

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 (PAC) 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 PAC in 1997 under the terms of a court-approved Scheme. SAIF is 'ring-fenced' within PAC 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.

From 21 October 2019 the UK business, M&G Prudential, successfully demerged from Prudential plc, creating a new FTSE 100 company called M&G plc. M&G plc will continue to operate the strong customer facing brand Prudential and the operation of the Scottish Amicable Funds within M&G plc is unchanged by the demerger. Your Board continue to represent your interests in this new corporate entity.

I am writing to inform you of how the Scottish Amicable Board has discharged its responsibilities during 2019.

Coronavirus

These are unprecedented times and we appreciate it is an unsettling time for policyholders. We have two clear priorities during this international emergency: protecting the well-being and safety of colleagues, and serving the needs of policyholders.

Our existing infrastructure has allowed a relatively seamless transition to adhere to Government guidelines on working, with the vast majority of employees now successfully, and efficiently, working from home. This operational resilience allows us to safeguard employees while continuing to serve policyholders as best as possible.

Thank you for your continued trust in us during this extraordinary period.

Scottish Amicable Capital Fund

SAIF 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 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 2019 was £0.7bn.

In return for the support provided by SACF, SAIF is required, under the terms of the Scheme, to pay PAC 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 £6.6m in 2019 (reduced from £7.0m in 2018).

As at the end of 2019, I am pleased to say that the Scottish Amicable Funds were in a strong financial condition. The financial strength of the funds is however reviewed on a regular basis, and in view of recent market falls in response to the coronavirus outbreak is currently being closely monitored. However, it is in such difficult times as these that the presence and size of SACF provides significant protection to SAIF policyholders.

Investment Policy

2019 was a favourable year for most asset classes, with positive returns seen in many investment markets. Overall, equity markets – including the UK – rose, and long term interest rates have reduced from 2018 levels⁽¹⁾.

The aim of the fund is to maximise investment return subject to an appropriate level of risk. In determining this level of risk, the Scottish Amicable Board considers the strength of the Scottish Amicable Funds relative to their risk appetite, policyholder expectations, investment views and ensuring that the assets held are appropriate to meet the timings of payments due to policyholders. In particular the allocation to real assets reflects the investment flexibility provided by SACF, and the strength of Prudential's With-Profits Fund.

In light of these factors the Board agreed to retain broadly the same level of risk as the previous year, with a slight reduction in the proportion of equity assets held by the fund to align with our long-term target allocation. This reduction in equity investment was afforded by an increase in fixed income holdings. However, given the rise in investment markets during 2019, at the end of 2019 65% of the actual assets backing SAIF's With-Profits liabilities were invested in real assets such as equities and property, compared with 62% at the end of 2018.

Against this background, SAIF delivered a return of 11.7% before tax over the year. However, past performance is not an indicator of future performance. 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 both the extreme current market conditions and future outlook.

Notes:

- ⁽¹⁾ Source: Financial Times website. FTSE 100 Total Return Index value increased by 17.3%, and UK 15-year gilt yields reduced by 0.51%, over 2019.

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. The continuing low interest rate environment makes such guarantees expensive to provide.

In 2020, regular bonus rates have been maintained at their existing levels⁽²⁾. At the same time the Scottish Amicable Board has set final bonus rates at levels that reflect the strong return during 2019, ensuring that claim values paid to policyholders claiming during the forthcoming year remain fair to continuing policyholders. However, final bonus rates are not guaranteed and can be varied at any time without prior notice. To ensure that bonuses remain fair, current rates are regularly reviewed and given the current extreme market volatility resulting from the coronavirus outbreak, and in line with the Principles and Practices of Financial Management (PPFM), changes to bonuses may be possible.

In 2019, the total value of bonuses allocated to SAIF With-Profits policies was £250m.

Notes:

- ⁽²⁾ Future regular bonus rates are not guaranteed.

Service Standards

Scottish Amicable policyholders in the first half of 2019 received the same high standard of service as was enjoyed by other Prudential policyholders. In the latter half of 2019, we migrated our policyholder administration system to a new platform, which resulted in a significant fall in service standards for which we apologise. Since then, significant work has been done focused on recovering service levels and we aim to continue to improve over 2020.

Service standards have inevitably been impacted by the coronavirus outbreak, however contingency plans are in place to ensure we remain committed to recovering service levels. We thank customers for their patience during these unprecedented times.

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 2019 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. The latest review is currently in progress and will be agreed between the Scottish Amicable Board and the Prudential Assurance Company 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 increasing the annual allocation to policy values from the Bonus Smoothing Account to 1.90% 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 0.90% p.a. as shown in the table below. This is an increase of 0.70% p.a. from the 2018 net addition to policy values (after GAR charges) of 0.20% p.a.

Allocation / (charge) to SAIF with-profits policies	% p.a.
Miscellaneous Surplus from non-profit & unit linked business	0.25
Allocation to Bonus Smoothing Account	1.90
Charge for GARs	(1.25)
Net allocation to policyholders	0.90

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 6% to 7.5%, effective from 1 January 2020. The enhancement is included within final bonus rates.

Following PAC's withdrawal from the annuity market, SAIF policyholders opting to exercise a GAR entitlement will, from November 2019, be provided with annuities fulfilled by Legal & General (L&G) instead of PAC. L&G offer better than market average rates, providing a better outcome overall for SAIF and hence SAIF policyholders.

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 PAC With-Profits Fund

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

The current trigger point is £1.8bn and the value of SAIF is £4.3bn at 31 December 2019. 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, active consideration is being given to merging the funds at an earlier date than required by the Scheme. Any such decision to merge early, which will have regard to both the interests of SAIF and other PAC policyholders, will be communicated to you ahead of merger and would require approval from the PAC Board and the Scottish Amicable Board, subject to the terms being agreed with the Scheme's Appointed Actuary and Monitoring Actuary, with notice provided to the regulator.

Monitoring Actuary

John McKenzie, Head of Insurance Transfers and Reporting Service at Hymans 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 2019 in accordance with the Scheme.

Annual Report and 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, global.mandg.com/investors/regulatory-returns or upon request from:

The Secretary
Scottish Amicable Board
3 Sheldon Square
Paddington
London
W2 6PR

Members of the Scottish Amicable Board

There have been no changes to the Scottish Amicable Board membership during 2019.

The Scottish Amicable Board 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