

# Scottish Amicable Insurance Fund Chairman's Statement

An update from the chairman of the Scottish Amicable Board, Bernard Solomons.

Dear Policyholder

The Scottish Amicable Board is a committee of The Prudential Assurance Company Limited ("Prudential") Board. It was set up solely to look after the interests of policyholders like yourself, whose policies were transferred into the Scottish Amicable Insurance Fund ("SAIF") of Prudential in 1997 under the terms of a court-approved Scheme. SAIF is 'ring-fenced' within Prudential for your benefit and your Board is responsible for its investment and bonus policy as well as ensuring that all the terms of the Scheme continue to be met. One of the key requirements of the Scheme is that the fund is managed in a sound and prudent fashion, and the Scottish Amicable Board are committed to ensuring that this is the case.

We are also responsible for the Scottish Amicable Capital Fund ("SACF"). The role of SACF is more fully described in the 'Scottish Amicable Capital Fund' section of this letter. SAIF and SACF are jointly referred to as the Scottish Amicable Funds.

I am writing to inform you of how the Scottish Amicable Board has discharged its responsibilities during 2018.

## Scottish Amicable Capital Fund

SAIF continues to benefit from the financial support provided by SACF. Although SACF is part of the Prudential With-Profits Fund, it is available to support the financial strength of your fund and has provided SAIF with a greater degree of investment flexibility than would otherwise have been the case. This greater investment flexibility is expected to result in an enhanced investment return and higher final bonuses, although this is not guaranteed.

SACF was set up as part of the Scheme with assets of £1.3bn initially, but is limited to be no more than 15% of the size of SAIF. As you know, SAIF is a closed fund, except for a small amount of additional premiums or increments. It is now steadily reducing in size as policy proceeds are paid out on maturity, surrender or death. As a result of the reduction in the size of SAIF, SACF has been reduced automatically in recent years to remain at the maximum level permitted by the Scheme. The value of SACF at the end of 2018 was £0.7bn.

In return for the support provided by SACF, SAIF is required, under the terms of the Scheme, to pay Prudential a charge of 1% of the average value of SACF each year (subject to a maximum amount of 0.15% of the average value of SAIF's With-Profits assets). This charge amounted to £7.0m in 2018 (reduced from £8.0m in 2017).

The financial strength of the Scottish Amicable Funds is reviewed on a regular basis and I am pleased to say that the funds remain in a strong financial condition.

## Investment Policy

2018 was a difficult year for most asset classes, with negative returns seen in many investment markets. Performance in equity markets, including the UK, was particularly poor, and long term interest rates remained at low levels by historic standards, broadly unchanged from 2017 levels<sup>(1)</sup>.

At the end of 2018, 62% of the actual assets backing SAIF's With-Profits liabilities were invested in real assets such as equities and property, compared with 66% at the end of 2017. This was due to reducing the real assets held by the fund to align with our long-term target allocation, and falls in equity markets towards the end of 2018. The allocation to real assets reflects the investment flexibility provided by SACF, and the strength of Prudential's With-Profits Fund. This level of investment in real assets aims to produce higher returns in the longer term than if the fund had a lower investment in equities and property. The Scottish Amicable Board monitors the proportion of assets invested in each asset class with particular regard to ensuring that the assets held are appropriate to meet the timings of payments due to policyholders.

Against this background, SAIF delivered a return of -2.8% before tax over the year. The change in your policy value from one year to the next will differ from the returns earned on the fund due to the smoothing of returns applied through the bonus rates and the impact of policy charges. Over the forthcoming bonus year, the majority of products will see similar or slightly higher bonus rates compared to last year. For example, policyholders with accumulating With-Profits policies will typically see changes in policy values ranging from a small reduction of 0.5% to an increase of up to 1.5%. Past performance is not an indicator of future performance. The value of your fund can go down as well as up, so you may get back less than you put in.

The Scottish Amicable Board believes that the investment strategy remains appropriate and should allow the fund to achieve satisfactory returns for SAIF policyholders over the longer term. However, we will continue to review the investment policy of SAIF regularly, having regard to the outlook for investment markets.

Notes:

<sup>(1)</sup> Source: Financial Times website. FTSE 100 Total Return Index value reduced by 8.7%, and UK 15-year gilt yields reduced by 0.04%, over 2018.

## Bonuses

As well as overseeing the investment policy of your funds, the Scottish Amicable Board's role is also to set a fair bonus policy. Its objective is to balance a desire to offer attractive regular bonuses with the need to control the increased value of guarantees provided by your fund when regular bonuses are added.

In the current bonus declaration, regular bonus rates have been maintained at their existing levels<sup>(2)</sup>. The continuing low interest rate environment makes such guarantees expensive to provide. At the same time the Scottish Amicable Board has set final bonus rates<sup>(3)</sup> at levels that ensure that claim values paid to policyholders claiming during the forthcoming year remain fair to continuing policyholders. Given the global market volatility seen in 2018, our smoothing process has worked to benefit policyholders by smoothing some of the extreme ups and downs of investment performance in order to provide a more stable return.

In 2018, the total value of bonuses allocated to SAIF With-Profits policies was £330m.

Notes:

<sup>(2)</sup> Future regular bonus rates are not guaranteed.

<sup>(3)</sup> Final bonus is not guaranteed and can be varied without notice.

## Service Standards

Scottish Amicable policyholders continued to receive the same high standard of service during 2018 as was enjoyed by other Prudential policyholders.

Since April 2008, Capita have been responsible for providing customer servicing, policy administration and related IT support to Prudential. In August 2018, M&GPrudential commenced a new 10-year partnership with Diligenta, part of Tata Consultancy Services a global leader in IT, business process and digital services, that enhances service for M&GPrudential's UK savings and retirement customers going forward. This agreement provides cost savings and greater certainty as to the future costs of servicing which benefits SAIF's With-Profits policyholders.

Given the number and complexity of transactions undertaken in managing SAIF, issues inevitably occur from time to time. The Scottish Amicable Board continues to monitor any issues that arise carefully to ensure that they are dealt with efficiently and that the interests of SAIF policyholders are protected.

## Charges to the Fund

The expenses charged to SAIF in 2018 reflected the actual cost of administering the fund over that period subject to a cap that they are not greater than the expenses charged to the corresponding Prudential Assurance Company policies. The Scottish Amicable Board reviews the basis for the allocation of these costs relative to costs allocated to other Prudential funds, and the latest review is currently in progress and will be agreed between the Scottish Amicable Board and the Prudential Board to ensure these charges are consistent with the limits in the Scheme.

Certain other expenses associated with the business of SAIF may also be charged to the fund. The Scottish Amicable Board keeps these additional costs under review and is satisfied with amounts charged.

In line with industry practice at the time, Guaranteed Annuity Rates (GARs) were included in certain pension policies when they were first taken out with Scottish Amicable. GARs allow those policyholders to receive a higher pension than would otherwise be available now. The Scottish Amicable Board, acting on the advice of the Monitoring Actuary, has approved maintaining the charge levied on all policies in respect of GAR costs at 1.25% p.a.

At the same time, your Board approved maintaining the annual allocation to policy values from the Bonus Smoothing Account at 1.20% p.a. Policy values also benefited from a further 0.25% p.a. that is stipulated from the Scheme in respect of miscellaneous surplus from non-profit and unit linked business. As a result there is a net addition to policy values after GAR charges of 0.20% p.a. which is unchanged from 2017, as shown in the table below:

Allocation/(charge) to SAIF with-profits policies	% p.a.
Miscellaneous Surplus from non-profit & unit linked business	0.25
Allocation to Bonus Smoothing Account	1.20
Charge for GARs	(1.25)
Net allocation to policyholders	0.20

The enhancement applied on claims (e.g. maturities, surrenders, deaths) in order to distribute any excess assets in the fund over the lifetime of SAIF policies has also been reviewed and your Board has approved an increase in the level of the enhancement from 5% to 6%, effective from 1 January 2019. The enhancement is included within final bonus rates.

## Home Purchaser Reviews

If you are a Home Purchaser policyholder, you will have received information to allow you to monitor the progress of your policy. If the review has highlighted that a shortfall is likely to arise on your policy, you should consider what action you need to take to ensure that you have sufficient funds to repay your loan.

## **Merger of the Scottish Amicable Funds with the Prudential With-Profits Fund and M&GPrudential Demerger from Prudential Plc**

The Scheme which transferred the business of Scottish Amicable Life Assurance Society to Prudential contains specific provisions for the merger of the Scottish Amicable Insurance Fund with the Prudential With-Profits Fund once the value of the Scottish Amicable Insurance Fund falls below a specified level.

The current trigger point is £1.8bn and the value of SAIF is £4.4bn at 31 December 2018. The conditions for the merger of the Funds are anticipated to happen in around three to four years' time. However, as SAIF continues to reduce in size, preliminary investigations into the possibility of merging the funds at an earlier date than required by the Scheme are ongoing. Any such decision to merge early, which will have regard to both the interests of SAIF and other PAC policyholders, would require approval from the PAC Board, the Scottish Amicable Board and regulatory approval.

In March 2018 Prudential plc announced that it intends to demerge its M&GPrudential business group, which includes Prudential, from Prudential plc. If the demerger goes ahead the operation of the Scottish Amicable Funds within the new independent M&GPrudential would continue as before and your Board will continue to represent your interests in this new corporate entity.

### **Monitoring Actuary**

John McKenzie, Head of Insurance Transfers and Reporting Service at Hyman Robertson LLP, Actuaries and Consultants, has been the Monitoring Actuary since August 2004.

He has had full access to the management of the Scottish Amicable Funds allowing him to provide the Scottish Amicable Board with advice on all matters envisaged by the Scheme. He has confirmed that in his opinion the Scottish Amicable Funds have been managed throughout 2018 in accordance with the Scheme.

## **Annual Report & Accounts**

Full financial statements are prepared for the Scottish Amicable Insurance Fund and are audited by KPMG.

A copy of these statements is available on our website, [www.prudential.co.uk/investors/reports/reports/2018](http://www.prudential.co.uk/investors/reports/reports/2018), or upon request from The Secretary, Scottish Amicable Board, 3 Sheldon Square, Paddington, London W2 6PR.

## **Members of the Scottish Amicable Board**

JP Miller left M&GPrudential and consequently resigned from the Board in July 2018. Stewart Gracie, M&GPrudential Director of Financial Strategy, has replaced him. There have been no other changes to the Scottish Amicable Board membership during 2018.

The Scottish Amicable Board now comprises Paul Dollman, Brian Medhurst, Stewart Gracie, Michael Walker and me.

The Scottish Amicable Board continues to manage the Scottish Amicable Funds having regard solely to the interests and reasonable expectations of the Scottish Amicable policyholders.

Thank you for continuing to invest with Prudential.

Yours faithfully,



Bernard Solomons  
Chairman, Scottish Amicable Board



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