SCOTTISH AMICABLE FUNDS

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

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Scottish Amicable Board Members

Bernard Solomons (Chairman)
Paul Dollman
JP Miller
Brian Medhurst
Michael Walker

Company Secretary of The Prudential Assurance Company Limited

Simon Mitchley

Auditors

KPMG LLP, London

Background

Under the terms of the Scheme for the transfer of the business of the Scottish Amicable Life Assurance Society to The Prudential Assurance Company Limited (the Scheme) on 30 September 1997, The Prudential Assurance Company Limited (PAC, also referred to as The Company) is required to produce for each financial year reports and accounts of the Scottish Amicable Funds (the Funds) as if they together constituted an authorised insurance company in accordance with the Financial Services and Markets Act 2000 (and, where necessary, the laws and regulations of any other jurisdiction) and generally accepted accounting practices and policies, and to have them audited by the auditors of PAC. The Funds comprise the Scottish Amicable Insurance Fund (the Fund), which is a closed fund, and the Scottish Amicable Capital Fund (the Capital Fund). The Scottish Amicable Insurance Fund receives financial support from the Scottish Amicable Capital Fund, and it protects the solvency position of the Scottish Amicable Insurance Fund and pays a fee to the With Profit Sub fund of PAC for this capital support.

In order to safeguard the ongoing interests of policyholders whose policies were transferred into the Fund, the Scheme established a special committee called the Scottish Amicable Board, with responsibility for the management (including investment and bonus policy) of the Funds.

Business Review

Principal Activity

In accordance with the terms of the Scheme governing the transfer of business, certain business has continued to be written in the Fund, which is a closed fund. This business is primarily in respect of increments to existing policies written by Scottish Amicable Life Assurance Society prior to 1 October 1997. New premiums for the year comprise £0.3m (2015: £0.3m) of single premiums, which are included in total premiums of £50.7m (2015: £61.8m).

The Fund is a sub-fund of PAC which 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 this business review present information about the Fund as an individual undertaking and are not consolidated.

The Fund's long-term products consist of life insurance, pension products and pension annuities. In common with other UK long-term insurance companies, the Fund's products are structured as either with-profits (or participating) products, or non-participating products including annuities in payment and unit-linked products. With-profits policies are supported by the with-profits sub-fund and can be single or regular premium. With-profits policyholders receive 100 per cent of the distribution from the Fund as bonus additions to their policies.

Risks & Uncertainties

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

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

The Fund is exposed to both financial and non-financial risks. The key risk factors, mentioned below, should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

Financial risks

The financial risk factors affecting the Fund include market risk, credit risk, insurance risk and liquidity risk. Further information on the financial risk management objectives and policies of the Fund and the exposure of the Fund to the financial risk factors is given in note 18 on page 28.

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 higher interest rates 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) Market risk

Market risk is the risk of loss for the Fund, 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 is one of the largest risks for the Fund. The current uncertainty in the global economic, political and market outlooks have increased market risk (e.g. increased volatility) and this could adversely affect the Fund principally through the following:

- Investment impairments or reduced investment returns, as a result of market volatility, could impair the Fund's ability to meet its policyholder liabilities.

- The asset and liability mismatch risk has increased due to historically low interest rates. The Fund manages this risk by appropriate matching of its assets and liabilities

(b) Credit risk

Credit risk is the risk of loss to the Fund 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 Fund is exposed to significant levels of credit risk, however this is mitigated by a large proportion of the annuity business being reinsured. 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 Fund, in the normal course of business enters into a variety of transactions with counterparties, including cash deposit, reinsurance and derivative transactions. Failure of any of these counterparties to discharge their obligations or where adequate collateral is not in place (e.g. in case of reinsurance counterparties), could have an adverse impact on the Fund's results.

(c) Insurance risk

Insurance risk is the risk of loss for our Fund, 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. This includes 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. These risks are less material than the market, credit and longevity risks. 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 Fund's (current and deferred) annuity customers live longer than expected in the Fund's current pricing and reserving assumptions, and as a result future reserving and capital assumptions are changed. As part of its annuity pricing and reserving policy, the Fund assumes that current rates of mortality continue to improve over time at levels based on the Funds' 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 Fund'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 Fund to strengthen its longevity assumptions would have an impact on the Fund's results.

- 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 Fund 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 Fund's operating results could be adversely impacted.

- Persistency Risk: This is the risk of actual persistency or customer retention levels being different to the Fund's expectations. This risk can materialise if more or (for some lines of business) fewer customers opt for early termination of their products than anticipated. The Fund'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 Fund's operating results could be adversely affected. This risk is only relevant to the non-annuity lines of business written by the Fund.

- 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 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 Fund'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 Fund 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 its obligations as they fall due in business as usual stress scenarios.

Liquidity risk is carefully managed, in particular to bank balances, cash-flow forecasting, appropriate fund management (to ensure that assets are not unduly concentrated in less liquid investments) and detailed cash-flow matching for the annuity business. 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 Fund 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 Fund 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) or regulatory interpretation applying to UK insurance companies may be applied retrospectively, may adversely affect the Fund's product range, distribution channels, capital requirements and, consequently, reported results and financing requirements. Regulators in jurisdictions in which the Fund operates may change the level of solvency capital required to be held or could introduce possible changes in the regulatory framework for pension arrangements, retirement income and investments, or the regulation of selling practices and solvency requirements. Following the recent legislative changes to the retirement market in the UK, there continues to be an uncertain regulatory and legislative environment.

The material regulatory and legal 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

(b) Strategic risk

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

The Fund operates a largely outsourced operating model, with heavy dependence on both internal and external organisations. This places strategic reliance on the performance of these organisations.

(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 Fund is exposed to operational risk in the ordinary course of its business and as a result may be subject to unplanned costs, regulatory fines or legal actions and disputes in relation to contracts or a course of conduct taken.

The Fund seeks to manage existing operational risk exposures and proactively identify and mitigate new exposures.

(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 Fund 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 Fund as well as the risk management processes and internal control mechanisms within the Fund ensure group risk is appropriately managed.

For and on behalf of the Scottish Amicable Board Members

Bernard Solomons
Chairman
11 May 2017

REPORT OF THE SCOTTISH AMICABLE BOARD FOR THE YEAR ENDED 31 DECEMBER 2016

Scope of report

This report comprises a profit and loss account and balance sheets for the Scottish Amicable Funds for the year ended 31 December 2016 together with explanatory notes.

Performance and Measurement

The Scottish Amicable Fund as a whole delivered a positive investment return of 15.8% in 2016 (2015: 2.1% return). Much of this investment performance was achieved through the very diversified nature of the Fund. As part of its asset allocation process, the fund managers constantly evaluate prospects for different markets and asset classes.

Scottish Amicable Board members

The present members of the Scottish Amicable Board, are shown on page 2.

Post balance sheet events

There have been no significant events affecting the Fund since the balance sheet date.

Corporate Responsibility

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

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

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

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

These themes provide clarity to the businesses as to how 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.

Statement of Directors' Responsibilities

Pursuant to its responsibility, in relation to the preparation of reports and accounts of the Scottish Amicable Funds, PAC requires another Prudential Group company, Prudential Distribution Limited (PDL), to prepare financial statements for the Funds in accordance with the requirements of the Scheme. The directors of PDL 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.*

The directors are responsible for preparing the Strategic Report and Directors' Report and the financial statements in accordance with applicable law and regulations, as if that law applied to the financial statements.

Under the terms of the Scheme the directors of PDL 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 Funds and of the profit or loss of the Funds for that period. In preparing these financial statements, the directors of PDL 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 Fund will continue in business.

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

In accordance with its responsibility for the management of the Funds, the Scottish Amicable Board has reviewed and, having received appropriate assurances from Prudential Distribution Limited and the Monitoring Actuary, has approved the financial statements for the year ended 31 December 2016.

Financial instruments

The Fund is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The financial risk factors affecting the Fund include market risk, credit risk and liquidity risk. Information on the financial risk management objectives and policies of the Fund and the exposure of the Fund to the financial risk factors is given in note 18.

Further information on the use of derivatives by the Fund is provided in note 18.

Auditors

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

Directors' and officers' protection

Prudential plc has arranged appropriate insurance cover in respect of legal action against directors and senior managers of companies within the Prudential Group. In addition, the Articles of Association of the Company 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 protection 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.

With-Profits Governance

PAC 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 of PAC 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 of PAC 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.

PAC has a With-Profits Actuary who has the specific duty to advise the Board of PAC 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 of PAC with all other actuarial advice. Both of these are Financial Conduct Authority and Prudential Regulatory Authority approved roles.

The Scottish Amicable Board has an appointed Monitoring Actuary who is employed by, or a partner in, an independent firm of consulting actuaries. The Monitoring Actuary advises the Board as to the proper operation of the Scottish Amicable Funds in order to safeguard the interests and reasonable expectations of the policyholders.

The affairs of the Scottish Amicable Funds have their own Principles of Financial Management which are set out in Schedule 8 of the Scheme legal documents.

Within this framework, the process by which decisions relating to with-profits issues are made in respect of the Fund is as follows:

(i) the Chief Actuary will make recommendations to the Scottish Amicable Board;
(ii) the Monitoring Actuary will advise the Scottish Amicable Board on the appropriateness of the recommendations in relation to the Scheme;
(iii) the Scottish Amicable Board will take the decision, having regard solely to the interest of the Fund's policyholders;
(iv) the With-Profits Actuary will advise the PAC Board on the appropriateness of the Scottish Amicable Board's decision, having regard to the company's PPFM;
(v) the With-Profits Committee will review the decision for consistency with the PPFM; and
(vi) the PAC Board will ratify the Scottish Amicable Board's decision.

For and on behalf of the Scottish Amicable Board Members

JP Miller

Scottish Amicable Board Member
11 May 2017

Independent auditors' report to The Prudential Assurance Company Limited (the Company) in respect of the Scottish Amicable Funds (the Funds)

We have audited the financial statements of the Funds for the year ended 31 December 2016 set out on pages 12 to 37. The financial statements have been prepared for the reasons set out in note 1 to the financial statements and on the basis of the financial reporting framework of UK Accounting Standards, including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and as if the Companies Act 2006 applied to them.

Our report has been prepared for the Company solely in connection with the terms of the Scheme for the transfer of the business of the Scottish Amicable Life Assurance Society to The Prudential Assurance Company Limited on 30 September 1997 (the Scheme). It has been released to the Company on the basis that our report shall not be copied, referred to or disclosed, in whole (save for the Company's own internal purposes) or in part, without our prior written consent.

Our report was designed to meet the agreed requirements of the Company determined by the Company's needs at the time. Our report should not therefore be regarded as suitable to be used or relied on by any party wishing to acquire rights against us other than the Company for any purpose or in any context. Any party other than the Company who obtains access to our report or a copy and chooses to rely on our report (or any part of it) will do so at its own risk. To the fullest extent permitted by law, we will accept no responsibility or liability in respect of our report to any other party.

Respective responsibilities of the directors of Prudential Distribution Limited and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 8, the directors of Prudential Distribution Limited are responsible for the preparation of financial statements that give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with the terms of our engagement letter dated 10 June 2016 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.

Opinion on non-statutory accounts

In our opinion the financial statements:

- give a true and fair view of the state of the Funds' affairs as at 31 December 2016 and the 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 Companies Act 2006, as if those requirements were to apply.

Daniel Cazeaux
For and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
Canary Wharf
London, E14 5GL
11 May 2017

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 £m	2015 £m
Technical Account			
Gross premiums written	2	**50.7**	61.8
Outward reinsurance premiums		**(26.1)**	(23.7)
Earned premiums, net of reinsurance		**24.6**	38.1
Investment income & realised gains	3	**558.8**	497.3
Unrealised gains / (losses)	3	**380.7**	(318.3)
		939.5	179.0
Claims incurred, net of reinsurance			
Claims paid - Gross amount		**(1,094.4)**	(1,084.7)
Claims paid - reinsurers share		**169.6**	160.8
Claims paid net of reinsurance		**(924.8)**	(923.9)
Change in provision for claims - Gross amount		**0.4**	7.6
Change in provision for claims - reinsurers share		**—**	0.0
Claims incurred net of reinsurance		**(924.4)**	(916.3)
Change in long-term business provisions			
Gross amount	13	**(41.9)**	856.6
Reinsurers share	13	**89.7**	(95.5)
		47.8	761.1
Other charges			
Net operating expenses	5	**(47.1)**	(32.7)
Investment expenses and charges	3	**(29.5)**	(26.9)
Tax attributable to the long term business	6	**(10.9)**	(2.3)
		(87.5)	(61.9)
Transfer to Fund for Future Appropriations	7	**—**	—

The technical account reflects the activities of the Fund.

	2016 £m	2015 £m
Non-technical account		
Balance on the long-term business technical account	**—**	—
Investment income & realised gains	**21.9**	86.3
Unrealised gains / (losses)	**103.1**	(55.2)
Investment expenses and charges	**(0.1)**	—
Interest charges	**(0.2)**	—
Profit on ordinary activities before tax	**124.7**	31.1
Tax on profit on ordinary activities		
Current tax charge	**(1.7)**	(0.7)
Deferred tax charge	**(2.7)**	0.6
Profit for the financial year	**120.3**	31.0

The non-technical account reflects the activities of the Capital Fund.

The notes and information on pages 16 to 37 form an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

		2016 £m	2015 £m
Balance on the long-term business technical account		**—**	—
Other comprehensive income; Actuarial (losses) gains on defined benefit pension schemes	8	**(7.9)**	—
Deferred tax charge credit		**1.3**	—
Transfer from (to) the fund for future appropriations		**6.6**	—
Total comprehensive income for the financial year		**—**	—

The notes and information on pages 16 to 37 form an integral part of these financial statements.

SCOTTISH AMICABLE FUNDS

BALANCE SHEET FOR THE FUND AS AT 31 DECEMBER 2016

	Note	2016 £m	2015 £m
Investments			
Land and buildings	9	—	357.7
Investments in group undertakings	9	452.5	110.6
Other financial investments	10	5,402.5	5,531.1
		5,855.0	5,999.4
Reinsurers' share of technical provisions			
Long-term business provision	13	456.9	438.7
Technical provisions for linked liabilities		1,725.7	1,647.9
		2,182.6	2,086.6
Debtors	11	19.7	7.0
Other assets			
Cash at bank and in hand		195.4	169.1
Prepayments and accrued income			
Accrued interest and rent		26.8	49.0
Other prepayments and accrued income		3.4	2.9
		30.2	51.9
		8,282.9	8,314.0
Subordinated liabilities	14	100.0	100.0
Fund for future appropriations	7	-	-
Technical provisions			
Long-term business provision	13	6,258.7	6,288.2
Claims outstanding	13	69.7	70.1
		6,328.4	6,358.3
Technical provisions for linked liabilities	13	1,719.3	1,647.9
Provisions for other risks and charges			
Deferred taxation	6	37.7	31.0
Provisions for DB Pensions		7.1	0.0
Obligations under finance leases		—	11.8
		44.8	42.8
Creditors			
Derivative Liabilities	18	19.0	76.5
Other creditors including taxation and social security	12	71.3	83.9
		90.3	160.4
Accruals and deferred income		0.1	4.6
		8,282.9	8,314.0

The notes and information on pages 16 to 37 form an integral part of these financial statements.

The accounts on pages 12 to 37 were approved by the Scottish Amicable Board on 11 May 2017.

B Solomons.

Bernard Solomons
Chairman of the Board Members

JP Miller
Board Member

BALANCE SHEET FOR THE CAPITAL FUND AS AT 31 DECEMBER 2016

	2016 £m	2015 £m
Investments		
Land and buildings	85.7	93.5
Other financial investments	794.1	802.6
	879.8	896.1
Other assets		
Cash at bank and in hand	71.3	85.9
	951.1	982.0
Capital Fund surplus	881.8	824.8
Provisions for other risks and charges		
Deferred taxation	4.2	1.6
Creditors		
Amounts due to fellow group undertakings	63.3	154.9
Tax payable	1.8	0.7
Other creditors including taxation and social security	65.1	155.6
	951.1	982.0

Reconciliation of the movement in the Capital Fund surplus for the year ended 31 December 2016

	2016 £m	2015 £m
Profit for the financial year	120.3	31.0
Reduction by reason of excess	(63.3)	(154.9)
Capital Fund surplus at beginning of year	824.8	948.7
Capital Fund surplus at end of year	881.8	824.8

The reduction by reason of excess is in accordance with the Scheme requirement to annually reduce the Capital Fund so its net assets are equal to 15% of the average value of the with-profit assets of the Scottish Amicable Insurance Fund. This reduction by reason of excess is paid into the long term assets of PAC's with-profit investments.

Given the structure of the Funds, the financial disclosures given in the notes only refer to the assets and liabilities of the Fund and not the Capital Fund, unless stated otherwise. This is because it is only the Fund that will pay the policyholders.

The notes and information on pages 16 to 37 form an integral part of these financial statements.

1. Accounting Policies

A. Fund information

Scottish Amicable Funds (the Funds) comprise the Scottish Amicable Insurance Fund (the Fund), which is a closed fund, and the Scottish Amicable Capital Fund (the Capital Fund). The Fund is a sub-fund of Prudential Assurance Company Limited (PAC). PAC 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 of accounts

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) as if they applied to the Funds. The financial statements comply with applicable accounting standards including 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.

The financial statements reflect the income and expenditure, assets and liabilities of the Fund and the Capital Fund. The Fund operates as a mutual fund whereby all results are wholly attributable to its members and are shown in the long term technical account. The Capital Fund is a hypothecation of assets from The Prudential Assurance Company's with profit sub fund established under the Scheme to provide capital support to the Fund. The results of its activities are shown in the non-technical profit and loss account.

Scheme rules require the assets of the Fund and the Capital Fund to be strictly segregated and the balance sheets reflect this requirement and show assets and liabilities of the Fund and Capital Fund separately. There were no changes to the results or net assets as a result of this presentation.

The Fund is a sub-fund of PAC and PAC's ultimate parent, Prudential plc, includes PAC in its consolidated financial statements. Details of where to obtain copies of the consolidated accounts are disclosed in note 16. In these financial statements, the Fund is considered to be a qualifying entity and has applied the exemptions available under FRS 102 in respect of the requirement to present a cash flow statement and related notes.

The financial statements are prepared in sterling (£) which is the functional currency of the Funds 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 Funds accounting policies. The table below sets out the areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements.

Critical accounting estimates and assumptions	Accounting policy/note reference
Measurement of long-term business provision	D and 12
Determination of fair value of financial investments	F and 17

The directors of Prudential Distribution Ltd (PDL) have a reasonable expectation that the Funds 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. This conclusion has been based upon the following: the Funds are part of PAC, a subsidiary within the Prudential Group and it and its parent company, which is the ultimate parent company, are continuing to trade profitably and there are no plans for liquidation.

The Company, of which the Funds are a part, is supported by its inherited estate, generates positive cashflows and has very low debt-financing. In addition consideration has also been given to the Fund's performance, the market in which it operates, its strategy and risks and uncertainties, the management of financial risk, including its exposure to credit risk and liquidity risk.

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

C. Long-term Business

Technical account treatment

Premiums and annuity considerations for conventional with-profit policies and other protection type life insurance 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.

Maturity claims are accounted for on the policy maturity date; annuities are accounted for when the annuity becomes due for payment; surrenders are accounted for when paid; and death claims are accounted for when notified.

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.

Fund for future appropriations

The fund for future appropriations represents all funds where the allocation to policyholders has not yet been determined.

In determining the amount of liabilities and fund for future appropriations the Fund has applied the approach previously followed of showing the working capital as zero, as the fund will be distributed fully. If this approach was not followed, the Fund would have been £125m (2015: (£131m)) rather than zero.

Long-term business provision

The assumptions used to calculate the long-term business provisions are described in Note 12.
The Fund applies FRS 103, which requires with-profits funds to use the realistic value of liabilities as the basis of reporting. 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 conventional with-profits policies a prospective bonus reserve valuation is performed instead, valuing future claims and expenses using the expected future bonus rates.

The liabilities include a market consistent valuation of the costs of guarantees, options and smoothing. This is determined using stochastic modelling. The liabilities include £412m (2014: £549m) in respect of annuity rate guarantees at vesting or on maturity attaching to certain pension products.

The FPRL also includes the distribution of surplus from non-profit business. For the Fund, the realistic liability calculation requires that the entire 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.

D. Reinsurance

In the normal course of business the Fund 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 share of benefits and claims recoverable from reinsurers. The measurement of reinsurance assets is consistent with the measurement of the underlying direct insurance contracts.

E. Investments

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

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

The Funds have chosen to account for their 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 *Basic Financial Instruments* (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 Fund 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 Fund 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 deemed to be held for trading. These investments are valued at fair value with all changes thereon being recognised in the profit and loss account. An analysis of net gains/losses is disclosed separately in Note 3.

The Fund 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 Fund applies an appropriate valuation technique such as discounted cash flow technique. Further information on valuation techniques is provided in Note 17.

(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 are carried at amortised cost using the effective interest method and subject to impairment reviews. The Fund measures the amount of the impairment loss by comparing the amortised cost with the present value of its estimated future cash flows discounted at the original effective interest rate.

Investments in group undertakings are carried at fair value through profit and loss.
Basic financial assets, including debtors and cash at bank and in hand are initially recognised at 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.

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 professional external valuers using the Royal Institute of Chartered Surveyors valuation standards.

In accordance with the provisions of Schedule 3, paragraph 76 of the Regulations, there is a requirement to show the net book value on a historical cost basis of properties in a note to the accounts.

Leases of investment property where the Fund 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.

F. 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 Fund holds financial liabilities on the following bases:

(i) Financial liabilities at fair value through profit and loss – these comprise derivatives. Derivative liabilities 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 3.
(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 are accounted for under FRS 103.
(iv) The subordinated liability is valued at amortised cost.

G. Taxation

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.

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.

H. Foreign currencies

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.

I. Provisions and contingencies

Appropriate provision is made in the financial statements where the Fund 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.

2. Gross premium analysis

	2016 £m	2015 £m
Gross premiums written:		
Direct	**29.8**	40.5
Reinsurance accepted	**20.9**	21.3
	50.7	61.8

Reinsurance accepted comprises amounts reassured into the Fund by Scottish Amicable Account in respect of with-profits contracts.

	2016 £m	2015 £m
By individual and group		
Individual business	**29.6**	40.1
Group contracts	**0.2**	0.4
	29.8	40.5
By frequency		
Regular premiums	**29.5**	40.2
Single premiums	**0.3**	0.3
	29.8	40.5

Annuity business from policy surrenders are classified as new single premiums. All premiums arise from business conducted in the UK, and relate mainly to participating business.

3. Investment income and expenses

(a) Investment income and realised gains and (losses)	**2016 £m**	2015 £m
Income from:		
Land and buildings	**16.1**	14.0
Listed investments	**167.6**	183.5
Unlisted investments	**22.3**	16.2
Other investments	**21.5**	21.8
Interest receivable from group undertakings	**54.4**	6.0
Other income	**6.2**	4.7
Total income	**288.1**	246.2
Realised gains and (losses) from:		
Land and buildings	**140.7**	6.5
Loans and receivables	**3.2**	(0.6)
Realisation of investments at fair value through profit and loss other than derivatives	**363.5**	222.4
Exchange gains	**28.1**	20.9
Realisation of derivatives	**(264.8)**	1.9
Total realised gains	**270.7**	251.1
Total investment income and realised gains and losses	**558.8**	497.3

(b) Unrealised gains and (losses) on investments	**2016 £m**	2015 £m
Land and buildings	**(144.9)**	28.0
Equity	**263.2**	(153.5)
Bonds	**158.9**	(123.8)
Other	**103.5**	(69.0)
	380.7	(318.3)

(c) Investment expenses and charges	**2016 £m**	2015 £m
Investment management fees payable to group undertakings	**17.0**	16.7
Property investment expenses	**4.0**	1.7
Interest payable to group undertakings	**8.5**	8.5
	29.5	26.9

4. Bonuses

Bonuses added during the year are included in the long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses in 2016 was £348.9m (2015: £357.6m).

5. Net operating expenses

	2016 £m	2015 £m
Capital fund support charge	**8.0**	8.9
Commission	**(5.3)**	0.6
Administration charges	**44.4**	23.2
	47.1	32.7

The remuneration of the auditors in respect of the statutory audit was £81,350 (2015: £81,350). The remuneration of the monitoring actuary for the year was £110,499 (2015: £87,660). The emoluments for the highest paid board member were £45,700 (2015: £44,875). Total fees payable in the year to 31 December 2016 were £179,992 (2015: £183,769).

6. Taxation

(a) Tax charged	**2016 £m**	2015 £m
Current tax:		
UK corporation tax on profit for the year	**15.5**	10.1
Adjustment in respect of previous years	**(17.5)**	2.6
Overseas tax	**4.9**	3.6
	2.9	16.3
Deferred tax:		
Origination and reversal of timing differences	**8.0**	(14.0)
Total charge for the year	**10.9**	2.3

(b) Provision for deferred tax	**2016 £m**	2015 £m
Deferred tax:		
Acceleration of capital allowances	**0.5**	1.1
Unrealised investment gains	**38.7**	30.2
Pension	**(1.3)**	0.0
Deferred acquisition costs	**(0.2)**	(0.3)
Total provisions	**37.7**	31.0

Movements on deferred tax liabilities are as follows:

Deferred tax liability at 1 January	**31.0**	45.0
Deferred tax charged/(credited) in the year	**8.0**	(14.0)
Deferred tax from statement of other comprehensive income - current year	**(0.9)**	—
Deferred tax from statement of other comprehensive income - prior year	**(0.4)**	—
Deferred tax liability at 31 December	**37.7**	31.0

The reduction in the UK corporation tax rate to 17 per cent from 1 April 2020 was substantively enacted on 6 September 2016 and has the effect of reducing the UK with-profits and shareholder-backed business element of the overall net deferred tax liabilities. However, there was no material change as at 31 December 2016.

7. Fund for future appropriations

The fund for future appropriations is £nil (2015: £nil) as the Fund will be pursuant to the Scheme fully distributed to its members.

8. 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 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. 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).

The contributions into the schemes are payable at the minimum level of contributions required under the scheme rules. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity. Further details of the pension schemes operated by the Company are disclosed in the accounts of The Prudential Assurance Company Limited and Prudential Financial Services Limited.

On the Statement of Other Comprehensive Income the 2015 equivalent figures for actuarial losses on defined benefit pension schemes and associated deferred tax charge credit were £2.8m and £0.4m respectively, a net loss of £2.4m. These were omitted from the 2015 Financial Statements.

9. Investments

(a) Land and buildings	**2016 £m**	2015 £m
Current value:		
Freehold	—	246.5
Leasehold with a term of over 50 years	—	111.2
	—	357.7
Cost:	**212.8**	273.2

Investment property	**2016 £m**	2015 £m
Balance at 1 January	**357.7**	389.7
Additions		
Resulting from acquisitions	—	—
Resulting from expenditure capitalised	**0.1**	0.4
Disposals	**(212.9)**	(60.7)
Net gain/(loss) from fair value adjustments	**(144.9)**	28.0
Other changes	—	0.3
Balance at 31 December	—	357.7

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

Freehold and leasehold land and buildings	**2016 £m**	2015 £m
At cost	—	273.2
Aggregate depreciation	—	(5.0)
Net book value based on historical cost	—	268.2

On 01/12/16 the UK property assets were transferred into a UK Limited Partnership (UKLP) structure in order to gain exposure to UK commercial property.

As a result of the above there are no investment properties held under finance leases at the end of 2016 (2015: £11.8m). A reconciliation between the total of future minimum lease payments at the balance sheet date, and their present value is shown below:

	2016 £m			2015 £m		
	Future minimum payments	**Future finance changes**	**PV of future minimum payments**	Future minimum payments	Future finance charges	PV of future minimum payments
Less than 1 year	—	—	—	0.6	—	0.6
1 to 5 years	—	—	—	2.3	(0.4)	1.9
Over 5 years	—	—	—	135.8	(126.5)	9.3
Total	—	—	—	138.7	(126.9)	11.8

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. The contractual obligations to purchase or develop investment properties at 31 December 2016 and 2015 were £Nil.
The Company's policy prior to the UKLP established on 01/12/16 was 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 were receivable in the 2015 periods:

	2016 £m	2015 £m
Less than 1 year	—	10.9
1 to 5 years	—	35.3
Over 5 years	—	27.6
Total	—	73.8

(b) Investments in group undertakings	**2016 £m**	2015 £m
Current value:		
Shareholdings	**434.5**	83.5
Loans	**18**	27.1
	452.5	110.6
Cost:		
Loans	**18**	27.1

10. Other financial investments

	Cost		**Carrying value**	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Shares and other variable yield securities and units in unit trusts	**2,162.0**	2,152.9	**2,806.3**	2,529.9
Debt securities and other fixed income securities	**1,716.9**	2,191.2	**2,015.2**	2,330.6
Mortgage loans	—	—	—	—
Loans to policyholders secured by insurance policies	**2.2**	3.2	**2.2**	3.2
Other loans	**43.2**	58.6	**42.4**	57.4
Participation in investment pools	**119.6**	110.7	**201.7**	185.8
Deposits with credit institutions	**270.7**	399.3	**270.7**	399.3
Derivative asset	—	—	**64.0**	24.9
	4,314.6	4,915.9	**5,402.5**	5,531.1

The table below analyses the derivative positions of the Fund.

	2016 £m		2015 £m	
	Fair value assets	**Fair value liabilities**	Fair value assets	Fair value liabilities
Derivative financial instruments held to manage credit, interest rate and currency profile:				
Interest rate swaps	**50.3**	**11.8**	20.3	8.8
Cross currency swaps	**—**	**—**	—	8.8
Currency exchange forward contracts	**12.9**	**5.3**	4.0	56.3
Bond futures	**0.1**	**1.9**	0.2	0.1
Credit default swaps	**—**	**—**	—	—
Derivative financial instruments held to manage equity risk and for efficient investment management:				
Equity index futures contracts	**0.8**	**—**	0.4	2.5
Total at 31 December	**64.1**	**19.0**	24.9	76.5

11. Debtors

	2016 £m	2015 £m
Amounts due from fellow group undertakings	**3.4**	2.6
Tax recoverable	**12.5**	1.2
Other	**3.8**	3.2
Total	**19.7**	7.0

Debtors include £0.1m (2015: £0.2m) due after more than one year.

12. Other creditors including tax and social security

	2016 £m	2015 £m
Amounts due to fellow group undertakings	**15.5**	9.3
Tax payable	**0.8**	4.8
Stock lending creditor	**46.3**	60.5
Other	**8.7**	9.3
Total	**71.3**	83.9

13. Long-term business provision

i) Analysis of movements in insurance liabilities

	Technical provisions		
	Technical Provisions £m	Linked liabilities £m	Total £m
At 1 January 2015	7,160.4	1,710.0	8,870.4
Premiums	38.8	(0.7)	38.1
Surrenders	(133.3)	0.3	(133.0)
Maturities/Deaths	(628.5)	(1.1)	(629.6)
Shareholders' transfers post tax	—	—	—
Switches	—	(161.3)	(161.3)
Investment-related items and other movements	(25.3)	32.2	6.9
Foreign exchange translation differences	(53.8)	68.5	14.7
As at 31 December 2015/1 January 2016	**6,358.3**	**1,647.9**	**8,006.2**
Premiums	25.3	(0.7)	24.6
Surrenders	(151.3)	22.2	(129.1)
Maturities/Deaths	(600.5)	(25.5)	(626.0)
Shareholders' transfers post tax	—	—	
Switches	—	(151.2)	(151.2)
Investment-related items and other movements	682.0	221.7	903.7
Foreign exchange translation differences	14.6	4.9	19.5
As at 31 December 2016	**6,328.4**	**1,719.3**	**8,047.7**

ii) Determining insurance liabilities

With-profits business

Assumptions for Realistic Reserves

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 - 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 in relation to investment returns, expenses and miscellaneous surplus. The assumptions include past expense write-offs and enhancements to asset shares, and are used when calculating specimen asset shares for the purpose of bonus setting.

The 2016 year end Investment Return for assets backing asset shares is:

Gross return	14.94%
Net return	12.53%

Prospective assumptions

Prospective assumptions are required for the adjustments to asset shares for the valuation of non-profit business, 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.

For stochastic modelling, the economic assumptions used are calibrated to risk-free returns and market prices to produce market consistent valuations of guarantees and options.

The value of non-profit business written is taken as the embedded value of the business calculated using risk free returns and discount rates.

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

The mortality assumption has been set to the best estimate assumptions underlying the Solvency II value.

The table below shows the 2016 mortality bases:

Product	Mortality Table (M/F)	Age Rating Years (M/F)	Multiplier % (M/F)
Life Term Business	AM92 / AF92	+1 / +1	70
Other SP Life Business	AM92 / AF92	+1 / +1	70
Other RP Life Business	AM92 / AF92	+1 / +1	70
Pension Term Business	AM92 / AF92	+1 / +1	60
Other Pension Business	AM92 / AF92	+1 / +1	60
AWP Life (Home Purchaser)	AM92 / AF92	+1 / +1	70

For persistency, the assumptions are best estimate based on recent experience analyses. The persistency assumptions used to value the cost of options and guarantees are reduced by a 10% margin to make approximate 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 Fund'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 swaps rate.

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, we have demonstrated that the model is able to closely reproduce these prices. Where this is not the case (for example for property and corporate bonds) we have applied expert judgement. We have also allowed 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 policy that the company will employ under varying investment conditions. Our stochastic modelling incorporates several management actions to protect the Fund in adverse investment scenarios. These management actions are consistent with the PPFM and our obligation to treat customers fairly.

Investment-linked business

A non-unit reserve is held for mortality, morbidity and expenses (including investment management expenses and other outgoings associated with payments to third parties). There has been no change in policy from 2015.

Other non-linked business

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

	2016		2015	
	Interest rate %	Actuarial mortality table reference	Interest rate %	Actuarial mortality table reference
Non profit retirement annuities* In deferment	2.040	90% AM/AF92+1yr	1.00	90% AM/AF92+1yr
In payment		83.2% PCMA00, 73.9% PCFA00 with improvements in line with a custom calibration of the CMI's 2014 mortality model, with a long-term mortality improvement rate of 2.25 % for males and 1.50% for females		83.2% PCMA00, 73.9% PCFA00 with improvements in line with a custom calibration of the CMI's 2014 mortality model, with a long-term mortality improvement rate of 2.25 % for males and 1.75% for females
Non profit immediate annuities (Individual)	2.543	89.1% PCMA00, 82.0% PCFA00 with improvements in line with a custom calibration of the CMI's 2014 mortality model, with a long-term mortality improvement rate of 2.25 % for males and 1.50% for females	3.335	89.1% PCMA00, 82.0% PCFA00 with improvements in line with a custom calibration of the CMI's 2014 mortality model, with a long-term mortality improvement rate of 2.25 % for males and 1.50% for females
Non profit immediate annuities (Group)	2.543	89.1% PCMA00, 82.0% PCFA00 with improvements in line with a custom calibration of the CMI's 2014 mortality model, with a long-term mortality improvement rate of 2.25 % for males and 1.50% for females	3.335	89.1% PCMA00, 82.0% PCFA00 with improvements in line with a custom calibration of the CMI's 2014 mortality model, with a long-term mortality improvement rate of 2.25 % for males and 1.50% for females
Non profit life assurances	1.632	100% AM/AF92+1 plus 1/3 AIDS 'R6A'	1.500	100% AM/AF92+1 plus 1/3 AIDS 'R6A'
Non profit pension assurances	2.040	90% AM/AF92+1 plus 1/3 AIDS 'R6A'	1.000	90% AM/AF92+1 plus 1/3 AIDS 'R6A'

- For Non profit retirement annuities (in payment), life expectancy at age 65 (for someone currently aged 45) has increased from 30.3 years to 30.5 years for men, due to one extra year of mortality improvements, and decreased from 31.3 years to 30.6 years for women due to a reduction in the long term improvement rate.
- For Non profit immediate annuities, life expectancy at age 65 has increased from 29.7 years to 29.9 years for men and increased from 29.6 years to 29.8 years for women due to one extra year of mortality improvements.
- For assurances, which remain unchanged from 2015, the probability of death for someone aged 45 before the end of a 20 year policy is 10.1% for men and 6.6% for women.

Other long term business provision

At 31 December 2016 a provision of £10.6m (2015: £3.8m) is held to meet compensation payments arising from 'business as usual' complaints from endowment policyholders. The provision has been calculated as a best estimate of the future compensation costs to policyholders who have not been time-barred from having their endowment policy reviewed. As described above, in addition a provision of £571m (2015: £412m) is held to cover the Fund's exposure due to guaranteed annuities.

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

The aggregate effect of assumption changes and modelling adjustments in 2016 was a net credit to the FFA of £2.0m (2015: net credit of £47.6m), relating to changes in mortality assumptions, offsetting releases of margins, expense, persistency and economic assumptions, where appropriate in the two periods.

14. Subordinated liabilities

In 1994, Scottish Amicable Finance plc (a wholly owned subsidiary of PAC) issued £100m of 8.5% undated subordinated guaranteed bonds. The interests of the holders of the bonds issued by Scottish Amicable Finance plc are subordinated to the entitlements of the policyholders of the Fund. The bonds are guaranteed by the Fund. The proceeds of the issue were lent to the Fund on equal terms as to interest, repayment and subordination as those applicable to the bonds. The fair value of the bonds at 31 December was £107.5m (2015 £111.8m).

15. Contingent liabilities

There are no contingent liabilities in 2016.

16. Related party transactions

Both the Scottish Amicable Insurance fund and the Scottish Amicable Capital fund are funds within PAC, itself a subsidiary of Prudential plc and has taken advantage of the exemption under 1(A) of FRS 102.33 *Related Party Disclosures* (FRS 102.33) relating to the disclosure of transactions with other wholly owned subsidiary undertakings of the Prudential group.

17. Ultimate and immediate parent company

The fund is a part of PAC and PAC's immediate and ultimate parent is Prudential Plc, which is the only parent company to prepare group accounts, copies of which can be obtained from the Company Secretary, Laurence Pountney Hill, London, EC4R 0HH.

18. Financial assets and liabilities

A. Financial instruments – designation and fair values

All financial assets of the Fund 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 £m	Fair value through profit and loss	Loans and receivables	Total carrying value	Fair value
Financial Assets				
Deposits with credit institutions	—	270.7	270.7	270.7
Equity securities and portfolio holdings in unit trusts	2,806.3	—	2,806.3	2,806.3
Debt securities and other fixed income securities (note iii)	2,015.2	—	2,015.2	2,015.2
Loans (note ii)	—	44.6	44.6	45.4
Other investments (note v)	201.7	—	201.7	201.7
Derivative asset	64.0	—	64.0	64.0
Accrued investment income	—	30.2	30.2	30.2
Other debtors	—	7.1	7.1	7.1
Cash at bank and in hand	—	195.4	195.4	195.4
Total	5,087.2	548.0	5,635.2	5,636.0

Financial Liabilities	Fair value through profit and loss	Amortised cost	Investment contracts with DPF	Total carrying value	Fair value
Subordinated liabilities	—	100.0	—	100.0	107.5
Investment contracts with discretionary participation	—	—	399.3	399.3	—
Other creditors	—	70.5	—	70.5	70.5
Derivative liabilities	19.0	—	—	19.0	19.0
Total	19.0	170.5	399.3	588.8	197.0

2015 £m	Fair value through profit and loss	Loans and receivables	Total carrying value	Fair value
Financial Assets				
Deposits with credit institutions	—	399.3	399.3	399.3
Equity securities and portfolio holdings in unit trusts	2,529.9	—	2,529.9	2,529.9
Debt securities and other fixed income securities (note iii)	2,330.6	—	2,330.6	2,330.6
Loans (note ii)	—	60.6	60.6	61.8
Other investments (note v)	185.8	—	185.8	185.8
Derivative asset	24.9	—	24.9	24.9
Accrued investment income	—	51.9	51.9	51.9
Other debtors	—	5.8	5.8	5.8
Cash at bank and in hand	—	169.1	169.1	169.1
Total	5,071.2	686.7	5,757.9	5,759.1

Financial Liabilities	Fair value through profit and loss	Amortised cost	Investment contracts with DPF	Total carrying value	Fair value
Subordinated liabilities	—	100.0	—	100.0	114.1
Investment contracts with discretionary participation features	—	—	396.8	396.8	—
Other creditors	—	79.0	—	79.0	79.0
Derivative liabilities	76.5	—	—	76.5	76.5
Total (note i)	76.5	179	396.8	652.3	269.6

Notes

(i) As at 31 December 2016 and 31 December 2015 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. The amounts of investment contracts with discretionary participation features are included within the Long-term business provision.
(ii) Loans and receivables are reported net of allowance for loan losses of £5.2m (2015: £1.2m).
(iii) As at 31 December 2016, £Nil (2015: £1.8m) of convertible bonds were included in debt securities. There were no convertible bonds included in borrowings.
(iv) 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.
(v) Other investments include participation in various investment funds and limited liability property partnerships.

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 Fund's entire holdings of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial instrument being fair valued. In some cases the fair value estimates cannot be substantiated by comparison to independent markets, nor can the disclosed value be realised in immediate settlement of the financial instrument.

The investment properties of the Fund 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 Fund's investment properties. As the comparisons are not with properties which are virtually identical to Fund'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.

Investments in group undertakings are valued at their current underlying 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.

The estimated fair value of derivative financial instruments reflects the estimated amount the Group 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.

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 FRS102.34 *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 Fund 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 fund valued with observable inputs. It also includes investment contract liabilities 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 £1,769m (2015: £2,004.6m), £107.4m (2015: £102.2m) 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.

2016 £m	**Level 1**	**Level 2**	**Level 3**	**Total**
Equity securities	2,734.9	70.8	0.7	2,806.4
Debt securities	245.3	1,769	0.9	2,015.2
Loans at FVTPL	—	36.4	7.7	44.1
Other investments (including derivative assets)	0.8	118.2	146.7	265.7
Derivative liabilities	(1.9)	(17.1)	—	(19)
Total financial investments, net of derivative liabilities	**2,979.1**	**1,977.3**	**156**	**5,112.4**
Total	**2,979.1**	**1,977.3**	**156**	**5,112.4**
Percentage of total	**58%**	**39%**	**3%**	**100%**

2015 £m	Level 1	Level 2	Level 3	Total
Equity securities	2,466.6	57.1	6.2	2,529.9
Debt securities	314.8	2,004.6	11.2	2,330.6
Loans at FVTPL	—	49.0	10.1	59.1
Other investments (including derivative assets)	0.6	26.6	183.5	210.7
Derivative liabilities	(2.7)	(73.8)	—	(76.5)
Total financial investments, net of derivative liabilities	**2,779.3**	**2,063.5**	**211**	**5,053.8**
Total	**2,779.3**	**2,063.5**	**211**	**5,053.8**
Percentage of total	**55%**	**41%**	**4%**	**100%**

The above tables relates to the total Fund. The fair value of the assets and liabilities in the Fund all relate to with-profit business.

Interest income and expense

The interest income on financial assets not at fair value through profit and loss was £3.8m for the year ended 31 December 2016 (2015: £5.3m). The interest expense on financial liabilities not at fair value through profit and loss was £8.5m for the year ended 31 December 2016 (2015: £8.5m).

B. Risk Management

The Fund's business involves the acceptance and management of risk. The Fund has in place a risk management process, which is undertaken in accordance with the 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. The Fund has not changed the processes used to manage its risks from previous periods.

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

Risk Type	**Definition**
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 and/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 position, 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 of the Company, resulting from changes in the level, trend or volatility of a number of insurance risk drivers. These include adverse longevity, mortality and
Liquidity risk	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.

C. Market Risk

The financial assets and liabilities attaching to the Fund's life assurance business are, to varying degrees, subject to market risk that may have a material effect on the profit or loss and equity.

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

Market risk for the Fund comprises two types of risk, namely:

- Interest rate risk: due to changes in market interest rates, and
- Currency risk: due to changes in foreign exchange rates.

The primary market risks that the Fund faces are equity risk and interest rate risk because most of its assets are investments that are either equity type investments and subject to equity price risk, or bonds, mortgages or cash deposits, the values of which are subject to interest rate risk.

The split of the Fund'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 Fund has available. This mix of liabilities allows the Fund to invest a substantial portion of its investment funds in equity and real estate investments that the Fund believes produce greater returns over the long term. On the other hand the Fund has some liabilities that contain guaranteed returns which generally will be supported by fixed income investments.

Currency Risk

As at 31 December 2016, the Fund held 46% (2015: 20%) and 8% (2015: 4%) of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency. The exchange risks inherent in these exposures are mitigated through the use of derivatives, mainly forward currency contracts.

D. Credit risk

Credit risk is the risk that a counterparty or an issuer of securities, which the Fund holds in its asset portfolio, defaults or another party fails to perform according to the terms of the contract. The Fund's long-term fund holds large amounts of interest rate sensitive investments that contain credit risk on which a certain level of defaults are expected. These expected losses are considered when the Fund 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 Fund is also exposed to credit-related losses in the event of non-performance by counterparties.

Debt Securities and Other Fixed Income Securities

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

	2016 £m	2015 £m
S&P – AAA	153	215.6
S&P – AA+ to AA-	374.1	453.6
S&P – A+ to A-	480.4	514
S&P – BBB+ to BBB-	518.9	617.9
S&P –Other	131.2	139.6
	1,657.6	1940.7
Moody's – Aaa	39.2	30.5
Moody's –Aa1 to Aa3	54.9	67.1
Moody's –A1 to A3	50.3	50.6
Moody's – Baa1 to Baa3	37.1	29.4
Moody's – Other	2	6.8
	183.5	184.4
Fitch	10.3	12.1
Other	163.8	193.4
Total debt securities and other fixed income securities	2,015.2	2,330.6

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, £99.7m (2015: £94.9m) were internally rated AAA to A-, £58.7m (2015: £86.5m) were internally rated BBB+ to B- and £5.4m were internally rated as below B- or unrated (2015: £12.0m).

Loans and receivables

Of the total loans and receivables £Nil (2015: £Nil) are past their due date but have not been impaired. In accordance with the accounting policies, impairment reviews were performed for loans and receivables. During the year ended 31 December 2016, impairment losses of £4.1m (2015: (£1.6m)) were recognised for loans and receivables.

Securities lending and reverse repurchase agreements

The Fund 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 Fund'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 Fund had lent £Nil (2015: £281m) of securities and held collateral under such agreements of £300m (2015: £300m).

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

Collateral and pledges under derivative transactions

The amount pledged for assets in respect of Over-the-Counter derivative transactions and repurchase arrangements was £58m (2015: £Nil).

E. Insurance risk

The Fund 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 Fund's annuity customers live longer than expected in the Fund's current pricing and reserving assumptions, and as a result future reserving and capital assumptions are changed.

The Fund conducts rigorous research into longevity risk, using data from its annuitant portfolio. As part of its pension annuity pricing and reserving policy, the Fund assumes that current rates of mortality continue to improve over time at levels based on the Fund'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 Fund's operating results could be adversely affected. Also any major medical breakthrough (for example in the treatment of cancer or other life-threatening diseases) that would require the Fund to strengthen its longevity assumptions would have an impact on the Fund'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 dependent on 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 Fund'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 Fund 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.

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.

F. Liquidity risk

Liquidity risk is the risk that the Fund may be unable to meet payment 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 Fund seeks to ensure that, even under adverse conditions, the Fund has access to the funds necessary to cover surrenders, withdrawals and maturing liabilities.

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

Liquidity analysis

(i) Contractual maturities of financial liabilities

There is no stated maturity date for the Subordinated liability of £100m as at the end of 2016 and 2015.

(ii) Maturity analysis of derivatives

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

	2016 £m	2015 £m
Derivative assets	64	24.9
Derivative liabilities	(19)	(76.5)
Net derivative position	45	(51.6)

The maturity date of the derivatives is less than one year as at the end of 2016 and 2015. This is due to 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 Fund has no cash flow hedges.

G. Derivatives

The Fund uses derivatives for efficient portfolio management to obtain cost effective and efficient exposure to various markets and to manage exposure to equity, interest rate, currency, credit and other business risks. It is the Fund's policy that cash or corresponding assets cover amounts at risk through derivative transactions. Derivative financial instruments used to facilitate efficient portfolio management and for investment purposes are carried at fair value with changes in fair value included in the profit and loss account. The Fund has not applied hedge accounting to its derivatives.

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

The Fund 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 PAC, (which the Fund is a sub-fund of), is one, and relevant counterparties in place under each of these market master agreements. The Fund also has the ability to enter into cleared derivative positions under the EMIR (European arket Infrastructure Regulation).

The total fair value balances of derivative assets and derivative liabilities are shown in Note 9.

19. Capital Requirements and Management

The introduction of Solvency II at the start of 2016 changed the capital dynamics of the Fund's 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 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.

Policyholder Fund

The Fund 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.

20. Additional Reserves

An operational issue was identified in 2015 for which the Fund still holds an additional reserve.

Pension equalisation

In 1990 the European Court of Justice ruled that pension schemes should equalise retirement ages for males and females. This ruling is known as the "Barber judgement". It has been discovered that benefits calculated or paid out for members in certain schemes were not compliant with the "Barber" judgement and that there has likely been an under-calculation of benefits for active and deferred members, and an underpayment for transferred out members, deceased members and pensioners.

A reserve of £35m was set up at year-end 2015 and remains for 2016 for compensation that SAIF may be liable to pay.