

# Equity Release Holdings Limited

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## Directors and Officers

### Directors

M Clarke-Whelan  
D Wynne  
Wilmington Trust SP Services (London) Limited

### Company Secretary

Wilmington Trust SP Services (London) Limited

### Independent Auditors

PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Central Square  
29 Wellington Street  
Leeds  
LS1 4DL

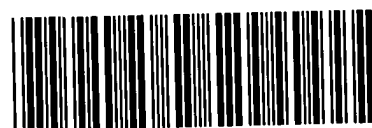
### Registered Office

c/o Wilmington Trust SP Services (London) Limited  
Third Floor  
1 King's Arms Yard  
London  
EC2R 7AF

### Company Number

Registered in England No. 4056288

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# Equity Release Holdings Limited

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# Equity Release Holdings Limited

Registered in England No. 4056288

## Strategic report

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The directors present their strategic report for Equity Release Holdings Limited (the Company) and its subsidiary holdings (the Group) for the year ended 31 December 2016.

### Review of the company's business

The Company is an investment holding company, which invests in companies established for the purpose of acquiring lifetime mortgage loans funded by the issue of loan notes.

During the term of this transaction, any amounts realised from the mortgage portfolio in excess of that due to the providers of the funding, less any related administrative costs and the Group's entitlement of 0.01% of interest accruing on the mortgages, will be payable to the originator, Aviva Equity Release UK Limited (UKER), a wholly owned subsidiary of Aviva Life & Pensions UK Limited (ultimate controlling entity Aviva plc.), in the form of deferred consideration. Any cash shortfalls will be met in the first instance out of this deferred consideration and ultimately, should shortfalls continue, will be borne by the noteholders.

Changes in market conditions have led to revisions in credit risk assumptions and changes in the discount rate. This has resulted in large fair value movements in the mortgage and loan note balances over their lives, which do not wholly off-set.

The Group bears the risk of sustained underperformance in the House Price Index (HPI), with the resultant increase in the likelihood that the mortgage debt will exceed the proceeds of the property sale at the date of redemption. A reinsurance contract is in place that has transferred some of the property risk onto a third party. However, due to the relatively low loan to values of the mortgages, where property price risk remains, house price values would have to be significantly lower than worst case market forecasts for house price deflation, coupled with an unexpected rise in short term mortality and morbidity rates, for the Group to make significant losses on negative equity.

### Financial position and performance

Income for the year is £201.6 million (2015: £74.0 million) and profit before tax is £8,000 (2015: £ 9,000).

Total equity has increased by £5,000 (2015: £6,000), reflecting the profit for the year.

### Future outlook

The directors consider that the Group will continue to operate in a manner consistent with 2016 into the foreseeable future.

### Principal risks and uncertainties

The principal risks and uncertainties to which the Group is exposed are outlined below:

#### *Market Risk*

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates, equity prices and property prices (HPI). Market risk arises within the Group due to fluctuations in the value of lifetime mortgage assets relative to the value of the property on which they are secured.

#### *Credit Risk*

Credit risk is the risk of adverse financial impact resulting from fluctuations in credit quality of third parties including default, rating transition and credit spread movements.

#### *Liquidity Risk*

Liquidity risk is the risk that if mortgages differ from expected cashflows, arising from changes in mortality and prepayment rates, liabilities cannot be met in a timely and cost-effective manner as they fall due.

## **Equity Release Holdings Limited**

### **Strategic report (continued)**

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#### *Operational Risk*

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

The Group uses a number of metrics to measure, monitor and control risks and a fuller explanation of these may be found in note 18 to the financial statements.

#### **Key performance indicators (KPIs)**

Income for the year is £201.6 million (2015: £74.0 million).

Finance costs and fee and commission expenses for the year are £54.2 million (2015: £55.1 million).

Profit for the year is £5,000 (2015: £6,000).

The increase in deferred consideration for the year is £146.9 million payable (2015: £18.2 million).

By order of the Board



**M Clarke-Whelan for and on behalf of**  
**Wilmington Trust SP Services (London) Limited**  
*Company Secretary*

*13 September 2017*

# Equity Release Holdings Limited

## Directors' report

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The directors present their annual report and audited financial statements for Equity Release Holdings Limited (the Company) and its subsidiary holdings (the Group) for the year ended 31 December 2016.

### Directors

The names of the present directors of the Company appear on page 1.

D Wynne was appointed as a director of the Company on 22 March 2017.

M H Filer resigned as a director of the Company on 10 April 2017.

### Dividend

The directors do not recommend the payment of a dividend for the year (2015: £nil).

### Financial instruments

The business of the Group includes the use of financial instruments. Details of the Group's risk management objectives and policies and exposures to risk relating to financial instruments are set out in note 18 to the financial statements.

### Future developments

Expected future developments of the Group are included within the 'Future outlook' section of the strategic report.

### Disclosure of information to the independent auditors

Each person who was a director of the Company and Group on the date that this report was approved confirms that:

- so far as the director is aware, there is no relevant audit information, being information needed by the independent auditors in connection with preparing their report, of which the independent auditors are unaware; and
- each director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the independent auditors are aware of that information.

### Directors' indemnity arrangements

At no time during the year did any director hold a material interest in any contract of significance with the Company or any of its subsidiary undertakings other than a third-party indemnity provision between each director and the Company.

### Corporate governance

The Company's ultimate controlling party is Aviva plc. The directors of Aviva Group companies are committed to high standards of Corporate Governance and support, but do not fully implement, The UK Corporate Governance Code (September 2012) ('the Corporate Governance Code'). The Group's Corporate Governance manual is available on the Group website at [www.aviva.com](http://www.aviva.com).

A Group Reporting Manual, including International Financial Reporting Standards (IFRS), has been defined and rolled out across the Group. A Financial Reporting Control Framework (FRCF) is in place across the Group. FRCF relates to the preparation of reliable financial reporting and preparation of local financial statements in accordance with IFRS. FRCF also allows compliance with the requirements of the Sarbanes-Oxley Act 2002.

The FRCF process follows a risk based approach, with management identification, assessment (documentation and testing), remediation as required, reporting and certification over key financial reporting related controls. Management quality assurance procedures over the application of the FRCF process are signed off by the business unit and regional Chief Executives and Chief Financial Officers.

# **Equity Release Holdings Limited**

## **Directors' report (continued)**

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### **Statement of directors' responsibilities**

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. In preparing the group financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standards Board (IASB). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and company and of the profit or loss of the group and company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union and IFRSs issued by IASB have been followed for the group financial statements and IFRSs as adopted by the European Union have been followed for the company financial statements, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group and company's transactions and disclose with reasonable accuracy at any time the financial position of the group and company and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

The directors are also responsible for safeguarding the assets of the group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board



**M Clarke-Whelan for and on behalf of**  
**Wilmington Trust SP Services (London) Limited**  
*Company Secretary*

*13 September 2017*

# **Equity Release Holdings Limited**

## **Independent auditors' report to the members of Equity Release Holdings Limited**

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### **Report on the financial statements**

#### **Our opinion**

In our opinion:

- Equity Release Holdings Limited's group financial statements and company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the company's affairs as at 31 December 2016 and of the group's profit and the group's and the company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

#### **Separate opinion in relation to IFRSs as issued by the IASB**

As explained in the accounting policies to the financial statements, the group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB). In our opinion, the group financial statements comply with IFRSs as issued by the IASB.

#### **What we have audited**

The financial statements, included within the Annual Report, comprise:

- the consolidated and company statements of financial position as at 31 December 2016;
- the consolidated income statement for the year then ended;
- the consolidated statements of cash flows for the year then ended;
- the consolidated and company statements of changes in equity for the year then ended;
- the accounting policies; and
- the notes to the financial statements, which include other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law and, as regards the company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

#### **Opinions 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; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the group, the company and their environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

#### **Other matters on which we are required to report by exception**

##### **Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

# **Equity Release Holdings Limited**

## **Independent auditors' report to the members of Equity Release Holdings Limited (continued)**

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### **Directors' remuneration**

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

### **Responsibilities for the financial statements and the audit**

#### **Our responsibilities and those of the directors**

As explained more fully in the Statement of directors' responsibilities 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) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

#### **What an audit of financial statements involves**

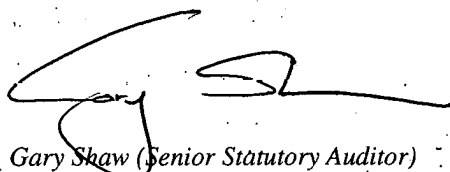
We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the group's and 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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report 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. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.



*Gary Shaw (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Leeds*

*13 September 2017*



# Equity Release Holdings Limited

## Accounting policies

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The Company, a limited company, which is incorporated and domiciled in the United Kingdom (UK), invests in companies established for the purpose of acquiring mortgage portfolios.

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

### **(A) Basis of presentation**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU), and those parts of the Companies Act 2006 applicable to those reporting under IFRS. In addition to fulfilling their legal obligation to comply with IFRS as adopted by the EU, the Group has also complied with IFRS as issued by the IASB and applicable at 31 December 2016. The financial statements have been prepared under the historical cost convention, except for mortgage loans and those financial instruments and financial liabilities (including derivative instruments) at fair value through profit and loss.

The financial statements are prepared on the going concern basis and in accordance with the Companies Act 2006.

The financial statements are stated in sterling, which is the Group's functional and presentational currency. Unless otherwise noted, the amounts shown in these financial statements are in thousands of pounds sterling (£'000).

Subsidiaries are all entities (including structured entities) over which the group has control. The group controls an entity when the group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the group.

The Company has elected not to present a Company Profit & Loss Account in accordance with the exemption under section 408 of the Companies Act 2006.

Minor clarifications to existing guidance on a number of standards became effective for the reporting period beginning on 1 January 2016. The principle clarifications are to IAS 16, Property, Plant and Equipment, IAS 38, Intangible Assets and IAS 27, Separate Financial Statements. The amendments do not have any impact on the Group's financial statements.

The IASB has issued three new standards which are not yet effective and have not been adopted early by the Group.

#### *(i) IFRS 9, Financial Instruments*

In July 2014, the IASB published IFRS 9, Financial Instruments, which will replace IAS 39, Financial Instruments: Recognition and Measurement. The standard incorporates new classification and measurement requirements for financial assets, the introduction of an expected credit loss impairment model which will replace the incurred loss model of IAS 39, and new hedge accounting requirements. The impact of the adoption of the new standard will be fully assessed by the Company during 2017. The standard applies to accounting periods beginning on or after 1 January 2018 and has been endorsed by the EU.

#### *(ii) IFRS 15, Revenue from Contracts with Customers*

IFRS 15 will replace IAS 18, Revenue, and establishes a model to be applied to all contracts with customers, except for insurance contracts, financial instruments and lease contracts. The impact of the adoption of the new standard will be fully assessed by the Company during 2017. The standard applies to accounting periods beginning on or after 1 January 2018 and has been endorsed by the EU.

#### *(iii) IFRS 16, Leases*

In January 2016, the IASB published IFRS 16, Leases, which will replace IAS 17, Leases. The standard removes the distinction between finance leases and operating leases for lessees, and proposes a new model whereby lessees include all lease contracts on the balance sheet. The impact of the adoption of IFRS 16 will be fully assessed by the Company during 2017. The standard applies to accounting periods beginning on or after 1 January 2019 and has not yet been endorsed by the EU.

## **Equity Release Holdings Limited**

### **Accounting policies (continued)**

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The IASB has issued a number of amendments to standards which are not yet effective and have not been adopted early by the Group.

- IAS 12, Recognition of Deferred Tax Assets for Unrealised Losses
- IAS 7, Disclosure Initiative
- IFRS 2, Classification and Measurement of Share-Based Payment Transactions

These have not yet been endorsed by the EU. The amendments are not expected to have a material impact on the financial statements of the Group.

#### **(B) Critical accounting estimates and judgements**

The preparation of the Group's financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expense. These major areas of judgement on policy application are summarised below:

- (i) Estimation of fair value of loan assets (set out in policy L and note 8)
- (ii) Estimation of fair value of borrowings (set out in policy Q and note 14)

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and their predictions of future events and actions. Actual results may differ from those estimates, possibly significantly. The list below sets out those items we consider particularly susceptible to changes in estimates and assumptions, and the relevant accounting policy:

- (i) Financial instruments (set out in policy J)
- (ii) Derivative financial instruments (set out in policy K)
- (iii) Deferred consideration (set out in policy O)
- (iv) Borrowings (set out in policy Q)

#### **(C) Fair value measurement**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. This presumes that the transaction takes place in the principal (or most advantageous) market under current market conditions. Fair value is a market-based measure and in the absence of observable market prices in an active market, it is measured using the assumptions that market participants would use when pricing the asset or liability.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received. In certain circumstances, the fair value at initial recognition may differ from the transaction price. If the fair value is not evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging), or is based on a valuation technique whose variables include only data from observable markets, then the difference between the fair value at initial recognition and the transaction price is not recognised immediately in the income statement but deferred and recognised in the income statement on an appropriate basis over the life of the instrument but no later than when the valuation is supported wholly by observable market data or the transaction is closed out or otherwise matured.

#### **(D) Subsidiaries**

Subsidiaries are stated at fair value, which is based on net asset value. Net asset value is estimated using applicable valuation models.

#### **(E) Segment reporting**

In compliance with IFRS 8, Segment Reporting, the Group must report financial information by segment. The Group operates in only one business and geographical segment and the Group has complied with the disclosure requirements for an entity that has a single reportable segment.

## **Equity Release Holdings Limited**

### **Accounting policies (continued)**

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#### **(F) Fee and commission income**

Fee and commission income consists primarily of administration fees and early redemption fees. These fees are recognised as revenue in the period in which they are collected.

#### **(G) Interest and similar income**

Interest and similar income consists of interest receivable for the year. Interest income is recognised as it accrues, taking into account the effective yield on the investment.

#### **(H) Other operating income**

Other operating income consists of reinsurance rebates which are recognised on an accruals basis.

#### **(I) Fee and commission expense**

Fee and commission expense consists primarily of fees payable to the originator, UKER, for administration of the mortgage and loan note portfolios, which are recognised on an accruals basis.

#### **(J) Financial instruments**

The Group classifies the lifetime mortgages and the associated liabilities and derivative financial instruments at fair value through profit and loss, since they are managed as a portfolio on a fair value basis. Presentation at fair value provides more relevant information and ensures that any accounting mismatch is minimised.

The fair value category has two sub-categories – those that meet the definition as being held for trading and those the Group chooses to designate as fair value (referred to in this accounting policy as ‘other than trading’). Derivative financial instruments are classified as trading. All other financial instruments in the fair value category are classified as other than trading.

Changes in the fair value of trading and other than trading instruments are included in the income statement in the period in which they arise. Instruments carried at fair value are measured using a fair value hierarchy, described in note 7.

#### **(K) Derivative financial instruments**

Derivative financial instruments include interest rate swaps and other financial instruments that derive their value mainly from underlying interest rates. All derivatives are initially recognised in the statement of financial position at their fair value, which usually represents their cost. They are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices or, if these are not available, by using valuation techniques such as discounted cash flow models. All derivatives are carried as assets when the fair values are positive and as liabilities when the fair values are negative. Premiums paid for derivatives are recorded as an asset in the statement of financial position at the date of purchase, representing their fair value at that date.

All of the Group’s derivative contracts are over-the-counter (OTC). OTC derivative contracts are individually negotiated between contracting parties and include options, swaps, caps and floors. Derivatives are subject to various risks including market, liquidity and credit risk, similar to those related to the underlying financial instruments. Many OTC transactions are contracted and documented under International Swaps and Derivatives Association (ISDA) master agreements or their equivalent, which are designed to provide legally enforceable set-off in the event of default, reducing the Group’s exposure to credit risk.

The Group has collateral agreements in place between relevant counterparties. Accounting policy M below covers collateral, both received and pledged, in respect of these derivatives.

The notional or contractual amounts associated with derivative financial instruments are not recorded as assets or liabilities in the statement of financial position as they do not represent the fair value of these transactions. These amounts are disclosed in note 19.

# Equity Release Holdings Limited

## Accounting policies (continued)

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### *Interest rate swaps*

Interest rate swaps are contractual agreements between two parties to exchange periodic payments in the same currency, each of which is computed on a different interest rate basis, on a specified notional amount. Most interest rate swaps involve the net exchange of payments calculated as the difference between the fixed and floating rate interest payments. Exposure to gain or loss on swap contracts will increase or decrease over their respective lives as a function of maturity dates, interest rates, and the timing of payments.

### **(L) Loans**

Lifetime mortgages are designated at fair value through profit and loss, since they are managed as a portfolio on a fair value basis, and presentation at fair value provides more relevant information and ensures that any accounting mismatch with the associated liabilities is minimised. The fair values are estimated using discounted cash flow models. These include a risk adjusted discount rate to reflect the risks associated with these products. They are revalued at each period end, with movements in their fair values being taken to the income statement.

### **(M) Collateral**

The Group receives and pledges collateral in the form of non-cash assets in respect of certain derivative contracts and loans, in order to reduce the credit risk of these transactions.

Non-cash collateral pledged is not derecognised from the statement of financial position unless the Group defaults on its obligations under the relevant agreement, and therefore continues to be recognised on the statement of financial position within the appropriate asset classification.

### **(N) Statement of cash flows**

#### *Cash and cash equivalents*

Cash and cash equivalents consist of cash at banks and in hand, deposits held on call with banks, treasury bills and other short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are those with less than three months' maturity from the date of acquisition, or which are redeemable on demand with only an insignificant change in their fair values.

#### *Operating cash flows*

Purchases and sales of loans and financial instruments are included within operating cash flows as they represent the operating activities of the Group.

### **(O) Deferred consideration**

During the term of this securitisation transaction, any amounts realised from the mortgage portfolio in excess of that due to the providers of the funding, less any related administrative costs and the Group's entitlement to 0.01% of interest accruing on the mortgages, will be payable to the originator, UKER, in the form of deferred consideration. Any cash shortfalls will be met in the first instance out of this deferred consideration and ultimately, should shortfalls continue, will be borne by the noteholders.

Where the cumulative income of the Group exceeds the expenditure, the gains are recorded in the statement of financial position within liabilities as deferred consideration.

### **(P) Income taxes**

The current tax expense is based on the taxable profits for the year, after any adjustments in respect of prior years. Taxable profits are computed in accordance with the provisions of current UK tax legislation. Tax, including tax relief for losses if applicable, is allocated over profits before taxation and amounts charged or credited to reserves as appropriate.

Provision is made for deferred tax liabilities, or credit taken for deferred tax assets, using the liability method, on all material temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

## **Equity Release Holdings Limited**

### **Accounting policies (continued)**

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Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

#### **(Q) Borrowings**

Loan notes backed by mortgages are designated at fair value through profit and loss as presentation at fair value provides more relevant information and ensures that any accounting mismatch is minimised. The fair values are estimated using discounted cash flow models, as described in note 7.

Borrowings that provide liquidity only are valued at amortised cost. The effective interest rate method is used for loans held at amortised cost, which consist of amounts owed to credit institutions and a subordinated loan.

All borrowing costs are expensed as they are incurred.

#### **(R) Share capital**

##### *Equity instruments*

An equity instrument is a contract that evidences a residual interest in the assets of an entity after deducting all its liabilities. Accordingly, a financial instrument is treated as equity if:

- (i) there is no contractual obligation to deliver cash or other financial assets or to exchange financial assets or liabilities on terms that may be unfavourable; and
- (ii) the instrument will not be settled by delivery of a variable number of shares or is a derivative that can be settled other than for a fixed amount of cash, shares or other financial assets.

#### **(S) Payables and other financial liabilities**

Financial liabilities are initially recognised at fair value and subsequently held at amortised cost. Payables mainly comprise derivatives and accrued interest. The accounting policy for derivatives is described in policy K above.

**Equity Release Holdings Limited**  
**Consolidated income statement**  
**For the year ended 31 December 2016**

	Note	2016 £'000	2015 £'000
<b>Income</b>			
Interest and similar income	G & 1	75,550	74,647
Net gains/(losses) on financial instruments	J & 1	121,886	(4,837)
Fee and commission income	F & 1	4,054	4,030
Other operating income	H & 1	101	143
		<b>201,591</b>	<b>73,983</b>
<b>Expenses</b>			
Fee and commission expense	I & 2	(3,814)	(3,844)
Other operating costs	2	(147,337)	(18,901)
Finance costs	2	(50,432)	(51,229)
		<b>(201,583)</b>	<b>(73,974)</b>
<b>Profit before tax</b>		<b>8</b>	<b>9</b>
Tax charge	P & 5	(3)	(3)
<b>Profit for the year</b>		<b>5</b>	<b>6</b>

The Group has no other comprehensive income.

The accounting policies (identified alphabetically) on pages 9 to 13 and notes (identified numerically) on pages 19 to 36 are an integral part of these financial statements.

**Equity Release Holdings Limited**  
**Consolidated statement of financial position**  
**As at 31 December 2016**

	Note	2016 £'000	2015 £'000
<b>Assets</b>			
Loans	L & 8	1,347,261	1,234,504
Receivables	9	191	565
Prepayments and accrued income		36	50
Cash and cash equivalents	N & 16	83,374	72,951
<b>Total assets</b>		<b>1,430,862</b>	<b>1,308,070</b>
<b>Equity</b>			
Ordinary share capital	R & 10	-	-
Retained earnings	11	82	77
<b>Total equity</b>		<b>82</b>	<b>77</b>
<b>Liabilities</b>			
Tax liabilities	P & 12	3	3
Deferred consideration	O & 13	322,083	175,190
Borrowings	Q & 14	1,057,361	1,079,969
Payables and other financial liabilities	S & 15	51,333	52,831
<b>Total liabilities</b>		<b>1,430,780</b>	<b>1,307,993</b>
<b>Total equity and liabilities</b>		<b>1,430,862</b>	<b>1,308,070</b>

The financial statements were authorised for issue by the Board of directors on 13 September 2017 and were signed on its behalf by



**M Clarke-Whelan for and on behalf of**  
**Wilmington Trust SP Services (London) Limited**  
*Director*

The accounting policies (identified alphabetically) on pages 9 to 13 and notes (identified numerically) on pages 19 to 36 are an integral part of these financial statements.

**Equity Release Holdings Limited**  
**Consolidated and company statements of changes in equity**  
**For the year ended 31 December 2016**

<i>The Group and Company</i>	<b>Note</b>	<b>Ordinary share capital £'000</b>	<b>Retained earnings £'000</b>	<b>Total equity £'000</b>
Balance at 1 January 2015		-	71	71
Profit for the year	11	-	6	6
<b>Balance at 31 December 2015</b>		<b>-</b>	<b>77</b>	<b>77</b>
Profit for the year	11	-	5	5
<b>Balance at 31 December 2016</b>		<b>-</b>	<b>82</b>	<b>82</b>

The accounting policies (identified alphabetically) on pages 9 to 13 and notes (identified numerically) on pages 19 to 36 are an integral part of these financial statements.



**Equity Release Holdings Limited**  
**Consolidated and company statements of cash flows**  
**For the year ended 31 December 2016**

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The cash flows presented in this statement cover all the Group's activities.

	Note	2016 £'000	2015 £'000
<b>Cash flows from operating activities</b>			
Cash generated from operations	16(a)	23,605	20,766
Tax paid		(3)	(3)
<b>Net cash generated from operating activities</b>		<b>23,602</b>	<b>20,763</b>
<b>Cash flows from financing activities</b>			
Repayment of borrowings		(13,179)	(8,113)
<b>Net cash used in financing activities</b>		<b>(13,179)</b>	<b>(8,113)</b>
<b>Net increase in cash and cash equivalents</b>		<b>10,423</b>	<b>12,650</b>
Cash and cash equivalents at 1 January		72,951	60,301
<b>Cash and cash equivalents at 31 December</b>	16(b)	<b>83,374</b>	<b>72,951</b>

Cash flows for the Company are £nil for the year (2015: £nil)

The accounting policies (identified alphabetically) on pages 9 to 13 and notes (identified numerically) on pages 19 to 36 are an integral part of these financial statements.

**Equity Release Holdings Limited**  
**Company statement of financial position**  
**As at 31 December 2016**

	Note	2016 £'000	2015 £'000
<b>Assets</b>			
Investments in subsidiaries	D & 6	121	116
<b>Total assets</b>		<b>121</b>	<b>116</b>
<b>Equity</b>			
Ordinary share capital	R & 10	-	-
Retained earnings	11	82	77
<b>Total equity</b>		<b>82</b>	<b>77</b>
<b>Liabilities</b>			
Borrowings	Q & 14	39	39
<b>Total liabilities</b>		<b>39</b>	<b>39</b>
<b>Total equity and liabilities</b>		<b>121</b>	<b>116</b>

The financial statements were authorised for issue by the Board of directors on 13 September 2017 and were signed on its behalf by



**M Clarke-Whelan for and on behalf of**  
**Wilmington Trust SP Services (London) Limited**  
*Director*

The accounting policies (identified alphabetically) on pages 9 to 13 and notes (identified numerically) on pages 19 to 36 are an integral part of these financial statements.

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016**

**1. Income**

	2016 £'000	2015 £'000
<i>The Group</i>		
<b>Interest and similar income</b>	<b>75,550</b>	<b>74,647</b>
<b>Financial instruments</b>		
Unrealised (losses)/gains on derivative contracts and embedded loans	(8,033)	1,130
Unrealised gains/(losses) on mortgage loans	126,132	(26,487)
Unrealised gains on loan notes	3,787	20,520
	<b>121,886</b>	<b>(4,837)</b>
<b>Fee and commission income</b>	<b>4,054</b>	<b>4,030</b>
<b>Other operating income</b>		
Reinsurance rebates	101	143
<b>Total income</b>	<b>201,591</b>	<b>73,983</b>

All revenue from external customers is derived from interest income received on mortgage loans and early redemption fees received. All revenue and non-current assets are derived in the United Kingdom and are attributable to one segment only. The Group has no reliance on major customers as all mortgages are granted on individual personal property.

**2. Expenses**

	2016 £'000	2015 £'000
<i>The Group</i>		
<b>Fee and commission expense</b>	<b>3,814</b>	<b>3,844</b>
<b>Other operating costs</b>		
Audit fees	126	96
Losses due to negative equity	318	556
Increase in deferred consideration	146,893	18,249
	<b>147,337</b>	<b>18,901</b>
<b>Finance costs</b>		
Interest expense on:		
Securitised mortgage loan notes	44,897	45,310
Financial liabilities held at amortised cost	1,202	1,225
Swap interest	2,310	2,700
Liquidity facility	644	650
Other	1,379	1,344
	<b>50,432</b>	<b>51,229</b>
<b>Total expenses</b>	<b>201,583</b>	<b>73,974</b>

2015 figures have been restated to show losses due to negative equity as a separate item under other operating expenses (previously included as fee and commission expense).

There were no employees during the year.

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

**3. Directors' emoluments**

Wilmington Trust SP Services (London) Limited received fees of £45,004 (2015: £45,510) including VAT during the year ended 31 December 2016 from the Group, in respect of structuring and management services.

**4. Independent auditors' remuneration**

	2016 £'000	2015 £'000
Fees for the statutory audit of these financial statements for the year	97	96

A proportion of audit fees in respect of audit of fellow group undertakings are borne by the Company.

Fees paid to PricewaterhouseCoopers LLP and its associates for services other than the statutory audit of the Group are not disclosed in these financial statements since the consolidated financial statements of the Company's ultimate controlling entity, Aviva plc (see note 21), are required to disclose other (non-audit) services on a consolidated basis.

**5. Tax charge**

**(a) Tax charged to the income statement**

The total tax charged to the income statement is as follows:

	2016 £'000	2015 £'000
<i>The Group</i>		
<b>Current tax</b>		
For the year	3	3
Total tax charged in the income statement (note 5(b))	3	3

**(b) Tax reconciliation**

The tax on the Group's profit before tax differs from (2015: differs from) the tax calculated at the standard UK corporation tax rate as follows:

	2016 £'000	2015 £'000
<i>The Group</i>		
Profit before tax	8	9
Tax calculated at standard UK corporation tax rate of 20% (2015: 20%)	2	2
Disallowable expenses	1	1
Total tax charge for the year (note 5(a))	3	3

Finance (No 2) Act 2015 introduced legislation reducing the rate of corporation tax from 20% at 1 April 2016 to 19% from 1 April 2017 and to 18% from 1 April 2020. The Finance Act 2016, which received Royal Assent on 15 September 2016, will reduce the corporation tax rate further to 17% from 1 April 2020. The changes in future tax rates are not expected to have a material impact on the Group's net assets.

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

**6. Investments in subsidiaries**

	2016 £'000	2015 £'000
<i>The Company</i>		
At 1 January	116	110
Fair value gains	5	6
At 31 December	121	116

The Company's subsidiaries, which are wholly owned and incorporated in England, are shown below:

Subsidiary	Principal activity
Equity Release Funding (No.1) plc (ERF1)	Investment in Lifetime mortgages
Equity Release Funding (No.2) plc (ERF2)	Investment in Lifetime mortgages
Equity Release Funding (No.3) plc (ERF3)	Investment in Lifetime mortgages

The registered office of all subsidiary undertakings is: c/o Wilmington Trust Services (London) Limited, Third Floor, 1 King's Arms Yard, London, EC2R 7AF.

The investments represent 2 fully paid ordinary shares and 49,998 partly paid at £0.25 ordinary shares in ERF1, ERF2 and ERF3. These shares are held at their fair value which approximates to the net asset value in the financial statements.

**7. Fair value methodology**

**(a) Basis for determining fair value hierarchy of financial instruments**

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the 'fair value hierarchy' described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

***Quoted market prices in active markets – ("Level 1")***

Inputs to Level 1 fair values are quoted prices (unadjusted) in active markets for identical assets and liabilities.

***Modelled with significant observable market inputs – ("Level 2")***

Inputs to Level 2 fair values are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the instrument. Level 2 inputs include the following:

- Quoted prices for similar assets and liabilities in active markets;
- Quoted prices for identical or similar assets and liabilities in markets that are not active, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly;
- Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads);
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means (market-corroborated inputs).

***Modelled with significant unobservable market inputs – ("Level 3")***

Inputs to Level 3 fair values are unobservable inputs for the asset or liability. Unobservable inputs may have been used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability.

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

Therefore, unobservable inputs reflect the assumptions the business unit considers that market participants would use in pricing the asset or liability. Examples are lifetime mortgage loans and the associated borrowings backing these loans.

***Changes to valuation techniques***

There were no changes in the valuation techniques during the year compared to those described in the 2015 financial statements.

***Comparison of the carrying amount and fair values of financial instruments***

Set out below is a comparison of the carrying amounts and fair values of financial instruments carried at amortised cost:

		2016		2015
	Fair value	Carrying amount	Fair value	Carrying amount
<i>The Group</i>	£'000	£'000	£'000	£'000
<b>Financial liabilities</b>				
Borrowings carried at amortised cost	20,734	27,959	19,708	29,882

Fair value of the following assets and liabilities approximate to their carrying amounts:

- Receivables
- Prepayments and accrued income
- Cash and cash equivalents
- Payables and other financial liabilities (excluding derivative liabilities)

**(b) Fair value hierarchy analysis**

An analysis of financial assets and liabilities according to fair value hierarchy is given below:

	2016		
	Fair Value Hierarchy		
<i>The Group</i>	Level 2	Level 3	Total Fair Value
	£'000	£'000	£'000
<b>Financial assets</b>			
Loans	-	1,347,261	1,347,261
<b>Financial liabilities</b>			
Borrowings	-	(1,029,402)	(1,029,402)
Derivative liabilities	(30,907)	-	(30,907)
Total financial liabilities	(30,907)	(1,029,402)	(1,060,309)
	2015		
	Fair Value Hierarchy		
<i>The Group</i>	Level 2	Level 3	Total Fair Value
	£'000	£'000	£'000
<b>Financial assets</b>			
Loans	608,407	626,097	1,234,504
<b>Financial liabilities</b>			
Borrowings	(945,008)	(105,079)	(1,050,087)
Derivative liabilities	(23,591)	-	(23,591)
Total financial liabilities	(968,599)	(105,079)	(1,073,678)

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

*Assets and liabilities for which fair value is disclosed*

The table below shows the fair values and the level in which they are categorised in the fair value hierarchy of assets and liabilities that are not carried at fair value but for which fair value is disclosed in the notes.

	Level 3	
	2016	2015
	£'000	£'000
<i>The Group</i>		
Borrowings measured at amortised cost	<b>20,734</b>	19,708

*Transfers between levels of the fair value hierarchy*

For recurring fair value measurements, the Group determines whether transfers have occurred between the levels of the fair value hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of the reporting year. If transaction prices used in the valuation of loans and loan notes becomes stale, and in the absence of any additional market transactions, the instruments may be reclassified.

**(c) Further information on Level 3 financial instruments**

The table below shows movements in the Level 3 financial assets and liabilities measured at fair value.

	2016		2015	
	Loans	Borrowings	Loans	Borrowings
	£'000	£'000	£'000	£'000
<i>The Group</i>				
<b>Total funds</b>				
Balance at 1 January	626,097	(105,079)	644,374	(101,971)
Additions	36,531	(2,059)	34,915	(1,991)
Redemptions	(35,335)	2,399	(41,643)	1,299
Gains/(losses) recognised in the year	2,598	(5,962)	(11,549)	(2,416)
Transfers in to Level 3	717,370	(918,701)	-	-
<b>Balance at 31 December</b>	<b>1,347,261</b>	<b>(1,029,402)</b>	626,097	(105,079)

The Group assesses the fair value hierarchy of its financial investments annually at 31 December. Transfers between fair value hierarchy levels are deemed to have occurred at the assessment date.

The net losses recognised in the income statement during the year for Level 3 assets and liabilities were £3.4 million (2015: losses of £14.0 million).

Lifetime mortgage loans amounting to £1,347.3 million (2015: £626.1 million) and securitised mortgage loan notes amounting to £1,029.4 million (2015: £105.1 million) are classified as Level 3 and valued using a discounted cash flow model. Cash flows are adjusted for credit risk and discounted using a yield curve and global assumptions for the liquidity premium. The model derives a best estimate view on property growth and explicitly calculates the additional return that would be demanded by investors due to uncertainties in the asset cash flows. The assets and liabilities have been classified as Level 3 as assumptions used to derive the property growth rates, mortality and morbidity assumptions, cost of capital, liquidity premium and credit risk are not deemed to be market observable. The liquidity premium has ranged between 220bps to 275bps.

During 2016 there has been a change to the model and assumptions used to value the lifetime mortgage loans and securitised mortgage loan notes. The loans and loan notes were previously valued using an internal Discounted Cash Flow (DCF) model. The revised DCF model, as described below, incorporates a greater number of inputs relevant to calculating a fair value of lifetime mortgage loans and the related liabilities, and provides a more robust fair value. Several significant inputs to the revised model are not deemed to be market observable, resulting in the transfer of the remainder of the loans and the loan notes to Level 3.

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

The impact of applying the revised model to these assets and liabilities has been to recognise net fair value gains of £103.8 million in profit before tax for the year.

The table below shows the sensitivity of the fair value of Level 3 investments at 31 December to changes in unobservable inputs to a reasonable alternative:

	2016		Change in fair value	
	Fair value £m	Most significant unobservable inputs	Positive impact £m	Negative impact £m
<i>The Group</i>				
<b>Loans</b>				
Lifetime mortgage loans	1,347.3	Credit spreads – 50bps	78.7	(56.3)
Securitised mortgage loan notes	(1,029.4)	Credit spreads – 50bps	35.2	(37.3)

An increase in credit spreads used in the discounted cash flow model for lifetime mortgage loans will decrease the fair value of the assets. An increase in credit spreads used in the discounted cash flow model for securitised mortgage loan notes will decrease the fair value of the liabilities. Fair value movements in assets and liabilities arising from change in credit spread will largely offset.

## 8. Loans

### (a) Carrying amounts

On 30 March 2001 and 11 June 2002, the Group purchased £214.0 million and £276.0 million respectively of mortgage assets at market value from UKER. These assets are a portfolio of UK Lifetime fixed rate residential mortgages, wholly secured on properties in the UK. On 27 June 2003, the Group purchased £404.0 million of mortgage assets at market value from UKER. These assets are a portfolio of UK lifetime fixed rate and index linked residential mortgages, wholly secured on properties in the UK. In order to fund the purchase of these mortgage assets, the Group issued a series of mortgage backed notes. Under the terms of this arrangement, the rights of the providers of the finance for this transaction are limited to the mortgage assets purchased and any related income generated by the portfolio, and are without recourse to UKER.

UKER is not obliged to support any losses which may arise in respect of the mortgage assets. During the term of these transactions, any amounts realised from the mortgage portfolios in excess of that due to the providers of the funding, less any related administrative costs and the Group's entitlement to 0.01% of interest accruing on the mortgages, will be payable to UKER in the form of deferred consideration. UKER administers the mortgage portfolios. The carrying amounts of loans at 31 December were as follows:

	2016 £'000	2015 £'000
<i>The Group</i>		
Lifetime mortgage loans (gross of indemnified guarantees)	1,281,552	1,160,889
Fair value of indemnified guarantees	65,709	73,615
<b>Lifetime mortgage loans</b>	<b>1,347,261</b>	<b>1,234,504</b>

Of the above total £1,264.0 million (2015: £1,143.7 million) is expected to be recovered more than one year after the statement of financial position date. This is because the majority of the loans are lifetime mortgages which by their nature do not have any contractual maturity and significant levels of early redemption are not anticipated.

The change in fair value of mortgage loans during the year attributable to a change in credit risk was a gain of £139.6 million (2015: gain of £8.1 million). The cumulative change attributable to changes in credit risk to 31 December 2016 was a loss of £67.9 million (2015: loss of £207.5 million). Further details of the fair value methodology are given in note 7.



**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

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**(b) Collateral**

The Group holds collateral in respect of all loans, in order to reduce the risk of non-recovery. This collateral generally takes the form of liens or charges over properties. As security for the lifetime mortgage and any other money owing from the customer, the property is charged to the Group by way of a legal mortgage with full title guarantee.

**9. Receivables**

	2016	2015
<i>The Group</i>	£'000	£'000
Amounts due from UKER	-	499
Amounts due from other related parties	191	66
	<b>191</b>	<b>565</b>

None of the above total (2015: £nil) is expected to be recovered more than one year after the statement of financial position date.

**10. Ordinary share capital**

Details of the Company's ordinary share capital at 31 December are as follows:

	2016	2015
	£	£
The allotted, called up and fully paid share capital of the Company was:		
2 (2015: 2) ordinary shares of £1 each	2	2

All shares are of the same class and rank pari passu.

**11. Retained earnings**

	2016	2015
<i>The Group and Company</i>	£'000	£'000
At 1 January	77	71
Profit for the year	5	6
At 31 December	<b>82</b>	<b>77</b>

**12. Tax liabilities**

**(a) General**

The Group has no tax liabilities payable in more than one year (2015: £nil).

**(b) Deferred tax**

The Group had no recognised or unrecognised deferred tax balances at the year end (2015: £nil).

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

**13. Deferred consideration**

	2016	2015
<i>The Group</i>	£'000	£'000
Balance at 1 January	175,190	156,941
Increase in deferred consideration	146,893	18,249
Balance at 31 December	322,083	175,190

All of the above consideration (2015: all) is expected to be paid more than one year after the statement of financial position date.

The Group has a contractual obligation to pay any surplus on the maturity of the fund to UKER. The deferred consideration balance represents management's best estimate at this point in time of the amount that will be payable (accounting policy O).

**14. Borrowings**

**(a) Carrying amount**

	2016	2015
<i>The Group</i>	£'000	£'000
Securitised mortgage loan notes	1,029,402	1,050,087
Subordinated debt	24,782	24,222
Amounts owed to credit institutions	3,138	5,621
Other loans	39	39
	1,057,361	1,079,969

The carrying amount of the above borrowings that are stated at amortised cost, being the subordinated debt, amounts owed to credit institutions and other loans, is £28.0 million (2015: £29.9 million). The corresponding fair value of these borrowings is £20.7 million (2015: £19.7 million).

The change in fair value of mortgage loan notes during the year attributable to a change in credit risk was a gain of £42.9 million (2015: loss of £7.8 million). The cumulative change attributable to changes in credit risk to 31 December 2016 was a gain of £118.6 million (2015: gain of £75.7 million). The above liabilities stated at fair value have been calculated in a consistent manner with the assets stated at fair value. Further details of the fair value methodology are included in note 7.

Of the above total £986.4 million (2015: £1,014.1 million) is expected to be paid more than one year after the statement of financial position date.

	2016	2015
<i>The Company</i>	£'000	£'000
Other loans	39	39

**(b) Loan notes and other borrowings**

**(i) Loan notes**

The Group loans are issued by Wilmington Trust SP Services Limited at a rate of 2.5% over base rate and will mature in the event that ERF1, ERF2 and ERF3 are wound up. The balance of these notes at 31 December 2016 is shown at fair value.

Each of the entities (ERF1, ERF2 and ERF3) are separate legal entities, with no right of offset between entities within the Group.

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

The loan notes are secured over a portfolio of mortgage loans within each legal entity, secured by first charges over residential properties in the UK. The mortgages were purchased from UKER. The notes are listed on the London Stock Exchange.

The B and M notes were issued at par, and the A2 notes and A3 notes were issued at a discount.

Interest on the notes is payable quarterly (excluding the A3 notes which is payable semi-annually) in arrears, at the following rates, unpaid interest is capitalised:

<b>£866.5 million mortgage backed loan notes</b>	<b>Capital balance outstanding at end of year (Total £867.2m)</b>	<b>Credit rating (S&amp;P, Moody's)</b>	<b>Interest rate</b>
Class A2 (i) (£197m)	£185,600,000	A-, Aaa	5.70%
Class A2 (ii) (£255m)	£250,797,000	A-, Aa1	5.88%
Class A2 (iii) (£310m)	£310,000,000	A-, Aaa	5.05%
Class A3 (£50m)	£36,000,000	A-, Aaa	2.45% (adjusted for LPI)
Class B (£42m)	£42,000,000	BBB, Aa3	LIBOR + 1.40% (LIBOR + 3.5% from Apr 2010)
Class M (£12.5m)	£42,800,000	Not rated	9.00%

The A2 (i) notes rank pari passu in point of payment and security without preference or priority amongst themselves. The A2 (i) notes rank in priority to the M notes in point of payment and security.

The A2 (ii) notes rank pari passu in point of payment and security without preference or priority amongst themselves.

The A2 (iii) and A3 notes rank pari passu in point of payment and security without preference or priority amongst themselves. The A2 (iii) and A3 notes rank in priority to the B notes in point of payment and security.

A2 (i), (ii), (iii), A3 and B notes are to be redeemed according to a redemption schedule commencing in May 2015, August 2016, July 2020, October 2033 and July 2033 respectively, although the group will be obliged to redeem (in full or in part) if certain early redemption conditions are satisfied.

Within ERF1, M notes are to be redeemed after the senior notes have been redeemed in full. The capital balance outstanding on the M notes includes £30.3 million (2015: £28.8 million) of capitalised interest. Unless previously redeemed in full, each class of notes will mature at its principal amount outstanding on the interest payment date falling in:

A2 (i) (ii) (iii) notes	February 2031, May 2032, April 2033 respectively
A3 notes	April 2023
B notes	April 2038
M notes	February 2031

ERF1, ERF2 and ERF3 may, at their option, redeem all (but not some only) of the notes at their principal amounts outstanding in the event of certain tax changes affecting the notes or the swap agreement (see note 19).

**(ii) Amounts owed to credit institutions**

ERF3 is committed to making a series of scheduled payments under the swap arrangement commencing in April 2029, which are required to be prepaid if cash is available upon repayment of the A1 notes. ERF2 and ERF3 have entered into contracts, the purpose of which is to both protect the Companies from interest rate risk on the floating rate notes, and to provide liquidity to the companies (note 19).

The existing contract for ERF3 is a non-derivative host contract (the fixed rate loan) with an embedded derivative (the interest rate swap). As the loan element of this contract is not directly funding the mortgages, it is shown as a liability under borrowings and valued at amortised cost. The interest rate swap element has been separated and accounted for as derivatives, at fair value through profit and loss (notes 15 & 19).

**Equity Release Holdings Limited**  
**Notes to the financial statements**  
**For the year ended 31 December 2016 (continued)**

At 31 December 2016 and 2015, ERF1 and ERF2 both had committed but undrawn 364 day borrowing facilities of £70 million Barclays Bank plc, which are renewed annually.

At 31 December 2016 and 2015, ERF3 had a committed but undrawn 364 day borrowing facility of £140 million with Barclays Bank plc and a committed but undrawn 364 day borrowing facility of £45 million with Citibank, which are renewed annually.

**(iii) Other borrowings**

On 27 June 2003, ERF3 entered into a subordinated loan agreement with UKER for £14.0 million at an interest rate of LIBOR + 1.75%. The capital balance outstanding on the subordinated loan includes £10.8 million (2015: £10.2 million) of capitalised interest. The subordinated loan (subordinated in point of payment and security to the notes) is to be redeemed after the notes have been redeemed in full.

**15. Payables and other financial liabilities**

	2016 £'000	2015 £'000
<i>The Group</i>		
Derivative financial liabilities (note 7(b) and note 19)	30,907	23,591
Interest payable on amounts owed to credit institutions (note 14(b)(ii))	16,514	24,304
Amounts due to UKER	3,305	2,117
Amounts due to other related parties	18	18
Other financial liabilities	589	2,801
	<b>51,333</b>	<b>52,831</b>

Of the above total, £25.6 million (2015: £30.5 million) is expected to be paid more than one year after the statement of financial position date.

**16. Consolidated statement of cash flows**

**(a) The reconciliation of profit before tax to the net cash inflow from operating activities is:**

	2016 £'000	2015 £'000
<b>Profit before tax</b>	<b>8</b>	<b>9</b>
Adjustments for:		
Fair value (gains)/losses on mortgage loans	(126,132)	26,487
Fair value gains on loan notes	(3,787)	(20,520)
Fair value losses/(gains) on derivatives and embedded loans	8,033	(1,130)
Interest receivable on mortgage loans	(75,278)	(74,383)
Changes in working capital:		
Decrease/(increase) in receivables	374	(196)
Decrease/(increase) in prepayments and accrued income	14	(7)
Increase in deferred consideration	146,893	18,249
Decrease in payables and other financial liabilities	(9,531)	(10,570)
Decrease in interest on subordinated loan	560	567
Repayment of borrowings	(6,202)	(5,414)
Proceeds from redemption of mortgages	88,653	87,674
<b>Cash generated from operations</b>	<b>23,605</b>	<b>20,766</b>

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Redemptions of mortgages are included within operating cash flows as they represent the operating activities of the Group.

**(b) Cash and cash equivalents in the consolidated statement of cash flows at 31 December comprised:**

	2016 £'000	2015 £'000
Cash at bank and in hand	<b>83,374</b>	72,951

**17. Capital**

In managing its capital, the Group seeks to retain financial flexibility by maintaining strong liquidity. The Group has committed but undrawn 364 day liquidity facilities, which have been sized to cover significant stresses on mortgage cash flows. The Group is not subject to any externally imposed capital requirements.

The Group manages IFRS shareholders' equity of £82,000 (2015: £77,000) as capital.

**18. Risk management**

**(a) Risk management framework**

The ultimate controlling party, Aviva plc, and its subsidiaries, joint ventures and associates (collectively known as "the Group") operate a risk management framework ("RMF"), which forms an integral part of the management and board processes and decision-making framework across the Group. The key elements of the Group's risk management framework comprise risk strategy and risk appetite, risk policy categorisation, enterprise-wide approach to managing risk, including how to identify, measure, manage, monitor and report risks, and risk governance and oversight (including boards and board committees, risk policies and business standards, delegated authorities and management committees, and roles and responsibilities).

The Group's approach to risk management ensures that significant existing or emerging risks are actively identified, measured, managed, monitored and reported on a continuous basis. The RMF has been adopted within the businesses collectively referred to as "UK Life" (including this Company). For the purposes of risk identification and measurement, risks are usually grouped by risk type: market, credit, life insurance, liquidity and operational risk. Risks falling within these types may affect a number of key metrics, including those relating to balance sheet strength, liquidity and profit. They may also affect the performance of the products that the Company delivers to customers and the service to customers and distributors, which can be categorised as risks to our brand and reputation or as conduct risk.

Risk models are an important tool in the Company's measurement of risk and are used to support the monitoring and reporting of the risk profile and in the consideration of the risk management actions available. The Company carries out a range of stress (where one risk factor, such as longevity, is assumed to vary) and scenario (where combinations of risk factors are assumed to vary) tests to evaluate their impact on the business and the management actions available to respond to the conditions envisaged. Board oversight of risk and risk management across the Group is maintained on a regular basis through its Risk Committee. The Board has overall responsibility for determining risk appetite, which is an expression of the risk it is willing to take. The Group's position against risk appetite is monitored and reported to the Board on a regular basis. A similar arrangement prevails at the UK Life business level.

UK Life sets limits to manage material risks to ensure the risks stay within risk tolerance (the desired or upper bound on the level of risk that UK Life will take in pursuit of its purpose and strategy). UK Life assesses the size and scale of a risk by considering how likely it is that the risk will materialise and the potential impact the risk could have on its business and its stakeholders. Where risks are outside of tolerance, actions are agreed to bring the risks within tolerance. Impact assessments are considered against financial, operational and reputational criteria and take into account underlying factors such as economic conditions, for example, UK economic growth and inflation.

# Equity Release Holdings Limited

## Notes to the financial statements

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The UK Life business has an established governance framework, which has the following key elements:

- Defined terms of reference for the legal entity boards and the associated board committees within the UK Life business, including the Risk Committee, Conduct Committee, Audit Committee, Investment Committee, With Profit Committee and Independent Governance Committee.
- A clear organisational structure with documented delegated authorities and responsibilities from the legal entity boards to CEOs and senior management. Often the senior management are assisted in discharging their delegated authority through the discussions at management committees (including the Life Executive Committee, Executive Risk Committee, Customer Committee and Asset Liability Committee).
- Adoption of the Group policy framework that defines risk appetite measures and sets out risk management and control standards for the Group's worldwide operations. The risk policies and associated business standards also set out the roles and responsibilities of Group, Businesses, Policy and Standard Owners, and Board and Management Committees.

UK Life operates within a three lines of defence risk management model that encourages close working relationships between line management and the risk function whilst facilitating independent assurance by internal audit, and the roles of the three lines of defence each contribute to embedded risk management:

- First line of defence (Management): Primary responsibility for risk identification, measurement, management, monitoring and reporting lies with management. The first-line management is responsible for the implementation and practice of risk management.
- Second line of defence (Risk function): Responsibility for reviewing and challenging the completeness and accuracy of risk identification, measurement, management, monitoring and reporting, and the adequacy of, and progress against, mitigation plans lies with the Risk function. This necessitates the early involvement by management of the risk function in key business decisions or projects, both in relation to customer and shareholder risks. The Risk function is responsible for overseeing effective operation of the Risk Management framework, particularly in relation to setting Risk Appetite, and compliance with Solvency II requirements.
- Third line of defence (Internal Audit function): Responsibility for assessing and reporting (to group and business unit audit, risk and governance committees, as appropriate) on the effectiveness of the design and operation of the framework of controls which enable risk to be assessed and managed lies with Internal Audit.

The Regulators also requires UK Life to assess its economic capital requirements to ensure that it adequately reflects the risks facing the business. UK Life has accordingly developed economic capital models that support the measurement, comparison and further understanding of its risks. The results of the modelling are incorporated into key strategic planning and decision-making processes. These models show the relative impact to economic capital from the risks faced. In turn this supports the assessment of appropriate and effective mitigating strategies where risks are outside of appetite.

#### **(b) Market risk**

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates and property prices (HPI). Market risk arises within the Group due to fluctuations in the value of lifetime mortgage assets relative to their funding and to the value of the property on which they are secured.

For each of the major components of market risk, described in more detail below, UK Life has put in place additional policies and procedures to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite. UK Life monitors adherence to this market risk policy and regularly reviews how these risks are being managed.

Profit for the Group for the year is calculated as 0.01% of interest accruing on the mortgages, with any excess or shortfall of income over expenditure reported in the statement of financial position, as described in accounting policy O. Accordingly, the impact on the Group of changes in economic factors and assumptions would be reflected in a change in the value of deferred consideration rather than profit.

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Consequently, the Group has not provided any detailed sensitivity analysis as required by IFRS 7 and the impact of the risks referred to below is restricted to the statement of financial position of the Group. Exposure to these risks is borne by the noteholders and other creditors of the Group.

**(i) Property price risk**

Property price risk arises from sustained underperformance in the HPI with the resultant increase in the likelihood that the mortgage debt will exceed the proceeds of the property sale at the date of redemption. A reinsurance contract is in place that has transferred most of the property risk onto a third party and accordingly, no sensitivity tests have been performed for changes in property prices.

The level of HPI is monitored and the impact of exposure to adverse movements in the HPI regularly reviewed. To mitigate this risk the loan to value ratios on origination are at low levels and the performance of the mortgage portfolio is monitored through dilapidation reviews. For the Group to make significant losses on negative equity, there would need to be a decrease in property values leading to house price deflation, alongside an unexpected rise in short term mortality and morbidity rates. Exposure to property price risk is borne by the noteholders and other creditors of the Group.

The HPI adjusted Loan to Value (LTV) percentage of the mortgage asset interest bearing balances as at 31 December 2016 are as follows:

<i>The Group</i>	<b>Age</b>							
	<b>Under 75</b>	<b>75-79</b>	<b>80-84</b>	<b>85-89</b>	<b>90-94</b>	<b>95-99</b>	<b>100+</b>	<b>Total</b>
<b>LTV</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Up to 40%</b>	40.4	236.2	337.8	177.4	52.6	8.2	0.4	<b>853.0</b>
<b>Up to 50%</b>	7.9	37.7	100.4	117.0	37.8	3.9	-	<b>304.7</b>
<b>Up to 60%</b>	1.0	7.6	35.4	42.7	38.2	9.0	0.8	<b>134.7</b>
<b>Up to 70%</b>	0.1	0.4	7.5	16.1	10.5	5.7	0.4	<b>40.7</b>
<b>Up to 80%</b>	-	-	0.2	3.5	3.1	3.4	-	<b>10.2</b>
<b>Up to 90%</b>	-	-	-	0.2	0.9	1.3	-	<b>2.4</b>
<b>Up to 100%</b>	-	-	-	-	-	-	-	<b>-</b>
<b>Over 100%</b>	-	-	0.5	0.4	0.2	0.5	-	<b>1.6</b>
<b>Total</b>	<b>49.4</b>	<b>281.9</b>	<b>481.8</b>	<b>357.3</b>	<b>143.3</b>	<b>32.0</b>	<b>1.6</b>	<b>1,347.3</b>

**(ii) Interest rate risk**

Interest rate risk arises primarily from fluctuations in the value of lifetime mortgage assets and their related funding and derivatives. Interest rate risk is controlled through the close matching of the duration and value of mortgages and mortgage funding and the use of derivatives, in order to hedge against unfavourable or unmatched market movements in interest rates inherent in the underlying mortgages and funding. The impact of exposure to sustained adverse interest rates is regularly monitored.

**(iii) Derivatives risk**

Derivatives are used within policy guidelines agreed by the Board of Directors of Aviva plc. Derivatives are used for risk hedging purposes and speculative activity is prohibited. OTC derivative contracts are entered into only with approved counterparties, thereby reducing the risk of credit loss.

**(iv) Prepayment risk**

Prepayment risk is the risk that the Equity Release mortgages will be repaid in a materially different profile to the expected profile at securitisation. This could lead to changes in the expected repayment rate of loan note interest and principal. This risk is mitigated by repayment charges applied to early redemptions.

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Prepayment would result in early termination payments on the swap with embedded loan. Under the terms of this liquidity arrangement the Group is committed to make a series of scheduled payments commencing in May 2028, which are required to be prepaid if cash is available. The present value of such prepayments, which represents the fair value, is partially dependent on long term swap rates. At year end it is estimated that such amounts will be £3.2 million (2015: £9.1 million) in excess of the amortised cost of the loan.

**(c) Credit risk**

Credit risk is the risk of adverse financial impact resulting from fluctuations in credit quality of third parties including default, rating transition and credit spread movements. The credit ratings of financial institutions to which the Group is exposed are monitored and if these fall below a certain threshold collateralisation or other risk mitigation techniques are implemented.

The carrying amount of assets included on the statement of financial position represents the maximum credit exposure of the Group at the statement of financial position date. There are no financial assets which are either past due or impaired.

*Concentrations of credit risk*

Individual loans represent little credit risk as the debt is ultimately repayable from the proceeds of the sale of the property on death of the mortgagee or on their transfer to long-term care.

The impact of collateral held on the net credit exposure is shown below.

			2016
<i>The Group</i>	Carrying value in the statement of financial position	Collateral held	Net credit exposure
	£'000	£'000	£'000
Loans	1,347,261	1,345,699	1,562
			2015
<i>The Group</i>	Carrying value in the statement of financial position	Collateral held	Net credit exposure
	£'000	£'000	£'000
Loans	1,234,504	1,234,504	-

Additional information in respect to collateral is provided in note 8(b). To the extent that collateral held is greater than the amount receivable that it is securing, the table above shows only an amount equal to the latter. In the event of default, any over-collateralised security would be returned to the relevant counterparty.

**(d) Liquidity risk**

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet commitments associated with financial instruments, if the cash flows from the mortgages differ from those expected. Such differences would arise from mortality, morbidity and voluntary prepayment risks.

Liquidity is provided to the Group through a swap agreement (see note 19) and at 31 December 2016 and 2015, ERF1, ERF2 and ERF3 had committed but undrawn 364 day borrowing facilities of £70 million, £70 million and £140 million respectively, which have been sized to cover significant stresses on mortgage cash flows.



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The contractual undiscounted cash flows in relation to liabilities have the following maturities:

	Within 1 year £m	1-5 years £m	Over 5 years £m	2016 No contractual maturity £m
<i>The Group</i>				
<b>Liabilities</b>				
Borrowings	70.9	331.5	978.4	3.1
Deferred consideration	-	-	-	322.1
Derivative financial liabilities	1.8	6.6	41.1	-
Payables and other financial liabilities	4.0	-	-	-
	Within 1 year £m	1-5 years £m	Over 5 years £m	2015 No contractual maturity £m
<i>The Group</i>				
<b>Liabilities</b>				
Borrowings	64.7	315.0	1,109.9	5.6
Deferred consideration	-	-	-	175.2
Derivative financial liabilities	1.8	5.4	54.3	-
Payables and other financial liabilities	4.9	-	-	-

The carrying value of the loan notes is £158.2 million higher (2015: £161.7 million higher) than the anticipated payment at maturity.

## 19. Derivative financial instruments

In June 2003, ERF3 entered into an interest rate swap agreement consisting of an interest rate swap and embedded loan, the purpose of which is to protect ERF3 both from interest rate risk in respect of the A1 floating rate notes and to provide liquidity. Under the terms of the swap ERF3 received interest of three month LIBOR and paid interest of 0.55% of the notional amount, payable quarterly. ERF3 terminated the swap during April 2013. Under the terms of the embedded loan, ERF3 is also committed to making a series of scheduled payments totalling £82.1 million commencing in April 2029.

At the point at which ERF3 terminated the swap, future interest receipts were accelerated and received in the form of an early termination payment. The market value of this early termination payment had been hedged by ERF3 through a second termination swap. If cash is available, future scheduled payments on the embedded loan would also be accelerated and repaid.

In June 2003, ERF3 entered into a further interest rate swap agreement, the purpose of which is to protect ERF3 from interest rate risk in respect of the B floating rate notes. The notional amount outstanding as at 31 December 2016 was £42.0 million (2015: £42.0 million) and the swap had an expiry date of April 2038. Under the terms of the swap, ERF3 receives interest of three month LIBOR and pays interest of 4.78% of the notional amount quarterly.

The fair value liability has been disclosed under "Derivative financial liabilities" in note 15.

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	2016			2015		
	Contract/ notional amount £'000	Fair value asset £'000	Fair value liability £'000	Contract/ notional amount £'000	Fair value asset £'000	Fair value liability £'000
<i>The Group</i>						
<b>Interest rate contracts</b>						
Interest rate swaps	42,000	-	30,907	42,000	-	23,591

**20. Financial assets and liabilities subject to offsetting, enforceable master netting arrangements and similar agreements**

Financial assets and liabilities are offset in the statement of financial position when the Group has a currently enforceable legal right to offset and has the intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously.

The Group mitigates credit risk in derivative contracts by entering into collateral agreements, where practical, and in ISDA master netting agreements to facilitate the Group's right to offset credit risk exposure. The credit support agreement will normally dictate the threshold over which collateral needs to be pledged by the Group or its counterparty.

Transactions requiring the Group or its counterparty to post collateral are typically the result of over-the-counter derivative trades, comprised mostly of interest rate swaps, currency swaps and credit swaps. These transactions are conducted under terms that are usual and customary to standard long-term borrowing, derivative, securities lending and securities borrowing activities.

	2016					
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial liabilities £'000	Gross amounts of recognised financial assets set off in the statement of financial position £'000	Net amounts of financial liabilities presented in the statement of financial position £'000	Financial instruments £'000	Collateral pledged £'000	Net amount £'000
<b>Financial liabilities</b>						
Derivatives	30,907	-	30,907	-	-	30,907
<b>Total</b>	<b>30,907</b>	<b>-</b>	<b>30,907</b>	<b>-</b>	<b>-</b>	<b>30,907</b>

The totals for each financial instrument in the tables above and below represent the total balance of the financial liability as aggregated into a line item in the statement of financial position, after including any other amounts not subject to enforceable netting arrangements.

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						2015
						Related amounts not set off in the statement of financial position
	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	Financial instruments	Collateral pledged	Net amount
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Financial liabilities</b>						
Derivatives	23,591	-	23,591	-	-	23,591
<b>Total</b>	<b>23,591</b>	<b>-</b>	<b>23,591</b>	<b>-</b>	<b>-</b>	<b>23,591</b>

**21. Related party transactions**

(a) The members of the Board of Directors are listed on page 1 of these financial statements.

Included within the loan notes issued by the three special purpose securitisation companies, Equity Release Funding (No.1) plc, Equity Release Funding (No.2) plc and Equity Release Funding (No.3) plc, are £113.8 million (2015: £112.9 million) of loan notes which are held by related parties. Interest settled during the year in respect of these loan notes amounted to £5.0 million (2015: £4.0 million).

Each of the entities (ERF1, ERF2 and ERF3) are separate legal entities, with no right of offset between entities within the group.

Amounts payable and receivable are not offset within the group financial statements unless a legal right of offset existed when the transactions occurred. Similar income and expenses payable and receivable are equally not offset unless a legal right of offset existed when the transactions occurred.

**(b) Expenses payable to related parties**

	2016 Incurred in year £'000	2015 Incurred in year £'000
UKER		
Cash handling and portfolio administration fees	3,733	3,773
Loan interest	4,404	4,219
Deferred consideration	146,893	18,249
	<b>155,030</b>	<b>26,241</b>

**(c) Payable at year end**

	2016 £'000	2015 £'000
UKER		
Deferred consideration	322,083	175,190
Subordinated debt	24,782	24,222
M note	51,771	49,632
Other	3,305	2,117
Other related parties	18	18
	<b>401,959</b>	<b>251,179</b>

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**(d) Receivable at year end**

	2016 £'000	2015 £'000
UKER	-	499
Other related parties	191	66
	<b>191</b>	<b>565</b>

**(e) Key management compensation**

Wilmington Trust SP Services (London) Limited received fees of £45,004 (2015: £45,510) including VAT during the year ended 31 December 2016 from the Group, in respect of structuring and management services.

There are no amounts receivable from or payments due to members of key management.

**(f) Parent entity**

The shares in the Company are held by Wilmington Trust SP Services (London) Limited, Director of the Company, and its nominee A Icolaro, under a declaration of trust for charitable purposes. The registered office of Wilmington Trust SP Services (London) Limited is Third Floor, 1 King's Arms Yard, London, EC2R 7AF.

**(g) Ultimate controlling entity**

The immediate and ultimate parent undertaking is Wilmington Trust SP Services (London) Limited, a company incorporated in England who hold the shares in the Company under a declaration of trust for charitable purposes.

The ultimate controlling party is Aviva plc, a company incorporated in England.

Aviva plc is the parent undertaking of the smallest and largest group of undertakings to consolidate these financial statements at 31 December 2016. The consolidated financial statements of Aviva plc are available on [www.aviva.com](http://www.aviva.com) or by application to the Group Company Secretary, Aviva plc, St. Helen's, 1 Undershaft, London EC3P 3DQ.