

PEARL GROUP MANAGEMENT SERVICES LIMITED

Company Registration Number: 3588063

STRATEGIC REPORT, DIRECTORS' REPORT AND
FINANCIAL STATEMENTS
for the year ended 31 December 2016

TUESDAY



A62P0X4I

A13

21/03/2017

#223

COMPANIES HOUSE

Contents	Page
Strategic report	3
Directors' report	5
Statement of Directors' responsibilities	6
Independent Auditor's report to the members of Pearl Group Management Services Limited	7
Statement of comprehensive income	8
Statement of financial position	9
Statement of cash flows	10
Statement of changes in equity	11
Notes to the financial statements	12

Strategic report

The Directors present the strategic report, the directors' report and the financial statements of Pearl Group Management Services Limited ('the Company') for the year ended 31 December 2016.

The Company is incorporated in the United Kingdom as a private limited company. Its registration number is 3588063 and its registered office is 1, Wythall Green Way, Wythall, Birmingham B47 6WG.

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS').

Business review**Principal activities**

The principal activity of the Company is the provision of management services, including governance and policy administration services, to the life assurance companies within the Phoenix Group. This will continue to be the principal activity for the foreseeable future.

The Company carries out the management services under arm's length, per policy based, Management Services Agreements ('MSA'). The Company has outsourced some of the services it provides under the MSAs to third parties.

On 31 July 2015, the Company acquired legal title to a portfolio of residential, equity release mortgages which it administered on behalf of Phoenix Life Limited ('PLL'), a fellow Group company that possessed beneficial interest of these mortgages. On 16 December 2016, PLL transferred such interest to Phoenix ER1 Limited ('PER1L'), a fully owned special purpose vehicle of PLL. PLL retains the risks and rewards of ownership.

The Company renegotiated MSAs with PLL to harmonise the contract terms, structures and charging basis of the previous MSAs with effect from 31 December 2015. As part of the harmonisation, the Company received up-front payments to assume various risks on behalf of PLL, which related to particular blocks of business and transferred selected other risks to PLL for a fee of £39,521,000. The fee income has been deferred and will be recognised in line with associated costs as and when they arise or as a result of a reduction in the risk. £1,192,000 has been recognised in income during the year (2015: expense of £84,000).

As part of the MSA harmonisation, a component of the MSA agreement was a profit share arrangement between the Company and Pearl Group Services Limited ('PGS'), a fellow Group company. As a result of this arrangement, the Company received £16,000,000 from PGS during the year. The income has been deferred and will be recognised on a straight line basis over the duration of the agreement, 5 years. During the year, £3,200,000 was recognised as income.

The Company has employees principally based in Wythall and London.

Principal risks and uncertainties

The Phoenix Group applies a consistent methodology for the identification, assessment, management and reporting of risk that includes a high level framework for the management of key risks within each business unit.

The key financial risks to which the Company is exposed are expense risk, liquidity risk, legislative and regulatory risk, VAT risk, credit risk, risk of outsourcer failure and operational risk. Capital and financial risk management are discussed within notes 23 and 24 of the financial statements.

The Company has legal title to a portfolio of residential mortgages. The economic exposure to the returns on the investment is with PLL, through its fully owned subsidiary, PER1L. Administration of this portfolio has been outsourced to Capita Mortgage Services Limited. However, the Company retains the ultimate liability for the administration, including all 'Treating Customers Fairly' ('TCF') requirements. In order to mitigate the risk of losses from the administration of this portfolio, the Company has received an unlimited indemnity from Impala Holdings Limited ('IHL'), its immediate parent company, against administration risk until such time as the Company ceases to hold legal title.

Key Performance Indicators ('KPIs')

The Company's performance is measured and monitored by the Board with particular regard paid to the following KPIs:

Cash flows

Cash flows are monitored closely by the business to ensure that all liabilities can be met as they fall due. In 2016, operations generated cash of £82,872,000 (2015: £20,871,000) and cash and cash equivalents increased by £47,171,000 (2015: £6,871,000).

Regulatory Capital

As the Company is regulated by the Financial Conduct Authority ('FCA'), it also regularly reviews and forecasts its adjusted net asset position as determined by Chapter 13 of IPRU (INV). At 31 December 2016, it had an excess over its regulatory capital requirements of £141,919,000 (2015: £149,327,000).

Profit before tax, profit after tax and total comprehensive income

As at 31 December 2016, the Company reported a profit before tax of £25,385,000 (2015: £18,754,000), a profit after tax of £21,450,000 (2015: £24,378,000) and total comprehensive income of £22,602,000 (2015: £28,965,000).

Employees

During the year, the Company maintained a policy of informing and involving employees on matters which concern them and in the achievement of its business goals. The Company has a comprehensive system for consultation and communication involving regular meetings between management and employees, team briefings, opinion surveys and the issue of various bulletins.

Employee development within the Company is promoted by encouraging staff to gain appropriate professional qualifications and assisting with wider personal development. The Phoenix Group has been a member of Business in the Community since 2010 and employees engage in various Corporate Responsibility activities, from initiatives to reduce or counteract the impact the Group is making on the environment to supporting local communities through volunteering and charity fundraising. Further information can be found in the Corporate Responsibility Statement included in the Phoenix Group Holdings Annual Return and Accounts.

The Company is committed to providing equal opportunities to all employees irrespective of their sex, age, sexual orientation, marital status, religion, race or disability. It is the Company's policy to give positive consideration to disabled persons with respect to applications for employment, training, career development and promotion, having regards to each individual's particular aptitudes and abilities.

Share schemes are offered to employees based on Group shares. The ultimate parent of the Company is Phoenix Group Holdings. Details of these schemes are disclosed within note 25 of the financial statements.

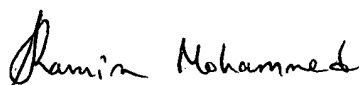
Corporate activities

On 1 November 2016, Phoenix Group acquired 100% of the issued share capital of AXA Wealth Limited ('AWL'), AXA Wealth Services Limited, AXA Sun Life Direct Limited, Winterthur Life UK Holdings Limited and AXA Trustee Services Limited from AXA UK plc. The AXA businesses comprise a pensions and investments business ('Embassy'), offering a range of propositions catering to both individual and corporate requirements and SunLife, a leader in the over 50's protection sector. The Group has acquired this group of companies to realise capital and cost synergies to be generated by leveraging the Group's existing operating platform and outsourcing model.

On 30 December 2016, Phoenix Group acquired 100% of the issued share capital of Abbey Life Assurance Company Limited, Abbey Life Trustee Services Limited and Abbey Life Trust Securities Limited from Deutsche Holdings No.4 Ltd (a wholly owned subsidiary of Deutsche Bank AG). Abbey Life carries on long-term insurance business and has been closed to new retail business since 2000. The acquisition of Abbey Life will benefit the Group by increasing long term cash generation and strengthening Group solvency.

During 2017, it is the Phoenix Group's intention to bring these entities into the existing Phoenix operating platform and outsourcing model, including policy administration by the Company similar to the existing MSA. This may impact the results of the Company in future periods.

On behalf of the Board



S Mohammed
Director

8 March 2017

Directors' report

Going concern

The Strategic report and the Directors' report summarise the Company's activities, its financial performance and its financial position together with any factors likely to affect its future development. In addition, the Strategic report discusses the principal risks and uncertainties it faces. Notes 23 and 24 to the financial statements summarise the Company's capital management and risk objectives and policies together with its financial risks.

The Directors have followed the UK Financial Reporting Council's "*Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks*" (issued April 2016) when performing their going concern assessment. As part of their comprehensive assessment of whether the Company is a going concern, the Directors have prepared cash flow and solvency forecasts for the Company for the foreseeable future.

As a result of this review, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Result and dividends

The results of the Company for the year are shown in the statement of comprehensive income on page 8. The profit before tax was £25,385,000 (2015: £18,754,000). No dividends were paid during the year (2015: £nil). During the year, the Company returned capital contributions of £30,000,000 (2015: £12,000,000).

Employees

Information on employees is shown in the Strategic report on page 3.

Directors

The names of those individuals who served as Directors of the Company during the year or who held office as at the date of signature of this report are as follows:

S Fawcett (resigned 1 October 2016)
A Kassimiotis
S Mohammed
R B F Seaman (appointed 23 February 2017)
R K Thakrar

Secretary

Pearl Group Secretariat Services Limited

Disclosure of indemnity

Qualifying third party indemnity arrangements (as defined in section 234 of the Companies Act 2006) were in force for the benefit of the Directors of the Company during the year and remain in place at the date of approval of this report.

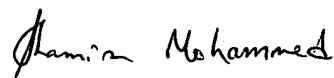
Disclosure of information to auditors

So far as each of the Directors is aware, there is no relevant audit information (as defined in the Companies Act 2006) of which the Company's auditors are unaware, and each of the Directors has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information (as defined) and to establish that the Company's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of section 418(2) of the Companies Act 2006.

Re-appointment of auditors

In accordance with section 487 of the Companies Act 2006, the Company's auditors, Ernst & Young LLP, will be deemed to have been re-appointed at the end of the period of 28 days following circulation of copies of these financial statements as no notice has been received from members pursuant to section 488 of the Companies Act 2006 prior to the end of the accounting reference period to which these financial statements relate.

On behalf of the Board



S Mohammed
Director
8 March 2017

Statement of Directors' responsibilities

The Directors are responsible for preparing the Directors' report and the Company financial statements ('the financial statements') in accordance with the applicable United Kingdom law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under the law the Directors have elected to prepare those statements in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS'). Under company law, the Directors must not approve the financial statements unless they are satisfied that they present fairly the financial performance, financial position and cash flows of the Company for the accounting period. A fair presentation of the financial statements in accordance with IFRS requires the Directors to:

- select suitable accounting policies in accordance with IAS 8: *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance;
- state that the Company has complied with applicable IFRS, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditor's report to the members of Pearl Group Management Services Limited

We have audited the financial statements of Pearl Group Management Services Limited for the year ended 31 December 2016 which comprise the accounting policies, the statement of comprehensive income, statement of financial position, the statement of cash flows, the statement of changes in equity and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 6, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the strategic report, directors' report and financial statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:


- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements;

Matters on which we are required to report by exception

In light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report or Directors' Report.

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

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


Benjamin Gregory (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

10 March 2017

PEARL GROUP MANAGEMENT SERVICES LIMITED

Statement of comprehensive income
for the year ended 31 December 2016

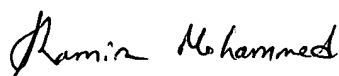
	Notes	2016 £000	2015 £000
Revenue			
Fee and commission income	3	174,457	172,424
Net investment income	4	3,719	3,271
Total revenue		<u>178,176</u>	<u>175,695</u>
Total income		<u>178,176</u>	<u>175,695</u>
Administrative expenses	5	(151,173)	(155,277)
Total operating expenses		<u>(151,173)</u>	<u>(155,277)</u>
Profit before finance costs and tax		27,003	20,418
Finance costs	8	(1,618)	(1,664)
Profit for the year before tax		<u>25,385</u>	<u>18,754</u>
Tax (charge)/credit	9	(3,935)	5,624
Profit for the year attributable to owners		<u>21,450</u>	<u>24,378</u>
Other comprehensive income:			
Fair value gains on revaluation	18	254	4,232
Deferred tax charge on share schemes	9	(321)	(173)
Current tax credit on share schemes	9	1,132	1,047
Deferred tax credit/(charge) on fair value gains on revaluation	9	87	(519)
Total comprehensive income for the year attributable to owners		<u>22,602</u>	<u>28,965</u>

PEARL GROUP MANAGEMENT SERVICES LIMITED

Statement of financial position
as at 31 December 2016

	Notes	As at 31 December 2016 £000	As at 31 December 2015 £000
Equity attributable to owners			
Share capital	10	38,613	38,613
Capital contribution reserve	11	18,263	48,263
Revaluation reserve	18	4,665	4,420
Retained earnings		24,398	2,041
Total equity		85,939	93,337
Non-current liabilities			
Long-term borrowings	12	58,800	60,800
Long-term provisions	13	3,415	3,415
Accruals and deferred income	15	95,970	87,902
Total non-current liabilities		158,185	152,117
Current liabilities			
Borrowings due for settlement within twelve months	12	2,063	3,928
Accruals and deferred income	15	29,698	26,467
Other payables	16	7,991	6,441
Total current liabilities		39,752	36,836
Total liabilities		197,937	188,953
Total equity and liabilities		283,876	282,290
Non-current assets			
Investments in subsidiaries	17	6,289	6,289
Property, plant and equipment	18	19,820	18,771
Loans and receivables	19	122,223	69,570
Deferred tax	14	3,375	5,003
Total non-current assets		151,707	99,633
Current assets			
Loans and receivables	19	-	49,643
Other receivables	20	30,079	78,095
Cash and cash equivalents	21	102,090	54,919
Total current assets		132,169	182,657
Total assets		283,876	282,290

On behalf of the Board



S Mohammed
Director

8 March 2017

PEARL GROUP MANAGEMENT SERVICES LIMITED

Statement of cash flows
for the year ended 31 December 2016

	Notes	2016 £000	2015 £000
Cash flows from operating activities			
Cash generated by operations	22	82,872	20,871
Net cash flows from operating activities		<u>82,872</u>	<u>20,871</u>
Cash flows from investing activities			
Purchase of property, plant and equipment	18	(218)	-
Net cash flows from investing activities		<u>(218)</u>	<u>-</u>
Cash flows from financing activities			
Interest paid		(3,483)	-
Repayment of borrowings	12	(2,000)	(2,000)
Return of capital contribution	11	(30,000)	(12,000)
Net cash flows from financing activities		<u>(35,483)</u>	<u>(14,000)</u>
Net increase in cash and cash equivalents		<u>47,171</u>	<u>6,871</u>
Cash and cash equivalents at the beginning of the year		54,919	48,048
Cash and cash equivalents at the end of the year	21	<u>102,090</u>	<u>54,919</u>

Supplementary disclosures on cash flow from operating activities

	2016 £000	2015 £000
Interest received	306	277
Interest paid	<u>(3,483)</u>	<u>-</u>

PEARL GROUP MANAGEMENT SERVICES LIMITED

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

	Share capital (note 10) £000	Capital contribution reserve (note 11) £000	Revaluation reserve £000	Retained earnings £000	Total £000
At 1 January 2016	38,613	48,263	4,420	2,041	93,337
Profit for the year	-	-	-	21,450	21,450
Other comprehensive income for the year	-	-	254	898	1,152
Total comprehensive income for the year	-	-	254	22,348	22,602
Amortisation of revaluation reserve (note 18)	-	-	(9)	9	-
Return of capital contribution (note 11)	-	(30,000)	-	-	(30,000)
At 31 December 2016	38,613	18,263	4,665	24,398	85,939

	Share capital (note 10) £000	Capital contribution reserve (note 11) £000	Revaluation reserve £000	Retained earnings £000	Total £000
At 1 January 2015	38,613	60,263	192	(22,696)	76,372
Profit for the year	-	-	-	24,378	24,378
Other comprehensive income for the year	-	-	4,232	355	4,587
Total comprehensive income for the year	-	-	4,232	24,733	28,965
Amortisation of revaluation reserve (note 18)	-	-	(4)	4	-
Return of capital contribution (note 11)	-	(12,000)	-	-	(12,000)
At 31 December 2015	38,613	48,263	4,420	2,041	93,337

Distributable reserves include the Capital contribution reserve and Retained earnings.

Notes to the financial statements

1. Accounting policies

(a) Basis of preparation

The financial statements have been prepared on a historical cost basis.

The financial statements are standalone financial statements and the exemption in paragraph 4 of IFRS 10 *Consolidated Financial Statements* and section 401 of the Companies Act 2006, have been used not to present consolidated financial statements. The results of the Company are consolidated into the accounts of the Company's ultimate parent Phoenix Group Holdings, a company incorporated in the Cayman Islands and resident in Jersey.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS').

The financial statements are presented in sterling (£) rounded to the nearest £000 except where otherwise stated.

Assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the statement of comprehensive income unless required or permitted by an IFRS or interpretation, as specifically disclosed in the accounting policies of the Company.

(b) Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Critical accounting estimates are those which involve the most complex or subjective judgements or assessments. The areas of the Company's business that typically require such estimates are the impairment tests for investments in subsidiaries, income taxes and recognition of provisions.

Impairment of investments in subsidiaries

Investments in subsidiaries are subject to regular impairment reviews. Impairments of investments in subsidiaries are measured at the difference between the carrying value of a particular asset and its estimated recoverable amount. Impairments are recognised in the statement of comprehensive income in the period in which they occur. The Company's policy in relation to impairment testing of investments in subsidiaries is detailed in accounting policy (g).

Income taxes

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all the available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which the losses can be relieved. The UK taxation regime applies separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets.

The accounting policy for income taxes (both current and deferred taxes) is discussed in more detail in accounting policy (d).

Provisions

The accounting policy for provisions is discussed in accounting policy (k).

Fair value of financial assets

The accounting policy for fair value of financial assets is discussed in accounting policy (h).

(c) Borrowings

Interest-bearing borrowings are recognised initially at fair value less any attributable transaction costs. The difference between initial cost and the redemption value is amortised through the statement of comprehensive income over the period of the borrowing using the effective interest method.

(d) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised in the statement of changes in equity, in which case it is recognised in this statement.

Current tax is the expected tax payable on the taxable income for the year, using tax rates and laws enacted or substantively enacted at the date of the statement of financial position together with adjustments to tax payable in respect of previous years.

Deferred tax is provided for on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not provided in respect of temporary differences arising from the initial recognition of goodwill and the initial recognition of assets or liabilities in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and laws enacted or substantively enacted at the period end.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(e) Employee benefits

The Company is a participating employer in the PGL pension scheme which has a defined contribution section and a dormant defined benefit section.

Defined contribution plans

Obligation for contributions to defined contribution pension plans are recognised as an expense in the statement of comprehensive income as and when incurred.

Defined benefit plans

No net defined benefit cost or cash contributions of the PGL scheme are borne by the Company as it is the policy of the Phoenix Group for these to be borne by the sponsoring employer for the PGL scheme, Phoenix Group Holdings (No.1) Limited, a Group entity.

(f) Property, plant and equipment

Owner-occupied property is stated at revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment. The property is revalued on a quarterly basis.

Owner-occupied property is depreciated over its estimated useful life, which is taken as 50 years, except where the residual value is greater than its carrying value in which case no depreciation is charged to profit or loss. Land is not depreciated.

A revaluation surplus is recorded in Other Comprehensive Income and credited to the asset revaluation reserve in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in profit or loss, the increase is recognised in profit and loss. A revaluation deficit is recognised in the statement of profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation reserve.

An annual transfer from the asset revaluation reserve to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Plant and equipment is stated at cost less accumulated depreciation. Depreciation is charged to the statement of comprehensive income on a straight-line basis over the estimated useful lives of the assets. The useful lives of the fixtures, fittings and equipment have been estimated as 3-10 years.

(g) Investment in subsidiaries

Investments in shares in subsidiaries are carried in the statement of financial position at cost less impairment.

At each reporting date, the Company assesses whether there are any indications of impairment or reversal of impairment. When such indications exist, an impairment test is carried out by comparing the carrying value of the investment against the estimate of the recoverable amount, which represents the higher of value in use or fair value less costs of disposal. Impairments and reversal of impairments are recognised as income or an expense in the statement of comprehensive income in the period in which they occur.

(h) Financial assets

Loans and receivables are non derivative financial assets with fixed or determinable payments that are not quoted in an active market. These investments are initially recognised at cost, being the fair value of the consideration paid for the acquisition of the investment. All transaction costs directly attributable to the acquisition are also included in the cost of the investment. Subsequent to initial recognition, these investments are carried at amortised cost, using the effective interest method.

Impairment of financial assets

The Company assesses at each period end whether a financial asset or group of financial assets held at amortised cost is impaired. The Company first assesses whether objective evidence of impairment exists for financial assets. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in the collective assessment of impairment.

(i) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and short-term deposits with an original maturity term of three months or less at the date of placement. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are deducted from cash and cash equivalents for the purpose of the statement of cash flows.

(j) Leases

Where a significant element of the risks and rewards of title to the asset is retained by the lessor, such leases are classified as operating leases.

(k) Provisions and contingent liabilities

A provision is recognised when the Company has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where the Company has a present legal or constructive obligation as a result of a past event but it is not probable that there will be an outflow of resources to settle the obligation or the amount cannot be reliably estimated, this is disclosed as a contingent liability.

(l) Dividends

Final dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Company's owners. Interim dividends are deducted from equity when they are paid.

Dividends for the year that are approved after the reporting period are dealt with as an event after the reporting period.

(m) Income recognition**Fee and commission income**

Fee and commission income relates to the following:

- policy administration fees, which are recognised as the services are provided; and
- other fees, which are recognised as the services are provided.

Fee income received for the indemnity of future risks is treated as deferred income in the period in which it is received and recognised as revenue either in line with actual costs incurred (as these costs are considered to best reflect the rendering of services) or as a result of a reduction in the assumed level of future risks.

Net investment income

Net investment income comprises interest, dividends and impairment reversals and losses on loans and receivables.

Interest income is recognised in the statement of comprehensive income as it accrues using the effective interest method. Dividend income is recognised in the statement of comprehensive income on the date the right to receive payments is established.

(n) Expense recognition**Share-based payments**

Equity-settled share-based payments to employees and others providing services are measured at the fair value of the equity instruments at the grant date. The fair value excludes the effect of non market-based vesting conditions. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in note 25.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Phoenix Group Holdings ('PGH'), the Company's ultimate parent company estimate of equity instruments that will eventually vest. At each period end, the Company revises its estimate of the number of equity instruments expected to vest as a result of the effect of non market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the statement of comprehensive income.

Finance costs

Interest payable is recognised in the statement of comprehensive income as it accrues and is calculated by using the effective interest method.

(o) Share capital and capital contributions**Ordinary share capital**

The Company has issued ordinary shares which are classified as equity.

Capital contributions

Capital contributions received by the Company and which contain no agreement for their repayment are recognised directly in the statement of changes in equity as a distributable reserve.

(p) Events after the reporting period

The financial statements are adjusted to reflect significant events that have a material effect on the financial results and that have occurred between the period end and the date when the financial statements are authorised for issue, provided they give evidence of conditions that existed at the period end. Events that are indicative of conditions that arise after the period end that do not result in an adjustment to the financial statements are only disclosed.

2. Financial information

The financial statements for the year ended 31 December 2016, set out on pages 8 to 30 were authorised by the Board of Directors for issue on 8 March 2017.

In preparing the financial statements the Company has adopted the following standards, interpretations and amendments which have been issued by the International Accounting Standards Board ('IASB') and have been adopted for use by the EU. None of the following have a material effect on the results of the Company.

- Annual Improvements 2012 – 2014 cycle;
- Disclosure initiative (Amendments to IAS 1 *Presentation of Financial Statements*); and
- Clarification of acceptable methods of depreciation and amortisation (Amendments to IAS 16 and IAS 38).

The IASB has issued the following new or amended standards and interpretations which apply from the dates shown. The Company has decided not to early adopt any of these standards, interpretations or amendments where this is permitted. The impact on the Company of adopting them is subject to evaluation:

- Disclosure initiative (Amendments to IAS 7 *Statement of Cash Flows*)(2017);
- Recognition of Deferred tax assets for unrealised losses (Amendments to IAS 12) (2017). The Company anticipates that these amendments are likely to have limited impact on amounts reported in respect of the Company's financial statements.
- IFRS 9 *Financial Instruments* (2018). This standard will replace IAS 39 *Financial Instruments: Recognition and Measurement*. The Company anticipates that these amendments are likely to have limited impact on amounts reported in respect of the Company's financial statements.
- IFRS 15 *Revenue from Contracts with Customers* (2018). IFRS 15 establishes a single comprehensive framework for determining whether, how and when revenue is recognised. The standard does not apply to financial instruments within the scope of IAS 39, and the Company anticipates that the application of IFRS 15 in the future is likely to have limited impact on the measurement and presentation of amounts reported in respect of the Company's financial statements.
- Classification and Measurement of Share-based payment (Amendments to IFRS 2)(2018).
- IFRS 16 *Leases* (2019). IFRS 16 will replace IAS 17 *Leases*. The new standard removes the classification of leases as either operating or finance leases for the lessee, thereby treating all leases as

PEARL GROUP MANAGEMENT SERVICES LIMITED

finance leases. This will result in the recognition of a right-to use asset and a lease liability for all of the Company's previously classified operating leases. The recognition of depreciation and an interest cost will result in a decreasing cost over the term of the lease compared to a straight line allocation of the lease rentals. Short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements. The Company anticipates that the application of IFRS 16 in the future is likely to have limited impact on amounts reported in respect of the Company's financial statements.

3. Fee and commission income

	2016 £000	2015 £000
Policy administration fees	101,748	100,343
Movement in deferred income (note 15)	4,732	(84)
Other fees	67,977	72,165
	<u>174,457</u>	<u>172,424</u>

Other fees include charges to group entities for pass-through costs, project work and head office costs.

Project related costs are allocated between the Company and PGS a fellow subsidiary, in accordance with a pre-defined governance framework. For certain long-term projects, a provisional allocation is used which is subject to refinement in subsequent periods.

During 2015, certain project costs were reallocated, which had a subsequent impact on the income received as reimbursement for those costs. Following this reallocation, deferred income was recognised against a lower value of costs incurred, and the deferred income balance was adjusted accordingly.

4. Net investment income

	2016 £000	2015 £000
Interest income	3,719	3,271
	<u>3,719</u>	<u>3,271</u>

Interest income includes interest of £3,010,000 (2015: £2,994,000) on loans to Group entities and interest of £403,000 (2015: £nil) charged on amounts due from Group entities.

5. Operating expenses

	2016 £000	2015 £000
Employee costs	77,971	72,508
Outsourcing expenses	53,011	61,575
Depreciation of property, plant and equipment (note 18)	317	362
Operating lease rentals (note 26)	4,497	4,428
Other	15,377	16,404
	<u>151,173</u>	<u>155,277</u>

Other operating expenses include contractor and professional fees incurred predominantly for project work.

Project related costs are allocated between the Company and PGS, a fellow subsidiary, in accordance with a pre-defined governance framework. For certain long-term projects, a provisional allocation is used which is subject to refinement in subsequent periods.

Staff costs and overheads are allocated between the Company and PGS, a fellow subsidiary.

PEARL GROUP MANAGEMENT SERVICES LIMITED

Employee costs comprise:

	2016 £000	2015 £000
Wages and salaries (including termination benefits)	63,949	58,735
Social security contributions	8,686	7,818
Other pension costs	5,336	5,955
	<u>77,971</u>	<u>72,508</u>

	2016	2015
Average number of persons employed	<u>697</u>	<u>688</u>

6. Directors' remuneration

	2016 £000	2015 £000
Salaries and short term benefits	<u>313</u>	<u>299</u>
Remuneration (excluding pension contributions and awards under share option schemes and other long-term incentive schemes)	<u>313</u>	<u>299</u>

Contributions to money purchase pension schemes	<u>11</u>	<u>13</u>
-------------------------------------------------	-----------	-----------

	2016	2015
Number of Directors who:		
- are members of a money purchase pension scheme	3	4
- have exercised share options during the year	3	1

	2016 £000	2015 £000
Highest paid Director's remuneration:	<u>269</u>	<u>253</u>

The Directors are employed by the Company or PGS, a fellow group entity. The total compensation paid to the Directors of the Company relates to services to the Company, regardless of which entity within the Phoenix Group has paid the compensation.

7. Auditors' remuneration

The remuneration of the auditors of the Company in respect of the audit of the financial statements was £100,000 (2015: £100,000). In addition, audit related assurance services of £3,000 were incurred during the year (2015: £3,000).

8. Finance costs

	2016 £000	2015 £000
Interest expense		
On borrowings at amortised cost	<u>1,618</u>	<u>1,664</u>

Interest expense includes interest of £1,618,000 (2015: £1,664,000) on loans from Group entities.

PEARL GROUP MANAGEMENT SERVICES LIMITED

9. Tax charge/(credit)

Current year tax charge/(credit)

	2016 £000	2015 £000
Current tax:		
UK Corporation tax	2,547	1,372
Adjustment in respect of prior years	(5)	(19,801)
Total current tax charge/(credit)	2,542	(18,429)
Deferred tax:		
Origination and reversal of temporary differences	1,550	12,649
Change in the rate of UK corporation tax	(157)	156
Total deferred tax charge	1,393	12,805
Total tax charge/(credit)	3,935	(5,624)

Tax credited to other comprehensive income

	2016 £000	2015 £000
Deferred tax (credit)/charge on revaluation of property	(87)	519
Deferred tax charge on share schemes	321	173
Current tax credit on share schemes	(1,132)	(1,047)
	(898)	(355)

Reconciliation of tax charge/(credit)

	2016 £000	2015 £000
Profit before tax	25,385	18,754
Tax at standard UK rate of 20% (2015: 20.25%)	5,077	3,798
Disallowable expenses	319	337
Adjustment to tax charge in respect of prior years	(5)	(7,506)
Deferred tax rate change	(157)	156
Share based remuneration	(537)	125
Temporary differences not valued	(762)	(2,534)
Total tax charge/(credit) for the year	3,935	(5,624)

PEARL GROUP MANAGEMENT SERVICES LIMITED

10. Share capital

The Company's Articles of Association contain a restriction on the number of shares that may be allotted.

	2016 £000	2015 £000
Authorised:		
100,000,000 (2015: 100,000,000) ordinary shares of £1 each	<u>100,000</u>	<u>100,000</u>
Issued and fully paid equity shares:		
38,613,037 (2015: 38,613,037) ordinary shares of £1 each	<u>38,613</u>	<u>38,613</u>

The holders of ordinary shares are entitled to one vote per share on matters to be voted on by owners and to receive such dividends, if any, as may be declared by the Board of Directors at its discretion out of legally available profits.

11. Capital contribution reserve

	2016 £000	2015 £000
As at 1 January	48,263	60,263
Return of capital contribution	<u>(30,000)</u>	<u>(12,000)</u>
As at 31 December	<u>18,263</u>	<u>48,263</u>

During the year, the company returned capital contributions of £30,000,000 (2015: £12,000,000).

12. Borrowings

	2016 £000 Carrying value	2015 £000 Carrying value	2016 £000 Fair value	2015 £000 Fair value
Amounts owed to Group entities at amortised cost:				
Subordinated loan from fellow subsidiary, Pearl Group Holdings (No.1) Limited ('PGH1')	56,000	57,839	56,000	56,000
Loan from fellow subsidiary, Phoenix Life Limited ('PLL')	<u>4,863</u>	<u>6,889</u>	<u>4,821</u>	<u>6,837</u>
	<u>60,863</u>	<u>64,728</u>	<u>60,821</u>	<u>62,837</u>
Amount due for settlement before 12 months	<u>2,063</u>	<u>3,928</u>		
Amount due for settlement after 12 months	<u>58,800</u>	<u>60,800</u>		

On 21 September 2007, the Company entered into a £110,000,000 credit facility agreement with fellow subsidiary, PGH1. Cash can be drawn down by the Company after giving five days written notice and is not repayable to PGH1 within two years of drawdown. Repayments are not allowed at any time without the express written consent of the FCA. In total £56,000,000 has been drawn down and remains outstanding at the year end (2015: £56,000,000). Interest of £1,511,000 (2015: £1,839,000) on the loan was charged by PGH1 to the Company in accordance with the agreement and was settled during the year (2015: £nil). Interest is payable at a rate of 6 month LIBOR plus 2% which is settled on a periodic basis.

On 1 May 2012, the Company entered into a £12,800,000 loan agreement with PLL, a fellow subsidiary. The loan is repayable in annual instalments of £2,000,000 plus accrued interest. Interest is payable at a rate of 6 month LIBOR plus 1.25%.

Determination of fair value and fair value hierarchy of borrowings

Borrowings are categorised as Level 3 financial instruments. The fair value of borrowings with no external market is determined by internally developed discounted cash flow models using a risk adjusted discount rate corroborated with external market data where possible.

There were no level 1 or level 2 borrowings in 2016 or 2015. There were no fair value gains or losses recognised in other comprehensive income.

PEARL GROUP MANAGEMENT SERVICES LIMITED

13. Provisions

Leasehold
Properties
£000

At 1 January and 31 December 2016

3,415

Amount due for settlement after 12 months

3,415

The leasehold property provision includes a dilapidations provision resulting from obligations under operating leases. It is expected that the dilapidations provision will be due for settlement after 12 months.

14. Tax assets and liabilities

2016
£000 2015
£000

Deferred Tax

The balances at 31 December comprise:

Deferred tax assets

3,375

5,003

Movements in deferred tax assets

Year ended 31 December 2016

	1 January	Recognised in the Income Statement	Recognised in other comprehensive income	31 December
	£000	£000	£000	£000
Trading losses	3,021	(3,021)	-	-
Provisions and other temporary differences	2,505	323	(321)	2,507
Unrealised gains	(519)	-	87	(432)
Accelerated capital allowances	(4)	1,304	-	1,300
	<u>5,003</u>	<u>(1,394)</u>	<u>(234)</u>	<u>3,375</u>

Year ended 31 December 2015

	1 January	Recognised in the Income Statement	Recognised in other comprehensive income	31 December
	£000	£000	£000	£000
Trading losses	15,332	(12,311)	-	3,021
Provisions and other temporary differences	3,198	(521)	(172)	2,505
Unrealised gains	-	-	(519)	(519)
Accelerated capital allowances	(31)	27	-	(4)
	<u>18,499</u>	<u>(12,805)</u>	<u>(691)</u>	<u>5,003</u>

The Finance Act 2015 set the rate of corporation tax at 20% from 1 April 2016. Finance (No 2) Act 2016 reduces the rate of corporation tax to 19% in April 2017 and 17% from April 2020. Consequently, a blended rate of tax has been used for the purposes of providing for deferred tax in these financial statements.

Deferred income tax assets are recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable.

	2016 £000	2015 £000
Deferred tax assets have not been recognised in respect of:		
Provisions and other temporary differences	<u>2,555</u>	<u>3,435</u>

PEARL GROUP MANAGEMENT SERVICES LIMITED

15. Accruals and deferred income

	2016 £000	2015 £000
Deferred income	99,170	87,902
Accruals	<u>26,498</u>	<u>26,467</u>
	<u>125,668</u>	<u>114,369</u>
Amount due for settlement before 12 months	<u>29,698</u>	<u>26,467</u>
Amount due for settlement after 12 months	<u>95,970</u>	<u>87,902</u>

The following table details the change in deferred income:

	2016 £000	2015 £000
At 1 January	87,902	48,297
Additions	16,000	39,521
Movement during the year (note 3)	<u>(4,732)</u>	<u>84</u>
At 31 December	<u>99,170</u>	<u>87,902</u>

In 2010, the Company agreed to indemnify PLL against the risk of certain future outsourcer costs, in return for which it received a fee of £47,000,000. In May 2015, under a similar agreement, a further fee of £5,000,000 was received. In both cases, recognition of income has been deferred and is released when relevant costs are incurred.

The Company renegotiated MSAs with PLL to harmonise the contract terms, structures and charging basis of the previous MSAs with effect from 31 December 2015. As part of the harmonisation, the Company accepted certain risks on behalf of PLL, which related to particular blocks of business and transferred selected other risks to PLL for a fee of £39,521,000. The fee income has been deferred and will be recognised in line with associated costs as and when they arise or as a result of a reduction in the assumed level of risk.

As a result of the MSA harmonisation, a component of the MSA agreement related to a profit share arrangement between the Company and PGS, a fellow subsidiary, where PGS transferred £16,000,000 cash to the Company. This is recognised on a straight line basis in the income statement over the duration of the agreement, 5 years. During the year, £3,200,000 was recognised as income.

16. Other payables

	2016 £000	2015 £000
Amounts owed to Group companies	6,218	4,979
Other payables	<u>1,773</u>	<u>1,462</u>
	<u>7,991</u>	<u>6,441</u>

17. Investment in subsidiaries

	2016 £000	2015 £000
Cost		
At 1 January and 31 December	<u>6,289</u>	<u>6,289</u>

There was no impairment in the value of investment in subsidiaries during 2016 or 2015.

PEARL GROUP MANAGEMENT SERVICES LIMITED

The subsidiaries of the Company are:

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
Pearl Life Services Limited	1 Wythall Green Way, Wythall, Birmingham, B47 6WG, England	Ordinary shares of £1
PGMS (Ireland) Holdings	Goodbody Secretarial Limited, International Financial Services Centre, 25/28 North Wall Quay, Dublin 1, Ireland	Ordinary shares of £1
PGMS (Glasgow) Limited	301 St Vincent Street, Glasgow, G2 5AB	Ordinary shares of £1
Alba Life Trustees Limited	301 St Vincent Street, Glasgow, G2 5HN	Ordinary shares of £1
Phoenix Life Insurance Services Limited	1 Wythall Green Way, Wythall, Birmingham, B47 6WG, England	Ordinary shares of £1
Phoenix SCP Pensions Trustees Limited	1 Wythall Green Way, Wythall, Birmingham, B47 6WG, England	Ordinary shares of £1
Phoenix SCP Trustees Limited	301 St Vincent Street, Glasgow, G2 5HN	Ordinary shares of £1
Phoenix Life Pension Trust Limited	1 Wythall Green Way, Wythall, Birmingham, B47 6WG, England	Ordinary shares of £1
Phoenix Pension Scheme (Trustees) Limited	1 Wythall Green Way, Wythall, Birmingham, B47 6WG, England	Ordinary shares of £1
Phoenix Pensions Trustee Services Limited	1 Wythall Green Way, Wythall, Birmingham, B47 6WG, England	Ordinary shares of £1
PGMS (Ireland) Limited (subsidiary of PGMS (Ireland) Holdings)	Goodbody Secretarial Limited, International Financial Services Centre, 25/28 North Wall Quay, Dublin 1, Ireland	Ordinary shares of £1

18. Property, plant and equipment

	Owner occupied property £000	Plant and equipment £000	Total £000
Cost or valuation			
At 1 January 2016	18,750	1,333	20,083
Additions	-	1,112	1,112
Fair value gains on revaluation	-	-	-
At 31 December 2016	<u>18,750</u>	<u>2,445</u>	<u>21,195</u>
Depreciation			
At 1 January 2016	-	(1,312)	(1,312)
Depreciation (note 5)	(254)	(63)	(317)
Fair value gains on revaluation	254	-	254
At 31 December 2016	<u>-</u>	<u>(1,375)</u>	<u>(1,375)</u>
Carrying amount			
At 31 December 2016	<u>18,750</u>	<u>1,070</u>	<u>19,820</u>

PEARL GROUP MANAGEMENT SERVICES LIMITED

	Owner occupied property £000	Plant and equipment £000	Total £000
Cost or valuation			
At 1 January 2015	15,000	1,333	16,333
Fair value gains on revaluation	3,750	-	3,750
At 31 December 2015	<u>18,750</u>	<u>1,333</u>	<u>20,083</u>
Depreciation			
At 1 January 2015	(240)	(1,192)	(1,432)
Depreciation (note 5)	(242)	(120)	(362)
Fair value gains on revaluation	482	-	482
At 31 December 2015	<u>-</u>	<u>(1,312)</u>	<u>(1,312)</u>
Carrying amount			
At 31 December 2015	<u>18,750</u>	<u>21</u>	<u>18,771</u>

The useful lives of plant and equipment have been taken as 5-10 years for fixtures and fittings and 3-5 years for computer equipment. Owner-occupied property has an estimated useful life of 50 years. Land is not depreciated.

Jones Lang LaSalle Limited, an accredited independent valuer completed a valuation of the owner occupied property at 31 December 2016 on an open market basis in accordance with the Royal Institution of Chartered Surveyors' requirements, which is deemed to equate to fair value. The fair value measurement for the land and buildings of £18,750,000 has been categorised as level 3 based on the non-observable inputs to the valuation technique used.

The following table shows a reconciliation from the opening to the closing fair values for the level 3 land and buildings at valuation:

	£000
At 1 January 2016	18,750
Depreciation recognised in profit or loss	(254)
Fair value gains on revaluation	254
At 31 December 2016	<u>18,750</u>

The fair value of the land and buildings at valuation was derived using the investment method supported by comparable evidence. The significant non-observable inputs used in the valuation are expected rental value per square foot and capitalisation rate. The fair value of the land and buildings valuation would increase/(decrease) if the expected rental value per square foot were higher/(lower) and the capitalisation rate were to be lower/(higher). If the owner occupied property was recognised at historical cost less accumulated depreciation, its carrying amount would have been approximately £13,856,000 at 31 December 2016 (2015: £14,092,000).

Unrealised gains of £4,665,000 (2015: £4,420,000) are held in the Revaluation Reserve within the Statement of Changes in Equity of which £254,000 (2015: £4,232,000) was recognised in the Statement of Other Comprehensive Income during the year. The Revaluation Reserve is not distributable. A movement in the Revaluation Reserve of £9,000 (2015: £4,000) has been transferred to retained earnings, being that part of the depreciation charge in respect of the revaluation uplift on the asset. The additional depreciation is systematically treated as realised over the estimated remaining life of the asset.

PEARL GROUP MANAGEMENT SERVICES LIMITED

19. Loans and receivables

	2016 £000 Carrying value	2015 £000 Carrying value	2016 £000 Fair value	2015 £000 Fair Value
Loans to Group companies at amortised cost:				
Pearl Life Holdings Limited	<u>122,223</u>	<u>119,213</u>	<u>114,557</u>	<u>112,338</u>
Repayable before 12 months	<u>-</u>	<u>49,643</u>		
Repayable after 12 months	<u>122,223</u>	<u>69,570</u>		

Loans totalling £70,752,000 (2015: £69,570,000) to fellow subsidiary Pearl Life Holdings Limited ('PLHL') are repayable on 2 September 2019 and incur interest at a rate of 12 month LIBOR plus 1.25%.

On 21 March 2016, the remaining loan balance to PLHL was extended from 31 December 2016 until 31 December 2021, and the rate of interest reduced from 6 month LIBOR plus 2.94% to 6 month LIBOR plus 1.75% with effect from 31 December 2016.

Determination of fair value and fair value hierarchy of loans and receivables

Loans and receivables are categorised as Level 3 financial instruments. The fair value of loans and receivables with no external market is determined by internally developed discounted cash flow models using a risk adjusted discount rate corroborated with external market data where possible.

There were no level 1 or level 2 loans and receivables in 2016 or 2015.

There were no fair value gains or losses recognised in other comprehensive income.

20. Other receivables

	2016 £000	2015 £000
Prepayments	4,115	3,444
Amounts owed by Group Companies	21,467	69,721
Other receivables	<u>4,497</u>	<u>4,930</u>
	<u>30,079</u>	<u>78,095</u>

During 2015, amounts owed by Group Companies included the risk transfer payments due from PLL, as detailed in note 15. This was received from PLL in 2016.

21. Cash and cash equivalents

	2016 £000	2015 £000
Bank and cash balances	(41)	(25)
Short-term deposits (including demand and time deposits)	<u>102,131</u>	<u>54,944</u>
	<u>102,090</u>	<u>54,919</u>

The carrying amounts of cash and cash equivalents are not materially different from their fair values at the year end.

The credit balance of £41,000 (2015: £25,000) included within bank and cash balances was due to timing differences and as such the bank balance was not overdrawn at the reporting date.

22. Cash flows***Cash flows from operating activities***

	2016 £000	2015 £000
Profit for the year before tax	25,385	18,754
Non-cash movements in profit for the year before tax		
Depreciation of property, plant and equipment	317	362
Interest expense on borrowings	1,618	1,664
Interest income on loans to Group entities	(3,010)	(2,994)
Interest income on amounts due from group entities	(403)	-
Changes in operating assets and liabilities		
Decrease/(increase) in other assets	48,419	(55,327)
Increase in other liabilities	10,546	58,412
Cash generated by operations	<u>82,872</u>	<u>20,871</u>

The cash flow has been prepared using the indirect method.

23. Capital management

The Company's capital comprises share capital and reserves. At 31 December 2016, total capital was £85,939,000 (2015: £93,337,000). The movement in capital during the year comprises total comprehensive income of £22,602,000 less the return of capital contribution of £30,000,000.

The Company is regulated by the FCA and must maintain capital of £20,000 (2015: £10,000). The Company's capital is monitored by the Directors and managed on an on-going basis. The Directors are responsible for ensuring that the Company maintains an appropriate level of capital to enable it to meet liabilities arising from reasonably foreseeable extreme events. The Company has implemented a system of regular reviews to monitor the level of capital in the short to medium term taking account of the anticipated future developments of the Company. At 31 December 2016, it had an excess over its regulatory capital requirements of £141,919,000 (2015: £149,327,000).

The Directors have prepared cash flow forecasts for the Company for the foreseeable future. The cash flow forecasts indicate that the Company is able to meet its obligations as and when they fall due for the foreseeable future.

24. Risk management

On 31 December 2015, the Company agreed a revised MSA with PLL. Under this agreement, the Company entered into further risk buyouts relating to regulatory change and expense risk. The Company received a cash consideration for accepting these risks.

At the time of the risk transfers, the consideration was determined to be adequate to meet the foreseeable costs of the risks crystallising and continues to be at 31 December 2016. The risks are assessed as part of the following items:

Expense risk

The Company carries the expense risk of reducing its expenses in line with fee income from per policy based management services agreements.

To maintain profitability, the Company has to deliver efficiencies to at least match policy run-off. One strategy to mitigate this risk has been to outsource administration services the cost of which runs down in line with policy run off.

The Company manages this risk through focus on cost reduction initiatives across the business with robust business plans, monitored by detailed reporting and regular re-forecasting. The Company monitors the level of risk in its ongoing expense base every month and the Phoenix Group holds appropriate levels of risk capital to encompass this.

Liquidity risk

The Company has exposure to liquidity risk as a result of normal business activities, specifically the risk arising from an inability to meet short-term cash flow requirements and this is monitored on an ongoing basis.

Key components of the monitoring framework include daily monitoring of cash flows and regular reviews with the parent company, IHL, to identify cash flow requirements.

Legislative and regulatory risk

The Company is subject to regulation by the FCA. The FCA has broad regulatory powers dealing with all aspects of financial services including, amongst other things, the authority to grant and, in specific circumstances, to vary or cancel permissions to carry out particular activities. Phoenix Group has processes in place to keep up to date with latest FCA guidelines and regulation. Phoenix Group is also responsible for treating its customers fairly and adheres to FCA guidelines in respect of this.

Following the risk transfers noted above, the Company is responsible for ensuring that PLL are compliant with all applicable laws and regulations. If the costs of compliance are higher than the value of the buyout, additional costs would be incurred by the Company. At the current time, there is no evidence that total costs will exceed the amount transferred.

VAT risk

The European Union is considering making VAT payable on Outsourcer fees. It is likely that this would give rise to additional expenses to the business. The Company has various agreements in place to mitigate some or all of this risk.

Given UK's decision to trigger the process of leaving the European Union, we will monitor development and assess impact in this area which remains uncertain to this date.

Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. These obligations can relate to both recognised and unrecognised assets and liabilities.

During the year, the Company's cash and cash equivalents have been held in authorised collective investment schemes ('CIS') which in turn invest only in money market instruments. The Company is exposed to the possible default of the underlying investments within the CIS, which are considered to be extremely low risk.

The Company is also exposed to credit risk relating to loans and receivables from other Group Companies, which are considered low risk. The credit risk from activities undertaken in the normal course of business is also considered to be extremely low risk, as the majority of amounts owed to the Company at the year-end are due from Group companies (note 20).

Risk of outsourcer failure

The Company carries the risk that the outsourcers are no longer able to commit to providing the agreed services at the agreed costs. The risk of outsourcers becoming insolvent is continually monitored closely by the Operational Governance Team and considered to be minimal.

Operational risk

The Company has legal title to a portfolio of residential mortgages; however, the economic exposure to the returns on the investment is with PLL, through its fully owned subsidiary, PER1L, which holds beneficial title to the loans. Administration of this portfolio has been outsourced to Capita Mortgage Services Limited. However, the Company retains the ultimate liability for the administration, including all TCF requirements. In order to mitigate the risk of losses from the administration of this portfolio, the Company has received an unlimited indemnity from IHL against administration risk until such time as the Company ceases to hold legal title.

25. Share-based payment

Equity-settled share-based payments to employees and others providing services are measured at the fair value of the equity instruments at the grant date. The fair value excludes the effect of non-market-based vesting conditions. Further details regarding the determination of the fair value of equity-settled share-based transactions are set below.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest. At each period end, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the consolidated income statement such that the cumulative expense reflects the revised estimate with a corresponding adjustment to equity.

Share-based payment expense

The expense recognised for employee services receivable during the year is as follows:

	2016	2015
	£000	£000
Expense arising from equity-settled share-based payment transactions	4,227	2,560

Whilst the expense arising from equity-settled transactions is recorded in the statement of comprehensive income, in accordance with IFRS 2 the corresponding credit entry is classified as a capital contribution received

from PGH within equity. However this capital contribution is immediately offset by a corresponding management recharge of equivalent value.

Share-based payment schemes in issue

Long-Term Incentive Plan ('LTIP')

In 2009, the Group implemented a long-term incentive plan to retain and motivate its senior management group. The awards under this plan are in the form of nil-cost options to acquire an allocated number of ordinary shares. Assuming no good leavers or other events which would trigger early vesting rights, the 2013, 2014, and 2015 LTIP awards are subject to performance conditions tied to the Company's financial performance over a three year period in respect of growth in Market Consistent Embedded Value ('MCEV') (up to 31 December 2015), growth in Own Funds (from 1 January 2016), cumulative cash generation and total shareholder return ('TSR'). The 2016 LTIP award is subject to performance conditions tied to the Company's performance in respect of cumulative cash generation and TSR.

For all LTIP awards made from 2015 onwards, a holding period applies so that any LTIP awards for which the performance vesting requirements are satisfied will not be released for a further two years from the third anniversary of the original award date. Dividends will accrue on LTIP awards until the end of the holding period. There are no cash settlement alternatives.

2016 LTIP awards were granted on 30 March 2016 and 2 June 2016. The number of shares for all outstanding LTIP awards has been increased to take into account the impact of the Group's rights issue. This adjustment has been based on the Theoretical Ex-Rights Price. The 2013 LTIP awards vested during the year. The 2014 award will vest on 26 March 2017, the 2015 award will vest on 28 September 2018 and the 2016 awards will vest on 30 March 2019 and 2 June 2019.

The fair value of these awards is estimated at the share price at the grant date, taking into account the terms and conditions upon which the instruments were granted. The fair value is adjusted in respect of the TSR performance condition which is deemed to be a 'market condition'.

Sharesave scheme

The sharesave scheme allows participating employees to save up to £250 each month over a period of either three or five years. This amount was increased to £500 each month with respect to the sharesave schemes from 2014 onwards.

Under the sharesave arrangement, participants remaining in the Group's employment at the end of the three or five year saving period are entitled to use their savings to purchase shares at an exercise price at a discount to the share price on the date of grant. Employees leaving the Group for certain reasons are able to use their savings to purchase shares if they leave less than six months before the end of their three or five year periods. The fair value of the awards has been determined using a Black-Scholes valuation model. Key assumptions within this valuation model include expected share price volatility and expected dividend yield.

The 2011 and 2012 sharesave awards were increased during 2013, and the exercise prices updated, as a result of the equity raising on 21 February 2013. All sharesave awards were increased in November 2016 following the Group's rights issue. The exercise price of these awards was also amended as a result of this issue. The 2016 sharesave awards were granted on 25 April 2016.

The following information was relevant in the determination of the fair value of the 2012 to 2016 sharesave awards in the year:

	2016 sharesave	2015 sharesave	2014 sharesave	2013 sharesave	2012 sharesave
Share price (£)	8.89	8.43	6.74	6.30	5.25
Exercise price (£)	6.39	6.29	5.13	4.76	3.96
(revised)					
Expected life (years)	3.25 and 5.25	3.25 and 5.25	3.25 and 5.25	3.25 and 5.25	3.25 and 5.25
Risk-free rate (%) based on UK Government Gilts	0.6 (for 3.25 year	0.8 (for 3.25 year	1.3 (for 3.25 year scheme)	0.4 (for 3.25 year scheme)	0.6 (for 3.25 year scheme)
commensurate with the expected term of the award	scheme) and 1.0 (for 5.25 year scheme)	scheme) and 1.2 (for 5.25 year scheme)	and 1.9 (for 5.25 year scheme)	and 0.8 (for 5.25 year scheme)	and 1.1 (for 5.25 year scheme)
Expected volatility (%) based on the share price volatility to date	30.0	30.0	30.0	30.0	30.0
Dividend yield (%)	6.0	6.3	7.9	8.5	8.0

Deferred Bonus Share Plan ('Deferred BSP')

Each year, part of the annual incentive for certain executives is deferred into Phoenix Group Holdings' shares. This grant of shares is conditional on the employee remaining in employment with the Group for a period of three years. For Deferred BSP awards made in 2015 and for those to be made in subsequent years, the three year deferral period will run to the dealing day following the three year anniversary of the announcement of the annual results. Dividends will accrue for Deferred BSP awards over the three year deferral period. The 2016 Deferred

PEARL GROUP MANAGEMENT SERVICES LIMITED

BSP was granted on 30 March 2016 and 2 June 2016 and is expected to vest on 24 March 2019. The number of shares for all outstanding Deferred BSP awards has been increased to take into account the impact of the Group's rights issue. This adjustment has been based on the Theoretical Ex-Rights Price. The 2013 Deferred BSP awards vested during the year. The 2014 awards are expected to vest on 28 March 2017 and the 2015 awards are expected to vest on 19 March 2018.

The fair value of these awards is estimated at the share price at the grant date, taking into account the terms and conditions upon which the options were granted.

Movements in the year

The following tables illustrate the number of, and movements in, share options during the year:

	LTIP Schemes	SAYE Schemes	Deferred BSP
Outstanding at 1 January 2016	2,264,827	757,477	448,856
Granted during the year	712,665	213,033	147,946
Cancelled during the year	-	(10,507)	-
Forfeited during the year	-	(6,281)	-
Sale	-	-	-
Exercised during the year	(594,641)	(145,825)	(155,297)
Rights issue	515,297	144,704	77,706
Outstanding at 31 December 2016	<u>2,898,148</u>	<u>952,601</u>	<u>519,211</u>
Outstanding at 1 January 2015	3,057,664	808,579	403,082
Granted during the year	705,957	233,763	126,768
Cancelled during the year	-	(19,151)	-
Forfeited during the year	(419,084)	(24,064)	-
Sale	-	1,407	-
Exercised during the year	(1,079,710)	(243,057)	(80,994)
Outstanding at 31 December 2015	<u>2,264,827</u>	<u>757,477</u>	<u>448,856</u>

The weighted average fair value of options granted during the year was £6.11 (2015: £6.93). The weighted average share price at the date of exercise for the rewards exercised is £7.69 (2015: £8.36). The weighted average remaining contractual life for the rewards outstanding as at 31 December 2016 is 1.3 years (2015: 1.6 years).

26. Operating leases

Operating lease rentals charged within administrative expenses amounted to £4,497,000 (2015: £4,428,000).

The Company has commitments under non-cancellable operating leases as set out below:

	2016 £000	2015 £000
Not later than one year	4,723	4,546
Later than one year and no later than five years	14,423	19,123
Later than five years	-	-

The operating lease commitments relate to St. Vincent Street, Glasgow and Juxon House, London. St. Vincent Street is currently occupied by Capita and Royal London. The lease expires in December 2020. There are no exit clauses in the lease. The lease is based on current market value and is reviewed twice yearly in each year of the term. The current rental figure was revised in June 2016.

Juxon House is currently occupied by Phoenix Group. The lease for Juxon House was renewed on 26 January 2015. The lease expires in July 2025 but the company has an option to break on 30 July 2020. The lease is based on current market value and is subject to review in July 2020.

27. Related party transactions

The Company enters into transactions with related parties in its normal course of business. These are at arm's length on normal commercial terms.

The Company provides management services to fellow subsidiaries within the Phoenix Group, in the form of staff and other services, under management services agreements. The income received by the Company for the year ended 31 December 2016 amounted to £170,464,000 (2015: £168,494,000). In addition to this, in 2015, the Company received £39,521,000 income from a fellow subsidiary, for the acceptance of various risks (note 15). The Company also received a fee of £16,000,000 (2015: £nil) from PGS as part of the profit share arrangement of which £3,200,000 (2015: £nil) has been included in income received by Group companies.

The Company charged interest on amounts due from fellow subsidiaries of £403,000 (2015: £nil). The Company incurred interest on loans from fellow subsidiaries of £1,618,000 (2015: £1,664,000) and charged interest on loans to fellow subsidiaries of £3,010,000 (2015: £2,994,000). No dividend was paid to the Company during the year (2015: £nil). The company returned capital contributions of £30,000,000 (2015: £12,000,000) to Impala Holdings Limited.

At 31 December 2016, the Company held legal title to a portfolio of residential, equity release mortgages with a fair value of £160m (2015: £162m) which it administers on behalf of PLL and its fully owned subsidiary, PER1L. However, the economic exposure to the returns on the investment resides with PLL. Any further risk is mitigated by the receipt of a guarantee from IHL.

Amounts due to related parties

	2016 £000	2015 £000
Loans due to fellow subsidiaries (note 12)	60,863	64,728
Other amounts due to parent	166	-
Other amounts due to fellow subsidiaries	<u>6,052</u>	<u>4,979</u>

Amounts due from related parties

	2016 £000	2015 £000
Loans due from fellow subsidiaries (note 19)	122,223	119,213
Other amounts due from parent	-	706
Other amounts due from fellow subsidiaries (note 20)	<u>21,467</u>	<u>69,015</u>

Key management compensation

The total compensation payable to employees classified as key management, which comprises the Directors, is disclosed in note 6.

Payments made to Directors of the Company's parent companies amounted to £5,590,270 (2015: £5,579,540) principally comprising remuneration and other benefits.

Dividends paid by the ultimate parent company to key management during the year amounted to £16,701 (2015: £11,038).

Parent and ultimate parent entity

Information on the Company's parent and ultimate parent is given in note 28.

28. Other information

The Company's principal place of business is the United Kingdom. The Company's immediate parent is Impala Holdings Limited and its ultimate parent is Phoenix Group Holdings, a company incorporated in the Cayman Islands and resident in Jersey. A copy of the financial statements of Phoenix Group Holdings can be obtained from the Company Secretary, 1st Floor, 32 Commercial Street, St. Helier, Jersey, JE2 3RU or www.thephoenixgroup.com.