Financial Liabilities</b>				
Amounts owed to credit institutions	1,067	-	1,067	1,067
Other borrowings not owed to credit institutions	49	-	49	49
	<u>1,067</u>	<u>-</u>	<u>1,116</u>	<u>1,116</u>
2014	1 year or less	No stated maturity	Total undiscounted cashflows	Total carrying value
<b>Financial Liabilities</b>				
Amounts owed to credit institutions	836	-	836	836
Other borrowings not owed to credit institutions	-	220	220	220
	<u>836</u>	<u>220</u>	<u>1,056</u>	<u>1,056</u>

## PRUDENTIAL RETIREMENT INCOME LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)

#### E. Derivatives and Hedging

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

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

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

#### Maturity analysis of derivatives

The net derivative position as at 31 December 2015 was a liability of £178m (2014: asset of £65m).

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

	2015 £m	2014 £m
Derivative assets	355	352
Derivative liabilities	(533)	(287)
<b>Net derivative position</b>	<b>(178)</b>	<b>65</b>

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

#### F. Credit Risk

##### Debt securities and other fixed income securities

The following table summarises by the rating, the securities held by the Company as at 31 December 2015 and 2014:

	2015 £m	2014 £m
S&P – AAA	3,103	3,038
S&P – AA+ to AA-	3,406	3,197
S&P – A+ to A-	4,718	5,961
S&P – BBB+ to BBB-	3,299	3,742
S&P – Other	176	182
	<u>14,702</u>	<u>16,120</u>
Moody's – Aaa	394	373
Moody's – Aa1 to Aa3	2,580	2,104
Moody's – A1 to A3	1,293	1,123
Moody's – Baa1 to Baa3	262	293
Moody's – Other	27	26
	<u>4,556</u>	<u>3,919</u>
Fitch	127	198
Other	3,083	2,624
<b>Total debt securities</b>	<b>22,468</b>	<b>22,861</b>

In the table above, S&P ratings have been used where available. For securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

Where no external ratings are available, internal ratings produced by the Prudential Group's asset management operations, which are prepared on a comparable basis to external ratings, are used where possible. Of the total debt securities held at 31 December 2015 which are not externally rated, £2,266m (2014: £1,800m) were internally rated AAA to A-, £755m (2014: £697m) were internally rated BBB to B- and £62m (2014: £127m) were unrated.

#### **Loans and receivables**

Of the total loans and receivables held £13m (2014 £Nil) are past their due date but have not been impaired. Of the total past due but not impaired, £13m (2014: £Nil) are less than 1 year past their due date. The Company expects full recovery of these loans and receivables. In accordance with accounting policy, impairment reviews were performed for loans and receivables. During the year ended 31 December 2015, no impairment losses (2014: £Nil) were recognised for loans and receivables.

#### **Securities lending and reverse repurchase agreements**

The Company has entered into securities lending (including repurchase agreements) whereby blocks of securities are loaned to third parties, primarily major brokerage firms. The amounts above the fair value of the loaned securities required to be held as collateral by agreements, depend on the quality of the collateral, calculated on a daily basis. The loaned securities are not removed from the Company's balance sheet, rather they are retained within the appropriate investment classification. Collateral, typically consists of cash, debt securities, equity securities and letters of credit. At 31 December 2015, the Company had lent £1,002m (2014: £1,169m) of securities and held collateral under such agreements of £1,022m (2014: £1,212m). Of this amount £62m (2014: £62m) related to another group company.

At 31 December 2015 the Company had entered into reverse repurchase transactions, under which it purchased securities and had taken on the obligation to resell the securities. The fair value of the collateral held in respect of these transactions was £651m (2014: £1,015m).

During 2015 and 2014 the Company did not take possession of any other collateral held as security.

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

#### **Collateral under derivative transactions**

At 31 December 2015, the Company had lent £236m (2014: £77m lent) for liabilities and held collateral of £317m (2014: £228m) in respect of over-the-counter derivative transactions.

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

Included within investment assets are £35m (2014: £35m) credit derivative swaps which are used to mitigate the Company's exposure to credit risk.

#### **G. Insurance Risk**

Profits from the shareholder backed annuity business are most sensitive to:

- The variance between actual and expected mortality experience;
- The extent to which changes in the assumed rate of improvements in mortality give rise to the changes in the measurement of liabilities;
- Change in credit default assumptions; and
- Changes in renewal expense levels

A decrease in assumed mortality rates of 1% would decrease pre-tax profits by approximately £47m (2014: £67m). A decrease in credit default assumption of 0.5% would increase pre-tax profits by £126m (£136m). A decrease in renewal expense (excluding asset management expenses) of 5% would increase pre-tax profits by £24m (£19m).

The effects on profits would be approximately symmetrical for changes in assumptions that are directionally opposite to those explained above.



## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

#### **25. Related undertakings**

On 6 April 2015 "The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015" came into force and are effective for financial years beginning on or after 1 January 2016. Notwithstanding this effective date, the exemption available under the Act to only list the principal subsidiary undertakings of the Company is no longer available for accounts approved on or after 1 July 2015.

The following is a list of direct subsidiary undertakings (shares held directly or via nominees) of the Company at 31 December 2015.

<b>Name</b>	<b>Class of Shares Held</b>	<b>Proportion Held</b>
Prudential Real Estate Investments 1 Limited	Ordinary Shares £100	100%
Prudential Equity Release Mortgages Limited	Ordinary Shares £100	100%

#### **26. Financial risk management**

##### Financial risks

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

The local economic outlook for 2016 is relatively unchanged from the previous year, with modest growth expected over the year. The global outlook continues to be mixed with increased uncertainty arising from a slowdown in China and increased volatility across global markets. This could adversely affect the Company's business and profitability. Interest rates within the UK and Eurozone remain close to historic lows, whilst the US raised interest rates in 2015 for the first time in nine years. Expectations regarding future interest rate paths are varied and this reflects the increased uncertainty across the global markets generally.

##### (a) Market risk

*Market risk is the risk of loss or adverse change in the financial condition of the Company resulting directly or indirectly from fluctuations in the level or volatility of market prices of assets and liabilities and changes in interest rates and exchange rates.*

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

##### (b) Credit risk

*Credit risk is the risk of loss to the Company resulting from fluctuations in the credit standing of issuers of securities, counterparties and debtors in the form of defaults, downgrades or widening of credit spreads.*

The Company is exposed to significant levels of credit risk which arises mainly from the corporate bond holdings backing the annuity business. Corporate borrowers continue to experience a challenging business environment and volatile profits and cash flows. This principally impacts credit risk through the following:

- Increased risk of credit losses through defaults and widening of credit spreads on corporate bonds. This is a material risk for the Company, although less significant in 2015 than in previous years due to market improvements, and is managed by careful management of the corporate bond portfolio and having appropriate concentration and credit rating limits in place;
- The Company, in the normal course of business enters into a variety of transactions with counterparties, including cash deposit, reinsurance and derivative transactions. Failure of any of these counterparties to discharge their obligations or where adequate collateral is not in place (e.g. in case of reinsurance counterparties), could have an adverse impact on the Company's results. The Company manages cash counterparty risk by using secured cash placements (such as reverse repos) and having counterparty concentration limits in place for unsecured cash deposits. Reinsurance counterparty risk is managed by diversifying reinsurance exposures across a number of counterparties and by having minimum counterparty credit rating limits and maximum concentration limits in place. Derivative counterparty risk is largely mitigated by careful counterparty selection and adequate collateralisation arrangements.

## **PRUDENTIAL RETIREMENT INCOME LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015 (continued)**

#### **(c) Insurance risk**

*Insurance risk is the risk of loss or of adverse change in the value of insurance liabilities of the Company, resulting from changes in the level, trend or volatility of a number of insurance risk drivers. These include adverse longevity and expense experience.*

The Company is exposed to significant levels of insurance risk. Insurance risk arises mainly in the form of longevity risk, which is the risk that the Company's (current and deferred) annuity customers live longer than allowed for in the Company's current pricing and reserving assumptions and as a result future reserving and capital assumptions are changed. The Company conducts rigorous research into longevity risk, using data from its annuitant portfolio. As part of its annuity reserving policy, the Company assumes that current rates of mortality continue to improve over time at levels based on the Company's calibration of the Continuous Mortality Investigations (CMI) 2014 mortality projection model as published by the Institute and Faculty of Actuaries.

If mortality improvement rates significantly exceed the improvement assumed, the Company's operating results could be adversely affected. Also any major medical breakthrough (for example in the treatment of cancer or other life-threatening diseases) that would require the Company to strengthen its longevity assumptions will have an impact on the Company's results.

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

In common with other industry participants, the profitability of the Company's businesses ultimately depends on a mix of factors including investment performance and asset impairments, longevity trends, unit cost of administration and new business acquisition expense.

#### **(d) Liquidity risk**

*Liquidity risk is the risk that the Company, although solvent on a balance sheet basis, does not have sufficient cash resources available to meet its obligations as they fall due or can secure them only at excessive cost.*

Liquidity risk is not a material risk for the Company. This risk is managed through careful management of bank balances, cash-flow forecasting, appropriate fund management (to ensure that assets are not unduly concentrated in less liquid investments) and detailed cash-flow matching for the annuity business.