

Registered No: 992726

PRUDENTIAL PENSIONS LIMITED

Annual Report and Financial Statements for the year ended 31 December 2018

PRUDENTIAL PENSIONS LIMITED

Incorporated and registered in England and Wales. Registered No. 992726.
Registered office: Laurence Pountney Hill, London EC4R 0HH.

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PRUDENTIAL PENSIONS LIMITED

Directors

Ms C Bousfield (appointed 15 February 2018)
Mr M Hawes (resigned 30 November 2018)
Mr D Macmillan (resigned 12 July 2018)
Mr P Spencer - Chairman

Secretary

Prudential Group Secretarial Services Limited

Auditor

KPMG LLP, London

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2018Principal activity

The principal activity of Prudential Pensions Limited (the Company) in the course of 2018 was transacting long-term insurance business in the United Kingdom. This activity is expected to continue in 2019.

Business reviewMarket review and strategy

The Company accepts reinsurance from both The Prudential Assurance Company Limited and external parties in respect of corporate pension schemes. In addition the Company sells direct investment only business to group pension schemes. Most of the Company's products are unit-linked products. The Company has a small book of annuities reassured to its immediate parent company, The Prudential Assurance Company Limited.

The operations of the Company are managed as part of M&GPrudential, which is within the Prudential plc Group. In August 2017, Prudential plc, the ultimate parent of the Company, brought together M&G, the investment management business, with Prudential's UK and European life insurance business ('Prudential UK'), of which the Company forms a part, to create M&GPrudential.

Reinsurance accepted consists of life insurance, pension products and pension annuities. The Company remains focused on maximising value from the opportunity afforded by the fast growing need for retirement solutions.

Direct investment only clients largely invest money into the Company on behalf of defined benefit pension schemes. The key determinant of success and retention is delivery of good investment performance. The Company is further exposed to changes in the marketplace, such as competitors' fund offerings for the traditional defined benefit book, and actively monitors those changes.

In March 2018 Prudential plc announced its intention to demerge M&GPrudential from Prudential plc, resulting in two separately-listed companies, with different investment characteristics and opportunities. M&GPrudential is one of the leading retirement and savings businesses in the UK and Europe. M&GPrudential as a standalone group will continue to drive its transformation into a more capital-efficient and customer-focused business, targeting growing customer demand for comprehensive financial solutions in these markets.

In support of this, M&GPrudential announced a major investment programme in the new combined business's infrastructure to improve customer service, accelerate product development, and widen customer choice. A substantial investment will be made over the next five years in transforming the business's operations, including building the digital distribution capability, to ensure the Company is well placed to meet the growing and evolving saving and investment needs of customers across retail, institutional and direct channels.

Performance and measurement

The following table sets out the key performance indicators for the Company. These are considered to be the key metrics for the Company.

Key Performance Indicators	2018	2017	Change
	£'000	£'000	%
Profit on ordinary activities before tax	7,602	6,852	10.9 %
Shareholder funds	80,901	74,750	8.2 %
Funds under management	11,223,917	12,187,929	(7.9)%
Estimated Solvency II capital surplus	39,786	28,901	37.7 %

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2018 (continued)

Profit on ordinary activities before tax has primarily increased due to a reduction in expenses in 2018. The Company's funds under management have decreased in 2018 due to falls in global stock markets. The increase in the estimated Solvency II capital surplus is due to the emergence of IFRS profit of £6.2m and a £4.0m reduction in Solvency Capital Requirement (SCR). This is further analysed in Note 16.

Risks & uncertainties

The Company is a wholly owned subsidiary of The Prudential Assurance Company Limited which is a subsidiary of M&G Prudential Limited, of which Prudential plc is the ultimate parent company ("the Group"). The Company is subject to the Group's internal control and risk management processes as detailed in the Group Governance Manual (GGM) and Group Risk Framework (GRF). The control procedures and systems established within the Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. As such, they can only provide reasonable rather than absolute assurance against misstatement or loss, and focus on optimising the levels of risk and reward with the aim of achieving the business objectives.

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

The Company's results and financial condition are exposed to both financial and non-financial risks. The key risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

Financial risks

The Company's exposure to financial risk is limited due to the nature of the unit-linked business where policyholder liabilities are essentially the same as the net asset values backing those liabilities. The financial risk factors affecting the Company include expense risk, market risk, persistency risk, liquidity risk and credit risk. Further information on the financial risk management objectives and policies of the Company and exposure of the Company to financial risk factors is given in Note 23.

Non-financial risk

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

a) Business environment risk

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

Key dimensions to business environment risk pertaining to the Company are regulatory, political, macroeconomic, technology and market competition.

- Regulatory: Changes in UK government policy, legislation (including tax), regulation or regulatory interpretation applying to insurance companies may adversely affect the Company's product range, distribution channels, capital requirements and, consequently, reported results and financing requirements.
- Political: Global political risks have been on the rise and look set to remain heightened. Domestically, the withdrawal of the UK from the EU introduces significant uncertainties for both the UK and the EU, affecting consumer and market confidence, and potentially increasing market volatility and the risk of a downturn in economic activity.
- Macroeconomic: Macroeconomics refers to the behaviour of the aggregate economy, focusing on factors such as economic growth, inflation, productivity and unemployment. The UK macroeconomic environment is expected to become more challenging, and may adversely impact consumer behaviour.
- Technology: The Company has a high dependency on technology to operate effectively and deliver the business plan, with the maintenance, integrity and resilience of the IT infrastructure and applications paramount to meeting business and customer needs. The rising cyber threat and importance of customer data security requires increased focus on cyber and data privacy controls to mitigate the risks posed by a larger digital footprint and increasingly sophisticated attacks.

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2018 (continued)

- Competition: The UK Financial Services market is highly competitive with several factors affecting the Company's ability to sell its products and maintain its profitability. Key considerations include: charges, financial strength and ratings; investment performance; brand strength and name recognition; developing demographic trends and customers' appetite or need for certain savings products.

b) Strategic risk

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

While not directly impacted, the Company is exposed to risk associated with strategic decisions taken at the Group or Prudential UK level. The merger of M&G and Prudential UK and demerger from Prudential plc, along with the transformation strategy, will deliver capital-light, digitally-enabled, customer-focused solutions. This presents a significant opportunity to leverage scale, financial strength and complementary product and distribution capabilities but does carry an element of strategic risk for the Company in terms of overall availability of funding, resources and the wider impacts of an extensive change agenda.

(c) Reputational risk

Reputational risk is the risk of loss resulting from failure to proactively monitor stakeholder perceptions and effectively respond to events which may impact the Company's reputation.

A number of external events during 2018 provided a reminder of the potential for reputational damage, and the merger, demerger and transformation activities increase exposure to reputation risk for the Company given the potential for business stretch noted above. Reputational risk considerations are also an important part of the Company's management of Environmental, Social and Governance issues.

d) Conduct risk

Conduct risk is the risk that arises from the approach taken to customer relationships throughout the business model and is the risk that the Company's behaviours and decision making are inappropriate, leading to unfair or poor outcomes for customers.

Customer needs are central to all decisions the Company makes regarding the provision of financial products and services. In so doing, the Company aims to uphold its reputation for acting responsibly and with integrity in supporting customers whilst respecting the laws and regulations, as well as meeting internationally accepted standards of responsible business conduct.

e) Operational risk

Operational risk is the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel and systems, or from external events. This includes employee error, system failures, fraud, the risk of a cyber-attack or some other event which disrupts business processes. This definition includes operational elements inherent across other risk categories.

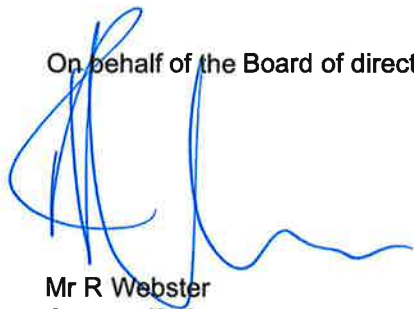
The Company's primary exposure to operational risk arises from business processes (e.g. customer administration, sales), people capabilities, operation of systems and financial reporting activity. The transformational changes to products, systems and outsourcers will all change the operational risk profile of the business, heightening it in the short-term but reducing it over the longer term. Additional exposure is anticipated as M&GPrudential demerges from Prudential plc.

f) Group risk

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

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

On behalf of the Board of directors

A handwritten signature in blue ink, appearing to be 'R Webster', written over the text 'On behalf of the Board of directors'.

Mr R Webster
On behalf of Prudential Group Secretarial Services Limited
Company Secretary
20 March 2019

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

Incorporated and registered in England and Wales. Registered no. 992726

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2018.

Likely developments, business strategies and prospects

Likely future developments in the business of the Company are discussed in the strategic report in accordance with Section 414C(11) of the Companies Act 2006 (the Act).

Corporate responsibility

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

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

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

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

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

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

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

Post balance sheet events

The Company has no post balance sheet events.

Financial performance and dividends

The state of affairs of the Company at 31 December 2018 is shown in the Statement of Financial Position on page 17. The statement of comprehensive income appears on pages 14 to 15. No interim dividend was paid in the year (2017: £Nil). No final dividend is proposed for the year (2017: £Nil).

Financial instruments

The Company is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The financial risk factors affecting the Company include market risk, credit risk and liquidity risk. Information on the financial risk management objectives and policies of the Company and the exposure of the Company to the financial risk factors is given in Note 23.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2018 (continued)

Share capital

There were no changes in the Company's share capital during 2018.

Directors

The present directors are shown on page 1.

Ms C Bousfield was appointed as a director on 15 February 2018.

Mr D Macmillan resigned as a director on 12 July 2018.

Mr M Hawes resigned as a director on 30 November 2018.

Disclosure to the auditor

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

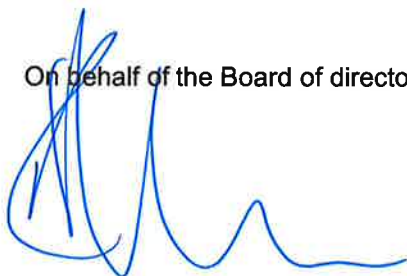
Auditor

KPMG LLP were reappointed as auditor of the Company by the members at last year's Annual General Meeting on 17 May 2018. It is the intention that KPMG LLP be reappointed under the deemed appointment rules of section 487 of the Companies Act 2006.

Directors' and officers' protection

Prudential plc has arranged appropriate insurance cover in respect of legal action against directors and senior managers of companies within the Prudential Group. In addition, the Articles of Association of the Company provide for the directors, officers and employees of the Company to be indemnified in respect of liabilities incurred as a result of their office. Prudential plc also provides protections for directors and senior managers of companies within the Group against personal financial exposure they may incur in their capacity. These include qualifying third party indemnity provisions (as defined by the relevant Companies Act) for the benefit of directors of Prudential plc, including, where applicable, in their capacity as a director of the Company and other companies within the Group. These indemnities were in force during 2018 and remain in force.

On behalf of the Board of directors



Mr R Webster
On behalf of Prudential Group Secretarial Services Limited
Company Secretary
20 March 2019

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

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

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101, *Reduced Disclosure Framework*.

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

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

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



Independent auditor's report

to the members of Prudential Pensions Limited

1. Our opinion is unmodified

We have audited the financial statements of Prudential Pensions Limited ("the Company") for the year ended 31 December 2018 which comprise the statement of comprehensive income, statement of financial position, statement of changes in equity and the related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of Company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework*; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were appointed as auditor by the shareholders on October 1999. The period of total uninterrupted engagement is for the 20 financial years ended 31 December 2018.

We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview

Materiality:	£58.7m (2017:£57.9m)
financial statements as a whole	0.5% of total assets (2017: 0.5% of total assets)

Risks of material misstatement vs 2017

Event driven NEW	The impact of uncertainties due to the UK exiting the European Union on our audit	▲
Recurring risks	Valuation of investments	◀▶

2. Key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
<p>The impact of uncertainties due to the UK exiting the European Union on our audit</p> <p>Refer to page 3 (Strategic report) and page 41 (financial disclosures)</p>	<p>Unprecedented levels of uncertainty</p> <p>All audits assess and challenge the reasonableness of estimates, in particular as described in the valuation of investments, and related disclosures, and the appropriateness of the going concern basis of preparation of the financial statements (see below). All of these depend on assessments of the future economic environment and the company's future prospects and performance.</p> <p>Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.</p>	<p>We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included:</p> <ul style="list-style-type: none"> — Our Brexit knowledge – We considered the directors' assessment of Brexit-related sources of risk for the company's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. — Sensitivity analysis – When addressing the valuation of investments, we compared the directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty. — Assessing transparency – As well as assessing individual disclosures as part of our procedures on valuation of investments, we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. <p>Our results:</p> <ul style="list-style-type: none"> — As reported under valuation of investments, we found the resulting estimates and related disclosures of these matters and the disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

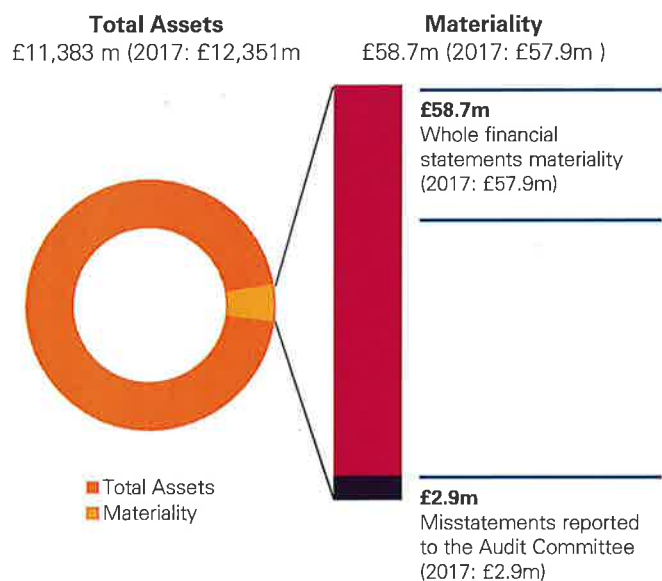
The risk	Our response
<p>Valuation of investments</p> <p>(2018: £11,316 million; 2017: £12,275 million)</p> <p>The risk is unchanged compared to the prior year.</p> <p>Refer to page 20 (accounting policy) and page 33 (financial disclosures).</p>	<p>Subjective valuation:</p> <p>The areas that involved significant audit effort and judgement were the valuation of the unlisted Net Asset Value ('NAV') fund representing 5.9 per cent (2017: 6.3%) of the Company's total investment assets. For these positions a reliable third party price was not readily available and therefore involved the application of expert judgement in the valuations adopted.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the valuation of technical provisions has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements.</p> <p>To audit the valuation of the NAV fund, we audited the underlying properties held in the fund and recalculated the Company's share of the NAV funds. Our procedures included:</p> <ul style="list-style-type: none"> — Methodologies and key assumptions: sought assistance from our own property valuation specialists to assess the methodologies and key assumptions used in the valuations of the properties. — Tests of detail: independently obtaining the most recent NAV statements and investment manager reports to assess the appropriateness of the fair value of the unlisted funds. — Assessing transparency: Assessing whether the Company's disclosures in relation to the valuation of investments are compliant with the relevant accounting requirements and appropriately present the sensitivities in the valuations based on alternative outcomes. <p>Our results</p> <p>We found the valuation of investments to be acceptable (2017 result: acceptable).</p>

3. Our application of materiality and an overview of the scope of our audit

Materiality for the financial statements as a whole was set at £58.7 million (2017: £57.9 million), determined with reference to a benchmark of total assets, of which it represents 0.5% (2016: 0.5%). We consider total assets to be the most appropriate metric given the nature of the business.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £2.9 million (2017: £2.9 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the company was undertaken to the materiality level specified above and was all performed at the Company's offices in London, Reading and Craigforth.



4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Company's business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. The risk that we considered most likely to adversely affect the Company's available financial resources over this period was adverse impacts arising from fluctuations or negative trends in the economic environment which affect the valuations of the Company's investments.

As these were risks that could potentially cast significant doubt on the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Company's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as failure of counterparties who have transactions with the Company (such as banks) to meet commitments that could give rise to a negative impact on the Company's financial position, increased illiquidity which also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline and the impact of Brexit on the economic environment and the resulting impact on the Company's capital resources.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter

5. We have nothing to report on the other strategic report and the directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in those reports;
- in our opinion the information given in the strategic report and the directors' report for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the other matters on which we are required to report by exception

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

- 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 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.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 8, the Directors are responsible for the preparation of the financial statements including being satisfied that they give a true and fair view. They are also responsible for: such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, and through discussion with the directors and other management (as required by auditing standards), and from inspection of the company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

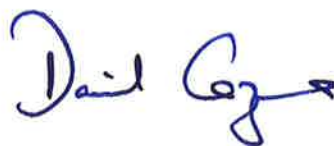
The potential effect of these laws and regulations on the financial statements varies considerably. Firstly, the company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of company's licence to operate. We identified the area of regulatory capital as that most likely to have such an effect recognising the financial and regulated nature of the company's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors [and other management] and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

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.



**Daniel Cazeaux (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor**

Chartered Accountants
15 Canada Square
Canary Wharf
London
E14 5GL
20 March 2019

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2018

<u>Long-term Business Technical Account</u>	<u>2018</u>	<u>2017</u>	
	£'000	£'000	Note
Investment income	939,977	1,129,198	4
Unrealised losses on investments	(1,340,349)	(92,773)	4
Other technical income	15,136	18,520	4
	<u>(385,236)</u>	<u>1,054,945</u>	
Change in other technical provisions, net of reinsurance			
Long-term business provision, net of reinsurance			
- gross amount	7,849	5,144	
- reinsurers' share	(7,749)	(5,267)	
	<u>100</u>	<u>(123)</u>	15
Change in technical provisions for linked liabilities	<u>403,410</u>	<u>(1,044,559)</u>	15
	<u>403,510</u>	<u>(1,044,682)</u>	
Net Operating Expenses			
- Acquisition costs	(107)	(65)	
- Administrative expenses	(1,400)	(4,551)	
Investment expenses and charges	(5,289)	(6,747)	4
Foreign exchange (losses)/gains	(1,955)	10,250	4
Interest payable	(5)	—	4
Tax attributable to long-term business	(3,483)	(3,665)	5
	<u>(12,239)</u>	<u>(4,778)</u>	
Balance on the long-term business technical account	<u>6,035</u>	<u>5,485</u>	

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

The accounting policies on pages 18 to 22 along with the accompanying notes on pages 22 to 42 form an integral part of these financial statements.

PRUDENTIAL PENSIONS LIMITED**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2018 (continued)**

<u>Non-Technical Account</u>	<u>2018</u> £'000	<u>2017</u> £'000	Note
Balance on the long-term business technical account	6,035	5,485	
Tax attributable to the balance on the long-term business technical account	1,422	1,325	5
Balance on the long-term business technical account before tax	<u>7,457</u>	<u>6,810</u>	
Investment income	151	52	4
Investment expenses and charges	(6)	(10)	4
Operating profit on ordinary activities before tax	<u>7,602</u>	<u>6,852</u>	
Tax on profit on ordinary activities	(1,451)	(1,334)	5
Profit and comprehensive income for the financial year	<u>6,151</u>	<u>5,518</u>	

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

The accounting policies on pages 18 to 22 along with the accompanying notes on pages 22 to 42 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2018

	Share Capital £'000	Capital Redemption Reserve £'000	Profit & Loss Account £'000	Total £'000
Balance at 1 January 2017	6,000	4,088	59,144	69,232
Profit	—	—	5,518	5,518
Total comprehensive income for the year	—	—	5,518	5,518
Balance at 31 December 2017	<u>6,000</u>	<u>4,088</u>	<u>64,662</u>	<u>74,750</u>
Balance at 1 January 2018	6,000	4,088	64,662	74,750
Profit	—	—	6,151	6,151
Total comprehensive income for the year	—	—	6,151	6,151
Balance at 31 December 2018	<u>6,000</u>	<u>4,088</u>	<u>70,813</u>	<u>80,901</u>

The accounting policies on pages 18 to 22 along with the accompanying notes on pages 22 to 42 form an integral part of these financial statements.

PRUDENTIAL PENSIONS LIMITED**STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2018**

	<u>2018</u> £'000	<u>2017</u> £'000	Note
<u>Assets</u>			
Investments			
Other financial investments	91,665	87,389	9
Assets held to cover linked liabilities	11,223,917	12,187,929	10
Reinsurers' share of technical provisions			
Long-term business provision	54,926	62,675	17
Debtors			
Other debtors	2,457	3,307	11
Other assets			
Cash at bank and in hand	10,322	9,600	12
Prepayments and accrued income	133	128	
Total assets	<u>11,383,420</u>	<u>12,351,028</u>	
<u>Equity and liabilities</u>			
Capital and reserves			
Share capital	6,000	6,000	14
Capital redemption reserve	4,088	4,088	
Profit and loss account	70,813	64,662	
Total shareholders' funds attributable to equity interests	<u>80,901</u>	<u>74,750</u>	
Technical provisions			
Long-term business provision	55,006	62,855	17
Technical provisions for linked liabilities	11,223,917	12,187,929	15
Provisions for other risks and charges			
Deferred taxation	1,436	1,832	5
Creditors			
Other creditors including taxation and social security	22,160	23,662	18
Total equity and liabilities	<u>11,383,420</u>	<u>12,351,028</u>	

The financial statements on pages 14 to 42 were approved by the board of directors on 20 March 2019.

The accounting policies on pages 18 to 22 along with the accompanying notes on pages 22 to 42 form an integral part of these financial statements.



Ms C Bousfield
Director
20 March 2019

NOTES ON THE FINANCIAL STATEMENTS

1. Accounting Policies

A. Company Information

Prudential Pensions Limited (the Company) is a private limited company, incorporated and registered in England and Wales.

The address of its registered office is Laurence Pountney Hill, London EC4R 0HH.

B. Basis of preparation

The Company is exempt by virtue of s400 of the Companies Act 2006 from the requirement to prepare group financial statements. These financial statements present information about the Company as an individual undertaking and are not consolidated.

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

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ("Adopted IFRS's"), but makes amendments where necessary in order to comply with Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

IFRS 9 *Financial Instruments* (IFRS 9) sets out the requirements for recognising and measuring financial assets and financial liabilities. This standard is effective from 1 January 2018 and replaces IAS 39 *Financial Instruments : Recognition and Measurement*. The adoption of IFRS 9 did not result in any material impact on the 1 January 2018 opening balance of retained earnings.

IFRS 15 *Revenue from Contracts with Customers* (IFRS 15), issued in May 2014, is effective for annual periods beginning on or after 1 January 2018, and supersedes all current revenue recognition requirements under IFRS. The standard provides clear guidance over when and how much revenue should be recognised, by introducing a principles-based recognition approach based on the concept of recognising revenue for obligations as they are satisfied. As the standard does not apply to business classified as insurance contracts, the relevance of IFRS 15 is to the accounting for revenue from investment management business and there is no impact as a result of the standard's adoption.

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

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- Cash Flow Statement and related notes;
- Comparative period reconciliations for share capital;
- Disclosures in respect of transactions between wholly owned subsidiaries within the Prudential Group;
- The effects of new but not yet effective accounting standards and;
- Disclosures in respect of the compensation of Key Management Personnel;
- Disclosures in respect of revenue from contracts with customers.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The area involving a higher degree of judgment or complexity, or where assumptions and estimates are significant to the financial statements is in the determination of fair value of financial investments, in Note 22 B.

NOTES ON THE FINANCIAL STATEMENTS (continued)

The directors have a reasonable expectation that the Company will be able to continue in operational existence for the foreseeable future and thus continue to adopt the going concern basis of accounting in preparing the financial statements. This conclusion has been based upon the following: the Company is a subsidiary within the Prudential Group and it, its parent company and the ultimate parent company are continuing to trade and there are no plans for liquidation, the Company has a satisfactory capital surplus, well in excess of the regulatory capital requirement (as shown in Note 16) and generates positive cashflows. In addition, consideration has also been given to the Company's performance, the market in which it operates, its strategy and risks and uncertainties, as set out in the Strategic Report, and the management of financial risk as set out in Note 23, including its exposure to liquidity risk and credit risk.

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

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

C. Long-term business

The measurement basis of assets and liabilities of long-term business contracts is dependent upon the classification of the contracts under FRS 101 as either insurance contracts, if the level of insurance risk is significant, or investment contracts if the risk is insignificant. The Company's contracts are mainly unit-linked contracts which are investment contracts without discretionary participating features.

As permitted by IFRS 4 *Insurance contracts* are accounted for under previously applied UK GAAP and therefore the modified statutory basis of reporting has continued to be applied.

Investment contracts without discretionary participation features are accounted for as financial liabilities under IFRS 9 (and before 1 January 2018, IAS 39) as they are closer in nature to a deposit style arrangement between the investors and the Company. Premiums and withdrawals for these contracts are recorded within the Statement of Financial Position as a movement on the investors' liability and the long-term business technical account reflects the fee income accounted for under IFRS 15 (and before 1 January 2018, IAS 18), expenses, and taxation on these contracts. The liabilities for investment contracts without discretionary participation features are included in Technical Provisions for Linked Liabilities in the Statement of Financial Position.

The long-term business provision is determined by the Company's directors based on advice from the Company's actuarial function holder, who determined the provision using recognised actuarial methods, with due regard to the actuarial principles laid down in Directive 2013/58/EU. Provisions are predominantly calculated by the net premium valuation method. Discount rates are derived based on gilt yields of a duration consistent with that of the underlying business.

D. Reinsurance

The Company seeks to reduce loss exposure by reinsuring certain levels of risk in various areas of exposure with other insurance companies or reinsurers. The measurement of reinsurance assets is consistent with the measurement of the underlying direct insurance contracts. An asset or liability is recognised in the Statement of Financial Position representing premiums due to or payments due from reinsurers and the share of benefits and claims recoverable from reinsurers.

NOTES ON THE FINANCIAL STATEMENTS (continued)

E. Classification of instruments issued by the Company

Having adopted FRS 101, IAS 32 is being applied to financial instruments issued by the Company and are treated as equity only to the extent that they meet the following two conditions:

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

F. Financial instruments - recognition and measurement

Financial assets - Policy applicable from 1 January 2018

Recognition and initial measurement

A financial asset is initially measured at fair value plus, for a financial asset not measured at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

Classification and subsequent measurement

On initial recognition, a financial asset is classified and measured at either amortised cost or fair value through profit or loss (FVTPL).

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All financial assets that do not meet the criteria for being measured at amortised cost, as described above, are measured at FVTPL. This includes assets that are held for trading or are part of a portfolio that is managed on a fair value basis. Derivatives are included in this category.

Financial assets are not reclassified subsequent to their initial recognition unless the Company changes its business model for managing financial assets, in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

Financial assets at FVTPL are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognised in profit or loss.

Financial assets at amortised cost are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognised in profit or loss. Any gain or loss on derecognition is recognised in profit or loss.

Financial assets - Policy applicable before 1 January 2018

Under IAS 39, upon initial recognition financial investments are recognised at fair value. The Company is permitted, subject to specific criteria, to designate its investments as either financial investments at fair value through profit or loss, financial investments held on an available-for-sale basis, financial investments held to maturity, or loans and receivables. The Company holds financial investments on the following bases:

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

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

NOTES ON THE FINANCIAL STATEMENTS (continued)

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

Financial liabilities - policy applicable from 1 January 2018

Financial liabilities are classified as measured at amortised cost (using the effective interest method) or FVTPL. A financial liability is classified as at FVTPL if it is in respect of an investment contract without participation features, held-for-trading or a derivative. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognised in profit or loss. Other financial liabilities are subsequently measured at amortised cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognised in profit or loss. Any gain or loss on derecognition is also recognised in profit or loss.

Financial liabilities - policy applicable before 1 January 2018

Financial liabilities are designated as either fair value through profit or loss or amortised cost. The Company holds financial liabilities on the following bases:

- (i) Financial liabilities at fair value through profit or loss – these comprise investment contracts without discretionary participation features and the accounting policy is described in C above.
- (ii) Financial liabilities that are not valued at fair value through profit or loss are mainly creditors shown at settlement value.

G. Financial instruments - Impairment

Financial assets impairment - Policy applicable from 1 January 2018

Impairment is recognised on financial assets measured at amortised cost based on expected credit losses (ECL). ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the Company in accordance with the contract and the cash flows that the Company expects to receive).

The impact of any collateral and financial guarantees is taken into account when determining ECL.

ECLs are discounted at the effective interest rate of the financial asset.

A financial instrument is considered to have low credit risk where it has an external credit rating of 'investment grade'. The Company has determined that the cash balances and deposits with credit institutions are considered to have low credit risk and therefore impairment is based on a 12 month ECL for these assets, where material. Loss allowances for trade receivables and contract assets are always measured at an amount equal to lifetime ECLs, where material.

Financial assets impairment - Policy applicable before 1 January 2018

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

H. IFRS 9: Premiums and claims accounting treatment

For unit-linked business, premiums are accounted for when the liabilities arising from the premiums are recognised. Premiums exclude any taxes or duties based on premiums.

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

NOTES ON THE FINANCIAL STATEMENTS (continued)

Under IFRS 9 (and before 1 January 2018, IAS 39), the accounting treatment for investment contracts without discretionary participation features reflects the deposit nature of the arrangement with premiums and claims reflected as deposits and withdrawals taken directly to the Statement of Financial Position as a movement on the investors liability with the long-term technical account reflecting fee income accounted for under IFRS 15 (and before 1 January 2018, IAS 18), expenses, and taxation on these contracts.

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

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

I. Tax

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

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

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. 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 enacted or substantively enacted at the Statement of Financial Position date.

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

J. Foreign currencies

Foreign currency assets and liabilities are translated at year end exchange rates. Foreign currency revenue transactions are translated at rates ruling at the transaction dates, except for accrued revenue items that are translated at year end exchange rates.

2. Transition to IFRS 9

(i) Classification and measurement

Under IFRS 9, the Company classifies its financial assets at FVTPL and amortised cost. For an explanation of how the Company classifies and measures financial instruments and accounts for related gains and losses under IFRS 9, see Note 1. The following table shows the original measurement category and carrying amount under IAS 39 and the new measurement category and carrying amount under IFRS 9 for each class of financial assets and financial liabilities as at 1 January 2018.

NOTES ON THE FINANCIAL STATEMENTS (continued)

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amounts under IFRS 9
			£'000	£'000
Deposits with credit institutions	Loans and receivables	Amortised cost	63,400	63,400
Debt securities	FVTPL	FVTPL	23,989	23,989
Assets held to cover linked liabilities	FVTPL	FVTPL	12,187,929	12,187,929
Other debtors	Loans and receivables	Amortised cost	3,307	3,307
Cash at bank and in hand	Loans and receivables	Amortised cost	9,600	9,600
Accrued investment income	Loans and receivables	Amortised cost	128	128
Total financial assets			12,288,353	12,288,353
Investment contracts without discretionary participating features	FVTPL	FVTPL	12,187,929	12,187,929
Deferred tax liabilities	Loans and receivables	Amortised cost	1,832	1,832
Other creditors	Loans and receivables	Amortised cost	23,662	23,662
Total financial liabilities			12,213,423	12,213,423

Under IAS 39, debt securities and assets held to cover linked liabilities were designated as at FVTPL because they were managed on a fair value basis and their performance was monitored on this basis. These assets have been classified as mandatorily measured at FVTPL under IFRS 9.

Cash balances and other debtors that were classified as loans and receivables under IAS 39 are now classified at amortised cost. There have been no reclassifications of financial assets out of FVTPL to the amortised cost category as a result of transition to IFRS 9.

The adoption of IFRS 9 did not result in any changes to the carrying value of financial assets.

(ii) Impairment

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an expected credit loss (ECL) model. The new impairment model applies to financial assets measured at amortised cost. Under IFRS 9, credit losses are recognised earlier than under IAS 39.

The adoption of IFRS 9 did not result in any material change to the amount of impairment losses recognised.

NOTES ON THE FINANCIAL STATEMENTS (continued)

3. Analysis of premiums

Gross Premiums

Premiums comprise corporate pension business where investment risk is borne by policyholders and which are transacted within the UK. All direct single and regular premiums are group pension business. Premiums for 2018 and 2017 are nil as all business is investment contracts without discretionary participation features and are deposit accounted, as described in the accounting policies.

	<u>2018</u>	<u>2017</u>
	£'000	£'000
New Business		
Single premiums – Pensions – Investment linked contracts		
Direct	444,304	1,134,248
External reinsurance accepted	49,957	40,185
Intragroup reinsurance accepted	<u>341,467</u>	<u>354,055</u>
	<u>835,728</u>	<u>1,528,488</u>

New business premiums include those contracts excluded from premium income in the technical account because they are accounted for as deposits. These are investment contracts without discretionary participation features and carry no significant insurance risk.

NOTES ON THE FINANCIAL STATEMENTS (continued)

4. Revenue and investment return

The revenue and investment return derive from financial instrument classifications as follows:

	Long-term business technical account		
	<u>2018</u> £'000	<u>2018</u> £'000	<u>2018</u> £'000
	At fair value through profit or loss	Amortised cost	Total
Investment income			
Income from listed investments	293,236	—	293,236
Income from other investments	8,238	445	8,683
Gains on the realisation of investments at fair value through profit or loss other than derivatives	640,151	—	640,151
Losses on the realisation of derivatives	(2,093)	—	(2,093)
	<u>939,532</u>	<u>445</u>	<u>939,977</u>
Investment expenses and charges			
Investment managers' expenses	(5,207)	(82)	(5,289)
Unrealised losses on investments			
Debt securities	(424)	—	(424)
Linked assets - other than derivatives	(1,338,370)	—	(1,338,370)
Linked assets - derivatives	(1,555)	—	(1,555)
	<u>(1,340,349)</u>	<u>—</u>	<u>(1,340,349)</u>
Foreign exchange losses	(1,955)	—	(1,955)
Fee income from investment contracts	15,136	—	15,136
Intragroup interest paid	—	(5)	(5)
Total revenue and investment return	<u>(392,843)</u>	<u>358</u>	<u>(392,485)</u>

	Non-technical account		
	<u>2018</u> £'000	<u>2018</u> £'000	<u>2018</u> £'000
	At fair value through profit or loss	Amortised cost	Total
Investment income			
Income from other investments	—	151	151
	<u>—</u>	<u>151</u>	<u>151</u>
Investment expenses and charges			
Investment managers' expenses	—	(6)	(6)
Total revenue and investment return	<u>—</u>	<u>145</u>	<u>145</u>

NOTES ON THE FINANCIAL STATEMENTS (continued)

	Long-term business technical account		
	<u>2017</u> £'000	<u>2017</u> £'000	<u>2017</u> £'000
	At fair value through profit or loss	Amortised cost	Total
Investment income			
Income from listed investments	310,558	—	310,558
Income from other investments	10,758	53	10,811
Gains on the realisation of investments at fair value through profit or loss other than derivatives	823,919	—	823,919
Losses on the realisation of derivatives	(16,090)	—	(16,090)
	<u>1,129,145</u>	<u>53</u>	<u>1,129,198</u>
Investment expenses and charges			
Investment managers' expenses	(6,717)	(30)	(6,747)
Unrealised gains / (losses) on investments			
Debt securities	(55)	—	(55)
Linked assets - other than derivatives	(96,910)	—	(96,910)
Linked assets - derivatives	4,192	—	4,192
	<u>(92,773)</u>	<u>—</u>	<u>(92,773)</u>
Foreign exchange gains	10,250	—	10,250
Fee income from investment contracts	18,520	—	18,520
Total revenue and investment return	<u>1,058,425</u>	<u>23</u>	<u>1,058,448</u>

	Non-technical account		
	<u>2017</u> £'000	<u>2017</u> £'000	<u>2017</u> £'000
	At fair value through profit or loss	Amortised cost	Total
Investment income			
Income from other investments	—	52	52
	<u>—</u>	<u>52</u>	<u>52</u>
Investment expenses and charges			
Investment managers' expenses	—	(10)	(10)
Total revenue and investment return	<u>—</u>	<u>42</u>	<u>42</u>

NOTES ON THE FINANCIAL STATEMENTS (continued)

5. Tax

(a) Tax charged/(credited)

	Long-term business technical account		Non-technical account	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Current tax				
UK Corporation tax on profits for the year	1,810	1,708	29	9
Adjustments in respect of previous years	8	17	—	—
	<u>1,818</u>	<u>1,725</u>	<u>29</u>	<u>9</u>
Foreign tax	2,061	2,340	—	—
Total current tax	<u>3,879</u>	<u>4,065</u>	<u>29</u>	<u>9</u>
Deferred tax				
Origination and reversal of temporary difference	(396)	(400)	—	—
Effect of changes in tax rate	—	—	—	—
Tax charge on profit on ordinary activities	<u>3,483</u>	<u>3,665</u>	<u>29</u>	<u>9</u>

Shareholders' attributable tax in respect of the long-term business

Current tax	1,818	1,725
Deferred tax	(396)	(400)
	<u>1,422</u>	<u>1,325</u>
Total	<u>1,451</u>	<u>1,334</u>

(b) Factors affecting tax charge for period

In July 2016 the UK Government announced additional reductions in the main rate of corporation tax rate to 19% from 1 April 2017 and to 17% from 1 April 2020. These additional reductions are reflected in the above figures as the changes were substantively enacted at the Statement of Financial Position date.

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

	2018 £'000	2017 £'000
Profit on ordinary activities before tax	<u>7,602</u>	<u>6,852</u>
Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 19.00% (2017: 19.25%)	1,444	1,319
Effects of		
Adjustments to current tax in respect of previous periods	8	15
Impact of changes in local statutory tax rates	(1)	—
Total tax charge for the period	<u>1,451</u>	<u>1,334</u>

NOTES ON THE FINANCIAL STATEMENTS (continued)

(c) Statement of Financial Position

	<u>2018</u> £'000	<u>2017</u> £'000
Provision for deferred tax		
Transitional adjustments	<u>1,436</u>	<u>1,832</u>
Undiscounted provision for deferred tax liability	<u>1,436</u>	<u>1,832</u>
Deferred tax liability at start of the period	1,832	2,232
Deferred tax credited in technical/non-technical account for the period	<u>(396)</u>	<u>(400)</u>
Deferred tax liability at the end of period	<u>1,436</u>	<u>1,832</u>

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

6. Staff costs

The Company has no employees (2017: Nil). Included within net operating expenses are amounts paid in return for management services provided to the Company by other group companies.

7. Directors' emoluments

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

	<u>2018</u> £'000	<u>2017</u> £'000
Aggregate emoluments and benefits	<u>7</u>	<u>5</u>

The Company's directors perform services for other group companies. These costs are not included in the amounts charged to the Company as shown in the table above.

8. Auditor's remuneration

	<u>2018</u> £'000	<u>2017</u> £'000
Audit of these financial statements	86	61
Other services including regulatory return	—	103
	<u>86</u>	<u>164</u>

The 2017 fee included £103k for other services including regulatory return for the audit of Solvency II including the SFCR. Solvency II is no longer being audited for the Company.

9. Other financial investments

	Cost		Carrying value	
	<u>2018</u> £'000	<u>2017</u> £'000	<u>2018</u> £'000	<u>2017</u> £'000
Debt securities and other fixed income securities	19,843	19,843	23,565	23,989
Deposits with credit institutions	<u>68,100</u>	<u>63,400</u>	<u>68,100</u>	<u>63,400</u>
	<u>87,943</u>	<u>83,243</u>	<u>91,665</u>	<u>87,389</u>

All debt securities and other fixed income securities are listed on a recognised UK investment exchange.

NOTES ON THE FINANCIAL STATEMENTS (continued)

10. Assets held to cover linked liabilities

	<u>2018</u>	<u>2017</u>
	£'000	£'000
Shares and other variable yield securities	4,869,439	5,573,823
British government securities - fixed income	819,976	1,012,633
British government securities - index linked	229,935	274,675
Debentures and loan stocks	4,405,909	3,965,267
Provincial & municipal stocks	401,791	602,892
Deposits with credit institutions	376,550	606,450
Derivatives	(2,060)	991
Other assets	122,377	151,198
Assets held to cover linked liabilities – carrying value	<u>11,223,917</u>	<u>12,187,929</u>
Assets held to cover linked liabilities - cost	<u>10,634,557</u>	<u>10,270,233</u>

Included within shares and other variable yield securities is a Fond commun de placement called M&G UK Property Fund FCP - FIS, which at 31 December 2018 was 98.52% owned by Prudential Pensions Limited (2017: 99.79%). The value of the investment in this fund at 31 December 2018 was £675.3m (2017: £759.5m). The registered office of this investment is 34-38 Avenue de la Liberté, L-1930 Luxembourg.

Included within other investments are derivatives owned by the fund to offset currency movements. These can have a negative valuation.

11. Other debtors

All debtors are due within one year.

	<u>2018</u>	<u>2017</u>
	£'000	£'000
Debtors arising from reinsurance operations	446	847
Amounts owed by group undertakings	—	337
Tax recoverable	—	8
Other debtors	<u>2,011</u>	<u>2,115</u>
	<u>2,457</u>	<u>3,307</u>

12. Bank current accounts

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

13. Assets attributable to the long-term business fund

Of the total amount of assets shown on the Statement of Financial Position, £11,352,204 thousand (2017: £12,319,928 thousand) is attributable to the long-term business fund.

14. Share capital

	<u>2018</u>	<u>2017</u>
	£'000	£'000
Issued and fully paid		
6 million ordinary shares (2017: 6 million) of £1 each	<u>6,000</u>	<u>6,000</u>

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

NOTES ON THE FINANCIAL STATEMENTS (continued)

15. Policyholder liabilities

	Long-term business provision net of reinsurance	Provision for linked liabilities net of reinsurance
	£'000	£'000
Balance at 1 January 2017	57	11,411,468
Movement in technical provisions for year		
Gross amount	(5,144)	1,044,559
Reinsurers' share	5,267	—
Deposits received from policyholders under investment contracts	—	1,528,690
Payments made to policyholders of investment contracts	—	(1,796,788)
As at 31 December 2017/1 January 2018	180	12,187,929
Movement in technical provisions for year		
Gross amount	(7,849)	(403,410)
Reinsurers' share	7,749	—
Deposits received from policyholders under investment contracts	—	835,910
Payments made to policyholders of investment contracts	—	(1,396,512)
Balance at 31 December 2018	80	11,223,917

All of the reinsurer's share of technical provisions for long-term business relates to reinsurance agreements with other Prudential Group companies. There are no gains or losses arising from these reinsurance agreements.

16. Capital requirements and management

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

The Company's estimated and unaudited shareholder Solvency II Own Funds at 31 December 2018 is £90.0m (2017: £82.9m).

The Solvency II Pillar I capital requirements at 31 December 2018 have been calculated using the Company's Internal Capital Model. The method used to calculate the capital has been to:

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

The Company manages its own funds to ensure that sufficient own funds are available on an ongoing basis to meet regulatory capital requirements. This is achieved by targeting a capital buffer in excess of regulatory capital

NOTES ON THE FINANCIAL STATEMENTS (continued)

requirements. This buffer is intended to absorb the impact of stressed market conditions and thus make the regulatory Statement of Financial Position resilient to stresses that affect the Company shareholder-backed business, and is calibrated such that following a stress event (at the calibrated likelihood) the business remains able to cover its Solvency II Solvency Capital Requirement (SCR).

Reconciliation of the Shareholder Funds to the estimated Solvency II Own Funds (unaudited)

	<u>2018</u>	<u>2017</u>
	<u>£'000</u>	<u>£'000</u>
31 December Shareholder funds	80,901	74,750
Liability valuation differences	30,597	27,754
Impact of risk margin	(19,578)	(17,920)
Increase in value of net deferred tax liabilities (resulting from valuation differences above)	(1,882)	(1,689)
31 December estimated Solvency II own funds	<u>90,038</u>	<u>82,895</u>

NOTES ON THE FINANCIAL STATEMENTS (continued)

17. Long-term business provision

The long-term business provision comprises a provision for annuity business.

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

Valuation interest rates and expense inflation have been amended in line with changes in market yields. Renewal expenses, mortality rates and mortality improvement rates have also been amended.

The reinsurers' share of the long-term business provision relates to cessions to The Prudential Assurance Company Limited, the immediate parent company.

The provision for annuity business has been calculated on the following bases:

	<u>2018</u>	<u>2017</u>
Discount Rate assumption pre-2019	2.650% for annuities	2.266% for annuities
Discount Rate assumption post-2019	2.669% for annuities	2.285% for annuities
Fund Growth	N/A for annuities	N/A for annuities
Expense Inflation	3.53% gross	3.89% gross
Renewal expenses:		
Reassured annuity business	£34.62 p.a. per policy plus third party (TCS) costs	£37.82 p.a. per policy
Annuity mortality	Mortality assumptions for UK non-profit annuity business are set in light of recent population and internal experience. The assumptions used are based on England & Wales General Population mortality tables (E&W Reference Population for males/females), with an allowance for expected future mortality improvements. Where annuities have been sold on an enhanced basis to impaired lives, an adjustment is made for the additional expected mortality. Future mortality improvements: Default calibration of CMI2016 with a long term rate of 1.75% for males and 1.50% for females plus 0.5% constant increase to per annum improvement rates.	Mortality assumptions for UK non-profit annuity business are set in light of recent population and internal experience. The assumptions used are based on standard population mortality tables (PMA08/PFA08 for males/females), with an allowance for expected future mortality improvements. Where annuities have been sold on an enhanced basis to impaired lives, an adjustment is made for the additional expected mortality. Future mortality improvements: In line with CMI 2015 model calibrated to reflect the Company's view of future mortality improvements. Long-term improvement rates of 2.25% for males and 2.00% for females has been used.

18. Creditors

All creditors are due within one year.

	<u>2018</u>	<u>2017</u>
	£'000	£'000
Creditors arising from reinsurance operations	—	1,924
Amounts due to group undertakings	1,582	2,073
Tax payable	3,353	4,070
Sundry creditors	17,225	15,595
	<u>22,160</u>	<u>23,662</u>

NOTES ON THE FINANCIAL STATEMENTS (continued)

19. Charges

In the normal course of business certain reinsurance liabilities were secured by a floating charge, ranking these liabilities equally with amounts due under unsecured direct (non-reinsurance) policies, over the long-term insurance assets of the Company. Amounts secured by charges of this nature were £4,853.2m, £278.4m, £84.1m, £38.5m, £17.3m and £5.9m, representing liabilities to six different customers (2017: £5,194.4m, £303.6m, £94.9m, £44.1m, £6.2m and £2.0m representing liabilities to six different customers).

20. Guarantees and Commitments

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

21. Immediate and ultimate parent company

The immediate parent company is The Prudential Assurance Company Limited. On 26 November 2018 the immediate parent's legal ownership was transferred from its previous parent company Prudential plc to a new holding company M&G Prudential Limited. M&G Prudential Limited is a subsidiary of Prudential plc. The ultimate parent of the Company therefore remains Prudential plc.

22. Financial Assets and Financial Liabilities

A. Financial assets and financial liabilities – classification and measurement

Under IFRS 9, financial assets and financial liabilities are valued at either FVTPL or amortised cost. Before 1 January 2018, all financial assets were designated as either FVTPL or loans and receivables. Financial liabilities were designated as either FVTPL or amortised cost.

2018	Fair value through profit or loss	Cost / Amortised Cost	Total carrying value	Fair value where applicable
	£'000	£'000	£'000	£'000
Financial Assets				
Deposits with credit institutions	—	68,100	68,100	68,100
Debt securities	23,565	—	23,565	23,565
Assets held to cover linked liabilities	11,223,917	—	11,223,917	11,223,917
Other debtors	—	2,457	2,457	2,457
Cash at bank and in hand	—	10,322	10,322	10,322
Accrued investment income	—	133	133	133
Total	11,247,482	81,012	11,328,494	11,328,494
Financial Liabilities				
Investment contracts without discretionary participating features	11,223,917	—	11,223,917	11,223,917
Deferred tax liabilities	—	1,436	1,436	1,436
Other creditors	—	22,160	22,160	22,160
Total	11,223,917	23,596	11,247,513	11,247,513

NOTES ON THE FINANCIAL STATEMENTS (continued)

2017	Fair value through profit or loss	Cost / Amortised Cost	Total carrying value	Fair value where applicable
	£'000	£'000	£'000	£'000
Financial Assets				
Deposits with credit institutions	—	63,400	63,400	63,400
Debt securities	23,989	—	23,989	23,989
Assets held to cover linked liabilities	12,187,929	—	12,187,929	12,187,929
Other debtors	—	3,307	3,307	3,307
Cash at bank and in hand	—	9,600	9,600	9,600
Accrued investment income	—	128	128	128
Total	12,211,918	76,435	12,288,353	12,288,353
Financial Liabilities				
Investment contracts without discretionary participating features	12,187,929	—	12,187,929	12,187,929
Deferred tax liabilities	—	1,832	1,832	1,832
Other creditors	—	23,662	23,662	23,662
Total	12,187,929	25,494	12,213,423	12,213,423

B. Financial assets and financial liabilities - determination of fair value

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

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

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

Financial assets held at amortised cost have been shown net of provisions for impairment. The fair value of deposits has been estimated from discounted cash flows expected to be received. The rate of discount used was the market rate of interest.

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

The fair value of investment contracts is based on the fair value of the assets held within the linked funds.

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

NOTES ON THE FINANCIAL STATEMENTS (continued)

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

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

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

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

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

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

In addition level 2 can include debt securities that are valued internally using standard market practices. None of the level 2 debt securities are valued internally in the current year. The Company's usual policy for valuing such securities is to use matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring a specified liquidity premium. The parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

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

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

NOTES ON THE FINANCIAL STATEMENTS (continued)

	31 December 2018			
	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Unit-linked				
Equity securities	4,194,187	675,252	—	4,869,439
Debt securities	1,158,231	4,699,380	—	5,857,611
Derivative assets	7	597	—	604
Derivative liabilities	(636)	(2,028)	—	(2,664)
Total financial investments, net of derivative liabilities:	5,351,789	5,373,201	—	10,724,990
Investment contracts without discretionary participation features held at fair value	—	(11,223,917)	—	(11,223,917)
Total	5,351,789	(5,850,716)	—	(498,927)
Percentage of total	(1,073)%	1,173%	—%	100%
Non-linked				
Debt securities	23,565	—	—	23,565
Total	23,565	—	—	23,565
Percentage of total	100 %	—%	—%	100%
Company total				
Equity securities	4,194,187	675,252	—	4,869,439
Debt securities	1,181,796	4,699,380	—	5,881,176
Derivative assets	7	597	—	604
Derivative liabilities	(636)	(2,028)	—	(2,664)
Total financial investments, net of derivative liabilities	5,375,354	5,373,201	—	10,748,555
Investment contracts without discretionary participation features held at fair value	—	(11,223,917)	—	(11,223,917)
Total	5,375,354	(5,850,716)	—	(475,362)
Percentage total	(1,131)%	1,231%	—%	100%

NOTES ON THE FINANCIAL STATEMENTS (continued)

	31 December 2017			
	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Unit-linked				
Equity securities	4,804,688	769,135	—	5,573,823
Debt securities	1,464,912	4,390,555	—	5,855,467
Derivative assets	1,036	581	—	1,617
Derivative liabilities	(111)	(516)	—	(627)
Total financial investments, net of derivative liabilities:	6,270,525	5,159,755	—	11,430,280
Investment contracts without discretionary participation features held at fair value	—	(12,187,929)	—	(12,187,929)
Total	6,270,525	(7,028,174)	—	(757,649)
Percentage of total	(828)%	928%	—%	100%
Non-linked				
Debt securities	23,989	—	—	23,989
Total	23,989	—	—	23,989
Percentage of total	100 %	—%	—%	100%
Company total				
Equity securities	4,804,688	769,135	—	5,573,823
Debt securities	1,488,901	4,390,555	—	5,879,456
Derivative assets	1,036	581	—	1,617
Derivative liabilities	(111)	(516)	—	(627)
Total financial investments, net of derivative liabilities	6,294,514	5,159,755	—	11,454,269
Investment contracts without discretionary participation features held at fair value	—	(12,187,929)	—	(12,187,929)
Total	6,294,514	(7,028,174)	—	(733,660)
Percentage total	(858)%	958%	—%	100%

NOTES ON THE FINANCIAL STATEMENTS (continued)

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

The following information reconciles the value of level 3 financial instruments at 1 January 2018 to that presented at 31 December 2018. Total gains and losses recorded in the long-term technical account in the period represents realised gains and losses, including interest and dividend income, unrealised gains and losses on financial instruments classified at fair value through profit or loss and foreign exchange movements on overseas investments. All these amounts are included within "investment income" and "unrealised gains/(losses)" in the long-term technical account.

Transfers between level 1 and level 3

As at 1 January 2018, no level 3 assets were held (2017: £74,000). During 2018, transfers out of level 3 to level 1 amounted to £nil (2017: £1,000). During 2018, there were no sales or purchases of level 3 items (2017: sales of £73,000).

Exposure to sovereign debt and bank debt

The Company exposure to UK sovereign debt held in non-linked funds is £23.6m (2017: £24.0m). The non-linked funds hold no foreign sovereign debt securities or bank debt securities.

The unit-linked funds hold a range of sovereign debt securities and bank debt securities, but due to the matching of policyholder liabilities to attaching asset value movements there is minimal exposure to these securities for the Company on the unit-linked contracts as the risks are borne by the policyholders.

C. Market Risk

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

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

Market risk comprises three types of risk, namely:

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

Due to the matching of policyholder liabilities to attaching asset value movements the unit-linked business is not directly affected by market risk. The principal factor affecting the results is investment performance through fund management fees.

(i) Interest rate risk

Due to the matching of policyholder liabilities to attaching asset value movements the unit-linked business within the Company is not directly sensitive to interest rate movements and so these assets are excluded from the tables below.

The following table shows an analysis of the classes of financial assets with direct exposure to interest rate risk where the Company still retains a risk. Each applicable class of the Company's assets are analysed between those exposed to fair value interest rate risk and those exposed to cash-flow interest rate.

2018	Fair value interest rate risk	Cash flow interest rate risk	Total
	£'000	£'000	£'000
Financial Assets			
Deposits with credit institutions	—	68,100	68,100
Debt securities	23,565	—	23,565
Cash at bank and in hand	—	10,322	10,322
	<u>23,565</u>	<u>78,422</u>	<u>101,987</u>

NOTES ON THE FINANCIAL STATEMENTS (continued)

2017	Fair value interest rate risk £'000	Cash flow interest rate risk £'000	Total £'000
Financial Assets			
Deposits with credit institutions	—	63,400	63,400
Debt securities	23,989	—	23,989
Cash at bank and in hand	—	9,600	9,600
	<u>23,989</u>	<u>73,000</u>	<u>96,989</u>

The estimated sensitivity of the Company to a movement in interest rates (including assumed investment returns for all asset classes, market values of debt securities and all risk discount rates) of 1% and 2% is as follows:

	31 December 2018			
	Fall of 1% £'000	Fall of 2% £'000	Rise of 1% £'000	Rise of 2% £'000
Carrying value of debt securities	2,842	5,684	(2,842)	(5,684)
Interest on deposits with credit institutions	(560)	(560)	784	1,568
Related tax effects	(388)	(871)	350	700
Net sensitivity of profit after tax and shareholders' funds	<u>1,894</u>	<u>4,253</u>	<u>(1,708)</u>	<u>(3,416)</u>

	31 December 2017			
	Fall of 1% £'000	Fall of 2% £'000	Rise of 1% £'000	Rise of 2% £'000
Carrying value of debt securities	3,043	6,085	(3,043)	(6,085)
Interest on deposits with credit institutions	399	399	730	1,460
Related tax effects	(585)	(1,102)	393	786
Net sensitivity of profit after tax and shareholders' funds	<u>2,857</u>	<u>5,382</u>	<u>(1,920)</u>	<u>(3,839)</u>

(ii) Currency risk

Due to the matching of policyholder liabilities to attaching asset value, movements in the unit-linked business are not directly sensitive to currency risk. Outside of the unit-linked business, no assets or liabilities are held in currencies other than the functional currency, Sterling.

(iii) Other price risk

Due to the matching of policyholder liabilities to attaching asset value movements the unit-linked business is not directly sensitive to other price risk. The Company does not hold any investment property outside of the unit-linked funds. The Company holds no equity securities outside of the unit-linked funds (2017: £nil), so is not exposed to other price risk.

D. Liquidity analysis

Contractual maturities

Maturity profile for investment contracts and durations of long-term business contracts on an undiscounted basis

The majority of the in force business consists of pooled investment vehicles used for pension scheme business which by nature do not have any contractual repricing or maturity dates, as the benefits are the realisation values of the units held in the internal linked funds and may be surrendered at any time.

The long-term business contracts are annuity contracts which have no maturity date. The liabilities for these contracts are wholly reassured so the maturity profile for the liability is matched by the profile for the asset and so no liquidity risk arises from these contracts.

NOTES ON THE FINANCIAL STATEMENTS (continued)

E. Credit Risk

Concentration of credit risk

The following table summarises by credit rating the securities held by the Company as at 31 December 2018 and 2017.

	<u>2018</u>	<u>2017</u>
	£'000	£'000
AA	<u>101,987</u>	<u>96,989</u>
Unit-linked	<u>101,987</u>	<u>96,989</u>
Total assets bearing credit risk	<u>11,223,917</u>	<u>12,187,929</u>
	<u>11,325,904</u>	<u>12,284,918</u>

Due to the matching of policyholder liabilities to attaching asset value movements there is minimal credit risk for the Company on the unit-linked contracts as the risks are borne by the policyholders.

There are no overdue debtors. There is minimal credit risk from reinsurance recoverable as this solely relates to reinsurance agreements with other Prudential Group companies.

Reverse repurchase agreements

At 31 December 2018, the Company had entered into reverse repurchase transactions under which it purchased securities and had taken on the obligation to resell the securities. The value of these transactions at 31 December 2018 was £444.7m (2017: £669.9m) The fair value of the collateral held in respect of these transactions was £453.5m (2017: £683.2m).

During 2018 and 2017 the Company did not take possession of any other collateral held as security.

Collateral and pledges under derivative transactions

At 31 December 2018, the Company had pledged £2.3m (2017: £nil) for liabilities and held collateral of £2.4m (2017: £0.3m) in respect of over-the-counter derivative transactions.

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

23. Financial risk management

The Company's exposure to financial risk is limited due to the nature of the unit-linked business where policyholder liabilities are essentially the same as the net asset values backing those liabilities. The financial risk factors affecting the Company include expense risk, market risk, persistency risk, liquidity risk and credit risk.

A significant part of the Company's profit is related to the fund management charges on its unit-linked products, which are proportionately dependent on the asset values in the funds under management. Any adverse impact on the current and expected future asset returns is therefore likely to impact the Company's profitability by reducing the value of funds under management and management charges collected.

a) Expense risk

Expense risk is the risk of loss or of adverse change in the profitability or financial situation of the Company resulting from changes in the level of expenses incurred.

Expense risk is the risk of actual expenses exceeding the assumptions in pricing and reserving bases. The Company makes assumptions about future expected levels of expenses for each line of business and uses these in pricing and calculating reserves. If the actual expenses exceed these assumptions, the Company's operating results could be adversely impacted.

NOTES ON THE FINANCIAL STATEMENTS (continued)

b) Market risk

Market Risk is the risk of loss, or of adverse changes in the financial situation resulting, directly or indirectly, from fluctuations in the prices of financial instruments. Market risk includes but is not limited to interest rate risk, inflation risk, equity risk, currency risk, property risk, basis risk and other assets / alternative investments risk.

The continued uncertainty in global economic, political and market outlooks, have increased market risk (e.g. increased volatility) and this could adversely affect the Company's business and profitability, principally through a fall in the Company's funds under management (FUM) due to reduced investment returns and adverse movements in foreign currency exchange rates (for overseas investment funds).

As a large proportion of the Company's income is earned via fund management charges expressed as a percentage of FUM, a fall in value as a result of market risk could adversely affect the Company's profitability.

c) Persistency risk

Persistency risk is the risk that customer retention levels are different from the Company's expectations.

The Company's persistency assumptions reflect the recent past experience for each relevant line of business including any expected trends in future persistency rates. If the actual levels of future persistency are significantly lower than assumed (that is, policy termination rates are significantly higher than assumed), the Company's results could be adversely affected.

d) Liquidity risk

Liquidity risk is the risk of the Company being unable to generate sufficient cash resources to meet financial obligations as they fall due.

The Company is covered by the GRF and the supporting policies for managing risk within the Group and, in accordance, has a defined liquidity risk appetite with associated triggers and limits. This risk is managed through careful management of bank balances and cash-flow forecasting.

To manage liquidity risk in property funds which are inherently more illiquid, deferral clauses are in place, which can allow the Company to defer cash payments to withdrawing customers in extreme adverse liquidity scenarios. Liquidity risk however cannot be completely eliminated for unit-linked funds, in particular over the short term, where market volatility can result in mass withdrawals over a short period of time.

e) Credit risk

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

Due to the matching of policyholder liabilities to attaching asset value movements the UK unit-linked business is not directly affected by credit risk. The Company is, however, exposed to credit-related losses in the event of non-performance by counterparties.

(i) Impairment methodology

The impairment allowance calculation is based on Prudential Group's counterparty default risk calibration used for Solvency II. The counterparty default risk uses a default state model and a recovery rate model which is run through 1 million scenarios to generate a probability distribution of losses.

This produces a loss rate reflecting the default losses as a percentage of exposure for various stresses over a 12 month period. These rates have been applied to the balances as at 31 December 2018 to derive the Expected Credit Losses (ECL).

The impact of collateral and financial guarantees has been considered, where relevant, in the determination of ECL. The Company held cash balances of £78.4m at 31 December 2018 (2017: £73.0m). These balances are held with bank and financial institution counterparties.

NOTES ON THE FINANCIAL STATEMENTS (continued)

A 12-month ECL has been calculated in respect of these balances. This reflects the short maturities of the exposures. The Company considers that its cash and cash equivalents have low credit risk based on the external credit ratings of the counterparties.

The adoption of IFRS 9 did not result in any material change to the amount of impairment losses recognised.

24. Post balance sheet events

The Company has no post balance sheet events.