SCOTTISH AMICABLE FUNDS

Annual Report and Financial Statements for the Year Ended 31 December 2019

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Board Members

Bernard Solomons (Chairman)
Paul Dollman
Stewart Gracie
Brian Medhurst
Michael Walker

Company Secretary of The Prudential Assurance Company Limited

Ms J A Owens

Auditors

KPMG LLP, London

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2019

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 £29.9m (2018: £38.5m). Premiums were higher in 2018 due to a change in mortality charges in relation to savings plans that resulted in an uplift of £7.9m.

The Fund is a sub-fund of PAC which is a wholly owned subsidiary undertaking of another company M&G plc (the M&G plc group or the Group) registered in England and Wales, 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.

M&G plc became the ultimate parent of the Company and the fund following a demerger from Prudential plc on 21 October 2019. M&G plc is a public limited company, limited by shares, incorporated and registered in England and Wales.

M&G plc was previously named M&G Prudential Limited. It registered as a public limited company M&G Prudential plc on 24 July 2019 and changed its name to M&G plc on 16 September 2019.

The Company continues to monitor the effects of the coronavirus ("COVID-19") outbreak which has been declared as a pandemic by the World Health Organization. COVID-19 has caused significant sickness and death globally, along with substantial isolation due to legislation restricting people's movements. The outbreak has not only prompted widespread health concerns, but has caused recent deteriorations in global market conditions. The eventual outcome is highly uncertain and is largely dependent on how successful authorities are at containing and managing the outbreak.

In these difficult times, the Company has two clear priorities: the safety and well-being of colleagues and continuing to serve customers to the best of our abilities. Detailed business continuity plans have been invoked to ensure that the Company can operate as usual in the face of the challenge posed by the spread of COVID-19. The vast majority of colleagues are now working from home with access to the full set of support systems and necessary equipment to do their jobs and are able to satisfactorily serve customers.

COVID-19 is expected to result in a deterioration in financial performance over 2020. The impact is discussed further in the post balance sheet event note in the Board report and note 21 to the financial statements.

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&G plc from Prudential plc. The demerger was completed on 21 October 2019, resulting in two separately listed groups, with different investment characteristics and opportunities. M&G plc is one of the leading retirement and savings businesses in the UK and Europe.

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 (now M&G plc).

The Company continued to make good progress on its five-year transformation plan. Transformation aims to improve the experience of its customers, provide a scalable platform for growth, and create business efficiencies, largely through significant investment in new administration systems and digitalisation.

Notwithstanding some initial difficulties notable progress on transformation in 2019 included the transfer of the Company's most complex life assurance system onto the BANCs platform of Diligenta, the UK subsidiary of Tata Consultancy Services.

Specifically in relation to Scottish Amicable Insurance Fund (SAIF) as it continues to reduce in size, preliminary investigations into the possibility of merging the fund into the With Profit Sub Fund (WPSF) earlier 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 plc, the parent company of the M&G group ("the Group") and is subject to the Group's internal control and risk management processes as detailed in the Group Governance Framework (GGF) and associated Group Risk Management Framework (RMF). 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 RMF requires all entities within the Group, including the Fund, to establish processes for identifying, evaluating and managing key risks. The RMF 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. The Fund continues to benefit from the financial support provided by SACF. Although SACF is part of the PAC With-Profits Fund, it is available to support the financial strength of SAIF and has provided SAIF with a greater degree of investment flexibility and risk protection than would otherwise be the case. This greater investment flexibility is expected to result in an enhanced investment return and higher final bonuses, although this is not guaranteed.

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 37.

(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 due to COVID-19 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. This risk is managed through the regular monitoring and reporting of the Fund's credit and counterparty exposures and the performance of its various investment managers; and

- 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. spread widening).

The Fund is exposed to significant levels of credit risk, however this is reduced by a large proportion of the annuity business being reinsured to PAC which is considered a strong counterparty. The credit risk arises mainly from the corporate bond holdings backing 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.

Credit and counterparty risk is managed through applying limits to the average credit quality, exposures to the largest counterparties and requiring approval for exposures above certain thresholds or to certain entities.

(c) Insurance risk

Insurance risk is the risk of loss for the 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 which is significantly reduced by a large proportion of the annuity business being reinsured to PAC. The other insurance risks run by the Fund are expense risk, persistency risk and mortality/morbidity risk. These risks apply to the Fund's life assurance and pension products but are less material in terms of potential financial impacts and solvency capital requirements 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 relative to the Fund's current reserving assumptions, and as a result future reserving are changed. In addition, overall amounts in payment to customers may be greater than anticipated due to longer life expectancy. Longevity risk is significantly reduced by a large proportion of the annuity business being reinsured to PAC.

- Expense Risk: This is the risk of actual expenses exceeding the assumptions in the pricing and reserving bases 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 to the reserving assumptions, the Fund's operating results could be adversely affected.

- Mortality and morbidity risks: These relate to more people dying or illness compared to best estimate assumptions. 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 is unable to generate sufficient cash resources at a reasonable cost to meet financial obligations (e.g. claims, creditors) as they fall due.

Liquidity risk exposure arises mainly from:

- higher than expected customer withdrawals or collateral requirements, and/or lower than expected market liquidity for assets in its with-profits and unit-linked funds;
- ineffective asset/liability matching or higher than expected credit defaults for non-profit annuity business, leading to a mismatch between cash received from the Company's investments and annuity payments to its customers; and
- higher than expected cash outflows from the shareholder business, e.g. due to tax or collateral requirements.

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. Furthermore the scheme contains specific provisions for the merger of the SAIF with the WPSF once the value of SAIF falls below a specified level.

Non-financial risk

The Fund is exposed to a wide range of non-financial risks.

(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.

- 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. The COVID-19 outbreak could have an impact on the environment the Company (of which the Fund is part) operates in. Consumers, businesses and governments are already counting the economic cost of the outbreak, necessitating governments and central banks across the world to intervene with rescue and stimulus packages at unprecedented levels. The virus could not only impact global growth in the short term, but could lead to a sustained period of economic stagnation. Customer behaviour may change as a result of the economic impact of the outbreak reducing the propensity for people to save and potentially impacting lapses and persistency.

- Political: In contrast to the parliamentary stasis in 2019, the result of the recent General Election provided the government with a strong mandate to progress its agenda and withdraw the UK from the EU. However, economic uncertainty will persist whilst the outcome of the UK/EU negotiations, notably the agreement or otherwise to a trade deal, remains unclear. There is a Brexit programme in place to identify and mitigate risks to the Company, including in the event of a no-deal outcome. We continue to focus on minimising the impact of Brexit on the service we provide to our customers. We are working with regulators and industry bodies to prepare for the end of the transition period. Furthermore, global political risks look set to remain heightened, affecting consumer and market confidence, and potentially increasing market volatility and the risk of a downturn in economic activity.

- Environmental, Social and Governance (ESG): Given the long term nature of the Fund's investment horizons, it is potentially more exposed to the long term implications of climate change risks. In the short-term, the Fund's stakeholders increasingly expect responsible investment principles to be adopted to demonstrate that ESG considerations (including climate change) are effectively integrated into investment decisions.

(b) Investment performance and risk

The investment objectives and risk profiles of the Fund are communicated to customers. A failure to deliver against these objectives (including sustained underperformance), maintain risk profiles that are consistent with customers' expectations, or ensure the Fund liquidity profile is appropriate for expected redemptions may lead to poor customer outcomes and result in Fund outflows and regulatory or reputational damage. For investment risk, there is no appetite for risk profiles to be inconsistent on a persistent basis with the expectations communicated to customers. Additionally, while accepting that there will inevitably be periods where performance varies, there is also no appetite for failure to deliver against the investment performance objectives set over the investment horizon indicated to customers.

(c) Strategic risk / transformation execution

Strategic risk is the risk of loss to the business or failure to maximise opportunity resulting from ineffective, inefficient development or implementation of business strategy. The Fund is exposed to risk associated with the strategic decisions taken by M&G plc. In particular, there are a number of significant transformation programmes underway to deliver the strategy for growth, improve customer outcomes and strengthen resilience and the control environment. A failure to deliver these programmes within timelines, scope and cost pose 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.

(d) Operational risk

Operational risk is the risk of financial and non-financial impacts resulting from inadequate or failed internal processes, or from personnel and systems. Operational failures can also give rise to financial risk exposures, for example through process failures in the management of market and credit risk. 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.

Overall, there is no appetite for material impacts (direct or indirect) to the Fund, including non-financial impacts suffered as a result of failing to develop, implement and monitor appropriate controls to manage such risks. The appetite for operational risk continually seeks ways to cost effectively minimise exposure to such risks rather that striving to eliminate them completely. Where material impacts do arise, the Fund seeks to mitigate these. A new integrated control framework, supported by governance, risk and compliance software, is being developed with the aim of delivering a single, consistent framework with enhanced analytics for capturing risk and control assessments, operational losses and risk events, lessons learnt and tracking issues and actions. There is also significant investment in operational resilience (resilience to and recovery from operational disruption).

(e) Third party risk

The Fund uses outsourcing and third party solution providers to reduce costs and manage delivery risks. The use of outsourcing and third party solution providers can impact its risk profile, for example, the service may fail, resulting in significant business interruptions, liability for losses and costs, reputational damage and regulatory breaches. The Company (of which the Fund is part) retains ultimate responsibility for any activity that is supplied or outsourced.

(f) Technology and security risk including data privacy

There is a high dependency on technology to operate effectively and to meet the growing digital needs of the Fund's customers. The sustained loss or unavailability of key hardware/software, inadequate information security arrangements and inappropriate deployment of digital solutions could result in an inability to meet requirements, leading to unfair customer outcomes, increased costs and/or regulator and reputational damage. Cyber related risks, including attempts by external parties to disrupt, inappropriately access and obtain customer data and funds will remain an ongoing threat. As the Fund's digital presence increases, this risk continues to be significant. Significant work and investment are ongoing to maintain, test and upgrade the IT environment, processes and controls to maintain IT resilience and the Fund's ability to prevent, detect and recover from security incidents.

(g) People risk

The Fund's success is dependent on the ability to attract, retain and develop highly qualified diverse professional people with the right mix of skills and behaviours to support the business. With the implementation of the transformation programme, the reputational impact of people risk is heightened in a number of areas such as industrial relations (including that of key third party providers), pay practices and people stretch.

(h) Reputational Risk

There is a risk that through its activities, behaviours or communications, the Fund fails to meet stakeholder expectations in ways which adversely impact trust and reputation. Furthermore, past and current decisions could pose reputational threats in the future. A number of factors mean that such pressures are likely to increase, including the rising interest of customers, regulators or investors in ESG issues, and social media providing the means for opinions to be stated and shared instantaneously.

(i) Regulatory compliance

Changes in UK government policy, legislation (including tax), regulation or regulatory interpretation applying to insurance companies may adversely affect the Fund's product range, capital requirements and, consequently, reported results and financing requirements.

The consequences of non-compliance can be wide-ranging and include customer detriment, reputational damage, costs to remediate, fines and restrictions on operations or products. Compliance with applicable regulations is therefore of utmost importance.

(j) Group risk

Group risk is defined as the risk that the financial position of a firm may be adversely affected by its relationships, financial or non-financial, with other firms in the same group or by risks which may affect the financial position of the whole group.

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2019 (CONTINUED)

Being a member of the wider M&G plc 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 or guarantees given by PAC was 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 ensure group risk is appropriately managed, including any potential conflicts of interest.

On Behalf of the Scottish Amicable Board members

B Solomons

Bernard Solomons
Chairman
28 May 2020

REPORT OF THE SCOTTISH AMICABLE BOARD FOR THE YEAR ENDED 31 DECEMBER 2019

Introduction

This report comprises a profit and loss account and balance sheet for the Scottish Amicable Funds for the year ended 31 December 2019 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 six 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 (FCA). 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 M&G plc 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 Material Subsidiary Corporate Governance Manual. This encompasses all key policies and procedures.

REPORT OF THE SCOTTISH AMICABLE BOARD FOR THE YEAR ENDED 31 DECEMBER 2019 (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 M&G 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>

<u>COVID-19 outbreak</u>

The Company continues to monitor the effects of the coronavirus ("COVID-19") outbreak which has been declared as a pandemic by the World Health Organization. The outbreak has not only prompted widespread health concerns, but has caused recent deteriorations in global market conditions. The eventual outcome is highly uncertain and is largely dependent on how successful authorities are at containing and managing the outbreak.

Covid-19 has resulted in market volatility. The deterioration in market conditions has resulted in a reduction in SAF's Solvency II surplus. The Fund's performance is being monitored on an on-going basis.

In the event that SAIF were to require capital support it would rely on support from PAC. Therefore, the impact of the recent market volatility and potential impact of COVID-19 on PAC's solvency position, and position as a going concern, has been assessed and the Directors consider that PAC continues to remain a going concern.

<u>Financial performance</u>

The Scottish Amicable Fund as a whole delivered a positive investment return of 11.88% in 2019 (2018: negative 2.71% return). Investment performance in 2018 was impacted by market uncertainty caused by Brexit. As part of its asset allocation process, the fund managers constantly evaluate prospects for different markets and asset classes. In line with the requirements of the Scheme any surplus generated in SAIF will ultimately be distributed to policyholders.

<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).

REPORT OF THE SCOTTISH AMICABLE BOARD FOR THE YEAR ENDED 31 DECEMBER 2019 (CONTINUED)

Scottish Amicable Board members

The present members of the Scottish Amicable Board, are shown on page 2. There have been no changes this year.

Disclosure to auditor

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 himself 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.

Auditor

KPMG LLP were reappointed as auditor of the Company by the members at the Annual General Meeting on 24 April 2017. It is the intention that KPMG LLP be reappointed under the deemed appointment rules of section 487 of the Companies Act 2006.

Directors' and officers' protection

M&G plc has arranged appropriate insurance cover in respect of legal action against directors and senior managers of companies within the M&G plc 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. M&G plc also provides protections for directors and senior managers of companies within the Group against personal financial exposure they may incur in their capacity. These include qualifying third party indemnity provisions (as defined by the relevant Companies Act) for the benefit of directors of M&G plc, including, where applicable, in their capacity as a director of the of the Funds and other companies within the Group. These indemnities were in force during 2019 and remain in force.

On behalf of the Scottish Amicable Board members

Stewart Gracie

Stewart Gracie
Scottish Amicable Board member
28 May 2020

STATEMENT OF BOARD RESPONSIBILITIES FOR THE YEAR ENDED 31 DECEMBER 2019

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 2019 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
- assessed the Fund's ability to continue as a going concern, disclosing, as applicable, matters relates to going concern; and
- used 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.

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 2019.

INDEPENDENT AUDITOR'S REPORT FOR THE YEAR ENDED 31 DECEMBER 2019

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 Fund for the year ended 31 December 2019 which comprise the Statement of Profit and Loss Account, Statement of 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 Fund's affairs as at 31 December 2019 and of its profit 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 10 December 2019. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Fund 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.

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 Fund or to cease its operations, and as they have concluded that the Fund's 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 Fund's business model and analysed how those risks might affect the Fund's 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 Fund will continue in operation.

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 2019. 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.

INDEPENDENT AUDITOR'S REPORT FOR THE YEAR ENDED 31 DECEMBER 2019

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.

Board responsibilities

As explained more fully in their statement set out on page 9, 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 Funds 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 Fund's 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 Fund's needs at the time. Our report should not therefore be regarded as suitable to be used or relied on by any party wishing to acquire rights against us other than the Funds for any purpose or in any context. Any party other than the Fund 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.

Ben Priestley
For and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
Canary Wharf
London, E14 5GL
28 May 2020

STATEMENT OF PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2019

The technical account reflects the activities of the Fund	**2019 £m**	2018 £m	Note
Long-term Business Technical Account			
Gross premiums written	**29.9**	38.5	2
Outward reinsurance premiums	**(15.4)**	(18.6)	
Earned premiums, net of reinsurance	**14.5**	19.9	
Investment income and realised gains	**302.9**	432.4	3
Unrealised gains / (losses)	**242.6**	(555.2)	3
	545.5	(122.8)	
Claims paid			
Claims paid - gross amount	**(775.1)**	(885.6)	
Claims paid - reinsurers share	**188.6**	177.8	
Claims paid, net of reinsurance	**(586.5)**	(707.8)	
Change in provision for claims - Gross amount	**21.7**	(0.1)	
Claims incurred net of reinsurance	**(564.8)**	(707.9)	
Change in long-term business provisions			
Gross amount	**51.1**	1,113.7	13
Reinsurers share	**0.1**	(253.7)	13
	51.2	860.0	
Other charges			
Net operating expenses	**(23.9)**	(30.7)	5
Investment expenses and charges	**(10.5)**	(16.5)	3
Tax attributable to the long term business	**(12.0)**	(2.0)	6
	(46.4)	(49.2)	
Transfer to Fund for Future Appropriations	**0.0**	0.0	7

The non-technical account reflects the activities of the Capital Fund	**2019 £m**	2018 £m
Non-technical account		
Balance on the long-term business technical account	—	—
Investment income & realised gains	**62.3**	36.1
Unrealised gains / (losses)	**21.3**	(75.0)
Investment expenses and charges	**(0.8)**	(0.7)
Profit / (Loss) on ordinary activities before tax	**82.8**	(39.6)
Tax on profit on ordinary activities		
Current tax charge	**(2.7)**	(0.8)
Deferred tax credit	**(0.8)**	1.7
Profit / (Loss) for the financial year	**79.3**	(38.7)

The accounting policies on pages 20 to 25 along with the accompanying notes on pages 25 to 43 form an integral part of the financial statements.

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2019

	2019 £m	2018 £m	Note
Balance on the long-term business technical account	**—**	—	
Other comprehensive income;			
Actuarial (losses) / gains on defined benefit pension schemes	**(0.6)**	1.6	8
Deferred tax (charge)	**0.1**	(0.3)	6
Transfer (to) the fund for future appropriations	**0.5**	(1.3)	
Total comprehensive income for the financial year	**—**	—	

The accounting policies on pages 20 to 25 along with the accompanying notes on pages 25 to 43 form an integral part of the financial statements.

BALANCE SHEET FOR THE FUND AS AT 31 DECEMBER 2019

	2019 £m	2018 £m	Note
Assets			
Investments			
Investments in group undertakings	**438.1**	494.6	9
Other financial investments	**4,271.0**	4,179.7	10
	4,709.1	4,674.3	
Reinsurers' share of technical provisions			
Long-term business provision	**372.2**	383.2	13
Technical provisions for linked liabilities	**1,529.1**	1,517.9	
	1,901.3	1,901.1	
Debtors	**40.6**	34.4	11
Other assets			
Cash at bank and in hand	**94.9**	110.7	
Prepayments and accrued income			
Accrued interest and rent	**17.3**	21.4	
Other prepayments and accrued income	**2.6**	2.4	
	19.9	23.8	
Total Assets	**6,765.8**	6,744.3	
Liabilities			
Subordinated liabilities	—	—	14
Fund for future appropriations	—	—	7
Technical provisions			
Long-term business provision	**4,903.1**	4,965.9	13
Claims outstanding	**48.7**	70.4	13
	4,951.8	5,036.3	
Technical provisions for linked liabilities	**1,529.1**	1,517.9	13
Provisions for other risks and charges			
Deferred taxation	**23.0**	26.2	6
Provisions for DB Pensions	**0.8**	2.4	
	23.8	28.6	
Creditors			
Derivative Liabilities	**18.9**	40.8	10
Other creditors including taxation and social security	**242.2**	120.7	12
	261.1	161.5	
Total Liabilities	**6,765.8**	6,744.3	

The accounting policies on pages 20 to 25 along with the accompanying notes on pages 25 to 43 form an integral part of the financial statements. The accounts were approved by the Scottish Amicable Board on 7 May 2020.

Stewart Gracie

Stewart Gracie
28 May 2020

BALANCE SHEET FOR THE CAPITAL FUND AS AT 31 DECEMBER 2019

	2019 £m	2018 £m
Assets		
Investments		
Land and buildings	**101.2**	120.2
Other financial investments	**607.9**	608.0
	709.1	728.2
Other assets		
Cash at bank and in hand	**56.0**	64.2
Total Assets	**765.1**	792.4
Liabilities		
Capital Fund surplus	**672.9**	680.4
Provisions for other risks and charges		
Deferred taxation	**2.7**	1.9
Creditors		
Amounts due to fellow group undertakings	**86.8**	109.3
Tax payable	**2.7**	0.8
Other creditors including taxation and social security	**89.5**	110.1
Total Liabilities	**765.1**	792.4

Reconciliation of the movement in the Capital Fund surplus for the year ended 31 December 2019

	2019 £m	2018 £m
Profit/(Loss) for the financial year	**79.3**	(38.7)
Reduction by reason of excess	**(86.8)**	(109.3)
Capital Fund surplus at beginning of year	**680.4**	828.4
Capital Fund surplus at end of year	**672.9**	680.4

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 20 to 25 along with the accompanying notes on pages 25 to 43 form an integral part of the financial statements.

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.

The address of the registered office of the Fund, PAC and M&G plc is:

10 Fenchurch Avenue
London
EC3M 5AG

B. Basis of Preparation

Under the terms of the Scheme for the transfer of the business of the Scottish Amicable Life Assurance Society to PAC on 30 September 1997, PAC is required to produce for each financial year reports and accounts of 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

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. Given the structure of the Funds, the financial disclosures given in the notes only refer to the assets and liabilities, and, income and expenses of the Fund and not the Capital Fund, unless stated otherwise. This is because it is only the Fund that will pay the policyholders. 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, M&G 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, disclose Key Management Personnel compensation and Related party transactions with wholly owned subsidiary undertakings in the M&G plc group.

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

Financial statement asset or liability	Key estimate and assumptions	Accounting policy/note reference
Measurement of long-term business provision	When measuring insurance contract liabilities, a number of assumptions are applied to estimate future amounts due to the policyholder. The areas where the assumptions could have a material impact when establishing policyholder contract liabilities for annuities are the assumed rates of policyholder mortality, the expected future costs for administering the underlying policies and the credit risk assumption based on the Fund's view of expected future investment defaults.	C and 13
Determination of fair value of financial investments	Determination of fair value of financial assets classified as level 3 in the fair value hierarchy are determined based on inputs which are not observable in the market requiring a high degree of estimation which could result in a significant change.	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 Fund is part of PAC, a subsidiary within the M&G plc Group and it and its ultimate parent company are continuing to trade profitably and there are no plans for liquidation. In the event that the Funds were to require capital support it would rely on support from PAC. The Company continues to monitor the effects of the coronavirus (COVID-19) outbreak which has been declared as a pandemic by the World Health Organization. The outbreak has not only prompted widespread health concerns, but has caused recent deteriorations in global market conditions. The eventual outcome is highly uncertain and is largely dependent on how successful authorities are at containing and managing the outbreak.

- The Company, of which the Fund is a part, is a subsidiary within the M&G plc Group and it and its ultimate parent company are continuing to trade profitably and there are no plans for liquidation. M&G plc and the Company have put in place intra-group arrangements to formalise circumstances in which capital support would be made available by M&G 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 Fund is 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 Fund, the Board has assessed the current and projected solvency position under Solvency II and considers it to have an appropriate capital surplus.

In addition consideration has also been given to the Company's (of which the Fund is a part) performance, the market in which it operates, its strategy and risks and uncertainties. These plans have been updated to take into consideration various scenarios and stress tests based on the current information available in respect of the COVID-19 outbreak, acknowledging that information in respect of the outbreak and its outcome are highly uncertain.

On the basis of the assessment described, the Board have adopted the going concern basis of accounting in preparing the Fund's financial statements for the year ended 31 December 2019.

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 £308m (2018: £288m) 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 £356m (2018: £328m) 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. If, in subsequent periods, an impaired loan or receivable recovers in value (in part or in full), and this recovery can be objectively related to an event occurring after the impairment, then the previously recognised impairment loss is reversed through the income statement (in part or in full).

The Funds policy on derecognition of financial assets is to only derecognise when it is deemed that substantially all the risks and rewards of ownership have been transferred.

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. <u>Financial Liabilities</u>

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.

The Fund's policy on derecognition of financial liabilities is to derecognise only when the obligation specified in the contract is discharged, cancelled or has expired.

G. <u>Taxation</u>

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. <u>Foreign currencies</u>

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

I. Cash at bank and in hand

The Fund applies the definitions of cash and cash equivalents as defined in FRS 102.7 *Statement of cashflows* (FRS 102.7) for amounts disclosed under cash at bank and in hand. This consists of cash at bank and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments with less than 90 day's maturity from the date of acquisition.

J. Provisions and contingencies

Provisions are recognised in the statement of financial position when the Fund has a present legal or constructive obligation resulting from a past event, it is more probable than not that a loss will be made in settling obligation and the amounts can be estimated reliably.

Provisions are measured, based on management's best estimate of the expenditure required to settle the obligation at the reporting date. Provisions are discounted and represent the present value of the expected expenditure where the effect of the time value of money is material.

Contingent liabilities are possible obligations of the Fund where the timing and amount are subject to significant uncertainty. Contingent liabilities are not recognised in the statement of financial position. Contingent liabilities are however disclosed, unless they are considered to be remote. If a contingent liability becomes probable and the amount can be reliably measured it is no longer treated as contingent and recognised as a liability.

Contingent assets which are possible benefits to the Fund are only disclosed if it is probable that the Fund will receive the benefit. Mirroring the treatment of contingent liabilities, if such a benefit becomes virtually certain, it is no longer considered contingent and is recognised on the statement of financial position as an asset.

2. Gross premium analysis

	Technical Account	
	2019	2018
	£m	£m
Gross premiums written:		
Direct	**20.4**	21.6
Reinsurance accepted	**9.5**	16.9
	29.9	38.5
By individual and group		
Individual business	**20.1**	21.4
Group Contracts	**0.3**	0.2
	20.4	21.6
By frequency		
Regular premiums	**20.3**	21.2
Single premiums	**0.1**	0.4
	20.4	21.6

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

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 2019 £m	2018 £m
Income from:		
Land and buildings	—	0.8
Other investments	**154.7**	168.1
Interest receivable from group undertakings	**1.1**	1.1
Other income	**7.6**	7.4
Total income	**163.4**	177.4
Realised gains and (losses) from:		
Loans and receivables	**0.3**	(0.1)
Realisation of investments at fair value through profit and loss other than derivatives	**149.2**	259.7
Exchange gains / (losses)	**(7.5)**	3.4
Realisation of (loss) / gain on derivatives	**(2.5)**	(8.0)
Total realised gains	**139.5**	255.0
Total investment income and realised gains and losses	**302.9**	432.4

(b) Unrealised gains and (losses) on investments	Technical Account 2019 £m	2018 £m
Equity	**140.2**	(384.2)
Bonds	**35.3**	(107.0)
Other	**67.1**	(64.0)
	242.6	(555.2)

(c) Investment expenses and charges	2019 £m	2018 £m
Investment management fees payable to group undertakings	**10.3**	12.0
Property investment expenses	**0.2**	0.2
Interest payable to group undertakings	—	4.3
	10.5	16.5

All income is from assets measured at fair value with the exception of interest income on loans and receivables which was £8.4m for the year ended 31 December 2019 (2018: £3.8m). All interest expense is from financial liabilities measured at fair value with the exception of interest expense on loans which was £nil for the year ended 31 December 2019 (2018: £4.3m).

All gains above are from assets measured at fair value with the exception of gains / (losses) on loans and receivables and exchange gains / (losses), which are on assets and liabilities measured at amortised cost.

4. Bonuses

Bonuses added during the year are included in the change in long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses in 2019 was £254.4m (2018: £328.1m).

5. Net operating expenses

	Technical Account	
	2019	2018
	£m	£m
Capital fund support charge	**8.0**	8.0
Commission	**—**	0.2
Benchmarking rebates	**(1.4)**	(1.7)
Administration charges	**17.3**	24.2
	23.9	30.7

The remuneration of the auditors in respect of the non-statutory audit was £81,350 (2018: £81,350). The remuneration of the monitoring actuary for the year was £118,976 (2018: £66,805). The emoluments for the highest paid Board member were £50,300 (2018: £48,700). Total Board member fees payable in the year to 31 December 2019 were £198,001 (2018: £192,488).

6. Taxation

	Technical account	
(a) Tax charged	**2019**	2018
	£m	£m
Current Tax		
UK corporation tax	**12.5**	8.5
Overseas tax	**2.2**	3.1
Adjustment in respect of prior years	**0.4**	1.4
Total current tax	**15.1**	13.0
Deferred Tax		
Origination and reversal of timing differences	**(3.1)**	(11.0)
Total deferred tax	**(3.1)**	(11.0)
Total charge for the year	**12.0**	2.0

(b) Provision for deferred tax	**2019**	2018
	£m	£m
Deferred tax:		
Acceleration of capital allowances	**0.4**	0.5
Unrealised investment gains	**22.6**	26.2
Defined benefit pension costs	**0.0**	(0.4)
Deferred acquisition costs	**0.0**	(0.1)
Total provisions	**23.0**	26.2

Movements on deferred tax liabilities are as follows:

Deferred tax liability at 1 January	**26.2**	36.9
Deferred tax (credited) in the year	**(3.1)**	(11.0)
Deferred tax from statement of other comprehensive income - current year	**(0.1)**	0.3
Deferred tax liability at 31 December	**23.0**	26.2

7. Fund for future appropriations

The funds for future appropriations is £nil (2018:£nil) as in accordance with the Scheme the Fund will be fully distributed to its members.

8. Defined Benefit Pension Schemes

The majority of staff employed by the M&G plc group in the UK are members of the M&G plc group's pension schemes. The largest scheme is the Prudential Staff Pension Scheme (PSPS). This scheme is primarily (based on total numbers in the scheme), 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 2019, the underlying PSPS liabilities account for 82% (2018: 82%) of the aggregate liabilities of the M&G plc group's defined benefit schemes. This scheme is in surplus.

There is also a smaller defined benefit scheme, Scottish Amicable Staff Pension Scheme (SASPS). This scheme is in deficit. SAIF contributes 3% of the deficit on a monthly basis. The actuarial loss in 2019 was £0.6m (2018: gain of £1.6m).

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% 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 a past service credit of £1.5m in SAIF and is reflected in the 2019 results within net operating expenses in the long-term business technical account.

Further details of the pension schemes operated by the Company are disclosed in the accounts of the Company.

9. Investments in group undertakings

	Cost		Carrying value	
	2019 £m	2018 £m	**2019 £m**	2018 £m
	£m	£m	**£m**	£m
Shareholdings	**335.6**	365.5	**426.6**	479.5
Loans	**11.5**	15.1	**11.5**	15.1
	347.1	380.6	**438.1**	494.6

10. Other financial investments

	Cost		Carrying value	
	2019	2018	**2019**	2018
	£m	£m	**£m**	£m
Fair value through profit and loss				
Shares and other variable yield securities and units in unit trusts	**1,639.3**	1,680.0	**2,069.6**	1,960.5
Debt securities and other fixed income securities	**1,248.8**	1,451.8	**1,392.5**	1,560.2
Participation in investment pools	**126.2**	132.0	**178.0**	185.6
Derivative asset	**—**	—	**120.7**	76.9
Amortised Cost				
Loans to policyholders secured by insurance policies	**0.1**	0.5	**0.1**	0.5
Other loans	**37.0**	42.5	**35.6**	41.2
Deposits with credit institutions	**474.5**	354.8	**474.5**	354.8
	3,525.9	3,661.6	**4,271.0**	4,179.7

The table below analyses the derivative positions of the Fund.

	2019 £m		2018 £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	**84.1**	**13.5**	72.8	9.9
Currency exchange forward contracts	**34.1**	**4.5**	2.1	28.8
Bond futures	**1.4**	**0.9**	1.9	1.2
Derivative financial instruments held to manage equity risk and for efficient investment management:				
Equity index futures contracts	**1.1**	**—**	0.1	0.9
Total at 31 December	**120.7**	**18.9**	76.9	40.8

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

11. Debtors

	2019 **£m**	2018 £m
Amounts due from fellow group undertakings	**10.4**	8.1
Tax recoverable	**12.1**	14.8
Other	**18.1**	11.5
Total	**40.6**	34.4

Debtors include £0.1m (2018: £0.1m) due after more than one year.

12. Other creditors including tax and social security

	2019 **£m**	2018 £m
Amounts due to fellow group undertakings	**54.7**	50.6
Tax payable	**0.8**	1.0
Stock lending creditor	**185.7**	68.8
Other	**1.0**	0.3
Total	**242.2**	120.7

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 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 2018/1 January 2019	**5,036.3**	**1,517.9**	**6,554.2**
Premiums	**16.7**	**(2.2)**	**14.5**
Surrenders	**(129.0)**	**64.0**	**(65.0)**
Maturities/Deaths	**(312.1)**	**(79.5)**	**(391.6)**
Switches	**(64.1)**	**(65.7)**	**(129.8)**
Investment-related items and other movements	**404.1**	**94.6**	**498.7**
Foreign exchange translation differences	—	—	—
As at 31 December 2019	**4,951.9**	**1,529.1**	**6,481.0**

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 2019 year end Investment Return for assets backing asset shares is a gross return of 11.70% (2018: (2.81)%) and a net return of 9.73% (2018: (2.26)%).

Prospective assumptions

Prospective assumptions are required for the adjustments to asset shares 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 table below shows the 2019 mortality bases which is unchanged from 2018:

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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).

Other non-linked business

Provisions are calculated on the following bases:

	2019		2018	
	Interest rate	**Actuarial mortality table reference**	Interest rate	Actuarial mortality table reference
Non profit retirement annuities In deferment // In payment	**1.34**	65% AMC00/AFC00+1yr // 83% (male), 81% (female) of PCxA00 Future mortality improvements: Default calibration of CMI2017 with a long term mortality improvement rate of 1.75% for males and 1.50% for females, plus a 0.5% constant increase to per annum improvements	1.87	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 a 0.5% constant increase to per annum improvements
Non profit immediate annuities	Fixed: 2.38 Linked: 2.30	The mortality assumptions are based on population mortality tables, with an allowance for expected future mortality improvements. The population tables are adjusted to account for specific socio-economic mortality differentials at an individual level and also the effects of selection in the annuity market over the lifetime of the policyholder. Future mortality improvements: Default calibration of CMI2017 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: 2.96 Linked: 2.89	The mortality assumptions are based on population mortality tables, with an allowance for expected future mortality improvements. The population tables are adjusted to account for specific socio-economic mortality differentials at an individual level and also the effects of selection in the annuity market over the lifetime of the policyholder. 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
Non profit life assurances	**1.07**	85% AMC00/AFC00+1yr	1.49	85% AMC00/AFC00+1yr
Non profit pension assurances	**1.34**	65% AMC00/AFC00+1yr	1.87	65% AMC00/AFC00+1yr

- For Non-profit retirement annuities (in payment), life expectancy at age 65 (for someone currently aged 65) has decreased from 28.9 years to 28.5 years for males and from 30.4 years to 30.1 for females. The decrease in life expectancies is a result of mortality improvements continuing to weaken under CMI2017 from CMI2016.
- 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. Life expectancy at age 65 (for someone currently aged 65) has decreased from 28.3 years to 28.0 years for males and has stayed the same, at 29.4 years, for females. The change in life expectancies is due to revised mortality improvement assumptions under CMI2017, allowing for portfolio adjustments.

Other long term business provision

At 31 December 2019 a provision of £0.8m (2018: £1.5m) 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 £385m (2018: £361m) is held to cover the Fund's exposure due to guaranteed annuities.

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 2019 (2018: 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 M&G plc group.

17. Ultimate and immediate parent companies

The Funds are a part of PAC and PAC's ultimate parent is M&G 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 M&G plc may be obtained from the Company Secretary, 10 Fenchurch Avenue, London EC3M 5AG.

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.

2019 £m	**Fair value through profit and loss**	**Loans and receivables**	**Total carrying value**	**Fair value**
Financial Assets				
Deposits with credit institutions	-	474.5	474.5	474.5
Equity securities and portfolio holdings in unit trusts	2,069.6	-	2,069.6	2,069.6
Debt securities and other fixed income securities	1,392.5	-	1,392.5	1,392.5
Loans (note i)	-	35.8	35.8	37.2
Other investments (note ii)	177.9	-	177.9	177.9
Derivative asset	120.7	-	120.7	120.7
Accrued investment income	-	19.8	19.8	19.8
Other debtors	-	28.5	28.5	28.5
Cash at bank and in hand	-	94.9	94.9	94.9
Total	**3,760.7**	**653.5**	**4,414.2**	**4,415.6**

Financial Liabilities	**Fair value through profit and loss**	**Amortised cost**	**Investment contracts with DPF**	**Total carrying value**	**Fair value**
Investment contracts with discretionary participation features (note iii)	-	-	426.5	426.5	-
Other creditors	-	241.4	-	241.4	241.4
Derivative liabilities	18.9	-	-	18.9	18.9
Total (note iv)	**18.9**	**241.4**	**426.5**	**686.8**	**260.3**

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
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

i. Loans and receivables are reported net of allowance for loan losses of £1.4m (2018: £5.9m).
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 2019 and 2018.

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 Company's policy is to recognise transfers into and transfers out of levels at the end of each half year except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Following the demerger, the M&G plc group has implemented a new policy for classifying financial instruments within the fair value hierarchy, which has been applied by the Company. Compared with the policy previously applied, it is more granular and data-driven, with a more prescriptive definition of an active market. In addition, the extent to which inputs for internally valued assets are considered observable has been refined.

The policy has been applied consistently within these financial statements and accordingly the 2018 comparative table below has been restated. The principal impacts of restating the 2018 comparatives were:

2018 £m	Previously Reported				Restated			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities	1,885.0	74.9	0.6	1,960.5	1,884.7	75.1	0.7	1,960.5
Debt securities	143.7	1,415.3	1.2	1,560.2	155.8	1,299.0	105.4	1,560.2
Loans at FVTPL	-	36.3	4.4	40.7	-	33.5	7.2	40.7
Other investments (including derivative assets)	2.0	109.8	150.6	262.5	2.0	100.2	160.3	262.5
Derivative liabilities	(2.2)	(38.6)	-	(40.8)	(2.2)	(38.6)	-	(40.8)
Total financial investments, net of derivative liabilities	**2,028.5**	**1,597.7**	**156.8**	**3,783.1**	**2,040.3**	**1,469.2**	**273.6**	**3,783.1**

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

Where there is sufficient evidence that the instruments were trading in an active market at the period end they are classified as Level 1. Level 1 principally includes exchange listed equities, mutual funds with quoted prices, exchange traded derivatives such as futures and options, and certain national government and corporate bonds.

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 less frequently traded national government debt securities which are valued using observable inputs, together with over-the-counter derivatives such as forward exchange contracts, certain loans that use observable inputs and non-quoted investment funds valued with observable inputs. It also includes investment contract liabilities without DPF that are valued using observable inputs.

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

Further details of internally valued level 3 assets are as follows:

- Debt securities which were either valued on a discounted cash flow method with an internally developed discount rate or using other valuation methodologies including enterprise valuation and estimated recovery (such as liquidators' reports). 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.

- Private equity and venture capital investments in both debt and equity securities which were valued internally using discounted cash flows based on management information available for these investments. The significant unobservable inputs include the determination of expected future cash flows on the investments being valued, determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The valuation is performed in accordance with International Private Equity and Venture Capital Association valuation guidelines. These investments were principally held by consolidated investment funds that are managed on behalf of third parties.

2019 £m	**Level 1**	**Level 2**	**Level 3**	**Total**
Equity securities	1,952.9	115.5	1.3	2,069.7
Debt securities	368.5	955.2	68.9	1,392.6
Loans at FVTPL	-	31.3	4.1	35.4
Other investments (including derivative assets)	2.5	134.4	161.8	298.7
Derivative liabilities	(0.9)	(18.0)	-	(18.9)
Total financial investments, net of derivative liabilities	2,323.0	1,218.4	236.1	3,777.5
Percentage of total	61%	32%	6%	100%

2018 £m	**Level 1**	**Level 2**	**Level 3**	**Total**
Equity securities	1,884.7	75.1	0.7	1,960.5
Debt securities	155.8	1,299.0	105.4	1,560.2
Loans at FVTPL	-	33.5	7.2	40.7
Other investments (including derivative assets)	2.0	100.2	160.3	262.5
Derivative liabilities	(2.2)	(38.6)	-	(40.8)
Total financial investments, net of derivative liabilities	2,040.3	1,469.2	273.6	3,783.1
Percentage of total	54%	39%	7%	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 RMF.

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.
Liquidity risk	The risk that the Fund may be unable to meet liabilities arising from a mismatch in liquidity of the underlying assets and the frequency of liability requirements of the Fund.

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.

Market risk for the Fund comprises six types of risk, namely:
- Interest rate risk: fluctuations in the level and volatility of interest rates or the shape or curvature of the yield curve or spread relationships.
- Inflation risk: fluctuations in actual or implied inflation rates.
- Equity risk: fluctuations in the level or volatility of equity investments.
- Property risk: fluctuations in the level or volatility of property investments.
- Currency risk: fluctuations, including translation risk, in the level or volatility of currency exposures.
- Alternative investments risk: fluctuations in the level or volatility of alternative investment exposures (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 2019, the Fund held 42 % (2018: 42%) and 22% (2018: 27%) 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 2019 and 2018:

	2019 £m	2018 £m
AAA	**110.0**	156.7
AA+ to AA-	**193.1**	265.7
A+ to A-	**407.5**	390.8
BBB+ to BBB-	**464.7**	499.8
Other	**217.2**	247.2
Total debt securities and other fixed income securities	**1,392.5**	1,560.2

In the table above credit ratings agencies S&P, Moody's and Fitch have been used where available. Where no external ratings are available internal ratings produced by the M&G plc 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 2019 which are not externally rated, £27.2m (2018: £80.8m) were internally rated AAA to A-, £31.8m (2018: £39.0m) were internally rated BBB+ to B- and £43.3m (2018: £5.4m) were internally rated as below B- or unrated.

Loans and receivables

Of the total loans and receivables £Nil (2018: £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 2019, impairment losses of £Nil (2018: £0.4m) 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 2019, the Fund had lent £140m (2018: £204m) of securities and held collateral under such agreements of £164m (2018: £240m).

During 2019 and 2018 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 £35m (2018: £66m).

E. Insurance risk

The Fund is exposed to significant levels of insurance risk. This 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. Longevity risk is significantly reduced by a large proportion of the annuity business being reinsured to PAC. If mortality improvement rates significantly exceed the improvement assumed, the Fund's results could be adversely affected. Further to this, 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 its results.

Longevity risk has been predominantly managed through:

- annual reviews of best estimate assumptions, supported by detailed assessments of actual mortality experience versus best estimate assumptions;
- longevity research;
- longevity risk transfer transactions, assessed against principles and guidance provided in the Reinsurance Appraisal Framework; and
- monthly monitoring of longevity exposure.

Other demographic risks such as persistency risk and non-annuitant mortality risk, and also expense risk are subject to regular reviews, with frequency and intensity proportionate to the materiality of the risk.

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 expected guarantee costs from with-profits if a different number of customers opt for earlier termination than expected.

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.

COVID-19 could have an adverse impact on both the liquidity needs and available liquidity of the Fund. The Fund has adequate liquid resources to manage an increase in demand.

Liquidity analysis

Maturity analysis of derivatives

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

	2019 £m	2018 £m
Derivative assets	**120.7**	76.9
Derivative liabilities	**(18.9)**	(40.8)
Net derivative position	**101.8**	36.1

The maturity date of the derivatives is less than one year as at the end of 2019 and 2018. 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 and Hedging

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 manages 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).

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

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.

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 2019 is £488m (2018: £534m) however this is reduced to £398m (2018: £425m) following the annual Scottish Amicable Capital Fund rebalancing payment.

The Solvency II Pillar I capital requirements at 31 December 2019 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.

The estimated and unaudited Solvency II capital position for the Fund as at 31 December 2019 and December 2018 is shown below:

	2019	2018
	Unaudited	Unaudited
	£m	£m
Solvency II Own Funds	**881**	884
Solvency II Capital Requirement (SCR)	**483**	459
Solvency II Surplus	**398**	425
Solvency II Coverage ratio	**182%**	193%

It should be noted that SAIF relies on SACF to cover it's capital requirements.

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.

Investigations are ongoing to determine the extent to which the Company was responsible or liable for any errors in members' benefit calculations and whether compensation or redress may be payable, and from which fund. Accordingly, as at 31 December 2019 an provision is held within the Fund of £8m (2018: £13m).

21. Post balance sheet events

The Company (of which the Funds are part) continues to monitor the effects of the COVID-19 outbreak which has been declared as a pandemic by the World Health Organization. The outbreak has not only prompted widespread health concerns, but has caused recent deteriorations in global market conditions. The eventual outcome is highly uncertain and is largely dependent on how successful authorities are at containing and managing the outbreak.

The global response to COVID-19 and the economic consequences are expected to result in a deterioration in financial performance over 2020.

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