SCOTTISH AMICABLE FUNDS

Annual Report and Financial Statements for the Year Ended 31 December 2018

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SCOTTISH AMICABLE FUNDS

Board Members

Bernard Solomons (Chairman)
Paul Dollman
Stewart Gracie (Appointed 27 July 2018)
Brian Medhurst
Michael Walker
JP Miller (Resigned 27 July 2018)

Company Secretary of The Prudential Assurance Company Limited

Jennifer Owens

Auditors

KPMG LLP, London

SCOTTISH AMICABLE FUNDS

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

Background

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

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

Principal activity

In accordance with the terms of the Scheme governing the transfer of business, certain business has continued to be written in the Fund, which is a closed fund. This business is primarily in respect of increments to existing policies written by Scottish Amicable Life Assurance Society prior to 1 October 1997. Total premiums for the year are £38.5m (2017: £39.4m).

The Fund is a sub-fund of PAC which is a wholly owned subsidiary undertaking of another company registered in England and Wales and therefore group financial statements and a group business review are not prepared. Accordingly, the financial statements and this business review present information about the Fund as an individual undertaking and are not consolidated.

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

Strategic direction

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.

On 26 November 2018 the Company'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, a public limited company, limited by shares,incorporated and registered in England and Wales and the parent company of the Prudential group ('the Prudential Group' or 'the Group').

Specifically in relation to Scottish Amicable Insurance Fund (SAIF) as it continues to reduce in size, preliminary investigations into the possibility of merging the funds at an earlier date than required by the Scheme are ongoing. Any such decision to merge early, which will have regard to both the interests of the SAIF and other PAC policyholders, would require approval from the PAC Board, the Scottish Amicable Board and regulatory approval.

Principal risks and uncertainties

The Fund is a sub-fund of PAC, which is a wholly owned subsidiary of the M&G Prudential Limited, which is a subsidiary of Prudential plc, the parent company of the Prudential group ("the Group") and 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 material misstatement or loss, and focus on optimising the levels of risk and reward within a clearly defined risk appetite, with the aim of achieving the business objectives.

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

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

Financial and Insurance risks

The financial risk factors affecting the Fund include market risk, credit risk, insurance risk and liquidity risk. Further information on the financial risk management objectives and policies of the Fund and the exposure of the Fund to the related risk factors is given in note 18 on page 31.

(a) Market risk

Market Risk is the risk of loss, or of adverse changes in the financial situation resulting, directly and 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.

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

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

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

(b) Credit risk

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

The Fund is exposed to significant levels of credit risk, however this is mitigated by a large proportion of the annuity business being reinsured. The credit risk arises mainly from the corporate bond holdings in the non-profit annuity and with-profits business. Corporate borrowers continue to experience a challenging business environment and volatile profits and cashflows. This principally impacts credit risk through the following:

- Increased risk of credit losses through defaults and widening of credit spreads on corporate bonds; and

- The Fund, in the normal course of business enters into a variety of transactions with counterparties, including cash deposit, reinsurance and derivative transactions. Failure of any of these counterparties to discharge their obligations or where adequate collateral is not in place (e.g. in case of reinsurance counterparties), could have an adverse impact on the Fund's results.

(c) Insurance risk

Insurance risk is the risk of loss for our Fund, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend or volatility of a number of insurance risk drivers.
Insurance risk arises mainly from the annuity business in the form of longevity risk. The other insurance risks run by the Fund are expense risk, persistency risk and mortality/morbidity risk. These risks are less material than the market, credit and longevity risks. In common with other industry participants, the profitability of the Fund's businesses ultimately depends on a mix of factors including investment performance and asset impairments, mortality and morbidity trends, policy surrender rates,and unit cost of administration.

- Longevity Risk: This is the risk that the Fund's (current and deferred) annuity customers live longer than expected in the Fund's current reserving assumptions, and as a result future reserving and capital assumptions are changed. In addition, overall amounts in payment to customers may be greater than anticipated due to longer life expectancy.

- Expense Risk: This is the risk of actual expenses exceeding the assumptions in the reserving basis and is relevant to all lines of business.

- Persistency Risk: This is the risk that customer retention levels are different from the Fund's expectations. This risk can materialise if more or (for some lines of business) fewer customers opt for early termination of their products than anticipated. The Fund's persistency assumptions reflect the recent past experience for each relevant line of business and expected trends in future persistency rates. If the actual levels of future persistency are significantly different than assumed in reserving and capital calculations, the Fund's operating results could be adversely affected.

- Mortality and morbidity risks: These relate to assumptions around the expected number of deaths or illnesses used in calculating reserves. These are relevant for those lines of business where the customer pay-out is dependent on death or illness.

(d) Liquidity risk

Liquidity risk is the risk that the Fund may be unable to meet payment of obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates.

Liquidity risk arises mainly as a result of

- unplanned policyholder withdrawals and collateral requirements in its with-profit business;
- surrenders and processing delays in its unit-linked business;
- lower than expected market liquidity for assets in the WP and UL funds; and
- cash outflows from the shareholder business due to tax.

Liquidity risk to the SAIF fund is expected to increase over time as the fund reduces in size. Close monitoring is undertaken to ensure that cash outflows can be met under base and stressed scenarios; the methods and assumptions used for this purpose are subject to an annual review.

Non-financial risk

The Fund 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 Funds are regulatory, political, macroeconomic, and technology.

- Regulatory: Changes in UK government policy, legislation (including tax), regulation or regulatory interpretation applying to insurance companies may adversely affect the Funds' product range, 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 Funds have 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. Our current reliance on a large number of legacy systems spread over a complex supply chain and increasing utilisation of outsourcing/Cloud deployments creates an enhanced risk of breaches and IT issues. Additionally, the rising cyber threat and importance of customer data security required increased focus on cyber and data privacy controls to mitigate the risks posed by a larger digital footprint and increasingly sophisticated attacks.

(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 business capabilities.

While not directly impacted, the Fund is exposed to risk associated with the strategic decisions taken at the Group or Prudential UK level. The Prudential UK transformation strategy, along with the integration of the M&G and Prudential UK businesses carries an element of strategic risk for the Fund 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 Fund. The anticipated Product Administration System (IT) migrations and increasing use of outsourcing and Cloud-based technologies pose a material threat to the Company's reputation if mishandled, due to the level of customer data potentially impacted and the visibility externally. Reputational risk considerations are also an important part of the Fund'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 Group's behaviours and decision making are inappropriate, leading to unfair or poor outcomes for customers.

Customer needs are central to all decisions the Fund makes regarding the provision of financial services. The Fund 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/profit) arising from inadequate or failed internal processes, personnel and systems, or from external events. This includes employee error, system failures, fraud or some other event which disrupts business processes.

The Fund's primary exposure to operational risk arises from business processes (e.g. customer administration), people capabilities, operation of systems and financial reporting activity. Additional exposure is anticipated as Prudential UK enacts its strategic merger and transformation ambitions and 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 Fund 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 Fund as well as the risk management processes and internal control mechanisms within the Fund ensure group risk is appropriately managed.This is particularly important given the planned demerger.

On Behalf of the Scottish Amicable Board members

Bernard Solomons
Chairman
9 May 2019

SCOTTISH AMICABLE FUNDS

REPORT OF THE SCOTTISH AMICABLE BOARD FOR THE YEAR ENDED 31 DECEMBER 2018

Introduction

This report comprises a profit and loss account and balance sheet for the Scottish Amicable Funds for the year ended 31 December 2018 together with explanatory notes.

With-profits governance

The Company produces an annual with profits report, which is available on request and our website at www.pru.co.uk, setting out how it has complied with its Principles and Practices of Financial Management (PPFM).

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

The Company has a With-Profits Actuary who has the specific duty to advise the PAC Board on the application of discretion in relation to with-profits business; and a Chief Actuary who provides the PAC Board with certain actuarial advice, and fulfils various statutory duties under the new regulatory reporting regime introduced on 1 January 2016. Both of these are Financial Conduct Authority and Prudential Regulatory Authority approved roles.

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

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

The affairs of the Scottish Amicable Funds have their own Principles of Financial Management which are set out in Schedule 8 of the Scheme legal documents. Within this framework, the process by which decisions relating to with-profits issues are made in respect of the Fund is as follows:

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

Corporate responsibility

The Funds are part of PAC, a wholly owned subsidiary within the Prudential Group and Corporate Responsibility (CR) is integral to the way the Group does business.

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

REPORT OF THE SCOTTISH AMICABLE BOARD FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

As a business that provides savings, income, investment and protection products and services, social value is created through the day-to-day operations. The Fund 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 Fund'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 Fund, 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.

<u>Post balance sheet events</u>

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

<u>Financial performance</u>

The Scottish Amicable Fund as a whole delivered a negative investment return of (2.71)% in 2018 (2017: positive 9.11% return). As part of its asset allocation process, the fund managers constantly evaluate prospects for different markets and asset classes.

<u>Financial instruments</u>

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

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

<u>Scottish Amicable Board members</u>

The present members of the Scottish Amicable Board, are shown on page 2. Stewart Gracie was appointed on 27 July 2018 and JP Miller resigned on 27 July 2018. There have been no further changes.

<u>Disclosure to auditor</u>

The members of the Board who held office at the date of approval of this Board report confirm that, so far as they are each aware, there is no relevant audit information of which the Funds' auditor is unaware; and each member has taken all the steps that they ought to have taken as a Board member to make themself aware of any relevant audit information and to establish that the Funds' 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.

<u>Auditor</u>

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

<u>Directors' and officers' protection</u>

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, including the Funds, to be indemnified in respect of liabilities incurred as a result of their office. Prudential plc also provides protection for directors and senior managers of companies within the Group against personal financial exposure they may incur in their capacity. 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 Funds and other companies within the Group. These indemnities were in force during 2018 and remain in force.

On behalf of the Scottish Amicable Board members

Stewart Gracie

Stewart Gracie

Scottish Amicable Board member
9 May 2019

SCOTTISH AMICABLE FUNDS

STATEMENT OF BOARD RESPONSIBILITIES FOR THE YEAR ENDED 31 DECEMBER 2018

Statement of the board's responsibilities

The Board has accepted responsibility for the preparation of these non-statutory accounts for the year ended 31 December 2018 which are intended by them to give a true and fair view of the state of affairs of the Funds and of the profit or loss for that period. It has decided to prepare the non-statutory accounts in accordance with UK accounting standards (UK Generally Accepted Accounting Practice), including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and as if applicable UK law applied to them.

Under the terms of the Scheme the Board must not approve the non-statutory accounts unless it is satisfied that they give a true and fair view of the state of affairs of the Funds and of the profit or loss of the Funds for that period. In preparing these non-statutory accounts, the Board has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that are reasonable and prudent;
- stated whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- asses the Fund's ability to continue as a going concern, disclosing, as applicable, matters relates to going concern; and
- prepared the financial statements on the going concern basis unless it is inappropriate to presume that the Fund will continue in business.

The Board is responsible for such internal control as it determines is necessary to enable the preparation of non-statutory accounts 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 fund and to prevent and detect fraud and other irregularities.

In accordance with its responsibility for the management of the Funds, the Scottish Amicable Board has reviewed and, having received appropriate assurances from PAC and the Monitoring Actuary, has approved the financial statements for the year ended 31 December 2018.

INDEPENDENT AUDITOR'S REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

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

Opinion

We have audited the non-statutory accounts of the Funds for the year ended 31 December 2018 which comprise the Statement of Profit and Loss Account, Statement if Comprehensive Income, Balance Sheet for the Fund, Balance Sheet for the Capital Fund, the Reconciliation of the Movement in the Capital Funds surplus and related notes, including the accounting policies in note 1. The non-statutory accounts have been prepared for the reasons set out in note 1.

In our opinion the non-statutory accounts:

- give a true and fair view of the state of the Funds' affairs as at 31 December 2018 and of its loss for the year then ended; and
- have been properly prepared in accordance with UK accounting standards, including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and
- have been prepared in accordance with the requirements of the Companies Act 2006, as if those requirements were to apply.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and the terms of our engagement letter dated 23 May 2018. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Funds in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

The impact of uncertainties due to the UK exiting the European Union on our audit

Uncertainties related to the effects of Brexit are relevant to understanding our audit of the non-statutory accounts. All audits assess and challenge the reasonableness of estimates made by the Board, such as valuation of technical provisions and valuation of investments and the related disclosures and the appropriateness of the going concern basis of preparation of the non-statutory accounts. All of these depend on assessments of the future economic environment and the Funds' future prospects and performance.

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. We applied a standardised firm-wide approach in response to that uncertainty when assessing the Funds' future prospects and performance. 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.

Going concern

The Scottish Amicable Board (the Board) has prepared the non-statutory accounts on the going concern basis as they do not intend to liquidate the Funds or to cease their operations, and as they have concluded that the Funds' Balance Sheet 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 non-statutory accounts (the going concern period).

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 non-statutory accounts. In our evaluation of the Board's conclusions, we considered the inherent risks to the Funds' business model, including the impact of Brexit, and analysed how those risks might affect the Funds' financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

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 Funds will continue in operation.

SCOTTISH AMICABLE FUNDS

INDEPENDENT AUDITOR'S REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

Other information

The Board are responsible for the other information, which comprises the Strategic Report and the Report of the Scottish Amicable Board for the year ended 31 December 2018. Our opinion on the non-statutory accounts does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our non-statutory accounts audit work, the information therein is materially misstated or inconsistent with the non-statutory accounts or our audit knowledge. Based solely on that work, we have not identified material misstatements in the other information.

The Board's responsibilities

As explained more fully in their statement set out on page 11, the Board is responsible for: the preparation of the non-statutory accounts, which are intended by them to give a true and fair view; such internal control as they determine is necessary to enable the preparation of non-statutory accounts that are free from material misstatement, whether due to fraud or error; assessing the Fund'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 Fund 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 non-statutory accounts as a whole are free from material misstatement, whether due to fraud 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 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 non-statutory accounts.

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

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

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

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

Daniel Cazeaux
For and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
Canary Wharf
London, E14 5GL
9 May 2019

SCOTTISH AMICABLE FUNDS

STATEMENT OF PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2018

The technical account reflects the activities of the Fund	**2018 £m**	2017 £m	Note
Long-term Business Technical Account			
Gross premiums written	**38.5**	39.4	2
Outward reinsurance premiums	**(18.6)**	(20.3)	
Earned premiums, net of reinsurance	**19.9**	19.1	
Investment income & realised gains	**432.4**	596.0	3
Unrealised losses	**(555.2)**	(69.6)	3
	(122.8)	526.4	
Claims paid			
Claims paid - gross amount	**(885.6)**	(995.5)	
Claims paid - reinsurers share	**177.8**	163.5	
Claims paid, net of reinsurance	**(707.8)**	(832.0)	
Change in provision for claims - Gross amount	**(0.1)**	(0.6)	
Claims incurred net of reinsurance	**(707.9)**	(832.6)	
Change in long-term business provisions			
Gross amount	**1,113.7**	380.8	13
Reinsurers share	**(253.7)**	(24.4)	13
	860.0	356.4	
Other charges			
Net operating expenses	**(30.7)**	(35.0)	5
Investment expenses and charges	**(16.5)**	(19.4)	3
Tax attributable to the long term business	**(2.0)**	(14.9)	6
	(49.2)	(69.3)	
Transfer to Fund for Future Appropriations	**0.0**	0.0	7

The non-technical account reflects the activities of the Capital Fund	**2018 £m**	2017 £m
Non-technical account		
Balance on the long-term business technical account	—	—
Investment income & realised gains	**36.1**	81.1
Unrealised (losses) / gains	**(75.0)**	9.9
Investment expenses and charges	**(0.7)**	(0.1)
(Loss)/Profit on ordinary activities before tax	**(39.6)**	90.9
Tax on profit on ordinary activities		
Current tax charge	**(0.8)**	(2.0)
Deferred tax credit	**1.7**	0.6
(Loss)/Profit for the financial year	**(38.7)**	89.5

The accounting policies on pages 18 to 22 along with the accompanying notes on pages 22 to 39 form an integral part of the financial statements.

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2018

	2018 £m	2017 £m	Note
Balance on the long-term business technical account	—	—	
Other comprehensive income;			
Actuarial gains on defined benefit pension schemes	**1.6**	2.4	8
Deferred tax (charge)	**(0.3)**	(0.4)	6
Transfer (to) the fund for future appropriations	**(1.3)**	(2.0)	
Total comprehensive income for the financial year	—	—	

The accounting policies on pages 18 to 22 along with the accompanying notes on pages 22 to 39 form an integral part of the financial statements.

SCOTTISH AMICABLE FUNDS

BALANCE SHEET FOR THE FUND AS AT 31 DECEMBER 2018

	2018 £m	2017 £m	Note
Assets	**£m**	£m	
Investments			
Investments in group undertakings	**494.6**	477.4	9
Other financial investments	**4,179.7**	5,015.8	10
	4,674.3	5,493.2	
Reinsurers' share of technical provisions			
Long-term business provision	**383.2**	417.3	13
Technical provisions for linked liabilities	**1,517.9**	1,739.2	
	1,901.1	2,156.5	
Debtors	**34.4**	36.2	11
Other assets			
Cash at bank and in hand	**110.7**	210.2	
Prepayments and accrued income			
Accrued interest and rent	**21.4**	23.8	
Other prepayments and accrued income	**2.4**	2.9	
	23.8	26.7	
Total Assets	**6,744.3**	7,922.8	
Liabilities			
Subordinated liabilities	—	100.0	14
Fund for future appropriations	—	—	7
Technical provisions			
Long-term business provision	**4,965.9**	5,856.5	13
Claims outstanding	**70.4**	70.4	13
	5,036.3	5,926.9	
Technical provisions for linked liabilities	**1,517.9**	1,741.0	13
Provisions for other risks and charges			
Deferred taxation	**26.2**	36.9	6
Provisions for DB Pensions	**2.4**	4.1	
	28.6	41.0	
Creditors			
Derivative Liabilities	**40.8**	16.5	10
Other creditors including taxation and social security	**120.7**	97.4	12
	161.5	113.9	
Total Liabilities	**6,744.3**	7,922.8	

The accounting policies on pages 18 to 22 along with the accompanying notes on pages 22 to 39 form an integral part of the financial statements. The accounts were approved by the Scottish Amicable Board on 7 May 2019.

Stewart Gracie

Stewart Gracie
9th May 2019

SCOTTISH AMICABLE FUNDS

BALANCE SHEET FOR THE CAPITAL FUND AS AT 31 DECEMBER 2018

	2018 £m	2017 £m
Assets		
Investments		
Land and buildings	**120.2**	92.1
Other financial investments	**608.0**	803.6
	728.2	895.7
Other assets		
Cash at bank and in hand	**64.2**	81.1
Total Assets	**792.4**	976.8
Liabilities		
Capital Fund surplus	**680.4**	828.4
Provisions for other risks and charges		
Deferred taxation	**1.9**	3.6
Creditors		
Amounts due to fellow group undertakings	**109.3**	142.9
Tax payable	**0.8**	1.9
Other creditors including taxation and social security	**110.1**	144.8
Total Liabilities	**792.4**	976.8

Reconciliation of the movement in the Capital Fund surplus for the year ended 31 December 2018

	2018 £m	2017 £m
Profit/(Loss) for the financial year	**(38.7)**	89.5
Reduction by reason of excess	**(109.3)**	(142.9)
Capital Fund surplus at beginning of year	**828.4**	881.8
Capital Fund surplus at end of year	**680.4**	828.4

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

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

The accounting policies on pages 18 to 22 along with the accompanying notes on pages 22 to 39 form an integral part of the financial statements.

SCOTTISH AMICABLE FUNDS

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting Policies

A. Fund Information

Scottish Amicable Funds (the Funds) comprise the Scottish Amicable Insurance Fund (the Fund), which is a closed fund, and the Scottish Amicable Capital Fund (the Capital Fund). The Fund is a sub-fund of The Prudential Assurance Company Ltd (PAC). PAC is a private limited company and is incorporated and registered in England and Wales.

During 2018, the address of the registered office of the Fund, PAC, M&GPrudential Limited and Prudential plc was:
Laurence Pountney Hill
London
EC4R 0HH

On 12 April 2019 the address of the registered office of the Fund, PAC, and M&GPrudential Limited changed to:
10 Fenchurch Avenue
London
EC3M 5AG

B. Basis of Preparation

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

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

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

The Fund is a sub-fund of PAC and PAC's ultimate parent, Prudential plc, includes PAC in its consolidated financial statements. Details of where to obtain copies of the consolidated accounts are disclosed in note 17. In these financial statements, the Fund is considered to be a qualifying entity and has applied the exemptions available under FRS 102 in respect of the requirement to present a cash flow statement and related notes.

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

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

The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Funds accounting policies. The table below sets out the areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements.

Critical accounting estimates	Accounting policy/note reference
Measurement of long-term business provision	C and 13
Determination of fair value of financial investments	E and 18

The Board has a reasonable expectation that the Funds will be able to continue in operational existence for the foreseeable future and thus continue to adopt the going concern basis of accounting in preparing the financial statements. This conclusion has been based upon the following:

- The Funds are part of PAC, a subsidiary within the Prudential Group and it and its ultimate parent company are continuing to trade profitably and there are no plans for liquidation.

- The Company, of which the Funds are a part, is a subsidiary within the Prudential Group and it and its ultimate parent company are continuing to trade profitably and there are no plans for liquidation. Prudential plc and the Company have put in place intra-group arrangements to formalise circumstances in which capital support would be made available by Prudential plc. While it is considered unlikely that such support will be required, the arrangements are intended to provide additional comfort to the Company and its policyholders.

- The Company, of which the Funds are a part, is supported by its inherited estate, generates positive cashflows and has very low debt-financing. As detailed in the Strategic Report on page 3, consideration has also been given to the Fund's performance, the market in which it operates, its strategy and risks and uncertainties, the management of financial risk, including its exposure to credit risk and liquidity risk.

In assessing the going concern of the Funds, the Board has assessed the current and projected solvency position under Solvency II and considers it to have an appropriate capital surplus.

C. Long-term Business

i. Technical account treatment

Premiums and annuity considerations for conventional with-profit policies and other protection type life insurance policies are accounted for when due. For unit linked business and unitised with-profit policies, premiums are accounted for when the liabilities arising from the premiums are recognised. Premiums exclude any taxes or duties based on premiums.

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

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

The fund for future appropriations (FFA) at the balance sheet date represents all funds where the allocation to policyholders has not been determined at the balance sheet date.

In determining the amount of liabilities and FFA the Fund has applied the approach previously followed of showing the working capital as zero, as the fund will be distributed fully. If this approach was not followed, the FFA would have been £288m (2017: £280m) rather than zero.

ii. Measurement of long-term business provision

The assumptions used to calculate the long-term business provisions are described in note 13.

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

The realistic value of liabilities is calculated as:
(i) a with-profits benefits reserve (WPBR) plus
(ii) future policy related liabilities (FPRL) plus
(iii) the realistic current liabilities of the Fund.

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

Asset shares are calculated by rolling up the premiums paid, less expenses and charges using the actual investment returns earned on the with-profits fund. The assumptions used within the asset share calculations are consistent with those that are actually used to determine policyholders' bonuses. A number of adjustments are made to reflect future expected policyholder benefits and other outgoings.

For certain classes of business a prospective bonus reserve valuation is performed instead, valuing future claims and expenses using the expected future bonus rates.

The FPRL include a market consistent valuation of the costs of guarantees, options and smoothing. This is determined using stochastic modelling. The liabilities include £328m (2017: £460m) in respect of annuity rate guarantees at vesting or on maturity attaching to certain pension products. The FPRL also includes the distribution of surplus from non-profit business. For the Fund, the realistic liability calculation requires that the entire surplus within the Fund is distributed to policyholders and therefore the FPRL is increased up to the point where the Fund has no working capital.

D. Reinsurance

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

E. Investments

Investment income and realised and unrealised gains in respect of long-term business are included in the long-term business technical account. Investment income and realised and unrealised gains or losses of the Capital Fund 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 balance sheet date and the reversal of unrealised investment gains and losses recognised in earlier accounting periods in respect of investment disposals.

Investments in group undertakings and participating interests are carried at fair value through profit and loss and long-term business investments are taken to the technical account. Investments of the Capital Fund are taken to the non-technical account.

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

(i) Financial investments at fair value through profit and loss – this comprises assets designated by management as fair value through profit and loss on inception and derivatives. These investments are valued at fair value with all changes thereon being recognised in the profit and loss account. An analysis of net gains/losses is disclosed separately in note 3.

The Fund uses bid prices to value its quoted financial investments. Actively traded investments without quoted prices are valued using external broker bid prices. If there is no active established market for an investment, the Fund applies an appropriate valuation technique such as discounted cash flow analysis. Further information on valuation techniques is provided in note 18.

(ii) Loans and receivables – these comprise investments that have fixed or determinable payments and are not designated as fair value through profit and loss or available-for-sale. These investments are carried at amortised cost using the effective interest method and subject to impairment reviews. The Fund measures the amount of the impairment loss by comparing the amortised cost with the present value of its estimated future cash flows discounted at the original effective interest rate.

Basic financial assets, including debtors and cash at bank and in hand are initially recognised at transaction price plus attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost using the effective interest method and subject to impairment reviews where appropriate.

The Fund uses derivatives for the purpose of efficient portfolio management or the reduction in investment risk. In so doing, the Fund obtains cost effective and efficient exposure to various markets to manage exposure to interest rate, currency, credit and other business risks. Derivatives are carried at fair value with movements in fair value being recorded in the long term technical account or non-technical account. The Fund has opted not to apply hedge accounting to derivatives.

F. Financial Liabilities

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

The Fund holds financial liabilities on the following bases:

(i) Financial liabilities at fair value through profit and loss - these comprise derivatives. Derivative liabilities and certain creditors are valued at fair value with all changes thereon being recognised in the profit and loss account. An analysis of net gains/losses is disclosed separately in note 3.
(ii) Financial liabilities that are not valued at fair value through profit and loss and are not investment contracts with DPF are mainly creditors shown at settlement value.
(iii) Investment contracts with DPF are accounted for under FRS 103.

G. Taxation

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

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

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

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.
Except where otherwise required by accounting standards, full provision for deferred tax without discounting is made for all timing differences which have arisen but not reversed at the balance sheet date.

H. Foreign currencies

Monetary foreign currency assets and liabilities are translated at the year end exchange rates and foreign currency transactions are translated into the functional currency using the spot exchange rates at the dates of the transactions. Exchange difference are included in the profit and loss account.

I. Provisions and contingencies

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

2. Gross premium analysis

	Technical Account	
	2018	2017
	£m	£m
Gross premiums written:		
Direct	**21.6**	25.4
Reinsurance accepted	**16.9**	14.0
	38.5	39.4
By individual and group		
Individual business	**21.4**	24.8
Group Contracts	**0.2**	0.6
	21.6	25.4
By frequency		
Regular premiums	**21.2**	24.8
Single premiums	**0.4**	0.6
	21.6	25.4

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

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

3. Investment income and expenses

(a) Investment income and realised gains and (losses)	Technical Account 2018 £m	2017 £m
Income from:		
Land and buildings	**0.8**	0.2
Other investments	**168.1**	203.1
Interest receivable from group undertakings	**1.1**	1.7
Other income	**7.4**	4.9
Total income	**177.4**	209.9
Realised gains and (losses) from:		
Loans and receivables	**(0.1)**	0.1
Realisation of investments at fair value through profit and loss other than derivatives	**259.7**	322.7
Exchange gains / (losses)	**3.4**	(3.8)
Realisation of (loss) / gain on derivatives	**(8.0)**	67.1
Total realised gains	**255.0**	386.1
Total investment income and realised gains and losses	**432.4**	596.0

(b) Unrealised (losses) and gain on investments	Technical Account 2018 £m	2017 £m
Equity	**(384.2)**	64.2
Bonds	**(107.0)**	(82.9)
Other	**(64.0)**	(50.9)
	(555.2)	(69.6)

(c) Investment expenses and charges	2018 £m	2017 £m
Investment management fees payable to group undertakings	**12.0**	10.5
Property investment expenses	**0.2**	0.4
Interest payable to group undertakings	**4.3**	8.5
	16.5	19.4

All income is from assets measured at fair value with the exception of interest income on loans and receivables which was £3.8m for the year ended 31 December 2018 (2017: £2.3m). All interest expense is from financial liabilities measured at fair value with the exception of interest expense on loans which was £4.3m for the year ended 31 December 2018 (2017: £8.5m).

All gains above are from assets measured at fair value with the exception of gains / (losses) on loans and receivables.

4. Bonuses

Bonuses added during the year are included in the long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses in 2018 was £328.1m (2017: £354.2m).

5. Net operating expenses

	Technical Account	
	2018	2017
	£m	£m
Capital fund support charge	**8.0**	8.0
Commission	**0.2**	0.3
Benchmarking rebates	**(1.7)**	(3.4)
Administration charges	**24.2**	30.1
	30.7	35.0

The remuneration of the auditors in respect of the non-statutory audit was £81,350 (2017: £81,350). The remuneration of the monitoring actuary for the year was £66,805 (2017: £92,510). The emoluments for the highest paid Board member were £48,700 (2017: £46,992). Total Board member fees payable in the year to 31 December 2018 were £192,488 (2017: £183,290).

6. Taxation

	Technical account	
(a) Tax charged	**2018**	2017
	£m	£m
Current Tax		
UK corporation tax	**8.5**	12.9
Overseas tax	**3.1**	4.0
Adjustment in respect of prior years	**1.4**	(0.8)
Total current tax	**13.0**	16.1
Deferred Tax		
Origination and reversal of timing differences	**(11.0)**	(1.2)
Total deferred tax	**(11.0)**	(1.2)
Total charge for the year	**2.0**	14.9

(b) Provision for deferred tax	**2018**	2017
	£m	£m
Deferred tax:		
Acceleration of capital allowances	**0.5**	0.7
Unrealised investment gains	**26.2**	37.2
Defined benefit pension costs	**(0.4)**	(0.9)
Deferred acquisition costs	**(0.1)**	(0.1)
Total provisions	**26.2**	36.9

Movements on deferred tax liabilities are as follows:

Deferred tax liability at 1 January	**36.9**	37.7
Deferred tax (credited) in the year	**(11.0)**	(1.2)
Deferred tax from statement of other comprehensive income - current year	**0.3**	0.4
Deferred tax liability at 31 December	**26.2**	36.9

7. Fund for future appropriations

The funds for future appropriations is £nil (2017:£nil) as the Fund will be pursuant to the Scheme fully distributed to its members.

8. Defined Benefit Pension Schemes

The majority of staff employed by the Prudential Group in the UK are members of the Prudential Group's pension schemes. The largest scheme is the Prudential Staff Pension Scheme (PSPS). This scheme is primarily a defined benefit scheme. This scheme was closed to new employees on 31 July 2003. Employees after this date are enrolled in the defined contribution section of the scheme. At 31 December 2018, the underlying PSPS liabilities account for 82% (2017: 82%) of the aggregate liabilities of the Prudential Group's defined benefit schemes.

There is also a smaller defined benefit scheme, Scottish Amicable Staff Pension Scheme (SASPS). SAIF contributes to 3% of the deficit on a monthly basis. The actuarial gain in 2018 was £1.6m (2017: £2.4m).

Both schemes are group pension schemes, whereby the costs associated with them are shared across different entities under common control. The contributions into the schemes are payable at the minimum level of contributions required under the scheme rules. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity.

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

The last completed actuarial valuation of the SASPS was as at 31 March 2017 and was finalised in 2017. This valuation demonstrated the scheme to be 75 per cent funded. Based on this valuation, it was agreed with the Trustees that the level of deficit funding is £26m per annum from 1 April 2017 to 31 March 2027, subject to review at subsequent valuations.

In January 2019, following consultation, the Company reached agreement that salary increases for defined benefit scheme members who earn in excess of £35,000 will no longer be pensionable after 30 September 2019. Pension benefits will still relate to how many years they have been active scheme members, as they do now, as long as they remain working for the Company. The impact of this is not reflected in the 2018 results.

Further details of the pension schemes operated by the Company are disclosed in the accounts of the Company and Prudential Financial Services Limited.

9. Investments in group undertakings

	Cost		**Carrying value**	
	2018 £m **£m**	2017 £m £m	**2018 £m** **£m**	2017 £m £m
Shareholdings	**365.5**	364.0	**479.5**	462.3
Loans	**15.1**	15.1	**15.1**	15.1
	380.6	379.1	**494.6**	477.4

10. Other financial investments

	Cost		Carrying value	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Fair value through profit and loss				
Shares and other variable yield securities and units in unit trusts	**1,680.0**	1,898.0	**1,960.5**	2,576.2
Debt securities and other fixed income securities	**1,451.8**	1,688.4	**1,560.2**	1,903.8
Participation in investment pools	**132.0**	111.3	**185.6**	173.8
Derivative asset	—	—	**76.9**	70.3
Amortised Cost				
Loans to policyholders secured by insurance policies	**0.5**	1.7	**0.5**	1.7
Other loans	**42.5**	42.0	**41.2**	41.0
Deposits with credit institutions	**354.8**	249.0	**354.8**	249.0
	3,661.6	3,990.4	**4,179.7**	5,015.8

The table below analyses the derivative positions of the Fund.

	2018 £m		2017 £m	
	Fair value assets	**Fair value liabilities**	Fair value assets	Fair value liabilities
Derivative financial instruments held to manage credit, interest rate and currency profile:				
Interest rate swaps	**72.8**	**9.9**	50.7	11.1
Inflation swaps	—	—	0.5	—
Currency exchange forward contracts	**2.1**	**28.8**	17.5	4.1
Bond futures	**1.9**	**1.2**	0.6	0.7
Derivative financial instruments held to manage equity risk and for efficient investment management:				
Equity index futures contracts	**0.1**	**0.9**	1.0	0.6
Total at 31 December	**76.9**	**40.8**	70.3	16.5

11. Debtors

	2018	2017
	£m	£m
Amounts due from fellow group undertakings	**8.1**	9.2
Tax recoverable	**14.8**	13.9
Other	**11.5**	13.1
Total	**34.4**	36.2

Debtors include £0.1m (2017: £0.1m) due after more than one year.

12. Other creditors including tax and social security

	2018 £m	2017 £m
Amounts due to fellow group undertakings	**49.4**	32.1
Tax payable	**1.0**	0.7
Stock lending creditor	**67.3**	54.3
Other	**3.0**	10.3
Total	**120.7**	97.4

13. Long-term business provision

i) Analysis of movements in insurance liabilities

	Technical provisions		
	Technical Provisions £m	Linked liabilities £m	Total £m
At 1 January 2017	6,328.4	1,719.3	8,047.7
Premiums	19.8	(0.7)	19.1
Surrenders	(159.3)	15.0	(144.3)
Maturities/Deaths	(513.5)	(15.7)	(529.2)
Switches	—	(158.4)	(158.4)
Investment-related items and other movements	255.5	184.3	439.8
Foreign exchange translation differences	(4.0)	(2.8)	(6.8)
As at 31 December 2017/1 January 2018	**5,926.9**	**1,741.0**	**7,667.9**
Premiums	**19.2**	**0.7**	**19.9**
Surrenders	**(142.0)**	**(0.1)**	**(142.1)**
Maturities/Deaths	**(438.8)**	**(1.3)**	**(440.1)**
Switches	**(0.6)**	**(125.0)**	**(125.6)**
Investment-related items and other movements	**(329.9)**	**(97.9)**	**(427.8)**
Foreign exchange translation differences	**1.5**	**0.5**	**2.0**
As at 31 December 2018	**5,036.3**	**1,517.9**	**6,554.2**

ii) Determining insurance liabilities

With-profits business

Assumptions for Realistic Reserves

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

Assumptions are required in three areas, namely:

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

Retrospective assumptions

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

The 2018 year end Investment Return for assets backing asset shares is:

Gross return	(2.81)%
Net return	(2.26)%

Prospective assumptions

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

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

Expense assumptions have been revised to reflect the most recent experience, and expected expenditure over the business planning period. The assumptions have also been revised to allow for the effect of the contracts signed with TCS. Under these contracts the costs for the administration of some of the Company's existing business and some future new business are fixed. In addition the new arrangements are expected to deliver new systems and processes that will reduce the costs of implementing one-off developments in future. Accordingly, an element of the savings expected to be obtained from the contracts signed with TCS have been incorporated into the expected expenses used for setting the expense assumptions.

The table below shows the 2018 mortality bases:

Product	Mortality Table (M/F)	Age Rating Years (M/F)	Multiplier % (M/F)
Accumulating With Profits Life Business	AMC00 / AFC00	+1 / +1	45
Conventional With Profits Life Business	AMC00 / AFC00	+1 / +1	55
Accumulating With Profits Pensions Business	AMC00 / AFC00	+1 / +1	40
Conventional With Profits Pensions Business	AMC00 / AFC00	+1 / +1	35

For mortality and persistency, the assumptions for asset share adjustments are the best estimate European Embedded Value assumptions. The persistency assumptions used to value the cost of options and guarantees are reduced by a 10% margin to make an allowance for the impact of policyholders' group actions in extreme market scenarios.

Stochastic asset model economic calibration and management actions

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

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

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

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

Investment-linked business

A non-unit reserve is held for mortality, morbidity and expenses (including investment management expenses and other outgoings associated with payments to third parties). There has been no change in policy from 2017.

Other non-linked business

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

	2018		2017	
	Interest rate	**Actuarial mortality table reference**	Interest rate	Actuarial mortality table reference
Non profit retirement annuities In deferment // In payment	**1.868**	65% AMC00/AFC00+1yr // 79.8% (male), 77.9% (female) of PCxA00 Future mortality improvements: Default calibration of CMI2016 with a long-term mortality improvement rate of 1.75% for males and 1.50% for females plus 0.5% constant increase to per annum improvement rates	1.828	65% AMC00/AFC00+1yr // 80.7% (male), 71.7% (female) of PCxA00 Future mortality improvements: Default calibration of the CMI's 2015 mortality model, with a long-term mortality improvement rate of 2.25 % for males and 2.00% for females
Non profit immediate annuities	**Fixed: 2.961** **Linked: 2.894**	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), adjusted to account for socio-economic mortality differentials at an individual level. The assumptions also include 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 mortality improvement rate of 1.75% for males and 1.50% for females plus 0.5% constant increase to per annum improvement rates	Fixed (pre-2019): 2.383 Fixed (post-2019): 2.395 Linked (pre-2019): 3.021 Linked (post-2019): 3.033	89.9% (male), 84.7% (female) of PCxA00 Future mortality improvements: Default calibration of the CMI's 2015 mortality model, with a long-term mortality improvement rate of 2.25 % for males and 2.00% for females
Non profit life assurances	**1.494**	**85% AMC00/AFC00+1yr**	1.462	85% AMC00/AFC00+1yr
Non profit pension assurances	**1.868**	**65% AMC00/AFC00+1yr**	1.828	65% AMC00/AFC00+1yr

- For Non-profit retirement annuities (in payment), life expectancy at age 65 (for someone currently aged 45) has decreased from 30.1 years to 28.9 years for males and from 32.3 years to 30.4 years for females. The decrease in life expectancies is a result of mortality improvements continuing to weaken under CMI2016 from CMI2015. The female life expectancy has decreased more than males due to base mortality assumptions of females being heavier.
- For Non-profit immediate annuities, the life expectancies for both males and females are based on an averaged basis that is consistent with the life specific basis outlined in the table above. Life expectancy at age 65 (for someone currently aged 45) has increased from 28.2 years to 28.3 years for males and decreased from 30.0 years to 29.4 years for females. The decrease in female life expectancy is a result of weaker future improvements under CMI2016. For males, the slight increase in life expectancy is a result of the change in base mortality being significant than the change in future improvements from CMI2015 to CMI2016.

Other long term business provision

At 31 December 2018 a provision of £1.5m (2017: £7.5m) is held to meet compensation payments arising from 'business as usual' complaints from endowment policyholders. The provision has been calculated as a best estimate of the future compensation costs to policyholders who have not been time-barred from having their endowment policy reviewed. As described above, in addition a provision of £361m (2017: £503m) is held to cover the Fund's exposure due to guaranteed annuities.

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

The aggregate effect of assumption changes in 2018 was a net credit to the FFA of £81m (2017: net credit of £84m), relating to changes in guaranteed annuity take-up rates, mortality, expense, persistency and tax assumptions, where appropriate in the two periods.

14. Subordinated liabilities

In 1994, Scottish Amicable Finance plc (a wholly owned subsidiary of PAC) issued £100m of 8.5% undated subordinated guaranteed bonds. The interests of the holders of the bonds issued by Scottish Amicable Finance plc are subordinated to the entitlements of the policyholders of the Fund. The proceeds of the issue were lent to the Fund on equal terms as to interest, repayment and subordination as those applicable to the bonds. The bonds were guaranteed by the Fund and were repaid on 30 June 2018.

15. Contingent liabilities

There are no contingent liabilities as at 31 December 2018 (2017: nil).

16. Related party transactions

The Company, of which the Funds are a part, has taken advantage of the exemption under 1(A) of FRS 102.33 *Related Party Disclosures* from disclosing transactions with other wholly owned subsidiary undertakings of the Prudential group.

17. Ultimate and immediate parent companies

The Funds are a part of PAC and PAC's ultimate parent is Prudential plc, which is the parent company that prepares consolidated accounts.

Copies of PAC's accounts may be obtained from 10 Fenchurch Avenue, London, EC3M 5AG.

Copies of the consolidated accounts of Prudential plc can be obtained from Angel Court, London, EC2R 7AG.

18. Financial assets and liabilities

A. Financial instruments – designation and fair values

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

2018 £m	Fair value through profit and loss	Loans and receivables	Total carrying value	Fair value
Financial Assets				
Deposits with credit institutions	-	354.8	354.8	354.8
Equity securities and portfolio holdings in unit trusts	1,960.5	-	1,960.5	1,960.5
Debt securities and other fixed income securities	1,560.2	-	1,560.2	1,560.2
Loans (note i)	-	41.7	41.7	43.0
Other investments (note ii)	185.6	-	185.6	185.6
Derivative asset	76.9	-	76.9	76.9
Accrued investment income	-	23.8	23.8	23.8
Other debtors	-	19.6	19.6	19.6
Cash at bank and in hand	-	110.7	110.7	110.7
Total	3,783.2	550.6	4,333.8	4,335.1

Financial Liabilities	Fair value through profit and loss	Amortised cost	Investment contracts with DPF	Total carrying value	Fair value
Subordinated liabilities	-	—	-	—	—
Investment contracts with discretionary participation features (note iii)	-	-	324.0	324.0	—
Other creditors	-	119.6	-	119.6	119.6
Derivative liabilities	40.8	-	-	40.8	40.8
Total (note iv)	40.8	119.6	324.0	484.4	160.4

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2017 £m	Fair value through profit and loss	Loans and receivables	Total carrying value	Fair value
Financial Assets				
Deposits with credit institutions	-	249.0	249.0	249.0
Equity securities and portfolio holdings in unit trusts	2,576.2	-	2,576.2	2,576.2
Debt securities and other fixed income securities	1,903.8	-	1,903.8	1,903.8
Loans (note i)	-	42.7	42.7	43.7
Other investments (note ii)	173.8	-	173.8	173.8
Derivative asset	70.3	-	70.3	70.3
Accrued investment income	-	26.7	26.7	26.7
Other debtors	-	22.3	22.3	22.3
Cash at bank and in hand	-	210.2	210.2	210.2
Total	4,724.1	550.9	5,275.0	5,276.0

Financial Liabilities	Fair value through profit and loss	Amortised cost	Investment contracts with DPF	Total carrying value	Fair value
Subordinated liabilities	-	100.0	-	100.0	104.4
Investment contracts with discretionary participation features (note iii)	-	-	380.0	380.0	-
Other creditors	-	96.8	-	96.8	96.8
Derivative liabilities	16.5	-	-	16.5	16.5
Total (note iv)	16.5	196.8	380.0	593.3	217.7

Notes

i. Loans and receivables are reported net of allowance for loan losses of £5.9m (2017: £5.6m).
ii. Other investments include participation in various investment funds and limited liability property partnerships.
iii. It is impractical to determine fair value of investment contracts with discretionary participation features due to the lack of a reliable basis to measure such features.
iv. For financial liabilities designated as fair value through profit and loss there was no material impact on profit from movements in credit risk during 2018 and 2017.

Determination of fair value

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

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

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

Other than the loans which have been designated at fair value through profit or loss account, the loans and receivables have been shown net of provisions for impairment, The discount rate is updated for the market risk rate of interest where applicable.

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

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

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

The table below includes financial instruments carried at fair value analysed by level of the FRS102.34 *Specialist Activities Financial Institutions* (FRS 102.34) paragraph 22 defined fair value hierarchy (and also includes loans carried at amortised cost in the balance sheet but for which the fair value is disclosed in the financial statements). This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

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

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

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

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

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

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £1,415.3m (2017: £1,696.5m), £77.9m (2017: £88.8m) are valued internally. The majority of such securities use matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring a specified liquidity premium. The 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 which are exposed to bespoke properties or risks and investments which are internally valued or subject to a significant number of unobservable assumptions. It also includes debt securities which are rarely traded or traded only in privately negotiated transactions and hence where it is difficult to assert that these have been based on observable market data. The inherent nature of the vast majority of these assets means that, in normal market conditions, there is unlikely to be significant change in the specific underlying assets classified as level 3.

2018 £m	**Level 1**	**Level 2**	**Level 3**	**Total**
Equity securities	**1,885.0**	**74.9**	**0.6**	**1,960.5**
Debt securities	**143.7**	**1,415.3**	**1.2**	**1,560.2**
Loans at FVTPL	**—**	**36.3**	**4.4**	**40.7**
Other investments (including derivative assets)	**2.1**	**109.8**	**150.6**	**262.5**
Derivative liabilities	**(2.2)**	**(38.6)**	**—**	**(40.8)**
Total financial investments, net of derivative liabilities	**2,028.6**	**1,597.7**	**156.8**	**3,783.1**
Percentage of total	**54%**	**42%**	**4%**	**100%**

2017 £m	Level 1	Level 2	Level 3	Total
Equity securities	2,510.4	65.0	0.8	2,576.2
Debt securities	206.3	1,696.5	1.0	1,903.8
Loans at FVTPL	—	33.1	9.0	42.1
Other investments (including derivative assets)	1.6	106.7	135.9	244.2
Derivative liabilities	(1.3)	(15.2)	—	(16.5)
Total financial investments, net of derivative liabilities	2,717.0	1,886.1	146.7	4,749.8
Percentage of total	57%	40%	3%	100%

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

B. Risk Management

The Fund's business involves the acceptance and management of risk. The Fund has in place a risk management process, which is undertaken in accordance with the GRF.

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

Risk Type	Definition
Market risk	The risk of loss for the Fund, or of adverse change in the financial situation, resulting directly or indirectly, from fluctuations in the level and/or volatility of market prices of assets and liabilities.
Credit risk	The risk of loss for the Fund or of adverse change in the financial position, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors in the form of default or other significant credit event (e.g. downgrade or spread widening).
Insurance risk	The risk of loss for the Fund, or of adverse change in the value of insurance liabilities of the Fund, resulting from changes in the level, trend or volatility of a number of insurance risk drivers. These include adverse longevity, mortality and morbidity experience.
Liquidity risk	The risk that the Fund may be unable to meet payment of obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates.

C. Market Risk

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

- Equity: due to fluctuations in equity prices;
- Interest rate: due to changes in market interest rates;
- Currency: due to changes in foreign exchange rates; and
- Other assets / alternative investments: due to fluctuations in any other market prices or alternative investments (other than those detailed above).

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

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

Sensitivity to market risks has no impact on profits and equity as the Fund does not generate a profit. This is because the movement in liabilities is fixed to ensure no result emanates.

Currency Risk

As at 31 December 2018, the Fund held 42 % (2017: 49%) and 27% (2017: 14%) of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency.

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

D. Credit risk

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

Debt Securities and Other Fixed Income Securities

The following table summarises by the rating the securities held by the Fund as at 31 December 2018 and 2017:

	2018 £m	2017 £m
AAA	**156.7**	206.8
AA+ to AA-	**265.7**	353.1
A+ to A-	**390.8**	513.4
BBB+ to BBB-	**499.8**	566.3
Other	**247.2**	264.2
Total debt securities and other fixed income securities	**1,560.2**	1,903.8

In the table above credit ratings agency have been used where available. For securities where our reference rating agency are not immediately available those produced by other rating agencies have been used as an alternative.

Where no external ratings are available internal ratings produced by the Prudential Group's asset management operations, which are prepared on a comparable basis to external ratings, are used where possible. Of the total debt securities held at 31 December 2018 which are not externally rated, £80.8m (2017: £91.7m) were internally rated AAA to A-, £39.0m (2017: £47.6m) were internally rated BBB+ to B- and £5.4m (2017: £7.4m) were internally rated as below B- or unrated.

Loans and receivables

Of the total loans and receivables £Nil (2017: £Nil) are past their due date but have not been impaired. In accordance with the accounting policies, impairment reviews were performed for loans and receivables. During the year ended 31 December 2018, impairment losses of £0.4m (2017: £0.3m) were recognised for loans and receivables.

Securities lending and reverse repurchase agreements

The Fund has entered into securities lending (including repurchase agreements) whereby blocks of securities are loaned to third parties, primarily major brokerage firms. The amounts above the fair value of the loaned securities required to be held as collateral by the agreements, depend on the quality of the collateral, calculated on a daily basis. The loaned securities are not removed from the Fund's balance sheet, rather they are retained within the appropriate investment classification. Collateral, typically consists of cash, debt securities, equity securities and letters of credit. At 31 December 2018, the Fund had lent £204m (2017: £184m) of securities and held collateral under such agreements of £240m (2017: £285m).

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

Collateral and pledges under derivative transactions

The amount pledged for assets in respect of over-the-counter derivative transactions and repurchase arrangements was £66m (2017: £53m).

E. Insurance risk

The Fund is exposed to significant levels of insurance risk. Insurance risk arises mainly from the annuity business in the form of longevity risk, which is the risk that the Fund's (current and deferred) annuity customers live longer than expected in the Fund's current reserving assumptions, and as a result future reserving and capital assumptions are changed.

The Fund conducts rigorous research into longevity risk, using data from its annuitant portfolio. As part of its pension annuity reserving policy, mortality rates are reviewed annually using external data at levels based on the Fund's calibration of the Continuous Mortality Investigations (CMI) 2016 mortality projection model as published by the Institute and Faculty of Actuaries. If mortality improvement rates significantly exceed the improvement assumed, the Fund's operating results could be adversely affected. Further any major medical breakthrough (for example in the treatment of cancer or other life-threatening diseases) that would require the Fund to strengthen its longevity assumptions would have an impact on the Fund's results.

Mortality and morbidity risks relate to assumptions around the expected number of deaths or illnesses used in calculating reserves. These are relevant for those lines of business where the customer payoff is dependent on death or illness. If the actual mortality or morbidity rates were significantly higher than those assumed in reserving, then the Fund would make a loss on certain lines of business which could be offset by potential gains on other lines of business due to the natural diversification between longevity and mortality risks.

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

Mortality and other insurance risk are relatively minor factors in the determination of the bonus rates. Adverse persistency experience can affect the level of profitability from with-profits.

F. Liquidity risk

Liquidity risk is the risk that the Fund may be unable to meet payment obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates. Liquidity management in the Fund seeks to ensure that, even under adverse conditions, the Fund has access to the funds necessary to cover surrenders, withdrawals and maturing liabilities. Liquidity risk is carefully managed in particular in relation to: bank balances, cashflow forecasting, appropriate fund management (to ensure that assets are not unduly concentrated in less liquid investments) and detailed cash-flow matching for the annuity business. Specific arrangements are also in place to manage liquidity in the linked funds.

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

Liquidity analysis

(i) Contractual maturities of financial liabilities

The loan provided by SAF plc was repaid in full on 30 June 2018.
(ii) Maturity analysis of derivatives

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

	2018 £m	2017 £m
Derivative assets	**76.9**	70.3
Derivative liabilities	**(40.8)**	(16.5)
Net derivative position	**36.1**	53.8

The maturity date of the derivatives is less than one year as at the end of 2018 and 2017. This is due to the basis on which they are managed (i.e. to manage principally asset or liability value exposures). Contractual maturities are not considered essential for an understanding of the timing of the cash flows for these instruments and in particular the Fund has no cash flow hedges.

G. Derivatives

The Fund uses derivatives for the purpose of efficient portfolio management or the reduction in investment risk. In so doing, the Fund obtains cost effective and efficient exposure to various markets and to manage exposure to equity, interest rate, currency, credit and other business risks. The Fund has opted not to apply hedge accounting to derivatives.

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

All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and CSA (Credit Support Annex) in accordance with the regulatory requirements.

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

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

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

The total fair value balances of derivative assets and derivative liabilities are shown in note 10.

19. Capital Requirements and Management (unaudited)

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

The Solvency II surplus for the Funds at 31 December 2018 is £534m (2017: £716m) however this is reduced to £425m (2017: £573m) following the annual Scottish Amicable Capital Fund rebalancing payment.

The Solvency II Pillar I capital requirements at 31 December 2018 have been calculated using the Funds' 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 Board 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 Funds manage their Own Funds to ensure that sufficient Own Funds are available on an ongoing basis to meet regulatory capital requirements. The risk appetite is the key tool for determining what level of own funds is needed to ensure that regulatory capital requirements continue to be met with a high degree of confidence.

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

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

The Fund's estimated Own Funds position for policyholder business is shown below, along with reconciliation to the fund for future appropriations.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Reconciliation of Policyholder Funds and FFA to the estimated Solvency II Own Funds (unaudited)

	2018 £m	2017 £m
FFA	**—**	—
Assets and current liability adjustments	**(1)**	(2)
Non Profit Liabilities	**30**	44
Future enhancements from Non Profit business	**(40)**	(52)
Future deductions	**288**	285
Risk margin	**(144)**	(162)
Transitional deduction	**74**	112
Investment Management Expenses on assets backing the Risk Margin	**(3)**	(4)
Solvency II Pillar I Own Funds	**204**	**221**

Analysis of movement in own funds (unaudited)

	2018 £m	2017 £m
Own Funds at 31 December	**221**	**6**
Underlying operating experience	19	75
Management actions	—	52
Operating experience	19	127
Non-operating experience (including market movements)	(36)	88
Own Funds at 31 December	**204**	**221**
Change in own funds	**(17)**	**215**

20. Additional Reserves

Pension equalisation

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

A reserve of £35m was set up at year-end 2015. Following a progressive reduction in the level of approximations used in determining the provisions over time this reduced to £13m, excluding any utilisation to date, for 2018 (2017: £21m). The reserve is for compensation that the Fund may be liable to pay.

21. Post balance sheet events

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