

SCOTTISH EQUITABLE PLC

STRATEGIC REPORT, DIRECTORS' REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED

31. DECEMBER 2018

COMPANY NUMBER SC144517

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Chairman

Michael J Merrick \*

Directors

Adrian T Grace

Stephen McGee

James Ewing

David M Dalton-Brown \*

Simon J Gulliford \*

Caroline F Ramsay \*

Adrian M Eastwood \*

Matthew J Rider \*

Michael J Rogers \*

Theresa P Froehlich \*

\* denotes non-executive Director

Secretary

James K MacKenzie

Registered Office

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Independent Auditors

PricewaterhouseCoopers LLP

Atria One

144 Morrison Street

Edinburgh

EH3 8EX

Company Number: SC144517

# SCOTTISH EQUITABLE PLC STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

## Principal activity

Scottish Equitable plc's (the Company) principal activity is the provision of corporate and individual pensions, protection products and savings products in the UK. The Company is primarily a long-term savings and protection business, supporting customers who are retired or saving for their retirement. Products are sold through its online platform, which enables advisors, employers and individuals to buy and manage investments online, and to also have a single view of investments. The principal activities of the Company's dormant subsidiary undertakings are shown under note 9 to the financial statements.

## Review of business and future developments

The Company primarily operates under the Aegon brand. The Company's business strategy is focused on developing the business as the leading platform savings, investments and pensions provider in the market.

The ongoing level of regulatory and legislative change is continuing to create new commercial opportunities. For example, automatic enrolment (which requires all employers to offer pensions to their employees) is driving greater numbers of customers to save in a pension. From 6 April 2019, the legislative minimum contributions increased.

In April 2015, the government removed restrictions on individuals being able to access their pension pots, thereby significantly increasing the flexibility with which individuals can use their pension savings. Individuals are now no longer restricted to buying an annuity or entering drawdown, and can choose to withdraw some of their money and take flexible income through drawdown, or secure income via an annuity or guaranteed product. This development has had a substantial impact on the "at retirement" market, with an increase in the purchase of income drawdown products, in addition to supporting a shift from traditional products to platforms better able to support the delivery of flexible solutions to customers.

The Directors remain confident that the Company is well placed for the challenges and opportunities that continue to arise through regulatory and market changes and the customer need to save into retirement.

## Acquisitions and Disposals

On 3 May 2016, the Company announced an agreement to acquire BlackRock Life Limited's defined contribution platform and administration business, strengthening its position as a leading player in the UK workplace market, adding Master Trust and Investment only capability with assets under management of around £16 billion. This transaction was completed on 1 July 2018 and the impact is disclosed in note 11.

In 2017, the Company completed the divestment of its annuity portfolio to Rothesay Life and Legal & General. These transactions were consistent with its ambition to free up capital from non-core businesses, and its capital position improved as a result of the transactions. The Company has approximately £0.7 billion of annuity liabilities remaining through an inward reinsurance transaction.

## Overview of sales and distribution channels

The Company has two main distribution channels: retail and workplace intermediaries. These are supported by the Company's Customer capability, which offers employees and adviser clients a market leading portal to view and manage their money. An award-winning platform supports these channels in an integrated way making it easier for customers to move between products and channels.

### *Retail channel*

The Company offers a comprehensive proposition to intermediaries and strategic partners underpinned by technology that drives efficiency and supports the profitability of advisors' businesses.

Aegon Retirement Choices (ARC) helps advisors and their customers save for the long-term and manage the transition from work to retirement. ARC uses leading-edge digital technology to deliver an intuitive method of saving for the long-term including retirement and taking income in retirement, such as the on-platform guaranteed drawdown product, and dealing with changing circumstances. It also provides valuable online reporting and lifestyle tools that enable advisors to demonstrate their professionalism and display their charges for advice in a transparent way.

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The Company offers a Self Invested Pension Plan, which provides a range of pre and post-retirement investment options for high-net-worth customers (including insured funds and a wide range of open-ended investment companies). Individual Savings Accounts (ISAs) and General Investment Accounts (GIAs) are also offered to customers by Aegon through other companies in the Aegon Group. The Company offers two distinct versions of the proposition targeted at distinct market segments:

- A 'fund supermarket' service, which includes multiple wrapper choices, fully open architecture fund choice and digital advisor / customer self-service access; and
- 'One Retirement', a standalone pension accumulation and drawdown product, designed to be a single-point solution for customers that do not have a broader set of needs.

The acquisition of Cofunds made Aegon UK the UK's leading 'fund supermarket', adding approximately £80 billion of assets, predominantly in ISAs and GIAs, complementing Aegon UK's core pension expertise. The modernisation of the Cofunds business by migrating it on to Aegon's market-leading technology has seen Aegon UK emerge with a market-leading position among intermediary platforms.

### *Workplace channel*

The Company is building and diversifying its workplace distribution capability to cover a range of intermediaries from IFAs to large Employee Benefit Consultants (EBCs). Services that the Company offers include:

- 'Workplace Aegon Retirement Choices', a comprehensive pension proposition that manages workplace pensions for employers in a seamless and streamlined way, enabling them to offer employees a choice of savings wrappers;
- Employers' auto-enrolment obligations, which are supported through Aegon's SmartEnrol capability;
- Support for the governance of the workplace pension scheme, which is offered through the sophisticated analytics of Aegon's Smart Governance;
- Employee access to Retiready, which enables employers to cater for all levels of employee investment knowledge and confidence, in addition to moving with their employees throughout their working life; and
- 'TargetPlan', Aegon UK's dedicated offering for large employers. This offers both a Trust-, Mastertrust- and Contract-based version underpinned by Aegon's market-leading employee engagement services.

Following the completion of the BlackRock Part VII transfer, Aegon is now aiming to create a market-leading proposition. This will combine Aegon's traditional strengths in employee engagement and online services with BlackRock's experience tailoring solutions to meet the distinct needs of larger employers.

### Customer capability

Aegon's digital retirement planning service is designed to help customers understand how 'on track' they are for the retirement they want, and to support them in taking action. Answering a few simple questions gives customers a Retiready score out of 100, showing how ready they are for retirement. Retiready is focused on both existing Aegon UK customers that no longer have an advisor and members of group pension schemes. The majority of customers receive the service having been 'upgraded' from Aegon UK's existing business, thereby allowing long-standing customers to benefit from the advantages of a modern digital pension. Retiready customers have access to a number of tools to help them better engage with and manage their retirement savings. As part of the Cofunds migration, Aegon UK is redeveloping its digital customer portal. This aims to offer an industry-leading customer experience, with the service then being rolled out to all customers.

### Overview of business Lines

Aegon UK was reorganised in 2016 to 'Digital Solutions' and 'Existing Business', which have separate leadership teams.

The Digital Solutions business is responsible for Aegon UK's new digital platform propositions sold through Retail Advisor and Workplace channels, together with the protection lines. The majority of new assets going forward will be accumulated in this business. In addition, where appropriate, the Company is upgrading customers from its Existing Business to Digital Solutions to ensure an enhanced customer experience, a more engaged relationship, and lower cost to serve.

The Existing Business is responsible for older products that are no longer actively marketed to new customers. However, new assets are accumulated as customers pay into existing policies, or as new employees join older workplace schemes. These

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propositions include older style group pensions, individual pensions and with-profits policies. In November 2018 the Company announced an extension to its partnership with Atos with a 15 year contract to service and administer the existing business. This builds on the existing relationship, which has seen Atos successfully administer 450,000 Digital Solutions protection policies since 2016.

Key performance indicators

The Board of the Company monitors the following key performance indicators. The table below compares certain major indicators between 2018 and 2017:

	<u>2018</u>	<u>2017</u>	<u>Change</u>
	<u>£m</u>	<u>£m</u>	<u>%</u>
Net income	159	34	368%
Administration expenses	319	358	(11)%
Platform assets under management*	24,730	20,813	19%
Gross deposits*	7,210	5,799	24%
Net deposits*	1,202	635	89%
Solvency II capital ratio	165%	171%	(4)%
Revenue generating investments	67,554	57,203	18%

\* Platform assets under management, Gross and Net deposits are not reported in the financial statements on pages 20 to 69 and are therefore non-GAAP measures. Platform assets under management represents the value of assets on the Aegon UK Group platform from the Company's customers. Gross deposits represent the value of cash inflows excluding protection and annuities. Net deposits represent cash inflows less cash outflows excluding protection and annuities.

Note: Administration expenses, Platform assets under management, Gross and Net deposits are monitored as part of the overall Aegon UK numbers reported on a regular basis into Aegon UK governance.

Net income amounted to £159.5m profit in 2018 compared to a £34.4m profit in 2017. Net income has increased primarily because of a decrease in administration expenses, a release of insurance contract liabilities using updated assumptions based on the latest available mortality tables and experience, a gain on unit matching<sup>1</sup> and lower losses on general account derivatives. These are set off against reduced bond income following prior year bond sales and 2017 benefited from a realised gain on an intercompany loan.

Administration expenses were £39.2m lower in 2018 than 2017. The contribution to the pension scheme in 2018 was £27.9m lower than in 2017, within the 2017 contributions was an additional one off contribution of £30m. This is set off against higher one off costs of £70.7m (2017: £63.3m) relating to projects, restructuring and strategic transactions (e.g. integration costs). Excluding these pension contributions and one-off costs, 2018 administration expenses were £18.7m lower than 2017.

Platform assets under management have increased by £3.9 billion in 2018 because of the upgrade programme from our existing business policy administration systems to platform of £2.9bn in 2018 (2017: £4.5bn) as well as through new business, set off against declining markets.

Gross deposits have increased by £1,411m compared to 2017 mainly driven by increased platform deposits.

Net deposits have improved by £567m compared to 2017 driven by higher positive net inflows on Platform offset by non platform outflows.

The Solvency II capital ratio for the Company is 165% at 31 December 2018, which is within our target capital of 140% - 180% and a decrease on prior year primarily driven by dividends paid in the year.

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<sup>1</sup> Unit matching is a method to hedge market risks on fee income.

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Revenue-generating investments (the total of Investments and Investments for account of policyholders) for the Company increased to £67.6 billion (2017 £57.2 billion) primarily as a result of the Part VII transfer in of £16bn of BlackRock business set off against a decrease in bond and equity markets.

The Company forms part of the UK segment of Aegon N.V., the ultimate parent undertaking of the Company. The strategy, performance and position of the UK are also discussed in the 'Strategic information' and 'Business overview' sections of the Aegon N.V. annual report, which does not form part of this report.

### Corporate governance

The Aegon UK plc Group, of which the Company is a significant part, has established a governance framework for monitoring and overseeing strategy, conduct of business standards and operations of the business that includes:

- a clearly stated corporate organisational structure, and written terms of reference for the Board and its committees, with appropriate delegated authorities;
- oversight from an Aegon UK Group Audit Committee, the members of which are non-executive Directors, which oversees internal control and financial reporting matters;
- a Risk Committee, the members of which are non-executive Directors, which oversees risk and capital matters;
- a risk management function providing a second line of defence, independent of operations and with responsibility for monitoring and reporting of risk;
- a regulatory risk team, which is part of the second line of defence, with responsibility for managing the relationship with key regulators, contributing to strategic change, establishing and maintaining the financial crime framework and monitoring and reporting on compliance with regulations;
- a forward-looking regulatory development group that identifies and mitigates risks from future political and regulatory change; and
- an internal audit function which provides independent, objective assurance over the complete control framework reporting to the Chairman of the Aegon UK Group Audit Committee and with direct access to all executive members, including the Chief Executive Officer.

The Board has eight non-executive members (25% of which are female) and three executive members. The non-executive Directors includes one representative from Aegon N.V., the Company's ultimate parent undertaking.

As a financial institution, the Company is required to comply with rules and guidance issued by the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA), which include high level standards covering Principles for Business and Senior Management Arrangements, Systems and Controls and requirements for the way the Company conducts its business.

### Capital Management

From 1 January 2016, the regulatory capital has been measured under the Solvency II regime. Under Solvency II, life insurance companies are required to maintain certain levels of shareholders' equity in accordance with EU directives, and have to hold the level of capital required to withstand a 1 in 200 shock on a 1-year value at risk basis.

Since the introduction of Solvency II on 1 January 2016, the Company has been using a Partial Internal Model to calculate the solvency position of its insurance activities. Under Solvency II rules and regulations, firms are able to calibrate an internal model approach to risk measurement and gain regulatory approval. The internal model was approved on 14 December 2015, by the PRA as part of the Internal Model Application Process. Subsequent changes to the Partial Internal Model to model operational and currency Standard Formula risks using an extended Internal Model have since also been approved. The calculation includes the use of the matching adjustment in line with Solvency II rules, agreed with the PRA, and uses the volatility adjuster in the calculation of the technical provisions for the With Profits business with investment guarantees. As a result of the annuity transactions with Rothersey Life and Legal & General announced on 11 April 2016 and 23 May 2016 respectively, with Part VII transfers completing in 2017, the Company no longer uses the Transitional Measures on Technical Provisions and therefore they have no impact on the published solvency position.

The Company also uses financial forecasts to cover the medium-term financial outlook of the business, including forecasts of solvency positions and key performance indicators under a variety of economic and operating scenarios, allowing for new

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business sales, to inform our capital and risk management decisions. This is a key element of our medium term plan and our Own Risk and Solvency Assessment, as required for Solvency II.

### *Fund structure*

The Company has a single long-term insurance fund, which is notionally divided into a with-profit sub fund ("WPSF"), and a non-profit sub fund ("NPSF"), consistent with the Scheme of Transfer of business from Scottish Equitable Life Assurance Society to the Company on 31 December 1993.

Generally all new long-term business of the Company is written in the NPSF which when taken with the shareholder's fund is managed to be independent of capital resources in the WPSF. The investments of the NPSF, otherwise known as general account investments are those where the financial risks are not borne by the policyholder. The risk profile of the NPSF was monitored by reference to the Solvency II capital positions. The shareholder has a 100% interest in the NPSF.

The WPSF is a mutual sub fund in which the shareholder has no financial interest other than certain charges. The WPSF is closed to all new business including those with investment guarantees (with the exception of certain contractual obligations such as premium increments) and is managed to be self-supporting in capital terms in line with Solvency II. The shareholder has a 0% interest in the WPSF, with the fund fully owned by the policyholders.

### Risk management and financial instruments

As an insurance provider, the Company is exposed to a variety of risks. Some of the Company's largest exposures are to changes in financial markets (e.g. interest rate and equity market risks) that affect the value of the investments held, and the liabilities from products that the Company sells. Other risks include insurance related risks, such as changes in mortality and the persistency rates as well as the operating expenses for the business.

The Company manages risk based on risk appetite and policies established across the Aegon Group with appropriate local application and consideration. Exposure to these risks is monitored by the Company's Board, and appropriate sub-committees of the Board (in particular the Risk Committee) and appropriate Executive/Management Committees.

The risk profile for the Company is also described within the Solvency & Financial Condition Report ('SFCR') (public disclosure required under Solvency II and is on Aegon UK's website). The Company's risk profile is classified under the following headings:

- Underwriting risk
- Market risk
- Credit risk
- Liquidity risk
- Operational risk
- Other material risks

### Underwriting risk

Underwriting risk exposures arise as a result of changes in demographic experience such as mortality and persistency.

### *Mortality and morbidity risk*

The general approach adopted by the Company in relation to the Protection portfolio, is to limit risk through widespread use of reinsurance.

### *Lapse risk*

The Company is exposed to lapse risk under contracts where it takes a number of years for annual charges to recoup expenses incurred. The Company has a number of processes in place, which are designed to improve the retention of in-force business.

### *Expense risk*

This is the risk that expenses increase by more than income due to inflation and other factors. The Company has in place expense management processes to manage this risk.

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#### Market risk

Market risk exposures arise as a result of investments in assets, which may fall in value, including equities, properties or other alternative asset classes. Such exposures may be indirect, for example where a fall in the value of investments held on behalf of customers results in a fall in expected future management fees.

#### *Interest rate risk*

The risk that the value of assets and the value of liabilities have different sensitivities to a change in interest rates. It is the risk that the net value of the business decreases with an adverse change in the level of interest rates.

The WPSF is exposed to falling interest rates on its guaranteed liabilities and on account of guaranteed annuity options, (Guaranteed Minimum Pension) GMP guarantees under Individual Buyout contracts and group deferred annuities. The WPSF's estate has been used to purchase a series of interest rate swaps and swaptions, which provide significant protection against falling interest rates. However, the very long-term and in some cases contingent nature of the liabilities in question makes it difficult to completely eliminate interest rate risk.

#### *Equity market risk*

The Company's main direct exposure to equity price risk arises within the WPSF, where certain with-profits funds offer guarantees that are backed by equities. This risk has been mitigated to a significant degree. In particular, the estate has been used to purchase a range of equity put options and put spreads which provide protection against equity markets falling below a specified level.

Equity price risk also arises in the NPSF. The Company's unit-linked funds invest heavily in equities, where the investment risk is borne by the Company's unit linked policyholders. The NPSF's exposure is mainly related to the impact that equity market levels have on annual management charges collected from unitised funds. As these fund-related charges are a significant element of earnings, equity fluctuations can have a significant impact on net income. The NPSF has purchased equity options to reduce the sensitivity of economic capital to significant falls in the UK equity markets. Further, during 2018, the firm has implemented a hedging strategy referred to as 'unit matching' which helps mitigate the risk of equity market falls (as the primary protection) but does expose the business to some equity increase risk.

#### *Alternative investment risk*

This risk relates to fluctuations in the market value of alternative asset classes because of changes in the financial condition of the underlying entity, reduced prospects, or a change in other underlying risk drivers. This is primarily property.

The Company's main direct exposure to property risk arises within the WPSF, where certain with-profits funds offer guarantees that are backed by investments including property. Property risk also arises in the NPSF. The Company's unit-linked funds invest in property, where the investment risk is borne by the Company's unit linked policyholders. The NPSF's exposure is limited to the impact that property valuations have on annual management charges collected from unitised funds.

#### *Currency risk*

The firm has only a small amount of direct exposure to foreign currency risk but as with equities, has indirect exposure relating to annual management charges collected from unitised funds. Most of the direct risk arises within WPSF asset shares, where the overseas element of overall equity and property exposure is expected to lie in the range 10% - 25%.

The NPSF has substantial investment with foreign currency exposure, through unit-linked funds, where the currency risk is primarily borne by policyholders. The NPSF's exposure is limited to the impact that currency market levels have on annual management charges collected from unitised funds. As there are substantial non-sterling assets, currency movements can significantly affect future annual management charges.

#### Credit risk

Credit risk arises principally as a result of the failure of any third party to make contractual payments to the Company, or as a result of changes in the value of any assets or liabilities that arise principally as a result of changes in the credit risk environment. Credit risk arises for the Company where (i) Investment funds managed on behalf of policyholders include investments in bonds and other credit linked assets. Any fall in the value of these investments will result in a fall in the value of future fee income and (ii) the Company also maintains direct investments in bonds or other similar assets in order to cover direct liabilities, including annuity liabilities or as investment of the Company's surplus assets.



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## Liquidity risk

Liquidity risk is the risk that the Company may have insufficient liquid assets to meet claims as they become due. As the Company has few guaranteed surrender values, invests primarily in tradable securities including a significant proportion of highly liquid assets and has cash flows broadly aligned to annuity outgoings, this is not generally a significant risk and has been considered in normal and stressed terms. The introduction of 'unit matching' in 2018 means that the firm now has a programme of unit buy-backs over time which is reflected in its liquidity projections and liquidity framework but generally act to improve available liquidity. In respect of unit-linked commercial property funds, the Company has the right to defer payment of certain withdrawals to allow for the orderly sale of properties so as to provide liquidity for the fund.

## Operational risk

The Company manages its operational risk to mitigate exposures against operational risk appetite across the business. Operational risk includes regulatory risk, which is the risk of non-compliance with statutory and regulatory requirements including those arising from financial crime. The oversight of our operational risk exposures is through the second line of defence Risk Function with reporting of risk exposures and incidents to the Company's Risk Committee.

## Other material risks

### *Pension scheme risk*

A defined benefit pension scheme is operated by Aegon UK plc, which was closed to future accrual in 2013. The Company is recharged by Aegon UK Corporate Services Ltd (AUKCS), based on employer contributions to the scheme. The Company's Solvency II capital position includes the pension scheme. This exposes the Company to significant interest rate, equity, inflation and longevity risk.

### *'Brexit risk'*

On 23 June 2016, the United Kingdom voted in a national referendum to withdraw from the European Union and has formally served notice to the European Council of its desire to withdraw. The implications of such a 'Brexit' remain unclear, with respect to the European integration process, the relationship between the UK and the European Union, and the impact on economies and businesses. Although the Company only writes business in the UK, the Company could be adversely impacted by related market developments such as higher financial market volatility in general due to increased uncertainty, which could reduce the value or results of the Company.

## Non-Financial information statement

### *(a) The Company's employees,*

AUKCS, a fellow subsidiary of Aegon UK plc, provides services to the Aegon UK Group (Aegon UK) and in particular employ those personnel who provide services to the Company. Therefore, the Company has no employees under contracts of service. All administrative expenses are recharged by the service company to the Company.

Aegon UK maintains a comprehensive and robust suite of employment policies designed to promote a positive and fair working environment. In particular, Aegon UK's Respect & Dignity policy promotes equality and diversity among the workforce. It is Aegon UK's policy to ensure equal opportunities for all employees. The only criteria considered for the recruitment or promotion of staff is suitability for the position, regardless of sex, marital status, age, religion, ethnic origin or disability (having due regard to the individual's aptitudes and abilities). It is Aegon UK's policy, wherever possible, to continue the employment of staff who have become disabled. No discrimination is made against disabled employees with regard to training, career development or promotion.

Through its Inclusion & Diversity Programme (I&D) in 2018, Aegon UK has appointed Executive Sponsors for I&D and has established work streams focused on Gender Equality, Wellbeing and the LGBTI+ community and has commissioned a detailed employee survey to better understand our Diversity Profile and inform our future Inclusion and Diversity strategy. In particular, we have taken the following steps in 2018:

- Publication of our Gender Pay Gap Report in March 2018
- Commitment to sign the Women in Finance Charter in February 2019
- Established Gender Diversity Targets for Senior Management (33% by end 2021)
- Support for National Coming Out Day 2018

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- Sponsorship of Pride Edinburgh and Pride Essex 2018
- Support to World Mental Health Day 2018, with a series of wellbeing roadshows across our locations

Aegon UK operates a robust pay and grading framework, based on a recognised job evaluation methodology. Within this framework, Aegon UK conducts annual benchmarking to ensure that terms and conditions of employment and employee total reward packages are positioned at competitive levels. All remuneration packages are compliant with applicable regulation in the UK. Aegon UK recognises Aegis the Union and Unite the Union for collective bargaining purposes and they are consulted on any significant proposals affecting employees, including the annual pay review, changes to employment policies and restructures in the workforce.

### *(b) Environmental matters*

Creating a bright future for all our stakeholders is at the heart of everything we do. A big part of this is our belief that, being part of a major international group, we have a responsibility to make a positive contribution to the society and environment we work in. Integral to Aegon UK's approach to environmental management is our Integrated Management System (IMS), which complies with the requirements of ISO 9001, ISO 14001, ISO 50001 and OHSAS 18001. Our IMS ensures that all of our environmental impacts are clearly identified, risk assessed and appropriate management procedures developed and implemented. This ensures that there is a continuous improvement process being pursued and that our environmental impacts minimised. This includes clearly identifying all legal aspects and statutory obligations with which Aegon UK has to ensure compliance with.

Within Aegon UK, we have developed and published our Environmental Policy, which clearly defines our vision and commitment to achieving our goal of minimising our impact on the environment and ensuring these goals are an integral part of our management processes.

As required by the standards defined by the International Standards Organisation (ISO), Aegon UK has a defined "Objectives & Targets Register" which clearly defines our environmental improvements objectives for 2017 in the following key areas:

- Waste Management
- Waste Recycling
- Energy Management – Gas/Electricity/Water
- Carbon Emissions – Travel/Fleet (Air/Train/Car)

The key elements to note are that Aegon UK procures all of its electricity as "Green" energy and actively manages all aspects of electricity use, 85% of all of our UK waste is recycled with no or little waste going to landfill sites. Our carbon impacts from our fleet is ranked in the top quartile against our peers and we have installed four electric charging points within our Edinburgh office to promote the use of hybrid/electric vehicles. All of our paper is sourced from sustainable forests, while our annual paper usage is declining as we introduce new on-line systems for communicating with our customers. We are in the process of implementing a new printer solution that will significantly reduce the use of paper through our onsite printers.

Our IMS and supporting ISO certifications are independently audited annually by Exovia BM Trada.

### *(c) Social matters*

Acting responsibly is central to how we govern the UK business. We run our business so that we create commercial success in a way that is both ethical and is respectful to customers and their goals. We have a duty of care to safeguard the money on which our customers' future hopes are based, for their retirement and as a safety net in case of need. Our products, services and communications are all designed to target the right customers, to ensure they can make sound decisions on their personal needs. We use our knowledge to help customers achieve their goals. We address our legal and regulatory duties as a regulated financial services business. We care about creating a positive impact for the communities and the environment in which we operate.

Our Global responsible business strategy is to help our customers improve their financial security and wellbeing (Wealth & Health). Our UK strategy is to help people achieve a lifetime of financial security. It is directly aligned to the Global responsible business strategy; we will focus on embracing the 'Wealth' theme in the near term and the 'Health' theme in the longer term. The 'floor' within the global strategy matches the Aegon UK approach for minimum standards; transparent products, data protection, procurement standards, diversity and equal rights, and responsible approach to tax, but we are proud to go beyond these standards in the UK.

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*(d) Respect for Human rights*

Within Aegon UK we strive to prohibit any form of modern slavery or human trafficking in our business and supply chain. We operate under a Code of Conduct that is applicable to all Aegon Group employees across the globe, and which includes commitments (amongst others) in relation to upholding internationally recognised human rights, complying with all applicable laws and regulations, dealing with business partners who share our core values, promotion of ethical behaviour and encourage the reporting of any illegal or unethical behaviour.

*No modern slavery within Aegon UK*

We strive to maintain and comply with a comprehensive suite of HR policies, governing the rights and entitlements of all employees working for Aegon UK, including with regard to health and safety, working hours, pay, benefits and other terms and conditions of employment. We encourage our employees to join the union recognised for their particular role/work location.

Our HR policies have been reviewed in the last 12 months and the terms, conditions and benefits of Aegon UK employees have been assessed to ensure that they comply with or exceed legal and regulatory requirements and to ensure that they are competitive within the financial services market in which we operate.

*No modern slavery in Aegon UK's supply chain*

Under our procurement and supplier management policies, we strive to ensure a zero tolerance approach to modern slavery and human trafficking in our supply chain. In the last 12 months, we have reviewed and updated our policies to make specific reference to the prohibition of modern slavery and human trafficking.

We operate a supplier management process under which each of our suppliers is categorised to reflect the supplier's criticality to Aegon UK's business and the level of risk posed by their operations. Each year we carry out due diligence, risk assessments, contract management, site visits, audits and monitoring, as appropriate to the categorisation of each supplier, to ensure their compliance with applicable law, regulation and with the requirements of our procurement and supplier management policies.

All of our key suppliers are required to confirm on an annual basis that they comply with applicable laws, including those relating to modern slavery and human trafficking. We have reviewed our standard contracts and strive to ensure that new suppliers comply with all applicable law and regulation, including laws and regulations against modern slavery and human trafficking.

*(e) Anti-corruption and anti-bribery matters*

The Company is committed to ensuring that all business activities are conducted with honesty and integrity. In order to manage the risk that the Company and/or its employees commit an act that would constitute bribery or corruption and or provide or accept gifts or entertainment that are not appropriate, the Company has an Anti-Bribery and Corruption Policy and Minimum Standards in place.

The policy applies to all employees and covers specific requirements relating to how the firm and its employees interact with intermediaries, agents and suppliers. This includes specific requirements relating to gifts and entertainment, sponsorships, charitable and political donations and how we engage with third parties.

The Company has a zero appetite for breaches of this policy and have appropriate controls in place to manage and oversee its application. The policy and Minimum Standards are reviewed annually to ensure they remains appropriate for the Company's business model.

In addition, all members of staff within the Company are required to complete mandatory training on an annual basis to ensure awareness of the Anti-Bribery and Corruption policy and Minimum Standards and its requirements.

By order of the Board



James K MacKenzie  
Company Secretary  
Aegon Lochside Crescent  
Edinburgh Park, Edinburgh  
17 April 2019

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DIRECTORS' REPORT FOR THE  
YEAR ENDED 31 DECEMBER 2018**

The Directors present their report and the audited Company financial statements for the year ended 31 December 2018. The Company is domiciled and incorporated in Scotland (registration number SC144517).

Structure of these financial statements

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union as they apply to the financial statements of the Company for the year ended 31 December 2018 and applied in accordance with the Companies Act 2006.

The Company has made use of the Companies Act 2006 S400 exemption from preparing consolidated financial statements. Copies of the consolidated financial statements of Aegon N.V., which include the results of the Company, are available to the public and may be obtained from The Company Secretary, Aegon UK plc, Aegon Lochside Crescent, Edinburgh Park, Edinburgh, EH12 9SE.

Financial results

The income before tax of the Company is a profit of £157.3m (2017: profit £55.4m). Interim dividends of £375.0m were paid during the year (2017: £387.7m). The Directors do not propose a final dividend payment for the year ended 31 December 2018 (2017: £nil). Further discussion of the result is included in the Strategic report.

Directors

The current Directors of the Company are shown on page 1. The following appointments and resignations occurred throughout the year. All other Directors served throughout the year.

Name of Director	Date of Resignation	Date of Appointment
Theresa P Froehlich	-	22 May 2018

Directors' qualifying third party indemnity provisions

During the year and to the date of signing this report, the Company maintained liability insurance for Directors and officers of the Company through arrangements made by Aegon N.V. for the benefit of itself and its subsidiary companies.

Employees

It is Aegon's policy to ensure equal opportunities for all employees of the Aegon UK Group. The only criteria considered for the recruitment or promotion of staff is suitability for the position, regardless of sex, sexual orientation, marital status, age, religion, ethnic origin or disability (having due regard to the individual's aptitudes and abilities). It is our policy, wherever possible, to continue the employment of staff who have become disabled (with appropriate re-training when required). No discrimination is made against disabled employees with regard to training, career development or promotion.

By means of regular announcements and staff briefings and meetings with the independent trade unions, AEGIS and UNITE, Aegon has maintained its policy of providing information and consulting on matters likely to affect the interests of staff.

Political contributions

No political contributions were made during the year (2017: £nil).

Going concern

In assessing whether the Company is a going concern the Directors have taken into account the latest guidance issued by the Financial Reporting Council.

The Strategic Report includes a review of the Company's business and future developments and a description of the Company's exposure to financial instruments and risk and capital management, including liquidity risk. In addition, the financial statements include notes on capital and solvency (note 26), capital commitments, contingent liabilities and charges (note 27) and risk management (note 29).

**SCOTTISH EQUITABLE PLC  
DIRECTORS' REPORT FOR THE  
YEAR ENDED 31 DECEMBER 2018**

The economic and political outlook for 2019 remains uncertain and there will be further challenges and opportunities that continue to arise through regulatory and market changes and the impact of the United Kingdom's decision to leave the European Union. The Directors consider that the Company has the plans and resources to manage its business risks successfully despite this economic and regulatory uncertainty through its plans for focussing on its digital solutions proposition including continuing to upgrade existing customers to its digital platform. The completion of the Part VII transfer of BlackRock's Defined Contribution business as well as the synergies created by Aegon UK plc managing Cofunds Limited alongside the Company means the business is well placed to capitalise on market opportunities as our proposition is strengthened.

As noted in the liquidity risk section the Company has sufficient liquid assets to enable it to meet liabilities as they fall due. Additionally in reaching a conclusion on going concern the Directors have considered projected regulatory capital positions in both normal and stressed scenarios together with the availability of a range of management actions.

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

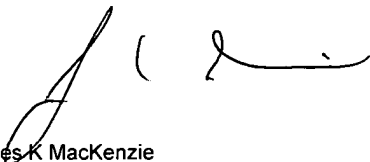
Independent auditors

In accordance with s489 of the Companies Act 2006, a resolution proposing that PricewaterhouseCoopers LLP be reappointed as auditors of the Company will be put to the Annual General Meeting. A resolution authorising the Directors to set the auditors' remuneration will also be proposed at the Annual General Meeting.

Disclosure of information to auditors

The Directors who held office at the date of approval of this report confirm that, so far as they are each aware, there is no relevant audit information, being information needed by the auditors in connection with preparing their report, of which the auditors are unaware; and each Director has taken all steps that they ought to have taken as Director to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

By order of the Board



James K MacKenzie  
Company Secretary  
Aegon Lochside Crescent  
Edinburgh Park  
Edinburgh  
17 April 2019

**SCOTTISH EQUITABLE PLC**  
**STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE**  
**YEAR ENDED 31 DECEMBER 2018**

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union, have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**SCOTTISH EQUITABLE PLC  
INDEPENDENT AUDITORS' REPORT  
TO THE MEMBERS OF SCOTTISH EQUITABLE PLC**

## **Report on the audit of the financial statements**

### **Opinion**

In our opinion, Scottish Equitable plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Strategic report, Directors' report and Financial Statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2018; the income statement, the statement of comprehensive income, the cash flow statement, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Independence*

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

Other than those disclosed in note 6 to the financial statements, we have provided no non-audit services to the company in the period from 1 January 2018 to 31 December 2018.

### **Our audit approach**

#### *Overview*

##### **Materiality**

- Overall materiality: £11.1m (2017: £13.6m), based on 1% of net assets.

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##### **Audit Scope**

- The company is an insurance company, with the main activities consisting of the provision of life assurance and pension products in the UK.
- We tailored the scope of our audit taking into account the significant balances within the company, the accounting processes and controls, and the industry in which the company operates.
- We obtained an understanding of the internal controls in place and identified and tested those controls on which we wished to place reliance and then performed substantive testing where required.

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##### **Key audit matters**

- Determination of actuarial assumptions for the valuation of insurance contract liabilities - annuities
- Valuation of derivatives and investment property
- Significant financial reporting transactions - Blackrock Transfer

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#### *The scope of our audit*

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

#### *Capability of the audit in detecting irregularities, including fraud*

Based on our understanding of the company and its industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK and European regulatory principles, such as those governed by the Prudential Regulation Authority and the Financial Conduct Authority, and we considered the extent to which non-compliance might have a material effect on the financial

## SCOTTISH EQUITABLE PLC INDEPENDENT AUDITORS' REPORT

statements of the company. We also considered those laws and regulations that have a direct impact on the financial statements of the company such as the Companies Act 2006, the Prudential Regulation Authority's regulations and the UK tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries, and inappropriate management bias in accounting estimates and judgemental areas of the financial statements such as the valuation of life insurance contract liabilities and the valuation of investments classified as level 3 under IFRS 13. Audit procedures performed by the engagement team included:

- Testing transactions entered into outside of the normal course of the company's business such as the Blackrock Part VII transfer;
- Procedures relating to the valuation of life insurance contract liabilities and the valuation of investments classified as level 3 under IFRS 13 as described in the related key audit matter below.
- Discussions with the Board, management, internal audit, senior management involved in the risk and compliance function and the company's legal function, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- Reviewing relevant meeting minutes including those of the Audit Committee;
- Assessment of matters reported on the company's whistleblowing helpline register and the results of management's investigation of such matters;
- Reading key correspondence with, reports to and making enquiries of meetings with the Prudential Regulation Authority and the Financial Conduct Authority in relation to compliance with laws and regulations;
- Reviewing data regarding policyholder complaints, the company's register of litigation and claims, internal audit reports, compliance reports in so far as they related to non-compliance with laws and regulations and fraud;
- Identifying and testing journal entries, focusing on those determined by us as displaying higher fraud risk characteristics, such as, but not limited to, unusual account combinations; and
- Designing audit procedures to incorporate unpredictability within our testing.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

### *Key audit matters*

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

<b>Key audit matter</b>	<b>How our audit addressed the key audit matter</b>
<p><b>Determination of actuarial assumptions for valuation of insurance contract liabilities - annuities</b></p> <p>The Directors' determination of assumptions for the valuation of insurance contract liabilities involves complex judgements about future events, both internal and external to the business. In particular, changes in assumptions can result in material impacts to the valuation of the annuity liabilities.</p> <p>We gave specific focus to longevity assumptions used in valuing annuity liabilities, due to the sensitivity of the company's profit to changes in these assumptions and the level of judgement involved in setting these assumptions.</p> <p>Refer to page 36 (Critical accounting estimates and judgements).</p>	<p>Our audit work in respect of actuarial assumptions in respect of annuity liabilities included:</p> <ul style="list-style-type: none"> <li>• Evaluating the design and testing the operating effectiveness of controls over accuracy and completeness of policy data. We also tested, on a sample basis the underlying data to source documentation.</li> <li>• Using our actuarial specialist team members, we applied our industry knowledge and experience and we compared the company's methodology, models and assumptions with recognised actuarial practices.</li> <li>• We tested the key judgements and controls over the preparation of the manually calculated components of the liability. We focused on the consistency in treatment and methodology period-on-period.</li> <li>• We used the results of an independent PwC annual benchmarking survey of assumptions to further challenge the assumption setting process. We compared management's assumptions to industry peers to identify any areas where they were out of line with industry practice and validated reasons for any such divergence.</li> </ul>



**SCOTTISH EQUITABLE PLC  
INDEPENDENT AUDITORS' REPORT**

**Key audit matter**

**How our audit addressed the key audit matter**

**The longevity assumptions**

The longevity assumptions used in valuing the annuity business have two main components:

Mortality base assumption: this is mainly driven by internal experience analyses of historical data applied to industry standard tables, but judgement is also required, for example, in the choice of the most appropriate industry base table.

Rate of mortality improvements: this part of the assumption is more subjective as there is insufficient own company experience due to lack of historic data from the in-force business to credibly determine the future rate of improvement. Therefore, as is the case for most insurers, it is informed by industry research and data.

In respect of the longevity assumptions our work included:

- Evaluating the company's choice of standard industry Continuous Mortality Investigation (CMI) tables and the company's base life expectancy data and comparing this to the industry base life expectancy tables to assess the reasonableness of the company's assumptions. We considered the appropriateness of the assumptions, assessed if there were any changes to the methodology, and evaluated the results of changes in comparison to our expectation.
- Evaluating the company's choice of projection model, and the calibration of this including the long-term improvement factors. In doing so, we challenged management on their choice, understood the impact of applying different models and calibrations and benchmarked the resulting expectations of life to ensure the choice of basis was not out of line with peers.

*Based on the work performed and the evidence obtained, we consider the approach taken and the assumptions used are reasonable.*

**Valuation of derivatives and investment property**

The company's financial investments enable it to support its insurance liabilities and meet regulatory capital requirements, as well as providing returns on shareholder assets. A significant proportion of the company's financial investments are valued by reference to prices on active markets. However, some are priced by reference to market data and/or valuation models and involve management judgement.

Derivative assets of £281.0m and Derivative liabilities of £62.6m require judgements because, for some instruments, quoted prices are not readily available (note 12). As such, management use models to estimate fair value. The key judgement for derivative valuations is whether there are any changes required to the methodology of these models as a result of market practice, accounting or regulatory updates.

Investment property (£549.4m) valuations involve a degree of complexity as they require the selection of assumptions, such as future rental income, to determine expected yields (note 11.1). Management engage independent property experts to assist in selecting these assumptions.

*Refer to page 38 to 39 (Critical accounting estimates and judgements).*

Our audit work in respect of the valuation of derivative assets and liabilities included:

- Evaluating the design and testing the operational effectiveness of key controls over derivative valuations, such as controls to re-perform valuations calculated by outsourced operations using independently sourced data.
- Understanding and assessing the models and methodology used for a sample of derivative investments across the investment portfolio, which management value using models. This included recalculating the sample of valuations using independent models and sourcing our own input data from recognised independent market sources and investigating any differences found that were greater than pre-defined thresholds.

Our audit work in respect of the valuation of investment property included:

- Assessing the company's external valuers' qualifications, expertise and independence, including reading their terms of engagement with the company to determine whether there were any matters that might have affected their objectivity or may have placed scope limitations on their work. We found no evidence to suggest that the objectivity of the valuers in their performance of the valuations was compromised.
- With the assistance of our property valuation experts, evaluating the assumptions used in a sample of investment property valuations by comparing a sample of the property yields used by management's property experts against published market benchmarks in order to identify any assumptions or valuations, which fell outside our expected range.
- Communicating with management's property experts to establish whether the valuation approach was in accordance with our expectations based on our own experience of the investment property industry.

*We determined that the assumptions used, and the resultant valuations of the derivatives and investment property were within ranges that we consider to be acceptable.*

**Significant financial reporting transactions - BlackRock Transfer**

On 3 May 2016, the company announced an agreement to acquire BlackRock Life Limited's defined contribution platform and administration business, with assets under administration of £16 billion. This transaction was finalised on 1 July 2018 via Part VII transfer.

Completion of the transfer has no impact on IFRS reported profit as the income from and administration of the transferred business has been accounted for within the company since the agreement with BlackRock was reached to acquire the business in 2016. The impact in the current year is the recognition on the Balance Sheet of £16b assets and £16b liabilities being

Our audit work in respect of the Part VII transfers included:

- Assessing the contractual terms and conditions of the transaction;
- Assessing the Part VII transfer documentation and ensuring appropriate approval was in place at the date of transfer;
- Assessing the completeness and accuracy of the assets and liabilities transferred at the completion of Part VII through seeking confirmation of the take-on assets and independently valuing these to ensure all securities were appropriately valued.

**SCOTTISH EQUITABLE PLC  
INDEPENDENT AUDITORS' REPORT**

**Key audit matter**

**How our audit addressed the key audit matter**

transferred in to the Company on completion of the Part VII transfer.

*We determined, based on our audit work, that the accounting for the transfers was appropriate, and in line with reporting requirements.*

Given the size and one-off nature of the transaction, we determined this to be a key audit matter.

**How we tailored the audit scope**

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)). We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as key audit matters in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

**Materiality**

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

<b>Overall materiality</b>	£11.1m (2017: £13.6m).
<b>How we determined it</b>	1% of net assets.
<b>Rationale for benchmark applied</b>	We have based materiality of the company on net assets. Being a 100% owned subsidiary, the users of the financial statements are focussed on the level of capital in the entity, the parent due to its focus on being able to receive dividends and the regulator because of its desire for the entity to maintain its regulatory capital. This is also in line with the interests of the secondary users such as policyholders whose focus will be on the ability of the entity to pay claims.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.4m (2017: £0.7m) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

**Conclusions relating to going concern**

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

**Reporting on other information**

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

# SCOTTISH EQUITABLE PLC INDEPENDENT AUDITORS' REPORT

## *Strategic Report and Directors' Report*

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

## **Responsibilities for the financial statements and the audit**

### *Responsibilities of the directors for the financial statements*

As explained more fully in the Statement of Directors' Responsibilities set out on page 13, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

### *Auditors' responsibilities for the audit of the financial statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a 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 the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditors' report.

### *Use of this report*

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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## **Other required reporting**

### **Companies Act 2006 exception reporting**

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

### **Appointment**

Following the recommendation of the audit committee, we were appointed by the directors on 9 June 2014 to audit the financial statements for the year ended 31 December 2014 and subsequent financial periods. The period of total uninterrupted engagement is 5 years, covering the years ended 31 December 2014 to 31 December 2018.



Catrin Thomas (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Edinburgh  
17 April 2019

**SCOTTISH EQUITABLE PLC**  
**INCOME STATEMENT**  
**FOR THE YEAR ENDED 31 DECEMBER 2018**

	Note	<u>2018</u> £m	<u>2017</u> £m
<b>Income</b>			
Premium income		6,640.8	8,398.9
Investment income	3	1,224.5	1,353.3
Fee and commission income		44.1	40.5
<b>Total revenues</b>		<u>7,909.4</u>	<u>9,792.7</u>
Income from reinsurance ceded		165.9	601.3
Results from financial transactions	4	(5,006.0)	4,176.3
<b>Total income</b>		<u>3,069.3</u>	<u>14,570.3</u>
<b>Charges</b>			
Premiums to reinsurers		217.1	517.9
Policyholders' claims and benefits	5	2,225.3	13,468.8
Commissions and expenses	6	468.4	525.4
Interest charges and related fees	7	1.2	2.8
<b>Total charges</b>		<u>2,912.0</u>	<u>14,514.9</u>
<b>Income before tax</b>		<u>157.3</u>	<u>55.4</u>
Income tax credit / (charge)	8	2.2	(21.0)
<b>Net income attributable to equity holders of Scottish Equitable plc</b>		<u>159.5</u>	<u>34.4</u>

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

The notes are an integral part of these financial statements.

**SCOTTISH EQUITABLE PLC**  
**STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED 31 DECEMBER 2018**

	Note	<u>2018</u> <u>£m</u>	<u>2017</u> <u>£m</u>
<b>Net income</b>		<b>159.5</b>	<b>34.4</b>
<b>Items that may be reclassified to profit or loss:</b>			
Gains on revaluation of available-for-sale investments	18.2	1.9	3.3
Gains transferred to income statement on disposal of available-for-sale investments	18.2	(53.8)	(5.4)
Tax relating to components of other comprehensive income	18.2	8.8	0.4
Other comprehensive loss for the year		<u>(43.1)</u>	<u>(1.7)</u>
<b>Total comprehensive income attributable to equity holders of Scottish Equitable plc</b>		<u><b>116.4</b></u>	<u><b>32.7</b></u>

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

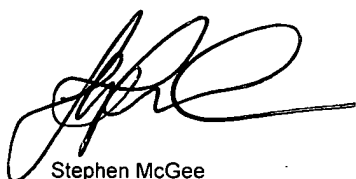
The notes are an integral part of these financial statements.

**SCOTTISH EQUITABLE PLC**  
**STATEMENT OF FINANCIAL POSITION**  
**AS AT 31 DECEMBER 2018**

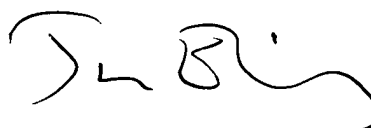
	Note	<u>2018</u> <u>£m</u>	<u>2017</u> <u>£m</u>
<b>Assets</b>			
Investments in subsidiaries	9	0.3	0.3
Investments	10	1,721.2	1,856.2
Investments for account of policyholders	11	65,832.3	55,346.6
Derivatives	12	281.0	327.6
Reinsurance assets	13	498.3	462.9
Deferred expenses	14	807.5	845.2
Deferred tax assets	15	104.4	67.7
Other assets and receivables	16	562.0	500.3
Cash and cash equivalents	17	60.5	92.9
<b>Total assets</b>		<u>69,867.5</u>	<u>59,499.7</u>
<b>Equity and liabilities</b>			
Shareholders' equity	18	1,107.5	1,366.1
Insurance contracts	19	1,290.9	1,389.1
Insurance contracts for account of policyholders	20	21,619.7	20,294.8
Investment contracts	21	199.8	246.5
Investment contracts for account of policyholders	22	44,829.2	35,394.0
Derivatives	12	62.6	81.7
Provisions	23	3.8	4.7
Deferred revenue liabilities	24	65.0	68.1
Other liabilities	25	689.0	654.7
<b>Total liabilities</b>		<u>68,760.0</u>	<u>58,133.6</u>
<b>Total equity and liabilities</b>		<u>69,867.5</u>	<u>59,499.7</u>

The notes are an integral part of these financial statements.

The financial statements were approved by the Board of Directors and are signed on its behalf by



Stephen McGee  
17 April 2019



James Ewing

**SCOTTISH EQUITABLE PLC**  
**CASH FLOW STATEMENT**  
**FOR THE YEAR ENDED 31 DECEMBER 2018**

	Note	<u>2018</u> £m	<u>2017</u> £m
<b>Income before tax</b>		<b>157.3</b>	<b>55.4</b>
Results from financial transactions	4	5,006.0	(4,176.3)
Amortisation and depreciation		33.4	44.3
<b>Adjustments of non-cash items</b>		<b>5,039.4</b>	<b>(4,132.0)</b>
Insurance and investment liabilities		(180.3)	(245.5)
Insurance and investment liabilities for account of policyholders		10,760.1	3,148.7
Accrued income and prepayments		(72.7)	65.0
Accrued expenses and other liabilities		98.0	(80.0)
<b>Changes in accruals</b>		<b>10,605.1</b>	<b>2,888.2</b>
Purchase of investments (other than money market investments)		(1,328.7)	(753.1)
Purchase of derivatives		(428.2)	(412.2)
Disposal of investments (other than money market investments)		1,369.2	888.6
Disposal of derivatives		315.0	447.5
Net (purchase) / disposal of investments for account of policyholders		(15,362.4)	859.0
Net disposal of money market investments		(22.9)	(14.9)
Net change in cash collateral		(67.7)	173.5
<b>Cash flow movements on operating items not reflected in income</b>		<b>(15,525.7)</b>	<b>1,188.4</b>
Tax paid		(14.7)	(28.2)
<b>Operating Cash flow</b>		<b>261.4</b>	<b>(28.2)</b>
Loans given to Group undertakings		-	(50.1)
Repayment of Loans by Group Undertakings		81.2	292.9
<b>Net cash flows generated from investing activities</b>		<b>81.2</b>	<b>242.8</b>
Dividends paid		(375.0)	(387.7)
<b>Net cash flows used in financing activities</b>		<b>(375.0)</b>	<b>(387.7)</b>
Net decrease in cash and cash equivalents <sup>1</sup>		(32.4)	(173.1)
Net cash and cash equivalents at 1 January	17	92.9	266.0
<b>Net cash and cash equivalents at 31 December</b>	<b>17</b>	<b>60.5</b>	<b>92.9</b>

<sup>1</sup>Included in net decrease in cash and cash equivalents are interest received £436.1m (2017: £503.9m), dividends received £756.4m (2017: £813.6m) and interest paid £1.2m (2017: £2.8m).

The notes are an integral part of these financial statements.

**SCOTTISH EQUITABLE PLC**  
**STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31 DECEMBER 2018**

	Note	<u>Share capital</u> £m	<u>Capital contributions reserve</u> £m	<u>Revaluation reserves</u> £m	<u>Retained earnings</u> £m	<u>Total shareholders' equity</u> £m
At 1 January 2018		625.0	856.5	46.5	(161.9)	1,366.1
Net income recognised in the income statement		-	-	-	159.5	159.5
Other comprehensive income:						
Revaluations	18.2	-	-	1.9	-	1.9
Gain transferred to income statement on disposal and impairment	18.2	-	-	(53.8)	-	(53.8)
Aggregate tax effect of items recognised in other comprehensive income	18.2	-	-	8.8	-	8.8
Total other comprehensive income		-	-	(43.1)	-	(43.1)
<b>Total comprehensive income</b>		-	-	(43.1)	159.5	116.4
Dividends Paid		-	(375.0)	-	-	(375.0)
<b>At 31 December 2018</b>	18	<u>625.0</u>	<u>481.5</u>	<u>3.4</u>	<u>(2.4)</u>	<u>1,107.5</u>

**STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31 DECEMBER 2017**

	Note	<u>Share capital</u> £m	<u>Capital contributions reserve</u> £m	<u>Revaluation reserves</u> £m	<u>Retained earnings</u> £m	<u>Total shareholders' equity</u> £m
At 1 January 2017		625.0	1,244.2	48.2	(196.3)	1,721.1
Net income recognised in the income statement		-	-	-	34.4	34.4
Other comprehensive income:						
Revaluations	18.2	-	-	3.3	-	3.3
Gain transferred to income statement on disposal and impairment	18.2	-	-	(5.4)	-	(5.4)
Aggregate tax effect of items recognised in other comprehensive income	18.2	-	-	0.4	-	0.4
Total other comprehensive income		-	-	(1.7)	-	(1.7)
<b>Total comprehensive income</b>		-	-	(1.7)	34.4	32.7
Dividends Paid		-	(387.7)	-	-	(387.7)
<b>At 31 December 2017</b>	18	<u>625.0</u>	<u>856.5</u>	<u>46.5</u>	<u>(161.9)</u>	<u>1,366.1</u>

The notes are an integral part of these financial statements.



**SCOTTISH EQUITABLE PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2018**

**1. Summary of significant accounting policies**

**1.1. Basis of preparation**

**1.1.1. *Introduction***

The financial statements have been prepared on a going concern basis (see Directors report for further details) and in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRS IC) as adopted by the European Union as they apply to the financial statements of the Company for the year ended 31 December 2018 and applied in accordance with the Companies Act 2006. The financial statements have been prepared in accordance with the historical cost convention as modified by those financial instruments (including derivatives) and financial liabilities that have been measured at fair value.

The Company has made use of the Companies Act 2006 S400 exemption from preparing consolidated financial statements.

The financial statements of the Company for the year ended 31 December 2018 were authorised for issue, in accordance with a resolution of the Directors, on 17 April 2019.

**1.1.2. *Adoption of new IFRS accounting standards***

New standards and amendments to standards become effective at the date specified by IFRS, but may allow companies to opt for an earlier adoption date. In 2018, the following amendments to existing standards issued by the IASB became mandatory but are not currently relevant or do not significantly impact the financial position or financial statements:

Accounting Standard / amendment/ interpretation	IASB effective date	Endorsed by EU	Impact on Company
IFRS 9 <i>Financial Instruments</i> , including the separate amendment applying IFRS 9 <i>Financial Instruments</i> with IFRS 4 <i>Insurance Contracts</i>	1 January 2018 (Company makes use of amendment)	Yes	See 1.1.4 for comments
IFRS 15 <i>Revenue from Contracts with Customers</i> , including clarifications to IFRS 15 as issued in 2016	1 January 2018	Yes	See 1.1.3 for comments
IFRS 2 <i>Clarifications of Classification and Measurement of Share-based Payment Transactions</i>	1 January 2018	Yes	Low
IAS 40 <i>Investment Property</i> , amendments regarding the transfer of property	1 January 2018	Yes	Low
IFRIC 22 <i>Foreign Currency Transactions and Advance Consideration</i>	1 January 2018	Yes	Low
Annual improvements 2014-2016	1 January 2018	Yes	Low

**1.1.3. *Adoption of new IFRS accounting standards***

IFRS 15 *Revenue from Contracts with Customers* issued in May 2014 and the amendments to IFRS 15 issued in April 2016 are effective for the Company from 1 January 2018. The adoption of this standard has a very limited impact on the Company's financial statements because insurance revenue is not in scope of IFRS 15 and because the other types of revenue are already materially compliant with this standard. Given the very limited impact on the Company's financial statements, the Company chose to apply the modified retrospective approach as its transition method.

**1.1.4. *Future adoption of new IFRS accounting standards***

The following standards and amendments to existing standards and interpretations, published prior to 1 January 2019, were not early adopted by the Company, but will be applied in future years:

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Accounting Standard / amendment/ interpretation	IASB effective date	Endorsed by EU	Impact on Company
IFRS 16 <i>Leases</i>	1 January 2019	Yes	See comments below
IFRS 17 <i>Insurance Contracts</i>	1 January 2022	No	See comments below
IFRIC 23 <i>Uncertainty over Tax Treatments</i>	1 January 2019	Yes	Low
Amendments to IAS 28 <i>Long-term Interests in Associates and Joint Ventures</i>	1 January 2019	Yes	Low
Annual Improvements 2015-2017	1 January 2019	No	Low
Amendment to IAS 19 <i>Plan Amendment, curtailment or settlement</i>	1 January 2019	No	Low
Amendments to IFRS 9: <i>Prepayment Features with Negative Compensation</i>	1 January 2019	Yes	Low
Amendments to references to <i>The Conceptual Framework in IFRSs</i>	1 January 2020	No	Low
Amendment to IFRS 3 <i>Business Combinations</i>	1 January 2020	No	Low
Amendments to IAS 1 and IAS 8 <i>Definition of Material</i>	1 January 2020	No	Low

IFRS 16 *Leases* - IFRS 16 *Leases*, which replaces IAS 17 *Leases* has been issued by the IASB in January 2016 and endorsed by the European Union in October 2017. It will be mandatorily effective for annual reporting periods beginning on or after 1 January 2019. IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments, which will replace the current 'Obligations under leases' disclosed under note 27 'Capital commitments, contingent liabilities and charges'. Lease costs will be recognised in the form of depreciation of the right-of-use asset and interest on the lease liability, as opposed to the treatment under IAS 17 where expenses are recognised when occurred in 'Administration expenses'. From a lessor perspective, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17, only with additional disclosure requirements. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

The Company has assessed the impacts of IFRS 16 during 2018, and has completed the implementation of the standard. In order to implement the standard, the Company has adopted a number of key options and practical expedients allowed under IFRS 16 of which the following are the most significant:

- The Company will apply the modified retrospective approach and therefore will not restate the comparative amounts for the year prior to initial application. Under this approach, on a lease-by-lease basis, the following two options are available: (i) right-of-use assets (mainly high value properties) measured on transition as if the new rules had always been applied, but discounted using the lessee's incremental borrowing rate at the date of initial application; or (ii) right-of-use assets measured at the amount of the lease liability on adoption (adjusted for any prepaid or accrued lease expenses). The Company will apply the former on implementation of IFRS 16; and
- The Company has elected to apply the 'grandfather' option, which means that all conclusions previously reached under IAS 17 (and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*) are deemed compliant with IFRS 16.

At transition, the Company expects to recognise a right-of-use asset of approximately £87.0m and a lease liability of £122.6m on 1 January 2019. The impact on shareholders' equity is expected to be approximately £35.6m lower and is recognised as an adjustment to the 2019 opening balance of retained earnings. The right-of-use asset relates entirely to a property. The most significant judgment for the Company is related to the determination of the appropriate discount rate used in measurement of the lease liability.

IFRS 9 *Financial Instruments* – The IASB issued the complete version of IFRS 9 *Financial Instruments* in July 2014 which was endorsed by the European Union in November 2016. IFRS 9 combines classification and measurement, the expected credit loss impairment model and hedge accounting. The standard replaces IAS 39 and all previous versions of IFRS 9. Under IFRS 9, financial assets are measured at amortised cost, fair value through profit or loss or fair value through other comprehensive income, based on both the entity's business model for managing the financial assets and the financial asset's contractual cash flow characteristics. The classification and measurement of financial liabilities is unchanged from existing requirements apart from own

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credit risk. For financial liabilities that are designated at fair value through profit or loss, the changes which are attributable to the change in an entity's own credit risk are presented in other comprehensive income, unless doing so would enlarge or create an accounting mismatch. For the impairment component, the IASB included requirements for a credit loss allowance or provision, which is based on expected losses rather than incurred losses.

Application of IFRS 9 is required for annual periods beginning on or after 1 January 2018. However, on 18 May 2017, the IASB published the final version of the IFRS 17 Insurance Contracts standard. Prior to its finalisation, the IASB issued an amendment to IFRS 4 Insurance Contracts (the predecessor standard to IFRS 17) that provides for a qualifying insurer a temporary exemption that permits, but does not require, the insurer to apply IAS 39 Financial Instruments: Recognition and Measurement rather than IFRS 9 for annual periods beginning before 1 January 2021 (i.e., a temporary exemption of IFRS 9). The objective of the amendment is to address the temporary accounting consequences of the different effective dates of IFRS 9 and IFRS 17. This amendment was endorsed by the European Union in November 2017. In November 2018, the IASB amended the effective dates of both IFRS 17 and IFRS 9 to 1 January 2022.

In order for an entity to be eligible for the temporary exemption it must have liabilities connected with insurance activities whose carrying value comprises either greater than 90% of the total carrying value of all liabilities or less than or equal to 90% but greater than 80%, and the insurer does not have significant activities unrelated to insurance. The Company conducted this analysis, and concluded that it meets the requirements for the temporary exemption as 99% of its liabilities are connected with insurance activities. As a result the Company will not implement IFRS 9 until 1 January 2022.

As the Company intends to defer the application of IFRS 9 until 2022, the full impact of the standard is not yet clear, however an initial impact assessment resulted in the expectation that it will have an impact on shareholders' equity, income and/or other comprehensive income and disclosures. An implementation project has started and will be combined with the implementation of IFRS 17 Insurance Contracts.

By qualifying for and electing the temporary exemption, the IFRS 4 amendment requires certain additional disclosures; specifically, the Company is required to disclose information to enable users of financial statements to compare insurers applying the temporary exemption with entities applying IFRS 9. This information is presented below.

**Fair value changes**

The fair value of financial assets of which cash flows represent solely payments of principal and interest on an outstanding principal amount, excluding any financial assets that are managed and whose performance is evaluated on a fair value basis as of 31 December, 2018 is £106.8m. The change in fair value during the reporting period of these financial assets, which were held at 31 December 2018 is £1.4m. Refer to note 28 for further detail in respect of these financial assets.

Cash and cash equivalents and receivables all pass the solely payments of principal and interest (SPPI) test and are held at amortised cost. For fair values of receivables, refer to note 28.

**Credit Risk**

The table below presents the credit risk rating grades, as of 31 December 2018, for financial assets with cash flows that are SPPI, excluding any financial assets that meet the definition of held for trading in IFRS 9, or that are managed and whose performance is evaluated on a fair value basis. The tables show the carrying value of those financial assets applying IAS 39 (in the case of financial assets measured at amortised cost, before adjusting for any impairment allowances).

<b>SPPI compliant financial assets at carrying value</b>	AAA	AA	A	BBB	BB	B	Not rated	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Debt securities and money market investments – carried at fair value through OCI	-	58.5	9.5	12.8	1.0	-	-	81.8
Loans to other Aegon N.V group undertaking – carried at amortised cost	-	-	-	-	-	-	25.0	25.0
<b>At 31 December 2018</b>	-	58.5	9.5	12.8	1.0	-	25.0	106.8

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At 31 December 2018, all of the financial assets of which cash flows represent SPPI, excluding any financial assets that are managed and whose performance is evaluated on a fair value basis, have low credit risk (rated BB or below). Refer to note 29 for detail on creditworthiness of financial assets.

IFRS 17 *Insurance contracts* - The IASB issued IFRS 17 Insurance Contracts in May 2017. IFRS 17 will replace IFRS 4, which was intended as an interim solution and allowed insurers to continue to use accounting principles that they had applied prior to the initial adoption of IFRS. IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued, reinsurance contracts held and investment contracts with discretionary participating features issued. The objective of IFRS 17 is to ensure that entities provide relevant information in a way that faithfully represents those contracts. This information should provide users of financial statements with a basis to assess the effects that the contracts, have on the financial position, financial performance and cash flows of the insurer. IFRS 17 also specifies presentation and disclosure requirements to enhance comparability between insurance companies.

In November 2018, the IASB agreed to start the process to amend IFRS 17 is to defer the mandatory effective date of IFRS 17 by one year (original effective date was 1 January 2021). Subject to IASB due process, entities will be required to apply IFRS 17 for annual periods beginning on or after 1 January 2022. The IASB noted that given the considerations to propose amendments to IFRS 17 in June/July 2019, and in light of the criteria for assessing them, any such potential amendments could take a year to finalise. As a consequence of the IFRS 17 deferral, the IASB also agreed to revise the fixed expiry date of the temporary exemption from IFRS 9 in IFRS 4 to allow entities to continue applying the temporary exemption from IFRS 9 until 1 January 2022. IFRS 17 represents a fundamental change to current financial reporting and the implementation effort is expected to be significant. The Company has established an implementation project and it is expected that the impact of the initial application on the Company's financial statements will be significant.

1.2. Foreign currency translation

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency at the rate of exchange prevailing at the statement of financial position date. Exchange differences on monetary items are recognised in the income statement when they arise, except when they are deferred in other comprehensive income as a result of a qualifying cash flow hedge.

1.3. Offsetting of assets and liabilities

Financial assets and liabilities are offset in the statement of financial position when the Company has a legally enforceable right to offset and has the intention to settle the asset and liability on a net basis or simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the Company or the counterpart.

1.4. Premium income

Gross premiums, including recurring and single premiums, from insurance contracts and from investment contracts with discretionary participation features are recognised as revenue when they become receivable. For investment contracts without discretionary participation features products where deposit accounting is required, the deposits are not reflected as premium income, but are recognised as part of the financial liability.

1.5. Investment income

For interest-bearing assets, interest is recognised as it accrues and is calculated using the effective interest rate method. Fees and commissions that are an integral part of the effective yield of the financial assets or liabilities are recognised as an adjustment to the effective interest rate of the instrument. Investment income includes the interest income and dividend income on financial assets carried at fair value through profit or loss. Investment income also includes dividends accrued, rental income due, as well as fees received for security lending.

1.6. Fee and commission income

Fees and commissions from investment management services are recognised as revenue over the period in which the services are performed.

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1.7. Policyholder claims and benefits

Policyholder claims and benefits consist of claims and benefits paid to policyholders, including benefit claims in excess of account value for products for which deposit accounting is applied, and the change in the valuation of liabilities for insurance and investment contracts. It includes internal and external claims handling costs that are directly related to the processing and settlement of claims. Deposit accounting is applied to investment contracts without discretionary participation features where amounts charged and paid to customers are recognised directly in the financial liability and not through the income statement as premium income and claims.

Claims payable on maturity are accounted for when due for payment, and claims payable on death are accounted for on notification. Surrenders are accounted for at the earlier of the payment date or when the policy ceases to be included within the relevant liability.

1.8. Results from financial transactions

Results from financial transactions include:

*Net fair value change on general account financial investments at fair value through profit or loss, other than derivatives*

Net fair value change of general account financial investments at fair value through profit or loss, other than derivatives, include fair value changes of financial assets carried at fair value through profit or loss. The net gains and losses do not include interest or dividend income.

*Realised gains and losses on financial investments*

Gains and losses on financial investments include realised gains and losses on general account financial assets, other than those classified as at fair value through profit or loss.

*Net fair value change on derivatives*

All changes in fair value are recognised in the income statement, unless the derivative has been designated as a hedging instrument in a cash flow hedge.

*Net fair value change on for account of policyholder financial assets at fair value through profit or loss*

Net fair value change on for account of policyholder financial assets at fair value through profit or loss include fair value movements of investments held for account of policyholders. The net fair value change does not include interest or dividend income.

*Other*

In addition, results from financial transactions include gains/losses on real estate (general account and account of policyholder).

1.9. Commissions and expenses

AUKCS, a fellow subsidiary of Aegon UK plc, provides services to the Aegon UK Group and in particular employ those personnel who provide services to the Company. Therefore, the Company has no employees under contracts of service. All administrative expenses are recharged by the service company to the Company with the exception of investment in real estate expenses, which are directly incurred by the Company. In respect of share-based payments, the recharges from the service companies are based on the expense calculated in accordance with IFRS 2 (share based payment). In respect of the defined benefit pension scheme operated by the Aegon UK plc group, recharges from the service companies are based on employer contributions to the scheme.

1.10. Interest charges and related fees

Interest charges and related fees includes interest expense on borrowings. Interest expense on borrowings carried at amortised cost is recognised in income statement using the effective interest method.

1.11. Investments

General account investments are investments of which the financial risks are not borne by the policyholder. Investments for general account comprise financial assets, excluding derivatives.

Financial assets are recognised on the trade date when the Company becomes a party to the contractual provisions of the instrument and are classified for accounting purposes depending on the characteristics of the instruments and the purpose for which they were purchased.

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*Classification*

The Company designates financial assets as fair value through profit or loss when by doing so it significantly reduces the accounting mismatch that would arise from measuring assets on a different basis to the underlying insurance liabilities. Financial assets with fixed or determinable payments that are not quoted in an active market and that the Company does not intend to sell in the near future or for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, are accounted for as loans. All remaining non-derivative financial assets are classified as available-for-sale.

*Measurement*

Financial assets are initially recognised at fair value excluding interest accrued to date plus, in the case of a financial asset not at fair value through profit or loss, any directly attributable incremental transaction costs. Loans are subsequently carried at amortised cost using the effective interest rate method. Financial assets at fair value through profit or loss are measured at fair value with all changes in fair value recognised in the income statement as incurred. Available-for-sale assets are recorded at fair value with unrealised changes in fair value recognised directly in other comprehensive income. Financial assets that are designated as hedged items are measured in accordance with the requirements for hedge accounting.

*Amortised Cost*

The amortised cost of a debt instrument is the amount at which it is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation of any difference between the initial amount and the maturity amount, and minus any reduction for impairment. The effective interest rate method is a method of calculating the amortised cost and of allocating the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the debt instrument or, when appropriate, a shorter period to the net carrying amount of the instrument. When calculating the effective interest rate, all contractual terms are considered. Possible future credit losses are not taken into account. Charges and interest paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts are included in the calculation.

*Fair Value*

Fair value is defined as the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). For quoted financial assets for which there is an active market, the fair value is the bid price at the statement of financial position date. In the absence of an active market, fair value is estimated by using present value based or other valuation techniques. Where discounting techniques are applied, the discount rate is based on current market rates applicable to financial instruments with similar characteristics. The valuation techniques that include unobservable inputs can result in a different outcome than the actual transaction price at which the asset was acquired. Such differences are not recognised in the income statement immediately but are deferred. They are released over time to the income statement in line with the change in factors (including time) that market participants would consider in setting a price for the asset. Interest accrued to date is not included in the fair value of the financial asset.

*Derecognition*

A financial asset is derecognised when the contractual rights to the asset's cash flows expire, when the Company has transferred the asset and substantially all the risks and rewards of ownership, or when the Company has transferred the asset without transfer of substantially all the risks and rewards of ownership, provided the other party can sell or pledge the asset. Financial assets, in respect of which the Company has neither transferred nor retained all the risks and rewards, are recognised to the extent of the Company's continuing involvement. If significantly all risks are retained, the assets are not derecognised. On derecognition, the difference between the disposal proceeds and the carrying amount is recognised in the income statement as a realised gain or loss. Any cumulative unrealised gain or loss previously recognised in the revaluation reserve in shareholders' equity is also recognised in the income statement.

*Security lending and repurchase agreements*

Financial assets that are lent to a third party or that are transferred subject to a repurchase agreement at a fixed price are not derecognised as the Company retains substantially all the risks and rewards of the asset. A liability is recognised for cash (collateral) received, on which interest is accrued.

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A security that has been received under a borrowing or reverse repurchase agreement is not recognised as an asset. A receivable is recognised for any related cash (collateral) paid by the Company. The difference between sale and repurchase price is treated as investment income. If the Company subsequently sells that security, a liability to repurchase the asset is recognised and initially measured at fair value.

*Collateral*

With the exception of cash collateral, assets received as collateral are not separately recognised as an asset until the financial asset they secure defaults. When cash collateral is recognised, a liability is recorded for the same amount.

1.12. Investments for account of policyholders

Investments held for account of policyholders consist of investments in financial assets, excluding derivatives, as well as investments in real estate. Investment return on these assets is passed on to the policyholder. Also included are the assets held by consolidated investment funds that are backing liabilities towards third parties. All financial asset investments for account of policyholder have been designated as at fair value through profit or loss. The accounting principles for financial assets are the same as those applicable to general account investments, as described in note 1.11.

*Real Estate*

Investments in real estate is property held to earn rentals or for capital appreciation, or both. Considering the Company's asset/liability management policies, under which both categories of property can be allocated to liabilities resulting from insurance and investment contracts, both are presented as investments.

All property is initially recognised at cost. Subsequently, investments in real estate are measured at fair value with the changes in fair value recognised in the income statement. Expenditure incurred after initial recognition of the asset is capitalised to the extent that the level of future economic benefits of the asset is increased. Costs that restore or maintain the level of future economic benefits are recognised in the income statement as incurred.

On disposal of an asset, the difference between the net proceeds received and the carrying amount is recognised in the income statement. Valuations of investments in real estate are carried out monthly to ensure the value correctly reflects the fair value at the statement of financial position date. Valuations are mostly based on active market prices, adjusted for any difference in the nature, location or condition of the specific property. If such information is not available, other valuation methods are applied, considering the current cost of reproducing or replacing the property, the value that the property's net earning power will support and the value indicated by recent sales of comparable properties.

1.13. Derivatives

*Definition*

Derivatives are financial instruments, classified as held for trading financial assets, whose value changes in response to an underlying variable, that require little or no net initial investment and are settled at a future date. Derivatives with positive values are reported as assets and derivatives with negative values are reported as liabilities.

*Measurement*

All derivatives are recognised on the statement of financial position at fair value. The fair value is calculated net of the interest accrued to date and is based on market prices, when available. When market prices are not available, other valuation techniques, such as option pricing or stochastic modelling, are applied. The valuation techniques incorporate all factors that market participants would consider and are based on observable market data, to the extent possible. All changes in fair value are recognised in the income statement unless the derivative has been designated as a hedging instrument in a cash flow hedge.

1.14. Reinsurance Assets

Reinsurance contracts are contracts entered into by the Company in order to receive compensation for losses on contracts written by the Company (outgoing reinsurance). Reinsurance assets are also held as part of exiting the business. For contracts transferring sufficient insurance risk, a reinsurance asset is recognised for the expected future benefits, less expected future reinsurance

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premiums. Reinsurance contracts with insufficient insurance risk transfer are accounted for as investment contracts, service contracts or borrowings, depending on the nature of the agreement.

Reinsurance assets are measured consistently with the amounts associated with the underlying insurance contracts and in accordance with the terms of each reinsurance contract. They are subject to impairment testing and are derecognised when the contractual rights are extinguished or expire or when the contract is transferred to another party.

The Company is not relieved of its legal liabilities when entering into reinsurance transactions, therefore the reserves relating to the underlying insurance contracts will continue to be reported on the statement of financial position during the contractual term of the underlying contracts.

Reinsurance premiums, commissions and claim settlements are accounted for in the same way as the original contracts for which the reinsurance was concluded. The insurance premiums for the original contracts are presented gross of reinsurance premiums paid.

1.15. Deferred expenses

*Deferred policy acquisition costs (DPAC)*

DPAC relates to insurance contracts and investment contracts with discretionary participation features and represents the variable costs that are related to the acquisition or renewal of these contracts. Acquisition costs are deferred to the extent that they are recoverable and are subsequently amortised based on either the expected future premiums or the expected gross profit margins. Estimates include, but are not limited to: an economic perspective in terms of future returns on bond and equity instruments; mortality, disability and lapse assumptions; expected transfer of policies between portfolios; maintenance expenses and expected inflation rates. For all products, DPAC is assessed for recoverability on a portfolio basis at least annually based on current estimates of future cash flows. The portion of DPAC that is determined not to be recoverable is charged to the income statement. DPAC is derecognised when the related contracts are settled, disposed of or transferred to another portfolio.

*Deferred cost of reinsurance*

A deferred cost of reinsurance is established when the Company enters into a reinsurance transaction, except for reinsurance transactions that are entered into as part of a plan to exit a business. When the Company enters into a reinsurance contract as part of a plan to exit a business, an immediate loss is recognised in the income statement. Upon reinsurance, the Company is not relieved of its legal liabilities, so the reserves relating to the underlying reinsured contracts will continue to be reported in the statement of financial position during the contractual term of the underlying contracts.

The difference, if any, between amounts paid in a reinsurance transaction and the amount of the liabilities relating to the underlying reinsured contracts is part of the deferred cost of reinsurance.

When losses on buying reinsurance are deferred, the amortisation is based on the assumptions of the underlying insurance contracts. The amortisation is recognised in the income statement

*Deferred transaction costs*

Deferred transaction costs relate to investment contracts without discretionary participation features under which the Company will render investment management services. Incremental costs that are directly attributable to securing these investment management contracts are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. The deferred transaction costs are amortised in line with fee income, unless there is evidence that another method better represents the provision of services under the contract. Deferred transactions costs are subject to impairment testing at least annually. Deferred transaction costs are derecognised when the related contracts are settled or disposed of.

1.16. Other assets and receivables

Other assets include trade and other receivables and prepaid expenses. Trade and other receivables are initially recognised at fair value and are subsequently measured at amortised cost.



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1.17. Cash and cash equivalents

Cash comprises cash at banks and in-hand. Cash equivalents are short-term, highly liquid investments generally with original maturities of three months or less that are readily convertible to known cash amounts, are subject to insignificant risks of changes in value and are held for the purpose of meeting short-term cash requirements. Money market investments that are held for investment purposes (backing insurance liabilities, investment liabilities or equity based on asset/liability management considerations) are not included in cash and cash equivalents but are presented as investments or investments for account of policyholders.

1.18. Impairment of assets

An asset is impaired if the carrying amount exceeds the amount that would be recovered through its use or sale. For tangible and intangible assets, financial assets and reinsurance assets, if not held at fair value through profit or loss, the recoverable amount of the asset is estimated when there are indications that the asset may be impaired.

*Impairment of non-financial assets*

Assets are tested individually for impairment when there are indications that the asset may be impaired. The impairment loss is calculated as the difference between the carrying and the recoverable amount of the asset, which is the higher of an asset's value in use and its net selling price. The value in use represents the discounted future net cash flows from the continuing use and ultimate disposal of the asset and reflects its known inherent risks and uncertainties.

*Impairment of debt instruments*

Debt instruments are impaired if there is objective evidence that a loss event has occurred after the initial recognition of the asset that has a negative impact on the estimated future cash flows. A specific security is considered to be impaired when it is determined that it is probable that not all amounts due (both principal and interest) will be collected as scheduled. Individually significant loans and other receivables are assessed separately.

For debt instruments carried at amortised cost, the carrying amount of impaired financial assets is reduced through an allowance account. The impairment loss is calculated as the difference between the carrying and recoverable amount of the investment. The recoverable amount is determined by discounting the estimated probable future cash flows at the original effective interest rate of the asset. For variable interest debt instruments, the current effective interest rate under the contract is applied. For debt instruments classified as available-for-sale, the asset is impaired to its fair value. Any unrealised gain or loss previously recognised in shareholders' equity is taken to the income statement as an impairment loss. After impairment, the interest accretion on debt instruments that are classified as available-for-sale is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Impairment losses recognised for debt instruments can be reversed if, in subsequent periods, the amount of the impairment loss decreases and that decrease can be related objectively to a credit related event occurring after the impairment was recognised. For debt instruments carried at amortised cost, the carrying amount after reversal cannot exceed its amortised cost at the reversal date.

*Impairment of reinsurance assets*

Reinsurance assets are impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that not all amounts due under the terms of the contract may be received. In such a case, the value of the reinsurance asset recoverable is determined based on the best estimate of future cash flows, taking into consideration the reinsurer's current and expected future financial conditions plus any collateral held in trust for the Company's benefit. The carrying value is reduced to this calculated recoverable value, and the impairment loss recognised in the income statement.

1.19. Equity

Financial instruments that are issued by the Company are classified as equity if they represent a residual interest in the assets of the Company after deducting all of its liabilities and the Company has an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation. Dividends and other distributions to holders of equity instruments are recognised directly in equity, net of tax.

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1.20. Insurance contracts

Insurance contracts are contracts under which the Company accepts a significant risk – other than a financial risk – from a policyholder by agreeing to compensate the beneficiary on the occurrence of an uncertain future event by which he or she will be adversely affected. Contracts that do not meet this definition are accounted for as investment contracts. The Company reviews homogeneous books of contracts to assess whether the underlying contracts transfer significant insurance risk on an individual basis. This is considered the case when at least one scenario with commercial substance can be identified in which the Company has to pay significant additional benefits to the policyholder. Contracts that have been classified as insurance are not reclassified subsequently.

Insurance liabilities are recognised when the contract is entered into and the premiums are charged. The liability is derecognised when the contract expires, is discharged or is cancelled. Substantially modified contracts are accounted for as an extinguishment of the original liability and the recognition of a new liability.

*Insurance contracts*

For valuation of the liabilities of the UK non-profit fund annuity business, the cash flow is projected using current data and assumptions. Each cash flow is valued using a current market discount rate after taking into account the risk of credit default. The liability is determined as the sum of the discounted value of the expected benefits and future administrative expenses directly related to the contract, less the discounted value of the expected theoretical premiums that would be required to meet the future cash outflows based on the valuation assumptions used plus the deferred income reserve.

Other insurance contracts in the NPSF with terms that are fixed and guaranteed and which are of a long duration (generally over 3 years), such as term life insurance, are measured using the net premium method. The liability is determined as the sum of the discounted value of the expected benefits and future administrative expenses directly related to the contract, less the discounted value of the expected theoretical premiums that would be required to meet the future cash outflows based on the valuation assumptions used. The liability is based on assumptions which are, for each cohort, determined at inception of the business and which include a margin for risk and adverse deviation.

The liability for insurance contracts with a short duration of generally less than 3 years comprises reserves for unearned premiums as well as for claims outstanding, which includes an estimate of the incurred claims that have not yet been reported.

*Insurance contracts for account of policyholders*

Insurance contracts under which the policyholder bears the risks associated with the underlying investments are classified as insurance contracts for account of policyholders. This classification comprises unit linked policies and with profit fund policies. Unit linked policies are measured at the nominal value of the policyholder unit account, with interest on any actuarial funding being at an expected rate of return. The liability for the WPSF represents the net assets of the fund. As the Company's WPSF is a 100:0 fund, all assets are expected to be distributed to with profits policyholders over time.

1.21. Investment contracts

Contracts issued by the Company that do not transfer significant insurance risk, but do transfer financial risk from the policyholder to the Company are accounted for as investment contracts. Depending on whether the Company or the policyholder runs the risks associated with the investments allocated to the contract, the liabilities are classified as investment contracts or as investment contracts for account of policyholders. Investment contract liabilities are recognised when the contract is entered into and are derecognised when the contract expires, is discharged or is cancelled.

*Investment contracts with discretionary participation features and investment contracts for account of policyholders with discretionary participation features*

Some investment contracts have participation features whereby the policyholder has the right to receive potentially significant additional benefits, which are based on the performance of a specified pool of investments held by the Company. If the Company has discretion over the amount or timing of the distribution of the returns to policyholders, the investment contract liability is measured based on the accounting principles that apply to insurance contracts with similar features.

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*Investment contracts for account of policyholders without discretionary participation features*

Investment contracts for account of policyholders without discretionary participation features are designated as at fair value through profit or loss. Contracts with unit-denominated payments are measured at current unit values, which reflect the fair values of the assets of the fund.

For unit-linked contracts without discretionary participation features and subject to actuarial funding, the Company recognises a liability at the funded amount of the units. The difference between the gross value of the units and the funded value is treated as an initial fee paid by the policyholder for future asset management services and is deferred. It is subsequently amortised over the life of the contract or a shorter period, if appropriate.

1.22. Interest bearing loans and borrowings

Borrowings include amounts due under reinsurance contracts, which do not transfer significant insurance risk. Obligations for loans and borrowings are recognised when the Company becomes party to the related contracts and are measured initially at the fair value of consideration received less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Borrowing costs are recognised as an expense when incurred. Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in finance revenue and finance cost. The liability is derecognised when the Company's obligation under the contract expires, is discharged or is cancelled.

1.23. Provisions

A provision is recognised for present legal or constructive obligations arising from past events, when it is probable that it will result in an outflow of economic benefits and the amount can be reliably estimated. Management exercises judgement in evaluating the probability that a loss will be incurred. The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the statement of financial position date, considering all its inherent risk and uncertainties, as well as the time value of money. The unwinding of the effect of discounting is recorded in the income statement as an interest expense.

1.24. Deferred revenue liabilities

A deferred income reserve is held to reflect the unearned future profit from the annuity contracts. The profit margin on each cohort of new business (including reinsurance) is deferred and released over time based on the expected cashflows over the life of the product at the time of sale.

Initial fees and front-end loadings paid by policyholders, for future investment management services related to investment contracts without discretionary participation features are also deferred and recognised as revenue when the related services are rendered. Profits on new business at policy inception for annuities are also deferred and recognised on a similar basis.

1.25. Tax assets and liabilities

*Current income tax*

Income tax assets and liabilities for the current period and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities, or paid to or recovered from other group companies in respect of group relief surrendered or received. The tax rates and laws used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date. Current income tax relating to items recognised directly in other comprehensive income is recognised in other comprehensive income and not in the income statement.

*Deferred income tax*

Deferred income tax is provided using the liability method on temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax and liabilities are recognised for all taxable temporary differences except:

- When the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss, and

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- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except:

- When the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss; and
- The carrying amount of deferred income tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred income tax assets are reassessed at each statement of financial position date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date. Deferred income tax relating to items recognised directly in other comprehensive income is recognised directly in other comprehensive income and not in the income statement. Deferred income tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred income tax relate to the same taxable entity and the same taxation authority.

*Policyholder tax*

The income tax charge comprises tax in respect of policyholders' returns and the balance, which represents the tax on equity-holder's returns. The income tax charge in respect of policyholders' returns reflects the movement in current and deferred income tax recognised in respect of those items of income, gains and expenses, which accrue to the benefit of policyholders.

1.26. Contingent assets and liabilities

Contingent assets are disclosed in the notes if the inflow of economic benefits is probable, but not virtually certain. When the inflow of economic benefits becomes virtually certain, the asset is no longer contingent and its recognition is appropriate. A provision is recognised for present legal or constructive obligations arising from past events, when it is probable that it will result in an outflow of economic benefits and the amount can be reliably estimated. If the outflow of economic benefits is not probable, a contingent liability is disclosed, unless the possibility of an outflow of economic benefits is remote.

2. **Critical accounting estimates and judgement in applying accounting policies**

Application of the accounting policies in the preparation of the financial statements requires management to apply judgement involving assumptions and estimates concerning future results or other developments, including the likelihood, timing or amount of future transactions or events. There can be no assurance that actual results will not differ materially from those estimates. Judgements and sources of estimation uncertainty are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting policies that are critical to the financial statement presentation and that require complex estimates or significant judgement are as follows:

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Financial statement area	Critical accounting estimates or assumptions	Related notes
Actuarial assumptions – insurance contracts	Mortality and morbidity assumptions	2.1
Actuarial assumptions – DPAC (unitised)	Unit fund growth rates, lapse rates and the allocation of future expenses between acquisition expenses and renewal expenses.	2.2
Actuarial assumptions – DPAC (non-unitised)	Discount rate, mortality rate, morbidity rate and persistency rates.	2.2
Actuarial assumptions – With profit fund	Future mortality improvement rates, future interest rates and future policyholder behaviour.	2.3
Deferred Tax asset – Pensions business	Retention of inforce pension business, the future plans for upgrades under the upgrade programme, expense assumptions, fixed interest and equity investment returns.	2.4
Deferred Tax asset – Life business	Lapse rates on inforce onshore bond business, and fixed interest and equity investment returns for inforce onshore bond and with profits business.	2.4
Financial statement area	Critical accounting judgements	Related note
Fair value and fair value hierarchy	Determination of the fair value of Investment property and derivatives that are categorised as level 3 in the fair value hierarchy.	2.5

**2.1. Actuarial assumptions – insurance contracts**

*Non-profit pension annuity business*

For valuation of the liabilities of the UK non-profit fund annuity business, the cash flow is projected using current data and assumptions. Each cash flow is valued using a current market discount rate after taking into account the risk of credit default. Annuity contracts are valued using current best estimate assumptions.

Mortality tables applied are generally developed based on a blend of Company experience and industry wide studies, taking into consideration product characteristics, own risk selection criteria, target market and past experience. Mortality improvement factors are a key assumption, which involves the extrapolation of prior mortality into the future. Mortality experience is monitored through regular studies and the mortality basis is updated annually.

Mortality assumptions as at 31 December 2018 are detailed below.

For the inwards reinsurance of annuity business that has been accepted on arm's length terms from Guardian Assurance plc (which was a fellow subsidiary undertaking until it was sold on 23 November 2011), the mortality basis is:

- For annuities less than or equal to £1500 p.a. : 119.90% of PML08 ultimate & 115.90% of PFL08 ultimate projected in line with CMI\_2017 model improvements using the "core" CMI assumptions including smoothing with a long-term annual improvement rate of 1.50% and 1.25% for males and females respectively beginning 1 January 2008.
- For annuities between £1500 & £4k p.a. : 108.63% of PML08 ultimate & 105.01% of PFL08 ultimate projected in line with CMI\_2017 model improvements using the "core" CMI assumptions including smoothing with a long-term annual improvement rate of 1.50% and 1.25% for males and females respectively beginning 1 January 2008.
- For annuities over £4k p.a. : 99.04% of PML08 ultimate & 95.73% of PFL08 ultimate projected in line with CMI\_2017 model improvements using the "core" CMI assumptions including smoothing with a long-term annual improvement rate of 1.50% and 1.25% for males and females respectively beginning 1 January 2008.

The valuation interest rate used to value the accepted annuity business is the risk-adjusted internal rate of return on the portfolio of assets backing the annuity book where the risk adjustment applied allows for the risk of rating changes and defaults on the assets.

*Non-profit employee benefits business*

The Employee Benefits unit offered a range of group protection products and, as such, provisions are mainly claims in payment and claims notified but not yet settled.

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*Non-profit protection business*

The liability for long duration insurance contracts in the NPSF with guaranteed or fixed account terms is based on the assumptions established at inception of the contract, reflecting the best estimates at the time increased with a margin for adverse deviation. Mortality and morbidity assumptions for each cohort are based upon experience with a 15% loading for any adverse deviation.

2.2. Actuarial assumptions – DPAC

Certain acquisition costs related to the sale of new policies and the purchase of policies already in force are recorded as DPAC assets. DPAC in respect of insurance contracts and investment contracts with discretionary participating features is amortised over time in line with estimated gross profits.

Significant assumptions for each unitised cohort include the annual long-term growth rate of the underlying assets and the lapse rates. The long-term growth rate for equities is based on historic returns, whilst lapse rates are based primarily on our own experience. For non-unitised business significant assumptions for each cohort include discount, mortality, morbidity and persistency rates.

DPAC is tested for recoverability based on current estimates of future cash flows. The most significant assumptions relating to DPAC recoverability are unit fund growth rates, lapse rates and the allocation of future expenses between acquisition expenses and renewal expenses.

2.3. Actuarial assumptions – With Profits fund

The liability for the WPSF represents the net assets of the fund. As the Company's WPSF is a 100:0 fund, we expect to distribute all assets to with profits policyholders over time. Liabilities for contracts within the WPSF are calculated on a Solvency II regulatory basis to ensure that the net assets are more than sufficient to cover these liabilities and associated capital requirements.

The factors giving rise to the greatest level of uncertainty in the calculation of these WPSF UK Solvency II liabilities are:

- Assumed rates of future mortality improvement in the calculation of provisions for deferred annuity liabilities remaining in the fund, specifically Guaranteed Annuity Options (GAOs) and Guaranteed Minimum Pensions (GMPs).
- Assumed levels of future interest rates in the calculation of provisions for GAOs and GMP deferred annuity liabilities.
- Assumed future policyholder behaviour, including future persistency experience and levels of future GAO take-up.

2.4. Taxation

Deferred tax assets are established for the tax benefit related to deductible temporary differences, carry forward of unused tax losses and carry forward of unused tax credits when in the judgement of the Directors it is probable that the Company will receive the tax benefits. Since there is no absolute assurance that these assets will ultimately be realised, management reviews the Company's deferred tax positions periodically to determine if it is probable that the assets will be realised.

In respect of the Pension business losses deferred tax asset recognised of £153.7m described in note 15, recoverability is considered probable taking into account:

- expected future IFRS profits from the in force Non BLAGAB business (being Pension and Protection business)
- the impact of the loss relief restriction rules enacted as part of Finance (No.2) Act 2017 whereby losses can only be set against a maximum £5m plus 50% of the remaining profit in any year.

Given the long term nature of the pension business the expected future profits from inforce business are projected over a 30 year period, it is considered that profits expected to arise within this timeframe satisfy the probable test for deferred tax asset recognition. Based on the projections at 31 December 2018 the deferred tax asset recognised in respect Pension business losses is expected to be recovered in full over 11 to 12 years. It is expected that circa 11% of the asset will be outstanding after 10 years.

The most significant assumptions relate to retention of inforce pension business, expense assumptions, fixed interest and equity investment returns.

In respect of the Life business deferred tax asset recognised of £43.0m described in note 15, the recoverability is considered probable taking into account:

- expected income from inforce onshore bond business

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- expected income from inforce with profits business

The asset is expected to be recovered over 11 to 12 years. The recoverability assessment undertaken at 31 December 2018 includes the freezing of indexation relief at 31 December 2017 within the calculation of the chargeable gains on property and equity investments that was substantively enacted on 21 February 2018.

The most significant assumptions relate to lapse rates on inforce onshore bond business, and fixed interest and equity investment returns for inforce onshore bond and with profits business.

2.5. Fair value and fair value hierarchy

The following is a description of the Company's methods of determining fair value, and a quantification of its exposure to assets and liabilities measured at fair value.

Fair value is defined as the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

In accordance with IFRS 13, the Company uses the following hierarchy for determining and disclosing the fair value of assets and liabilities:

- Level I: quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company can access at the measurement date;
- Level II: inputs other than quoted prices included within Level I that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices of identical or similar assets and liabilities) using valuation techniques for which all significant inputs are based on observable market data; and
- Level III: inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) or using valuation techniques for which any significant input is not based on observable market data.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active or quoted market prices are not available, a valuation technique is used.

The degree of judgement used in measuring the fair value of assets and liabilities generally inversely correlates with the level of observable valuation inputs. The Company maximises the use of observable inputs and minimises the use of unobservable valuation inputs when measuring fair value. Financial instruments, for example, with quoted prices in active markets generally have more pricing observability and less judgement is used in measuring fair value. Conversely, financial instruments for which quoted prices are not available have less observability and are measured at fair value using valuation models or other pricing techniques that require more judgement.

The assets and liabilities categorisation within the fair value hierarchy is based on the lowest input that is significant to the fair value measurement.

An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The judgement as to whether a market is active may include, although not necessarily determinative, lower transaction volumes, reduced transaction sizes and, in some cases, no observable trading activity for short periods. In inactive markets, assurance is obtained that the transaction price provides evidence of fair value or determined that the adjustments to transaction prices are necessary to measure the fair value of the instrument.

The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain assets and liabilities are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable and, for such assets and liabilities, the derivation of fair value is more judgmental. An instrument in its entirety is classified as valued using significant unobservable inputs (Level III) if, in the opinion of management, a significant proportion of the instrument's carrying amount is driven by unobservable inputs. "Unobservable" in this context means

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that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value. Additional information is provided in the table headed "Significant unobservable assumptions" in note 28 Fair value. While the Company believes, its valuation techniques are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain instruments (both financial and non-financial) could result in a different estimate of fair value at the reporting date.

To operationalise the Company's fair value hierarchy, individual instruments (both financial and non-financial) are assigned a fair value level based primarily on the type of instrument and the source of the prices (e.g. index, third-party pricing service, broker, internally modelled). Periodically, this logic for assigning fair value levels is reviewed to determine if any modifications are necessary in the context of the current market environment.

**3. Investment income**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Interest income	424.3	490.2
Dividend income	755.3	814.4
Rental income	44.9	48.5
Derivative income	-	0.2
<b>Total investment income</b>	<u>1,224.5</u>	<u>1,353.3</u>

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Investment income related to general account	49.6	75.4
Investment income for account of policyholders	1,174.9	1,277.9
<b>Total investment income</b>	<u>1,224.5</u>	<u>1,353.3</u>

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Investment income from:		
Shares	755.3	814.4
Debt securities and money market instruments	417.7	473.6
Loans	3.6	14.4
Real estate	44.9	48.5
Other	3.0	2.4
<b>Total investment income</b>	<u>1,224.5</u>	<u>1,353.3</u>

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Investment income from financial assets held for general account:		
Available-for-sale	8.9	11.3
Financial assets at fair value through profit or loss	34.1	47.3
Loans measured at amortised cost	3.6	14.4
Other	3.0	2.4
<b>Investment income related to general account</b>	<u>49.6</u>	<u>75.4</u>

Investment income from general account loans, relates to loans to the parent undertaking and to a fellow subsidiary. For terms and conditions relating to related party transactions, refer to note 31. Included in interest income is £nil (2017: £nil) in respect of interest income accrued on impaired financial assets. The interest income of financial assets that are not carried at fair value through profit or loss amounted to £15.5 m (2017: £28.1m).



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**4. Results from financial transactions**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Net fair value change on general account financial investments at fair value through profit or loss (all designated), other than derivatives	(38.1)	8.4
Realised gains and losses on general account financial investments	53.8	56.9
Fair valued changes on general account economic hedges for which no hedge accounting is applied	(5.4)	(63.2)
Net fair value change on for account of policyholder financial assets at fair value through profit or loss (all designated)	(5,020.9)	4,142.8
Net fair value change on investments in real estate for account of policyholders	4.6	31.4
<b>Total results from financial transactions</b>	<u><u>(5,006.0)</u></u>	<u><u>4,176.3</u></u>

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Net fair value change on general account financial investments at fair value through profit or loss, other than derivatives comprise:		
Shares	(0.4)	0.2
Debt securities and money market investments	(37.7)	8.2
<b>Total</b>	<u><u>(38.1)</u></u>	<u><u>8.4</u></u>

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Realised gains and losses on general account financial investments relate to:		
Debt securities and money market investments	53.8	5.4
Gain on repayment of intercompany loans	-	51.5
<b>Total</b>	<u><u>53.8</u></u>	<u><u>56.9</u></u>

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Realised gains and losses on general account financial investments relate to:		
Available-for-sale investments	53.8	5.4
Gain on repayment of intercompany loans	-	51.5
<b>Total</b>	<u><u>53.8</u></u>	<u><u>56.9</u></u>

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Net fair value change for account of policyholder financial investments at fair value through profit or loss (all designated) comprise:		
Shares	(1,564.7)	1,545.7
Debt securities and money market investments	(208.5)	39.3
Separate accounts and unconsolidated investment funds	(3,112.5)	2,475.2
Derivatives	(135.2)	82.6
<b>Total</b>	<u><u>(5,020.9)</u></u>	<u><u>4,142.8</u></u>

Investments for account of policyholders comprise financial assets and investments in real estate. Refer to note 11 for further information. Financial assets for account of policyholder are classified as fair value through profit or loss. Investment income on investments for account of policyholders is included in investment income, see note 3.

**5. Policyholders' claims and benefits**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Claims and benefits paid to policyholders	8,124.5	10,236.4
Change in valuation of liabilities for insurance contracts	1,226.7	5,841.4
Change in valuation of liabilities for investment contracts	(7,125.9)	(2,609.0)
<b>Total</b>	<u><u>2,225.3</u></u>	<u><u>13,468.8</u></u>

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**6. Commissions and expenses**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Commissions	74.2	72.8
Investment management expenses	37.4	42.0
Administration expenses	319.1	358.3
Deferred expenses	(60.4)	(57.0)
Amortisation of deferred expenses	98.1	109.3
<b>Total</b>	<u><u>468.4</u></u>	<u><u>525.4</u></u>

Investment management expenses of £41.2m (2017: £39.3m) are recharged to the Company by Kames Capital plc, a fellow subsidiary of Aegon N.V..

Administrative expenses of £315.5m (2017: £355.1m) were recharged to the Company by AUKCS, a fellow subsidiary of Aegon UK plc. Administration expenses recharged by AUKCS of £70.7m were incurred in 2018 in relation to business transformation and project costs (2017: £63.3m). Operating lease payments included in administration expenses recharged by AUKCS during the year amounted to £4.3m (2017: £4.1m). Commission expenses of £74.2m (2017: £72.8m) were incurred during the year.

Also included within the administration expenses recharged by AUKCS are:

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Amount paid to auditors	1.0	0.9
Audit of the financial statements	1.0	0.9
Other fees to auditors:		
Audit of regulatory return	0.3	0.3
Audit services in respect of ultimate parent and associated undertakings	0.9	2.0
<b>Total amount paid to auditors</b>	<u><u>2.2</u></u>	<u><u>3.2</u></u>

The amounts of Directors' remuneration were as follows:

	<u>2018</u>	<u>2017</u>
	<u>£'000</u>	<u>£'000</u>
Fees	684.4	735.0
Remuneration including bonuses	2,796.5	2,343.5
Aggregate amounts receivable by Directors in respect of long-term incentive schemes (other than shares and share options)	-	-
<b>Total amounts of Directors' remuneration</b>	<u><u>3,480.9</u></u>	<u><u>3,078.5</u></u>

No Contributions were made for Directors (2017: nil) to defined contribution schemes (2017: £nil).

Two Directors received Aegon N.V. shares in relation to long-term incentive schemes in 2018 (2017: two). Compensation in respect of loss of office to Directors is £nil in 2018 (2017: £nil).

The Executive Directors of the Company are also Executive Directors of other Aegon UK plc group companies. The total remuneration of the Executive Directors is disclosed above, all of which was paid by the Aegon UK plc group. The Directors do not believe that it is practicable to apportion this amount between their services as Executive Directors of the Company and its subsidiaries and their services to other Aegon UK plc group companies.

Fees relate to payments to Non-Executive Directors. Non-Executive Directors do not participate in any incentive or bonus plans or pension arrangements. The above includes the following amounts in respect of the highest paid Director for his services to the Company and other Aegon UK plc group companies.

	<u>2018</u>	<u>2017</u>
	<u>£'000</u>	<u>£'000</u>
Remuneration including bonuses	1,635.5	1,278.8
Aggregate amounts receivable by Directors in respect of long-term incentive schemes (other than shares and share options)	-	-
<b>Total in respect of highest paid Director</b>	<u><u>1,635.5</u></u>	<u><u>1,278.8</u></u>

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The remuneration for the highest paid Director included above is also disclosed in the Aegon UK plc financial statements where they are also a Director.

The highest paid Director at 31 December 2018 and 31 December 2017 was not a member of the defined benefit pension scheme. No Contributions (2017: £nil) were made to a defined contribution scheme in respect of the highest paid Director at 31 December 2018.

The highest paid Director received Aegon N.V. shares in relation to long-term incentive schemes in 2018 and 2017.

**7. Interest charges and related fees**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Bank interest	1.1	0.5
Other	0.1	2.3
<b>Total</b>	<u>1.2</u>	<u>2.8</u>

**8. Income Tax charge**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
<b>Current Tax</b>		
Current year	34.2	49.8
Adjustments to prior year	(8.5)	0.4
	<u>25.7</u>	<u>50.2</u>
<b>Deferred Tax</b>		
Reversal of temporary differences	(14.2)	(24.3)
Change in deferred tax rate	(0.6)	4.0
Change in recognition of deferred tax assets	(6.7)	(9.3)
Adjustment in respect of prior years	(6.4)	0.4
<b>Income tax (credit) / charge for the year</b>	<u>(2.2)</u>	<u>21.0</u>

The Finance (No. 2) Act 2015, substantively enacted on the 26 October 2015, included future reductions to the corporation tax rate from 20% to 19% with effect from 1 April 2017 and then to 18% from 1 April 2020. This was subsequently amended by the Finance Act 2016, substantively enacted on 6 September 2016, the corporation tax rate will now reduce from 19% to 17% with effect from 1 April 2020.

The impact of these reductions in tax rates on the deferred tax balances have been included in the above figures and the deferred tax tables.

*Reconciliation between standard and effective income tax:*

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Income before tax	<u>157.3</u>	<u>55.4</u>
Income tax charge calculated using weighted average applicable statutory rates	29.9	10.7
Difference due to the effects of:		
Non-taxable income <sup>1</sup>	-	(5.4)
Non tax deductible expenses <sup>2</sup>	0.2	1.5
Change in tax rate	(0.6)	4.0
Other taxes <sup>3</sup>	(10.1)	18.7
Recognition of deferred tax asset previously unrecognised <sup>4</sup> (note 15)	(6.7)	(9.3)
Adjustment to prior years <sup>5</sup>	(14.9)	0.8
<b>Income tax (credit)/charge for the year</b>	<u>(2.2)</u>	<u>21.0</u>

The weighted average applicable tax rate for 2018 is 19.00% (2017: 19.25%).

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The accounting for items in the income statement results in reconciling items in the table above. The value of these varies from year to year depending on the underlying accounting values.

<sup>1</sup> Non-taxable income relates to income taxed on a tax basis and not an accounting basis.

<sup>2</sup> The non tax deductible expenses includes costs relating to projects, restructuring and strategic transactions (e.g. integration costs) which are not tax deductible.

<sup>3</sup> Within Other Taxes, there is the effect of Policyholder tax (as defined in note 1.25) which has equal and opposite amounts included in the Income before tax and Tax charge such that the Income after tax is nil and so will always give rise to a reconciling difference in the above table.

<sup>4</sup> The benefit of £6.7m (2017: £9.3m) relates to the recognition of deferred tax assets re excess expenses that were previously unrecognised (see note 15).

<sup>5</sup> The prior year benefit has arisen as a result of losses being surrendered as group relief from other group companies at nil value.

The Company is party to claims to recover tax in respect of overseas income relating to assets in policyholder funds. There is significant uncertainty on the outcome of these claims and they are not expected to materially affect profit for the year attributable to shareholders or total equity. The final judgement in the case on which the claims are based was passed down by the Supreme Court in July 2018. The claims will be updated to reflect the final judgement before being filed with HMRC during 2019

**9. Investments in subsidiaries**

At 31 December 2018, the Company held shares in the following subsidiary undertakings operating in the UK, each undertaking has only one class of share. The table below represents a complete list of the Companies subsidiaries. Investments in subsidiaries are accounted for at fair value.

Name	Principal Activity	Registered Address	Holding %
Scottish Equitable (Managed Funds) Ltd	Reassurance of life assurance business (until 31 December 2009) (dormant)	Edinburgh Park, Edinburgh, Lothian, EH12 9SE, Scotland	100
Aegon UK IT Services Ltd	Leasing Company (dormant)	Edinburgh Park, Edinburgh, Lothian, EH12 9SE, Scotland	99*

\* 1% is held by the Company's parent Scottish Equitable Holdings Limited.

**10. Investments**

Investments for general account comprise financial assets, excluding derivatives. Refer to note 11 for investments for which the investment risk is borne by the policyholders and to note 12 for details on general account derivatives.

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Fair value through profit or loss – designated:		
Shares	2.9	3.3
Debt securities and money market investments	873.0	1,133.8
Other Trading	428.5	-
	<u>1,304.4</u>	<u>1,137.1</u>
Available-for-sale:		
Shares	310.0	137.8
Debt securities and money market investments	81.8	475.0
	<u>391.8</u>	<u>612.8</u>
Loans measured at amortised cost:		
Loans to other Aegon N.V. group undertaking	25.0	106.3
	<u>25.0</u>	<u>106.3</u>
<b>Total investments for the general account</b>	<u><u>1,721.2</u></u>	<u><u>1,856.2</u></u>

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Of the debt securities and money market investments, £84.4m is current (2017: £61.8m).

The loans to other Aegon N.V. group undertaking as at 2018 year end comprise:

- A loan to Cofunds Limited with a value of £25m (2017: £25m), with annual interest charged at three-month LIBOR + 2%, which is repayable in 2021 or earlier in certain circumstances.

The 2017 year-end Loans to other Aegon N.V. group undertaking also included:

- A loan to Aegon UK plc with a value of £50m, with annual interest charged at six-month LIBOR + 3.5%, which was repayable in 2027 or earlier in certain circumstances. This was repaid on 29 May 2018.
- A loan to Aegon International B.V. with a value of £31.3m, which was repayable in 2033 or earlier in certain circumstances with annual interest charged at six-month LIBOR + 5.78%. This was repaid on 20 December 2018.

**11. Investments for account of policyholders**

Investments for account of policyholders comprise financial assets at fair value through profit or loss, excluding derivatives, as well as investments in real estate. Refer to note 12 for details on derivatives for account of policyholders.

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Fair value through profit or loss:		
Shares	11,178.0	13,679.2
Debt securities	6,515.2	7,212.5
Money market and other short term investments	1,342.6	1,699.8
Deposits with financial institutions	2,897.0	2,459.4
Separate accounts and unconsolidated investment funds	<u>43,350.1</u>	<u>29,716.3</u>
	65,282.9	54,767.2
Investments in real estate	<u>549.4</u>	<u>579.4</u>
<b>Total investments for account of policyholders</b>	<u><u>65,832.3</u></u>	<u><u>55,346.6</u></u>

On 2 July 2018, the Company completed the part VII transfer of the BlackRock defined contribution platform and pension administration business. No consideration was paid for the acquisition upon completion of the Part VII transfer. A deferred consideration is payable if the Company fails to generate £42m in revenue for BlackRock over 7 years from 22 August 2016. A true-up mechanism is in place where the Company will make-up any shortfall if the level of revenue to BlackRock falls below £18m cumulative to year 3, £18m for the 3 years to year 6 and £6m in year 7. At 31 December 2018 the provision for deferred consideration included in note 24 is £3.8m (2017: £4.7m).

The following assets and liabilities were received upon completion of the Part VII transfer as at 2 July 2018.

	<u>2018</u>
	<u>£m</u>
<b>Assets</b>	
Investments for account of policyholder	16,151.2
Other assets and receivables	208.7
Cash and cash equivalents	<u>13.5</u>
<b>Total assets</b>	<u>16,373.4</u>
<b>Equity</b>	-
<b>Liabilities</b>	
Investment contracts for account of policyholder	16,286.3
Other liabilities	<u>87.1</u>
<b>Total liabilities</b>	<u>16,373.4</u>
<b>Total equity and liabilities</b>	<u><u>16,373.4</u></u>

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**11.1 Investments in real estate**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
At 1 January	579.4	585.6
Additions	-	6.5
Subsequent expenditure capitalised	3.8	0.8
Disposals	(38.4)	(46.6)
Fair value gains	4.6	33.1
<b>At 31 December</b>	<u><u>549.4</u></u>	<u><u>579.4</u></u>

No property interests held under operating leases are classified and accounted for as investment property. The investment property is fully leased out under cancellable operating leases. Rental income is reported as part of investment income in the income statement.

In relation to investments for account of policyholder operating leases that are in the name of the Company the following future minimum lease payments are receivable:

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Not later than one year	8.9	10.2
After one year but no more than five years	26.1	28.3
After five years	20.7	27.0
<b>Future minimum lease payments receivable</b>	<u><u>55.7</u></u>	<u><u>65.5</u></u>

There are no restrictions on the realisability of investment property or the remittance of income and proceeds of disposal. All property was last valued in 2018 by independent external appraisers, see note 28 for further details.

The direct operating expenses relating to investments in real estate for account of policyholders that generated rental income was £3.6m (2017: £3.2m).

**12. Derivatives**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
<b>Assets</b>		
Rights under derivatives contracts not designated as a hedge – general account	31.8	17.7
Rights under derivatives contracts not designated as a hedge – for account of policyholder	249.2	309.9
	<u>281.0</u>	<u>327.6</u>
<b>Liabilities</b>		
Obligations under derivatives contracts not designated as a hedge – general account	(12.0)	(13.8)
Obligations under derivatives contracts not designated as a hedge – for account of policyholder	(50.6)	(67.9)
	<u>(62.6)</u>	<u>(81.7)</u>
<b>Total net derivatives</b>	<u><u>218.4</u></u>	<u><u>245.9</u></u>

Of these derivatives, £2.3m net asset is current (2017: £ (17.9)m). See note 1.13 for details on measurement of derivatives.

The fair value of the derivatives reflects the estimated amounts that the Company would receive or pay to terminate the contracts on the reporting date. Market quotes are available for many derivatives; for those products without readily available market quotes, generally accepted valuation models, such as option pricing, are used to estimate fair value.

The Company uses derivatives as part of the asset management process in both the unit linked and with profits funds. The use of derivatives is either for efficient portfolio management or for the reduction of equity, interest rate and currency risks. The Scottish

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Equitable With Profits Fund holds interest rate swaptions and swaps in connection with guaranteed annuity option liabilities and general interest rate risks. Currency forwards are also used in the management of currency exposure within funds.

Over-the-counter derivatives are also used in the with-profits fund and the non-profit sub fund for the reduction of equity risk. A series of equity puts and put spreads are in place in the With Profits fund to limit the sensitivity of fund solvency to equity market falls. The non-profit sub fund also holds a number of equity options and total return swaps to reduce the sensitivity of economic capital to significant falls in the UK equity market.

Exchange traded derivative positions are all cleared through a central clearer and margining is reviewed daily. For over-the-counter derivatives, collateral is used to limit the counterparty exposures arising. Interest rate swaps purchased since May 2016 are subject to central clearing obligations.

**13. Reinsurance assets**

Assets arising from reinsurance contracts related to:	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Life insurance general account	<u>498.3</u>	<u>462.9</u>
<b>Total reinsurance assets</b>	<u><u>498.3</u></u>	<u><u>462.9</u></u>

£2.5m of the reinsurance assets are current (2017: £1.9m). Included within Life insurance general account in 2017 was £7.7m reinsurance asset with Aegon Ireland plc, which was part of the Aegon Group until its sale on 3 April 2018 and £1m (2017: £0.5m) with Blue Square Re part of the Aegon Group.

Movements during the year in reinsurance assets relating to life insurance general account:	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
At 1 January	462.9	439.0
Gross premium and deposits – existing and new business	161.0	356.5
Unwind of discount / interest credited	17.4	19.0
Transfer to assets held for resale	-	(182.2)
Insurance liabilities released and other movements	<u>(143.0)</u>	<u>(169.4)</u>
<b>At 31 December</b>	<u><u>498.3</u></u>	<u><u>462.9</u></u>

Movements during the year in reinsurance assets relating to life insurance for account of policyholders:	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
At 1 January	-	-
Gross premium and deposits – existing and new business	-	2.9
Transfer to Assets held for resale	-	(2.9)
<b>At 31 December</b>	<u><u>-</u></u>	<u><u>-</u></u>

**14. Deferred expenses**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
DPAC for insurance contracts and investment contracts with discretionary participation features	773.1	806.7
Deferred transaction costs for investment contracts	<u>34.4</u>	<u>38.5</u>
<b>Total deferred expenses</b>	<u><u>807.5</u></u>	<u><u>845.2</u></u>

In regards to deferred expenses, £91.1m is current (2017: £98.2m).

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	<u>DPAC</u>		<u>Deferred transaction costs</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
At 1 January	806.7	854.7	38.5	42.8
Costs deferred during the year	60.4	57.0	-	-
Amortisation through income statement	(94.0)	(105.0)	(4.1)	(4.3)
<b>At 31 December</b>	<b>773.1</b>	<b>806.7</b>	<b>34.4</b>	<b>38.5</b>

**15. Deferred tax assets**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Deferred tax assets	<u>104.4</u>	<u>67.7</u>

	<u>Financial</u>	<u>Insurance</u>	<u>Deferred</u>	<u>Losses</u>	<u>Other</u>	<u>Total</u>
	<u>Assets</u>	<u>Contracts</u>	<u>Expenses</u>			
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
At 1 January 2018	(9.5)	-	(98.6)	162.2	13.6	67.7
Change in deferred tax rate	-	-	(1.2)	1.7	0.1	0.6
(Charged) / credited to income statement	-	-	11.1	(10.2)	26.4	27.3
(Charged) / credited to other comprehensive income	8.8	-	-	-	-	8.8
<b>At 31 December 2018</b>	<b>(0.7)</b>	<b>-</b>	<b>(88.7)</b>	<b>153.7</b>	<b>40.1</b>	<b>104.4</b>

	<u>Financial</u>	<u>Insurance</u>	<u>Deferred</u>	<u>Losses</u>	<u>Other</u>	<u>Total</u>
	<u>Assets</u>	<u>Contracts</u>	<u>Expenses</u>			
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
At 1 January 2017	(9.9)	(50.4)	(110.6)	200.8	8.2	38.1
Change in deferred tax rate	-	(5.8)	(1.6)	5.0	(1.6)	(4.0)
(Charged) / credited to income statement	-	56.2	13.6	(43.6)	7.0	33.2
(Charged) / credited to other comprehensive income	0.4	-	-	-	-	0.4
<b>At 31 December 2017</b>	<b>(9.5)</b>	<b>-</b>	<b>(98.6)</b>	<b>162.2</b>	<b>13.6</b>	<b>67.7</b>

The weighted average applicable tax rate for 2018 is 19.00% (2017: 19.25%).

The UK tax regime for insurance companies splits earnings between Life business and Pension business. The deferred tax asset shown above comprises a deferred tax asset of £66.0m in respect of Pension business and a deferred tax asset of £38.4m in respect of the Life business "Income less Expenses" basis of taxation (2017: £56.2m in respect of Pension business profits and a deferred tax asset of £11.5m in respect of the Life business "Income less Expenses" basis of taxation). The £38.4m is made up of a deferred tax asset in respect of Excess Expenses of £43.0m offset by a £4.6m deferred tax liability in relation to Capital Gains. Under the taxation rules, the deferred tax asset in respect of Life business can only be recovered against future Life business investment income and gains. The critical accounting estimates and judgements relating to the recovery of this deferred tax asset are described in note 2.4.

No deferred tax asset is recognised on the statement of financial position in respect of policyholder capital losses arising under capital gains tax legislation of £21m (2017: £21m). The deferred tax asset in respect of excess management expenses has been fully recognised, (2017: £33m excess management expenses were not recognised). The value of unrecognised deferred tax asset in respect of excess management expenses is therefore £nil (2017: £7m). The losses and excess management expenses may carry forward without expiry.



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**16. Other assets and receivables**

	<u>Note</u>	<u>2018</u>	<u>2017</u>
		<u>£m</u>	<u>£m</u>
Receivables	16.1	470.4	395.9
Accrued income		91.6	104.4
<b>Total other assets and receivables</b>		<u>562.0</u>	<u>500.3</u>

All accrued income is current.

**16.1. Receivables**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Receivables from policyholders	33.3	47.8
Receivables from reinsurers	30.7	24.2
Receivables from fellow Aegon N.V. subsidiary undertakings	4.7	1.8
Cash outstanding from assets sold	114.8	15.2
Cash collateral on derivative transactions pledged	4.0	3.0
Cash collateral receivable	-	0.4
Income tax receivable	22.9	33.9
Margins on futures contracts	128.4	123.9
Collateralised loans	62.5	84.8
Other	69.1	60.9
<b>Total receivables</b>	<u>470.4</u>	<u>395.9</u>

£9.0m of the income tax receivable is non-current (2017: £14.5m) and is expected to be received in 2020. All other receivables are current. Carrying amounts disclosed reasonably approximate the fair values at year end.

**17. Cash and cash equivalents**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Cash collateral relating to derivatives	0.8	4.1
Short term deposits	-	60.7
Cash at bank	59.7	28.1
<b>Total cash and cash equivalents</b>	<u>60.5</u>	<u>92.9</u>

The weighted effective interest rate on short-term deposits and cash at bank was 0.3% (2017: 0.3%) and these deposits have an average maturity date of 2 days (2017: 4 days). Cash and cash equivalents are not subject to any restrictions.

The carrying amounts disclosed reasonably approximate the fair values as at the year-end.

**18. Shareholders' equity**

	<u>Note</u>	<u>2018</u>	<u>2017</u>
		<u>£m</u>	<u>£m</u>
Share capital	18.1	625.0	625.0
Capital contributions		481.5	856.5
Revaluation reserves	18.2	3.4	46.5
Retained earnings		(2.4)	(161.9)
<b>Total shareholders' equity</b>		<u>1,107.5</u>	<u>1,366.1</u>

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**Nature and purposes of other reserves - Capital Contribution Reserve**

The capital contribution reserve is used to record capital contributions received from the immediate parent undertaking. Within the capital contribution reserve £293.9m (2017: £668.9m) is considered distributable and the remaining reserve is considered non-distributable. A dividend of £375.0m (2017: £387.7m) was paid from the reserve during the year.

**18.1 Share capital**

	<b>2018</b>	<b>2017</b>
	<b>£m</b>	<b>£m</b>
Allotted, called up and fully paid:		
625,000,000 Ordinary shares of £1 each (2017: 625,000,000 Ordinary shares of £1 each)	<b>625.0</b>	<b>625.0</b>

**18.2 Revaluation reserves**

	<b>Available-for-sale</b>	
	<b>Debt Securities</b>	
	<b>£m</b>	
<b>At 1 January 2018</b>	<b>46.5</b>	
Gross revaluation	1.9	
Gains transferred to income statement on disposal and impairment of available-for-sale investments	(53.8)	
Other comprehensive income for the year before tax	(51.9)	
Tax effect	8.8	
Other comprehensive income for the year after tax	(43.1)	
<b>At 31 December 2018</b>	<b>3.4</b>	
	<b>Available-for-sale</b>	
	<b>Debt Securities</b>	
	<b>£m</b>	
<b>At 1 January 2017</b>	<b>48.2</b>	
Gross revaluation	3.3	
Gains transferred to income statement on disposal and impairment of available-for-sale investments	(5.4)	
Other comprehensive income for the year before tax	(2.1)	
Tax effect	0.4	
Other comprehensive income for the year after tax	(1.7)	
<b>At 31 December 2017</b>	<b>46.5</b>	

The revaluation accounts for available-for-sale investments and represents unrealised gains and losses on these investments, net of tax. Upon sale, the amounts realised are recognised in the income statement. Upon impairment, unrealised losses are recognised in the income statement. No amounts have been released from equity to be included in the initial measurement of non-financial assets or liabilities.

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**19. Insurance contracts**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
<b>At 1 January</b>	<b>1,389.1</b>	<b>1,544.7</b>
Gross premium and deposits – existing and new business	249.4	244.8
Unwind of discount / interest credited	34.7	39.7
Change in assumptions:		
- Economic*	(16.0)	31.6
- Non economic**	(33.1)	(5.0)
Insurance liabilities released and other movements	(333.2)	(284.5)
Transfer to Liabilities held for sale	-	(182.2)
<b>At 31 December</b>	<b><u>1,290.9</u></b>	<b><u>1,389.1</u></b>

\* Economic assumption changes include change in valuation interest rates

\*\* Non-economic assumption changes include £(35.1)m from longevity basis change and £2m from expense basis change.

**20. Insurance contracts for account of policyholders**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
<b>At 1 January</b>	<b>20,294.8</b>	<b>14,249.2</b>
Gross premium and deposits – existing and new business	5,261.5	7,001.4
Unwind of discount / interest credited	(1,384.3)	1,694.5
Insurance liabilities released	(2,552.3)	(2,647.4)
Transfer to liabilities held for sale	-	(2.9)
<b>At 31 December</b>	<b><u>21,619.7</u></b>	<b><u>20,294.8</u></b>

**21. Investment contracts**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
<b>At 1 January</b>	<b>246.5</b>	<b>312.5</b>
Investment contract liabilities released	(46.7)	(66.0)
<b>At 31 December</b>	<b><u>199.8</u></b>	<b><u>246.5</u></b>

**22. Investment contracts for account of policyholders**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Without discretionary participation features	17,676.2	2,311.9
With discretionary participation features	27,153.0	33,082.1
<b>Total investment contracts for account of policyholders</b>	<b><u>44,829.2</u></b>	<b><u>35,394.0</u></b>
With discretionary participation features:		
	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
<b>At 1 January</b>	<b>33,082.1</b>	<b>35,827.9</b>
Gross premium and deposits – existing and new business	1,130.8	1,149.6
Investment contract liabilities released	(5,753.6)	(7,887.8)
Investment return credited	(1,306.3)	3,992.4
<b>At 31 December</b>	<b><u>27,153.0</u></b>	<b><u>33,082.1</u></b>

Investment contracts with discretionary participation features are not measured at fair value and there is currently no agreed definition of fair value for discretionary participation features. In the absence of such a definition, it is not possible to provide a range of estimates within which a fair value is likely to fall. There is no active market for these instruments, which will be settled with policyholders in the normal course of business.

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Changes in the fair value of investment contracts without discretionary participation features that are designated as fair value through profit and loss were not attributable to the change in the Company's credit spread. There are no significant differences between the carrying amount of these financial liabilities and the contractual amount payable at maturity (net of surrender penalties).

**23. Provisions**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
At 1 January	4.7	-
Additional provisions	-	4.7
Reductions resulting from re-measurement	<u>(0.9)</u>	<u>-</u>
<b>At 31 December</b>	<b><u>3.8</u></b>	<b><u>4.7</u></b>

£3.8m provisions are current (2017: £nil).

**24. Deferred revenue liabilities**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
At 1 January	68.1	103.6
Release to income statement	<u>(3.1)</u>	<u>(35.5)</u>
<b>At 31 December</b>	<b><u>65.0</u></b>	<b><u>68.1</u></b>

£3.3m deferred revenue liabilities are current (2017: £3.2m).

**25. Other liabilities**

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Payables due to policyholders	150.8	119.1
Payables due to brokers and agents	3.0	4.6
Payables out of reinsurance	9.0	21.6
Social security and taxes payable	3.5	1.4
Investment creditors	201.7	115.9
Cash collateral	279.5	347.2
Payables to fellow Aegon N.V. subsidiary undertakings	2.0	3.5
Other creditors and accruals	<u>39.5</u>	<u>41.4</u>
<b>Total other liabilities</b>	<b><u>689.0</u></b>	<b><u>654.7</u></b>

Of the other liabilities, £689.0m are current (2017: £654.7m). The carrying amounts disclosed reasonably approximate the fair values at year-end.

**26. Capital and solvency**

The Company uses a Partial Internal Model to calculate the solvency position of its insurance activities. The internal model was approved on 14 December 2015, by the PRA as part of the Internal Model Application Process. Subsequent changes to the Partial Internal Model to model operational and currency Standard Formula risks using an extended Internal Model have since also been approved. The calculation includes the use of the matching adjustment in line with Solvency II rules and agreed with the PRA.

*Strategic importance*

The Company's approach towards capital management plays a vital role in supporting the execution of its strategy. The Company fundamentally seeks to ensure it has adequate capitalisation to cover the Company's obligations towards its customers. Through having a robust business strategy and ongoing business performance, the Company also seeks to provide for a sustainable dividend to its shareholders.

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*Management of capital*

Disciplined risk and capital management support the Company's decisions. The Company balances the funding of new business growth with the funding required to ensure that the Company's obligations towards policyholders are always adequately met, and with providing for a sustainable dividend to its shareholder.

The Company's goal is to maintain a strong financial position and to be able to sustain losses from adverse business and market conditions. The Company's overall capital management strategy is based on adequate solvency capital and capital quality.

The Company's capital management framework involves the use of internal target capital management zones, supported by robust risk and capital monitoring processes that trigger and escalate interventions on a timely basis if and when needed. The goal of the framework is to ensure that capital is always being managed towards these internal target ranges and management actions identified where the solvency level falls below the regulatory minimum capital requirements.

*Capital adequacy*

The Company manages its capital to its target capitalisation levels under the Aegon capital management framework. The Company's capital management framework sets a Solvency II capital ratio target range of 140% – 180%. The year-end solvency ratio is 165% (2017: 171%).

*Minimum solvency requirement*

The Company sets the minimum regulatory capital requirements as the level around which regulators will formally require management to provide regulatory recovery plans, which is set as the 100% Solvency Capital Requirement (SCR).

*Capital quality*

The table below shows that the Company's available own funds are entirely invested in Tier one unrestricted capital:

	<u>31 December 2018</u>	<u>31 December 2017</u>
	<u>Available own funds</u>	<u>Available own funds</u>
	<u>£m</u>	<u>£m</u>
Tier one unrestricted	1,992.9	2,198.3
Tier one restricted	-	-
Tier two	-	-
Tier three	-	-
<b>Total tiers</b>	<u>1,992.9</u>	<u>2,198.3</u>

IFRS equity compares to Solvency II own funds as follows:

	<u>31 December 2018</u>	<u>31 December 2017</u>
	<u>£m</u>	<u>£m</u>
Shareholders' equity	1,107.5	1,366.1
Solvency II revaluations	<u>1,092.1</u>	<u>1,061.1</u>
<b>Excess of assets over liabilities</b>	<b>2,199.6</b>	<b>2,427.2</b>
Availability adjustments	<u>(206.7)</u>	<u>(228.9)</u>
<b>Available own funds</b>	<u>1,992.9</u>	<u>2,198.3</u>

The revaluation differences stem from the difference in valuation between IFRS and Solvency II frameworks, which can be grouped into the following categories:

- Items that are not recognised under Solvency II. The most relevant examples of this category for the Company include DAC and deferred revenues. The revaluation difference stemming from this category amounted to £742.4m (2017: £777.0m) compared to the IFRS Statement of Financial Position; and

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- Items that are recognised under Solvency II, but not under IFRS. The primary example relates to the Aegon UK plc Group defined benefit pension scheme deficit of £41.3m (2017: £109.6m), which is recognised within the Company under Solvency II; and
- Items that have a different valuation treatment between IFRS and Solvency II. Solvency II is a market consistent framework hence all assets and liabilities are to be presented at fair value, while IFRS also includes other valuation treatments in addition to fair value. The most relevant examples of this category for the Company include, reinsurance assets, and insurance and investment contract liabilities. This also includes a Solvency II risk margin within the Technical Provisions. The revaluation difference stemming from this category amounted to £1,875.8m (2017: £1,947.7m) compared to the IFRS Statement of Financial Position.

The availability adjustments are changes to the availability of own funds of the Company due to the Solvency II requirements. This relates to the ring-fenced restriction for the with profit sub fund as the shareholder has a 0% interest in the with profit sub fund, with the fund fully owned by the policyholders.

*PRA capital requirements*

In accordance with the Scheme of Demutualisation, free capital in the WPSF is not freely available for use by the NPSF or Shareholder's Fund and vice versa. The Scheme of Demutualisation also sets out the circumstances under which the NPSF may be required to provide support to the WPSF.

The Company has met its regulatory capital requirements during 2018 and 2017.

**27. Capital commitments, contingent liabilities and charges**

- (a) As at 31 December 2018 there were no material future capital commitments (2017: £nil). There were no material contracts for capital expenditure for which no provision had been made in the financial statements (2017: £nil).
- (b) The Directors have identified an element of risk in connection with overseas taxation, which could potentially give rise to a tax impact of £6m (2017: £6m), which would be borne by the shareholder. The Directors believe the likelihood of this shareholder impact crystallising is possible but not probable and therefore no provision has been made in these financial statements.

(c) Obligations under leases:

The Company has entered into a commercial lease on a property. The remaining duration of the lease is 18 years. Future minimum rentals payable under the non-cancellable operating lease are as follows:

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Not later than one year	7.0	6.9
After one year but no more than five years	30.1	29.6
After five years	129.6	137.5
<b>Total obligations under leases</b>	<u><u>166.7</u></u>	<u><u>174.0</u></u>

(d) Charges

The Company has granted a Deed of Charge (incorporating a floating charge) in favour of Winterthur Pension Funds UK Limited (Winterthur), created on 12 October 2006, relating to an external fund link the Company has with Winterthur. The reserves accepted as at 31 December 2018 were £25.1m (2017: £32.2m).

The Company also granted a bond and floating charge to Guardian Assurance plc on 30 December 2005 in respect of reinsurance contracts (relating to annuities, other classes of insurance business) between the Company and Guardian Assurance plc. The reserves accepted as at 31 December 2018 were £708.7m (2017: £812.6m). Guardian Assurance plc was a fellow subsidiary of the Company's ultimate parent undertaking Aegon N.V. until 23 November 2011 when it was sold to a third party. On 23 November 2011, the Company also granted a floating charge to Guardian Assurance plc in respect of the Company's payment obligations under the reinsurance contracts.

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The Company granted a Security Assignment (incorporating a fixed charge over certain collateral accounts) on 17 May 2013 in favour of a corporate policyholder, relating to a unit linked life insurance policy. The value of the fixed charge as at 31 December 2018 is £110.3m (2017: £118.9m).

The Company granted a Deed of Charge (incorporating a fixed charge) in favour of Friends Life WL Limited, created on 18 October 2013, relating to a reinsurance contract between the Company and Friends Life WL Limited and a similar agreement to Mobius Life Ltd in 13 July 2017. The value of the fixed charges as at 31 December 2018 are £1.1m and £4.6m respectively (2017: £2.4m, £3.8m).

**28. Fair value**

The estimated fair values of the Company's assets and liabilities correspond with the amounts that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When available, the Company uses quoted market prices in active markets to determine the fair value of investments and derivatives. In the absence of an active market, the fair value of investments in financial assets is estimated by using other market observable data, such as corroborated external quotes and present value or other valuation techniques. An active market is one in which transactions are taking place regularly on an arm's length basis. A fair value measurement assumes that an asset or liability is exchanged in an orderly transaction between market participants, and accordingly, fair value is not determined based upon a forced liquidation or distressed sale.

Valuation techniques are used when the Company determines the market is inactive or quoted market prices are not available for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). Therefore, unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). These inputs are developed based on the best information available.

The Company employs an oversight structure over valuation of financial instruments that includes appropriate segregation of duties. Senior management, independent of the investing functions, is responsible for the oversight of control and valuation policies and for reporting the results of these policies. For fair values determined by reference to external quotation or evidenced pricing parameters, independent price determination or validation is utilised to corroborate those inputs. Further details of the validation processes are set out below.

Valuation of assets and liabilities is based on a pricing hierarchy, in order to maintain a controlled process that will systematically promote the use of prices from sources in which the Company has the most confidence, where the least amount of manual intervention exists and to embed consistency in the selection of price sources. Depending on asset type, the pricing hierarchy consists of a waterfall that starts with making use of market prices from indices and follows with making use of third-party pricing services or brokers.

Fair value measurement

The description of the Company's methods of determining fair value and the valuation techniques are described below.

*Shares*

Fair values for unquoted shares are estimated using observations of the price/earnings or price/cash flow ratios of quoted companies considered comparable to the companies being valued. Valuations are adjusted to account for company-specific issues and the lack of liquidity inherent in an unquoted investment. Illiquidity adjustments are generally based on available market evidence. In addition, a variety of other factors are reviewed by management, including, but not limited to, current operating performance, changes in market outlook and the third-party financing environment.

*Debt securities*

When available, the Company uses quoted market prices in active markets to determine the fair value of its debt securities. These market quotes are obtained through index prices or pricing services.

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The fair values of debt securities (including Asset Backed Securities (ABS), Residential Mortgage Backed Securities (RMBS), Commercial Mortgage Backed Securities (CMBS) and ABS's-Other) are determined by management after taking into consideration several sources of data. The Company's valuation policy dictates that publicly available prices are initially sought from several third party pricing services. In the event that pricing is not available from these services, those securities are submitted to brokers to obtain quotes. The majority of brokers' quotes are non-binding. As part of the pricing process the Company assesses the appropriateness of each quote (i.e., as to whether the quote is based on observable market transactions or not) to determine the most appropriate estimate of fair value. Lastly, securities are priced using internal cash flow modelling techniques. These valuation methodologies commonly use the following inputs: reported trades, bids, offers, issuer spreads, benchmark yields, estimated prepayment speeds, and/or estimated cash flows. Only pricing services and brokers with a substantial presence in the market and with appropriate experience and expertise are used.

Third party pricing services will often determine prices using recently reported trades for identical or similar securities. The pricing service makes adjustments for the elapsed time from the trade date to the statement of financial position date to take into account available market information. Lacking recently reported trades, third party pricing services and brokers will use modelling techniques to determine a security price where expected future cash flows are developed based on the performance of the underlying collateral and discounted using an estimated market rate. Also included within the modelling techniques for ABS, RMBS, CMBS and ABS's-Other securities are estimates of the speed at which principal will be repaid over their remaining lives. These estimates are determined based on historical repayment speeds (adjusted for current markets) as well as the structural characteristics of each security.

*Money market and other short-term investments and deposits with financial institutions*

The fair value of assets maturing within a year is assumed to be approximated by their carrying amount adjusted for credit risk, where appropriate, based on market observable credit spreads.

*Financial derivatives*

Where quoted market prices are not available, other valuation techniques, such as option pricing or stochastic modelling, are applied. The valuation techniques incorporate all factors that market participants would consider and are based on observable market data when available. All models are validated before they are used and calibrated to ensure that outputs reflect actual experience and comparable market prices.

Fair values for exchange-traded derivatives, principally futures and certain options, are based on quoted market prices. Fair values for over-the-counter (OTC) derivative financial instruments represent amounts estimated to be received from or paid to a third party in settlement of these instruments. These derivatives are valued using pricing models based on the net present value of estimated future cash flows, directly observed prices from exchange-traded derivatives, other OTC trades, or external pricing services. Most valuations are derived from swap and volatility matrices, which are constructed for applicable indices and currencies using current market data from many industry standard sources. Option pricing is based on industry standard valuation models and current market levels, where applicable. The pricing of complex or illiquid instruments is based on internal models. For long-dated illiquid contracts, extrapolation methods are applied to observed market data in order to estimate inputs and assumptions that are not directly observable. To value OTC derivatives, management uses observed market information, other trades in the market and dealer prices.

The Company normally mitigates credit risk in derivative contracts by entering into collateral agreements where practical and in International Securities and Derivatives Association (ISDA) master netting agreements for each of the Company's legal entities to facilitate the Company's right to offset credit risk exposure. Where appropriate collateral is not held by the Company or the counterparty, the fair value of derivatives is adjusted for credit risk based on market observable spreads. Changes in the fair value of derivatives attributable to changes in counterparty credit risk were not significant.

*Real estate*

Valuations of investments in real estate is conducted in full by independent external appraisers every month. Appraisals are based on Royal Institute of Chartered Surveyors (RICS) guidelines (The Red Book). Valuations are mostly based on active market prices, adjusted for any difference in the nature, location or condition of the specific property. If such information is not available, other valuation methods are applied, considering the current cost of reproducing or replacing the property, the value that the property's net earning power will support and the value indicated by recent sales of comparable properties.



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<u>2018</u>	Note	<u>Level I</u> <u>£m</u>	<u>Level II</u> <u>£m</u>	<u>Level III</u> <u>£m</u>	<u>Total</u> <u>£m</u>
Financial assets carried at fair value					
<i>Available-for-sale investments</i>					
Debt securities and money market investments	10	3.1	78.7	-	81.8
Shares	10	-	310.0	-	310.0
		<u>3.1</u>	<u>388.7</u>	<u>-</u>	<u>391.8</u>
<i>Fair value through profit or loss</i>					
Shares	10	-	2.9	-	2.9
Debt securities	10	321.0	552.0	-	873.0
Other trading	10	-	428.5	-	428.5
Investments for account of policyholders	11	12,661.4	52,374.8	246.7	65,282.9
Investments in real estate for policyholders	11	-	-	549.4	549.4
Derivatives	12	5.4	273.8	1.8	281.0
Investments in subsidiaries	9	-	-	0.3	0.3
		<u>12,987.8</u>	<u>53,632.0</u>	<u>798.2</u>	<u>67,418.0</u>
<b>Total assets at fair value</b>		<u><b>12,990.9</b></u>	<u><b>54,020.7</b></u>	<u><b>798.2</b></u>	<u><b>67,809.8</b></u>
<i>Liabilities carried at fair value through profit or loss</i>					
Investments contracts for account of policyholders	22	-	17,676.2	-	17,676.2
Derivatives	12	12.8	49.8	-	62.6
<b>Total liabilities at fair value</b>		<u><b>12.8</b></u>	<u><b>17,726.0</b></u>	<u><b>-</b></u>	<u><b>17,738.8</b></u>
<u>2017</u>	Note	<u>Level I</u> <u>£m</u>	<u>Level II</u> <u>£m</u>	<u>Level III</u> <u>£m</u>	<u>Total</u> <u>£m</u>
Financial assets carried at fair value					
<i>Available-for-sale investments</i>					
Debt securities and money market investments	10	415.9	59.1	-	475.0
Shares	10	-	137.8	-	137.8
		<u>415.9</u>	<u>196.9</u>	<u>-</u>	<u>612.8</u>
<i>Fair value through profit or loss</i>					
Shares	10	-	3.3	-	3.3
Debt securities	10	428.8	705.0	-	1,133.8
Investments for account of policyholders	11	15,004.8	39,608.5	153.9	54,767.2
Investments in real estate for policyholders	11	-	-	579.4	579.4
Derivatives	12	17.7	307.4	2.5	327.6
Investments in subsidiaries	9	-	-	0.3	0.3
		<u>15,451.3</u>	<u>40,624.2</u>	<u>736.1</u>	<u>56,811.6</u>
<b>Total assets at fair value</b>		<u><b>15,867.2</b></u>	<u><b>40,821.1</b></u>	<u><b>736.1</b></u>	<u><b>57,424.4</b></u>
<i>Liabilities carried at fair value through profit or loss</i>					
Investments contracts for account of policyholders	22	-	2,311.9	-	2,311.9
Derivatives	12	26.1	55.6	-	81.7
<b>Total liabilities at fair value</b>		<u><b>26.1</b></u>	<u><b>2,367.5</b></u>	<u><b>-</b></u>	<u><b>2,393.6</b></u>

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**Movements in Level 3 financial instruments measured at fair value**

The following table summarises the change of all assets and liabilities measured at estimated fair value on a recurring basis using significant unobservable inputs (Level III), including realised and unrealised gains (losses) of all assets and liabilities and unrealised gains (losses) of all assets and liabilities still held at the end of the respective period.

	Available- for-sale investments	Investments at fair value through profit or loss			
		Debt securities	Investments for account of policyholders	Investments in real estate for policyholders	Derivatives
2018	£m	£m	£m	£m	£m
<b>At 1 January</b>	-	153.9	579.4	2.5	0.3
Acquisition through business combination	-	115.4	-	-	-
Total gains / (losses) in income statement *	-	(5.0)	6.3	(0.7)	-
Purchases	-	36.9	2.1	-	-
Sales	-	(54.5)	(38.4)	-	-
Transfers from Level II to Level III	-	-	-	-	-
Transfers from Level III to Level I	-	-	-	-	-
Transfers from Level III to Level II	-	-	-	-	-
<b>At 31 December</b>	-	246.7	549.4	1.8	0.3
Total (losses) or gains for the year included in income statement for assets held at 31 December 2018	-	(6.0)	3.8	0.5	-

	Available- for-sale investments	Investments at fair value through profit or loss			
		Debt securities	Investments for account of policyholders	Investments in real estate for policyholders	Derivatives
2017	£m	£m	£m	£m	£m
<b>At 1 January</b>	-	190.7	585.6	3.4	0.3
Total gains / (losses) in income statement *	-	11	31.4	(0.9)	-
Purchases	-	28	9	-	-
Sales	-	(75.8)	(46.6)	-	-
Transfers from Level II to Level III	-	-	-	-	-
Transfers from Level III to Level I	-	-	-	-	-
Transfers from Level III to Level II	-	-	-	-	-
<b>At 31 December</b>	-	153.9	579.4	2.5	0.3
Total gains or (losses) for the year included in income statement for assets held at 31 December 2017	-	9.1	32.4	0.2	-

\* Includes impairments. Gains and losses are recorded in the line item Results from financial transactions of the income statement.

\*\*\* This is the total gains / losses for the year during which the financial instrument was in Level III.

The Company's policy is to record transfers of assets and liabilities between Level I, Level II and Level III at their fair values as of the beginning of each reporting period.

During 2018, the Company transferred no financial instruments from Level II to Level III of the fair value hierarchy (2017: no transfers).

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**Significant unobservable assumptions**

The table below presents information about the significant unobservable inputs used for recurring fair value measurements for certain Level III assets and liabilities.

	31 December 2018	Valuation technique	Significant unobservable input*	Range (weighted average)
	£m			
<b>Fair value through profit or loss</b>				
Investment in subsidiaries	<u>0.3</u>	Net asset value	n.a.	n.a.
<b>Total</b>	<u><b>0.3</b></u>			

	31 December 2017	Valuation technique	Significant unobservable input*	Range (weighted average)
	£m			
<b>Fair value through profit or loss</b>				
Investment in subsidiaries	<u>0.3</u>	Net asset value	n.a.	n.a.
<b>Total</b>	<u><b>0.3</b></u>			

\* Not applicable (n.a.) has been included when no significant unobservable assumption has been identified and used.

Investments for account of policyholders, including derivatives, are excluded from the table above and from the disclosure regarding reasonably possible alternative assumptions. Policyholder assets, and their returns, belong to policyholders and do not impact the Company's net income or equity. The effect on total assets is offset by the effect on total liabilities.

In regards to Level III holdings, it is not considered that there were reasonably possible alternative assumptions that would significantly impact net income, total equity or total assets.

**Fair value information about assets and liabilities not measured at fair value**

The following table presents the carrying values and estimated fair values of assets and liabilities, excluding assets and liabilities, which are carried at fair value on a recurring basis.

	Carrying amount 31 December 2018	Estimated fair value hierarchy			Total estimated fair value 31 December 2018
		Level I	Level II	Level III	
	£m	£m	£m	£m	£m
<b>Assets</b>					
Loans – held at amortised cost	25.0	-	-	25.0	25.0
	Carrying amount 31 December 2017	Estimated fair value hierarchy			Total estimated fair value 31 December 2017
		Level I	Level II	Level III	
	£m	£m	£m	£m	£m
<b>Assets</b>					
Loans – held at amortised cost	106.3	-	-	106.3	118.5

Certain financial instruments that are not carried at fair value are carried at amounts that approximate fair value, due to their short-term nature and generally negligible credit risk. These instruments include cash and cash equivalents, short-term receivables and accrued interest receivable, short-term liabilities, and accrued liabilities. These instruments are not included in the table above.

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**29. Risk management**

**29.1 General**

The Company is exposed to non-financial and financial risks. Non-financial risks incorporating insurance risks are mortality/morbidity (primarily longevity), lapses, and operational risk including legal, compliance and financial crime risks. The Company is also exposed to broader strategic risks.

Strategic risk is the risk of loss or reduced earnings due to inappropriate strategic decisions and/or implementation of these decisions. This includes consideration of regulatory and market changes such as the impacts of Solvency II and Pensions Reform. A key role of the Board is to focus on the Company's strategy and ensure the necessary resources are in place to meet the Company's objectives, assisted by the Risk Committee, which considers all risk matters relating to the Company. The overall governance framework is described in the Corporate Governance section in the strategic report.

The main financial risks are credit risk, liquidity risk and market risk, with the principal elements of market risk being interest rate risk, equity price risk and currency risk.

Exposure to these risks are monitored by the Company's Board, and appropriate sub-committees of the Board (in particular the Risk Committee) and appropriate Executive/Management Committees (in particular the Executive Committee).

In the quantitative analyses of credit and liquidity risk that follow assets held within unit-linked funds and the WPSF have been excluded. It is considered that this principle, which is unchanged from the prior year, to be appropriate as the risks are principally borne by the policyholder rather than the shareholder. The shareholder's exposure to these risks in respect of policyholder funds is as follows:

- In respect of unit-linked funds, exposure to credit risk is primarily related to the impact that credit risk has on annual management charges collected from unitised fixed interest funds. Through investment in External Fund Links there is an additional counterparty risk. Liquidity risk is limited as claims payments are met from the sale of unit linked assets. In respect of unit linked commercial property funds, the Company has the right to defer payment of certain withdrawals to allow for the orderly sale of properties so as to provide liquidity for the fund.
- In respect of the WPSF, the shareholder has no financial interest other than certain charges, with claims being met from the sale of WPSF assets. The WPSF is managed to balance the need to run-off the estate fairly across with-profits policyholders and to limit shareholder exposure to supporting the fund in extremis. The shareholder's exposure to guarantees in the WPSF is described in the Fund Structure paragraph of the Risk and Capital Management and Financial Instruments section of the Strategic Report.

**29.2 Credit risk**

Credit risk is the risk that the counterparty to a financial instrument will fail to discharge an obligation and cause the Company to incur a financial loss. An indication of the Company's exposure to credit risk is the quality of the investments and counterparties with which it transacts. The Company manages credit risk exposure by individual counterparty, sector and asset class, including cash positions. The Company is most exposed to credit risk on debt securities and money market investments, derivative financial instruments, cash and cash equivalents and reinsurance arrangements. Debt securities and money market investments mainly comprise government bonds and corporate bonds. The Company's general policy is to hold an appropriate spread of assets between counterparties in order to reduce risk. Additionally, the Company would normally expect at least 95% of its fixed interest securities to have credit ratings of BBB or higher. The Company prefers to work only with reinsurance companies that have a strong credit rating subject to an economic assessment of the terms on offer. Using a reinsurer with a credit rating below AA requires approval under Aegon UK's governance process as well as approval by Aegon's Group Reinsurance Use Committee in The Hague. Credit risk associated with derivatives is substantially reduced through the use of collateralisation on "over-the-counter" derivatives and margining on exchange-traded and centrally cleared derivatives. Where the Company enters into stock lending and repurchase arrangements credit risk is substantially reduced due to collateral arrangements.

Aegon N.V. operates a Credit Name Limit Policy (CNLP) under which limits are placed on the aggregate exposure that it has to any one counterparty. Limits are placed on the exposure at both group level and individual country units. The limits placed on the UK relate primarily to the Company with the limits being agreed by management as suitable for the size and nature of the Company's business. The limits also vary by a rating system, which is a composite of the main rating agencies (S&P, Moody's and Fitch) and

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Aegon N.V.'s internal rating of the counterparty. If an exposure exceeds the stated limit, then the exposure must be reduced to the limit for the Company and rating category as soon as possible.

The Company follows a CNLP in line with Aegon N.V. Under the CNLP a composite rating is used, which is based on a combination of the ratings of the constituents mentioned. The rating used is the lower of the external rating and the internal rating.

The following tables give an indication of the level of creditworthiness of those categories of assets that are most exposed to credit risk, using principally ratings prescribed by major rating agencies.

29.2.1 The first table shows financial assets (and excludes reinsurance) and the second table shows reinsurance assets.

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
AAA	75.0	122.0
AA	555.8	1,039.1
A	298.6	463.4
BBB	84.9	69.4
BB	1.0	7.7
Assets not rated	31.8	17.7
<b>Total Assets by Credit Risk</b>	<b><u>1,047.1</u></b>	<b><u>1,719.3</u></b>

Financial assets above comprise:	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Derivative financial instruments	31.8	17.7
Debt securities and money market investments	954.8	1,608.8
Cash and cash equivalents	60.5	92.8
	<b><u>1,047.1</u></b>	<b><u>1,719.3</u></b>

In respect of the Company, investments in subsidiaries and loans to other Aegon N.V. group undertakings are not rated.

The ratings for reinsurance assets are:	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
AA	265.1	253.4
A	220.9	201.3
BBB	11.3	-
Not rated *	1.0	8.2
<b>Total Reinsurance by Credit Rating</b>	<b><u>498.3</u></b>	<b><u>462.9</u></b>

\* The intercompany reinsurance asset with Blue Square Reinsurance was not rated (2017: not rated).

29.2.2 Credit risk concentrations by sector for general account debt securities and money market investments are as follows:

	<u>2018</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>
Asset backed securities:		
Asset backed securities - Other	55.2	78.2
Commercial mortgage backed securities	113.6	129.3
Residential mortgage backed securities	-	15.1
Financial	147.9	161.6
Industrial	190.8	226.0
Utility	54.2	57.4
Sovereign exposure	393.1	941.2
<b>Total Credit Risk Concentrations</b>	<b><u>954.8</u></b>	<b><u>1,608.8</u></b>

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**29.2.3 Structured entities**

The Company's investments in unconsolidated structured entities such as RMBSs, CMBSs, ABSs and some of the investment funds for general accounts are presented in the line item 'Investments' of the statement of financial position.

The Company's interests in these unconsolidated structured entities can be characterised as basic interests, the Company does not have loans, derivatives or other interests related to these investments. Specifically for RMBSs, CMBSs and ABSs the maximum exposure to loss is equal to the carrying amount, which is reflected in the credit risk concentration table regarding debt securities and money market investments (29.2.2). To manage credit risk the Company invests primarily in senior notes of RMBSs, CMBSs and ABSs. The composition of the RMBSs, CMBSs and ABSs portfolios of the Company are widely dispersed looking at the individual amount per entity, therefore the Company only has non-controlling interests in individual unconsolidated structured entities.

The Company did not provide financial or other support to unconsolidated structured entities. Nor does the Company have intentions to provide financial or other support to unconsolidated structured entities in which the Company has an interest or previously had an interest. The Company did not recognise other interests in unconsolidated structured entities such as commitments, guarantees, provisions, derivative instruments or other liabilities.

For RMBSs, CMBSs and ABSs in which the Company has an interest at reporting date, the following table presents total income received from those interests. The Investments column reflects the carrying values recognised in the statement of financial position of the Company's interests in RMBSs, CMBSs and ABSs.

	<u>Total income for the year ended 31 December 2018 (£m)</u>			<u>31 December 2018 (£m)</u>
	<u>Interest income</u>	<u>Total gains and losses</u>	<u>Total</u>	<u>Investments</u>
Residential mortgage backed securities	-	-	-	-
Commercial mortgage backed securities	1.2	33.6	34.8	113.6
ABS's – Other	0.5	17.7	18.2	55.2
<b>Total</b>	<b>1.7</b>	<b>51.3</b>	<b>53.0</b>	<b>168.8</b>

	<u>Total income for the year ended 31 December 2017 (£m)</u>			<u>31 December 2017 (£m)</u>
	<u>Interest income</u>	<u>Total gains and losses</u>	<u>Total</u>	<u>Investments</u>
Residential mortgage backed securities	0.1	3.2	3.3	15.1
Commercial mortgage backed securities	1.3	39.2	40.5	129.3
ABS's – Other	0.8	25.5	26.3	78.2
<b>Total</b>	<b>2.2</b>	<b>67.9</b>	<b>70.1</b>	<b>222.6</b>

There were no impairments included in the total income for the year ended 31 December 2018, relating to unconsolidated structured entities (2017: £nil).

**29.2.4 European Peripheral Country Exposure**

In Europe, countries such as Portugal, Italy, Ireland, Greece and Spain have been particularly affected by financial and economic conditions creating a heightened perceived risk of default on the sovereign debt of those countries. The Company has no direct exposure to the governments of the above peripheral European countries.

The table below shows the fair value of the Company's exposure to financial institutions of these countries, based on the country where the ultimate parent is domiciled. All the exposure relates to general account debt securities.

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		<u>Fair value</u>	<u>Fair value</u>
		<u>2018</u>	<u>2017</u>
		<u>£m</u>	<u>£m</u>
Italy	Corporates	<u>0.8</u>	<u>0.9</u>
		<u>0.8</u>	<u>0.9</u>

There is regular reporting of exposure to these countries to management committees. All exposure to Banks and Other Financial Institutions is to subordinated bonds.

In addition to the above exposure, the Company's General Account also has further indirect exposure to the governments of peripheral European countries. These further indirect exposures mainly arise through holdings in other European sovereigns and financial institutions who themselves have exposure to peripheral European sovereigns (a second-order exposure) or who themselves have exposure to financial institutions, corporates and individuals in peripheral European countries (a third-order exposure). The table below provides, in respect of general account debt securities, fair value of our exposure to sovereigns and financial institutions of non-peripheral European countries:

		<u>Fair value</u>	<u>Fair value</u>
		<u>2018</u>	<u>2017</u>
		<u>£m</u>	<u>£m</u>
Belgium	Sovereign	37.5	40.5
France	Sovereign	59.3	60.9
	Banks	29.5	50.4
Germany	Sovereign	-	45.8
UK	Sovereign	632.4	1,184.3
	Banks	17.6	21.2
	Other financial institutions	20.9	53.1
		<u>797.2</u>	<u>1,456.2</u>

Included within the table above is £7.8m (2017: £371.1m) of bonds carried at amortised cost. The amortised cost of the bonds is analysed below.

		<u>2018</u>	<u>2017</u>
		<u>£m</u>	<u>£m</u>
UK	Sovereign	2.9	365.5
	Banks	2.9	2.8
	Other financial institutions	2.0	2.0
France	Banks	-	0.8
		<u>7.8</u>	<u>371.1</u>

Reporting to the Board and management committees related to the potential impact of peripheral European countries in stressed situations also considers contagion to banks and financial institutions in the countries listed above.

**29.2.5 Past due assets or impaired assets**

General account impaired assets at 31 December 2018 have a market value of £nil (2017: £nil). Financial assets that are past due but not impaired as at 31 December 2018 have a market value of £nil (2017: £nil).

**29.2.6 Collateral**

As at 31 December 2018 general account stock lent to third parties, under standard market terms, totalled £nil (2017: £2.0m) for which cash collateral of £nil (2017: £2.0m) had been received and asset collateral of £nil (2017: £nil).

No investments were pledged as collateral for derivative liabilities (2017: £nil). No investments were received as collateral for derivative assets (2017: £nil). The Company does not have the right to sell or repledge these investments.

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The Company has a collateral agreement in relation to a reinsurance contract. As at 31 December 2018, debt securities of £774.0m have been pledged (2017: £855.4m). The assets have been placed in a custodian account to which the counterparty only gains access on a contractual default or the liquidation of the Company.

**29.2.7 General Account – maximum exposure**

The Company's maximum exposure to credit risk from investment in general account financial assets is fully reflected on the Statement of financial position. There is £22.6m cash collateral (2017: £8.9m) and no investment collateral (2017: £nil) backing the general account financial assets.

**29.3 Liquidity risk**

The tables below sets out a maturity analysis for the Company's general account financial liabilities (non-derivatives and derivatives) based on remaining contractual maturities.

**29.3.1 Maturity analysis – gross undiscounted cash flows (for non-derivatives)**

	<u>On</u>	<u>&lt; 1 yr</u>	<u>1&lt;5 yrs</u>	<u>5&lt;10 yrs</u>	<u>&gt;10 yrs</u>	<u>Total</u>
	<u>Demand</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
	<u>2018</u>	<u>2018</u>	<u>2018</u>	<u>2018</u>	<u>2018</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Other financial liabilities	-	617.7	-	-	-	617.7

	<u>On</u>	<u>&lt; 1 yr</u>	<u>1&lt;5 yrs</u>	<u>5&lt;10 yrs</u>	<u>&gt;10 yrs</u>	<u>Total</u>
	<u>Demand</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Other financial liabilities	-	174.3	-	-	-	174.3

All investment contract liabilities are repayable in less than one year.

**29.3.2 Maturity analysis (derivatives) (Contractual cash flows) <sup>1</sup>**

	<u>&lt; 1 yr</u>	<u>1&lt;5 yrs</u>	<u>5&lt;10 yrs</u>	<u>&gt;10 yrs</u>	<u>Total</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
	<u>2018</u>	<u>2018</u>	<u>2018</u>	<u>2018</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Gross settled:</b>					
Cash inflows	12.7	-	-	-	12.7
Cash outflows	(2.9)	-	-	-	(2.9)
	<u>9.8</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9.8</u>
<b>Net settled:</b>					
Cash inflows	2.1	4.4	0.6	1.6	8.7
Cash outflows	-	-	-	(1.9)	(1.9)
	<u>2.1</u>	<u>4.4</u>	<u>0.6</u>	<u>(0.3)</u>	<u>6.8</u>



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	<u>&lt; 1 yr</u>	<u>1&lt;5 yrs</u>	<u>5&lt;10 yrs</u>	<u>&gt;10 yrs</u>	<u>Total</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Gross settled:					
Cash inflows	9.0	-	-	-	9.0
Cash outflows	(4.9)	-	-	-	(4.9)
	<u>4.1</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4.1</u>
Net settled: <sup>2</sup>					
Cash inflows	-	-	-	-	-
Cash outflows	(19.6)	-	-	-	(19.6)
	<u>(19.6)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(19.6)</u>

<sup>1</sup> Financial derivatives include all derivatives regardless whether they have a positive or negative value. The cash outflow represents the pay leg of the derivative.

<sup>2</sup> Net settled contracts comparative information has been included as it was omitted in error in the prior year.

The Company's liquidity management is based on expected claims and benefit payments rather than on the contractual maturities. The projected cash benefit payments below are based on management's best estimates of the expected gross benefits and expenses, partially offset by the expected gross premiums, fees and charges relating to the existing business in force. Estimated cash benefit payments are based on mortality, morbidity and lapse assumptions comparable with the Company's historical experience, modified for recently observed trends. Actual payment obligations may differ if experience varies from these assumptions. The cash benefit payments are presented on an undiscounted basis and are before deduction of tax and before reinsurance.

29.3.3 *Financial liabilities relating to insurance and investment contracts<sup>1</sup>*

	<u>&lt; 1 yr</u>	<u>1&lt;5 yrs</u>	<u>5&lt;10 yrs</u>	<u>&gt;10 yrs</u>	<u>Total</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
	<u>2018</u>	<u>2018</u>	<u>2018</u>	<u>2018</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Insurance contracts	(20.9)	72.8	214.7	508.7	775.3
Insurance contracts for account of policyholders	1,191.5	5,731.6	8,348.4	40,490.4	55,761.9
Investment contracts	-	-	-	-	-
Investment contracts for account of policyholders	2,382.9	9,576.8	18,745.9	45,906.5	76,612.1

	<u>&lt; 1 yr</u>	<u>1&lt;5 yrs</u>	<u>5&lt;10 yrs</u>	<u>&gt;10 yrs</u>	<u>Total</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Insurance contracts	(20.4)	94.7	256.2	565.5	896.0
Insurance contracts for account of policyholders	1,168.1	5,578.6	7,860.2	32,582.4	47,189.3
Investment contracts	-	-	-	-	-
Investment contracts for account of policyholders	2,003.8	8,703.2	11,085.0	35,828.4	57,620.4

<sup>1</sup> The liability amount reflects the discounting for interest as well as adjustments for the timing of other factors as described above.

As a result, the sum of the cash benefit payments shown for all years in the table exceeds the corresponding liability amounts included in notes 19 to 22.

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**29.4 Market Risk**

Results of the Company's sensitivity analyses are presented throughout this section to show the estimated sensitivity of Net Income and Shareholders' Equity to various scenarios. For interest rate risk and equity market risk, the analysis shows how these measures would have been affected by changes in the relevant risk variable that were reasonably possible at the reporting date. In performing the analyses and determining the potential impact for the financial year, the assumption is made that the financial instrument exposures at the statement of financial position date were in existence for a full year. For each sensitivity test the impact of a reasonably possible change in a single factor is shown. The sensitivities do not reflect what the results for the period would have been if risk variables had been different, because, for financial instruments, the analysis is based on the exposures in existence at the reporting date rather than on those that actually occurred during the year. Nor are the sensitivities intended to be an accurate prediction of the Company's future equity or earnings. The analysis does not take into account the impact of future new business, which is an important component of the Company's future earnings. It also does not consider all instruments available to management to respond to changes in financial environment, such as changing investment portfolio allocations or adjusting premiums and crediting rates. Furthermore, the results of the analyses cannot be extrapolated for wider variations since effects are not always linear. No risk management process can clearly predict future results.

**29.4.1 Interest rate risk**

The sensitivity analysis in the table below shows an estimate of the effect of a parallel shift in the yield curve on net income and shareholders' equity. Increases in interest rates have a negative effect on net income and shareholders' equity in the current year. Decreases in interest rates have a positive effect on net income and shareholders' equity in the current year. The 2018 impact is primarily driven by interest rate swaps.

	<u>Impact on</u> <u>net income</u> <u>2018</u> <u>£m</u>	<u>Impact on</u> <u>equity</u> <u>2018</u> <u>£m</u>	<u>Impact on</u> <u>net income</u> <u>2017</u> <u>£m</u>	<u>Impact on</u> <u>equity</u> <u>2017</u> <u>£m</u>
Immediate change				
Shift up 100 basis points	(80.7)	(82.8)	(28.4)	(49.9)
Shift down 100 basis points	103.2	105.5	32.5	54.0

In respect of 2018 the sensitivity of net income to a 100bp increase in short term (3 month) interest rates combined with a 100bp reduction in long-term (10 years) interest rates is an increase in Net Income of £115.1m (2017: £33.8m). The sensitivity of net income to a 100bp decrease in short term interest rates combined with a 100bp increase in long interest rates is a reduction in Net Income of £(92.6)m (2017: £(29.6)m).

**29.4.2 Equity price risk**

The sensitivity analysis of Net Income and Shareholders' Equity to changes in equity prices is presented in the table below. The sensitivity of Net Income and Shareholders' Equity reflects the impact of equity price changes on fund related charges and the impact of equity price changes on unit matching and equity options held to reduce the sensitivity of economic capital to significant falls in the UK equity market.

	<u>Impact on</u> <u>net income</u> <u>2018</u> <u>£m</u>	<u>Impact on</u> <u>equity</u> <u>2018</u> <u>£m</u>	<u>Impact on</u> <u>net income</u> <u>2017</u> <u>£m</u>	<u>Impact on</u> <u>equity</u> <u>2017</u> <u>£m</u>
Immediate change				
Equity increase 10%	(14.3)	(14.3)	3.3	3.3
Equity decrease 10%	20.1	20.1	(1.4)	(1.4)
Equity increase 20%	(26.6)	(26.6)	7.0	7.0
Equity decrease 20%	56.5	56.5	7.1	7.1

**29.4.3 Currency risk**

The sensitivity analysis of net income and shareholders' equity to changes in currency is presented in the table below. The sensitivity of net income and shareholders' equity primarily reflects the impact of currency changes on fund related charges and

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the impact of currency changes on unit matching held to reduce the sensitivity of economic capital to significant falls in overseas equity markets.

	<u>Impact on</u> <u>net income</u>	<u>Impact on</u> <u>equity</u>	<u>Impact on</u> <u>net income</u>	<u>Impact on</u> <u>equity</u>
	<u>2018</u>	<u>2018</u>	<u>2017</u>	<u>2017</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Immediate change				
GBP increases by 15% against all currencies	8.3	8.3	(17.1)	(17.1)
GBP decreases by 15% against all currencies	(9.6)	(9.6)	17.1	17.1

29.5 Underwriting risk

The Company's earnings are impacted by the extent to which actual claims experience is consistent with the assumptions used in setting prices for products and establishing technical liabilities and liabilities for claims. To the extent that actual claims experience is less favourable than the underlying assumptions used in establishing such liabilities, income would be reduced. Furthermore, if these higher claims were part of a permanent trend, the Company may be required to increase liabilities, which could also reduce income. In addition, certain acquisition costs related to the sale of new policies and the purchase of policies already in force have been recorded as assets on the statement of financial position and are being amortised into income over time. If the assumptions relating to the future profitability of these policies (such as future claims, investment income and expenses) are not realised, the amortisation of these costs could be accelerated and may even require write offs due to non-recoverability. This could have an adverse effect on the Company's business, results of operations and financial condition.

Sources of underwriting risk include policy lapses and policy claims such as mortality, morbidity and expenses. In general, the Company is at risk if policy lapses increase, as sometimes the Company is unable to fully recover up-front expenses in selling a product despite the presence of commission recoveries or surrender charges and fees. For mortality and morbidity risk, the Company sells certain types of policies that are at risk if mortality or morbidity increases, such as term life insurance, and sells certain types of policies that are at risk if mortality decreases (longevity risk) such as annuity products. The Company is also at risk if expenses are higher than assumed by management.

The Company monitors and manages its underwriting risk by underwriting risk type. Attribution analysis is performed on earnings in order to understand the source of any material variation in actual results from what was expected. The Company also perform experience studies for underwriting risk assumptions, comparing the Company's experience to industry experience as well as combining the Company's experience and industry experience based on the depth of the history of each source to the Company's underwriting assumptions. Where products have flexible policy charges the Company uses these analyses as the basis for modifying these charges, with a view to maintain a balance between policyholder and shareholder interests. The Company also has the ability to reduce expense levels over time, thus mitigating unfavourable expense variation.

Sensitivity analysis of net income and shareholders' equity to mortality risk, lapse risk and morbidity risk is presented in the table below using a permanent shock applied to all of the Company's products, both products exposed to an increase and products exposed to a decrease in the rates.

	<u>Impact on</u> <u>net income</u>	<u>Impact on</u> <u>equity</u>	<u>Impact on</u> <u>net income</u>	<u>Impact on</u> <u>equity</u>
	<u>2018</u>	<u>2018</u>	<u>2017 *</u>	<u>2017 *</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Immediate change				
10% increase in mortality experience *	26.0	26.0	29.3	29.3
10% decrease in mortality experience *	(29.2)	(29.2)	(32.8)	(32.8)
20% increase in lapses	(6.1)	(6.1)	(11.3)	(11.3)
20% decrease in lapses	6.1	6.1	11.3	11.3
10% increase in morbidity experience	(0.5)	(0.5)	(0.5)	(0.5)
10% decrease in morbidity experience	0.5	0.5	0.5	0.5

\* The comparatives for mortality experience have been changed to present on a consistent basis with the current year methodology.

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29.6 Operational risk

In the normal course of business, reviews of processes and procedures are undertaken to ensure that customers are treated fairly, and to respond to matters raised by policyholders and their representatives. The Company does not believe that material liabilities will arise from such reviews, however there is a risk that the Company is not able to resolve such matters in the manner that it expects.

30. **Offsetting enforceable master netting arrangements and similar agreements**

The following table provides details relating to the effect or potential effect of netting arrangements, including rights of set-off associated with the Company's recognised financial assets and recognised financial liabilities.

	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the Statement of financial position	Net amounts of financial assets presented in the Statement of financial position	Related amounts not set off in the Statement of financial position	Net amount	
	£m	£m	£m	Financial instruments £m	Cash collateral received (excluding surplus collateral) £m	£m
<b>Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements</b>						
<b>2018</b>						
Derivatives	275.6	-	275.6	84.2	189.1	2.3
<b>At 31 December</b>	<b>275.6</b>	<b>-</b>	<b>275.6</b>	<b>84.2</b>	<b>189.1</b>	<b>2.3</b>
<b>2017</b>						
Derivatives	309.7	-	309.7	55.4	241.8	12.5
<b>At 31 December</b>	<b>309.7</b>	<b>-</b>	<b>309.7</b>	<b>55.4</b>	<b>241.8</b>	<b>12.5</b>
<b>Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements</b>						
	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the Statement of financial position	Net amounts of financial liabilities presented in the Statement of financial position	Related amounts not set off in the Statement of financial position	Net amount	
	£m	£m	£m	Financial instruments £m	Cash collateral received (excluding surplus collateral) £m	£m
<b>2018</b>						
Derivatives	49.8	-	49.8	47.0	1.3	1.5
<b>At 31 December</b>	<b>49.8</b>	<b>-</b>	<b>49.8</b>	<b>47.0</b>	<b>1.3</b>	<b>1.5</b>
<b>2017</b>						
Derivatives	55.4	-	55.4	55.4	-	-
<b>At 31 December</b>	<b>55.4</b>	<b>-</b>	<b>55.4</b>	<b>55.4</b>	<b>-</b>	<b>-</b>

Financial assets and liabilities are not offset in the Statement of financial position.

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The Company mitigates credit risk in derivative contracts by entering into collateral agreements, where practical, and in ISDA master netting agreements to facilitate Company's right to offset credit risk exposure. The credit support agreement will normally dictate the threshold over which collateral needs to be pledged by the Company or its counterparty. Transactions requiring the Company or its counterparty to post collateral are typically the result of over-the-counter derivative trades, comprised mostly of interest rate swaps, currency swaps and credit swaps. These transactions are conducted under terms that are usual and customary to standard long-term borrowing, derivative, securities lending and securities borrowing activities, as well as requirements determined by exchanges where the bank acts as intermediary.

**31. Related party transactions**

**31.1 Immediate parent undertaking**

The entire issued share capital of the Company at the year-end is held by Scottish Equitable Holdings Limited, which is registered in Scotland.

**31.2 Ultimate parent undertaking**

The results of the Company are consolidated in the financial statements of Aegon N.V., the ultimate parent undertaking, which is incorporated in the Netherlands. Copies of the consolidated financial statements of Aegon N.V. are available to the public and may be obtained from The Company Secretary, Aegon UK plc, Aegon Lochside Crescent, Edinburgh Park, Edinburgh, EH12 9SE.

**31.3 Year-end balances and transactions with related parties**

Administration expenses are recharged to the Company at cost by AUKCS, which is a fellow Aegon N.V. subsidiary (see note 6 for total amount of such transactions). The terms of loans to related parties are described in note 10. Interest received from related parties is set out in note 3.

Commissions and expenses include commission paid, at normal market prices, to fellow subsidiary undertakings of £0.2m (2017: £0.2m)

Asset management services are provided to the Company by Kames Capital plc, a fellow Aegon N.V. subsidiary undertaking. Kames Capital plc provides investment services to the Company at prices, which are agreed from time to time between the Company and Kames Capital plc taking into account the size and nature of the service (see note 6 for total amount of such transactions).

The Company had reinsurance arrangements with Aegon Ireland plc and Blue Square Re during 2018. Reinsurance premiums of £1.3m & £2.9m (2017: £4.9m & £2.5m) were paid respectively. Reinsurance claims were received of £2.2m (2017: £1.9m) from Blue Square Re.

Outstanding payables are unsecured, interest free and cash settlement is generally expected within 30 to 90 days of invoice. Outstanding receivables relate to unsecured, interest free intercompany accounts with no specified credit period. The Company has not provided or benefited from any guarantees for any related party receivables or payables.

Year-end balances related to related party transactions are detailed in notes 10, 13, 16.1 and 25.

**31.4 Compensation of key management personnel (including Directors)**

	<u>2018</u>	<u>2017</u>
	<u>£'000</u>	<u>£'000</u>
Short term employee benefits	3,224.0	2,952.7
Post employment employee benefits	35.5	40.8
Other long-term benefits	-	-
Termination benefits	535.9	-
Share based payments	560.9	555.7
<b>Total compensation of key management personnel (including Directors)</b>	<b>4,356.3</b>	<b>3,549.2</b>

**32. Events after the reporting period**

There are no events noted after the reporting period that require to be disclosed.