

Registered No: 15454

## **THE PRUDENTIAL ASSURANCE COMPANY LIMITED**

**Annual Report and Financial Statements for the Year Ended  
31 December 2016**

**THE PRUDENTIAL ASSURANCE COMPANY LIMITED**

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

**Registered office: Laurence Pountney Hill, London EC4R 0HH**

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THE PRUDENTIAL ASSURANCE COMPANY LIMITED

**Directors**

Mr P Spencer - Chairman (appointed 1 January 2016)  
Mr M Wells - Deputy Chairman (resigned 29 September 2016)  
Mr J Deeks (appointed 21 October 2016)  
Mr N A Nicandrou  
Mr H A Hussain (resigned 19 July 2016)  
Mr M J Yardley  
Ms J Dawson (appointed 20 July 2016)  
Mr R Bennison (appointed 31 August 2016)  
Mr C Adamson  
Mr J Foley (appointed 19 January 2016)  
Ms C Bousfield (Appointed 10 November 2016)

**Company Secretary**

Ms J Fountain (resigned 22 January 2016)  
Mr G R S Dunlop (appointed 22 January 2016)

**Auditor**

KPMG LLP, London

**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

Principal activity

The principal activity of the Company in the course of 2016 was transacting long-term insurance business in the United Kingdom. Throughout 2016 the Company also owned several insurance subsidiary undertakings and a branch in Poland that transacted insurance business in the United Kingdom and overseas. These activities will continue in 2017.

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

Business review

Market review and strategy

The fundamentals underpinning the UK's retirement market are changing. Risk and responsibility for retirement provision continues to transfer away from the state and corporates to individuals. As customers adjust to the reforms introduced by Pension Freedoms in 2015, the new flexible arrangements to control their own pensions have been accompanied by significant complexity which is adding to the burden of personal responsibility to secure an income in retirement. Investment risk, longevity risk and inflation risk are to be mitigated by today's retirement saver.

Over 70 per cent of liquid assets in the UK are owned and controlled by the over 50s and as this demographic is expected to grow by over 2.1m between 2016 and 2030, more people, with more savings, will live longer. This provides significant new opportunities for the Company as the demand for risk-managed investments to fund retirement is predicted to rise accordingly.

Customer expectations are higher than ever. Increased life expectancy in retirement has put increased demands on long-term product performance, and technology is revolutionising the ways in which company and customer interact.

The Company's brand benefits from a heritage that stretches back 168 years and a franchise that is based on long-term thinking, longevity experience, market-leading multi-asset investment capability and financial strength. Such attributes continue to be highly sought after by customers adjusting to pension freedoms and by financial advisers who require a brand they can trust to help secure dependable incomes in retirement for their clients.

To support its customers in this changing environment, the Company's product and distribution profile has evolved by increasing the range of product options to mirror the flexibilities of the pension freedoms era. There has been a shift away from a reliance on annuity business to a focus on more flexible bond, ISA, pension and income drawdown products across a range of tax efficient solutions. The Company has responded to changes in the market following the introduction of pension freedoms by launching the Prudential Retirement Account - an online account based plan, that provides customers with the flexibility to save for their retirement, provide an income in retirement and facilitate access to their fund as they save. At its core is PruFund, the Company's unique customer proposition managed by the Prudential Portfolio Management Group, the Company's award-winning and market leading multi-asset management team. From a single fund when launched in 2004, PruFund today comprises six risk-rated funds, offers global investment diversification across 25 different asset-classes and delivers smoothing through the strength of the Company's With-Profits Fund.

Having identified a number of alternative capital deployment opportunities and following the introduction of Solvency II the Company and its subsidiaries did not write any bulk annuity business in 2016 and has now withdrawn from this market.

In response to the findings of the FCA's thematic review of non-advised annuity sales practices, the Company will review internally vesting annuities sold without advice by the Company and its subsidiaries after 1 July 2008. Reflecting this, the Company's 2016 result includes a provision of £175m for the cost of this review and related potential redress. The provision does not include potential insurance recoveries of up to £175m.

The Company is focused on maintaining the growth momentum created by the structural changes to retirement provision in the UK and on delivering a growth strategy underpinned by investment in product, service and distribution capabilities to meet the evolving needs of customers.

**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

Investment in technology is also enabling customers to engage more flexibly with the Company digitally and online. Easier access to product information for customers is provided by the My Pru App, while the Company's Retirement Ready Guide App was created to provide clear and easy-to-understand information for those coming up to retirement. Technology has also helped the Company to improve online services for advisers and enhance its tele-underwriting service for the Prudential Investment Plan, reducing the amount of time advisers spend on administration and freeing up time to spend with their clients.

The Company has also focused on deepening its already-strong relationships with independent financial advisers. An important part of the Company's service offering is the ongoing hands-on support for intermediary advisers from its regional sales units, technical helpline and business development and consultancy team. The Company's adviser webinars attracted more than 11,000 attendees in 2016 while also hosting 58 adviser seminars across the UK, covering a range of topical and technical subjects, to help these advisers deal with a changing regulatory landscape.

The evolving nature of how the Company interacts with customers is also driving ambitions to grow its direct-to-consumer business, where the Company has strengthened its capability ahead of a range of forthcoming developments, including launch of a direct-to-consumer ISA.

The Company's roll out of business in Poland continued in 2016 with sales increasing by 86 per cent in local currency terms. Significant milestones during the year included growing the number of financial planning consultants to 721, entering the multi-agency market and securing three affinity distribution deals with Polish telecommunications companies.

On 1 October 2016 the business of one of the Company's subsidiaries, Prudential Retirement Income Limited (PRIL), transferred into the Company following a Part VII Transfer under the Financial Services and Markets Act 2000. The quota share arrangement between the Company and PRIL increased from 20% to 100% on 1 January 2016 and subsequently ceased on the date of the transfer.

**Key performance indicators and measurement**

| Key Performance Indicators                                                                                                  | 2016<br>£m | 2015<br>£m |
|-----------------------------------------------------------------------------------------------------------------------------|------------|------------|
| New business profit                                                                                                         | 41         | 30         |
| Core operating profit <sup>note (i)</sup>                                                                                   | 261        | 306        |
| Non-core operating profit:                                                                                                  |            |            |
| Effect on operating profit caused by the initial increase in the PRIL reinsurance quota share arrangement on 1 January 2016 | 1,443      | —          |
| Effect of longevity reinsurance transactions                                                                                | 197        | 60         |
| Other management actions to improve solvency                                                                                | 135        | 57         |
| FCA thematic review provision                                                                                               | (175)      | —          |
| Total Operating Profit <sup>note (ii)</sup>                                                                                 | 1,902      | 453        |
| Non-operating profit items                                                                                                  | (1,539)    | 1,554      |
| Profit on ordinary activities before tax                                                                                    | 363        | 2,007      |
| Shareholders' funds                                                                                                         | 13,623     | 10,493     |
| APE sales <sup>note (iii)</sup>                                                                                             | 1,145      | 918        |
| Estimated Solvency II capital surplus: <sup>note (iv)</sup>                                                                 |            |            |
| Policyholders' capital surplus                                                                                              | 3,719      | 3,118      |
| Shareholders' capital surplus                                                                                               | 4,642      | 3,259      |

**Notes**

- (i) Core operating profit reflects the ongoing operations of the business.
- (ii) Operating profit is the underlying operating result based on longer term investment returns and excludes non-operating items such as the revaluation of, and dividends from, the Company's subsidiaries.
- (iii) Annual premium equivalent (APE) sales comprise regular premium sales plus one-tenth of single premium insurance sales.

**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

- (iv) As set out in available capital section on page 5 the estimated solvency position includes the impact of recalculated transitionals. The surplus in the 2015 column is at 1 January 2016.

Operating Profit

The operating profit from core in-force business of £261m is comprised of £269m (2015: £269m) from the with-profits fund and a loss of £8m (2015: profit £37m) from the shareholder fund. The with-profits shareholder transfer is unchanged from 2015, reflecting the stable nature of contributions from this source. The decrease in profits of £45m from a profit of £37m in 2015 to a loss of £8m in 2016 in the shareholder fund result includes an increase in the annuity business profits of £80m, caused mainly by the ongoing effect of the increase in quota share arrangement. This increase in profits is offset by other operating losses which have increased by £125m from a loss of £5m in 2015 to a loss of £130m in 2016. The main reasons for the increase in losses include various one-off items of expenditure occurring in 2016 (£92m) and the cessation of profits on protection business in 2016 (£40m in 2015).

The increase in the profits arising from longevity reinsurance and other management actions to improve solvency is caused primarily by the increase in the PRIL quota share arrangement from 20% to 100% on 1 January 2016.

Non-Operating Profit

The main component of the non-operating items is the revaluation of shareholder subsidiaries reported in the non-technical account. This has decreased by £2,309m from a profit of £1,304m in 2015 to a loss of £1,005m in 2016. This is caused primarily by a reduction in the value of PRIL following the Part VII transfer, partially offset by an increase in the value of the other subsidiaries, the most material of these being Prudential Hong Kong Limited.

Also included in non-operating results are losses of £586m as a result of short-term fluctuations (2015: loss of £29m). This comprises losses on the partial equity hedge of the shareholder transfers in respect of future years £220m (2015: profit of £32m), realised and unrealised losses on bonds transferred from PRIL following the Part VII transfer £102m, a loss of £173m on the transfer of the equity release mortgages to PRIL on 1 January 2016 and the reduction in value of the equity release mortgages retained in PAC of £36m.

Profit on ordinary activities before tax

The results of the Company for the year as set out on pages 17 to 18 show a profit on ordinary activities before tax of £363m (2015: £2,007m profit), £1,644m lower than in 2015.

Shareholders' Funds

The shareholders' funds of the Company total £13,623m (2015: £10,493m). The increase of £3,130m, after taking account of dividends paid to Prudential plc of £343m is due to profit after tax of £114m and a movement in retained earnings following the PRIL Part VII transfer of £3,359m.

APE Sales

Sales on an APE basis (Regular Premiums plus 1/10<sup>th</sup> Single Premiums) are £1,145m, 25 per cent higher than 2015 sales of £918m.

Following the decision to withdraw from the bulk annuity market, the Company and its subsidiaries have successfully replaced the reduction in annuity sales with Retail APE sales up 32 per cent on 2015 to £1,143m (taking into account the PRIL Part VII transfer), driven by the continued, growing demand for its savings and retirement products, including the PruFund range, Flexible Income Drawdown, non-advised income drawdown plan - Pension Choices Plan and the Prudential Retirement Account launched in Q3 2016.

On-going demand for the Company's PruFund multi-asset funds remains strong as customers continue to be attracted by its performance track record, the benefits of a smoothed return in managing market volatility and its ability to reduce customer investment risk in the current market conditions. The PruFund range of investment funds within an ISA wrapper generated APE sales of £124m, with assets under management totalling £1.9bn at the end of December 2016. In total across all products, PruFund APE sales of £873m increased by 52 per cent from 2015, with total assets under management having increased 50 per cent since the start of the year to £24.7bn.

**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

Onshore bonds APE sales of £288m increased by 12 per cent and offshore bonds APE sales of £84m rose by 22 per cent compared to 2015. Reflecting increased demand for the Company's wider range of investment propositions, post-pension reforms, income drawdown APE sales have increased by 62 per cent to £165m and individual pensions APE sales have increased by 93 per cent to £289m compared to 2015. The launch of the Prudential Retirement Account in Q3 2016 has generated £50m APE (within Individual Pensions) and £26m APE (within Income Drawdown). Our strong sales performance demonstrates our success in diversifying our product portfolio in response to the expanding market for flexible retirement income and pensions products.

Corporate pensions APE sales were 13 per cent lower than 2015. However, the Company remains the largest provider of Additional Voluntary Contribution plans within the public sector, where the Company provides schemes for 74 of the 99 public sector authorities in the UK (2015: 73 of the 101 schemes).

APE sales of individual annuities have decreased by 3 per cent to £33m from the same period last year. There has been a significant decline in this business since 2014 and now represents only 5 per cent of retail sales. The Company has taken steps to curtail retail sales by establishing an annuity panel arrangement with a number of firms to provide annuities to our retiring customers. This new service will be phased-in over the course of 2017.

In Poland, the Company's life business continues to grow steadily. The business continues in its development of new distribution channels and enhancement of existing channels. Brand awareness is improving, demonstrating the Company's ability to effectively enter new markets.

Available Capital

With effect from 1 January 2016, the Company adopted Solvency II as its consolidated capital regime. This was developed by the EU in order to harmonise the various regimes previously applied across EU member states.

The high quality and recurring nature of the Company's operating capital generation and its disciplined approach to managing balance sheet risk enabled it to enter the new Solvency II regime with a strong Shareholders' capital surplus of £3.3bn at 1 January 2016. These factors also provided meaningful protection against the significant adverse market-driven effects on this metric in 2016. The Company's shareholder Solvency II capital surplus was estimated at £4.6bn, after allowing for recalculation of transitional measures at 31 December 2016, equivalent to a cover ratio of 163 per cent<sup>note(i)</sup> (1 January 2016: 147 per cent<sup>note(ii)</sup>).

While the surplus position of the Company's with-profits funds remain strong on a Solvency II basis, it is ring-fenced from the shareholder balance sheet and is therefore excluded from the Company's estimated shareholder Solvency II surplus results. The Company's estimated with-profits funds Solvency II surplus at 31 December 2016 was £3.7bn, after allowing for recalculation of transitional measures as at 31 December 2016, equivalent to a cover ratio of 179 per cent<sup>note(i)</sup> (1 January 2016: 172 per cent<sup>note(ii)</sup>).

The with-profits sub-fund earned a return of 13.6 per cent before tax in 2016. The with-profits fund is invested across a broad range of assets and aims to provide steady returns to customers. It is the largest fund of its kind in the UK and its financial strength has enabled the Company to add approximately £21.5bn to policy values in the last 10 years. Over the same period the fund has delivered a cumulative investment return of 84.2 per cent, compared with the FTSE-All Share (total return) index return of 71.8 per cent.

The Company's available capital position is covered further in note 30 on page 73.

As at the date of signing the accounts, the Company's Financial Strength is rated Aa3 by Moody's (negative outlook), AA by Standard & Poor's (stable outlook) and AA by Fitch (stable outlook).

Note

- (i) The estimated solvency position includes the impact of recalculated transitionals at the valuation date, which has reduced the Company shareholder surplus from £5.1bn to £4.6bn and increased the policyholder surplus from £3.6bn to £3.7bn. The formal Quantitative Reporting Templates (Solvency II regulatory templates) will include transitional measures without this recalculation. The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profit funds and staff pension schemes in surplus.
- (ii) The cover ratios of 172 per cent and 147 per cent were finalised figures for 1 January 2016.

**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

**Risks & 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 can only provide reasonable and not absolute assurance against material misstatement or loss, and focus on optimizing 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 and from the underlying business within its investments in a number of subsidiary and associate companies, the value of which can be affected by certain risks factors. The key risk factors, mentioned below, should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

Financial risks

The Company is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The financial risk factors affecting the Company include market risk, credit risk, insurance risk and liquidity risk. Further information on the financial risk management objectives and policies of the Company and the exposure of the Company to the financial risk factors is given in note 27 on page 48, note 29 (C) on page 66 and in note 29 (E) on page 69.

Political uncertainty is expected to continue to impact market sentiment and volatility. Expectations regarding future interest rate paths are varied but the consensus is pointing to a higher interest rate environment going forward especially against a backdrop of a recent increase in inflation in the UK and the US. It is however uncertain how markets and the economy will adjust over the short to medium term.

A significant part of the Company's profit is related to bonuses for policyholders declared on its with-profits products, which are broadly based on historic and current rates of return on equity, property and fixed income securities, as well as the Company's expectations of future investment returns. Any adverse impact on the current and expected future asset returns may impact the current and future levels of with-profits bonuses and is therefore likely to impact the Company's profitability.

(a) Market risk

*Market risk is the risk of loss or of adverse change in the financial situation, resulting directly or indirectly, from fluctuations in the level or volatility of market prices of assets and liabilities.*

The key areas of the business impacted by market risk are the non-profit annuity business, the present value of expected future shareholder transfers from the with-profits business, the lifetime mortgage book and the value of the business in the Hong Kong subsidiary. The continued uncertainty in the global economic, political and markets outlooks, have increased market risk (e.g. increased volatility) and this could adversely affect the Company's business and profitability, principally through the following:

- Investment impairments or reduced investment returns, as a result of market volatility, could result in direct losses and may also impair the Company's ability to write desired volumes of new business, which would, in turn, have a negative impact on the Company's assets under management and profitability.
- The asset and liability mismatch risk and the risk of insolvency has increased due to historically low interest rates. The Company manages this risk by appropriate matching of its assets and liabilities.



STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)

(b) Credit risk

*Credit risk is the risk of loss for our business, or of adverse change in the financial situation, resulting from fluctuations in the credit standing of issuers of securities, counterparties and debtors in the form of defaults, or other significant credit event (e.g. downgrades or spread widening).*

The Company is exposed to significant levels of credit risk. The credit risk arises mainly from the corporate bond holdings in the non-profit annuity and with-profits business. Corporate borrowers continue to experience a challenging business environment and volatile profits and cashflows. This principally impacts credit risk through the following:

- Increased risk of credit losses through defaults and widening of credit spreads on corporate bonds; and
- 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 (in case of reinsurance counterparties), could have an adverse impact on the Company's results.

(c) Insurance Risk

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

Insurance risk arises mainly from the annuity business in the form of longevity risk. The other insurance risks run by the Company are expense risk, persistency risk and mortality/morbidity risk. 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, mortality and morbidity trends, policy surrender rates, unit cost of administration and new business acquisition expense.

- Longevity risk: This is the risk that the Company's (current and deferred) annuity customers live longer than expected 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 pricing and 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 and capital surplus could be adversely affected. Further 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 would have an impact on the Company's results and financial strength.
- Expense risk: This is the risk of actual expenses exceeding the assumptions in pricing and reserving bases and is relevant to all lines of business. The Company makes assumptions about future expected levels of expenses for each line of business and uses these in pricing and calculating reserves. If the actual expenses exceed these assumptions, the Company's operating results could be adversely impacted. The nature of the contractual arrangement with the Company's principal outsourcer partially mitigates this risk.
- Persistency risk: This is the risk of actual persistency or customer retention levels being different to the Company's expectations. This risk can materialise if more or (for some lines of business) fewer customers opt for early termination of its products than anticipated. The Company's persistency assumptions reflect the recent past experience for each relevant line of business including any expected trends in future persistency rates. If the actual levels of future persistency are significantly different than assumed in reserving and capital calculations, the Company's operating results could be adversely affected. This risk is only relevant to the non-annuity lines of business written by the Company.
- Mortality and morbidity risks: These relate to assumptions around the expected number of deaths or illnesses used in pricing and calculating reserves. These are relevant for those lines of business where the customer payoff is dependent on a death or illness. An example is the impact of epidemics or other events that cause a large number of illnesses and/or deaths. Significant influenza epidemics have occurred three times in the last century, but the likelihood, timing, or the severity of future epidemics cannot be predicted. The effectiveness

**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Company's loss experience if such an epidemic were to occur. If the actual mortality or morbidity rates were significantly higher than those assumed in pricing and reserving, then the Company would make a loss on certain lines of business which could be offset by potential gains on other lines of business due to the natural diversification between longevity and mortality risks.

**(d) Liquidity risk**

*Liquidity risk is the risk of the Company being unable to generate sufficient cash resources to meet financial obligations as they fall due in business as usual and stress scenarios.*

Liquidity risk is carefully managed in particular in relation to: bank balances, cashflow 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. Specific arrangements are also in place to manage liquidity in the linked funds, particularly property funds where the underlying assets are relatively illiquid.

**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 the associated regulatory risks, 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), regulation or regulatory interpretation 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. Regulators in jurisdictions in which the Company operates may change the level of solvency capital required to be held or could introduce possible changes in the regulatory framework for long-term savings and retirement arrangements and investments, or the regulation of selling practices and solvency requirements. In addition, there could be changes to the maximum level of non-domestic ownership by foreign companies in certain jurisdictions.

The material regulatory and legislative change risks currently faced are:

- The EU's Solvency II Directive came into effect on 1 January 2016; however the UK's vote to leave the EU has the potential to result in changes to future applicability of the regime in the UK. In September 2016, following the Brexit vote, the UK Treasury published terms of reference of its consultation into Solvency II to consider the options for British insurers and to assess the impact of the regime on the competitiveness of the UK insurance industry, the needs of UK consumers and the wider UK business economy. The outcome is likely to be dependent on the overall Brexit agreement reached between the UK and EU. Separately, the European Commission has commenced a review of some elements of the application of the Solvency II legislation with a particular focus on the Solvency Capital Requirement calculated using the standard formula.
- 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.
- The withdrawal of the UK from the EU will 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 ongoing uncertainty and likelihood of a lengthy negotiation period may increase volatility in the markets where we operate, creating the potential for a general downturn in economic activity and for further or prolonged falls in interest rates in due to easing of monetary policy and investor sentiment.

The market for UK financial services is highly competitive with several factors affecting the Company's ability to sell its products and its continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management

**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

performance, historic bonus levels, developing demographic trends and customers' appetite for certain savings products.

Changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or the Company's financial condition but could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties.

**(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 Company's capabilities.*

The strategic focus on with-profits and long-term savings and retirement products means the Company is dependent on being able to continue to deliver profitable volumes from these lines of business and that unplanned regulatory or legal changes do not adversely impact customer or advisor behaviour. The concentration leaves the Company's UK business at risk to a significant change in its business model arising from future regulatory developments.

The Company operates a largely outsourced operating model, with heavy dependence on both internal and external organisations. Outsourced activities include investment management, a significant part of the Company's customer-facing functions as well as 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 customer 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 whilst 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 consumers 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 and through intermediaries.

**(d) Operational risk**

*Operational risk is the risk of loss (or unintended gain/profit) arising from inadequate or failed internal processes, personnel and systems, or from external events. This includes employee error, system failures, fraud or some other event which disrupts business processes.*

The Company manages and mitigates its operational risk using the following:

- Operational risk and outsourcing and third-party supply policies;
- Corporate insurance programmes to limit the impact of operational risks;
- Scenario analysis for operational risk capital requirements, which focus on extreme, yet plausible, events;
- Internal and external review of cyber security capability;
- Regular testing of elements of the disaster-recovery plan.

An important element of operational risk relates to compliance with changing regulatory requirements. The high rate of global regulatory change, in an already complex regulatory landscape, increases the risk of non-compliance due to a failure to identify, correctly interpret, implement and / or monitor regulations. Legislative developments over recent years, together with enhanced regulatory oversight and increased capability to issue sanctions has resulted in a complex regulatory environment which may lead to breaches of varying magnitude if the Company's business-as-usual operations are not compliant. As well as prudential regulation, the Company focuses on conduct regulation, including regulations related to anti-money laundering, bribery and corruption, and sales practices. The Company has a particular focus on these regulations in newer/emerging markets.

The performance of core activities places reliance on IT infrastructure which supports day-to-day transaction-processing. The Company's IT environment must also be secure and it must address an increasing cyber risk threat as our digital footprint increases. The risk that the Company's IT infrastructure does not meet these key

**STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

requirements is a key area, in particular it focuses on the risk that reliance on legacy IT infrastructure which supports core activities/processes affects business continuity or impacts on business growth.

As well as the above, other key areas of focus within operational risk include:

- the risk of a significant failure of a third-party provider impacting critical services;
- the risk of trading or transaction errors having a material cost;
- the risk that errors within models and user designed applications used by the Company result in incorrect or inappropriate transactions being instructed;
- departure of key persons or teams resulting in disruption to current and planned business activities;
- the risk that key people, processes and systems are unable to operate (thus impacting on the on-going operation of the Company) due to a significant unexpected external event.
- the risk that a significant project fails or partially fails to meet its objectives, leading to financial loss, and
- the risk of inadequate or inappropriate controls, governance structures or communication channels in place to support the desired culture and ensure that the Company is managed in line with the core business values, within the established risk appetite and in alignment with external stakeholder expectations.

**(e) Group risk**

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

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

On behalf of the Board of directors.



G R S Dunlop  
Company Secretary  
24 March 2017

## THE PRUDENTIAL ASSURANCE COMPANY LIMITED

### **DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

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

#### 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.

#### Subsidiary and associate undertakings and branches

Particulars of the Company's subsidiary undertakings at 31 December 2016 are shown on page 75 in note 31. At 31 December 2016 the Company had a branch outside the United Kingdom in Poland.

#### With-profits governance

The Company produces an annual report, which is available on request, setting out how it has complied with its Principles and Practices of Financial Management (PPFM).

The Board has established a With-Profits Committee (WPC), made up of five members (each of whom is external and independent of the Company). The WPC provides the Board with an independent assessment of the way in which the Company manages its with-profits business, its compliance with the PPFM, and how the Company balances the rights and interests of policyholders and shareholders in relation to its with-profits funds. The WPC has the right, if it wishes, to make a statement to with-profits policyholders in addition to the Company's report described above.

The Company has a With-Profits Actuary who has the specific duty to advise the Board on the application of discretion in relation to with-profits business; and a Chief Actuary (previously the Actuarial Function Holder) who will provide the Board with all other actuarial advice. Both of these are Financial Conduct Authority and Prudential Regulation Authority approved roles.

The Company has an Independent Governance Committee (IGC), formed as part of the Government's initiative to improve outcomes for pension scheme members. As a large pension scheme provider, the Company is required to set up and support an IGC, whose findings are reported to the Board and the Financial Conduct Authority. The IGC act solely in the interests of scheme members, and to assess, raise concerns and report on the value for money of the Company's contract-based defined contribution workplace pension schemes on an ongoing basis, ensuring compliance with regulatory and legislative requirements.

#### 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

**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

- 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 the 8 February 2017 the Company entered into a longevity reinsurance transaction resulting in a reduction of net technical provisions of £0.6bn.

On the 6 March 2017 the Supreme Court announced that it would hear HMRC's appeal against a Court of Appeal decision in the Company's favour, covered further in note 8 page 34.

Accounts

The state of affairs of the Company at 31 December 2016 is shown in the balance sheet on pages 21 and 22. The profit and loss account appears on pages 17 and 18.

Share Capital

There have been changes in the Company's share capital during 2016 as shown on page 47 in note 22.

Dividends

An interim dividend of £343m (2015: £361m) was declared on 30 December 2016, resulting in the release of £343m from the retained profit and reserves of the Company. The directors have not declared a final dividend on the ordinary shares for 2016 (2015: £Nil).

No dividend was paid on the A preference shares in 2016 (2015: £Nil). No dividend was paid on any other preference shares.

Directors

The present directors are shown on page 1. Mr H A Hussain resigned on 19 July 2016 and Mr M Wells resigned on 29 September 2016. Mr J Foley was appointed on 19 January 2016, Mr J Deeks was appointed on 21 October 2016 and Ms C Bousfield was appointed on 10 November 2016. A new Independent Chairman, Mr P Spencer was also appointed, as at 1 January 2016 and new non-executive directors Ms J Dawson and Mr R Bennison were appointed on 20 July 2016 and 31 August 2016 respectively. There have been no further changes.

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 he ought to have taken as a director to make himself 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.

Financial instruments

The Company is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The financial risk factors affecting the Company include market risk, credit risk and liquidity risk. Information on the financial risk management objectives and policies of the Company and the exposure of the Company to the

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

**DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (continued)**

financial risk factors is given in note 29 (E) on page 69. Further information on the use of derivatives by the Company is provided in note 29 (G) on page 72.

Auditor

The directors re-appointed KPMG LLP as auditor of the Company on 19 May 2016. 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) 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 provide for 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 2016 and remain in force.

On behalf of the Board of directors.



G R S Dunlop  
Secretary  
24 March 2017

**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, the 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 FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

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 judgements 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 the 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.



## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED**

We have audited the financial statements of The Prudential Assurance Company Limited for the year ended 31 December 2016 set out on pages 17 to 84. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

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

### **Respective responsibilities of directors and auditor**

As explained more fully in the Directors' Responsibilities Statement set out on page 14, 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 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 2016 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 matter prescribed by the Companies Act 2006**

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

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic Report and the Directors' Report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED**

**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 2017

**Profit and Loss Account for the year ended 31 December 2016**

| Note | <u>Long-term Business Technical Account</u>                | <u>2016</u><br>£m   | <u>2015</u><br>£m |
|------|------------------------------------------------------------|---------------------|-------------------|
| 3    | Gross premiums written                                     | 33,093              | 7,581             |
|      | Outward reinsurance premiums                               | (635)               | (320)             |
|      | Earned premiums, net of reinsurance                        | <u>32,458</u>       | <u>7,261</u>      |
| 4    | Investment income                                          | 9,647               | 6,109             |
|      | Unrealised gains (losses) on investments                   | 9,718               | (2,738)           |
|      | Claims paid                                                |                     |                   |
|      | Gross amount                                               | (10,991)            | (9,366)           |
|      | Reinsurers' share                                          | 985                 | 694               |
|      | Claims paid, net of reinsurance                            | <u>(10,006)</u>     | <u>(8,672)</u>    |
|      | Change in provision for claims                             |                     |                   |
|      | Gross amount                                               | (30)                | (81)              |
|      | Claims incurred, net of reinsurance                        | <u>(10,036)</u>     | <u>(8,753)</u>    |
|      | Change in long-term business provision                     |                     |                   |
|      | Gross amount                                               | (37,179)            | 146               |
|      | Reinsurers' share                                          | 785                 | (520)             |
|      |                                                            | <u>(36,394)</u>     | <u>(374)</u>      |
|      | Change in technical provision for linked liabilities       | (400)               | 276               |
|      | Change in other technical provisions, net of reinsurance   | <u>(36,794)</u>     | <u>(98)</u>       |
| 6    | Net operating expenses                                     | (893)               | (690)             |
| 7    | Investment expenses and charges                            | (405)               | (331)             |
| 8    | Tax attributable to the long-term business                 | (1,061)             | (144)             |
|      | Transfer to the fund for future appropriations             | (1,237)             | (239)             |
|      | <b>Balance on the long-term business technical account</b> | <u><b>1,397</b></u> | <u><b>377</b></u> |

The notes and information on pages 23 to 84 form an integral part of the financial statements.

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**Profit and Loss Account for the year ended 31 December 2016 (continued)**

Note **Non-Technical Account**

|   |                                                                                    | <b><u>2016</u></b>    | <b><u>2015</u></b> |
|---|------------------------------------------------------------------------------------|-----------------------|--------------------|
|   |                                                                                    | <b>£m</b>             | <b>£m</b>          |
|   | Balance on the long-term business technical account                                | <b>1,397</b>          | 377                |
| 8 | Tax credit attributable to the balance on the long-term business technical account | <b>346</b>            | 90                 |
|   | Balance on the long-term business technical account before tax                     | <b><u>1,743</u></b>   | <u>467</u>         |
| 4 | Investment (losses) income                                                         | <b>(829)</b>          | 178                |
|   | Unrealised (losses) gains on investments                                           | <b>(557)</b>          | 1,356              |
|   | Other income                                                                       | <b>29</b>             | 28                 |
|   | Other charges                                                                      | <b>(23)</b>           | (22)               |
|   | Total (loss) profit on other activities                                            | <b><u>(1,380)</u></b> | <u>1,540</u>       |
|   | Profit on ordinary activities before tax                                           | <b><u>363</u></b>     | <u>2,007</u>       |
| 8 | Tax on profit on ordinary activities                                               | <b>(249)</b>          | (86)               |
|   | <b>Profit for the financial year</b>                                               | <b><u>114</u></b>     | <u>1,921</u>       |

The notes and information on pages 23 to 84 form an integral part of the financial statements.

**Note: General Business Technical Account**

The Company no longer underwrites new non-life insurance contracts directly and its run-off obligations have been reinsured (as explained further in note 3b). As such the non-life business is no longer material enough to require the presentation of a technical underwriting account and instead the relevant information is presented in note 3b.

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Statement of Comprehensive Income for the year ended 31 December 2016

Note

|    |                                                                                   | <u>2016</u>  | <u>2015</u>  |
|----|-----------------------------------------------------------------------------------|--------------|--------------|
|    |                                                                                   | £m           | £m           |
|    | <b>Profit for the financial year</b>                                              | <b>114</b>   | <b>1,921</b> |
|    | Other comprehensive income:                                                       |              |              |
| 2  | Movement in retained earnings following the PRIL Part VII transfer                | <b>3,359</b> | —            |
|    | Revaluation of company-occupied property                                          | <b>5</b>     | 21           |
| 10 | Actuarial (losses) gains on defined benefit pension schemes                       | <b>(75)</b>  | 29           |
|    | Deferred tax charge credit                                                        | <b>13</b>    | (5)          |
|    | Transfer from (to) the fund for future appropriations                             | <b>57</b>    | (45)         |
|    | <b>Total other comprehensive income for the financial year, net of income tax</b> | <b>3,359</b> | —            |
|    | <b>Total comprehensive income for the financial year</b>                          | <b>3,473</b> | <b>1,921</b> |

The notes and information on pages 23 to 84 form an integral part of the financial statements.

**Statement of changes in equity for the year ended 31 December 2016**

|                                                             | Share<br>Capital | Other<br>reserves<br>(*) | Profit and<br>loss<br>account | Total         |
|-------------------------------------------------------------|------------------|--------------------------|-------------------------------|---------------|
|                                                             | £m               | £m                       | £m                            | £m            |
| Balance at 1 January 2015                                   | 330              | 536                      | 8,067                         | 8,933         |
| Profit for the financial year                               | —                | —                        | 1,921                         | 1,921         |
| Other comprehensive income for the financial year           | —                | —                        | —                             | —             |
| Total comprehensive income for the financial year           | —                | —                        | 1,921                         | 1,921         |
| Dividends                                                   | —                | —                        | (361)                         | (361)         |
| Total distribution to owners, recognised directly in equity | —                | —                        | (361)                         | (361)         |
| Balance as at 31 December 2015                              | <b>330</b>       | <b>536</b>               | <b>9,627</b>                  | <b>10,493</b> |
| Balance as at 1 January 2016                                | 330              | 536                      | 9,627                         | 10,493        |
| Profit for the financial year                               | —                | —                        | 114                           | 114           |
| Other comprehensive income for the financial year           | —                | —                        | 3,359                         | 3,359         |
| Total comprehensive income for the financial year           | —                | —                        | 3,473                         | 3,473         |
| Dividends                                                   | —                | —                        | (343)                         | (343)         |
| Total distribution to owners, recognised directly in equity | —                | —                        | (343)                         | (343)         |
| Balance as at 31 December 2016                              | <b>330</b>       | <b>536</b>               | <b>12,757</b>                 | <b>13,623</b> |

(\*) Other reserves are capital reserves relating to the acquisition of Scottish Amicable Life Assurance Society in 1997.

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Balance sheet as at 31 December 2016

| Note | <u>Assets</u>                                                 | <u>2016</u><br>£m | <u>2015</u><br>£m |
|------|---------------------------------------------------------------|-------------------|-------------------|
| 13   | Intangible assets                                             |                   |                   |
|      | Licence                                                       | 15                | 31                |
|      | Computer software                                             | 5                 | 3                 |
|      |                                                               | <u>20</u>         | <u>34</u>         |
|      | Investments                                                   |                   |                   |
| 14   | Land and buildings                                            | 8,624             | 8,085             |
| 15   | Investments in group undertakings and participating interests | 11,019            | 11,485            |
| 16   | Other financial investments                                   | 134,086           | 95,062            |
|      | Deposits with ceding undertakings                             | —                 | 4,584             |
|      |                                                               | <u>153,729</u>    | <u>119,216</u>    |
| 17   | Assets held to cover linked liabilities                       | 18,495            | 11,861            |
| 18   | Reinsurers' share of technical provisions                     |                   |                   |
|      | Long-term business provision                                  | 1,925             | 9,832             |
|      | Claims outstanding                                            | 150               | 145               |
|      | Technical provisions for linked liabilities                   | 5,433             | 4,954             |
|      |                                                               | <u>7,508</u>      | <u>14,931</u>     |
|      | Debtors                                                       |                   |                   |
|      | Debtors arising out of direct insurance operations            |                   |                   |
|      | Policyholders                                                 | 22                | 44                |
|      | Intermediaries                                                | 1                 | 1                 |
|      | Debtors arising out of reinsurance operations                 | 5                 | 5                 |
| 19   | Other debtors                                                 | 1,251             | 1,127             |
|      |                                                               | <u>1,279</u>      | <u>1,177</u>      |
|      | Other assets                                                  |                   |                   |
| 20   | Cash at bank and in hand                                      | 2,960             | 1,462             |
| 14   | Finance lease assets                                          | 33                | 33                |
|      |                                                               | <u>2,993</u>      | <u>1,495</u>      |
|      | Prepayments and accrued income                                |                   |                   |
|      | Accrued interest and rent                                     | 968               | 645               |
|      | Deferred acquisition costs (DAC)                              |                   |                   |
|      | Long-term business                                            | 51                | 59                |
|      | Accrued external dividends receivable                         | 52                | 40                |
|      | Other prepayments and accrued income                          | 411               | 178               |
|      |                                                               | <u>1,482</u>      | <u>922</u>        |
|      | Total assets (excluding pension asset)                        | <u>185,506</u>    | <u>149,636</u>    |
| 10   | Pension asset                                                 | 17                | 85                |
|      | Total assets (including pension asset)                        | <u>185,523</u>    | <u>149,721</u>    |

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**Balance sheet as at 31 December 2016 (continued)**

| Note | <b><u>Liabilities</u></b>                              | <b><u>2016</u></b><br>£m | <b><u>2015</u></b><br>£m |
|------|--------------------------------------------------------|--------------------------|--------------------------|
|      | Capital and reserves                                   |                          |                          |
| 22   | Share capital                                          | 330                      | 330                      |
|      | Other reserves                                         | 536                      | 536                      |
|      | Profit and loss account                                | 12,757                   | 9,627                    |
| 3    | Shareholders' funds – equity interests                 | <u>13,623</u>            | <u>10,493</u>            |
|      | Fund for future appropriations                         | 11,933                   | 10,759                   |
|      | Technical provisions                                   |                          |                          |
| 27   | Long-term business provision                           | 125,380                  | 103,122                  |
| 9    | Claims outstanding                                     | 618                      | 583                      |
|      | Unearned revenue provision                             | 18                       | 22                       |
|      | Total technical provisions                             | <u>126,016</u>           | <u>103,727</u>           |
|      | Technical provisions for linked liabilities            | 23,928                   | 16,815                   |
|      | Provisions for other risks and charges                 |                          |                          |
| 8    | Deferred taxation                                      | 1,150                    | 658                      |
| 14   | Obligations under finance leases                       | 37                       | 66                       |
|      | Other                                                  | 217                      | 70                       |
|      |                                                        | <u>1,404</u>             | <u>794</u>               |
|      | Deposits received from reinsurers                      | 1,295                    | 1,133                    |
|      | Creditors                                              |                          |                          |
|      | Creditors arising out of direct insurance operations   | 71                       | 147                      |
|      | Creditors arising out of reinsurance operations        | 25                       | 78                       |
|      | Other borrowings not owed to credit institutions       | 163                      | 175                      |
| 23   | Other creditors including taxation and social security | 6,925                    | 5,503                    |
| 24   | Preference shares                                      | 1                        | 1                        |
|      |                                                        | <u>7,185</u>             | <u>5,904</u>             |
|      | Accruals and deferred income                           | 139                      | 96                       |
|      | <b>Total liabilities</b>                               | <b><u>185,523</u></b>    | <b><u>149,721</u></b>    |

The notes and information on pages 23 to 84 form an integral part of the financial statements.

The accounts on pages 17 to 84 were approved by the Board of directors on 22 March 2017.



J S Deeks  
Director  
24 March 2017



**Notes on the financial statements**

**1. Accounting policies**

**A. Company Information**

The Prudential Assurance Company Limited (the Company) is a private limited company and is incorporated and registered in England and Wales. The address of its registered office is Laurence Pountney Hill, London EC4R 0HH.

**B. Basis of Preparation**

The financial statements are prepared in accordance with Part 15 of the Companies Act 2006 (the Act) and Schedule 3 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the Regulations). The financial statements are prepared in accordance with Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (FRS 102) and Financial Reporting Standard 103, "Insurance Contracts" (FRS 103), and have been prepared under the historical cost accounting rules, modified to include the revaluation of investments.

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

The Company's ultimate parent, Prudential plc, includes the Company in its consolidated financial statements. Details of where to obtain copies of the consolidated accounts are disclosed in note 26. In these financial statements, the Company is considered to be a qualifying entity and has applied the exemptions available under FRS 102 in respect of the following disclosures:

- Reconciliation of the number of shares outstanding from the beginning to end of the period;
- Cashflow Statement and related notes;
- Key Management Personnel Compensation; and
- Related party transactions with wholly owned subsidiary undertakings of the Prudential Group.

As the consolidated financial statements of Prudential plc include the equivalent disclosures, the Company has also taken the exemptions under FRS 102 available in respect of certain disclosures required by FRS 102.26 *Share Based Payments* (FRS 102.26).

The financial statements are prepared in sterling (£) which is the functional currency of the Company and rounded to the nearest million (£m).

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

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.

| <b>Critical accounting estimates and assumptions</b> | <b>Accounting policy/note reference</b> |
|------------------------------------------------------|-----------------------------------------|
| Classification of insurance and investment contracts | C                                       |
| Measurement of long-term business provision          | C and 27                                |
| Determination of fair value of financial investments | F and 29                                |
| Measurement of pension scheme                        | J and 10                                |

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 and its parent company, which is also the ultimate parent company, are continuing to trade profitably and there are no plans for liquidation. Prudential plc and the Company have put in place intra-group arrangements to formalise circumstances in which capital support would

Notes on the financial statements (continued)

**1 Accounting Policies (continued)**

be made available by Prudential plc. While it is considered unlikely that such support will be required, the arrangements are intended to provide additional comfort to the Company and its policyholders.

The Company's long-term business fund is supported by its inherited estate (note 28 on page 54), 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 Strategic Report on pages 2 to 10, the management of financial risk as set out in note 29, including its exposure to credit risk and liquidity risk which it carefully manages through cash-flow forecasting and fund management.

In assessing the going concern of the Company, the directors have assessed the Company's current and projected solvency position under Solvency II, which became effective on 1 January 2016, and considers the Company to have an appropriate capital surplus.

**C. Long-term Business**

**i. *Classification of insurance and investment contracts***

The measurement basis of liabilities of long-term business contracts is dependent upon the classification of the contracts under FRS 103 as either insurance contracts, if the level of insurance risk is significant, or investment contracts if the risk is insignificant. A further distinction is made between investment contracts with and without discretionary participation features. Discretionary participation features (DPF) represent the contractual right to receive additional profit-sharing benefits as a supplement to guaranteed benefits. The Company's insurance contracts and investment contracts with discretionary participation features are primarily with-profits and other protection type or annuity policies. The investment contract without discretionary participation features classification applies primarily to certain unit-linked and similar contracts written by the Company. Insurance contracts and investment contracts with discretionary participation features are accounted for under FRS 103. Investment contracts without discretionary participation features are accounted for as financial liabilities under FRS 102.11 *Basic Financial Instruments* (FRS 102.11) and, where relevant the provisions of the FRS 102.23 *Revenue* (FRS 102.23) in respect of the attaching investment management features of the contracts.

The provisions for investment contracts without discretionary participation features are included in Technical Provisions for Linked Liabilities in the balance sheet.

**ii. *Technical account treatment***

Premiums and annuity considerations for conventional with-profit policies and other protection type life insurance and annuity policies are accounted for when due. For unit-linked business and unitised with-profit policies, premiums are accounted for when the liabilities arising from the premiums are recognised. Premiums exclude any taxes or duties based on premiums. Pensions annuity contracts that vest during the year are included in claims incurred and premium income at the annuity purchase price.

Claims paid include maturities, annuities, surrenders and death. Maturity claims are accounted for on the policy maturity date. Annuity claims are accounted for when the annuity becomes due for payment. Surrenders are accounted for when paid and death claims when notified.

Under FRS 102.11, the accounting treatment for investment contracts without discretionary participation features reflects the deposit nature of the arrangement with premiums and claims reflected as deposits and withdrawals taken directly to the balance sheet as a movement on the investors' liability with the long-term technical account reflecting fee income, expenses and taxation on these contracts.

The costs of acquiring new non-profit insurance contracts, principally commission and certain costs associated with policy issue and underwriting, which are not matched by policy charges are capitalised and amortised against margins in future revenues on the related insurance contracts for non-profit business to the extent that the amounts are recoverable out of margins.

Under FRS 102.11, for the investment contracts without discretionary participation features, only the incremental, directly attributable acquisition costs relating to the securing of investment management element of the contracts can be capitalised and amortised in line with related revenue. If these contracts involve up-front charges, this income is also deferred and amortised through the technical account in line with contractual service provision.

Notes on the financial statements (continued)

**1 Accounting Policies (continued)**

Deferred acquisition costs, deferred income reserves and provisions for future expenses commonly called "sterling reserves" are not permitted to be recognised under FRS 102 for investment contracts.

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

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

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

*iii. Measurement of long-term business provisions*

The assumptions used to calculate the long-term business provisions are described in note 28.

The Company applies FRS 103, which requires with-profits funds to use the realistic value of liabilities as the basis for the estimated value of the liabilities to be included in the financial statements.

Realistic reserves are established using best estimate assumptions, and taking into account the firm's regulatory duty to treat its customers fairly.

The realistic value of liabilities is calculated as:

- (i) a with-profits benefits reserve (WPBR) plus
- (ii) future policy related liabilities (FPRL) plus
- (iii) the realistic current liabilities of the fund

The WPBR is the main component of the product related liability, and is mainly determined using a retrospective asset share calculation.

Asset shares are calculated by rolling up the premiums paid, less expenses and charges using the actual investment returns earned on the with-profits fund. The assumptions used within the asset share calculations are consistent with those that are actually used to determine policyholders' bonuses. A number of adjustments are made to reflect future expected policyholder benefits and other outgoings. For certain classes of business including conventional with-profits whole life, industrial branch and many pension contracts (which have capped charges) a prospective bonus reserve valuation is performed instead, valuing future claims and expenses using the expected future bonus rates.

The FPRL includes a market consistent valuation of the costs of guarantees, options and smoothing. This is determined using stochastic modelling. Previously the UK gilt rate was used, however following the implementation of Solvency II the risk free rate is now assumed to be the UK swap rate. This has resulted in an increase in the long-term business provision compared to the prior year as the swap yield is 50-100bps lower than the gilt rate.

The FPRL also includes other liabilities such as tax on shareholder transfers and enhancements to policy benefits arising from the distribution of surplus from non-profit business written within the with-profits fund. For the Scottish Amicable Insurance Fund (SAIF), the realistic liability calculation requires that all of the surplus within the fund is distributed to policyholders and therefore the FPRL is increased up to the point where the fund has no working capital.

Under FRS 103, shareholders' transfers are recognised only on declaration.

**D. General Business**

The Company no longer underwrites general business directly and its run-off obligations have been reinsured externally.

**Notes on the financial statements (continued)**

**1 Accounting Policies (continued)**

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

Transactions in respect of general business operations in run-off are presented in note 3b.

**E. Reinsurance**

In the normal course of business the Company seeks to reduce loss exposure by reinsuring certain levels of risk in various areas of exposure with other insurance companies or reinsurers. An asset or liability is recognised in the balance sheet representing premiums due to or payments due from reinsurers and the reinsurers share of technical provisions. The measurement of reinsurance share of technical provisions is consistent with the measurement of the underlying direct insurance contracts.

**F. Investments**

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

Realised gains or losses are determined as the difference between net proceeds on disposal and the purchase price. Movements in unrealised gains or losses 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.

Investments in group undertakings and participating interests are carried at fair value through profit and loss. The Company's long-term business investments are taken to the technical account while the shareholder investments are taken to the non-technical account.

The Company has chosen to account for its financial instruments in accordance with FRS 102.11.2(b) which applies the recognition and measurement provisions of IAS 39 (as adopted for use in the EU) with disclosure requirements of FRS 102.11 and FRS 102.12 *Other Financial Instruments* (FRS 102.12). Upon initial recognition financial investments are recognised at fair value. Subsequently, the Company is permitted, subject to specific criteria, to designate its investments as either financial investments at fair value through profit and loss, financial investments held on an available-for-sale basis, financial investments held to maturity, or loans and receivables. The Company holds financial investments on the following bases:

- (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. These investments are valued at fair value with all changes thereon being recognised in the profit and loss account. An analysis of net gains/losses is disclosed separately in note 4 and note 16. 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 cashflow technique. Further information on valuation techniques is provided in note 29 (A).
- (ii) Loans and receivables - these comprise 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 loans to policyholders and other unsecured loans and receivables. These investments are carried at amortised cost using the effective interest method and subject to impairment reviews where appropriate. The Company measures the amount of the impairment loss by comparing the amortised cost with the present value of its estimated future cashflows discounted at the original effective interest rate. Certain mortgage loans of the Company have been designated at fair value through profit and loss as this loan portfolio is managed and evaluated on a fair value basis and these are included within loans in the balance sheet.

Basic financial assets, including deposits with ceding undertakings, debtors arising out of direct insurance operations/reinsurance operations, other debtors and cash at bank and in hand are initially recognised at

Notes on the financial statements (continued)

**1 Accounting Policies (continued)**

transaction price plus attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost using the effective interest method and subject to impairment reviews where appropriate.

The Company uses derivatives for the purpose of efficient portfolio management or the reduction in investment risk. In so doing, the Company obtains cost effective and efficient exposure to various markets and to manage exposure to interest rate, currency, credit and other business risks. Derivatives are carried at fair value with movements in fair value being recorded in the long term technical account or non-technical account.

Properties are carried at fair value, with changes in fair value included in the profit and loss account in accordance with FRS 102.16 *Investment Property* (FRS 102.16). Properties are valued annually, by a number of different professional external valuers using the Royal Institution of Chartered Surveyors valuation standards. No depreciation is provided on investment properties as the directors consider that to depreciate them would not give a true and fair view.

In accordance with the provisions of Schedule 3, paragraph 76 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, there is a requirement to show the net book value on a historical cost basis of properties in a note to the accounts. For this purpose properties are depreciated over forty years. Leasehold properties are depreciated over forty years, or if the lease is less than forty years, over the length of the lease.

Leases of investment property where the Company has substantially all the risks and rewards of ownership are classified as finance leases (leasehold property). Finance leases are capitalised at the leases inception at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Company-occupied properties are carried at fair value in the balance sheet and are valued annually, by a number of different external valuers using the Royal Institution of Chartered Surveyors valuation standards. An increase in fair value is recognised in other comprehensive income, except to the extent that it is the reversal of a previous valuation decrease which was recognised in profit or loss. A decrease in fair value is recognised immediately in profit or loss, except to the extent that it reverses a previous revaluation surplus recognised in other comprehensive income. No depreciation is provided on company-occupied property as such depreciation would be immaterial.

**G. Financial Liabilities**

Financial liabilities are designated as either fair value through profit and loss, amortised cost or investment contracts with discretionary participation features accounted for under FRS 103.

The Company holds financial liabilities on the following bases:

- (i) Financial liabilities at fair value through profit and loss - these comprise derivatives, investment contracts without discretionary participation features and certain creditors. Derivative liabilities and certain creditors are valued at fair value with all changes thereon being recognised in the profit and loss account. An analysis of net gains/losses is disclosed separately in note 4 and note 16. The accounting policies for investment contracts without discretionary participation features are described in section C above.
- (ii) Financial liabilities that are not valued at fair value through profit and loss and are not investment contracts with discretionary participation features are mainly creditors shown at settlement value.
- (iii) Investment contracts with discretionary participation features. The accounting policy is covered in section C above.

**H. Tax**

Tax on the profit or loss for the year comprises current and deferred tax. The UK HM Revenue & Customs rules for taxing long-term business are significantly different to those applying to non-insurance companies and the different classes of business written by the Company are themselves subject to distinct rules.

Current tax is the expected tax payable on all taxable profits arising in the current year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. Taxable profits have been calculated using accounting profit or loss as a starting point.

**Notes on the financial statements (continued)**

**1 Accounting Policies (continued)**

Deferred tax is provided on timing differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rate that is expected to apply to the reversal of the related difference, using tax rates enacted or substantively enacted at the balance sheet date.

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

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

**I. Foreign Currency**

Foreign currency revenue transactions are translated at average exchange rates for the year. Monetary foreign currency assets and liabilities are translated at year end exchange rates. Exchange differences are included in the profit and loss account.

**J. Pension Costs**

The Company applies the requirements of FRS 102.28 *Employee Benefits* (FRS 102.28). The Prudential Group operates a number of defined benefit pension schemes and a portion of these defined benefit pension schemes' surpluses or deficits is attributed to the Company. Further details are disclosed in note 10.

The assets and liabilities of the defined benefit pension schemes of the Prudential Group are subject to a full triennial actuarial valuation using the projected unit method. Estimated future cashflows are discounted at a high quality corporate bond rate, adjusted to allow for the difference in duration between the bond index and the pension liabilities where appropriate, to determine their present value. The Prudential Staff Pension Scheme (PSPS) is the largest defined benefit scheme and accounts for 82% of the underlying scheme liabilities of the Prudential Group's defined benefit schemes. The difference between the fair value of the scheme assets and the actuarial value of the scheme liabilities is a surplus or deficit on the scheme. The Company's share of pension surplus is recognised to the extent that the Company is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme.

The aggregate of the actuarially determined service cost of the currently employed personnel, gains and losses on settlements and curtailments, and the net interest on the net defined benefit liability (asset) are recognised in the profit and loss account.

The actuarial gains and losses which arise from changes in assumptions, the return on plan assets greater or less than the discount rate, and experience gains and losses on liabilities are recognised in the statement of comprehensive income. Actuarial gains and losses also include adjustment for unrecognised pension surplus.

Actuarial gains and losses on defined benefit pension schemes have been reclassified from profit and loss to other comprehensive income, as this presentation is considered to more effectively meet the presentation requirements of FRS 102.28. The reclassification has no effect on total profit or total comprehensive income for the prior year as the gain/loss is ultimately transferred to the fund for future appropriations.

**K. Intangible Assets**

Intangible assets are carried at cost less amortisation and any accumulated impairment losses.

Intangible assets include a licence, which represents the value of an agreement with a fellow subsidiary company for the use of certain Scottish Amicable assets, which is being amortised over a period of 20 years to 30 September 2017, on a basis consistent with the revenue stream from the agreement.

Intangible assets also include computer software amortised over three years.

**Notes on the financial statements (continued)**

**1 Accounting Policies (continued)**

L. Dividend Policy

Interim and final dividends are recognised in the period in which they are declared to the extent that they are unconditional on any future events. Dividends declared after the balance sheet in respect of the prior reporting period are treated as a non-adjusting event.

M. Share-based Payments

The Company offers share award and option plans for certain key employees and a SAYE plan for all UK employees. The Company has both equity-settled plans and cash-settled plans.

Share options and awards of the parent company's equity instruments, for which the parent company (Prudential plc) has the obligation to settle, are valued using the share price at the date of grant and are accounted for as equity-settled i.e. recognised in equity as a capital contribution from Prudential plc. Share options and awards for which the Company has the obligation to settle are valued using the share price at the balance sheet date and are accounted for as cash-settled i.e. as an obligation to transfer the equity instruments of Prudential plc. The compensation costs for all awards and options are recognised in net income over the plans' respective vesting periods.

N. Cash at bank and in hand

The Company applies the definitions of cash and cash equivalents as defined in FRS 102.7 *Statement of cashflows* (FRS 102.7) for amounts disclosed under cash at bank and in hand. This consists of cash at bank and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments with less than 90 day's maturity from the date of acquisition.

O. Provisions and contingencies

Appropriate provision is made in the financial statements where the Company either has an obligation, or it is probable that it has an obligation, arising from past events and a reliable estimate of the obligation can be made. Consistent with FRS 102.21 *Provisions and Contingencies* (FRS 102.21) no provisions are made for contingent liabilities, but they are disclosed.

**Notes on the financial statements (continued)**

**2. Transfers of business**

On 1 October 2016 the business of Prudential Retirement Income Limited (PRIL) was transferred into the Company following a Part VII Transfer under the Financial Services and Markets Act 2000. In line with the scheme, following the transfer, PRIL has retained assets of £100m to cover residual requirements which will remain in PRIL until liquidation.

The deposit-back arrangement and intragroup balance, previously held under the quota share arrangement between the Company and PRIL, prior to the Part VII Transfer, ceased on the date of the Transfer, hence the reduction in Deposits with Ceding Undertakings in the balance sheet.

The assets and liabilities transferred into the Company are shown as below:

|                                                                  | £m            |
|------------------------------------------------------------------|---------------|
| <b>Assets</b>                                                    |               |
| Land and buildings                                               | 1,030         |
| Other financial investments                                      | 28,522        |
| Assets held to cover linked liabilities                          | 7,229         |
| Reinsurers' share of long term business provision                | 31,352        |
| Reinsurers' share of technical provisions for linked liabilities | 209           |
| Other debtors                                                    | 457           |
| Cash at bank and in hand                                         | 297           |
| Accrued interest and rent                                        | 352           |
| <b>Total assets</b>                                              | <b>69,448</b> |
| <b>Liabilities</b>                                               |               |
| Long-term business provision                                     | 24,130        |
| Technical provisions for linked liabilities                      | 7,438         |
| Deferred taxation                                                | 139           |
| Creditors arising out of reinsurance operations                  | 10            |
| Other creditors including taxation and social security           | 34,351        |
| Accruals and deferred income                                     | 21            |
| <b>Total liabilities</b>                                         | <b>66,089</b> |
| <b>Capital and reserves</b>                                      | <b>3,359</b>  |



THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

3. Segmental Analysis

(a) Long-term business

Premiums and profit

|                | Gross premiums written |              | Balance on the technical account before tax |            |
|----------------|------------------------|--------------|---------------------------------------------|------------|
|                | 2016                   | 2015         | 2016                                        | 2015       |
|                | £m                     | £m           | £m                                          | £m         |
| United Kingdom | 32,220                 | 6,866        | 1,749                                       | 471        |
| Poland         | 9                      | 5            | (6)                                         | (4)        |
| Europe         | 864                    | 710          | —                                           | —          |
|                | <u>33,093</u>          | <u>7,581</u> | <u>1,743</u>                                | <u>467</u> |

New business

|                | Regular premiums |            | Single premiums |              |
|----------------|------------------|------------|-----------------|--------------|
|                | 2016             | 2015       | 2016            | 2015         |
|                | £m               | £m         | £m              | £m           |
| United Kingdom | 167              | 220        | 8,866           | 6,264        |
| Poland         | 7                | 3          | —               | —            |
| Europe         | —                | —          | 841             | 688          |
|                | <u>174</u>       | <u>223</u> | <u>9,707</u>    | <u>6,952</u> |

Analysis of premium income

|                                                                                                          | 2016          | 2015         |
|----------------------------------------------------------------------------------------------------------|---------------|--------------|
|                                                                                                          | £m            | £m           |
| Direct                                                                                                   | 9,270         | 6,571        |
| Reinsurance accepted                                                                                     | 23,823        | 1,010        |
|                                                                                                          | <u>33,093</u> | <u>7,581</u> |
| Individual business                                                                                      | 8,530         | 6,006        |
| Group contracts                                                                                          | 740           | 565          |
|                                                                                                          | <u>9,270</u>  | <u>6,571</u> |
| Regular premiums                                                                                         | 845           | 892          |
| Single premiums                                                                                          | 8,425         | 5,679        |
|                                                                                                          | <u>9,270</u>  | <u>6,571</u> |
| Participating contracts                                                                                  | 5,358         | 3,997        |
| Non-participating contracts                                                                              | 345           | 261          |
| Linked long-term contracts (excluding investment contracts without discretionary participation features) | 3,567         | 2,313        |
|                                                                                                          | <u>9,270</u>  | <u>6,571</u> |
| United Kingdom                                                                                           | 9,261         | 6,566        |
| Poland                                                                                                   | 9             | 5            |
| Europe                                                                                                   | —             | —            |
|                                                                                                          | <u>9,270</u>  | <u>6,571</u> |

**Notes on the financial statements (continued)**

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

**Net reinsurance income**

Net reinsurance income in respect of long-term business for the year ended 31 December 2016 was £1,613m (2015: £192m expense).

**(b) General business**

Analysis of technical account

|           | <b>Gross<br/>Claims<br/>Incurred</b> |                    | <b>Reinsurance<br/>Balance</b> |                    |
|-----------|--------------------------------------|--------------------|--------------------------------|--------------------|
|           | <b><u>2016</u></b>                   | <b><u>2015</u></b> | <b><u>2016</u></b>             | <b><u>2015</u></b> |
|           | <b>£m</b>                            | <b>£m</b>          | <b>£m</b>                      | <b>£m</b>          |
| Other (*) | <b>8</b>                             | <b>6</b>           | <b>(8)</b>                     | <b>(6)</b>         |
|           | <b><u>8</u></b>                      | <b><u>6</u></b>    | <b><u>(8)</u></b>              | <b><u>(6)</u></b>  |

\* Other business is primarily employers' liability and public liability insurance.

The remaining general business is operations in run-off comprising UK personal and commercial lines of general insurance business. All the business is fully reinsured externally and as such there is no profit or loss arising. The business reinsured is mostly UK employers' liability and public liability business.

**(c) Shareholders' funds**

Shareholders' funds relate to the following countries:

|                | <b>Shareholders' Funds</b> |                      |
|----------------|----------------------------|----------------------|
|                | <b><u>2016</u></b>         | <b><u>2015</u></b>   |
|                | <b>£m</b>                  | <b>£m</b>            |
| United Kingdom | <b>13,626</b>              | <b>10,491</b>        |
| Poland         | <b>(3)</b>                 | <b>2</b>             |
| Total          | <b><u>13,623</u></b>       | <b><u>10,493</u></b> |

**Notes on the financial statements (continued)****4. Investment income**

|                                                                                                            | <b>Long-term business</b> |              | <b>Non-technical account</b> |             |
|------------------------------------------------------------------------------------------------------------|---------------------------|--------------|------------------------------|-------------|
|                                                                                                            | <u>2016</u>               | <u>2015</u>  | <u>2016</u>                  | <u>2015</u> |
|                                                                                                            | £m                        | £m           | £m                           | £m          |
| Income from:                                                                                               |                           |              |                              |             |
| Group undertakings                                                                                         | 5,223                     | 79           | 94                           | 234         |
| Other investments                                                                                          |                           |              |                              |             |
| Land and buildings                                                                                         | 457                       | 423          | —                            | —           |
| Listed investments                                                                                         | 3,313                     | 2,884        | 9                            | —           |
| Unlisted investments                                                                                       | 231                       | 233          | —                            | —           |
| Other investments                                                                                          | 344                       | 395          | 78                           | 27          |
|                                                                                                            | <u>9,568</u>              | <u>4,014</u> | <u>181</u>                   | <u>261</u>  |
| Gains (losses) on loans and receivables                                                                    | 66                        | (23)         | (173)                        | —           |
| Gains on the realisation of investments at fair value through profit and loss other than derivatives       | 4,055                     | 1,732        | 24                           | —           |
| (Losses) gains on the realisation of derivatives – see note 29                                             | (4,662)                   | 170          | (75)                         | (36)        |
| Impairment in the value of subsidiaries                                                                    | —                         | —            | (786)                        | (48)        |
| Exchange gains                                                                                             | 576                       | 168          | —                            | 1           |
| Fees for policy administration and asset management services arising from unit-linked investment contracts | 44                        | 48           | —                            | —           |
|                                                                                                            | <u>9,647</u>              | <u>6,109</u> | <u>(829)</u>                 | <u>178</u>  |

**5. Bonuses**

Bonuses added during the year are included in the change in the long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses was £2,332m (2015: £2,352m) analysed between the with-profits sub-fund and defined charge participating sub-fund of £1,983m (2015: £1,994m) and the Scottish Amicable Insurance Fund of £349m (2015: £358m).

**6. Net operating expenses**

|                                                           | <b>Long-term business</b> |             |
|-----------------------------------------------------------|---------------------------|-------------|
|                                                           | <u>2016</u>               | <u>2015</u> |
|                                                           | £m                        | £m          |
| Acquisition costs                                         | 218                       | 332         |
| Change in deferred acquisition costs                      | 9                         | 11          |
| Administrative expenses*                                  | 649                       | 330         |
| Amortisation of licence and distribution rights (note 13) | 17                        | 17          |
|                                                           | <u>893</u>                | <u>690</u>  |

\* Included in administrative expenses is the establishment of a provision of £175m to cover the costs of undertaking the FCA Thematic Review (covered further in note 28 page 55).

Acquisition costs include commission refunds in respect of long-term direct insurance business of £5m (2015: commission payment of £98m). Administrative expenses include commissions in respect of long-term direct

**Notes on the financial statements (continued)**

insurance business of £43m (2015: £43m) . Administrative expenses are principally recharged from Prudential Distribution Limited, a service company within the Prudential Group.

No exchange differences have been credited (charged) to administrative expenses.

**7. Investment expenses and charges**

|                                | <b>Long-term business</b> |                    |
|--------------------------------|---------------------------|--------------------|
|                                | <b><u>2016</u></b>        | <b><u>2015</u></b> |
|                                | £m                        | £m                 |
| Investment management expenses | <b>372</b>                | 300                |
| Interest on bank borrowings    | <b>33</b>                 | 31                 |
|                                | <b><u>405</u></b>         | <u>331</u>         |

**8. Tax**

The reduction in the UK corporation tax rate to 17% from 1 April 2020 was substantively enacted on 6 September 2016 which has had the effect of reducing the UK with-profits and shareholder-backed business element of the overall net deferred tax liabilities by £7m at 31 December 2016. The effect of this change is reflected in the financial statements for the year ended 31 December 2016.

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.

The Company is the lead litigant in a group action against HM Revenue and Customs (HMRC) about the correct historic tax treatment applying to dividends received from overseas portfolio investments of its with-profits funds. The Company has so far been successful in its litigation and in April 2016 the Court of Appeal upheld an earlier High Court decision in the Company's favour. HMRC is now exercising its right to petition the Supreme Court. The Company has recognised a prior year policyholder tax credit of £150m in respect of its claim against HMRC (2015: £Nil). £39m of this amount has been paid by HMRC to the Company and the balance is held as an amount of tax due from HMRC. If the litigation is successful the Company will be entitled to interest on the tax repaid to it. At the balance sheet date, the Company has received from HMRC and recognised £40m (2015: £Nil) in respect of the interest that may be due. Under the terms of the agreement governing the domestication of the Company's Hong Kong branch in 2014, its Hong Kong subsidiary is entitled to a proportionate share of any tax and interest ultimately paid to the Company. At the balance sheet date the Company is holding a provision of £12m (2015: £Nil) in respect of this liability which is included within current tax payable (See note 23 page 48).

On 6 March 2017 the Supreme Court announced that it would hear HMRC's appeal against the Court of Appeal decision in the Company's favour.

**Notes on the financial statements (continued)**

**a) Tax charged (credited)**

|                                                                            | <b>Long-term funds</b> |             | <b>Shareholders' Profits</b> |             |
|----------------------------------------------------------------------------|------------------------|-------------|------------------------------|-------------|
|                                                                            | <b>2016</b>            | <b>2015</b> | <b>2016</b>                  | <b>2015</b> |
|                                                                            | <b>£m</b>              | <b>£m</b>   | <b>£m</b>                    | <b>£m</b>   |
| <b>Current Tax</b>                                                         |                        |             |                              |             |
| UK corporation tax                                                         | 770                    | 152         | (107)                        | 4           |
| Double tax relief                                                          | (11)                   | (3)         | —                            | —           |
| Overseas tax                                                               | 70                     | 38          | —                            | —           |
| Adjustments in respect of prior year                                       | (117)                  | 17          | (6)                          | (2)         |
| Total current tax                                                          | 712                    | 204         | (113)                        | 2           |
| <b>Deferred tax</b>                                                        |                        |             |                              |             |
| Origination and reversal of timing differences <sup>note(i)</sup>          | 363                    | (66)        | —                            | —           |
| Adjustments in respect of prior year                                       | 2                      | —           | —                            | —           |
| Total deferred tax                                                         | 365                    | (66)        | —                            | —           |
| <b>Shareholders' attributable tax in respect of the long-term business</b> |                        |             |                              |             |
| Current                                                                    | —                      | —           | 367                          | 107         |
| Deferred                                                                   | —                      | —           | (21)                         | (17)        |
| Total shareholders' attributable tax                                       | —                      | —           | 346                          | 90          |
| <b>Tax allocated to non-technical account</b>                              | (16)                   | 6           | 16                           | (6)         |
| <b>Tax charge on profit on ordinary activities</b>                         | <b>1,061</b>           | <b>144</b>  | <b>249</b>                   | <b>86</b>   |

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

|                                                                                                                                                 | <b>2016</b> | <b>2015</b> |
|-------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|
|                                                                                                                                                 | <b>£m</b>   | <b>£m</b>   |
| Profit on ordinary activities before tax                                                                                                        | 363         | 2,007       |
| Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 20 per cent (2015: effective rate of 20.25 per cent) | 73          | 406         |
| Permanent differences                                                                                                                           | 157         | 12          |
| Adjustment to current tax in respect of previous periods                                                                                        | (7)         | (2)         |
| Different tax bases of long-term insurance (current tax)                                                                                        | 1           | 2           |
| Effect of short term timing differences                                                                                                         | (2)         | (6)         |
| Effect of overseas tax                                                                                                                          | —           | —           |
| Non-taxable income                                                                                                                              | (17)        | (57)        |
| Revaluation of subsidiaries                                                                                                                     | 44          | (269)       |
| Total tax charge for the period                                                                                                                 | 249         | 86          |

**Notes on the financial statements (continued)****c) Balance Sheet**

|                                                                                               | Attributable to<br>Long-term funds |             | Attributable to<br>Shareholders' funds |             |
|-----------------------------------------------------------------------------------------------|------------------------------------|-------------|----------------------------------------|-------------|
|                                                                                               | <u>2016</u>                        | <u>2015</u> | <u>2016</u>                            | <u>2015</u> |
|                                                                                               | £m                                 | £m          | £m                                     | £m          |
| <b>Provision for Deferred Tax</b>                                                             |                                    |             |                                        |             |
| Accelerated capital allowances                                                                | 17                                 | 18          | —                                      | —           |
| Short term timing differences                                                                 | —                                  | (1)         | 0                                      | (1)         |
| Unrealised gains                                                                              | 1,020                              | 643         | —                                      | —           |
| Deferred acquisition costs                                                                    | (83)                               | (91)        | —                                      | —           |
| Life transitional arrangements                                                                | 194                                | 75          | —                                      | —           |
| Pension asset                                                                                 | 2                                  | 15          | —                                      | —           |
| Undiscounted provision for deferred tax liability                                             | <u>1,150</u>                       | <u>659</u>  | <u>—</u>                               | <u>(1)</u>  |
| <br>Deferred tax liability (deferred tax asset) at<br>start of the period                     | <br>659                            | <br>720     | <br>(1)                                | <br>(1)     |
| Deferred tax charged in technical/non-<br>technical account for the period <sup>note(i)</sup> | 363                                | (66)        | 1                                      | —           |
| Transfer in from PRIL                                                                         | 139                                | —           | —                                      | —           |
| Deferred tax credit from statement of<br>comprehensive income                                 | (13)                               | 5           | —                                      | —           |
| Adjustment in respect of prior year                                                           | 2                                  | —           | —                                      | —           |
| Deferred tax liability (deferred tax asset) at end<br>of the period                           | <u>1,150</u>                       | <u>659</u>  | <u>—</u>                               | <u>(1)</u>  |

Note (i) Deferred tax on actuarial gains and losses on defined benefit pension schemes has been reclassified from profit and loss to other comprehensive income, as this presentation is considered to more effectively meet the presentation requirements of FRS 102.28. The reclassification has no effect on total profit or total comprehensive income for the prior year as the net gain/loss is ultimately transferred to the fund for future appropriations.

Deferred tax is provided at the rate applicable when the temporary differences are expected to reverse. The net reversal of the deferred tax balance expected to occur in the next 12 months is uncertain as this will relate mainly to the valuation of unrealised gains which cannot be reliably estimated.

**9. Incurred but not reported provision**

A gross and ceded IBNR (Incurred but not Reported) provision of £110m (2015: £110m) has been maintained for the general insurance business operations in run off, primarily for industrial disease exposure, and is included within claims outstanding. This liability is reinsured externally and there is a corresponding asset held in reinsurance receivables.

**10. Information on staff and pension costs**

The average number of persons employed by the Company during the year was:

|                | <u>2016</u> | <u>2015</u> |
|----------------|-------------|-------------|
| United Kingdom | 9           | 11          |
| Poland         | 126         | 104         |
|                | <u>135</u>  | <u>115</u>  |

**Notes on the financial statements (continued)**

The majority of employees in the UK are employed by Prudential Distribution Limited, a service company within the Prudential Group.

|                                   | <b>2016</b> | <b>2015</b> |
|-----------------------------------|-------------|-------------|
|                                   | <b>£m</b>   | <b>£m</b>   |
| Wages and salaries                | <b>5</b>    | <b>4</b>    |
| Social security and pension costs | <b>1</b>    | <b>—</b>    |
|                                   | <b>6</b>    | <b>4</b>    |

**Defined Benefit Pension Schemes**

The majority of staff employed by the Prudential Group in the UK are members of the Prudential Group's pension schemes. The largest scheme is the Prudential Staff Pension Scheme (PSPS). This scheme is primarily (based on total numbers in the scheme), a defined benefit scheme but no employees with employment offers after 31 July 2003 are eligible for membership of the defined benefit section of the Scheme. They are instead enrolled in the defined contribution section of the scheme. At 31 December 2016, the underlying PSPS liabilities account for 82% (2015: 84%) of the aggregate liabilities of the Prudential Group's defined benefit schemes. There is also a smaller defined benefit scheme, Scottish Amicable Staff Pension Scheme (SASPS).

For both schemes, the projected unit method was used for the most recent full actuarial valuations. Defined benefit schemes are subject to full actuarial valuation every three years to assess the appropriate level of funding for schemes having regard to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds.

The last completed actuarial valuation of PSPS was as at 5 April 2014 and was finalised in 2015. This valuation demonstrated the scheme to be 107 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's funding objective. The contributions into the scheme are payable at the minimum level of contributions required under the scheme rules. Excluding expenses, the contributions are now payable at approximately £6m per annum for ongoing service of active members of the scheme. No deficit or other funding is required. Deficit funding for PSPS, where applicable, is apportioned in the ratio of 70/30 between the PAC with-profits fund and Prudential plc based on the sourcing of previous contributions. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity.

The last completed actuarial valuation of the SASPS was as at 31 March 2014 and was finalised in 2015. This valuation demonstrated the scheme to be 78 per cent funded. Based on this valuation, it was agreed with the Trustees to increase the previous level of deficit funding of £13.1m to £21m per annum from 1 January 2015 to 31 March 2024, subject to review at subsequent valuations.

For SASPS, as at 31 December 2016 40% of the deficit is attributable to the Company's with-profits fund (2015: 40%). The remaining shareholders' share of the deficit of SASPS is borne by Prudential Financial Services Limited, a fellow subsidiary undertaking of the Prudential Group.

**Corporate Governance**

The Company's UK pension schemes are regulated by 'The Pension Regulator' in accordance with the Pension Act 1995. Trustees have been appointed for each pension scheme and they have the ultimate responsibility to ensure that the scheme is managed in accordance with the Trust Deed & Rules. The Trustees are required by the Pension Regulator to be well conversant with the Trust Deed & Rules and to act in accordance with these Rules.

The Rules of the defined benefit section of PSPS, a final salary scheme, specify that, in exercising its investment powers, the Trustee's objective is to achieve the best overall investment return consistent with the security of the assets of the scheme. In doing this, consideration is given to the nature and duration of the scheme's liabilities. The Trustee sets the benchmark for the asset mix, following analysis of the liabilities by the Scheme's Actuary and, having taken advice from the Investment Managers, then selects benchmark indices for each asset type in order to measure investment performance against a benchmark return.

**Notes on the financial statements (continued)**

The Trustee reviews strategy, the asset mix benchmark and the Investment Managers' objectives every three years, to coincide with the Actuarial Valuation, or earlier if the Scheme Actuary recommends. Interim reviews are conducted annually based on changing economic circumstances and financial market levels.

The Trustee sets the general investment policy and specifies any restrictions on types of investment and the degrees of divergence permitted from the benchmark, but delegates the responsibility for selection and realisation of specific investments to the Investment Managers. In carrying out this responsibility, the Investment Managers are required by the Pensions Act 1995 to have regard to the need for diversification and suitability of investments. Subject to a number of restrictions contained within the relevant asset management agreements, the Investment Managers are authorised to invest in any class of investment asset. However, the Investment Managers will not invest in any new class of investment asset without prior consultation with the Trustee.

The Trustee consults the Principal Employer, The Prudential Assurance Company, on the investment principles, but the ultimate responsibility for the investment of the assets of the scheme lies with the Trustee.

The investment policies and strategies for the SASPS which is also a final salary scheme, follow similar principles, but have different target allocations reflecting the particular requirements of the scheme.

The key assumptions adopted for the valuations in PSPS and SASPS were:

|                                           | <b><u>2016</u></b> | <b><u>2015</u></b> |
|-------------------------------------------|--------------------|--------------------|
|                                           | <b>%</b>           | <b>%</b>           |
| Price inflation:                          |                    |                    |
| Retail Price Index (RPI)                  | <b>3.2</b>         | 3.0                |
| Consumer Price Index (CPI)                | <b>2.2</b>         | 2.0                |
| Rate of increase in salaries              | <b>3.2</b>         | 3.0                |
| Rate of increase of pensions in payments: |                    |                    |
| PSPS                                      |                    |                    |
| Guaranteed - LPI (Max 5%)                 | <b>2.5</b>         | 2.5                |
| Guaranteed - LPI (Max 2.5%)               | <b>2.5</b>         | 2.5                |
| Discretionary                             | <b>2.5</b>         | 2.5                |
| SASPS                                     | <b>3.2</b>         | 3.0                |
| Rate used to discount scheme liabilities  | <b>2.6</b>         | 3.8                |

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality. The specific allowance made is in line with a custom calibration and was updated in 2016 to reflect the 2014 mortality model from the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries (CMI). For the PSPS immediate annuities in payment, in 2016 and 2015, a long-term improvement rate of 1.75 per cent per annum and 1.25 per cent per annum were applied for males and females, respectively.

The most recent full valuations have been updated to 31 December 2016 applying the principles prescribed by FRS 102.28.



THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

The combined assets and liabilities of PSPS and SASPS were:

|                                                | <u>31 December 2016</u> |     | <u>31 December 2015</u> |     |
|------------------------------------------------|-------------------------|-----|-------------------------|-----|
|                                                | £m                      | %   | £m                      | %   |
| Equities                                       | 582                     | 7   | 537                     | 7   |
| Bonds                                          | 7,201                   | 86  | 6,278                   | 85  |
| Properties                                     | 116                     | 1   | 70                      | 1   |
| Other assets                                   | 529                     | 6   | 511                     | 7   |
| Total value of assets                          | 8,428                   | 100 | 7,396                   | 100 |
| Present value of underlying scheme liabilities | 7,947                   |     | 6,510                   |     |
| Underlying surplus in the schemes              | 481                     |     | 886                     |     |

Of which the following amounts have been attributed to the Company:

|                                                 | <u>2016</u> | <u>2015</u> |
|-------------------------------------------------|-------------|-------------|
|                                                 | £m          | £m          |
| Attributable to the Company's with-profits fund | 17          | 85          |

None of the scheme assets included shares in or property occupied by the Company.

The total actual return on scheme assets for both PSPS and SASPS is a gain of £1,333m (2015: net loss of £1m) of which a gain of £892m (2015: net loss of £0.6m) relates to the amounts attributable to the Company's with-profits fund.

The surplus in the Prudential Staff Pension Scheme recognised in the balance sheet of the Company represents the element of the amount which is recoverable through reduced future contributions that is attributable to the Company and is net of the apportionment to Prudential plc.

**Underlying scheme assets and liabilities of PSPS and SASPS**

The change in the present value of scheme liabilities and the change in the fair value of the scheme assets of PSPS and SASPS are as follows:

| 2016 £m                                           | Assets       | Liabilities    | Net surplus  | Effect of FRS 102 for derecognition of surplus | Total surplus (deficit) | PAC share of surplus (deficit) |
|---------------------------------------------------|--------------|----------------|--------------|------------------------------------------------|-------------------------|--------------------------------|
| Net surplus (deficit) at start of year            | 7,396        | (6,510)        | 887          | (800)                                          | 87                      | 85                             |
| Current service cost                              | —            | (27)           | (27)         | —                                              | (27)                    | (9)                            |
| Net interest on net defined benefit               | 275          | (241)          | 34           | (32)                                           | 2                       | 3                              |
| Administration expenses                           | (5)          | —              | (5)          | —                                              | (5)                     | (3)                            |
| Benefit payments                                  | (341)        | 341            | —            | —                                              | —                       | —                              |
| Company contributions*                            | 39           | —              | 39           | —                                              | 39                      | 16                             |
| Employee contributions                            | 1            | (1)            | —            | —                                              | —                       | —                              |
| Actuarial gains and losses                        | 1,063        | (1,510)        | (447)        | 274                                            | (173)                   | (75)                           |
| <b>Net surplus (deficit) at end of year</b>       | <b>8,428</b> | <b>(7,948)</b> | <b>481</b>   | <b>(558)</b>                                   | <b>(77)</b>             | <b>17</b>                      |
| <b>PSPS net surplus (deficit) at end of year</b>  | <b>7,627</b> | <b>(6,910)</b> | <b>717</b>   | <b>(558)</b>                                   | <b>159</b>              | <b>111</b>                     |
| <b>SASPS net surplus (deficit) at end of year</b> | <b>801</b>   | <b>(1,038)</b> | <b>(236)</b> | <b>—</b>                                       | <b>(236)</b>            | <b>(94)</b>                    |

\* The contributions include deficit funding, ongoing service contributions and expenses.

**Notes on the financial statements (continued)**

| 2015 £m                                           | Assets       | Liabilities    | Net surplus | Effect of FRS 102 for derecognition of surplus | Total surplus (deficit) | PAC share of surplus (deficit) |
|---------------------------------------------------|--------------|----------------|-------------|------------------------------------------------|-------------------------|--------------------------------|
| Net surplus (deficit) at start of year            | 7,651        | (6,954)        | 696         | (710)                                          | (14)                    | 34                             |
| Current service cost                              | —            | (29)           | (29)        | —                                              | (29)                    | (12)                           |
| Negative Past Service Cost                        | —            | 48             | 48          | —                                              | 48                      | 34                             |
| Net interest on net defined benefit               | 263          | (237)          | 26          | (26)                                           | —                       | 1                              |
| Administration expenses                           | (5)          | —              | (5)         | —                                              | (5)                     | (3)                            |
| Benefit payments                                  | (293)        | 293            | —           | —                                              | —                       | —                              |
| Company contributions*                            | 38           | —              | 38          | —                                              | 38                      | 16                             |
| Employee contributions                            | 1            | (1)            | —           | —                                              | —                       | —                              |
| Actuarial gains and losses                        | (259)        | 370            | 111         | (64)                                           | 47                      | 15                             |
| <b>Net surplus (deficit) at end of year</b>       | <b>7,396</b> | <b>(6,510)</b> | <b>885</b>  | <b>(800)</b>                                   | <b>85</b>               | <b>85</b>                      |
| <b>PSPS net surplus (deficit) at end of year</b>  | <b>6,727</b> | <b>(5,758)</b> | <b>969</b>  | <b>(800)</b>                                   | <b>169</b>              | <b>118</b>                     |
| <b>SASPS net surplus (deficit) at end of year</b> | <b>669</b>   | <b>(752)</b>   | <b>(84)</b> | <b>—</b>                                       | <b>(84)</b>             | <b>(33)</b>                    |

\* The contributions include deficit funding, ongoing service contributions and expenses.

Per FRS 102.28.22, a surplus is only recognised to the extent that the Company is able to access the surplus either through an unconditional right of refund to the surplus or through reduced future contributions relating to ongoing service, which have been substantively enacted or contractually agreed. The Company does not have an unconditional right of refund to any surplus of the scheme. The PSPS pension asset represents the present value of the economic benefit to the Company from the difference between future ongoing contributions to the scheme and estimated accrued cost of service.

**Pension charge and actuarial (losses) gains of PSPS and SASPS**

The pension charge relating to PSPS attributable to the Company is related to the surplus recognised on the balance sheet of the Company.

The actuarial (losses) gains relating to PSPS attributable to the Company's with-profits fund are related to the surplus recognised on the balance sheet of the Company. In 2016, the actuarial losses attributable to the Company's with-profits fund included a credit of £186m (2015: a charge of £49m) for the adjustment to the unrecognised portion of the PSPS surplus which has not been applied against the pension charge. Since the shareholders' profit in respect of the Company's with-profits fund is a function of the actuarially determined surplus for distribution, the overall profit and loss account result is not directly affected by the level of pension cost or other expenses relating to the with-profits fund. The pension credit of £9m (2015: charge of £20m) and actuarial loss of £75m (2015: actuarial gains of £29m) attributable to the Company's with-profits fund are included in the statement of comprehensive income and reflected in the transfer to or from the fund for future appropriations.

Total employer contributions expected to be paid into PSPS and SASPS for the year ending 31 December 2017 amounts to £38.2m, reflecting the annual accrual cost and deficit funding (SASPS only), and expenses.

The table below shows the sensitivity of the underlying PSPS and SASPS liabilities at 31 December 2016 of £6,910m (2015: £5,758m) and £1,037m (2015: £752m) to changes in discount rates, inflation rates and mortality rate assumptions.

**Notes on the financial statements (continued)**

| <b>Assumption</b> | <b>Change in assumption</b>                                                                                                         | <b>Impact on PSPS and SASPS scheme liabilities on FRS102.28 basis</b> |
|-------------------|-------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------|
| <b>2016</b>       |                                                                                                                                     |                                                                       |
| Discount rate     | Decrease by 0.2% from 2.6% to 2.4%                                                                                                  | Increase scheme liabilities by:<br>PSPS 3.5%<br>SASPS 5.4%            |
| Discount rate     | Increase by 0.2% from 2.6% to 2.8%                                                                                                  | Decrease scheme liabilities by:<br>PSPS 3.5%<br>SASPS 5.0%            |
| Rate of inflation | RPI: Decrease by 0.2% from 3.2% to 3.4%<br>CPI: Decrease by 0.2% from 2.2% to 2.4%<br>with consequent reduction in salary increases | Decrease scheme liabilities by:<br>PSPS 0.6%<br>SASPS 4.2%            |
| Mortality rate    | Increase life expectancy by 1 year                                                                                                  | Increase scheme liabilities by:<br>PSPS 3.5%<br>SASPS 3.6%            |
| <b>2015</b>       |                                                                                                                                     |                                                                       |
| Discount rate     | Decrease by 0.2% from 3.8% to 3.6%                                                                                                  | Increase scheme liabilities by:<br>PSPS 3.3%<br>SASPS 5.1%            |
| Discount rate     | Increase by 0.2% from 3.8% to 4.0%                                                                                                  | Decrease scheme liabilities by:<br>PSPS 3.1%<br>SASPS 4.7%            |
| Rate of inflation | RPI: Decrease by 0.2% from 3.0% to 3.2%<br>CPI: Decrease by 0.2% from 2.0% to 2.2%<br>with consequent reduction in salary increases | Decrease scheme liabilities by:<br>PSPS 0.5%<br>SASPS 4.0%            |
| Mortality rate    | Increase life expectancy by 1 year                                                                                                  | Increase scheme liabilities by:<br>PSPS 3.2%<br>SASPS 2.5%            |

The sensitivity of the underlying pension scheme liabilities as shown above does not directly equate to an impact on shareholders' profit or shareholders' funds due to the allocation of a share of the interest in financial position of the PSPS and SASPS to the Company's with-profits fund as described above.

The amounts attributable to the Company's with-profits fund for both PSPS and SASPS are absorbed by the transfer to or from the fund for future appropriations and therefore have no direct effect on shareholders' profit or shareholders' funds.

**Share-based payments**

The Company maintains a number of main share options and share option plans relating to Prudential plc shares, which are described below.

**(i) Savings Related Options**

The Company participates in share option schemes satisfied by the issue of new shares: UK-based executive directors and eligible employees are eligible to participate in the Prudential HM Revenue & Customs (HMRC)-approved UK savings related share option scheme (SAYE scheme). These schemes allow all eligible employees to save towards the exercise of options over Prudential plc shares with the option price set at the beginning of the savings period at a discount of up to 20 per cent of the market price.

Participants can elect to enter into savings contracts of up to £500 per month for a period of three or five years. At the end of this term, participants may exercise their options within six months and purchase shares. If an option is not exercised within six months, participants are entitled to a refund of their cash savings plus interest if applicable under the rules. Shares are issued to satisfy those options which are exercised. No options may be granted under the schemes if the grant would cause the number of shares which have been issued, or which remain issuable pursuant to options granted in the preceding 10 years under the scheme and other share option schemes operated by the Company, or which have been issued under any other share incentive scheme of the Company, to exceed 10 per cent of Prudential plc's ordinary share capital at the proposed date of grant.

**Notes on the financial statements (continued)****(ii) Share Incentive Plan**

UK-based executive directors and employees are also eligible to participate in the Company's HMRC-approved Share Incentive Plan (SIP). All UK-based employees are able to purchase shares of Prudential plc up to a value of £150 per month from their gross salary (partnership shares) through the SIP. For every four partnership shares bought, an additional matching share is awarded, purchased by Prudential on the open market. Dividend shares accumulate while the employee participates in the plan. Partnership shares may be withdrawn from the scheme at any time. If the employee withdraws from the plan, or leaves the Group, matching shares are forfeited.

**11. Directors' emoluments**

|                                                                                                  | <u>2016</u>      | <u>2015</u>      |
|--------------------------------------------------------------------------------------------------|------------------|------------------|
|                                                                                                  | £                | £                |
| Aggregate emoluments                                                                             | 3,885,627        | 1,832,299        |
| Aggregate amounts receivable (excluding shares) under long term incentive schemes                | —                | —                |
| Excess retirement benefits:                                                                      |                  |                  |
| Current directors                                                                                | 158,953          | 23,900           |
| Past directors                                                                                   | 37,138           | 133,099          |
| Other cash payments                                                                              | —                | —                |
|                                                                                                  | <u>4,081,718</u> | <u>1,989,298</u> |
| Highest Paid Director:                                                                           |                  |                  |
| Aggregate emoluments and amounts receivable (excluding shares) under long term incentive schemes | <u>2,106,289</u> | <u>1,169,425</u> |

Emoluments are reported for directors who are deemed to work for the Company i.e. provide qualifying services in accordance with Schedule 5 of the Regulations. Two directors (2015: one) exercised share options during the year. Two directors (2015: two) were entitled to shares under Prudential's main long-term incentive scheme and one director (2015: nil) was entitled to retirement funds under defined benefit schemes. The highest paid director in both 2016 and 2015 did not exercise any share options but did receive shares under long-term incentive schemes.

**12. Auditor's remuneration**

During the year the Company obtained the following services from KPMG LLP (KPMG) at costs as detailed below:

|                                                              | <u>2016</u> | <u>2015</u> |
|--------------------------------------------------------------|-------------|-------------|
|                                                              | £m          | £m          |
| <b>Audit services:</b>                                       |             |             |
| Fees payable to KPMG for the audit of the Company's accounts | 2           | 2           |

The Company has not disclosed the fees payable to KPMG for 'Non-audit services' as this information is included in the consolidated financial statements of Prudential plc.

**Notes on the financial statements (continued)****13. Intangible assets**

|                                                        | <b>Licence<br/>£m</b> | <b>Computer<br/>Software<br/>£m</b> | <b>Total<br/>£m</b> |
|--------------------------------------------------------|-----------------------|-------------------------------------|---------------------|
| Cost:                                                  |                       |                                     |                     |
| At 1 January 2016                                      | 174                   | 4                                   | 178                 |
| Exchange differences                                   | —                     | 1                                   | 1                   |
| Additions                                              | —                     | 2                                   | 2                   |
| At 31 December 2016                                    | <b>174</b>            | <b>7</b>                            | <b>181</b>          |
| Amortisation:                                          |                       |                                     |                     |
| At 1 January 2016                                      | 143                   | 1                                   | 144                 |
| Recognised in the long-term business technical account | 16                    | 1                                   | 17                  |
| At 31 December 2016                                    | <b>159</b>            | <b>2</b>                            | <b>161</b>          |
| Net book value at 31 December 2016                     | <b>15</b>             | <b>5</b>                            | <b>20</b>           |
| Net book value at 31 December 2015                     | <b>31</b>             | <b>3</b>                            | <b>34</b>           |

The licence represents the value of an agreement, which commenced in 1997, with a fellow subsidiary company for the use of certain Scottish Amicable assets, which is being amortised over a period of 20 years to 30 September 2017, on a basis consistent with the revenue stream from the agreement. Under this basis, the amortisation commenced in the year 2000, when the benefits from the agreement first started to arise, with the intention of the licence being fully amortised by 30 September 2017.

There have been no impairments during the year (2015: £Nil).

**14. Land and buildings**

|                                              | <b>2016<br/>£m</b> | <b>2015<br/>£m</b> |
|----------------------------------------------|--------------------|--------------------|
| Current value                                |                    |                    |
| Freeholds                                    | 4,431              | 4,144              |
| Leaseholds with a term of over 50 years      | 3,618              | 3,281              |
| Leaseholds with a term of less than 50 years | 575                | 660                |
|                                              | <b>8,624</b>       | <b>8,085</b>       |
| Cost                                         | <b>5,945</b>       | <b>5,284</b>       |

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

|                                         | <b>2016<br/>£m</b> | <b>2015<br/>£m</b> |
|-----------------------------------------|--------------------|--------------------|
| At cost                                 | 5,945              | 5,284              |
| Aggregate depreciation                  | (3,309)            | (3,164)            |
| Net book value based on historical cost | <b>2,636</b>       | <b>2,120</b>       |

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

**Notes on the financial statements (continued)**

**(a) Company-occupied property**

|                               | <u>2016</u> | <u>2015</u> |
|-------------------------------|-------------|-------------|
|                               | £m          | £m          |
| <b>Balance at 1 January</b>   | <b>152</b>  | 131         |
| Revaluations                  | 5           | 21          |
| Disposals                     | (21)        | —           |
| <b>Balance at 31 December</b> | <b>136</b>  | 152         |

**(b) Investment property**

|                                             | <u>2016</u>  | <u>2015</u> |
|---------------------------------------------|--------------|-------------|
|                                             | £m           | £m          |
| <b>Balance at 1 January</b>                 | <b>7,933</b> | 7,622       |
| Additions                                   |              |             |
| Resulting from PRIL Part VII Transfer       | 1,030        | —           |
| Resulting from acquisitions                 | 229          | 384         |
| Resulting from expenditure capitalised      | 162          | 46          |
| Disposals                                   | (480)        | (552)       |
| Net (loss) gain from fair value adjustments | (489)        | 508         |
| Other changes                               | 103          | (75)        |
| <b>Balance at 31 December</b>               | <b>8,488</b> | 7,933       |

The 2016 profit and loss account includes rental income from investment properties of £457m (2015: £423m).

A reconciliation between the total of future minimum lease payments at the balance sheet date, and their present value is shown below:

|                  | <u>2016</u>                   |                              |                                     | <u>2015</u>                   |                              |                                     |
|------------------|-------------------------------|------------------------------|-------------------------------------|-------------------------------|------------------------------|-------------------------------------|
|                  | £m                            |                              |                                     | £m                            |                              |                                     |
|                  | Future<br>minimum<br>payments | Future<br>finance<br>charges | PV of future<br>minimum<br>payments | Future<br>minimum<br>payments | Future<br>finance<br>charges | PV of future<br>minimum<br>payments |
| Less than 1 year | 2                             | —                            | 2                                   | 3                             | —                            | 3                                   |
| 1 to 5 years     | 7                             | (1)                          | 6                                   | 13                            | (2)                          | 11                                  |
| Over 5 years     | 251                           | (222)                        | 29                                  | 578                           | (526)                        | 52                                  |
| <b>Total</b>     | <b>260</b>                    | <b>(223)</b>                 | <b>37</b>                           | <b>594</b>                    | <b>(528)</b>                 | <b>66</b>                           |

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on the future value of a factor that changes other than with the passage of time. There was no contingent rent recognised as income or expense in 2016 or 2015. There are no restrictions on the realisability of investment property or the remittance of income and proceeds of disposal. The contractual obligations to purchase or develop investment properties at 31 December 2016 were £377m (2015: £409m).

The Company's policy is to let investment properties to tenants through operating leases. Minimum future rentals to be received on non-cancellable operating leases of the Company's freehold investment properties are receivable in the following periods:

|                  | <u>2016</u>  | <u>2015</u> |
|------------------|--------------|-------------|
|                  | £m           | £m          |
| Less than 1 year | 242          | 221         |
| 1 to 5 years     | 862          | 774         |
| Over 5 years     | 2,387        | 1,998       |
| <b>Total</b>     | <b>3,491</b> | 2,993       |

**Notes on the financial statements (continued)**

**(c) Finance lease asset**

A reconciliation between the total of future minimum lease payments recoverable by the Company at the balance sheet date, and their present value is shown below:

|                  | <u>2016</u>                |                        |                                  | <u>2015</u>                |                        |                                  |
|------------------|----------------------------|------------------------|----------------------------------|----------------------------|------------------------|----------------------------------|
|                  | £m                         |                        |                                  | £m                         |                        |                                  |
|                  | Future minimum receivables | Future finance credits | PV of future minimum receivables | Future minimum receivables | Future finance credits | PV of future minimum receivables |
| Less than 1 year | 2                          | —                      | 2                                | 2                          | —                      | 2                                |
| 1 to 5 years     | 9                          | (2)                    | 7                                | 9                          | (2)                    | 7                                |
| Over 5 years     | 374                        | (350)                  | 24                               | 375                        | (351)                  | 24                               |
| Total            | 385                        | (352)                  | 33                               | 386                        | (353)                  | 33                               |

**15. Investments in group undertakings and participating interests**

|                                                                              | <u>Cost</u>  |              | <u>Current value</u> |               |
|------------------------------------------------------------------------------|--------------|--------------|----------------------|---------------|
|                                                                              | <u>2016</u>  | <u>2015</u>  | <u>2016</u>          | <u>2015</u>   |
|                                                                              | £m           | £m           | £m                   | £m            |
| Long-term fund investments                                                   | 988          | 572          | 1,930                | 1,440         |
| Shareholder investments                                                      | 1,236        | 1,236        | 7,779                | 8,785         |
|                                                                              | <u>2,224</u> | <u>1,808</u> | <u>9,709</u>         | <u>10,225</u> |
| Interest in joint ventures and associate long-term fund investments          | 207          | 207          | 410                  | 434           |
| Debt securities issued by, and loans to group undertakings – long term funds | 900          | 826          | 900                  | 826           |
| Total                                                                        | <u>3,331</u> | <u>2,841</u> | <u>11,019</u>        | <u>11,485</u> |

Refer to note 32 for further information on the related undertakings of the Company.

**16. Other financial investments**

|                                                                     | <u>Cost</u>    |               | <u>Carrying value</u> |               |
|---------------------------------------------------------------------|----------------|---------------|-----------------------|---------------|
|                                                                     | <u>2016</u>    | <u>2015</u>   | <u>2016</u>           | <u>2015</u>   |
|                                                                     | £m             | £m            | £m                    | £m            |
| Shares and other variable yield securities and units in unit trusts | 32,043         | 29,899        | 43,267                | 36,114        |
| Debt securities and other fixed income securities                   | 61,822         | 41,417        | 71,750                | 43,630        |
| Derivative assets                                                   | 509            | 279           | 2,529                 | 1,234         |
| Participation in investment pools                                   | 2,314          | 1,733         | 3,586                 | 2,533         |
| Loans secured by mortgages                                          | 2,548          | 1,860         | 2,706                 | 1,912         |
| Loans to policyholders secured by insurance policies                | 6              | 8             | 6                     | 8             |
| Other loans                                                         | 784            | 534           | 739                   | 523           |
| Deposits with credit institutions                                   | 9,503          | 9,108         | 9,503                 | 9,108         |
|                                                                     | <u>109,529</u> | <u>84,838</u> | <u>134,086</u>        | <u>95,062</u> |

The change in carrying value of other financial investments included in the Profit and Loss account was a gain of £7,794m (2015: £3,196m loss) analysed between a gain of £8,132m (2015: £3,225m loss) included in the

**Notes on the financial statements (continued)**

Long-term business technical account and a £338m loss (2015: £29m gain) included in the Non-technical account. The change in carrying value of £7,794m (2015: £3,196m loss) included a gain of £5,219m (2015: £607m loss) in respect of equity securities, a gain of £1,142m (2015: £1,755m loss) in respect of debt securities, a gain of £1,223m (2015: £891m loss) in respect of derivatives and a gain of £210m (2015: £57m gain) in respect of other financial instruments.

|                                                                     | <b>Carrying value</b> |             |
|---------------------------------------------------------------------|-----------------------|-------------|
|                                                                     | <b>2016</b>           | <b>2015</b> |
|                                                                     | <b>£m</b>             | <b>£m</b>   |
| Amounts included in the above relating to listed investments:       |                       |             |
| Shares and other variable yield securities and units in unit trusts | <b>40,914</b>         | 34,171      |
| Debt securities and other fixed income securities                   | <b>65,196</b>         | 40,933      |
|                                                                     | <b>106,110</b>        | 75,104      |

The table below analyses the derivative positions of the Company:

|                                                                                                  | <b>2016</b>       |                        | <b>2015</b>       |                        |
|--------------------------------------------------------------------------------------------------|-------------------|------------------------|-------------------|------------------------|
|                                                                                                  | <b>£m</b>         |                        | <b>£m</b>         |                        |
|                                                                                                  | Fair value assets | Fair value liabilities | Fair value assets | Fair value liabilities |
| Derivative financial instruments held to manage interest rate and currency profile:              |                   |                        |                   |                        |
| Interest rate swaps                                                                              | 2,025             | 459                    | 951               | 129                    |
| Cross currency swaps                                                                             | 3                 | 522                    | 24                | 211                    |
| Currency exchange forward contracts                                                              | 116               | 452                    | 45                | 961                    |
| Bond futures                                                                                     | 3                 | 6                      | 6                 | 2                      |
| Credit Default Swaps                                                                             | 18                | —                      | 2                 | —                      |
| Inflation Swaps                                                                                  | 244               | 281                    | 115               | 86                     |
| Derivative financial instruments held to manage market risk and efficient investment management: |                   |                        |                   |                        |
| Equity options                                                                                   | 96                | —                      | 86                | —                      |
| Equity futures                                                                                   | 16                | 10                     | 5                 | 38                     |
| Equity warrants                                                                                  | 8                 | —                      | —                 | —                      |
| Total                                                                                            | <b>2,529</b>      | <b>1,730</b>           | <b>1,234</b>      | <b>1,427</b>           |

The nature of the derivative financial instruments, used by the Company in 2016, are similar to those used in 2015 and includes the partial equity hedge of the shareholder transfers expected to emerge from the Company's with-profits sub-fund, which was set up in 2013; this arrangement was extended in 2016. The use of derivatives is disclosed in note 29G.

**17. Assets held to cover linked liabilities**

|                                         | <b>Cost</b>   |             | <b>Carrying value</b> |             |
|-----------------------------------------|---------------|-------------|-----------------------|-------------|
|                                         | <b>2016</b>   | <b>2015</b> | <b>2016</b>           | <b>2015</b> |
|                                         | <b>£m</b>     | <b>£m</b>   | <b>£m</b>             | <b>£m</b>   |
| Assets held to cover linked liabilities | <b>13,618</b> | 9,757       | <b>18,495</b>         | 11,861      |

**18. Reinsurers' share of technical provisions**

During 2016 the UK insurance operations entered into five additional longevity reinsurance transactions covering £5.4bn of annuity liabilities. This contributed to £197m profit.



**Notes on the financial statements (continued)**

The contribution to profit from similar longevity reinsurance transactions in 2015 was £231m covering £6.4bn of annuity liabilities in Prudential Retirement Income Limited (on a UK GAAP basis).

At 31 December 2016, longevity reinsurance covered £14.4bn of annuity liabilities equivalent to 42% of total annuity liabilities.

The reinsurers' share of the long-term business provision relates mainly to cessions to Prudential Hong Kong Limited, a subsidiary of the Company. The reinsurers' share of the technical provisions for linked liabilities relates mainly to cessions to Prudential Pensions Limited and Prudential Hong Kong Limited, both subsidiaries of the Company.

Included in income and expense in the profit and loss account is £7,423m reflecting the movement in the reinsurers' share of technical provision to £7,508m at 31 December 2016 from £14,931m at 31 December 2015.

**19. Other debtors**

|                                                                    | <b><u>2016</u></b>  | <b><u>2015</u></b>  |
|--------------------------------------------------------------------|---------------------|---------------------|
|                                                                    | <b>£m</b>           | <b>£m</b>           |
| Amounts owed by holding company                                    | <b>553</b>          | 709                 |
| Amounts owed by fellow subsidiaries                                | <b>114</b>          | 50                  |
| Amounts owed by subsidiary companies, associate and joint ventures | <b>87</b>           | 115                 |
| Tax recoverable                                                    | <b>272</b>          | 125                 |
| Other                                                              | <b>225</b>          | 128                 |
|                                                                    | <b><u>1,251</u></b> | <b><u>1,127</u></b> |

Other debtors include £nil (2015: £2m) due after more than one year.

**20. Bank current accounts**

Under the terms of the Company's arrangements with the Prudential Group's main UK banker, 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.

**21. Assets attributable to the long term business fund**

Of the total amount of assets shown in the balance sheet on page 21, £175,556m (2015: £139,153m) is attributable to the long-term business fund.

**22. Share capital**

The Company's issued share capital is £329,517,064 comprising 1,318,068,254 ordinary shares of 25p each fully paid. This includes the re-designation of 347,600,000 B Preference Shares of 25p each fully paid as ordinary shares of 25p each on 10 November 2016. There were no further changes in the share capital of the Company that took place during the year.

**Notes on the financial statements (continued)**

**23. Other creditors including tax and social security**

|                                                                    | <u>2016</u>  | <u>2015</u>  |
|--------------------------------------------------------------------|--------------|--------------|
|                                                                    | £m           | £m           |
| Amounts owed to fellow subsidiaries and holding company            | 243          | 234          |
| Amounts owed to subsidiary companies, associate and joint ventures | 678          | 1,740        |
| Tax                                                                | 364          | 131          |
| Derivative liability (see note 16)                                 | 1,730        | 1,427        |
| Other creditors                                                    | 3,910        | 1,971        |
|                                                                    | <u>6,925</u> | <u>5,503</u> |

**24. Preference shares**

|                                | <u>2016</u> | <u>2015</u> |
|--------------------------------|-------------|-------------|
|                                | £m          | £m          |
| A preference shares of £1 each | 1           | 1           |

The A Preference Shares issued have not been redeemed by the Company but can be redeemed without notice at any time. The premium payable on redemption amounts to 28.08p, which is increased by the percentage of the RPI from a date 30 days prior to the first issue of any preference shares to a date 30 days prior to redemption. The A Preference Shares carry the right to receive an index linked cumulative preferential dividend, payable annually. The A Preference Shares carry no voting rights except if a resolution is proposed abrogating, varying or modifying any of the rights or privileges of the holders of the A Preference Shares, but carry preferential rights in priority to other shareholders to payment on a return of capital in the event of the winding up of the Company.

**25. Ultimate parent company**

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

**26. Related party transactions**

The Company has taken advantage of the exemption under FRS 102.33 *Related Party Disclosures* (FRS 102.33) paragraph 1A from disclosing transactions with other wholly-owned subsidiary undertakings of the Prudential Group.

**27. Long-term business provision**

The Company's long-term products consist of life insurance, pensions and pension annuities. In common with other UK long-term insurance companies, the Company's products are structured as either with-profits (or participating) products, or non-participating products including annuities in payment and unit-linked products. Depending upon the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies. With-profits policies are supported by the with-profits sub-fund and can be single or regular premium. The return to shareholders on virtually all with-profits products is in the form of a statutory transfer to the Company's shareholders' funds which is analogous to a dividend from the Company's long-term fund and is dependent upon the level of bonuses credited or declared on policies in that year. There are two types of bonuses – "annual" and "final". Annual bonuses are declared once a year, and are determined as a prudent proportion of the long-term expected future investment return on the underlying assets. Once credited, annual bonuses are guaranteed in accordance with the terms of the particular product. In contrast, "final" bonuses are only guaranteed until the next bonus declaration, and are primarily determined on the actual investment return achieved, smoothed over the

**Notes on the financial statements (continued)**

life of the policy. With-profits policyholders currently receive 90 per cent of the distribution from the with-profits sub-fund as bonus additions to their policies and shareholders receive 10 per cent as a statutory transfer.

The Scottish Amicable Insurance Fund (SAIF) is a closed sub-fund that contains the bulk of the business originally written by the Scottish Amicable Life Assurance Society and acquired by the Company on 30 September 1997. Under the terms agreed at the time of the purchase, the SAIF inherited estate will be distributed to with-profits policyholders as an addition to the with-profits benefits arising in SAIF. The SAIF policyholders therefore receive 100 per cent of the distribution from the sub-fund as bonus additions to their policies.

The defined charge participating sub-fund (DCPSF) forms part of the Company's long-term fund and comprises the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France, the defined charge participating with-profits business reassured into the Company from both Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd and the with-profits annuity business transferred to the Company from the Equitable Life Assurance Society on 31 December 2007. All profits in this fund accrue to policyholders in the DCPSF.

There is a substantial volume of non-participating business in the with-profits sub-fund; profits from this business accrue to the with-profits sub-fund. The Company also writes non-participating business, the profit on which accrues solely to shareholders.

**Notes on the financial statements (continued)***i Analysis of movements in insurance liabilities including FFA*

|                                              | Technical Provisions       |                          |                |
|----------------------------------------------|----------------------------|--------------------------|----------------|
|                                              | Technical Provisions<br>£m | Linked liabilities<br>£m | Total<br>£m    |
| At 1 January 2015                            |                            |                          |                |
| Comprising                                   |                            |                          |                |
| Technical provisions                         | 103,816                    | 17,253                   | 121,069        |
| Fund for future appropriations               | 10,476                     | —                        | 10,476         |
|                                              | <b>114,292</b>             | <b>17,253</b>            | <b>131,545</b> |
| Premiums                                     | 6,758                      | 359                      | 7,117          |
| Surrenders                                   | (3,136)                    | (630)                    | (3,766)        |
| Maturities/Deaths                            | (4,494)                    | (597)                    | (5,091)        |
| Shareholders' transfers post tax             | (214)                      | (1)                      | (215)          |
| Switches                                     | (189)                      | 189                      | —              |
| Investment-related items and other movements | 1,496                      | 242                      | 1,738          |
| Foreign exchange translation differences     | 14                         | —                        | 14             |
| Assumption changes                           | (41)                       | —                        | (41)           |
| <b>As at 31 December 2015/1 January 2016</b> | <b>114,486</b>             | <b>16,815</b>            | <b>131,301</b> |
| Comprising                                   |                            |                          |                |
| Technical provisions                         | 103,727                    | 16,815                   | 120,542        |
| Fund for future appropriations               | 10,759                     | —                        | 10,759         |
|                                              | <b>114,486</b>             | <b>16,815</b>            | <b>131,301</b> |
| Premiums                                     | 27,298                     | 5,598                    | 32,896         |
| Surrenders                                   | (3,875)                    | (626)                    | (4,501)        |
| Maturities/Deaths                            | (4,712)                    | (697)                    | (5,409)        |
| Shareholders' transfers post tax             | (215)                      | —                        | (215)          |
| Switches                                     | (152)                      | 152                      | —              |
| Investment-related items and other movements | 4,670                      | 2,685                    | 7,355          |
| Foreign exchange translation differences     | 528                        | 1                        | 529            |
| Assumption changes                           | (79)                       | —                        | (79)           |
| <b>As at 31 December 2016</b>                | <b>137,949</b>             | <b>23,928</b>            | <b>161,877</b> |
| Comprising                                   |                            |                          |                |
| Technical provisions                         | 126,016                    | 23,928                   | 149,944        |
| Fund for future appropriations               | 11,933                     | —                        | 11,933         |
|                                              | <b>137,949</b>             | <b>23,928</b>            | <b>161,877</b> |

Durations of long-term business contracts on a discounted basis:

With the exception of most unitised with-profit bonds and other whole of life contracts the majority of the contracts of the Company have a contract term. However, in effect, the maturity term of contracts reflects the earlier of death, maturity, or lapse of the contract. In addition, with-profit contracts include projected future bonuses based on current investment values. The actual amounts payable will vary with future investment performance of SAIF and the WPSF. Instead the Company uses cash flow projections of expected benefit payments. The following

**Notes on the financial statements (continued)**

table shows the maturity profile of the cash flows used for insurance contracts i.e. those containing significant insurance risk, and investment contracts, which do not contain significant insurance risk:

| 2016          | With-profits business |                        |         | Ex-PAL Business       | Ex-PRIL Business      | Other                 |                        | Total |
|---------------|-----------------------|------------------------|---------|-----------------------|-----------------------|-----------------------|------------------------|-------|
|               | Insurance contracts % | Investment contracts % | Total % | Insurance contracts % | Insurance contracts % | Insurance contracts % | Investment contracts % |       |
| 0-5 years     | 37                    | 37                     | 37      | 29                    | 24                    | 36                    | 33                     | 34    |
| 5-10 years    | 23                    | 28                     | 26      | 24                    | 22                    | 23                    | 23                     | 23    |
| 10-15 years   | 15                    | 17                     | 16      | 18                    | 18                    | 14                    | 17                     | 16    |
| 15-20 years   | 10                    | 10                     | 10      | 12                    | 14                    | 9                     | 13                     | 11    |
| 20-25 years   | 7                     | 4                      | 5       | 7                     | 10                    | 6                     | 7                      | 6     |
| Over 25 years | 8                     | 4                      | 6       | 10                    | 12                    | 12                    | 7                      | 10    |

| 2015          | With-profits business |                        |         | Ex-PAL Business       | Other                 |                        |         |
|---------------|-----------------------|------------------------|---------|-----------------------|-----------------------|------------------------|---------|
|               | Insurance contracts % | Investment contracts % | Total % | Insurance contracts % | Insurance contracts % | Investment contracts % | Total % |
| 0-5 years     | 36                    | 39                     | 38      | 33                    | 32                    | 35                     | 35      |
| 5-10 years    | 23                    | 27                     | 25      | 25                    | 24                    | 23                     | 23      |
| 10-15 years   | 15                    | 17                     | 16      | 18                    | 16                    | 17                     | 16      |
| 15-20 years   | 10                    | 10                     | 10      | 11                    | 11                    | 12                     | 11      |
| 20-25 years   | 7                     | 4                      | 5       | 6                     | 7                     | 7                      | 7       |
| Over 25 years | 9                     | 3                      | 6       | 7                     | 10                    | 6                      | 8       |

**Notes:**

- (i) The cash flow projections of expected benefit payments used in the maturity profile table above are from in-force business and exclude the value of future new business, including vesting of internal pension contracts.
- (ii) Benefit payments do not reflect the pattern of bonuses and shareholder transfers in respect of the with-profits business.
- (iii) Investment contracts under Other comprise unit-linked and similar contracts.
- (iv) For business with no maturity term included within the contracts, for example with-profits investment bonds such as Prudence Bond, an assumption is made as to likely duration based on prior experience.

*ii Determining insurance liabilities*

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

**Business in With-Profits Sub-Fund, SAIF and Defined Charge Participating Sub-Fund**

The overarching principle in assumption setting is that realistic provisions are established using best estimate assumptions, taking into account the firm's regulatory duty to treat its customers fairly.

Assumptions are required in three areas, namely:

- (i) Retrospective assumptions,
- (ii) Prospective assumptions, and
- (iii) Stochastic modelling assumptions relating to the economic asset model and management actions.

**Retrospective assumptions**

Retrospective assumptions are required for the accumulation of past asset shares up to the valuation date. These assumptions are determined by reference to actual past experience primarily in relation to investment returns, expenses and miscellaneous surplus. The assumptions include past expense write-offs and enhancements to asset shares, and are as used when calculating specimen asset shares for the purpose of bonus setting.

**Notes on the financial statements (continued)**

The 2016 year end Investment Return for asset shares is:

| Return       | With-Profits Sub Fund Main Asset Share Fund | High Reversionary Bonus fund (held within the With-Profits Sub-Fund) | PruFund Cautious Fund (held within the With-Profits Sub-Fund) | SAIF   |
|--------------|---------------------------------------------|----------------------------------------------------------------------|---------------------------------------------------------------|--------|
| Gross return | 14.50%                                      | 10.43%                                                               | 11.03%                                                        | 14.94% |
| Net return   | 12.23%                                      | 8.86%                                                                | 9.11%                                                         | 12.53% |

The High Reversionary Bonus and PruFund Cautious funds are contained within the With-Profits Sub-Fund. Compared with the assets backing the main asset share fund, the High Reversionary Bonus and PruFund Cautious funds are both allocated a higher proportion of fixed interest securities and a lower proportion of equities.

**Prospective assumptions**

Prospective assumptions are required for the adjustments to asset shares where a prospective calculation gives a higher result and for the stochastic modelling of the cost of guarantees, options and smoothing.

For asset share adjustments, the economic assumptions used represent our best estimate assumptions allowing for prevailing market conditions at the valuation date.

Expense assumptions have been revised to reflect the company's most recent experience, and expected expenditure over the business planning period.

The table below shows the mortality bases used for the valuation at 31 December 2016:

| Product                                    | Mortality Table (M/F)             | Age Rating Years (M/F) | Multiplier % (M/F) |
|--------------------------------------------|-----------------------------------|------------------------|--------------------|
| Prudence Bond                              | AM92 / AF92                       | -1/-1                  | 90 / 90            |
| PSA / PIB                                  | AM92 / AF92                       | -0.5/-0.5              | 70 / 70            |
| Personal Pensions                          | AM92 / AF92                       | -1/-1                  | 95 / 95            |
| Ordinary Branch assurances                 | AM92 / AF92                       | -0.5/-0.5              | 85 / 85            |
| Industrial Branch                          | PAC 78 WL (Internal Table)        | +0 / +0                | 55 / 55            |
| With-Profit Deferred Annuities             | PMA92c2004 (1d) / Female not used | +0 / +0                | 48/ not used       |
| SAIF Conventional With-Profits             | AM92 / AF92                       | +1 / +1                | 70 / 70            |
| SAIF/Ex-SAL Accumulating With-Profits Life | AM92 / AF92                       | +1 / +1                | 70 / 70            |

For mortality and persistency, the assumptions for most products are based on those used for European Embedded Value calculations. The persistency assumptions used to value the cost of options and guarantees are reduced by a 10% margin to make an allowance for the impact of policyholders' group actions in extreme market scenarios.

**Stochastic asset model economic calibration and management actions**

The cost of options, guarantees and smoothing are assessed on a market consistent basis, so that the reserves held are equal to the theoretical cost of hedging the guarantees in the market. In the absence of a deep, liquid market these costs are assessed using a "market consistent" model, with a market consistent calibration.

In order to value the Company's guarantees and options, the stochastic asset/liability model projects the with-profits liabilities forward over the next 40 years for 5,000 separate economic scenarios.

The risk free rate was assumed to be the UK swap rate. Previously the UK gilt rate was used. This has resulted in an increase in the long-term business provision compared to the prior year as the swap yield is 50-100bps lower than the gilt rate.

**Notes on the financial statements (continued)**

Separate asset models are used for the risk free rate, UK equities, overseas equities, corporate bonds, property and real interest rates. Where appropriate securities or derivatives are traded, it has been demonstrated that the model is able to closely reproduce these prices. Where this is not the case (for example for property and corporate bonds) expert judgement has been applied. Allowance has also been made for the correlation of investment returns between different asset classes.

The cost of guarantees, options and smoothing is very sensitive to the bonus, market value reduction and investment policies that the Company will employ under varying investment conditions. The stochastic modelling incorporates several management actions to protect the fund in adverse investment scenarios. These management actions are consistent with the PPFM and the obligation to treat customers fairly.

**Other non-linked business**

Provisions are predominantly calculated by the net premium valuation method. Discount rates are derived based on gilt yields of a duration consistent with that of the underlying business as these yields are representative of the returns that will be earned on the investments backing these liabilities, and also allow for inflation growth.

The following discount and mortality bases were used:

|                                                               | Interest Rate<br>% | Actuarial Mortality Table Reference*                                                   |
|---------------------------------------------------------------|--------------------|----------------------------------------------------------------------------------------|
| <b><u>UK (excluding Scottish Amicable Insurance Fund)</u></b> |                    |                                                                                        |
| Term assurances - life business                               | 1.02               | AM/AF92+1                                                                              |
| Term assurances - pensions business                           | 1.28               | 75% AM/AF92+1                                                                          |
| Ex-PAL Annuities (Fixed) - pre 1/1/2019                       | 2.40               | 97% - 98% PCMA00 + CMI_2014_PRU_M[2.25];<br>92% - 103% PCFA00 + CMI_2014_PRU_F[1.50]** |
| Ex-PAL Annuities (Fixed) - post 1/1/2019                      | 2.42               | 97% - 98% PCMA00 + CMI_2014_PRU_M[2.25];<br>92% - 103% PCFA00 + CMI_2014_PRU_F[1.50]** |
| Ex-PAL Annuities (Linked) - pre 1/1/2019                      | -1.25              | 97% - 98% PCMA00 + CMI_2014_PRU_M[2.25];<br>92% - 103% PCFA00 + CMI_2014_PRU_F[1.50]** |
| Ex-PAL Annuities (Linked) - post 1/1/2019                     | -1.23              | 97% - 98% PCMA00 + CMI_2014_PRU_M[2.25];<br>92% - 103% PCFA00 + CMI_2014_PRU_F[1.50]** |
| Ex-PRIL Annuities (Fixed) - pre 1/1/2019                      | 2.54               | 94% - 95% PCMA00 + CMI_2014_PRU_M[2.25];<br>83% - 96% PCFA00 + CMI_2014_PRU_F[1.50]**  |
| Ex-PRIL Annuities (Fixed) - post 1/1/2019                     | 2.55               | 94% - 95% PCMA00 + CMI_2014_PRU_M[2.25];<br>83% - 96% PCFA00 + CMI_2014_PRU_F[1.50]**  |
| Ex-PRIL Annuities (Linked) - pre 1/1/2019                     | -0.93              | 94% - 95% PCMA00 + CMI_2014_PRU_M[2.25];<br>83% - 96% PCFA00 + CMI_2014_PRU_F[1.50]**  |
| Ex-PRIL Annuities (Linked) - post 1/1/2019                    | -0.91              | 94% - 95% PCMA00 + CMI_2014_PRU_M[2.25];<br>83% - 96% PCFA00 + CMI_2014_PRU_F[1.50]**  |
| Other Shareholder Annuities (Fixed) - pre 1/1/2019            | 2.52               | 83% PCMA00 + CMI_2014_PRU_M[2.25];<br>74% PCFA00 + CMI_2014_PRU_F[1.50]**              |
| Other Shareholder Annuities (Fixed) - post 1/1/2019           | 2.54               | 83% PCMA00 + CMI_2014_PRU_M[2.25];<br>74% PCFA00 + CMI_2014_PRU_F[1.50]**              |
| Other WPSF Annuities (Fixed)                                  | 2.75               | 97% PCMA00 + CMI_2014_PRU_M[2.25];<br>92% PCFA00 + CMI_2014_PRU_F[1.50]**              |
| Other WPSF Annuities (Linked)                                 | 1.00               | 97% PCMA00 + CMI_2014_PRU_M[2.25];<br>92% PCFA00 + CMI_2014_PRU_F[1.50]**              |
| <b><u>Scottish Amicable Insurance Fund</u></b>                |                    |                                                                                        |
| Term assurances - life business                               | 1.63               | AM/AF92+1                                                                              |
| Term assurances - pensions business                           | 2.04               | 90% AM/AF92+1                                                                          |

\*For assurances, provision for AIDS is made either by increasing the underlying mortality rates or by holding an explicit additional provision. In both cases, the adjustment is one-third of the "R6A" tables.

**Notes on the financial statements (continued)**

\*\* CMI\_2014\_PRU\_M[2.25] and CMI\_2014\_PRU\_F[1.50] are the male and female improvement rates produced by Prudential's internal calibration of the 2014 CMI model, with long term rates of 2.25% and 1.50%.

**Linked business in the Shareholder Fund and Scottish Amicable Insurance Fund**

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

|                         |                                                  |
|-------------------------|--------------------------------------------------|
| Discount Rate           | 1.28% Gross                                      |
| Fund Growth             | 5.50% Gross                                      |
| Mortality               | AM/AF92+1 plus 1/3 AIDS "R6A" for most contracts |
| Administration Expenses | £39 to £280 p.a. depending on the product type   |
| Expense Inflation       | 4.50% Shareholder and 6.00% SAIF                 |

**Linked business in the With-Profit Sub-Fund**

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

|                         |                                               |
|-------------------------|-----------------------------------------------|
| Discount Rate           | 1.28% Gross                                   |
| Fund Growth             | 5.50% Gross                                   |
| Mortality               | AM/AF92 -3 years                              |
| Administration Expenses | £46 to £80 p.a. depending on the product type |
| Expense Inflation       | 6.00%                                         |

**Other long-term business provisions**

Additional provisions have been established, the most significant being for the potential costs and expenses of compensating the Company's pension policyholders under the Financial Services Authority (FSA), the UK insurance regulator at the time, review of pension opt-outs and transfer cases, for the potential costs of compensating endowment mortgage policyholders and for the potential cost of meeting annuity rate guarantees at vesting. Refer to note 29.

*iii Effect of changes in assumptions used to measure insurance assets and liabilities*

For the with-profits sub-fund, the aggregate effect of assumption changes and modelling adjustments in 2016 was a net charge to the FFA of £78m (2015: net charge of £114m), relating to changes in mortality, expense, persistency and tax assumptions, where appropriate in the two periods.

**28. Contingencies and Related Obligations**

**Pension Mis-selling Review**

The pensions review by the Financial Services Authority (FSA), the UK insurance regulator at the time, of past sales of personal pension policies required all UK life insurance companies to review their cases of potential mis-selling and record a provision for the estimated costs. Prudential met the requirement of the FSA (the UK insurance regulator at the time) to issue offers to all cases by 30 June 2002.

At 31 December 2016, the pension mis-selling provision was £505m (2015: £429m) and is included within the long-term business provision. The table below summarises the change in the pension mis-selling provision for the year ended 31 December 2016.



**Notes on the financial statements (continued)**

|                                                            | Year Ended<br>31 December 2016 | Year Ended<br>31 December 2015 |
|------------------------------------------------------------|--------------------------------|--------------------------------|
|                                                            | £m                             | £m                             |
| Balance at start of the period                             | 429                            | 328                            |
| Changes to actuarial assumptions and method of calculation | 121                            | 144                            |
| Discount unwind                                            | 0                              | 2                              |
| Redress paid to policyholders                              | (44)                           | (44)                           |
| Payment of administrative costs                            | (1)                            | (1)                            |
| Balance at end of the period                               | 505                            | 429                            |

The pension mis-selling provision at 31 December 2016 of £505m is stochastically determined on a discounted basis. The average discount rate implied in the movement in the year is 1.1 per cent (2015: 2.0 per cent).

Provisions in respect of the costs associated with the review have been included in the change in long-term technical provisions in the Company's long-term technical account and the transfer to or from the fund for future appropriations has been determined accordingly.

The directors believe that, based on current information, the provision, together with future investment return on the assets backing the provision, will be adequate to cover the costs of pension mis-selling including administration costs. Such provision represents the best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased.

The costs associated with the pension mis-selling review have been met from the inherited estate. Accordingly, these costs have not been charged to the asset shares used in the determination of policyholder bonus rates. Hence policyholders' payout values have been unaffected by pension mis-selling.

In 1998, Prudential stated that deducting mis-selling costs from the inherited estate would not impact its bonus or investment policy and it gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged. The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing.

This review was completed on 30 June 2002. The assurance will continue to apply to any policy in force at 31 December 2003, both for premiums paid before 1 January 2004, and for subsequent regular premiums (including future fixed, retail price index or salary related increases and Department of Work and Pensions rebate business). The assurance has not applied to new business since 1 January 2004. New business in this context consists of new policies, new members to existing pension schemes plus regular and single premium top-ups, transfers and switches to existing arrangements. The maximum amount of capital support available under the terms of the assurance will reduce over time.

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

**FCA Thematic Review**

Prudential has agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review will examine whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. The review is expected to commence in 2017 and last a period of three years. A provision of £175m has been established at 31 December 2016 to cover the costs of undertaking the review and any potential redress. The ultimate amount that will be expended by the Company on the review remains uncertain. Although the Company's professional indemnity insurance may mitigate the overall financial impact of this review, with potential insurance recoveries of up to £175m, no such recovery has been factored in the provision, in accordance with the requirements of FRS102.21 "Provisions and Contingencies".

**Notes on the financial statements (continued)**

**Mortgage Endowment Products Review**

Historically, in common with several other UK insurance companies, the Company used to sell low-cost endowment products related to repayment of residential mortgages. At sale, the initial sum assured is set at a level such that the projected benefits, including an estimate of the annual bonus receivable over the life of the policy, would equal or exceed the mortgage debt. The FSA (the UK regulator at the time) was concerned that the maturity value of some of these products would be less than the mortgage debt because of a decrease in expected future investment returns since these products were sold. The FSA (the UK regulator at the time) worked with insurance companies to devise a programme whereby the companies write to customers indicating whether they may have a possible shortfall and outline the actions that the customers can take to prevent this possibility. This programme remains in place following the change in the regulatory regime.

The Company is exposed to mortgage endowment products in respect of policies issued by Scottish Amicable Life plc (SAL) and policies issued by Scottish Amicable Life Assurance Society (SALAS) and transferred into the Scottish Amicable Insurance Fund (SAIF). Technical provisions of £0.4m (2015: £0.4m) in the shareholder fund and £10.6m (2015: £3.8m) in SAIF were held at 31 December 2016 to cover potential compensation in respect of mortgage endowment product mis-selling claims. As SAIF is a separate ring-fenced fund, wholly attributable to the policyholders of the fund, this provision has no impact on shareholders.

In addition, the Company's main with-profits fund paid compensation of £0.9m in respect of mortgage endowment products mis-selling claims in the year ended 31 December 2016 (2015: £0.8m) and held a technical provision of £12.7m at 31 December 2016 (2015: £12.7m) in respect of further compensation. In line with the time limit prescribed by the FSA, the insurance regulator at that time, and the Association of British Insurers, impacted customers have three years to lodge a mis-selling complaint from the date they receive their first "red" letter indicating that there is a high risk their mortgage endowment may not achieve its projected final value.

**Guaranteed Annuities**

The Company used to sell guaranteed annuity products in the UK and held a technical provision of £62m at 31 December 2016 (2015: £47m) within the main with-profits fund to honour guarantees on these products.

The Company's main exposure to guaranteed annuities in the UK is through the Scottish Amicable Insurance Fund (SAIF) and a technical provision of £571m was held in SAIF at 31 December 2016 (2015: £412m) to honour the guarantees.

**Guarantees and Commitments**

Since 2012 the Company has agreed to guarantee the funding obligation at the date of the last triennial valuation that Prudential Distribution Limited (PDL), a service company within the Prudential Group and principal employer, and other participating employers have to the Scottish Amicable Pension Scheme. The funding obligation arises from the deficit in this pension scheme as at 31 March 2014 (£166m). Payment under the guarantee would be exercised should PDL fail to meet its funding obligation. The guarantee expires on 31 March 2024.

The Company has undrawn commitments of £2.3bn (2015: £2.0bn) to private equity and infrastructure funds in which the Company is already an investor. These funds will be drawn down at the fund managers' discretion over a 3 to 5 year period.

The Company also provides, from time to time, other guarantees and commitments to other companies within the Group and third parties entered into in the normal course of business but the directors do not consider that the amounts involved are significant.

**Support of Long-term Business Funds by Shareholders' Funds**

As a proprietary insurance company, the Company is liable to meet its obligations to policyholders even if the assets of the long-term funds are insufficient to do so. The assets, represented by the unallocated surplus of with-profits funds, in excess of amounts expected to be paid for future terminal bonuses and related shareholder transfers ('the excess assets') in the long-term funds could be materially depleted over time by, for example, a significant or sustained equity market downturn, costs of significant fundamental strategic change or a material increase in the pension mis-selling provision. In the unlikely circumstance that the depletion of the excess assets within the long-term fund was such that the Company's ability to satisfy policyholders' reasonable expectations

**Notes on the financial statements (continued)**

was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders' funds to the long-term funds to provide financial support.

In 1997, the business of Scottish Amicable Life Assurance Society, a mutual society, was transferred to the Company. In effecting the transfer, a separate sub-fund, the Scottish Amicable Insurance Fund (SAIF), was established within the Company's long-term business fund. This sub-fund contains all the with-profits business and all other pension business that was transferred. No new business has been or will be written in the sub-fund and the sub-fund is managed to ensure that all the invested assets are distributed to SAIF policyholders over the lifetime of the SAIF policies. With the exception of certain amounts in respect of the unitised with-profits life business, all future earnings arising in SAIF are retained for SAIF policyholders. Any excess (deficiency) of revenue over expense within SAIF during a period is offset by a change in the SAIF technical provisions (no FFA is shown for SAIF in 2016 because technical provisions are set to equal assets). Shareholders have no interest in the profits of SAIF but are entitled to the investment management fees paid on this business.

SAIF with-profits policies contain minimum levels of guaranteed benefit to policyholders. In addition, as mentioned earlier in this note, certain pensions products have guaranteed annuity rates at retirement. Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations of the policyholders of SAIF, the Company's long-term fund would be liable to cover any such deficiency in the first instance.

The Polish branch became operational in March 2013. The Company's inherited estate is contributing to the costs of establishing the branch. The inherited estate is expected to recoup this funding over time from charges levied, however, if experience is not as expected there is an obligation of the Company's shareholder funds to ensure the inherited estate will be repaid in full with interest.

**Litigation**

The Company is, and in the future may be, subject to legal actions and disputes in the ordinary course of its business. Current litigation includes a claim for £149m in respect of which the Company is one of a number of defendants relating to the financial restructuring carried out by a borrower in one of the Company's investments. The outcome of litigation is always uncertain but the Company believes it has good grounds to defend these claims. In addition, a judgment has been made in favour of the Company (as a lending noteholder) in response to the partial early redemption of notes from a commercial property investment and an £18m early redemption payment is currently in escrow, which, subject to any appeal, will be released to the Company.

While the outcome of these and other matters cannot be predicted with certainty, the directors believe that the ultimate outcome of such litigation will not have a material adverse effect on the Company's financial condition and results.

**Intra-group Capital Support Arrangements**

Prudential plc and the Company have put in place intra-group arrangements to formalise circumstances in which capital support would be made available by Prudential plc (including in the scenarios referred to in Pension Mis-selling Review above). While it is considered unlikely that such support will be required, the arrangements are intended to provide additional comfort to the Company and its policyholders.

In 2016 the Company put in place an arrangement to formalise circumstances in which capital support would be made available to Prudential Pensions Limited (PPL). The drawdown of support would be triggered by a breach of pre-specified solvency conditions in PPL (105% of Solvency Capital Requirement or 105% of Economic Capital Requirement).

Following the domestication of the Hong Kong branch on 1 January 2014 a series of intra-group capital support arrangements have been put in place:

- **New Business Support Commitment:**

For a period of three years from the transfer date of 1 January 2014 capital support shall be provided from the Company's shareholders' fund to its with-profits fund to enable it to maintain the expectations of its with-profits policyholders as if the assets of the inherited estate had not been transferred to the new business sub-fund of PHKL. The maximum amount of support available had reduced to nil by 31 December 2016.

**Notes on the financial statements (continued)**

• **PHKL Pension Mis-selling Costs Assurance:**

The PHKL shareholder fund will provide capital support to enable PHKL to satisfy its obligations to manage its in-force sub-fund as if the Company's pension mis-selling costs had not been deducted from the PHKL inherited estate. The Company, in turn, will provide capital support from its shareholders' fund to PHKL to the extent that there are insufficient assets in the PHKL shareholders' fund to enable PHKL to support its obligations to its in-force sub-fund.

• **Capital Support from Prudential plc:**

Prudential plc will also provide capital support as necessary to PHKL and PGHK to support new business growth and to maintain solvency. These support arrangements meet a condition set by the Hong Kong regulator (amongst other matters) for its approval of the domestication of the Hong Kong branch.

There is an obligation of the Company's shareholder funds to support Prudential Financial Planning Ltd, another group company, which became operational in 2013. Part of the acquisition costs incurred in the early years of operation are to be spread over five years to reflect the period over which the benefit, in terms of sales, would arise. Where the initial funding is provided by the Company's with-profits fund, it is subject to support from the shareholder funds that in the event of a closure during this period, the amortisation will be reversed and the shareholder will reimburse the consequent estate drain.

**Notes on the financial statements (continued)****29. Financial assets and liabilities****A. Financial instruments - designation and fair values**

All financial assets of the Company are designated as either fair value through profit and loss or loans and receivables. Financial liabilities are designated as either fair value through profit and loss, amortised cost or investment contracts with discretionary participation features accounted for under FRS 103 as described in the Accounting Policies section.

| 2016                                                       | Fair value through profit and loss<br>£m | Loans and receivables<br>£m | Total carrying value<br>£m | Fair value<br>£m |
|------------------------------------------------------------|------------------------------------------|-----------------------------|----------------------------|------------------|
| <b>Financial Assets</b>                                    |                                          |                             |                            |                  |
| Deposits with credit institutions                          | —                                        | 9,503                       | 9,503                      | 9,503            |
| Equity securities and portfolio holdings in unit trusts    | 43,267                                   | —                           | 43,267                     | 43,267           |
| Debt securities and other fixed income securities (note i) | 71,750                                   | —                           | 71,750                     | 71,750           |
| Loans (note ii)                                            | 1,615                                    | 1,836                       | 3,451                      | 3,540            |
| Participation in investment pools                          | 3,586                                    | —                           | 3,586                      | 3,586            |
| Derivative assets                                          | 2,529                                    | —                           | 2,529                      | 2,529            |
| Assets held to cover linked liabilities                    | 18,495                                   | —                           | 18,495                     | 18,495           |
| Debtors arising out of direct insurance operations         | —                                        | 23                          | 23                         | 23               |
| Debtors arising out of reinsurance operations              | —                                        | 5                           | 5                          | 5                |
| Accrued investment income                                  | —                                        | 1,431                       | 1,431                      | 1,431            |
| Other debtors                                              | —                                        | 979                         | 979                        | 979              |
| Cash at bank and in hand                                   | —                                        | 2,960                       | 2,960                      | 2,960            |
| Finance Lease asset                                        | 33                                       | —                           | 33                         | 33               |
| <b>Total</b>                                               | <b>141,275</b>                           | <b>16,737</b>               | <b>158,012</b>             | <b>158,101</b>   |

|                                                                          | Fair value through profit and loss<br>£m | Amortised cost<br>£m | Investment contracts with DPF<br>£m | Total carrying value<br>£m | Fair value<br>£m |
|--------------------------------------------------------------------------|------------------------------------------|----------------------|-------------------------------------|----------------------------|------------------|
| <b>Financial Liabilities</b>                                             |                                          |                      |                                     |                            |                  |
| Finance lease obligations                                                | —                                        | 37                   | —                                   | 37                         | 37               |
| Other borrowings not owed to credit institutions (note iii)              | —                                        | 163                  | —                                   | 163                        | 163              |
| Investment contracts with discretionary participation features (note iv) | —                                        | —                    | 52,478                              | 52,478                     | —                |
| Investment contracts without discretionary participation features        | 7,231                                    | —                    | —                                   | 7,231                      | 7,231            |
| Creditors arising out of direct insurance operations                     | —                                        | 71                   | —                                   | 71                         | 71               |
| Creditors arising out of reinsurance operations                          | —                                        | 25                   | —                                   | 25                         | 25               |
| Deposits received from reinsurers                                        | —                                        | 1,295                | —                                   | 1,295                      | 1,295            |
| Other creditors                                                          | 385                                      | 4,446                | —                                   | 4,831                      | 4,831            |
| Derivative liabilities                                                   | 1,730                                    | —                    | —                                   | 1,730                      | 1,730            |
| <b>Total (note v)</b>                                                    | <b>9,346</b>                             | <b>6,037</b>         | <b>52,478</b>                       | <b>67,861</b>              | <b>15,383</b>    |

**Notes on the financial statements (continued)**

| 2015                                                       | Fair value through profit and loss<br>£m | Loans and receivables<br>£m | Total carrying value<br>£m | Fair value<br>£m |
|------------------------------------------------------------|------------------------------------------|-----------------------------|----------------------------|------------------|
| <b>Financial Assets</b>                                    |                                          |                             |                            |                  |
| Deposits with credit institutions                          | —                                        | 9,108                       | 9,108                      | 9,108            |
| Equity securities and portfolio holdings in unit trusts    | 36,114                                   | —                           | 36,114                     | 36,114           |
| Debt securities and other fixed income securities (note i) | 43,630                                   | —                           | 43,630                     | 43,630           |
| Loans (note ii)                                            | 256                                      | 2,187                       | 2,443                      | 2,763            |
| Participation in investment pools                          | 2,533                                    | —                           | 2,533                      | 2,533            |
| Derivative assets                                          | 1,234                                    | —                           | 1,234                      | 1,234            |
| Assets held to cover linked liabilities                    | 11,861                                   | —                           | 11,861                     | 11,861           |
| Deposits with ceding undertakings                          | —                                        | 4,584                       | 4,584                      | 4,584            |
| Debtors arising out of direct insurance operations         | —                                        | 45                          | 45                         | 45               |
| Debtors arising out of reinsurance operations              | —                                        | 5                           | 5                          | 5                |
| Accrued investment income                                  | —                                        | 863                         | 863                        | 863              |
| Other debtors                                              | —                                        | 1,002                       | 1,002                      | 1,002            |
| Cash at bank and in hand                                   | —                                        | 1,462                       | 1,462                      | 1,462            |
| Finance Lease asset                                        | 33                                       | —                           | 33                         | 33               |
| <b>Total</b>                                               | <b>95,661</b>                            | <b>19,256</b>               | <b>114,917</b>             | <b>115,237</b>   |

|                                                                          | Fair value through profit and loss<br>£m | Amortised cost<br>£m | Investment contracts with DPF | Total carrying value<br>£m | Fair value<br>£m |
|--------------------------------------------------------------------------|------------------------------------------|----------------------|-------------------------------|----------------------------|------------------|
| <b>Financial Liabilities</b>                                             |                                          |                      |                               |                            |                  |
| Finance lease obligations                                                | —                                        | 66                   | —                             | 66                         | 66               |
| Other borrowings not owed to credit institutions (note iii)              | —                                        | 175                  | —                             | 175                        | 175              |
| Investment contracts with discretionary participation features (note iv) | —                                        | —                    | 42,709                        | 42,709                     | —                |
| Investment contracts without discretionary participation features        | 6,749                                    | —                    | —                             | 6,749                      | 6,749            |
| Creditors arising out of direct insurance operations                     | —                                        | 147                  | —                             | 147                        | 147              |
| Creditors arising out of reinsurance operations                          | —                                        | 78                   | —                             | 78                         | 78               |
| Deposits received from reinsurers                                        | —                                        | 1,133                | —                             | 1,133                      | 1,133            |
| Other creditors                                                          | 258                                      | 3,687                | —                             | 3,945                      | 3,945            |
| Derivative liabilities                                                   | 1,427                                    | —                    | —                             | 1,427                      | 1,427            |
| <b>Total (note v)</b>                                                    | <b>8,434</b>                             | <b>5,286</b>         | <b>42,709</b>                 | <b>56,429</b>              | <b>13,720</b>    |

**Notes**

- (i) As at 31 December 2016, £303m (2015: £477m) of convertible bonds were included in debt securities. There were no convertible bonds included in borrowings.
- (ii) Loans and receivables are reported net of allowance for loan losses of £12m (2015: £8m losses).
- (iii) As at 31 December 2016, £163m (2015: £175m) of loans repayable, contingent on regulatory surplus emerging, was included in "Other borrowings not owed to credit institutions".
- (iv) It is impractical to determine fair value of investment contracts with discretionary participation features due to the lack of a reliable basis to measure such features.

**Notes on the financial statements (continued)**

- (v) For financial liabilities designated as fair value through profit and loss there was no material impact on profit from movements in credit risk during 2016 and 2015.

**Determination of fair value**

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

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

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

The investment properties of the Company are externally valued by professionally qualified external valuers using the Royal Institution of Chartered Surveyors valuation standards. An 'income capitalisation' technique is predominantly applied for these properties. This technique calculates the value through the yield and rental value depending on factors such as the lease length, building quality, covenant and location. The variables used are compared to recent transactions with similar features to those of the Company's investment properties. As the comparisons are not with properties which are virtually identical to Company's investment properties, adjustments are made by the valuers where appropriate to the variables used. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of the properties.

The Company's shareholder investments in entities that undertake insurance business, and also the investment in the entity that undertakes mortgage lending and administration, are valued using embedded values as determined in accordance with the European Embedded Value (EEV) principles. The EEV basis results have been prepared in accordance with the amended EEV Principles dated April 2016, prepared by the CFO Forum of major European insurers. Investments in other subsidiaries are valued based on net asset value where the directors consider that net asset value provides a close approximation to fair values.

The loans and receivables have been shown net of provisions for impairment. 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 where applicable.

The estimated fair value of derivative financial instruments reflects the estimated amount the Company would receive or pay in an arm's length transaction. This 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 is determined using discounted cash flows of the amounts expected to be paid.

**Notes on the financial statements (continued)**

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

The table below includes financial instruments carried at fair value analysed by level of the FRS 102.34 *Specialist Activities Financial Institutions* (FRS 102.34) para. 22 defined fair value hierarchy (and also includes loans carried at amortised cost in the balance sheet but for which the fair value is disclosed in the financial statements). This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

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 without DPF that are valued using observable inputs.

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £67,743m (2015: £39,795m), £7,909m (2015: £3,597m) 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, directly held investment properties and investments in property funds which are exposed to bespoke properties or risks and investments which are internally valued or subject to a significant number of unobservable assumptions. 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.



**Notes on the financial statements (continued)**

|                                                                                     | 31 December 2016 |         |         |         |
|-------------------------------------------------------------------------------------|------------------|---------|---------|---------|
|                                                                                     | Level 1          | Level 2 | Level 3 | Total   |
|                                                                                     | £m               | £m      | £m      | £m      |
| <b>With-profits*</b>                                                                |                  |         |         |         |
| Investment properties                                                               | —                | —       | 7,263   | 7,263   |
| Equity securities and portfolio holdings in unit trusts                             | 40,784           | 2,350   | 95      | 43,229  |
| Debt securities                                                                     | 5,488            | 39,499  | 206     | 45,193  |
| Loans                                                                               | —                | 1,034   | 439     | 1,473   |
| Other investments (including derivative assets)                                     | 19               | 3,485   | 2,433   | 5,937   |
| Derivative liabilities                                                              | (16)             | (729)   | —       | (745)   |
| Total financial investments, net of derivative liabilities                          | 46,275           | 45,639  | 10,436  | 102,350 |
| Percentage of total                                                                 | 45%              | 45%     | 10%     | 100%    |
| <b>Unit-linked</b>                                                                  |                  |         |         |         |
| Assets held to cover linked liabilities                                             | 8,027            | —       | 20      | 8,047   |
| Total investments net of derivative liabilities                                     | 8,027            | —       | 20      | 8,047   |
| Investment contract without discretionary participation features held at fair value | —                | (7,231) | —       | (7,231) |
| Total                                                                               | 8,027            | (7,231) | 20      | 816     |
| Percentage of total                                                                 | 984%             | (886%)  | 2%      | 100%    |
| <b>Non-linked shareholder-backed**</b>                                              |                  |         |         |         |
| Investment properties                                                               | —                | —       | 1,583   | 1,583   |
| Equity securities and portfolio holdings in unit trusts                             | 38               | —       | —       | 38      |
| Debt securities                                                                     | 6,998            | 28,244  | 252     | 35,494  |
| Loans                                                                               | —                | 2,025   | 79      | 2,104   |
| Other investments (including derivative assets)                                     | —                | 524     | 1       | 525     |
| Derivative liabilities                                                              | —                | (985)   | —       | (985)   |
| Total financial investments, net of derivative liabilities                          | 7,036            | 29,808  | 1,915   | 38,759  |
| Percentage of total                                                                 | 18%              | 77%     | 5%      | 100%    |
| <b>Company total</b>                                                                |                  |         |         |         |
| Investment properties                                                               | —                | —       | 8,846   | 8,846   |
| Equity securities and portfolio holdings in unit trusts                             | 40,822           | 2,350   | 95      | 43,267  |
| Debt securities                                                                     | 12,486           | 67,743  | 459     | 80,688  |
| Loans                                                                               | —                | 3,059   | 517     | 3,576   |
| Other investments (including derivative assets)                                     | 19               | 4,009   | 2,434   | 6,462   |
| Assets held to cover linked liabilities                                             | 8,027            | —       | 20      | 8,047   |
| Derivative liabilities                                                              | (16)             | (1,714) | —       | (1,730) |
| Total financial investments, net of derivative liabilities                          | 61,338           | 75,447  | 12,371  | 149,156 |
| Investment contract without discretionary participation features held at fair value | —                | (7,231) | —       | (7,231) |
| Total                                                                               | 61,338           | 68,216  | 12,371  | 141,925 |
| Percentage of total                                                                 | 43%              | 48%     | 9%      | 100%    |

\* With-profits includes assets held to cover index-linked liabilities.

\*\* Non unit-linked shareholder-backed includes assets held to cover index-linked liabilities which transferred into the Company as part of the PRIL Part VII transfer.

**Notes on the financial statements (continued)**

|                                                                                     | 31 December 2015 |               |               |               |
|-------------------------------------------------------------------------------------|------------------|---------------|---------------|---------------|
|                                                                                     | Level 1          | Level 2       | Level 3       | Total         |
|                                                                                     | £m               | £m            | £m            | £m            |
| <b>With-profits*</b>                                                                |                  |               |               |               |
| Investment properties                                                               | —                | 2             | 7,722         | 7,724         |
| Equity securities and portfolio holdings in unit trusts                             | 33,388           | 2,186         | 506           | 36,080        |
| Debt securities                                                                     | 4,640            | 36,937        | 200           | 41,777        |
| Loans                                                                               | —                | 864           | 401           | 1,265         |
| Other investments (including derivative assets)                                     | 13               | 1,704         | 2,205         | 3,922         |
| Derivative liabilities                                                              | (40)             | (1,325)       | —             | (1,365)       |
| Total financial investments, net of derivative liabilities                          | 38,001           | 40,368        | 11,034        | 89,403        |
| Percentage of total                                                                 | 43%              | 45%           | 12%           | 100%          |
| <b>Unit-linked</b>                                                                  |                  |               |               |               |
| Assets held to cover linked liabilities                                             | 7,830            | —             | —             | 7,830         |
| Total financial investments net of derivative liabilities                           | 7,830            | —             | —             | 7,830         |
| Investment contract without discretionary participation features held at fair value | —                | (6,749)       | —             | (6,749)       |
| Total                                                                               | 7,830            | (6,749)       | —             | 1,081         |
| Percentage of total                                                                 | 724%             | (624%)        | —%            | 100%          |
| <b>Non-linked shareholder-backed</b>                                                |                  |               |               |               |
| Investment properties                                                               | —                | —             | 209           | 209           |
| Equity securities and portfolio holdings in unit trusts                             | 34               | —             | —             | 34            |
| Debt securities                                                                     | 1,103            | 2,858         | 9             | 3,970         |
| Loans                                                                               | —                | 1,493         | 7             | 1,500         |
| Other investments (including derivative assets)                                     | —                | 5             | 1             | 6             |
| Derivative liabilities                                                              | —                | (62)          | —             | (62)          |
| Total financial investments, net of derivative liabilities                          | 1,137            | 4,294         | 226           | 5,657         |
| Percentage of total                                                                 | 20%              | 76%           | 4%            | 100%          |
| <b>Company total</b>                                                                |                  |               |               |               |
| Investment properties                                                               | —                | 2             | 7,931         | 7,933         |
| Equity securities and portfolio holdings in unit trusts                             | 33,422           | 2,186         | 506           | 36,114        |
| Debt securities                                                                     | 5,743            | 39,795        | 209           | 45,747        |
| Loans                                                                               | —                | 2,357         | 408           | 2,765         |
| Other investments (including derivative assets)                                     | 13               | 1,709         | 2,206         | 3,928         |
| Assets held to cover linked liabilities                                             | 7,830            | —             | —             | 7,830         |
| Derivative liabilities                                                              | (40)             | (1,387)       | —             | (1,427)       |
| Total financial investments, net of derivative liabilities                          | 46,968           | 44,662        | 11,260        | 102,890       |
| Investment contract without discretionary participation features held at fair value | —                | (6,749)       | —             | (6,749)       |
| <b>Total</b>                                                                        | <b>46,968</b>    | <b>37,913</b> | <b>11,260</b> | <b>96,141</b> |
| <b>Percentage of total</b>                                                          | <b>49%</b>       | <b>39%</b>    | <b>12%</b>    | <b>100%</b>   |

\* With-profits includes assets held to cover index-linked liabilities.

Assets held to cover unit-linked liabilities, shown in the table, only covers those assets which are required to be disclosed under the provisions of FRS 102.34 for the fair value hierarchy. There are a further £1,099m (2015: £1,752m) of assets which comprise the total assets held to cover unit-linked liabilities, which consist mainly of cash at bank, other debtors and property.

**Interest income and expense**

The interest income on financial assets not at fair value through profit and loss was £107m for the year ended 31 December 2016 (2015: £154m).

The interest expense on financial liabilities not at fair value through profit and loss was £8m for the year ended 31 December 2016 (2015: £5m).

**B. Risk Management**

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

**Notes on the financial statements (continued)**

A number of risk factors affect the Company's operating results and financial condition. The financial risk categories affecting the Company's financial instruments and insurance assets and liabilities are set out below:

| <b>Risk Type</b> | <b>Definition</b>                                                                                                                                                                                                                                                                           |
|------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Market risk      | The risk of loss for the Company, or of adverse change in the financial situation, resulting directly or indirectly, from fluctuations in the level or volatility of market prices of assets and liabilities.                                                                               |
| Credit risk      | The risk of loss for the Company or of adverse change in the financial situation, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors in the form of default or other significant credit event (e.g. downgrade or spread widening). |
| Insurance risk   | The risk of loss for the Company, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend or volatility of a number of insurance risk drivers. These include adverse longevity, mortality and morbidity experience.                          |
| Liquidity risk   | The risk of the Company being unable to generate sufficient cash resource to meet financial obligations as they fall due in business as usual and stress scenarios.                                                                                                                         |

The financial assets and liabilities attaching to the Company's life assurance business are, to varying degrees, subject to the risks described above that may have a material effect on the profit or loss and shareholders' funds. They can be categorised as follows:

- With-profits sub-fund business;
- SAIF; and
- Shareholder fund.

*With-profits sub-fund business*

The shareholder results of the Company's with-profits business are sensitive to market risk only through the indirect effect of investment performance on declared policyholder bonuses. During 2013 the Company entered into a partial equity hedge of the shareholder transfers expected to emerge from the with-profits sub-fund in order to mitigate this risk and it was extended in 2015 and 2016. The investment assets of the Company's with-profits fund are subject to market risk. However, changes in their carrying value, net of the related changes to asset-share liabilities of with-profit contracts, affect the level of funds for future appropriations, which is accounted for as a liability, movements in its value do not affect shareholders' profit or shareholders' funds.

The shareholder results of the Company's with-profits fund correspond to the shareholders' share of the cost of bonuses declared on the with-profits business. This currently corresponds to one-ninth of the cost of bonuses declared.

Investment performance is a key driver of bonuses, and hence the shareholders' share of cost of bonuses. Due to the 'smoothed' basis of bonus declaration the sensitivity to investment performance in a single year is low relative to movements in the period to period performance. However, over multiple periods it is important.

Mortality and other insurance risk are relatively minor factors in the determination of the bonus rates. Adverse persistency experience can affect the level of profitability from with-profits but in any given one year, the shareholders' share of cost of bonus may only be marginally affected. However, altered persistency trends may affect future expected shareholder transfers.

*SAIF*

SAIF is a ring-fenced fund in which, apart from asset management fees, shareholders have no interest. Accordingly, the Company's profit and shareholders' funds are insensitive to the direct effects of market risk attaching to SAIF's assets and liabilities.

*Shareholder fund*

The Company's shareholder fund principally comprises annuity business previously written by Scottish Amicable Life, annuity business accepted from the quota share reinsurance arrangement with Prudential Retirement Income Ltd (until the part VII transfer took place), credit life, unit-linked and other non-participating business. The financial assets covering the liabilities for those types of business 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 shareholder fund'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.

**Notes on the financial statements (continued)**

The liabilities of the unit-linked business change in line with the matching linked assets. Amounts under unit-linked contracts are generally repayable on demand and the Company is responsible for ensuring there is sufficient liquidity within the asset portfolio to enable liabilities to unit-linked policyholders to be met as they fall due. Other liabilities of the Company's shareholder fund are broadly insensitive to market risk.

The principal items affecting the results of the Company's shareholder fund are mortality and credit experience.

**C. Market Risk**

As described in section B market risk is the risk of loss, or of adverse change in the financial situation resulting directly or indirectly, from fluctuations in the level or volatility of market prices of assets and liabilities.

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 primary market risks that the Company faces are equity risk and interest rate risk because most of its assets are investments that are either equity type of investments and subject to equity price risk, or bonds, mortgages and cash deposits, the values of which are subject to interest rate risk. The amount of risk borne by the Company's shareholders depends on the extent to which its customers share the investment risk through the structure of the Company's products.

The split of the Company's investments between equity investments and interest-sensitive instruments depends principally on the type of liabilities supported by those investments and the amount of capital the Company has available. This mix of liabilities allows the Company to invest a substantial portion of its investment funds in equity and property investments that the Company believes produce greater returns over the long term. On the other hand the Company has some liabilities that contain guaranteed returns which generally will be supported by fixed income investments.

**Interest rate risk**

The net exposure to interest rate movement for the Company is very substantially ameliorated by virtue of the close matching of assets with appropriate duration to the liabilities.

The close matching by the Company of assets of appropriate duration to its shareholder fund's annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and FRS 103 is not the same, with contingency reserves and some other margins for prudence not included for FRS 103 reporting purposes. As a result FRS 103'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 2016 and 2015 are as follows:

|                                                             | <u>2016</u>         |                     |                     |                     | <u>2015</u>         |                     |                     |                     |
|-------------------------------------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
|                                                             | Fall of<br>1%<br>£m | Rise of<br>1%<br>£m | Fall of<br>2%<br>£m | Rise of<br>2%<br>£m | Fall of<br>1%<br>£m | Rise<br>of 1%<br>£m | Fall of<br>2%<br>£m | Rise<br>of 2%<br>£m |
| Carrying value of debt securities and derivatives           | 5,508               | (4,527)             | 12,353              | (8,313)             | 537                 | (445)               | 1,216               | (825)               |
| Long term business provision                                | (4,466)             | 3,636               | (10,023)            | 6,635               | (406)               | 338                 | (899)               | 621                 |
| Related tax effects                                         | (177)               | 151                 | (396)               | 285                 | (24)                | 19                  | (57)                | 37                  |
| Net sensitivity of profit after tax and shareholders' funds | 865                 | (740)               | 1,934               | (1,393)             | 107                 | (88)                | 260                 | (167)               |

**Notes on the financial statements (continued)**

**Other Price Risk - Equities and Property**

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

|                                                             | <b>2016</b>                |                            | <b>2015</b>                |                            |
|-------------------------------------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
|                                                             | <b>Decrease<br/>of 20%</b> | <b>Decrease<br/>of 10%</b> | <b>Decrease<br/>of 20%</b> | <b>Decrease<br/>of 10%</b> |
|                                                             | <b>£m</b>                  | <b>£m</b>                  | <b>£m</b>                  | <b>£m</b>                  |
| Pre-tax profit                                              | (324)                      | (162)                      | (49)                       | (24)                       |
| Related deferred tax effects                                | 55                         | 28                         | 10                         | 5                          |
| Net sensitivity of profit after tax and shareholders' funds | <b>(269)</b>               | <b>(134)</b>               | <b>(39)</b>                | <b>(19)</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 risk sensitivity analysis shown above the Company has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity 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.

**Currency Risk**

As at 31 December 2016 the Company held 33% and 4% (2015: 38% and 2%) of its financial assets and financial liabilities, respectively in currencies, mainly US dollar and Euro, other than the functional currency of the relevant business unit.

The financial assets, of which 68% (2015: 82%) are held by the with-profit fund, allow the fund to obtain exposure to foreign equity markets.

The financial liabilities, of which 87% (2015: 87%) are held by the with-profit fund, mainly relate to investment contracts with discretionary participation features.

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

**D. Credit risk**

The Company's long-term fund holds large amounts of investments that contain credit risk on which a certain level of defaults is expected. These expected losses are considered when the Company determines the crediting rates, deposit rates and premium rates for the products that will be supported by these assets. Certain over-the-counter derivatives contain a credit risk element that is controlled through evaluation of collateral agreements and master netting agreements on interest rate and currency swaps. The Company is also exposed to credit-related losses in the event of non-performance by counterparties.

**Notes on the financial statements (continued)****Debt Securities and Other Fixed Income Securities**

The following table summarises by rating the securities held by the Company as at 31 December 2016 and 2015.

|                                                         | 2016 £m |            |          |              |            |       | Total  |
|---------------------------------------------------------|---------|------------|----------|--------------|------------|-------|--------|
|                                                         | AAA     | AA+ to AA- | A+ to A- | BBB+ to BBB- | Below BBB- | Other |        |
| With-profits                                            | 5,617   | 8,740      | 9,859    | 11,807       | 2,225      | 4,700 | 42,948 |
| Non-linked shareholder-backed                           | 3,754   | 8,356      | 8,354    | 3,752        | 251        | 4,335 | 28,802 |
| Total debt securities and other fixed income securities | 9,371   | 17,096     | 18,213   | 15,559       | 2,476      | 9,035 | 71,750 |

|                                                         | 2015 £m |            |          |              |            |       | Total  |
|---------------------------------------------------------|---------|------------|----------|--------------|------------|-------|--------|
|                                                         | AAA     | AA+ to AA- | A+ to A- | BBB+ to BBB- | Below BBB- | Other |        |
| With-profits                                            | 5,377   | 7,631      | 8,917    | 11,264       | 1,941      | 4,530 | 39,660 |
| Non-linked shareholder-backed                           | 581     | 1,335      | 902      | 746          | 57         | 349   | 3,970  |
| Total debt securities and other fixed income securities | 5,958   | 8,966      | 9,819    | 12,010       | 1,998      | 4,879 | 43,630 |

The credit ratings, information or data contained in this report which are attributed and specifically provided by S&P, Moody's and Fitch Solutions and their respective affiliates and suppliers ("Content Providers") is referred to here as the "Content". Reproduction of any Content in any form is prohibited except with the prior written permission of the relevant party. The Content Providers do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. The Content Providers expressly disclaim liability for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold any such investment or security, nor does it address the suitability an investment or security and should not be relied on as investment advice.

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

Where no external ratings are available internal ratings produced by the Prudential Group's asset management operations, which are prepared on a comparable basis to external ratings, are used where possible. Of the total debt securities held at 31 December 2016 which are not externally rated, £5,781m (2015: £2,474m) were internally rated AAA to A-, £2,582m (2015: £1,832m) were internally rated BBB+ to B- and £673m were internally rated as below B- or unrated (2015: £574m). The majority of the unrated debt security investments were held by the Company's with-profits fund and relate to convertible debt and other investments which are not covered by rating analysts nor have an internal rating attributed to them.

As detailed in section B the primary sensitivity of profit or loss and shareholders' equity of the Company relates to non-linked shareholder-backed business which covers the "other funds" in the table above.

Excluded from the table above is £9,198m (2015: £2,289m) of assets backing unit-linked and index-linked contracts which are included within assets held to cover linked liabilities. The holders of these contracts bear the credit risk arising from these assets.

The Company's exposure to the eurozone sovereigns of Portugal, Italy, and Spain is £169m (2015: £80m) with £79m (2015: £77m) in the with-profits fund and £90m (2015: £3m) in the shareholder funds. The Company's exposure to banking operations in these eurozone countries is £124m (2015: £62m) with £73m (2015: £59m) in the with-profits fund and £51m (2015: £3m) in the shareholder funds. The Company had no sovereign or banking debt exposure in Greece or Cyprus in 2016 or 2015.

**Loans and receivables**

In accordance with accounting policy, impairment reviews were performed for loans and receivables. During the year ended 31 December 2016, impairment losses of £27m (2015: £2m) and reversal of impairment losses of £4m (2015: £9m) were recognised for loans and receivables.

**Notes on the financial statements (continued)**

Of the total loans and receivables held £7m (2015: £1m) are past their due date but have not been impaired. 93% (2015: 100%) of the loans and receivables that are past due but not impaired are less than one year past their due date for 2016. The Company expects full recovery of these loans and receivables.

**Reinsurer's share of technical provisions**

The majority of the reinsurers' share of technical provisions relate to cessions to subsidiaries of the Company. See note 18.

Of the reinsurer's share of technical provisions at 31 December 2016 of £7,508m (2015: £14,931m), 18% (2015: 4%) of the balance relates to companies outside of the Prudential Group and of this 77% (2015: 76%) of the balances were from reinsurers with S&P's rating of AA- and above, based on the ratings at the time of signing these financial statements.

**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 the 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 2016, the Company has £8,113m (2015: £4,687m) of lent securities and assets subject to repurchase agreements. The cash and securities collateral held or pledged under such agreements was £8,653m (2015: £5,002m).

At 31 December 2016, 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 £9,273m (Restated 2015: £9,772m).

During 2016 and 2015 the Company did not take possession of any other collateral held as security.

**Collateral and pledges under derivative transactions**

At 31 December 2016, the Company had pledged £690m (2015: £550m) for liabilities and held collateral of £1,870m (2015: £795m) 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 agreement.

**E. Insurance Risk**

The Company is exposed to significant levels of insurance risk. Insurance risk arises mainly from the annuity business in the form of longevity risk, which is the risk that the Company's (current and deferred) annuity customers live longer than expected in the Company's current pricing and reserving assumptions, and as a result future reserving and capital assumptions are changed. The Company conducts rigorous research into longevity risk, using data from its annuitant portfolio. As part of its pension annuity pricing and 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. Further 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 would have an impact on the Company's results.

Mortality and morbidity risks relate to assumptions around the expected number of deaths or illnesses used in pricing and calculating reserves. These are relevant for those lines of business where the customer payoff is dependant on a death or illness. An example is the impact of epidemics or other events that cause a large number of illnesses and/or deaths. Significant influenza epidemics have occurred three times in the last century, but the likelihood, timing, or the severity of future epidemics cannot be predicted. The effectiveness of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Company's loss experience if such an epidemic were to occur. If the actual mortality or morbidity rates were significantly higher than those assumed in pricing and reserving, then

**Notes on the financial statements (continued)**

the Company would make a loss on certain lines of business which could be offset by potential gains on other lines of business due to the natural diversification between longevity and mortality risks.

*Shareholder fund*

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

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

A decrease in assumed mortality rates of 1% would decrease pre-tax profits by approximately £67m (2015: £19m). A decrease in renewal expenses (excluding asset management expenses) of 5% would increase pre-tax profits by £41m (2015: £11m). The effect on profits would be approximately symmetrical for changes in assumptions that are directionally opposite to those explained above. The net effect on profit after tax and shareholders' equity from all the changes in assumptions as described above would be an increase of approximately £21m (2015: £7m). This analysis has been determined by varying the relevant assumption as at the reporting date while holding all other assumptions constant. There has been a large increase in 2016 due to the PRIL Part VII transfer.

Unit-linked business, by virtue of the design features of most of the contracts which provide low levels of mortality cover, the profits are relatively insensitive to changes in mortality experience.

*With-profits sub-fund business*

Mortality and other insurance risk are relatively minor factors in the determination of the bonus rates. Adverse persistency experience can affect the level of profitability from with-profits but in any given one year, the shareholders' share of cost of bonus may only be marginally affected. However, altered persistency trends may affect future expected shareholder transfers.

**F. Liquidity Risk**

As described in section B liquidity risk is the risk that the Company may be unable to meet payment of obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates. Liquidity management in the Company seeks to ensure that, even under adverse conditions, the Company has access to the funds necessary to cover surrenders, withdrawals and maturing liabilities.

In practice, most of the Company's assets are marketable securities. This, combined with the fact that a large proportion of the liabilities contain discretionary surrender values or surrender charges, reduces the liquidity risk.

**Liquidity Analysis**

(i) Contractual maturities of financial liabilities

The following tables set 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.

| <b>2016</b>                                      | 1 year or less | After 1 year to 5 years | After 5 years to 10 years | After 10 years to 15 years | After 15 years to 20 years | Over 20 years | Total undiscounted cashflows | Total carrying value |
|--------------------------------------------------|----------------|-------------------------|---------------------------|----------------------------|----------------------------|---------------|------------------------------|----------------------|
| Financial Liabilities                            | £m             | £m                      | £m                        | £m                         | £m                         | £m            | £m                           | £m                   |
| Amounts owed to credit institutions              | 2              | 2                       | 2                         | 2                          | 1                          | 29            | 38                           | 38                   |
| Other borrowings not owed to credit institutions | 36             | 127                     | —                         | —                          | —                          | —             | 163                          | 163                  |
|                                                  | <b>38</b>      | <b>129</b>              | <b>2</b>                  | <b>2</b>                   | <b>1</b>                   | <b>29</b>     | <b>201</b>                   | <b>201</b>           |



**Notes on the financial statements (continued)**

| <b>2015</b>                                      | 1 year or less | After 1 year to 5 years | After 5 years to 10 years | After 10 years to 15 years | After 15 years to 20 years | Over 20 years | Total undiscounted cashflows | Total carrying value |
|--------------------------------------------------|----------------|-------------------------|---------------------------|----------------------------|----------------------------|---------------|------------------------------|----------------------|
|                                                  | £m             | £m                      | £m                        | £m                         | £m                         | £m            | £m                           | £m                   |
| Financial Liabilities                            |                |                         |                           |                            |                            |               |                              |                      |
| Amounts owed to credit institutions              | 3              | 11                      | 19                        | 7                          | 6                          | 20            | 66                           | 66                   |
| Other borrowings not owed to credit institutions | 5              | 170                     | —                         | —                          | —                          | —             | 175                          | 175                  |
|                                                  | <b>8</b>       | <b>181</b>              | <b>19</b>                 | <b>7</b>                   | <b>6</b>                   | <b>20</b>     | <b>241</b>                   | <b>241</b>           |

## ii) Maturity analysis of derivatives and investment contracts

The following table provides a maturity analysis of derivative assets and liabilities:

| <b>2016</b>             | Total carrying value | 1 year or less | After 1 to 3 years | After 3 to 5 years | After 5 years | Total      |
|-------------------------|----------------------|----------------|--------------------|--------------------|---------------|------------|
|                         | £m                   | £m             | £m                 | £m                 | £m            | £m         |
| Net derivative position | <b>799</b>           | <b>799</b>     | —                  | —                  | —             | <b>799</b> |

  

| <b>2015</b>             | Total carrying value | 1 year or less | After 1 to 3 years | After 3 to 5 years | After 5 years | Total |
|-------------------------|----------------------|----------------|--------------------|--------------------|---------------|-------|
|                         | £m                   | £m             | £m                 | £m                 | £m            | £m    |
| Net derivative position | (193)                | (193)          | —                  | —                  | —             | (193) |

The net derivative positions as shown in the table above comprise the following derivative assets and liabilities:

|                                              | <b>2016</b>    | <b>2015</b> |
|----------------------------------------------|----------------|-------------|
|                                              | £m             | £m          |
| Derivative assets (note 16)                  | <b>2,529</b>   | 1,234       |
| Derivative liabilities (note 16 and note 24) | <b>(1,730)</b> | (1,427)     |
| Net derivative position                      | <b>799</b>     | (193)       |

The derivative assets and liabilities have been included at fair value within the 1 year or less column representing 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.

**Notes on the financial statements (continued)**

The table below shows the maturity profile for investment contracts on an undiscounted basis to the nearest billion. This maturity profile has been based on the cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing the European Embedded Value (EEV) basis results.

|                                        | 1 year<br>or less | After 1<br>year to<br>5 years | After 5<br>years to<br>10<br>years | After 10<br>years to<br>15 years | After 15<br>years to<br>20 years | Over 20<br>years | Total un-<br>discounted<br>value | Total<br>carrying<br>value |
|----------------------------------------|-------------------|-------------------------------|------------------------------------|----------------------------------|----------------------------------|------------------|----------------------------------|----------------------------|
|                                        | £bn               | £bn                           |                                    | £bn                              | £bn                              | £bn              | £bn                              | £bn                        |
| <b>2016</b>                            |                   |                               |                                    |                                  |                                  |                  |                                  |                            |
| Life assurance<br>investment contracts | 6                 | 22                            | 23                                 | 15                               | 10                               | 9                | 85                               | 60                         |
| <b>2015</b>                            |                   |                               |                                    |                                  |                                  |                  |                                  |                            |
| Life assurance<br>investment contracts | 5                 | 19                            | 18                                 | 13                               | 9                                | 8                | 72                               | 49                         |

This table has been prepared on an undiscounted basis and accordingly the amounts shown for life assurance investment contracts differ from those included in the balance sheet. Durations of long-term business contracts, covering both insurance and investment contracts, on a discounted basis are included below.

**G. Derivatives and Hedging**

The Company uses derivatives for the purpose of efficient portfolio management or the reduction in investment risk. In so doing, the Company obtains cost effective and efficient exposure to various markets and to manage exposure to equity, interest rate, currency, credit and other business risks.

The Company uses various interest rate derivative instruments such as interest rate swaps and swaptions to reduce exposure to interest rate volatility.

The Company also uses various currency derivatives in order to limit volatility due to foreign currency exchange rate fluctuations arising on securities denominated in currencies other than sterling.

All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and CSA (Credit Support Annex). 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. The Company also has the ability to enter into cleared derivative positions under the EMIR (European Market Infrastructure Regulation).

The total fair value balances of derivative assets and liabilities are shown in note 16.

There are hedging arrangements in place for the liabilities. In addition to some product/purpose specific arrangements, the main objective of the hedging arrangement is to broadly match a subset of the market consistent liabilities and hence protect the Solvency II position of the with-profits business against adverse market movements. A benchmark of a theoretical replicating portfolio (comprising of equity put options and interest rate exposures) representing the liabilities has been determined, based on characteristics of the with-profits liability.

The Company deals in an appropriate amount of hedging instruments so that movements in the instruments held reflect movements in the benchmark put options representing the liabilities. The actual and required hedging positions are monitored at least monthly, and the 1-month Value at Risk between the assets and benchmark is calculated. If this amount is significant, then an assessment is made as to whether or not to address the balance, and how much to rebalance. Automatic rebalancing is triggered if the monthly Value at Risk position of the hedges exceed the agreed threshold.

During 2013 the Company entered into a partial equity hedge of the shareholder transfers expected to emerge from the Company's with-profits sub-fund and it was extended in 2015 and 2016. The effect in 2016 is an unrealised loss of £202m (2015: unrealised gain of £29m) and a realised loss of £75m (2015: realised loss of £36m) charged to the non-technical account.

**Notes on the financial statements (continued)**

**30. Capital Requirements and Management**

The introduction of Solvency II at the start of 2016 changed the capital dynamics of the Company's life operations which are directly impacted by this change. In overview, it permitted the inclusion of future profits in the available capital of the business but increased the statutory capital requirements.

The Company's estimated and unaudited shareholder Solvency II Own Funds at 31 December 2016 is £13.5bn, after allowing for recalculation of transitional measures as at 31 December 2016. This relates to shareholder-backed business including future with-profits shareholder transfers, but excludes the shareholders' share of the estate in line with Solvency II requirements.

While the surplus position of the Company with-profits funds remain strong on a Solvency II basis, it is ring-fenced from the shareholder balance sheet and is therefore excluded from the Company's shareholder Solvency II surplus results. The Company's estimated and unaudited with-profits funds Solvency II Own Funds at 31 December 2016 was £8.4bn, after allowing for recalculation of transitional measures as at 31 December 2016.

The Solvency II Pillar I capital requirements at 31 December 2016 have been calculated using the Company's Internal Capital Model. The method used to calculate the capital has been to:

- (i) identify the major risks to which the business is exposed,
- (ii) specify a probability distribution which defines the full range of outcomes for each risk, including the 99.5% (or 1-in-200) worst outcome that the directors believe could occur over the coming year,
- (iii) specify an appropriate dependency structure between each of the risks,
- (iv) use stochastic modelling to generate up to 100,000 equally likely risk scenarios where each risk is simulated at the same time, having regard to the probability distribution for each risk and the dependency between different risks,
- (v) calculate the change in the available capital over a one year period in each scenario, and
- (vi) set the capital as the change in the available capital in the 99.5th worst scenario.

**Shareholder fund**

The Company manages its Own Funds to ensure that sufficient Own Funds are available on an ongoing basis to meet regulatory capital requirements. This is achieved by targeting a capital buffer significantly in excess of regulatory capital requirements. This buffer is intended to absorb the impact of stressed market conditions and thus make the regulatory balance sheet resilient to stresses that affect the Company shareholder-backed business, and is calibrated such that following a stress event (at the calibrated likelihood) the business remains able to cover its Solvency II Solvency Capital Requirement (SCR).

Projections are performed over three and five year time horizons to understand how the Own Funds and capital position is expected to develop and how this might be affected by adverse events taking place. Informed by the results of these projections there are a number of actions available to management to influence the development of the Own Funds position, including (but not limited to) changes to investment strategy, dividend policy, risk transfer and recalculation of the Transitional Measure on Technical Provisions.

**Policyholder Fund**

The Company manages its Own Funds to ensure that sufficient Own Funds are available on an ongoing basis to meet regulatory capital requirements. The risk appetite is the key tool for determining what level of Own Funds is needed to ensure that regulatory capital requirements continue to be met with a high degree of confidence.

Projections are performed over three and five year time horizons to understand how the Own Funds and capital position is expected to develop and how this might be affected by adverse events taking place, including assessment against risk appetite. Informed by the results of these projections there are a number of actions available to management to influence the development of the Own Funds position, including (but not limited to) changes to investment strategy, bonus policy, level and type of new business, risk transfer and recalculation of the Transitional Measure on Technical Provisions.

The capital requirement required by regulation was maintained during the year.

The Company's estimated Own Funds position for shareholder and policyholder business separately is shown below, along with reconciliations to shareholders' funds and the fund for future appropriations.

**Notes on the financial statements (continued)****Reconciliation of the Shareholder Funds and FFA to the estimated Solvency II Own Funds (unaudited)**

|                                                                                                | <b>2016</b>   |
|------------------------------------------------------------------------------------------------|---------------|
|                                                                                                | <b>£m</b>     |
| <b>UK with profits funds</b>                                                                   |               |
| Fund for Future Appropriations                                                                 | 11,933        |
| Value of shareholder transfers                                                                 | (2,271)       |
| Impact of risk margin (net of transitionals)                                                   | (704)         |
| Other valuation differences                                                                    | (527)         |
| <b>With Profits Ring Fenced Fund - Estimated Solvency II Own Funds</b>                         | <b>8,431</b>  |
| <b>Other long term business</b>                                                                |               |
| Shareholders' equity                                                                           | 13,623        |
| Impact of risk margin (net of transitionals)                                                   | (935)         |
| Add value of shareholder transfers                                                             | 3,242         |
| Asset Valuation differences                                                                    | (2,293)       |
| Other valuation differences                                                                    | (277)         |
| Increase in value of net deferred tax liabilities (resulting from valuation differences above) | 166           |
| Restrictions on Ring Fenced Funds                                                              | (3,789)       |
| <b>Estimated Company Solvency II Own Funds<sup>note(i)</sup></b>                               | <b>18,168</b> |

**Note**

- (i) The estimated solvency position includes the impact of recalculated transitionals at the valuation date, which has reduced the Company shareholder Own Funds by £0.5bn and increased the policyholder own funds by £0.1bn. The formal Quantitative Reporting Templates (Solvency II regulatory templates) will include transitional measures without this recalculation.

**Reconciliation of the Shareholder Funds and FFA to available capital resources on PRA Solvency I basis**

|                                                                                                                                                                   | <b>Policyholder</b> | <b>Non-profit sub-fund</b> | <b>Shareholder</b> | <b>Company Total</b> |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|----------------------------|--------------------|----------------------|
|                                                                                                                                                                   | <b>£m</b>           | <b>£m</b>                  | <b>£m</b>          | <b>£m</b>            |
| <b>31 December 2015 Shareholder Funds</b>                                                                                                                         | —                   | 960                        | 9,533              | 10,493               |
| <b>31 December 2015 Fund for Future Appropriations</b>                                                                                                            | <b>10,730</b>       | <b>29</b>                  |                    |                      |
| Shareholders' share of realistic liabilities                                                                                                                      | (2,346)             | —                          |                    |                      |
| Deferred acquisition costs of non-participating business and intangible assets (distribution rights and licence) not recognised for regulatory reporting purposes | (4)                 | (89)                       |                    |                      |
| Adjustment from FRS102 basis pension surplus attributable to WPSF to pension liability for regulatory purposes                                                    | (125)               | —                          |                    |                      |
| Valuation difference on non-profit annuity liabilities                                                                                                            | (113)               | —                          |                    |                      |
| Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis)                                             | (554)               | (410)                      |                    |                      |
| <b>31 December 2015 Total available capital resources of life assurance businesses on PRA Solvency I basis</b>                                                    | <b>7,588</b>        | <b>490</b>                 |                    |                      |

**Notes on the financial statements (continued)****31. 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.

The following is a list of related undertakings of the Company at 31 December 2016.

**(i) Direct subsidiary undertakings****Investment**

| <b>Name</b>                                    | <b>Classes of Shares held</b> | <b>Proportion held</b> | <b>Country of Incorporation</b> | <b>Address</b>                                                                                       |
|------------------------------------------------|-------------------------------|------------------------|---------------------------------|------------------------------------------------------------------------------------------------------|
| Cardinal Distribution Park Management Limited  | Ordinary Shares               | 66%                    | United Kingdom                  | 5th Floor Cavendish House<br>39 Waterloo Street<br>Birmingham, B2 5PP                                |
| Carraway Guildford General Partner Limited     | Ordinary Shares               | 100%                   | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| Central Square Leeds Limited                   | Ordinary Shares               | 100%                   | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| Cribbs Mall Nominee (1) Limited                | Ordinary Shares               | 100%                   | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| Edger Investments Limited                      | Ordinary Shares               | 100%                   | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| Euro Salas Properties Limited                  | Ordinary Shares               | 100%                   | United Kingdom                  | 7 West George Street, Glasgow,<br>G2 1BA                                                             |
| Greenpark (Reading) Limited Partnership (The)  | Limited Partnership Interest  | 100%                   | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| Manchester Nominee (1) Limited                 | Ordinary Shares               | 100%                   | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| Minster Court Estate Management Limited        | Ordinary Shares               | 56%                    | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| NAPI REIT, Inc.                                | Ordinary Shares               | 99%                    | USA                             | The Corporation Trust<br>Incorporated<br>300 E Lombard Street<br>Baltimore, MD 21202<br>Maryland USA |
| Optimus Point Management Company Limited       | Ordinary Shares               | 99.95%                 | United Kingdom                  | Barrat House Cartwright Way,<br>Bardon Hill, Coalville,<br>Leicestershire, LE67 1UF                  |
| Pacus (UK) Limited                             | Ordinary Shares               | 100%                   | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| PPMC First Nominees Limited                    | Ordinary Shares               | 100%                   | United Kingdom                  | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                          |
| Prudential Dublin Investment Ltd               | Ordinary Shares               | 100%                   | Ireland                         | IFSC, North Wall Quay, Dublin 1                                                                      |
| Prudential Investments (Luxembourg) 2 S.à r.l. | Ordinary shares               | 100%                   | Luxembourg                      | 34-38, avenue de la Liberté<br>Luxembourg<br>L-1930                                                  |
| Prudential Properties Trusty Pty Limited       | Unclassified Shares           | 100%                   | Australia                       | Darling Park Tower 2<br>Sydney<br>Australia                                                          |

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

**Notes on the financial statements (continued)**

|                                              |                 |      |                |                                                     |
|----------------------------------------------|-----------------|------|----------------|-----------------------------------------------------|
| Prudential Property Investments Limited      | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |
| Prudential Real Estate Investments 2 Limited | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |
| Prudential Real Estate Investments 3 Limited | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |
| Prutec Limited                               | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |
| PVM Partnerships Limited                     | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |
| Sealand (No 1) Limited                       | Ordinary Shares | 100% | Jersey         | PO Box 87, 22 Grenville Street<br>St Helier, Jersey |
| Sealand (No 2) Limited                       | Ordinary Shares | 100% | Jersey         | PO Box 87, 22 Grenville Street<br>St Helier, Jersey |
| Smithfield Limited                           | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |
| The Hub (Witton) Management Company Limited  | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |
| Three Snowhill Birmingham S.a.r.l            | Ordinary Shares | 100% | Luxembourg     | 5 rue Guillaume Kroll, L-1882,<br>Luxembourg        |
| Two Snowhill Birmingham S.a.r.l.             | Ordinary shares | 100% | Luxembourg     | 5 rue Guillaume Kroll, L-1882,<br>Luxembourg        |
| Wessex Gate Limited                          | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |
| Westwacker Limited                           | Ordinary Shares | 100% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH         |

**Insurance**

| Name                                           | Classes of Shares held | Proportion held | Country of Incorporation | Address                                                         |
|------------------------------------------------|------------------------|-----------------|--------------------------|-----------------------------------------------------------------|
| Prudential General Insurance Hong Kong Limited | Ordinary Shares        | 100%            | Hong Kong                | 59/F, One Island East, 18 Westlands Road, Quarry Bay, Hong Kong |
| Prudential Hong Kong Limited                   | Ordinary Shares        | 100%            | Hong Kong                | 59/F, One Island East, 18 Westlands Road, Quarry Bay, Hong Kong |
| Prudential International Assurance plc         | Ordinary Shares        | 100%            | Ireland                  | Montague House, Adelaide Road, Dublin 2, Ireland                |
| Prudential Pensions Limited                    | Ordinary Shares        | 100%            | United Kingdom           | Laurence Poutney Hill<br>London<br>EC4R 0HH                     |

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

**Notes on the financial statements (continued)**

**Pension**

| Name                                          | Classes of Shares held | Proportion held | Country of Incorporation | Address                                     |
|-----------------------------------------------|------------------------|-----------------|--------------------------|---------------------------------------------|
| Prudential Corporate Pensions Trustee Limited | Ordinary Shares        | 100%            | United Kingdom           | Laurence Poutney Hill<br>London<br>EC4R 0HH |
| Prudential Retirement Income Limited          | Ordinary Shares        | 100%            | United Kingdom           | Craigforth, Stirling, Scotland,<br>FK9 4UE  |

**Holding company**

| Name                            | Classes of Shares held | Proportion held | Country of Incorporation | Address                                     |
|---------------------------------|------------------------|-----------------|--------------------------|---------------------------------------------|
| Prudential Holborn Life Limited | Ordinary Shares        | 100%            | United Kingdom           | Laurence Poutney Hill<br>London<br>EC4R 0HH |

**Mortgage lending**

| Name                                  | Classes of Shares held | Proportion held | Country of Incorporation | Address                                    |
|---------------------------------------|------------------------|-----------------|--------------------------|--------------------------------------------|
| Prudential Lifetime Mortgages Limited | Ordinary Shares        | 100%            | United Kingdom           | Craigforth, Stirling, Scotland,<br>FK9 4UE |

**Financing**

| Name                          | Classes of Shares held | Proportion held | Country of Incorporation | Address                                    |
|-------------------------------|------------------------|-----------------|--------------------------|--------------------------------------------|
| Scottish Amicable Finance plc | Ordinary Shares        | 100%            | United Kingdom           | Craigforth, Stirling, Scotland,<br>FK9 4UE |

**Service**

| Name                                                 | Classes of Shares held | Proportion held | Country of Incorporation | Address                                             |
|------------------------------------------------------|------------------------|-----------------|--------------------------|-----------------------------------------------------|
| Prudential International Management Services Limited | Ordinary Shares        | 100%            | Ireland                  | Montague House, Adelaide<br>Road, Dublin 2, Ireland |

**Liquidation**

| Name                                   | Classes of Shares held | Proportion held | Country of Incorporation | Address                                               |
|----------------------------------------|------------------------|-----------------|--------------------------|-------------------------------------------------------|
| MM&S (2375) Limited                    | Ordinary Shares        | 100%            | United Kingdom           | Mazars Llp, 90 St. Vincent<br>Street, Glasgow, G2 5UB |
| Prudential Annuities Limited           | Ordinary Shares        | 100%            | United Kingdom           | Mazars Llp, 45 Church Street,<br>Birmingham, B3 2RT   |
| Scottish Amicable ISA Managers Limited | Ordinary Shares        | 100%            | United Kingdom           | Mazars Llp, 90 St. Vincent<br>Street, Glasgow, G2 5UB |
| Empire Holding S.a.r.l.                | Ordinary Shares        | 100%            | Luxembourg               | 5 rue Guillaume Kroll, L-1882,<br>Luxembourg          |
| LIPP S.à r.l.                          | Ordinary Shares        | 100%            | Luxembourg               | 5 rue Guillaume Kroll, L-1882,<br>Luxembourg          |

**Notes on the financial statements (continued)**

**Dormant**

| Name                                     | Classes of Shares held | Proportion held | Country of Incorporation | Address                                     |
|------------------------------------------|------------------------|-----------------|--------------------------|---------------------------------------------|
| Scottish Amicable Life Assurance Society | No Share Capital       | 100%            | United Kingdom           | Craigforth, Stirling, Scotland, FK9 4UE     |
| Warren Farm Office Village Limited       | Ordinary Shares        | 100%            | United Kingdom           | Laurence Poutney Hill<br>London<br>EC4R 0HH |

(ii) Other subsidiaries, associated undertakings, joint ventures and significant holdings

**Investment**

| Name                                                      | Classes of Shares held       | Proportion held | Country of Incorporation | Address                                                                                                  |
|-----------------------------------------------------------|------------------------------|-----------------|--------------------------|----------------------------------------------------------------------------------------------------------|
| BOCHK Aggressive Growth Fund                              | Ordinary shares              | 56.67%          | Hong Kong                | 27th Floor<br>Bank of China Tower<br>Central and Western District,<br>Hong Kong                          |
| BOCHK Balanced Growth Fund                                | Ordinary shares              | 43.57%          | Hong Kong                | 12th Floor and 25th Floor<br>Citicorp Centre, 18 Whitfield<br>Road, Causeway Bay, Wan<br>Chai, Hong Kong |
| BOCHK China Equity Fund                                   | Ordinary shares              | 60%             | Hong Kong                | 12th Floor and 25th Floor<br>Citicorp Centre, 18 Whitfield<br>Road, Causeway Bay, Wan<br>Chai, Hong Kong |
| BOCHK Conservative Growth Fund                            | Ordinary shares              | 47.1%           | Hong Kong                | 12th Floor and 25th Floor<br>Citicorp Centre, 18 Whitfield<br>Road, Causeway Bay, Wan<br>Chai, Hong Kong |
| BWAT Retail Nominee (1) Limited                           | Ordinary Shares              | 50%             | United Kingdom           | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                              |
| BWAT Retail Nominee (2) Limited                           | Ordinary Shares              | 50%             | United Kingdom           | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                              |
| Calera Capital Partners IV - A AIV I, L.P.                | Limited Partnership Interest | 32.87%          | USA                      | Corporation Trust Centre, 1209<br>Orange St, Wilmington, DE<br>19801<br>Delaware, USA                    |
| Carraway Guildford (Nominee A) Limited                    | Ordinary Shares              | 100%            | Jersey                   | 13 Castle Street, St Helier, JE4<br>5UT                                                                  |
| Carraway Guildford (Nominee B) Limited                    | Ordinary Shares              | 100%            | Jersey                   | 13 Castle Street, St Helier, JE4<br>5UT                                                                  |
| Carraway Guildford Investments Unit Trust                 | Units                        | 100%            | Jersey                   | C/o Sanne Group<br>13 Castle Street,<br>St Helier,<br>Jersey JE4 5UT                                     |
| Carraway Guildford Limited Partnership                    | Limited partnership interest | 100%            | United Kingdom           | Lloyds Chambers<br>1 Portsoken Street<br>London<br>E1 8HZ                                                |
| Centaurus Retail LLP                                      | Limited Partnership Interest | 50%             | United Kingdom           | 40 Broadway, London, SW1H<br>0BU                                                                         |
| Centre Capital Non-Qualified Investors IV AIV Orion, L.P. | Membership Interest          | 45.74%          | USA                      | 2711 Centerville Road, Ste 400,<br>Wilmington, DE, 19808,<br>Delaware, USA                               |
| Centre Capital Non-Qualified Investors IV AIV-ELS, L.P.   | Membership Interest          | 45.92%          | USA                      | 2711 Centerville Road, Ste 400,<br>Wilmington, DE, 19808,<br>Delaware, USA                               |



**Notes on the financial statements (continued)**

|                                                                   |                      |        |                |                                                                      |
|-------------------------------------------------------------------|----------------------|--------|----------------|----------------------------------------------------------------------|
| Centre Capital Non-Qualified Investors IV AIV-RA, L.P.            | Membership Interest  | 45.92% | USA            | 2711 Centerville Road, Ste 400, Wilmington, DE, 19808, Delaware, USA |
| Centre Capital Non-Qualified Investors IV, L.P.                   | Membership Interest  | 45.67% | USA            | 2711 Centerville Road, Ste 400, Wilmington, DE, 19808, Delaware, USA |
| Centre Capital Non-Qualified Investors V AIV-ELS LP               | Membership Interest  | 36.58% | USA            | 2711 Centerville Road, Ste 400, Wilmington, DE, 19808, Delaware, USA |
| Centre Capital Non-Qualified Investors V LP                       | Membership Interest  | 32.65% | USA            | 2711 Centerville Road, Ste 400, Wilmington, DE, 19808, Delaware, USA |
| CF Prudential European QIS Fund                                   | Ordinary Shares      | 97.73% | United Kingdom | 17 Rochester Row, London SW1P 1QT                                    |
| CF Prudential Japanese QIS Fund                                   | Ordinary Shares      | 97.73% | United Kingdom | 17 Rochester Row, London SW1P 1QT                                    |
| CF Prudential North American QIS Fund                             | Ordinary Shares      | 97.9%  | United Kingdom | 135 Bishopsgate, London EC2M 3UR                                     |
| CF Prudential Pacific Markets Trust Fund                          | Ordinary Shares      | 97.91% | United Kingdom | Laurence Poutney Hill London EC4R 0HH                                |
| CF UK Growth Qualified Investor Scheme                            | Ordinary Shares      | 98.6%  | United Kingdom | 17 Rochester Row, London SW1P 1QT                                    |
| Cribbs Causeway JV Limited                                        | Ordinary Shares      | 50%    | United Kingdom | 40 Broadway, London SW1H 0BU                                         |
| Cribbs Causeway Merchants Association Ltd                         | Limited by Guarantee |        | United Kingdom | Management Offices, The Mall at Cribbs Causeway, Bristol             |
| Eastspring Investments - Asia Pacific Equity Fund                 | Ordinary Shares      | 76.21% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Asian Bond Fund                            | Ordinary Shares      | 21.61% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Asian Dynamic Fund                         | Ordinary shares      | 40.15% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Asian Equity Fund                          | Ordinary shares      | 59.43% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Asian High Yield Bond Fund                 | Ordinary shares      | 22.93% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Asian Low Volatility Equity Fund           | Ordinary shares      | 100%   | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments China Equity Fund                          | Ordinary shares      | 39.98% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Emerging EMEA Dynamic Fund                 | Ordinary shares      | 57.74% | Luxembourg     | 26, Boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Global Emerging Markets Bond Fund          | Ordinary shares      | 44.63% | Luxembourg     | 26, Boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Global Market Navigator Fund               | Ordinary shares      | 89.69% | Luxembourg     | 26, Boulevard Royal Luxembourg L-2449                                |
| Eastspring Investments Global Multi Asset Income Plus Growth Fund | Ordinary shares      | 100%   | Luxembourg     | 26, Boulevard Royal Luxembourg L-2449                                |

**Notes on the financial statements (continued)**

|                                                                 |                              |        |                |                                                                                                              |
|-----------------------------------------------------------------|------------------------------|--------|----------------|--------------------------------------------------------------------------------------------------------------|
| Eastspring Investments Greater China Equity Fund                | Ordinary shares              | 73.25% | Luxembourg     | 26, Boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments Hong Kong Equity Fund                    | Ordinary shares              | 99.57% | Luxembourg     | 26, Boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments India Equity Fund                        | Ordinary shares              | 78.95% | Luxembourg     | 26, Boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments Japan Fundamental Value Fund             | Ordinary shares              | 67.09% | Luxembourg     | 26, Boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments Latin American Equity Fund               | Ordinary shares              | 33.18% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments North America Value Fund                 | Ordinary shares              | 67.62% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments SICAV-FIS - Alternative Investments Fund | Ordinary shares              | 51.71% | Luxembourg     | 2-4 rue Eugene Ruppert Luxembourg 2453                                                                       |
| Eastspring Investments SICAV-FIS - Asia Pacific Loan Fund       | Ordinary shares              | 56.81% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments SICAV-FIS Universal USD Bond Fund        | Ordinary shares              | 100%   | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments US Corporate Bond Fund                   | Ordinary shares              | 59.05% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                                                        |
| Eastspring Investments World Value Equity Fund                  | Ordinary shares              | 83.64% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                                                        |
| Fashion Square ECO LP                                           | Limited Partnership Interest | 50%    | USA            | The Corporation Trust Company, Corporation Trust Centre, 1209 Orange St, Wilmington, DE 19801, Delaware, USA |
| Foudry Properties Limited                                       | Ordinary Shares              | 50%    | United Kingdom | Clearwater Court, Vastern Road, Reading RG1 8DB                                                              |
| Global Low Volatility Equity fund D Acc                         | Ordinary shares              | 94.59% | Luxembourg     | 26, boulevard Royal Luxembourg L-2449                                                                        |
| Infracapital Partners                                           | Limited partnership interest | 33.04% | United Kingdom | Laurence Poutney Hill London EC4R 0HH                                                                        |
| Infracapital Partners II LP                                     | Limited partnership interest | 25.98% | United Kingdom | Laurence Poutney Hill London EC4R 0HH                                                                        |
| Jefferies Capital Partners V, L.P.                              | Limited Partnership Interest | 5.48%  | USA            | The Corporation Trust Company, Corporation Trust Centre, 1209 Orange St, Wilmington, DE 19801, Delaware, USA |
| JNL Strategic Income Fund LLC                                   | Ordinary Shares              | 100%   | USA            | The Corporation Trust Company, Corporation Trust Centre, 1209 Orange St, Wilmington, DE 19801, Delaware, USA |
| Lion Credit Opportunity Fund III                                | Ordinary Shares              | 32.26% | Ireland        | 3rd Floor Kilmore House, Park Lane, Dublin 1, Dublin, D01 YE64, Ireland                                      |

**Notes on the financial statements (continued)**

|                                                 |                              |        |                |                                                                         |
|-------------------------------------------------|------------------------------|--------|----------------|-------------------------------------------------------------------------|
| Lion Credit Opportunity Fund XII                | Ordinary Shares              | 32.26% | Ireland        | 3rd Floor Kilmore House, Park Lane, Dublin 1, Dublin, D01 YE64, Ireland |
| MCF S.r.l.                                      | Ordinary shares              | 45%    | Italy          | Via Romagnosi 18/a, 00196 Roma, Italy                                   |
| M&G Asia Property Fund                          | Ordinary Shares              | 40.35% | Luxembourg     | 34-38 Avenue de la Liberté, L-1930 Luxembourg                           |
| M&G Corporate bond Fund                         | Ordinary shares              | 24.4%  | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Dividend Fund                               | Ordinary Shares              | 54.67% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Emerging Markets Bond Fund                  | Ordinary Shares              | 23.85% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Episode Defensive Fund                      | Ordinary Shares              | 94.62% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Episode Macro Fund                          | Ordinary Shares              | 31.22% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G European Credit Investments Fund            | Ordinary Shares              | 100%   | Luxembourg     | 80, route d'Esch<br>Luxembourg<br>L-1470                                |
| M&G European High Yield Credit Investments Fund | Ordinary Shares              | 100%   | Luxembourg     | 80, route d'Esch<br>Luxembourg<br>L-1470                                |
| M&G European Property Fund SICAV-FIS            | Ordinary Shares              | 68.06% | Luxembourg     | 34-38, avenue de la Liberté<br>Luxembourg<br>L-1930                     |
| M&G European Secured Property Income Fund       | Units                        | 51.12% | Luxembourg     | 34-38 Avenue de la Liberté, L-1930 Luxembourg                           |
| M&G European Select Fund                        | Ordinary Shares              | 37.3%  | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Gilt & Fixed Interest Income Fund           | Ordinary shares              | 41.11% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Global Select Fund                          | Ordinary shares              | 23.69% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Global Corporate Bond Fund                  | Ordinary Shares              | 61.98% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Global Credit Investments Fund              | Ordinary Shares              | 100%   | Luxembourg     | 80, route d'Esch<br>Luxembourg<br>L-1470                                |
| M&G Managed Growth Fund                         | Ordinary Shares              | 26.4%  | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Pan European Dividend Fund                  | Ordinary Shares              | 21.6%  | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Property Portfolio Feeder                   | Ordinary Shares              | 28.25% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                             |
| M&G Real Estate Debt Fund LP                    | Limited partnership interest | 29.15% | Guernsey       | Ground Floor, Dorey Court, Admiral Park, St Peter Port, GY1 2HT         |

**Notes on the financial statements (continued)**

|                                              |                              |        |                |                                                                                                          |
|----------------------------------------------|------------------------------|--------|----------------|----------------------------------------------------------------------------------------------------------|
| M&G Traditional Credit Fund                  | Ordinary Shares              | 45.41% | Ireland        | 78 Sir John Rogerson's Quay<br>Dublin 2<br>Dublin<br>D02 RK57, Ireland                                   |
| M&G UK Companies Financing Fund II LP        | Limited partnership interest | 48.32% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                              |
| Manchester JV Limited                        | Ordinary Shares              | 50%    | United Kingdom | 40 Broadway, London, SW1H 0BU                                                                            |
| Old Kingsway, LP                             | Limited Partnership Interest | 100%   | USA            | Corporation Service Company<br>2711 Centreville Road, suite<br>400, Wilmington, DE 19808<br>Delaware USA |
| PPM America Private Equity Fund LP           | Limited Partnership Interest | 45.23% | USA            | c/o United Corporate Services,<br>774 Walker Road, Suite C,<br>Dover, DE 19904                           |
| PPM America Private Equity Fund II LP        | Limited Partnership Interest | 49.75% | USA            | c/o United Corporate Services,<br>774 Walker Road, Suite C,<br>Dover, DE 19904                           |
| PPM America Private Equity Fund III LP       | Limited Partnership Interest | 49.75% | USA            | c/o United Corporate Services,<br>774 Walker Road, Suite C,<br>Dover, DE 19904                           |
| PPM America Private Equity Fund IV LP        | Limited Partnership Interest | 49.88% | USA            | c/o United Corporate Services,<br>774 Walker Road, Suite C,<br>Dover, DE 19904                           |
| PPM America Private Equity Fund V LP         | Limited Partnership Interest | 49.88% | USA            | c/o United Corporate Services,<br>774 Walker Road, Suite C,<br>Dover, DE 19904                           |
| PPM America Private Equity Fund VI LP        | Limited Partnership Interest | 45.34% | USA            | c/o United Corporate Services<br>874 Walker Road, Suite C,<br>Dover, Delaware 19904                      |
| Property Partners (Two Rivers) Limited       | Ordinary Shares              | 50%    | United Kingdom | Bow Bells House, 1 Bread Street, London                                                                  |
| Prudential Credit Opportunity SCSp           | Ordinary shares              | 100%   | Luxembourg     | 1, rue Hildegard von Bingen,<br>L - 1282, Luxembourg                                                     |
| Prudential Development Management Limited    | Ordinary Shares              | 100%   | United Kingdom | Laurence Poutney Hill, London,<br>EC4R 0HH, United Kingdom                                               |
| Prudential Dynamic 10-40 Portfolio           | Ordinary Shares              | 31.74% | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic 20 - 55 Portfolio         | Ordinary Shares              | 35%    | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic 40-80 Portfolio           | Ordinary Shares              | 38.61% | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic 0-30 Portfolio            | Ordinary Shares              | 29.95% | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic 60-100 Portfolio          | Ordinary Shares              | 40.41% | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic Focused 0-30 Portfolio    | Ordinary Shares              | 66.09% | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic Focused 10-40 Portfolio   | Ordinary Shares              | 42.44% | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic Focused 20 - 55 Portfolio | Ordinary Shares              | 50.4%  | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic Focused 40-80 Portfolio   | Ordinary Shares              | 49.92% | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Dynamic Focused 60-100 Portfolio  | Ordinary Shares              | 70.93% | United Kingdom | 17 Rochester Row, London<br>SW1P 1QT                                                                     |
| Prudential Equity Release Mortgages Limited  | Ordinary Shares              | 100%   | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                              |

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

**Notes on the financial statements (continued)**

|                                                 |                              |        |                |                                                                                                                     |
|-------------------------------------------------|------------------------------|--------|----------------|---------------------------------------------------------------------------------------------------------------------|
| Prudential Greenfield LP                        | Limited partnership interest | 100%   | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                                         |
| Prudential M&G UK Companies Financing Fund LP   | Limited partnership interest | 34.42% | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                                         |
| Prudential UK Real Estate Nominee 1 Limited     | Ordinary Shares              | 100%   | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                                         |
| Prudential UK Real Estate Nominee 2 Limited     | Ordinary Shares              | 100%   | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                                         |
| Prudential UK Real Estate Investments 1 Limited | Ordinary Shares              | 100%   | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                                         |
| Randolph Street LP                              | Limited Partnership Interest | 100%   | USA            | Corporation Service Company,<br>2711 Centreville Road, Suite<br>400, Wilmington, Delaware<br>19808                  |
| Sectordate Limited                              | Ordinary Shares              | 33%    | United Kingdom | 5th Floor Cavendish House<br>39 Waterloo Street<br>Birmingham, B2 5PP                                               |
| SMLLC                                           | Limited Partnership Interest | 100%   | USA            | Corporation Service Company,<br>2711 Centreville Road, Suite<br>400, Wilmington, Delaware<br>19808                  |
| St Edward Homes Limited                         | Ordinary Shares              | 50%    | United Kingdom | Berkeley House, 19 Portsmouth<br>Road, Cobham, Surrey KT11<br>1JG                                                   |
| The Car Auction Unit Trust                      | Ordinary shares              | 50%    | Guernsey       | Dorey Court, Admiral Park<br>St Peter Port<br>GY1 3BG, Guernsey                                                     |
| The Heights Management Company Limited          | Ordinary Shares              | 50%    | United Kingdom | Laurence Poutney Hill<br>London<br>EC4R 0HH                                                                         |
| The St Edward Homes Partnership                 | Limited Partnership Interest | 50%    | United Kingdom | Berkeley House, 19 Portsmouth<br>Road, Cobham, Surrey KT11<br>1JG                                                   |
| The Strand Property Unit Trust                  | Units                        | 50%    | Jersey         | Liberte house, 19-23 La Motte<br>Street, St Helier, Jersey,<br>Channel Islands, JE2 4SY                             |
| The Two Rivers Trust                            | Units                        | 50%    | Jersey         | Liberte house, 19-23 La Motte<br>Street, St Helier, Jersey,<br>Channel Islands, JE2 4SY                             |
| US Strategic Income Bond Fund D USD Acc         | Ordinary shares              | 100%   | Luxembourg     | 26, boulevard Royal,<br>Luxembourg, L-2449                                                                          |
| US Total Return Bond Fund D USD Acc             | Ordinary shares              | 100%   | Luxembourg     | 26, boulevard Royal,<br>Luxembourg, L-2449                                                                          |
| Wynnefield Private Equity Partners II, LP       | Limited Partnership Interest | 99%    | USA            | The Corporation Trust Company<br>Corporation Trust Centre<br>1209 Orange St., Wilmington,<br>DE 19801 Delaware, USA |

**In liquidation**

| Name                                           | Classes of Shares held | Proportion held | Country of Incorporation | Address                                               |
|------------------------------------------------|------------------------|-----------------|--------------------------|-------------------------------------------------------|
| Prudential Europe Assurance Holdings Limited   | Ordinary Shares        | 100%            | United Kingdom           | Mazars LLP, 90 St. Vincent<br>Street, Glasgow, G2 5UB |
| Scottish Amicable PEP and ISA Nominees Limited | Ordinary Shares        | 100%            | United Kingdom           | Mazars LLP, 90 St. Vincent<br>Street, Glasgow, G2 5UB |

**Notes on the financial statements (continued)**

**Financing**

| Name                                       | Classes of Shares held | Proportion held | Country of Incorporation | Address                                                                                   |
|--------------------------------------------|------------------------|-----------------|--------------------------|-------------------------------------------------------------------------------------------|
| Prudential Vietnam Finance Company Limited | Ownership Interest     | 100%            | Vietnam                  | 25/F, Saigon Trade Centre, 37 Ton Duc Thang Street, District 1, Ho Chi Minh City, Vietnam |

**32. Acquisition and disposal of material subsidiaries and participating interests**

On 9 November 2015 Prudential Annuities Limited, a wholly owned subsidiary of the Long-term fund went into liquidation. The original cost was £648m.

On 18 December 2015 as part of a restructuring arrangement Prudential Europe Assurance Holdings Limited (PEAH) and MM&S subsidiaries owned by the Shareholder fund went into liquidation. The original cost was £40m. The companies paid dividends of £210m satisfied by the transfer of ownership PIA and PIMS companies previously owned by PEAH. The companies were transferred to PAC at a fair value of £195m.

**33. Post balance sheet events**

On the 8 February 2017 the Company entered into a longevity reinsurance transaction resulting in a reduction of net technical provisions of £0.6bn.

On the 6 March 2017 the Supreme Court announced that it would hear HMRC's appeal against a Court of Appeal decision in the Company's favour, covered further in note 8 page 34.