# The Prudential Assurance Company Limited

## Solvency and Financial Condition Report

**31 December 2019**

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This report has been prepared in compliance with the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009|138|EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) ('Delegated Regulation'). The structure of this report follows the structure set out in Annex XX and discloses the information referred to in Articles 292 to 298 of the Delegated Regulation. The report also contains narrative information in quantitative and qualitative form supplemented, where appropriate, with quantitative templates.

# Summary

## *Company background*

The Prudential Assurance Company Limited ('PAC', 'the Company') was founded in the United Kingdom ('UK') in 1848, and is a provider of savings and retirement income products. The Company's biggest strength comes from providing investments that help its customers meet their long-term goals, whilst also protecting them against short-term market fluctuations.

The Company's long-term products consist of life insurance, pension products and pension annuities. In common with other UK long-term insurance companies, the Company's products are structured as either with-profits participating products, or non-participating products including annuities in payment and unit-linked products. Depending on the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies.

The Company's core strengths in with-profits and financial products for retirement are underpinned by expertise in areas such as understanding life expectancy, managing investment risk and a range of investment assets.

Throughout 2019 the Company owned two insurance subsidiary undertakings Prudential Pensions Limited ('PPL'), and Prudential International Assurance plc ('PIA'). These transacted insurance business in the United Kingdom and overseas.

The Company is a wholly owned subsidiary of M&G plc (previously known as M&G Prudential Ltd) which de-merged from Prudential plc on 21 October 2019. The demerger resulted in two separately-listed companies, with different investment characteristics and opportunities. M&G plc is a savings and investments business, managing investments for both individuals and for large institutional investors, such as pension funds, around the world. The group also owns M&G Group Limited which performs investment management services for the Company.

The Company consists of the With-Profits Fund and the Shareholder Fund. The With-Profits Fund is made up of the With-Profits Sub-Fund ('WPSF'), the Scottish Amicable Insurance Fund ('SAIF') and Defined Charge Participating Sub-Fund ('DCPSF') as shown in the table below.

**Figure 1: Company Structure**

<table>
<tr><th colspan="6">The Prudential Assurance Company limited (PAC)</th></tr>
<tr><th colspan="3">Shareholder-backed business</th><th colspan="3">With-Profits Fund</th></tr>
<tr><td colspan="2">Shareholder Fund</td><td rowspan="2">Non Profit Sub-Fund (NPSF) "0:100"</td><td rowspan="2">With Profits Sub-Fund (WPSF) "90:10"</td><td rowspan="2">Scottish Amicable Insurance Fund (SAIF) "100:0"</td><td rowspan="2">Defined Charge Participating Sub-Fund (DCPSF) "100:0"</td></tr>
<tr><td>General Insurance Fund "0:100"</td><td>Other "0:100"</td></tr>
</table>

The proportion of divisible profit attributable to with-profits policyholders in the WPSF is defined by the Articles of Association as being at least 90 per cent. Most of the With-Profits Fund business is written in the WPSF and is attributed in a 90:10 ratio between with-profit policyholders and shareholders. The shareholder profits arising from traditional with-profits business are recognised via a shareholder transfer, which only crystallises at the point when a claim is paid to the policyholder and is 1/9th of the difference between the policyholder payout and the premium(s) paid.

PruFund is the customer proposition managed by the Company's market leading multi-asset management team. It is a transparent and modern way of with-profits investing in the UK, which offers individuals different rates of smoothed return aligned with their tolerance for risk. Unlike traditional with-profits products, no regular or final bonuses are declared for PruFund contracts. Customer investment return is determined by an Expected Growth Rate (EGR) which is declared each quarter. The shareholder transfer only crystallises at the point when a payout is made to the customer and is 1/9th of the difference between the customer payout and the premium(s) paid. Hedging of equity exposures is in place to partially mitigate and protect the value of such shareholder transfers.

The with-profits fund is the largest fund of its kind in the UK. It is invested across a broad range of assets and aims to provide steady returns to customers. The Company uses its bonus process to smooth some of the extreme highs and lows of investment performance. During 2019, investment

returns for the with-profits fund increased by 11.5% before tax (2018: decrease of 2.8%), and over the last ten years the fund has delivered a cumulative investment return of 115.5% before tax.

The whole of the profit arising in SAIF, including profits or losses on its non-profit business, will be allocated to with-profits policyholders in SAIF (i.e. SAIF is a "100:0" sub-fund). SAIF is a sub-fund closed to new business that contains the bulk of the business originally written by the Scottish Amicable Life Assurance Society acquired by the Company in 1997. The profit in the DCPSF which forms part of the Company's long term fund arises solely from investment performance and is entirely attributable to DCPSF policyholders (i.e. the DCPSF is a "100:0" sub-fund).

All the profit from shareholder-backed business which includes the Shareholder Fund and NPSF is attributable to shareholders (i.e. the Shareholder Fund and NPSF are "0:100" sub-funds).

***Business and performance***

**Demerger from Prudential plc**

On 21 October 2019, M&G plc demerged from Prudential plc. The Demerger was implemented by Prudential plc making an in-specie distribution of M&G plc shares to Prudential plc shareholders who were registered on the Prudential Share Register at 6pm on 18 October 2019.

A Demerger Agreement governs the post-demerger obligations of the newly formed M&G plc Group and the Prudential plc (and its subsidiaries) in respect of, among other things, data sharing and their respective indemnity obligations.

The demerger resulted in changes to the structure of the group which are shown in section A1.2.

Following demerger, the Company forms a much larger portion of the M&G plc Group compared to when part of Prudential plc.

**Performance of businesses**

The Company's diverse business offering and disciplined financial management enabled it to deliver resilient financial performance in a challenging environment.

The Company uses 'adjusted operating profit before tax' as its measure of underwriting performance. For the year ended 31 December 2019, total adjusted operating profit before tax was £748 million (2018: £1,141 million). The adjusted operating profit consists of £324 million (2018: £320 million) relating to the shareholder transfer from the with-profits fund offset by £82 million (2018: £65 million) for hedging the shareholder transfer, £460 million profit (2018: £1,132 million) relating to the annuities business, and £46 million (2018: £246 million loss) on unit-linked and other business.

For the annuities business, assumption changes contributed £166 million (2018: £470 million) to adjusted operating profit, of which £126m (2018: £441m) related to changes in the longevity assumption basis. The longevity changes reflect a recent slowdown in life expectancy improvements, and the adoption of the Continuous Mortality Investigation (CMI) 2017 model, albeit with an uplift to the calibration such that additional liabilities are held to cover potential differences in experience between the portfolio and the England and Wales population. Longevity assumption changes for 2018 contributed £441m to operating profit (see A.1.4.7 for further details).

The UK GAAP profit on ordinary activities before tax is £1,047 million (2018: £1,352 million). The UK GAAP profit on ordinary activities before tax reflects the adjusted operating profit discussed above, as well as non-operating profit items consisting of the impact of short-term investment fluctuations, dividend income, impacts of business disposals and corporate transactions, as well as transformation and restructuring costs.

The Company's total non-operating result has increased by £88 million to a profit of £299 million in 2019 from a profit of £211 million in 2018. This is mainly due to capital gains on surplus assets and on shareholder fund assets partially offset by losses on the partial hedge of the shareholder transfers and a reduction in dividends received from subsidiaries (see A.3.1 and A.4.1 for further details).

Further information on adjusted operating and UK GAAP profits is provided in sections A.2 and A. 3.1, and the Solvency II position including capital generation is set out in Section E.

**Figure 2: Key Performance Indicators**

| | 2019<br>£m | 2018 *<br>£m |
|---|---|---|
| **Total adjusted operating profit before tax** | 748 | 1,141 |
| **UK GAAP Profit before tax attributable to shareholders** | 1,047 | 1,352 |
| **Solvency II capital surplus:** | | |
| Overall | 3,057 | 3,691 |
| Shareholder | 3,057 | 3,691 |
| With-Profits Fund | 7,628 | 5,458 |
| **Solvency II capital surplus ratio:** | | |
| Regulatory Solvency ratio | 131% | 140% |
| Shareholder | 159% | 172% |
| With-Profits Fund | 267% | 231% |

*The 2018 figures are restated based on a move from operating profit to adjusted operating profit.

Solvency II surplus and coverage ratio

Both With-Profits Fund and shareholder Solvency II surplus allow for the recalculation of the transitional measure on technical provisions as at 31 December 2019 following approval from the Prudential Regulation Authority (PRA).

The high quality and recurring nature of the Company's capital generation and its disciplined approach to managing balance sheet risk provide meaningful protection against significant adverse market-driven effects on this metric.

The Company has generated a shareholder capital surplus over the period before dividends and retains a surplus of £3.1 billion. However, after allowing for dividend payments of £2.1 billion, the Company's shareholder solvency surplus has reduced over 2019 by £0.6 billion. The reduction due to dividend payments was largely offset by £0.6 billion expected returns and capital releases on in-force business, £0.5 billion from changes in economic conditions, revised assumptions of £0.2 billion (mainly longevity and expenses) and £0.2 billion relating to management actions. See section E.1.2 for further details.

The Company's With-Profits Fund solvency position has strengthened over 2019 with surplus increasing by £2.2 billion. This predominantly reflects the release of capital and liabilities of £0.9 billion on in-force business, £0.7 billion model changes, £0.4 billion benefit from investment returns over the period, and £0.2 billion of non-market assumption changes.

The Company continues to monitor the effects of the coronavirus (COVID-19) outbreak which has been declared as a pandemic by the World Health Organization. Further detail on the impact of COVID-19, and the impact on the Company's solvency position, is included in Section A.5.3.

***Overview***

The fundamentals underpinning the UK's retirement market continue to change. Risk and responsibility for retirement provision continues to transfer away from the state and employers to individuals. The flexible arrangements introduced by Pensions Freedom in 2015 allow individuals to take control over their own pensions but have introduced significant additional complexity. The burden of mitigating investment risk, longevity risk and inflation risk in respect of retirement income increasingly falls directly onto individuals.

To support its customers in this changing environment, the Company's product and distribution profile has evolved by increasing the range of product options to mirror the flexibilities of the pensions freedom era. There has been a shift away from a reliance on annuity business to a focus on more flexible bond, ISA, pension and income drawdown products across a range of tax efficient solutions through the Company's PruFund range of products.

In 2019 PruFund reached assets under management or administration (AuMA) of £54 billion (2018: £43 billion), up 25 per cent. As part of the product offering within PruFund, the Prudential Retirement Account (an online account based plan, that provides customers with the flexibility to save for their retirement, benefit from an income in retirement and facilitate access to their fund as they save), experienced another successful year, with AuMA at 31 December 2019 of £18 billion (2018: £12 billion).

The Company continues to focus on deepening its already strong relationships with independent financial advisers. An important part of the Company's service offering is the ongoing hands-on support from its regional sales units, technical helpline and business development and consultancy team. The Company also distributes products via other group companies. Prudential Financial Planning Limited provides restricted advice services and Prudential Distribution Limited intermediates non-advised sales.

### *System of governance*

The Board of The Prudential Assurance Company Limited is collectively responsible for the long-term success of the Company and for providing leadership within a framework of effective controls. The control environment enables the Board to identify significant risks and apply appropriate measures to manage and mitigate them.

The Company's governance structures are kept under constant review to ensure they suit the needs of the business and stakeholders. In 2018 the Company became a wholly owned subsidiary of M&G plc, which was a newly formed subsidiary of Prudential plc prior to demerger. Upon demerger in October 2019, there were changes to the Board governance as detailed in section B.1.

The Board and its Committees operate under approved terms of reference which are reviewed at least annually. The Board also undertakes an annual review of its performance and effectiveness.

Further information on the Company's system of governance including information on the composition of its Board, key functions, risk management and internal control system is provided in Section B.

### *Risk profile*

The Company generates value for shareholders by selectively taking exposure to risks that are adequately rewarded and that can be appropriately quantified and managed. The Company retains risks within a clearly defined risk appetite, which contributes to value creation and provides the ability to withstand the impact of an adverse stressed outcome.

The Company defines 'risk' as the uncertainty that it faces in successfully implementing its strategies and objectives.  This includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the Company.  As such, material risks will be retained selectively if there is value in doing so, and where it is consistent with the Company's risk appetite and philosophy towards risk-taking.

For retained risks, the Company ensures that it has the necessary capabilities, expertise, processes and controls to appropriately manage the exposure.

Further information on the main risks inherent in the business, and how these risks are managed, is provided in Section C. Risks covered include insurance or underwriting risk, market risk, credit risk, liquidity risk, operational risk, business environment and market forces risk, investment performance and risk, strategic risk/transformation execution, technology and security risk including data privacy, people risk, reputational risk, regulatory compliance and group risk.

### *Valuation for solvency purposes*

For the purposes of Solvency II reporting, the Company applies the Solvency II valuation rules to value the assets and liabilities of the Company:

(i) As a general principle, technical provisions under Solvency II are valued at the amount for which they could theoretically be transferred immediately to a third party in an arm's length transaction. The technical provisions consist of a best estimate liability and the risk margin, reduced by the "transitional measures on technical provisions" where relevant.

(ii) The assets and other liabilities are valued under Solvency II at the amount for which they could be exchanged between knowledgeable and willing parties in arm's length transactions. The assets and other liabilities are valued separately using methods that are consistent with this principle in accordance with the valuation approaches set out in the Solvency II Directive.

As at 31 December 2019 the Company's excess of assets over liabilities was £20.4 billion (2018: £18.5 billion), which is £14.8 billion higher than the value under UK GAAP. There are a number of valuation

differences with the most significant being the treatment of the fund for future appropriations which consists of unallocated surplus of the with profits fund (£16.1 billion). This is treated as a liability under UK GAAP but recognised as part of the excess of assets over liabilities in the Solvency II balance sheet.

Further information on the valuation of assets, technical provisions and other liabilities of the Company for solvency purposes is provided in Section D, including a discussion of the differences between Solvency II and the UK GAAP valuation bases.

***Capital management***

The Company manages its Solvency II own funds as its measure of capital. It manages its Solvency II capital to ensure that sufficient own funds are available on an ongoing basis to meet regulatory capital requirements.

The own funds eligible to cover its solvency capital requirements ('SCR') and minimum SCR ('MCR') are £12.8 billion and are all classified as Tier 1 unrestricted own funds.

The Company has been granted approval by the PRA to calculate its SCR based on its internal model. The Internal Model governance framework was reviewed as part of the 2019 Major Model Change application which was approved by the PRA in October 2019.

The SCR reflects the key risks the Company is exposed to, the most significant of which are market risks (primarily spread and equity risk) and longevity risk.

At 31 December 2019, the SCR was £9.7 billion (2018: £9.3 billion). The minimum capital requirement ('MCR') is currently 25 per cent (2018: 25 per cent) of the SCR, £2.4 billion at 31 December 2019 (2018: £2.3 billion).

The Company's SCR and MCR have been met at all times throughout 2019. At 31 December 2019, the Company’s Solvency II surplus was £12.8 billion (2018: £3.7 billion).

**Shareholder view of solvency**

The Company reports a shareholder view of solvency, which is considered to provide a more relevant reflection of the capital strength of the Company.

The Company shareholder Solvency II capital position and coverage ratio calculation recognises both the exposure to the with-profits fund by including the present value of future expected shareholder transfers within own funds, and the risk associated with those shareholder transfers within the SCR. This calculation results in the same Solvency II surplus of £3.1 billion, but provides a higher solvency coverage ratio of 159% than the regulatory solvency coverage ratio.

The regulatory solvency coverage ratio treats with-profits funds as having a coverage ratio of 100% (as any surplus in the ring-fenced with-profits fund that the shareholder is entitled to under Solvency II regulations has already been captured in the shareholder view of solvency) thereby dampening the overall ratio. The regulatory solvency coverage ratio was 131% at 31 December 2019.

A summary of the reconciliation of the Company’s shareholder Solvency II position published in the Company’s 2019 financial statements to the Solvency II position, incorporating the Company’s ring-fenced funds, included in the quantitative reporting templates attached to this document, is provided in Section E.

**Sensitivity of solvency to matching adjustments and transitional measures**

The Regulatory Solvency Ratio is underpinned by the use of a matching adjustment to calculate the technical provisions on its annuity business and by transitional measures on technical provisions. Without these items the solvency ratio would change as set out in the table below.

**Figure 3: Solvency Ratio**

| | Solvency ratio at 31 December 2019 | | | |
|---|---|---|---|---|
| | As reported | Without the matching adjustment | Without transitional measures on technical provisions | Without transitional measures on technical provisions or MA |
| Regulatory solvency | 131% | 86% | 116% | 76% |
| Shareholder solvency | 159% | 77% | 129% | 59% |

Annually, the Company prepares a plan which includes the projected development of the solvency position. The plan allows for the reduction to the TMTP over the 16 year amortisation period. The surplus generated from the in-force book is sufficient to offset the amortisation of the TMTP.

Additional information on the components of the Company's own funds and solvency capital requirement are also provided in Section E.

# A Business and performance

*(Unaudited)*

## A.1 Business

### A.1.1 Overview

***Name and legal form***

The Prudential Assurance Company Limited ('the Company') is a company limited by shares incorporated and registered in England and Wales.

The Company is a wholly owned subsidiary of M&G plc ('the M&G plc group' or 'the Group'). M&G plc became the ultimate parent of the Company following a demerger from Prudential plc on 21 October 2019. M&G plc is a public limited company, limited by shares, incorporated and registered in England and Wales. The Group is an international financial services group, with significant operations in the United Kingdom and overseas.

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

The registered office of the Company and M&G plc is:
10 Fenchurch Avenue
London
EC3M 5AG

Prior to 12 April 2019 the address of the registered office of the Company was:
Governors House
Laurence Pountney Hill
London
EC4R 0HH

This Solvency and Financial Condition Report ('SFCR') covers the Company on a solo entity basis.

***Supervisory authority and Group supervisory authority***

The Company and the Group are supervised and authorised by the PRA, the Company's lead supervisor in accordance with the Financial Services and Markets Act 2000 ('FSMA'). The contact details are:

Prudential Regulation Authority
Bank of England
20 Moorgate
London
EC2R 6DA
United Kingdom

***External auditor***

The Company is audited by KPMG LLP. The contact details are:

KPMG LLP
15 Canada Square
London
E14 5GL
United Kingdom

***Holders of qualifying holdings***

As at 31 December 2019, M&G plc, incorporated and registered in England and Wales, is the only holder of qualifying holdings in the Company (being holdings of 10 per cent or more of the capital or voting rights).

### A.1.2 Company structure

***Material subsidiaries of the Company***

The Company's material trading subsidiaries at 31 December 2019 are set out below:

| | Main activity | Country of incorporation |
|---|---|---|
| Prudential Pensions Limited | Insurance | England and Wales |
| Prudential International Assurance plc | Insurance | Ireland |

The Company has 100 per cent of the voting rights of the subsidiaries listed above. The percentage of equity owned is the same as the percentage of the voting rights held.

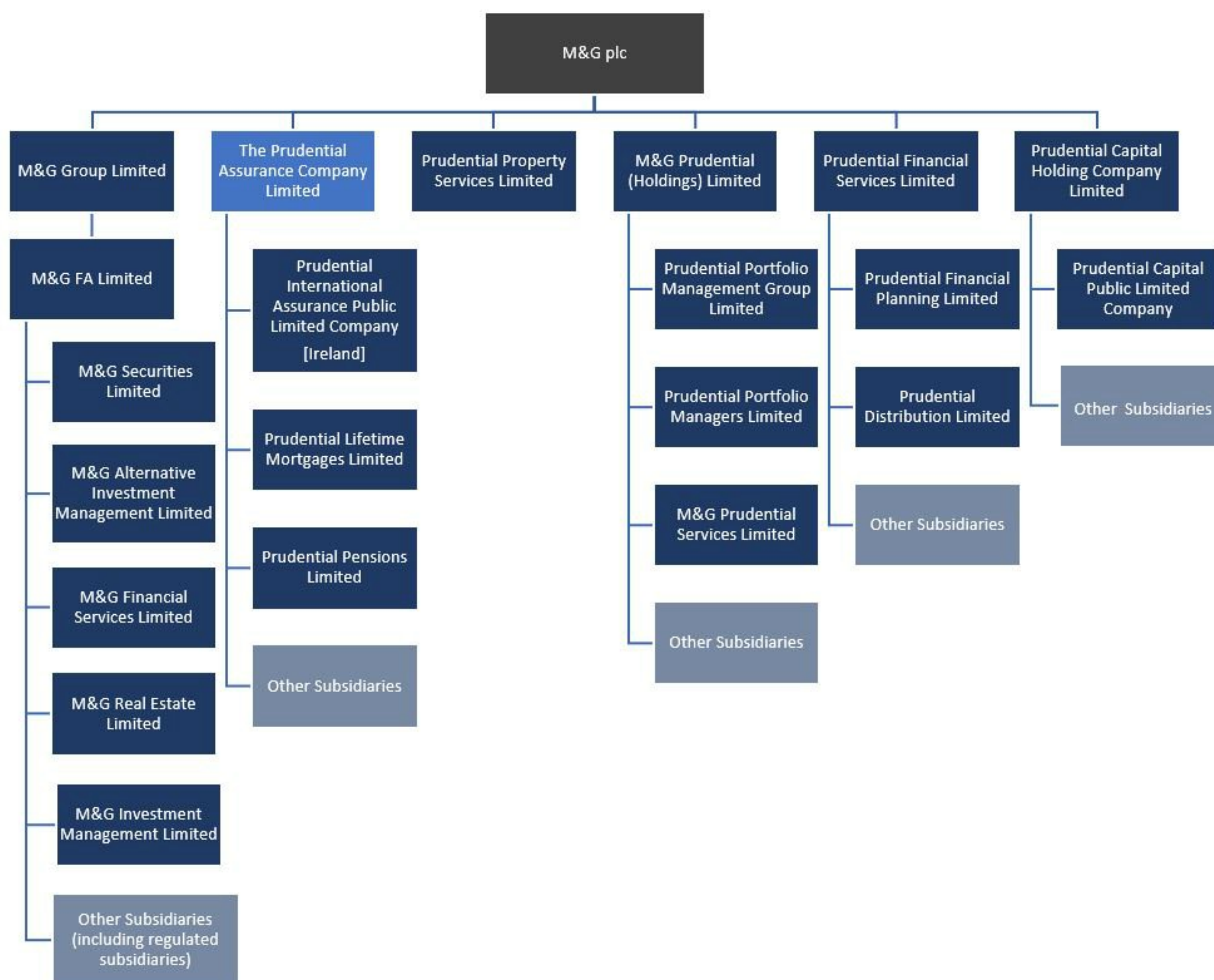
A complete list of the Company's related undertakings comprising subsidiaries, joint ventures, associates and other significant holdings is provided in Appendix A.

***Legal structure of the Group and related undertakings***

The Company is part of the M&G plc group and is the principal insurance company within the group forming a major part of the group's operations. An M&G plc group SFCR will be submitted to the PRA in April 2020. This Company will be included within the scope of the M&G plc group SFCR. In previous years this Company was included within the scope of the Prudential plc group SFCR.

Figure 4 below shows, in a simplified form, the direct subsidiary undertakings of the ultimate parent company, M&G plc and its significant subsidiaries as at 31 December 2019.

**Figure 4: Simplified structure of M&G plc as at 31 December 2019**




## A.1.3 Business and performance

***Material lines of business and material geographical areas***

The Company transacts long-term insurance business in the United Kingdom ('UK'). Throughout 2019 the Company also owned insurance subsidiary undertakings in the UK and in the Republic of Ireland.

The Company's long-term products consist of life insurance, pension products and pension annuities. In common with other UK long-term insurance companies, the Company's products are structured as either with-profits participating products, or non-participating products including annuities in payment and unit-linked products. Depending on the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies.

The Company's UK insurance subsidiary, Prudential Pensions Limited mainly sells unit-linked products.

The Company's Irish subsidiary, Prudential International Assurance plc ('PIA'), is a leading insurer in the offshore bond market while also providing risk insurance for its UK policyholders. PIA sells to both UK and non-UK nationals. Its focus in 2019 has been the sale of multi-asset solutions to UK nationals resident in the UK and selected countries in continental Europe.

In January 2019, in accordance with Part VII of the Financial Services and Markets Act (FSMA), the Company transferred all of its long term European business (excluding the UK) into PIA. The business transferred consisted of business underwritten in the Company's Polish branch (as detailed in section A.1.4.3 below), and also legacy business underwritten in other European countries. The Company's Polish branch is no longer active.

### A.1.4 Significant business or other events that have a material impact on the Company over the reporting period

#### A.1.4.1 Demerger of M&G plc from Prudential plc

On 21 October 2019, following a prior announcement of intentions to demerge in March 2018, M&G plc (the UK & European business of Prudential plc) demerged from Prudential plc, resulting in two separately-listed companies. The Company forms a major part of M&G plc.

The Demerger Agreement contains mutual cross indemnities under which the Company's new Group (M&G plc Group) indemnifies the Post-Demerger Prudential plc against losses, costs, damages and expenses of any kind suffered or arising directly or indirectly from or in consequence of the business carried on by the Company prior to the Demerger and Prudential plc indemnifies the Group against losses, costs, damages and expenses of any kind suffered or arising directly or indirectly from or in consequence of the business carried on by the Prudential Group other than the Group prior to the Demerger.

#### A.1.4.2 Part VII transfer of Rothesay Life reinsured annuities

In preparation for the demerger, the Company agreed a transaction in March 2018 to reinsure a significant portion of its shareholder annuity portfolio. Under the terms of the agreement the portfolio was initially reinsured to Rothesay Life, with the intention to then transfer most of the portfolio in accordance with Part VII of the Financial Services and Markets Act 2000 (FSMA). However, on 16 August 2019, the High Court declined to sanction the Part VII transfer.

The Company and Rothesay Life were granted leave to appeal the judgement. The pros and cons of appealing were carefully discussed by the Directors, noting that Rothesay Life had indicated that they were willing to appeal. It was also noted that there was wider industry interest. Consequently the Company and Rothesay Life decided to lodge appeals on 27 September 2019 having taken account of the long-term impact on both the business and policyholders. The Court of Appeal has not yet finalised the date of the appeal hearing. However, we do not expect the hearing to be until later in the year, with the Court of Appeal’s judgement to follow. The High Court’s judgement has no direct impact on the reinsurance with Rothesay Life and has not had a significant financial impact on the Company's 2019 results. The reinsurance remains in place. As with other changes to the business, the Company's priority is to ensure these customers are treated fairly.

The Solvency II liabilities relating to the Company’s total UK shareholder annuity portfolio as at 31 December 2019 were £29.5 billion, of which £12.4 billion is reinsured by Rothesay Life.

#### A.1.4.3 Part VII transfer of EU business to PIA

M&G plc has been reviewing its operations across Europe since the UK voted to leave the European Union. In January 2019, in accordance with Part VII of the FSMA, the Company transferred all of its long-term European business (excluding the UK) into PIA, a subsidiary of the Company which is based in the Republic of Ireland. The business transferred consisted of the business underwritten in the Company's Polish branch, and also legacy business underwritten in other European countries.

Both with-profits and shareholder-backed business transferred, however the with-profits business was reinsured back to the Company. The reinsurance arrangements were implemented in order to provide policyholders with continued access to the returns from the Company's with-profits funds, on the same basis as prior to the transfer.

The shareholder-backed business has not been reinsured back to the Company following the Part VII transfer. The Company transferred net assets of £15 million to PIA and as consideration, PIA issued additional share capital to the Company resulting in an increase in the investment held. The cost of the additional investment was immediately impaired which resulted in no overall gain or loss. The Company's Polish branch is no longer active.

#### A.1.4.4 Sale of Vietnamese subsidiary

Prudential Holborn Life Limited (PHL) is a wholly owned subsidiary of the Company. In June 2019, PHL completed the sale of its subsidiary Prudential Vietnam Finance Company and undertook a capital reduction to permit remittance of the £97 million net disposal proceeds from the sale to the Company (and onwards to Prudential plc, the previous ultimate parent company). The remittance of £97 million to the Company has been treated as a return of capital of £59 million, being the original cost of investment

in PHL, and a dividend of £38 million. As at 31 December 2019 the Company holds only a nominal investment in PHL of £1.

#### A.1.4.5 Liquidation of Prudential Retirement Income Limited

The Company's former subsidiary Prudential Retirement Income Limited (PRIL) was placed into liquidation in December 2017. In September 2019 PRIL was liquidated, resulting in a return of capital of £100 million to the Company. The return of capital was settled through the cancellation of a £100 million loan PRIL had granted to the Company.

#### A.1.4.6 Hong Kong reinsurance recapture

The non-profit annuity business owned by the with-profits fund and previously reinsured to Prudential Hong Kong Limited was recaptured on 1 October 2019, in anticipation of the Group's demerger from Prudential plc. The 'recaptured reinsurance premium' in the long-term technical account of £1.1 billion was equal to the value of the recaptured business. A deposit-back liability of a similar value was extinguished. The transaction removes the reinsurance recoverable from the balance sheet with a corresponding charge to reinsurance recoverable 'change in long-term business provision'. The net impact on the long-term technical account was a loss of £24 million on a UK GAAP basis, arising from the difference between the recaptured reinsurance premium and the settlement of the reinsurance recoverable.

On 14 December 2018, the beneficial interests in the Company's Hong Kong subsidiaries, Prudential Hong Kong Limited and Prudential General Insurance Hong Kong Limited were sold to Prudential Corporation Asia Limited, with the legal ownership transferring on 19 December 2018.

#### A.1.4.7 Changes in longevity assumptions

Changes to the longevity assumption basis contributed £126 million to adjusted operating profit before tax. The changes reflect a recent slowdown in life expectancy improvements, and the adoption of the Continuous Mortality Investigation (CMI) 2017 model, albeit with an uplift to the calibration such that additional liabilities are held to cover potential differences in experience between the portfolio and the England and Wales population. Longevity assumption changes for 2018 contributed £441 million to adjusted operating profit and reflected changes to annuitant mortality assumptions to reflect current mortality, as well as the adoption of the Continuous Mortality Investigation ('CMI') 2016 model and some refinements to the Company's expectations for mortality for its portfolio.

#### A.1.4.8 Thematic Review of Annuities Sales Practices ('TRASP')

The Company held a provision at 31 December 2019 for review of past annuity sales after utilisation during the year of £100 million (31 December 2018: £324 million). The Company agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. During 2019 the Company made significant progress towards completing the review. In addition, the Company will be conducting a review of other groups of annuities sold after 1 July 2008 which were outside the scope of the original review. The review is examining whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from the Company or another pension provider. The ultimate amount that will be expended by the Company on the review will remain uncertain until the project is completed.

A gross provision of £175 million was established in 2016 to cover the costs of undertaking the review and any related redress and increased by £225 million to £400 million in 2017. No change was made to the provision in 2018 and an increase of £33 million was made in 2019. The ultimate amount that will be expended by PAC on the review will remain uncertain until the project is completed. The key assumptions underlying the provision are average cost of redress per customer and cost of rectification per customer. An increase in the average cost of redress per customer for outstanding cases of 10% would result in the provision recognised increasing by £7 million. An increase in the total outstanding cost of rectification of 20% would result in the provision recognised increasing by £7 million.

In connection with the FCA findings that led to Prudential agreeing to conduct the TRASP past business review, on 30 September 2019 the FCA fined the Company £24 million in respect of failures related to non-advised sales of annuities. This was fully settled during 2019. The Company has largely completed remediation on the relevant cases.

In 2018, income of £166 million from insurance recoveries in connection with TRASP was recognised and this has not recurred in 2019.

#### A.1.4.9 Dividends to parent companies

The Board decided to pay a total of £340 million in normal dividends to Prudential plc. It was also decided to pay £1,083 million as a special dividend, which was the Solvency II surplus in excess of the Company's target solvency coverage ratio. Of this total cash dividends of £1,423 million, £253 million was declared on 6 June 2019 and the remaining £1,170 million was declared on 16 September 2019.

In addition a non-cash dividend consisting of £537 million of loan assets due from Prudential plc, the previous parent of the Company, was declared on 11 June 2019 ahead of the demerger. A further dividend of £97 million was paid out in relation to the sale of Prudential Vietnam Finance Company as detailed in A.1.4.4.

Finally, on 30 November 2019, £63 million of loans provided by the Company to Prudential Financial Services Limited, a fellow M&G plc Group company, were cancelled and this has been accounted for as a deemed distribution.

#### A.1.4.10 Pension Mis-selling review

The UK insurance regulator required all UK life insurance companies to review sales of personal pensions policies for potential mis-selling.

Whilst the Company believed it met the requirements of the FSA (the UK insurance regulator at the time) to issue offers of redress to all impacted customers by 30 June 2002, there is a population of customers who, whilst an attempt was made at the time to invite them to participate in the review, may not have received their invitation. These customers are being re-engaged to ensure they have the opportunity to take part in the review.

At 31 December 2019, the pension mis-selling amount included within the long-term business provision was £420 million (2018: £777 million).

## A.2 Underwriting performance

The Company uses UK GAAP to prepare its solo entity statutory financial statements, and IFRS to report the results of the Company to M&G plc for inclusion in the Group results.

The Company also uses certain financial measures that are not defined or recognised under UK GAAP including 'adjusted operating profit before tax' which is management's alternative performance measure of profitability and is used for key decision making and the internal performance management of its operating segments. This metric has been used as the measure of underwriting performance discussed in this section.

The Company uses this metric because it is less affected than UK GAAP measures of performance by one-time impacts, and therefore, in the Company's view provides a better basis for assessing trends in the operational performance of the Company over time. This measure is not defined under UK GAAP and other companies may calculate such measures differently. The Company has aligned this measure to M&G plc's measure of 'adjusted operating profit before tax.'

Exceptional costs associated with fundamental one-off group-wide restructuring and transformation are not included in adjusted operating profit before tax.

For the Company's business written in the with-profits fund, adjusted operating profit before tax includes the statutory transfer to shareholders gross of attributable shareholder tax. Short term temporary movements in the fair value of instruments held to mitigate equity risk in the transfer are excluded from adjusted operating profit before tax. These hedges are matched to the statutory transfer on an economic basis rather than a UK GAAP basis, which may result in a mismatch between the movement in the instrument and the corresponding impact on the statutory transfer. Any such mismatch is reflected in adjusted operating profit before tax.

For the Company's shareholder annuity and non-linked products, adjusted operating profit before tax is calculated using long-term investment assumptions which reflect the Group's expectation of investment returns over the lifetime of the relevant product, allowing for expected payments into and

from the product. Adjusted operating profit before tax excludes impacts that are the result of short-term, unrealised market movements.

Certain significant additional one-off items are excluded from adjusted operating profit before tax where those items are considered to be non-recurring or strategic, or considered to be one-off, due to their size or nature, and therefore not indicative of the long-term operating performance of the Company. Such items are considered on a case by case basis. As noted above, exceptional costs associated with fundamental one-off group-wide restructuring and transformation are not included in adjusted operating profit before tax.

The key adjusting items between UK GAAP profit before tax attributable to shareholders and adjusted operating profit before tax are shown in Section A.2.1 below, whilst an analysis of premiums, claims, expenses and investment return is given in Section A.5.2.

### A.2.1 Adjusted Operating profit before tax

The table below reconciles the Total adjusted operating profit before tax to the UK GAAP profit for the year.

**Figure 5: Adjusted operating profit before tax for the year-ended 31 December 2019 (with 31 December 2018 comparison)**

| | 2019<br>£m | 2018*<br>£m | Change<br>% |
|---|---|---|---|
| **Total adjusted operating profit before tax** | **748** | **1,141** | **(34)** |
| Short-term fluctuations in investment returns | 217 | (11) | (2,073) |
| Sale of Hong Kong subsidiaries | — | 599 | (100) |
| Dividends from subsidiaries | 53 | 183 | (71) |
| Partial sale of annuity portfolio | 53 | (508) | (110) |
| Transformation costs | (24) | (52) | (54) |
| **Profit before tax attributable to shareholders** | **1,047** | **1,352** | **(23)** |

*The 2018 figures have been restated from those previously presented to show the adjusted operating profit on the current basis.

For 2019 and for 2018 the only differences between the current and previous bases are that exceptional costs associated with fundamental one-off group-wide restructuring and transformation are not included in 'adjusted operating profit before tax'. Such costs totalled £24m for 2019 (2018: £52m) and are included in non-operating profit in the table above.

The Company's total adjusted operating profit before tax of £748 million in 2019 was 34 per cent (£393 million) lower than the 2018 adjusted operating profit before tax of £1,141 million.

The with-profits shareholder transfer of £324 million (2018: £320 million) is £4 million higher than 2018 mainly due to PruFund business, where shareholder transfers have risen as funds under management have grown and the business matures.

The Company partially hedges movements in equity markets affecting the shareholder transfer. Equity markets performed strongly in 2019 which contributed to an £82 million loss (2018: £65 million) on the derivative protection.

For the annuities business, assumption changes contributed £166 million (2018: £470 million) to adjusted operating profit before tax, of which £126 million (2018: £441 million) related to changes in the longevity assumption basis (See A.1.4.7 for details).

The annuities result includes a charge of £33 million in relation to the Thematic Review of Annuities Sales Practices (TRASP) and a fine from the FCA of £24 million related to non-advised sales of annuities. This was fully settled during 2019. In 2018, income of £166 million from insurance recoveries in connection with TRASP was recognised and this has not recurred in 2019.

The expected return on assets and release of margins contributed £216 million (2018: £251 million). Asset trading and the impact of changes in interest rates contributed £165 million (2018: £80 million). New business loss and other items contributed a loss of £30 million (2018: profit of £165 million).

Within Unit-linked and other business, the partial release of a provision for Pension Age Equalisation of £25 million relating to shareholder-backed business was a significant contributor to profits of £46 million. In 2018 the unit linked and other business total loss of £246m included a £56m one-off cost related to the development of the Company's business in Poland, the cost of the provision in respect of equalising guaranteed minimum pensions of £55m and a £34m one-off shareholder contribution to the with-profits corporate pension business.

The results of the Company for the year show a profit on ordinary activities before tax of £1,047m (2018: £1,352m). This is made up of the total adjusted operating profit described above, together with the non-operating items as described in the table above. In 2018 the partial sale of the annuity portfolio resulted in a £508m loss. In 2019 the partial sale of the annuity portfolio resulted in a £53m gain relating principally to contractual adjustments to premiums.

Further detail on non-operating profit items in relation to short-term fluctuations are set out in Section A.3.1 and dividends in section A.4.1.

### A.2.2 UK GAAP adjusted operating profit analysed by Solvency II lines of business

UK GAAP adjusting operating profit before tax, as discussed above, is allocated by material Solvency II lines of business as shown in the table below:

**Figure 6: Adjusted operating profit before tax for the year-ended 31 December 2019 (with 31 December 2018 comparison)**

| | 2019<br>£m | 2018<br>£m | Change<br>% |
|---|---|---|---|
| Insurance with-profits participation[1] | 324 | 320 | 1 |
| Other (comprising index-linked and unit-linked insurance, other life insurance and life reinsurance)[2] | 424 | 821 | (48) |
| **Adjusted operating profit before tax** | 748 | 1,141 | (34) |

[1] Insurance with-profits participation comprises the shareholders' transfer from the with-profits funds of the Company.
[2] Other comprises mainly profits relating to the shareholder annuity business.

## A.3 Investment performance

### A.3.1 Short-term fluctuations

As explained in Section A.2 Underwriting Performance, the Company describes its UK GAAP performance by reference to adjusted operating profit before tax and non-operating profit.

UK GAAP adjusted operating profit before tax is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and assumed longer-term returns is reported within short-term fluctuations in investment returns.

Included in non-operating results are gains of £217 million as a result of short-term fluctuations (2018: loss of £11 million).

This increase was mainly due to capital gains on surplus assets and on shareholder fund assets of £455 million (2018: loss of £234 million).

During 2013 the Company entered into a partial equity hedge of the shareholder transfers expected to emerge from the Company's with-profits sub-fund, which has been extended in 2018 and 2019. The non-operating profit includes losses on the partial hedge of the shareholder transfers in respect of future years of £167 million (2018: gain of £216 million).

During 2018 and 2019 the Company entered into hedges against the equity risk affecting future shareholder transfers from the with-profits sub fund, specifically with regard to the PruFund 2018 and 2019 new business, as arise over the contract period of 10 years. During 2019, the transaction resulted in a £25 million loss (2018: £Nil).

There were further unrealised losses of £60 million in relation to interest rate swaps. The losses were a result of a 2019 interest rate overlay (IO) programme which was implemented to manage the Company's exposure to interest rate movements for shareholder-backed business on a Solvency II basis, following the disposal of surplus assets within the Company's shareholder backed portfolios. There were unrealised losses in respect of interest rate sensitivity hedging, driven by lower than expected interest rate volatility 2019.

### A.3.2 Investment management expenses

The total investment management expenses incurred by the Company's insurance operations, including those that were paid to the Company's asset management operations totalled £285 million (2018: £330 million).

The decrease in investment management expenses was caused by a number of items including lower project fees than 2018, a reduction in unit-linked fees caused partly by lower fund closure costs, a one off re-charge of fees from the Company to PIA in 2019 and a decrease in the Company's contribution to service charges due to fewer vacant properties.

An analysis of investment return in the income statement by asset class is given in Section A.5.2.4.

### A.3.3 Investments in securitisations

Certain of the securities classified as asset-backed securities meet the definition of securitisation under Solvency II for the purpose of the Solvency II capital requirements calculation. Investments in securitisations are subject to specific spread stresses in the calculation in order to ensure that risks arising from securitisation positions are reflected appropriately.

At 31 December 2019, all of the £4,506 million of asset-backed securities (2018: £5,739 million) meet the definition of investments in securitisations.

## A.4 Performance of other activities

### A.4.1 Investments in subsidiaries and dividends

The contribution to non-operating profit by the Company's subsidiaries is shown in the shareholder profit table in Section A.2.1. This consists of any gains or losses from the sale of shareholder-backed subsidiaries and dividend income from subsidiaries.

Dividends totalling £53 million (2018: £183 million) were received from shareholder subsidiaries during the year. PHL remitted £97 million to the Company following the sale of its subsidiary Prudential Vietnam Finance Company. The amount consisted of a dividend of £38 million and a return of capital of £59 million. The Company also received a dividend of £15 million from PPL. All amounts for 2018 were in respect of the Hong Kong subsidiaries prior to their sale.

For 2018 the Hong Kong subsidiaries contributed a gain of £599 million prior to transfer to another Prudential plc company.

### A.4.2 Leasing

The Company's operating and finance lease arrangements relate principally to properties.

The Company holds investment properties which are leased out to earn a return. Further information on the Company's leasing arrangements is provided below.

The Company does not hold any individually material leasing arrangements.

#### A.4.2.1 Operating leases

The Company as a lessor
Investment properties principally relate to the Company's with-profits funds and are carried at fair value. The Company's policy is to let investment properties to tenants through operating leases.

The 2019 income statement includes rental income from investment properties of £554 million (2018: £466 million) and direct operating expenses including repairs and maintenance arising from these properties of £43 million (2018: £50 million).

The Company as a lessee
The Company leases two properties under non-cancellable operating lease arrangements to provide office space for employees. One lease commenced in September 2002 and expires in September 2022; the other lease commenced in December 2013 and is due to expire in 2030, however there is a break option on that lease in 2025. The total operating lease expense in 2019 was £3 million (2018: £4 million).

#### A.4.2.2 Finance leases

The Company as a lessor
As at 31 December 2019, investment properties of £33 million (2018: 33 million) are held under finance lease assets, within receivables.

The 2019 income statement includes finance income from investment properties of £2 million (2018: £2 million).

The Company as a lessee
The Company's portfolio of investment properties comprise both freehold and leasehold properties. As at 31 December 2019, investment properties of £3,477 million (2018: £3,959 million) are held under finance leases. These finance leases are arrangements which grant very long leases with a large payment made upfront with minimal ground rent payable on an annual basis.

The 2019 income statement includes £6 million in respect of finance lease charges (2018: £8 million).

## A.5 Any other information

### A.5.1 Additional analysis of profits before tax by nature of revenue and charges

Total profit before tax attributable to shareholders for the year-ended 2019 was £1,047 million (2018: £1,352 million), representing adjusted operating profit of £748 million (2018: £1,141 million), as set out in Figure 5 and discussed in Section A.2.1, and non-operating profit of £299 million (2018: profit of £211 million). Analysis of profit before tax is shown in Figure 7 below by nature of revenue and charges, on a UK GAAP basis.

**Figure 7: Total revenue and charges for the year-ended 31 December 2019 (with 31 December 2018 comparison)**

| | 2019<br>£m | 2018<br>£m |
|---|---|---|
| Gross premiums written | 11,063 | 13,002 |
| Outward reinsurance premiums | (949) | (13,117) |
| Recaptured reinsurance premiums | 1,086 | — |
| **Earned premiums, net of reinsurance** | **11,200** | **(115)** |
| **Other income** | **2** | **19** |
| Investment income | 8,537 | 20,684 |
| Unrealised gains (losses) on investments | 7,942 | (22,952) |
| **Investment return** | **16,479** | **(2,268)** |
| **Total revenue, net of reinsurance** | **27,681** | **(2,364)** |
| Claims paid – gross amount | (12,671) | (12,163) |
| Claims paid – reinsurers' share | 1,757 | 1,435 |
| Change in provision for claims - gross amount | (21) | (34) |
| Change in long-term business provision - gross amount | (10,733) | 2,417 |
| Change in long-term business provision - reinsurers' share | 249 | 9,074 |
| Change in long-term business provision - recaptured reinsurance | (1,110) | — |
| Change in technical provision for linked liabilities | 119 | 3,721 |
| **Claims incurred and changes in other long-term business and technical provisions – Net of reinsurance** | **(22,410)** | **4,450** |
| Net operating expenses | (767) | (947) |
| Investment expenses and charges | (435) | (343) |
| Other charges | (64) | (20) |
| Tax attributable to the long-term business | (674) | 371 |
| Actuarial and other (losses) gains on pension schemes | (187) | 46 |
| Transfer (from) to the fund of future appropriations | (2,371) | 85 |
| **Profit before tax (being tax attributable to shareholders' and policyholders' returns)** | **773** | **1,278** |
| Tax credit attributable to the balance on the long-term business technical account | 274 | 74 |
| **Profit on ordinary activities before tax** | **1,047** | **1,352** |

**Hong Kong re-capture**

The Company entered into a quota share reassurance treaty with PHKL in 2013 for 10.43% of the with-profit annuity book. In preparation for the demerger from Prudential plc, this was recaptured with effect from 1 October 2019. The Hong Kong treaty recapture was treated as an unwind of the original quota share contact. This resulted in a reduction to outward reinsurance premium expenses and a charge to reinsurers claims in the figures above, resulting in a loss of £24m on a UK GAAP basis. The reinsurance recoverable and deposit-back liability have been removed from the balance sheet.

### A.5.2 Premiums, claims and expenses

#### A.5.2.1 Comparison of earned premiums with the prior period

**Figure 8: Premiums by Solvency II line of business for the year-ended 31 December 2019 (with 31 December 2018 comparison)**

| | Health insurance £m | Insurance with profit participation £m | Index-linked and unit-linked insurance £m | Other life insurance £m | Accepted life insurance £m | Total 2019 £m | Total 2018 £m |
|---|---|---|---|---|---|---|---|
| Premiums earned - gross | 16 | 9,411 | 474 | 418 | 1,051 | 11,370 | 13,378 |
| Outward reinsurance premiums | (2) | (1) | (368) | 146 | — | (225) | (13,460) |
| Earned premiums, net of reinsurance | 14 | 9,410 | 106 | 564 | 1,051 | 11,145 | (82) |

Gross premiums for the Company decreased from £13,378 million in 2018 to £11,370 million in 2019, driven by a slowdown in Retirement Account premiums, principally within the 'insurance with profit participation' line of business.

The gross earned premiums of £11,063 million for 2019 in Figure 7 above on UK GAAP basis excludes £307 million of premiums for investment contracts without discretionary participation features (as defined by FRS 103 insurance contracts) reflecting the deposit nature of these contracts. The premiums for these investment contracts without discretionary participation features are included in premiums written and earned under Solvency II. The gross premiums amount of £11,370 million, including these investment contracts, is analysed above in Figure 8.

Premiums classified above as 'Insurance with-profits participation' principally relate to PruFund business. There was strong demand for the Company's PruFund multi-asset funds during 2019 as customers were attracted by its performance track record, the benefits of a smoothed return in managing market volatility and its ability to reduce customer investment risk.

The decrease in outward reinsurance premiums from £13,460 million in 2018 to £225 million in 2019 is primarily due to 2018 including a £12,148 million one-off premium relating to the reinsurance of part of the annuity portfolio to Rothesay Life which is not applicable for 2019. In addition, 2019 includes a large reinsurance premium refund of £1,086 million due to the Hong Kong re-capture described in A.5.1.

### A.5.2.2 Comparison of benefits and claims with the prior period

**Figure 9: Benefits and claims by Solvency II line of business for the year-ended 31 December 2019 (with 31 December 2018 comparison)**

| | Health insurance £m | Insurance with profit participation £m | Index-linked and unit-linked insurance £m | Other life insurance £m | Accepted life insurance £m | Total 2019 £m | Total 2018 £m |
|---|---|---|---|---|---|---|---|
| Claims incurred and changes in other long-term business and technical provisions, gross of reinsurance | 2 | (17,168) | (2,139) | (2,850) | (1,778) | (23,933) | (7,927) |
| Reinsurers share of claims incurred and changes in other long-term business and technical provisions | 15 | 4 | 1,150 | 368 | — | 1,537 | 12,310 |
| Claims incurred and changes in other long-term business and technical provisions, net of reinsurance | 16 | (17,164) | (988) | (2,482) | (1,778) | (22,396) | 4,383 |

Claims incurred and changes in other long-term business and technical provisions (net of reinsurance) totalling £22,410 million in 2019 (as noted in Figure 7 above on a UK GAAP basis) includes £20 million (2018: £20 million) of claims handling expenses and an adjustment for other charges of £48 million (2018: £43 million). These amounts are not included in the benefits and claims net of reinsurance (£22,396 million) analysed above in figure 9 on a Solvency II basis, which also includes £55 million (2018: £34 million) deposit accounting not included in figure 7 on a UK GAAP basis.

Claims incurred and changes in other long-term business and technical provisions (gross of reinsurance) have increased by 202 per cent from £7,927 million in 2018 to £23,933 million in 2019.

The £16,006 million increase in claims incurred and changes in other long term business provisions gross of reinsurance consists of an increase of £12,374 million for insurance with profit participation mainly due to positive investment returns in 2019 in contrast to negative investment returns in 2018.

The total of other life insurance and accepted life insurance of £4,628 million has increased by £2,347 million since 2018 due to market movements, as well as increases due to assumption changes. The remaining £1,352 million movement is mainly related to index-linked and unit-linked insurance and is caused by positive investment returns.

The difference between 2019 and 2018 reinsurers share of claims incurred is a result of 2018 including £11,219 million within other life insurance due to the reinsurance of part of the annuity portfolio to Rothesay Life which was not repeated in 2019. This is partially offset by a reduction in reinsurers share of claims incurred of £1,110 million in relation to the Hong Kong recapture described in section A.5.1.

### A.5.2.3 Acquisition costs and other expenditure

Net operating expenses consist of acquisition costs £169 million (2018: £183 million) and administration expenditure £598 million (2018: £766 million). Investment expenses and charges are comprised of investment management expenses £285 million (2018: £330 million), plus interest on bank borrowings of £38 million (2018: £13 million) and investment return payable to reinsurers of £112 million (2018: Nil).

Administration expenditure has decreased by £168 million from £766 million in 2018 to £598 million in 2019, mainly due to a credit to past service costs relating to freezes in pensionable salary and a

reduction in restructuring costs mainly due to lower transformation costs. The decrease in investment management expenses is detailed in section A.3.2.

There was higher interest on borrowings mainly as a result of an increase in gilt rates affecting the interest on a deposit backed reinsurance arrangement. The investment return payable to reinsurers in 2019 relates to the deposit back arrangement with Prudential Hong Kong Limited. As Prudential Hong Kong Limited was previously a group company the investment return was treated as a deduction in investment return.

### A.5.2.4 Investment return by asset class

**Figure 10: Investment return for the year-ended 31 December 2019 (with 31 December 2018 comparison)**

| | 2019<br>£m | 2018<br>£m |
|---|---|---|
| **Income** | | |
| Investment properties | 554 | 466 |
| Loans | 152 | 144 |
| Equity securities and portfolio holdings in unit trusts | 1,986 | 1,756 |
| Debt securities | 2,299 | 2,473 |
| Other investments (including deposits) | 672 | 709 |
| **Total income** | **5,663** | **5,548** |
| **Investment appreciation (depreciation) and other investment return** | | |
| Investment properties | (595) | 57 |
| Loans | (9) | 4 |
| Equity securities and portfolio holdings in unit trusts | 6,645 | (5,593) |
| Debt securities | 3,609 | (2,090) |
| Other investments (including deposits) | 1,166 | (193) |
| **Total investment appreciation (depreciation) and other investment return** | **10,816** | **(7,815)** |
| **Total investment return** | **16,479** | **(2,267)** |

Investment return principally comprises interest income, dividends, and investment appreciation/ depreciation (realised and unrealised gains and losses) on investments designated as fair value through profit or loss. It also includes impairment losses relating to assets held at amortised cost.

Total income has increased by £115 million from £5,548 million in 2018 to £5,663 million in 2019. Equity securities contributed an increase of £230 million and investment properties an increase of £88 million, offset by reductions in debt securities of £174 million.

Investment return from equity securities and portfolio holdings in unit trusts has increased from a loss of £5,593 million to a gain of £6,645 million due to positive investment return in 2019 compared to the negative investment return in 2018. Investment return from debt securities have also increased due to positive investment returns in 2019.

Other investments are carried at fair value through profit or loss and consist mainly of revaluation in subsidiaries and derivative movements.The increase of £1,359 million compared to 2018 is a result of a £2,595 million increase in the value of derivatives which produced a profit in 2019 and losses in 2018. There was also a £270 million increase in mortgage loans. These were offset by £958 million decrease in the revaluation of subsidiaries, a decrease of £356 million in exchange movements and a £192 million lower return on other investments including limited partnerships.

### A.5.3 Post balance sheet events

On 26 February 2020 the Company announced the 2019 annual bonus rates for the with-profits fund. The Company also announced an additional bonus of 1.25% to enhance the unsmoothed value of plans for customers with traditional and accumulating policies. It may be necessary to take back the additional bonus in order to protect the interests of all customers and the strength of the fund at a future date, although this is not expected to happen. For PruFund customers, additional surplus has been shared by increasing the unit price by 0.9%.

On 4 March 2020 the Company approved an interim dividend of £410m to be paid to M&G plc. The results and financial position discussed in this report are before recognition of this amount.

**Coronavirus impact**

The Company continues to monitor the effects of the COVID-19 outbreak which has been declared as a pandemic by the World Health Organization. Along with causing widespread infection globally, COVID-19 has prompted many governments to impose measures to contain the outbreak, including restrictions of movement, closure of businesses and banning large gatherings or events. The outbreak has not only prompted widespread health concerns, but has caused a deterioration in global market conditions. The eventual outcome is highly uncertain and is largely dependent on how successful authorities are at containing and managing the outbreak.

In these difficult times, the Company has two clear priorities: the safety and well-being of colleagues and continuing to serve customers and clients to the best of our abilities. Detailed business continuity plans have been invoked to ensure that the Company and the wider Group can operate as usual in the face of the challenge posed by the spread of COVID-19. The vast majority of colleagues are now working from home with access to the full set of support systems and necessary equipment to do their jobs. We continue to actively manage the Company's funds our customers and clients invest in and continue to service our customers' policies, including making all annuity payments. We understand that these are volatile times and, where appropriate, has put in place enhanced investment reporting and updates to support our customers and clients.

The volatility associated with COVID-19 also has an impact on the Company's solvency position. As noted previously at 31 December 2019 the Company's regulatory Solvency II coverage ratio was 131% and the Company's shareholder Solvency II coverage ratio was 159%. The Company's with-profits Solvency II coverage ratio was 267%. The deterioration in global market conditions since that date has resulted in a reduction to these ratios, consistent with that indicated by the sensitivities reported in Section C7.2. However, it is noted that the simple sensitivities given in section C.7.2 cannot capture the actual market movements perfectly given the complex nature of the financial markets and their impact on the variety of assets held. In line with the Company's Risk Management Framework, a number of actions have been taken since 31 December 2019 or are in progress which, together with the expected underlying capital generated over the period, benefit the solvency position and ratios. The sensitivity analysis shown in Section C.7.2 is still applicable, after allowing for these actions.

Management will continue to manage the Solvency position in line with the Company's risk appetite and limits, described in section B.3.1.4, as events unfold.

# B System of governance
*(Unaudited)*

## B.1 General information on the system of governance

### B.1.1 Overview

The PRA requires that firms have in place an effective system of governance which provides for the sound and prudent management of the business. The system of governance must include an adequate, transparent organisational structure with clear allocation and appropriate segregation of responsibilities.

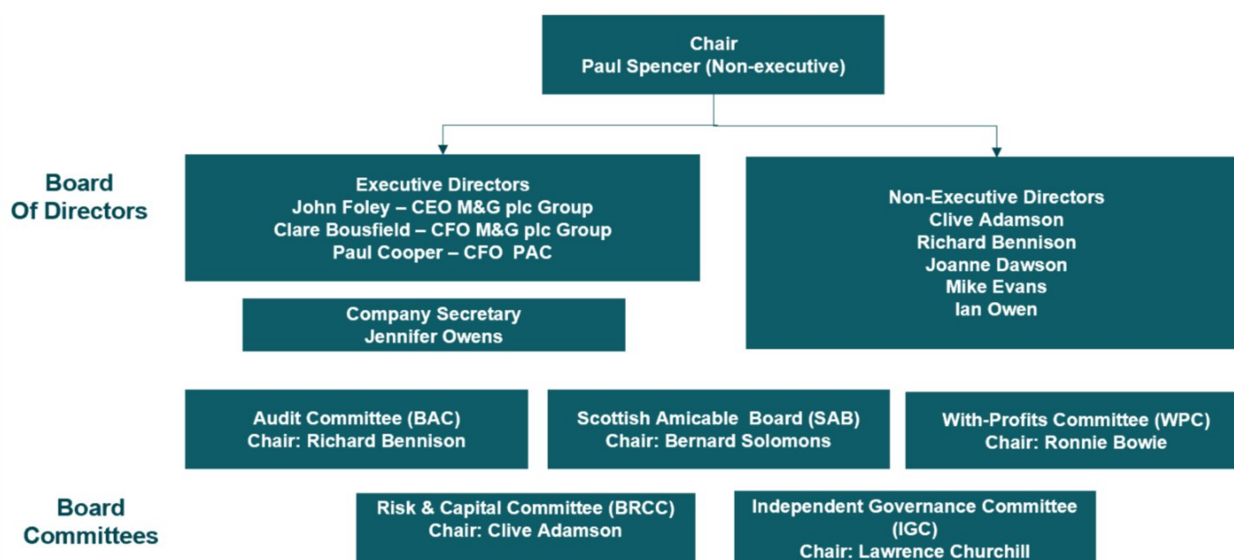
As noted in Section A, PAC ('the Company') is a wholly owned subsidiary of M&G plc, the parent company of the M&G plc Group ('the Group').

The Company's Board is collectively responsible for the long-term success of the Company and for providing leadership within a framework of effective controls. The control environment enables the Board to identify significant risks and apply appropriate measures to manage and mitigate them. The Group and the Company's governance structures have been designed to ensure they are aligned to the needs of the newly demerged Group and its stakeholders, and fully comply with the UK Corporate Governance Code.

### B.1.2 Board and Senior Management

The Company's Board members and its committees are set out in Figure 11 below.

**Figure 11: Company Board and Board Committees as at 31 December 2019**




Note: Lawrence Churchill is stepping down as Chair of the ICG in April 2020 and will be replaced by Bruce Rigby, who will formally take on the role of Chair from July 2020. Richard Bennison, Independent NED and Chairman of the BAC, retires in April 2020.

The Company Board is authorised to exercise all the powers of the Company subject to complying with the Group Governance Framework ('GGF'). The GGF details the Group's approach to governance, risk management and internal controls, including policies that apply to the conduct of the Company and its employees, taking into account statutory, regulatory and other relevant matters.

The GGF, including the Risk Management Framework ('RMF'), came into effect on the date of demerger. Prior to this, the Company complied with the Prudential plc Group Governance Manual ('GGM').

Compliance with the GGF, including the RMF, is attested to annually. The GGM was also attested to up to the point of demerger.

The Company's Board composition was reviewed in 2019 in preparation for the demerger to ensure it remains appropriate for the Company and in the context of the new Group structure and relevant regulations. The Board comprises nine members:

- an Independent Non-Executive Chair, Paul Spencer;
- five Independent Non-Executive Directors ('NEDs'), Clive Adamson, Richard Bennison, Joanne Dawson, Mike Evans and Ian Owen. Richard Bennison and Clive Adamson serve as the independent Chairs of the Board Audit and Board Risk and Capital Committees respectively; and
- three Company executive directors, namely, the Group Chief Executive Officer ('CEO'), who is also the CEO of the Company, the Group Chief Finance Officer ('CFO') of M&G plc and the CFO of the Company.

The Board considers all its NEDs to be independent and that it has complied with the requirements of the corporate governance code in relation to the balance of Executive and NEDs on the Board and the audit committee. The NEDs are responsible for both supporting and overseeing executive management whilst, as members of a unitary Board, sharing in the wider duty to promote the success of the Company and to ensure the Company continues to meet its Threshold Conditions (minimum conditions requiring to be met to undertake its regulated activities). In the run-up to demerger, Mark FitzPatrick, Prudential plc's Group CFO, was a NED member of the Board, representing the interests of Prudential plc. Mr FitzPatrick stood down from the Board shortly before demerger.

The appointment of independent NEDs on the Board recognises the Company's obligation, as a regulated entity, to take decisions independently in the interests of the safety and soundness of the Company and its customers, as well as to meet relevant legal and governance responsibilities.

Given the importance of the Company to the Group's overall business, Mike Evans, (Chair of M&G plc) and Clive Adamson (Independent NED and Chair, M&G plc Board Risk Committee) also serve as directors of the Company. M&G plc Executive Directors, John Foley (CEO) and Clare Bousfield (CFO), serve as directors of both M&G plc and the Company.

The Company's board operates within the overall ambit of the GGF, which sets out the respective roles and responsibilities between the Group and the entities, allowing for the appropriate management of potential conflicts of interest, as well as the required interactions and two way flow of information, including requirements as to the upward and downward escalation of relevant issues. The membership of the Board and their roles as at 31 December 2019 is detailed in Figure 12 below.

**Figure 12: Composition of the Board as at 31 December 2019**

| Board Members | Role |
|---|---|
| Paul Spencer | Chairman and Independent NED (SMF 9) |
| Clive Adamson | Independent NED and Chairman of the BRCC (SMF 10) |
| Richard Bennison | Independent NED and Chairman of the BAC (SMF 11) |
| Clare Bousfield | Director and CFO M&G plc (SMF 3 and SMF 7) |
| Michael Evans | Independent NED (SMF 7) and Chairman of M&G plc |
| Ian Owen | Independent NED (Notified NED) |
| Joanne Dawson | Independent NED (Notified NED) |
| John Foley | Director and CEO M&G plc and the Company (SMF 1 and SMF 3) |
| Paul Cooper | Director and CFO (SMF2 and SMF3) |

**Key Function Holders**

John Foley, the CEO of M&G plc, is also the CEO (SMF1) of the Company. As a Solvency II entity, the Company is required to identify its Key Functions and name Key Function Holders ('KFHs'), the senior managers within the Company in charge of those Key Functions. The Company's KFHs are set out below:

- Actuarial - Jonathan Hughes (SMF20)
- Compliance - David Nancarrow (SMF16)

- Distribution - David Macmillan (SMF18)
- Finance - Paul Cooper (SMF2)
- HR - Irene McDermott Brown (SMF7)
- Internal Audit - Karen Connell (SMF5)
- Investments - David King (SMF18)
- Money Laundering - Catherine Fleuty (SMF17)
- Operations - Roddy Thomson (SMF24)
- Risk & Resilience - Keith Davies (SMF4 & SMF7)
- With Profits Actuary - Peter Needleman (SMF20a)

**Note:** Keith Davies, M&G plc's Chief Risk and Resilience Officer ('CRRO'), resigned in February 2020. Julian Adams, Director of Public Policy and Regulation ('DPPR'), has taken interim accountability for the M&G plc CRRO role whilst a recruitment process is conducted. Peter Needleman, the With-Profits Actuary, announced his retirement and was replaced by Phil Roberts in March 2020.

**Material changes to the system of governance**

In readiness for the demerger, governance arrangements were reviewed to ensure they remain appropriate to the Company's position within the new Group. Whilst changes were primarily implemented at M&G plc level (and will be documented in the M&G plc Solvency and Financial Condition Report ('SFCR')), some incidental changes have been made to the Company's governance arrangements (e.g. including representation on the M&G plc Board). Such governance arrangements remain subject to on-going review post demerger as transformation continues and to ensure compliance with best practice.

### B.1.3 Responsibility of the Board and Board Committees

The Board and its Committees operate under approved terms of reference which are reviewed at least annually. The Board also undertakes an annual review of its performance and effectiveness.

**The Board**

The Board responsibilities are detailed in Figure 13 below.

**Figure 13: Board responsibilities**

| Responsibility | Terms of Reference |
| --- | --- |
| Strategy, Budgets and Business Plans | • approving the Company's strategy, long-term objectives, annual budgets and business plan prior to their submission to M&G plc; and<br>• monitoring implementation of the Company's strategy and long-term objectives, annual budgets and business plan as approved by the M&G plc Board, and overseeing any corrective action taken by the Company. |
| Structure and Capital | • approving, subject to the GGF, the following matters;<br>◦ material changes to the Company's corporate structure, including decisions to cease operations in parts of the Company or to extend activities into new business or geographic areas;<br>◦ material changes to the Company's capital structure, including reduction of capital, share issues and the re-organisation or restructuring of capital;<br>the raising of, or committing to, external finance and financing programmes; and<br>◦ material transactions and certain other matters. |
| Financial Reporting and Dividends | • approving the Company's Annual Report and Accounts;<br>• approving the payment of dividends;<br>• monitoring whether the Company adopts the Group's accounting policies;<br>• endorsing the proposed appointment, reappointment or removal of the Company's external auditor; and<br>• regularly reviewing the overall financial condition of the Company and its subsidiaries, any relevant credit ratings and regulatory capital requirements. |

<table>
<tr><th>Responsibility</th><th>Terms of Reference</th></tr>
<tr><td>Internal Control and Risk Management</td><td>• overseeing that an effective system of internal control and risk management is in place, maintained and reviewed annually;<br>• approving the Company’s risk appetite and monitoring whether the overall risk appetite and tolerance of the Company’s business adheres to the Group RMF, policies and limits; and<br>• overseeing and approving, where applicable, material disclosures to, and regular reporting required by, regulators, including the SFCR and Regular Supervisory Report (‘RSR’).</td></tr>
<tr><td>Board and other appointments</td><td>• taking the following actions, each in accordance with the GGF;<br>◦ implementing changes to the structure, size and composition of the Board and membership, including the chairmanship of its committees;<br>◦ approving the appointment and removal of Directors;<br>• overseeing, in conjunction with the CEO, that there is a succession planning process in place for executive directors and senior management; and<br>• overseeing that there is an effective process for the ongoing refreshment of NEDs.</td></tr>
<tr><td>Governance</td><td>• overseeing that an evaluation of the Board’s own performance, that of its committees and of all directors is undertaken in accordance with the GGF and that an appropriate plan of action is adopted to address matters identified in the evaluation;<br>• overseeing that the Company adheres to the GGF;<br>• authorising any actual or potential conflict of interest situation applying to any director; and<br>• authorising the Company Secretary to arrange for all directors to obtain, at the Company’s expense, appropriate external professional advice where necessary.</td></tr>
<tr><td>Delegation of Authorities</td><td>• delegating authority to a number of standing and ad hoc committees of the Board and regularly reviewing the terms of reference for, and reports from, the committees, in adherence with the GGF; and<br>• the CEO has responsibility for the operational management of the Company and its subsidiaries, and may sub-delegate authority as they determine.</td></tr>
<tr><td>With-Profits</td><td>• overseeing that the interests of the with-profits policyholders are appropriately considered in relation to matters affecting with-profits policyholders as a whole or as separately identifiable groups of policyholders; and<br>• receiving advice from the With-Profits Committee (‘WPC’) to ensure compliance with the Company’s Principles and Practices of Financial Management (‘PPFM’).</td></tr>
<tr><td>Investment Strategy</td><td>• inputting into the development of, and approving, the Company’s investment strategy in the context of Company’s business strategy; and<br>• monitoring the implementation of the Company’s investment strategy, and overseeing any corrective action taken by the Company.</td></tr>
</table>

**Board Committees**

The Board has established a number of committees comprising independent NEDs to provide oversight and challenge, and to assist the Board in discharging its responsibilities effectively.

The role of each principal standing committee of the Board, together with details of the current Chair, are summarised in Figure 14 below

**Figure 14: Summary of the role of Board Committees as at 31 December 2019**

| Committee | Role of Committee |
|---|---|
| **Board Audit Committee (BAC)** | **Chair : Richard Bennison**<br>The BAC assists the Board in meeting its responsibilities for the integrity of the Company's financial reporting, including the effectiveness of the internal control and risk management systems, and for monitoring the effectiveness and objectivity of the internal and external auditors. The BAC's membership is wholly independent. |
| **Board Risk and Capital Committee (BRCC)** | **Chair : Clive Adamson**<br>The BRCC's role is to assist the Board in meeting its responsibility for overseeing the effectiveness of risk and capital management for all financial and non-financial risks faced by the Company. The BRCC's membership is wholly independent. |
| **With-Profits Committee (WPC)** | **Chair: Ronnie Bowie**<br>The WPC acts in an advisory capacity to inform the Company's decision making, to ensure that the interests of with-profits policyholders are appropriately considered before decisions are made. The WPC's membership is wholly independent. |
| **Independent Governance Committee (IGC)** | **Chair: Lawrence Churchill**<br>The IGC acts in an advisory capacity, solely in the interest of pension scheme members, and to assess, raise concerns and report on the value for money of the Company's contract-based defined contribution workplace pension schemes. Half of the IGC's members are independent. |
| **Scottish Amicable Board (SAB)** | **Chair: Bernard Solomons**<br>The SAB manages the business of the Scottish Amicable Funds, transferred to the Company as part of the transfer of business from the Scottish Amicable Life Assurance Society. A majority of the SAB members are independent. |

The key functional control areas of Risk, Internal Audit Compliance and Actuarial report to Board Committees in accordance with each Committee's terms of reference. It is the responsibility of the BAC to review the resources of Internal Audit and Compliance through its review of annual plans and progress of their delivery during the year. In addition, the Actuarial function reports annually to the BAC on its resources and the activities undertaken over the year. The Risk function reports on its activities on an ongoing basis to the BRCC. Further information on the key functions is given in Sections B.3-B.6.

### B.1.4 Board Remuneration

**Remuneration Committee and strategy**

The M&G plc Board has established a Remuneration Committee ('RemCo') to ensure alignment of the remuneration policy and structures across the Group, including for the Company, with the Group's business strategy, objectives, values, risk framework, risk appetites and long-term interests.

The RemCo's responsibilities include, but are not limited to:

- establishing and maintaining the principles and framework of the remuneration policies of the Group and ensuring compliance with those policies; and
- determining the design, implementation and operation of remuneration arrangements, including, where relevant, benefits and pension arrangements, for the Chair, the Directors, members of senior management, Material Risk Takers and other individuals identified as Solvency II Staff[1] under remuneration regulations that apply to the Group, and individuals whose total annual remuneration exceeds an amount determined by the RemCo from time to time.

[1] The PRA has defined these as Board members, Executive Committee members, Key Function Holders under Solvency II, Senior Manager Functions, Material Risk Takers

The members of the Committee are all independent NEDs. To ensure that the interests of the Company are appropriately represented, Mike Evans and Clive Adamson (Board members of both M&G plc and the Company) and Joanne Dawson (Board member) are all standing attendees of the M&G plc RemCo.

The Group's remuneration strategy and policy is to have in place remuneration structures and processes that adhere to the following principles:

- promote the long-term success of the Group and its companies, including the Company;
- attract, motivate and retain the best talent to help ensure the continued growth and success of the Group as a separately listed company;
- support the Group's diversity and inclusion objectives to provide equality of opportunity for all who apply for and perform work for the Group;
- align the interests of the Executive Directors, Senior Managers and employees with the interests of current and future shareholders and other stakeholders;
- strike an appropriate balance between short-term and long-term performance with strong linkage to Group performance, effective risk management, management of conflicts of interest, customer outcomes, the culture and values of the Group and long-term shareholder value creation;
- are simple and transparent, both externally and to colleagues; and
- are compliant with relevant local remuneration regulation requirements.

The Group's Remuneration Policy was implemented at the point of demerger. Previously, the Group complied with the Prudential plc Remuneration Policy. The Group's Remuneration Policy is subject to a binding vote by shareholders at least every three years and will be reviewed at the Group's 2020 Annual General Meeting.

**Remuneration architecture**

Executive remuneration is aligned to the Group's purpose and values and clearly linked to the successful delivery of the Group's long-term strategy. Both fixed and variable remuneration is assessed against market data and internal benchmarks on an annual basis and balanced so that the fixed component represents a sufficiently high proportion of the total remuneration. This avoids employees being overly dependent on the variable components and helps to mitigate unintended consequences and inappropriate behaviours to the detriment of customer outcome.

Variable remuneration available to employees includes short-term incentives (i.e. annual bonus, quarterly sales incentives for sales staff) and long-term incentive plan ('LTIP') awards.

Annual bonus measures include various combinations of company specific financial and/or strategic targets, Group financial targets, functional targets and individual performance reflecting the level, nature and scope of an individual's role and the practice in the market in which the Group operates. This allows the Group to operate a fully flexible bonus policy, including the possibility of not paying an annual bonus, based on financial and non-financial criteria. All awards granted over M&G plc shares are subject to malus during the vesting period.

The Group does not operate any supplementary pension or early retirement schemes. The Group's defined benefit schemes are closed to new members.

**Remuneration for NEDs and the Chair**

The remuneration of NEDs is determined in accordance with the Company's Articles of Association. Levels of remuneration for the Chair and all NEDs reflect the time commitment and responsibilities of the role.

All NEDs receive a basic fee for their duties as a Board member. The basic and any additional fees payable are periodically reviewed against market data, the time commitment and other requirements of the role. NEDs are not eligible to participate in short-term and long-term incentive plans and do not receive a pension allowance or participate in employee pension schemes. Travel and business expenses incurred in the normal course of business, for example, in relation to attendance at Board and committee meetings, are met by the Company, including any tax liabilities arising in relation to such business expenses.

**Remuneration governance**

Governance processes provide robust and independent oversight of reward, effective management of any potential conflicts of interest and reflect the need to link remuneration decisions with the Group's risk appetite.

The RemCo must consult and receive advice from the M&G plc Board Risk Committee and Audit Committee, the control functions and the subsidiary Boards, including the Company's, when setting the remuneration strategy and framework.

The M&G plc CRRO is actively involved in ensuring that remuneration across the Group reflects the extent to which decisions were made within the organisation's risk appetite. The CRRO provides a report to the Committee, at least once a year, which:

- provides context on the risk environment during the period;
- assesses risk performance and the overall effectiveness of the control environment;
- identifies any significant risk issues that should be considered by the Committee;
- assesses the appropriateness of the remuneration structure; and
- assesses the degree to which performance plans are appropriate in the context of risk appetite, including whether a risk modifier should be considered by the Committee.

### B.1.5 Material transactions with directors and shareholders

**Transactions with directors**

In addition to remuneration for their role on the Board, executive officers and directors of the Company may, from time to time, purchase insurance, asset management or annuity products marketed by the Company and other companies within the Group in the ordinary course of business on substantially the same terms as those prevailing at the time for comparable transactions with other persons.

In accordance with the Companies Act 2006, directors are required to disclose any transactions that may represent a conflict of interest to their roles. In 2019, no such transactions have been disclosed.

**Transactions with shareholders**

Transactions with shareholders are described in Section A 1.4.1.

## B.2 Fit and proper requirements

The Company ensures that Senior Managers are fit and proper to undertake their role through the implementation of a Fit and Proper Policy. The Fit and Proper Policy applies to:

- all persons approved by the PRA and/or FCA as holding Senior Management Functions ('SMFs'), including approved NEDs;
- all persons defined as KFHs and notified to the regulator;
- all persons defined as standard NEDs and notified to the regulator; and
- all persons defined as holding a Certification Function.

There is an annual certification exercise completed to demonstrate compliance with the GGF, which includes the Fit and Proper Policy, and the system of internal control.

### B.2.1 Fit and proper criteria

All individuals to whom the Fit and Proper Policy applies fulfil the following requirements:

- competence and capability, i.e. that they have the necessary skills to carry out the function they are to perform;
- financial soundness; and
- propriety, including adherence to conduct rules.

There are five conduct rules which apply to all staff:

- acting with integrity;
- acting with due skill, care and diligence;
- being open and cooperative with regulators;
- paying due regard to the interest of customers; and
- observing proper standards of market conduct.

There are an additional three conduct rules that apply to SMFs, requiring Senior Managers to:

- take reasonable steps to ensure that the business of the firm within the function is controlled effectively;
- take reasonable steps to ensure that the business of the firm within the function complies with relevant regulatory requirements and standards; and
- ensure that where responsibilities are delegated, the delegation is to an appropriate person and is effectively overseen.

There is a further rule which applies to SMFs and NEDs, requiring any information of which the PRA or FCA would reasonably expect to be notified, to be appropriately disclosed.

### B.2.2 Fit and proper assessments

The Company has processes for assessing the fitness and propriety of persons covered under the Fit and Proper Policy, in order that:

- during the recruitment phase and before any regulatory application is made an assessment of the person's fitness is conducted, including:
    - professional and formal qualifications;
    - knowledge and relevant experience;
    - basic criminology disclosure ('DBS') check;
    - credit check; and
    - regulatory references.

- the ongoing fitness and propriety of relevant individuals is assessed (at least annually), including:
    - self-disclosure questionnaires;
    - sample DBS/credit checks (ensuring full coverage on a rolling three year cycle);
    - an assessment of competency and capability to fulfil role; and
    - an assessment of compliance with the conduct rules.

The Company will notify the PRA and FCA of any change in the fit and proper status of SMFs (including, should instances arise, where individuals have been replaced because they are no longer fit and proper), and of any breaches to conduct rules by SMFs and certified individuals.

## B.3 Risk management system including the Own Risk and Solvency Assessment

### B.3.1 Risk governance, culture and the risk management cycle

Risk is defined as the uncertainty the Company faces in successfully implementing its strategies and objectives. This includes all internal and external events, acts or omissions that have the potential to threaten the success of the Company or the interests of its customers. Material risks will be retained selectively where there is value to do so, and where it is consistent with the Company's and wider Group's risk appetite and philosophy towards risk-taking.

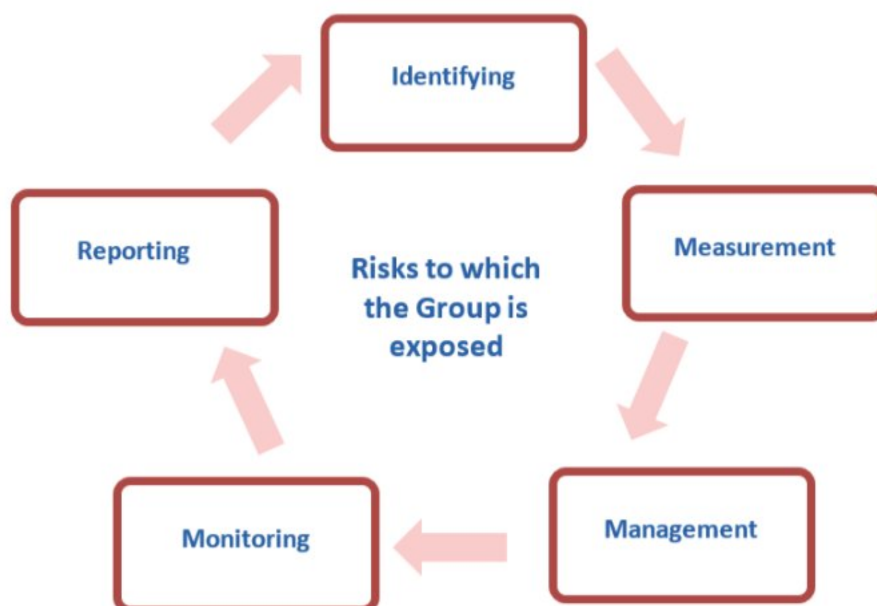
The Board has ultimate responsibility for risk across the Company.

To assist the Company's Board in discharging its responsibilities, the Group has implemented a comprehensive approach to identifying, measuring, managing, monitoring and reporting risks ('the risk management cycle'), supported by an embedded risk culture and strong risk governance. This is set out in the Group's RMF.

The Group's RMF is designed to manage risk within agreed appetite levels which are aligned to delivering the Group and Company strategy for shareholders and customers.

The key components of the Group RMF are described below.

**Figure 15: Risk Management Cycle**




## Risk culture

Culture is a strategic priority of the Board, which recognises the importance of good culture in the way that the Company does business. Risk culture is a subset of broader organisational culture, which shapes the organisation-wide values that are used to prioritise risk management behaviours and practices.

The responsibility for instilling an appropriate corporate and risk culture within the Company lies with both the Group and Company Boards which, together with senior management, promotes a responsible culture of risk management by emphasising and embedding the importance of balancing risk with profitability and growth in decision making, and providing fair customer outcomes, whilst also ensuring compliance with regulatory requirements and internal policies.

To help embed this culture, the Group Board sets and approves:

- risk appetite and associated risk mandates and limits, determining how these are then delegated or cascaded to the Group's subsidiaries, including the Company, and/or individuals to execute;
- the RMF and supporting risk policies; and
- assignment of responsibilities for controls and reporting.

The Company's performance management and reward structure balances risk with profitability and growth, in the performance evaluation of key individuals, including both senior management and those directly responsible for risk management.

## Risk committees

The Company's risk governance comprises the organisational structures, reporting relationships, delegations of authority, roles and responsibilities, and risk policies that have been established to influence and oversee decisions and control activities on risk-related matters. This encompasses individuals, key functions and committees involved in the management of risk.

The Company's risk governance structure is led by the BRCC, the three members of which are independent NEDs. The BRCC assists the Board in providing leadership and oversight of the Company's overall risk appetite in addition to guidance on risk tolerance and strategy. The Committee oversees and advises the Board on the current and potential future risk exposures of the Company, ensuring compliance with the RMF, monitoring its effectiveness and adherence to the various risk policies. The BRCC also supports the Board and management in embedding and maintaining a supportive culture in relation to the management of risk.

In addition, there are various executive risk forums to ensure risk issues are considered and escalated appropriately. In particular, the M&G plc Executive Risk Committee ('ERC'), which is a sub-committee of the M&G plc Executive Committee, has the following objectives:

- to provide oversight on risk and compliance matters across the M&G plc Group;
- to support the Executive Committees of M&G plc and the regulated entities, including the Company, in meeting their responsibilities and to assist the CRRO in relation to risk management and compliance matters;
- to assist the DPPR in the oversight of their regulatory compliance responsibilities;
- to assist the Chief Risk Officers ('CROs') and Chief Compliance Officers ('CCOs') of the M&G plc regulated entities, including the Company, in relation to risk management and compliance matters; and
- to oversee the approach to and direction of risk management including regulatory compliance across M&G plc.

The membership and structure of the ERC is segregated by Group and principal subsidiaries, including the Company, which enables separate oversight, discussion and approval of specific matters relevant to the Company and appropriate management of potential conflicts of interest. Matters are escalated to the M&G plc Board Risk Committee and, for matters relevant to the Company, to the BRCC by the Committee's Chair, the CRRO, if appropriate to do so.

The system of internal control, including risk management, is based on the principles of 'Three Lines of Defence' ('3LOD'): 1) risk taking and management, 2) risk oversight, and 3) independent assurance.

**Figure 16: Three Lines of Defence**

| Line of Defence: | 1LOD | 2LOD | 3LOD |
|---|---|---|---|
| Business Area: | Business | Risk & Compliance | Internal Audit |
| Responsibility: | Risk Taking and Management | Risk Oversight and Challenge | Independent Assurance |
| Activity: | • Identify, own, manage and report risks<br>• Execute business plan and strategy<br>• Establish and maintain controls<br>• Stress / scenario modelling<br>• Operate within systems and controls<br>• Ongoing self-assessment of control environment effectiveness | • Owner of Risk Framework<br>• Stress / scenario setting and oversight<br>• Regulatory liaison<br>• Advice and guidance<br>• Risk and Compliance monitoring and assurance activities<br>• Risk and Compliance reporting | • Independent assurance of 1LOD and 2LOD<br>• Independent 3LOD thematic reviews and risk and controls assessment |

Business areas take and manage risks within the limits proposed by Risk and approved by the Board.

Risk and Compliance functions are structurally independent of the 1st Line, providing risk oversight and challenge and compliance guidance and monitoring.

Internal Audit is empowered by the BAC to audit the design and effectiveness of internal controls, including the risk management system.

### Risk categorisation and policies

The RMF is structured around a set of defined risks which serves as a reference point for the Group-wide application of the risk management cycle, in terms of risk policies, standards, risk appetite statements, limits and controls. Risk categories are prescribed at a minimum of two levels across the risk universe, and are consistent with the set of model inputs ("risk drivers") used in the Solvency II Internal Model. Risk policies are in place for all material risk categories.

Risk policies set out specific requirements to be applied in the management of each risk type. Policy requirements are typically principles based, and seek to address fundamental concepts rather than operational procedures. This allows business users to determine how to comply with the requirements in the most appropriate way for their part of the business commensurate with the level of risk. Risk policy requirements are attested to as part of the GGF and RMF annual attestation exercise.

**Risk appetite and limits**

The Group's risk appetite and tolerance to take on risk is specified through risk appetite statements and limits that are aligned to, and reviewed with respect to, its business model and strategy. Risk appetite is the amount and type of risk the Group, including the Company, is willing to accept in pursuit of its business objectives.

The Group has established aggregate risk appetite statements and limits for capital (regulatory and economic), liquidity and dividend volatility. The capital risk appetite is supported by a solvency intervention ladder which sets out management actions for implementation or consideration at different levels of regulatory solvency. Both the Group and the Company's expected ability to stay within appetite is assessed during the annual business planning process, with the actual position monitored and managed regularly throughout the year.

Risk appetite statements and accompanying financial limits are also in place for significant individual risks, including a comprehensive Group Approved Limits Framework ('GALF'). In combination, the individual appetite statements and limits are set such that the Group operates in line with the aggregate approved risk appetite statements and limits. The GALF sets specific limits for the Company where appropriate to do so.

Risk exposures are monitored against appetite, both at individual and aggregate level, to ensure compliance with the GALF which, together with limit utilisation, form a core element of risk reporting to Board and Executive Risk Committees. Prescribed forward looking indicators are used to help inform whether a risk may move outside of limit together with appropriate management actions. An imminent or actual breach of a limit is escalated to the CRRO within 24 hours of identification.

**The risk management cycle**

As set out in Figure 15, the risk management cycle is the ongoing process of identifying, measuring, managing, monitoring and reporting the risks to which the business is exposed.

(i) Risk identification

Risk identification is derived through a number of processes, in particular the annual top-down, emerging and bottom-up risk identification processes supported by an annual exercise of stress and scenario testing to assess the magnitude of risks. Each of these is designed to identify and assess risk from a different perspective to form an overall understanding of the Company's risk profile and how it has and is expected to evolve.

(ii) Risk measurement

Risks are measured using appropriate metrics as defined in the setting of risk appetite limits and indicators. Point-in-time measures are supplemented by quarterly sensitivities and stress and scenario testing. Reverse stress testing is also used to provide management with information on the resilience of the Company's balance sheet and sustainability of its profitability.

Operational and organisational risks, including reputational risk, are less easily quantifiable; however a risk incident ("Notifiable Events") process is in place to ensure that risk events are identified, assessed and managed in a timely manner. For all material incidents (whether losses, gains or near misses), a lessons learnt exercise is carried out.

(iii) Risk monitoring

Risk monitoring is an ongoing process to track the status of risks and is undertaken by both risk owners and through oversight and assurance activities undertaken by the Risk, Compliance and Internal Audit functions (for example, limits and transactions monitoring, assurance and lessons learned reviews, model validation reviews, risk deep dives and regulatory compliance monitoring).

(iv) Risk management

Risks are evaluated, treated and managed against the defined risk appetite limits and indicators in order to establish whether the business is operating within risk appetite. Where risk appetite is exceeded, or close to being exceeded, management are expected to take action to appropriately treat the risk through mitigation, transfer, or avoidance, or to formally accept the risk. Key investment decisions and projects are subject to detailed risk reviews and go/no go decisions which fully consider all relevant risks and Risk and Resilience's risk opinion. The resilience of the business and its ability to respond to and recover from major incidents is also regularly tested.

(v) Risk reporting

To ensure timely and appropriate decision making, the Board, its committees and senior management are provided with accurate and timely risk reports and management information, including:

- regular management information driven off and aligned to the top-down risk identification process, prepared by the Risk function on behalf of the CRRO, which is presented to the ERC and BRCC to enable oversight of such risks on an ongoing basis; and
- Own Risk and Solvency Assessment ('ORSA') reporting, further details of which are contained in Section B.3.4.

Further information on the management of significant risks to which the Company is exposed is set out in Section C.

### B.3.2 The Risk function

Within the 3LOD model, the Risk function (known internally as 'Risk and Resilience') is part of the 2$^{nd}$ LOD and is responsible for risk oversight. The Risk function assists the Board to formulate and implement the approved GALF, risk management plans, risk policies, risk reporting and risk identification processes. Whilst the 1$^{st}$ Line has responsibility for risk-taking, this is constrained within clear parameters set by Risk. The Risk function also monitors and assesses the risk taking activities of the 1$^{st}$ Line, challenging, where appropriate, the actions taken to manage and control risks and approving any significant changes to controls.

The Risk function's responsibilities include, but are not limited to:

- coordinating the identification and assessment of key risks to establish the risk profile used as a basis for setting qualitative risk appetite statements and quantitative limits, and the management information received by Risk Committees and the Board;
- independently monitoring and reporting that risk exposures are managed within appetite and limits and in line with specified parameters and policies, with regular Risk MI, including on Top Risks, to relevant Boards and Committees;
- providing overall coordination and oversight of risk management processes and systems;
- supporting the Board and management in embedding and maintaining a supportive culture in relation to risk management;
- testing the Group's internal controls and procedures for financial reporting;
- overseeing that the development of the Internal Model is within the framework of model governance and remains fit for purpose;
- providing input and review of public and regulatory disclosures, such as the SFCR;

- performing the ORSA, risk assessing the business plan, undertaking stress and scenario testing including Reverse Stress Testing, and informing the key areas of risk based decision making;
- developing and implementing an enhanced resilience framework (covering financial, organisational and operational resilience) to enable the Group to respond to and recover from changing internal or external circumstances, or during and after crises (whether unforeseen or not); and
- considering material findings from regulatory reviews and interactions with regulators which impact on risk governance or risk management processes.

In order to fulfil these responsibilities, the Risk function liaises with other functions (including Actuarial, Internal Audit and Compliance), to provide technical expertise and advice throughout the risk management cycle. The Risk function is also subject to an annual effectiveness review which is discussed at the BRCC.

### B.3.3 Internal model

The Solvency II Internal Model is a key risk management tool and refers to the systems and processes used to identify, monitor and quantify risks for the purpose of calculating the Solvency II capital requirement (‘SCR’, ‘Pillar I’) and management's own assessment of economic capital (‘ECap’, ‘Pillar II’) requirements.

To ensure that the Internal Model is, and continues to be, suitable to support this assessment of risk and capital, the Company has implemented a governance and control framework in relation to:

- **model use:** to provide assurance that the model is widely used in the business, playing an important role in the system of governance and decision-making processes;
- **model change:** where changes to the Internal Model are required (e.g. adjustments, enhancements), these are implemented in a consistent and controlled manner with consideration of any potential implications;
- **model limitations, assumptions and judgements:** to note the circumstances under which the Internal Model does not work effectively, including where assumptions and judgements are made, making sure these are reasonable and understood by those who may rely upon any model output; and
- **model validation:** to confirm that the capital requirements resulting from the Internal Model remain appropriate and provide assurance as to the reliability of the Internal Model to senior management and the Board. The Internal Model Validation (‘IMV’) team within the Risk function provides independent assurance that the Internal Model remains fit for purpose and compliant with all applicable rules through a risk-based programme of assurance activity, which also acts as an incentive for the model’s ongoing improvement.

In advance of the demerger, the Internal Model governance framework was reviewed to ensure it remains appropriate for the Group and its insurance subsidiaries, including the Company. This formed part of the 2019 Major Model Change application which was approved by the PRA in October 2019.

This model governance framework is implemented in accordance with the Internal Model Risk Policy which, in turn, is aligned with the relevant requirements of the Solvency II Directive. Further policies, operational standards and governance committees support the application of the Internal Model Risk Policy. The model governance framework is being rolled out to a wider universe of key models and user developed applications (‘UDAs’) through the implementation of a new Model and UDA Risk Policy.

The Internal Model Governance Oversight Committee (‘IMGOC’) and the Technical Actuarial Committee (‘TAC’) have responsibility for ensuring that the Internal Model is, and continues to be, suitable to support the assessment of risk and capital and that it complies with all regulatory requirements. The IMGOC is responsible for overseeing the use and independent validation of the Internal Model. The TAC is responsible for reviewing and approving the methodology, and assumptions for the Internal Model, including any changes to the model. The IMGOC and TAC report to the ERC, which is chaired by the CRRO. The CRRO reports to the Board as necessary on matters relating to the Internal Model.

During 2019, as part of demerger, the remit of the IMGOC and TAC was broadened to include Group-level governance responsibilities including, for example, the validation of the consolidated Group SCR.

### B.3.4 Own Risk and Solvency Assessment

The ORSA is the Company's ongoing process for identifying, assessing, controlling, monitoring and reporting the risks to which the business is exposed, and of assessing the own funds necessary to ensure that the Company's solvency needs are met at all times. Risk appetite and limits are the key controls that apply on the current and future risk profile, as a result of the Company's strategy and business plan and ensure that the Company complies with its solvency requirements on a continuous basis under a reasonable range of scenarios. This process is documented and evidenced through an ORSA report. The entirety of the ORSA processes are undertaken at least annually with a subset (in particular, those making up the risk management cycle) performed on a continuous basis as part of normal day-to-day risk management activity.

An ad hoc ORSA may be triggered by a material change in the Company's risk profile. Circumstances which could trigger an ad hoc ORSA are set out in the ORSA standards and include: a significant change in market or liquidity conditions; a significant operational incident; a new material risk exposure; and a significant business decision (e.g. change in business strategy, sale or acquisition of a business). Where a trigger is activated, the CRRO will decide on which ORSA processes are required to be performed and reported, including whether a revised ORSA Report, or equivalent, is required.

The ORSA report includes a current and forward looking assessment of both the capital and solvency position as well as the risk profile of the Company providing the means to understand the links between strategy, risk and capital. It combines the analysis performed by, and the outcomes of, the ongoing risk and capital management processes that are embedded and which have been reviewed by various committees, including the ERC and BRCC. It also provides a quantitative and qualitative assessment of the Company's risk profile and solvency needs on a forward looking basis incorporating the Company's strategy and business plan, including appropriate stress tests. The scope of the ORSA report covers all the known risks of the Company.

The Risk function is responsible for the preparation of the ORSA report with input from key stakeholders as set out in Figure 17 below. Embedding of the ORSA drives the top-down understanding of risks to the Company and ensures the central focus of the Internal Model in decision making.

**Figure 17: High level overview of ORSA responsibilities**

| Stakeholder | Roles/ Responsibilities |
|---|---|
| Board | Steer and challenge throughout the ORSA process; approve the ORSA report. |
| BRCC | Review of the ORSA and recommendation to the Board for approval. |
| ERC | Review of the ORSA prior to submission to BRCC and the Board. |
| CRRO | Ownership of the ORSA report. |
| Risk | Preparation of the ORSA report, in collaboration with functional areas. |
| Finance | Preparation of quantitative inputs to the ORSA report. |

## B.4 Internal control system

### B.4.1 Overview

The Company's system of internal control, as set out in the GGF, has a key role in the management of risks that are significant to the fulfilment of its business objectives. The purpose of the internal control system is to set the parameters and procedures that ensure the effectiveness and efficiency of operations, the reliability of reporting (both internal and external) and that help deliver the business

strategy in a controlled way, meeting regulatory and other requirements. The key elements of the internal control system are:

- **Matters reserved for the Board:** approval of strategic decisions, subject to the GGF, including approving the Company's risk strategy, together with the setting of risk appetites and tolerances, is reserved for the Board;
- **Management/Delegated Authority:** the Company is managed in accordance with the authority delegated by the Board;
- **Lines of Responsibility:** Senior Managers have clearly defined lines of responsibility for their function and delegated authority;
- **Appropriate Recording:** transactions are appropriately recorded to permit the preparation of reliable financial statements;
- **Financial Reporting Control Procedures and Systems:** the internal control over financial reporting environment includes procedures and systems which are regularly reviewed;
- **Protection of Assets:** the assets of the Company are appropriately protected;
- **Financial Crime (Fraud and Money Laundering):** financial crime is prevented or detected; and
- **Risk Management:** the risks to which the Company is exposed are identified and managed.

The Company's system of control largely follows the approach previously adopted under Prudential plc's GGM. However, a new integrated control framework, supported by an industry-leading Governance, Internal Audit, Risk and Compliance software, is in development with the aim of implementing a single, consistent enterprise-wide control framework with enhanced analytics.

The Board has delegated authority to the BAC to review the framework and effectiveness of the systems of internal control. The BAC is supported in this responsibility by the assurance work carried out by Internal Audit, Risk and Compliance.

### B.4.2 Compliance function

Like the Risk function, the Compliance function is structurally independent of the 1st Line. It provides dedicated support for and coordination of regulatory interactions across the business. The function also provides guidance, advice and feedback on regulation (current and future developments), as well as setting and advising on compliance standards. Routine monitoring and deep dive activities are carried out to assess compliance with regulatory principles, rules and expectations. The Compliance function reports to the DPPR, with the annual Compliance Plan and required resources agreed by the BAC.

The GGF includes the Regulatory Compliance Risk Policy and Conduct Risk Policy, which set out the principles and minimum requirements by which the Company conducts its business including the management of any conflicts of interest. Compliance policies were updated as part of the creation of the GGF and RMF for demerger and are reviewed and attested to annually.

The policies support the implementation of the Group's risk management principles to:

- have an effective risk culture, promote appropriate conduct and deploy adequate and appropriate training, skills and resources in respect of regulatory compliance risk management;
- maintain an appropriate and transparent organisational structure with clear allocation of responsibilities and delegated authorities for the management of regulatory compliance risk;
- operate an effective risk management cycle to identify, measure, manage, monitor and report on regulatory compliance risks on an on-going basis;
- embed conduct risk management within the culture and thinking of all employees; and
- maintain a business that is compliant with applicable laws and regulatory rules and principles, such as Treating Customers Fairly and FCA principles for business.

The policies include requirements to:

- treat customers fairly, openly and honestly;
- provide and promote a range of products and services that meet customer needs, are easy to understand and that deliver real value;

- maintain honest, constructive and open relationships with governments and regulators to ensure mutual trust, respect and understanding;
- comply with all applicable laws, rules and regulations in every country in which the Company operates;
- accept responsibility in all its activities for compliance with the spirit as well as the letter of all applicable laws, rules and regulations;
- act with due skill, care and diligence;
- ensure that an effective compliance culture thrives and operates at all levels of the business; and
- maintain appropriate means of identifying, assessing, managing and reporting regulatory compliance risks within the Company and on an aggregated basis across the Group.

## B.5 Internal Audit function

Internal Audit operates as the 3rd Line of Defence in the 3LOD model, providing independent assurance to the Board and Executive management on the adequacy of the design and effectiveness of the organisation's systems of internal control, including risk management, governance and operational processes, thereby helping the Board and Senior Management protect the assets, reputation and future sustainability of the organisation.

Internal Audit activity is not restricted in scope in any way and is empowered by the BAC to audit all parts of the Company and has full access to any of the organisation's records, physical properties and personnel. All employees are requested to assist Internal Audit in fulfilling its roles and responsibilities. In executing its responsibilities, Internal Audit adheres to:

- the Institute of Internal Auditors requirements as set out in the Institute of Internal Audit's 'Code of Ethics' and 'International Standards for the Professional Practice of Internal Auditing';
- the Chartered Institute of Internal Auditor's revised guidance, 'Effective Internal Audit in the Financial Services Sector' ('CIIA Code');
- the International Association of Insurance Supervisors ('IAIS') Core Principles and the European Confederation of Institutes of Internal Audit ('ECIIA'), effective in 2019, prescribing the principal requirements for Internal Audit functions in Insurance Companies under the Solvency II framework;
- the requirements for Internal Audit functions set out in the Solvency II Directive 2009/138/EC (Level 1 text) Article 47 and Delegated Regulation (EU) 2015/35 (Level 2 text) Article 271; and
- the requirements of the Senior Managers and Certification Regime ('SMCR') and the Group's Fit and Proper Policy.

Internal Audit maintains independence and objectivity in the discharge of responsibilities and appropriate reporting lines are in place to support this goal:

- in accordance with the Internal Audit Charter, the Company has an Internal Audit team, led by the Prudential UK Audit Director who reports to the Chief Audit Officer ('CAO') as functional head, and has direct access to the Chair of the BAC. The CAO will consider the independence, objectivity and tenure of the Prudential UK Audit Director when performing their appraisals;
- the Prudential UK Audit Director reports audit related matters to the BAC and communicates directly with the Committee through attendance at its meetings. In addition, the Prudential UK Audit Director is invited to private sessions with the Committee members on a regular basis to discuss coverage and any restrictions on Internal Audit's work, as well as engaging in regular dialogue with the BAC Chair outside of the formal Committees to discuss upcoming meetings and the risk and control landscape;
- the Prudential UK Audit Director is empowered to attend and observe all or part of the Company's Executive Committee and Board meetings and any other key management decision making committees and activities as appropriate;
- the Head of Operations and Quality Assurance, who is independent of the Prudential UK audit team, monitors and evaluates the function's adherence with all relevant Internal Audit standards of practice and audit methodology. The results of these assessments are presented directly to the M&G plc Audit Committee. An independent external assessment of the Internal Audit function is performed every 5 years in line with Internal Audit standards;
- the assessment of the adequacy and effectiveness of the Risk, Compliance and Finance functions is within the scope of Internal Audit. As such, Internal Audit is independent of these functions and is neither responsible for, nor part of, them;

- all Internal Audit personnel exhibit the highest level of professional objectivity in carrying out their duties, make a balanced assessment of all relevant circumstances, remain impartial and seek to avoid any professional or personal conflict of interest. Internal Audit has no direct operational responsibility or authority over any business activity or personnel outside of the function; and
- like all areas, Internal Audit maintains a conflicts of interest register. Potential conflicts are recorded and monitored by the Head of Operations and Quality Assurance, including a quarterly review of reported conflicts to assess appropriate management oversight.

## B.6 Actuarial function

The Chief Actuary for the Company, which is a PRA SMF role under the new SMCR, is also the Actuarial Function Holder for the Company. The Chief Actuary team within the Risk function, and specified individuals within the wider business, are responsible for carrying out the tasks of the Actuarial function on behalf of the Chief Actuary.

The need for, and the scope of, the Actuarial function is defined in Article 48 of the Solvency II Directive. This sets out the tasks that the Actuarial function is responsible for. In addition to the tasks defined in Article 48, the CRRO, as the head of Risk and Resilience, has delegated a number of the risk management responsibilities to the Chief Actuary, in particular, oversight of the calibration and calculation of the SCR. This ensures that the Actuarial function is embedded in the key stages of the risk management system in relation to the calculation of capital requirements. The primary activities undertaken by the Actuarial function to meet its responsibilities are summarised below.

**Valuation of technical provisions**

The Finance function proposes the valuation methodology and assumptions, and calculates the technical provisions. The Chief Actuary reviews the valuation methodology and assumptions, the models and data used in the calculation of the technical provisions and the resulting technical provisions and advises the BAC and BRCC accordingly. The report to these committees constitutes a component report of the overall Actuarial Function Report.

**Underwriting**

The Chief Actuary reviews and advises on all aspects of the underwriting arrangements on an ongoing basis. In addition, the Chief Actuary carries out an annual review of such arrangements focusing on different aspects each year, depending on previous reviews, recent business activities and any particular issues that he wishes to review further. The Chief Actuary provides an annual report to the BRCC expressing an opinion on the underwriting policy, identifying any deficiencies and providing recommendations. This constitutes a component report of the overall Actuarial Function Report.

**Reinsurance arrangements**

The Chief Actuary reviews and advises on the reinsurance arrangements on an ongoing basis. In addition, the Chief Actuary carries out an annual review of the reinsurance policy, focusing on different aspects each year, depending on previous reviews, recent business activities and any particular issues that he wishes to review further. The Chief Actuary provides an annual report to the BRCC expressing an opinion on the adequacy of the reinsurance arrangements, identifying any deficiencies and providing recommendations. This constitutes a component report of the overall Actuarial Function Report.

**Capital requirements**

The Finance function proposes the valuation methodology and assumptions and calculates the SCR. The Chief Actuary reviews the valuation methodology and assumptions and the resulting SCR and advises the BAC and BRCC accordingly. The Chief Actuary also chairs the TAC, the internal management committee with responsibility for internal capital model methodology and assumptions.

**Actuarial function report**

The Actuarial function provides a written report to the BRCC, at least annually, to document the tasks that have been undertaken by the Actuarial function and their results, to identify any deficiencies and provide recommendations as to how such deficiencies should be remedied. This report summarises the tasks described above and highlights the key areas of focus following the Actuarial function's activities each year.

## B.7 Outsourcing

The Company continues to increase its outsourcing footprint, using outsourcing and third party solution providers to allow focus on its core business strengths, reduce costs and manage its delivery risks. The Company recognises that the use of outsourcing and third party solution providers can impact its risk profile, for example, a service may fail, resulting in significant business interruptions, poor customer outcomes, liability for losses and costs, reputational damage and regulatory breaches. The Company retains ultimate responsibility for any activity that is supplied or outsourced.

Outsourcing partners, in the UK, India and the USA, provide various business operations, including a significant part of the UK back office and customer facing operations as well as a number of IT support functions and investment operations. During 2019, the Company continued to deepen its strategic outsourcing relationship with Diligenta Limited for the provision of legacy policy administration services and with Tata Consultancy Services for IT hosting and infrastructure management services, whilst also entering into a new agreement with HSBC for the provision of fund accounting, custody and regulatory reporting for the Company's life funds. As a consequence of the demerger, certain key services, including those relating to data centres, are also now provided via Prudential plc to the Group under the terms of a Transitional Services Agreement. Intra-group outsourcers provide various services including fund management and portfolio management services.

A new Third Party Risk Management Policy is being implemented to strengthen the framework for managing third party risk across the Group. This addresses third party risks through a risk management lifecycle framework, including requirements to:

- consistently identify and categorise areas of third party risks;
- incorporate third party arrangements into strategic and operational business planning;
- consistently assess third party risks in line with applicable policies, standards and procedures;
- utilise scenario analysis to assess the impact and consequences of third party failures on operational resilience and continuing viability, with risk assessments linking the potential impact of risks to customer outcomes;
- monitor the third party risk profile relative to risk appetite;
- disclose applicable third party risks in financial reporting and to other relevant stakeholders; and
- regularly inform relevant Boards and Risk Committees of the aggregated third party risk profile, policy compliance and associated regulatory requirements.

The Third Party Risk Management Policy provides definitions of types of third party arrangement (e.g. supplier, outsourcer, intra-group, etc.) and materiality, along with minimum controls to manage them.

## B.8 Any other information

The Board confirms that there is an ongoing set of processes for identifying, evaluating and managing the significant risks faced by the Company, which has been in place throughout 2019 and up to the date of this report.

The Board has considered the outcome of the risk management and internal control effectiveness review for 2019 which covered all material controls, including financial, operational and compliance controls. The review identified a number of actions to further enhance the risk management system and strengthen the overall control environment to ensure their continuing effectiveness, with a particular focus on the Group's information technology controls and supplier risk management, including the robustness of the end to end controls following the outsourcing of the Company's life fund accounting. The Audit Committees at M&G plc Group and subsidiary level, including for the

Company, collectively monitor outstanding actions in these and other areas, and ensure sufficient resource and focus is in place to resolve such actions within a reasonable timeframe.

## C Risk profile

*(Unaudited)*

Under the Solvency II regime, companies are required to calculate capital requirements in line with Solvency II regulations. Companies are also required to form their own internal assessment of the capital needed to ensure that they can meet liabilities as they fall due, allowing for the risks that they retain ('ECAP', 'Pillar II'). For the Company, the Solvency II regulatory capital requirements are more prudent than the internal assessment.

The Company's Solvency II Pillar 1 valuation is produced for the Company as a whole (the regulatory basis). However, for internal business and risk management purposes, separate valuations are produced for the Company's shareholder-backed business and the policyholder-backed business in the with-profits fund.

The Company's Solvency II capital requirements are calculated using its Internal Model, which is based on the Group's assessment of the risks it faces.

The charts below show the undiversified SCR by risk category as at 31 December 2019 for shareholder-backed and policyholder-backed business. Detailed information on the SCR allocation is set out in Section E.2.

**Figure 18: Shareholder undiversified SCR as at 31 December 2019**

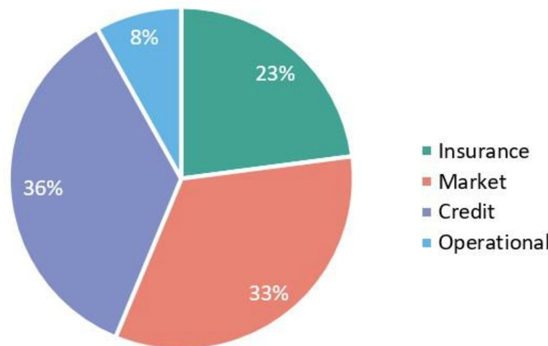
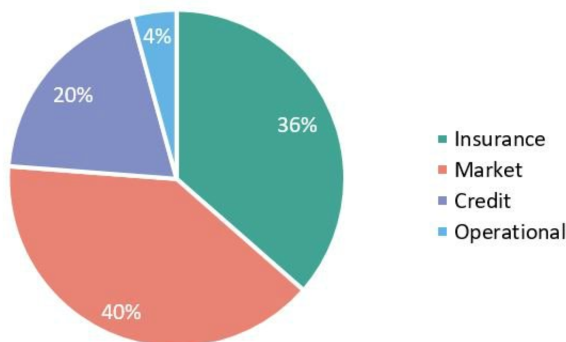



**Figure 19: With-profits fund undiversified SCR as at 31 December 2019**




The charts above show that the shareholder business has a proportionately greater exposure to credit risk, primarily arising from the holdings in fixed income investments held to back the annuity business. The with-profits fund has a higher proportionate exposure to market risk arising from the investments held in the with-profits business including a significant allocation to equities and property. The key risk exposures are discussed in the following sections:

- Underwriting risk, often described as insurance risk, which includes longevity, persistency and expense risk (refer to Section C.1);
- Market risk, which includes equity, interest rate and currency risks (refer to Section C.2);
- Credit and counterparty risk (refer to Section C.3);
- Liquidity risk (refer to Section C.4);

- Operational risk (refer to Section C.5); and
- Other material risks (refer to Section C.6).

In December 2018, the Company submitted a Major Model Change application, which was approved by the PRA and implemented on 30 June 2019. This model change covered the credit risk model and the deferred tax model. A further Major Model Change was approved by the PRA in 2019 as a result of the demerger of M&G plc from Prudential plc. This covered the reduction in scope of the Internal Model from the then Prudential plc Group to the new M&G plc group.

## C.1 Underwriting risk

### C.1.1 Risk exposure

The Company is exposed to longevity, expense and persistency risk as a result of its business operations, of which longevity risk is the most significant underwriting risk. The charts below set out the Company's exposures (as a % of the undiversified SCR) to each of these risks. Mortality and morbidity risk accounts for only c.2% of the SCR and so has been grouped under the longevity risk category.

**Figure 20: Shareholder undiversified insurance risk SCR as at 31 December 2019**

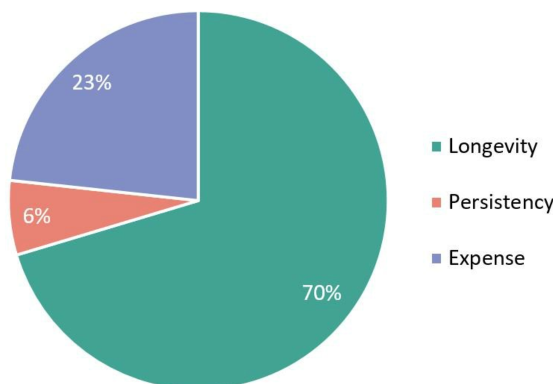
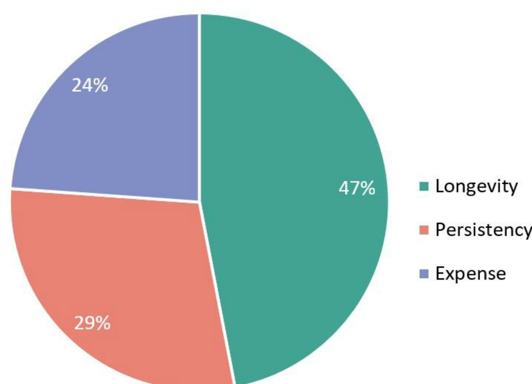



**Figure 21: With-profits fund undiversified insurance risk SCR as at 31 December 2019**




**Longevity**

Longevity risk i.e. the risk of unexpected changes in the life expectancy (longevity) of policyholders, arises primarily in relation to the Company's large in-force annuity book and is a material risk for both the shareholder-backed business and with-profits fund. However, the Company has materially reduced its shareholder exposure to longevity risk in recent years by entering into a number of reinsurance arrangements, including the 2018 reinsurance arrangement with Rothesay Life covering annuity liabilities of £12.4 billion (as at 31 December 2019).

The with-profits fund's exposure to longevity risk primarily, arises from non-profit annuity business and with-profits (deferred and immediate) annuity business. The longevity exposure increased by c. £1.1 billion during 2019 due to the recapture of business previously reinsured to Prudential Hong Kong Limited.

**Persistency risk**

The Company is also exposed to persistency risk, i.e. the risk of unexpected changes in policyholder rates of policy exit. The financial significance of this risk is expected to gradually increase in future years for the Company's shareholder-backed business, as a result of the planned growth in PruFund sales, with the shareholder exposure arising in relation to transfers from the with-profits fund. An increase in policyholder exits reduces the value of these transfers.

The with-profits fund is exposed to persistency risk, with the impact generally depending on the level of investment guarantees included in the products. Reductions in policyholder exits will tend to increase the expected costs of meeting obligations to policyholders, due to an increase in the number of policies remaining in-force with the potential for a guarantee to apply. However, in recent years new business sales volumes have been dominated by business without material guarantees.

**Expense risk**

The Company is also exposed to expense risk, i.e. the risk that expenses (including future expense inflation) could be higher than anticipated. However, this risk is expected to decrease as base costs are reduced as a result of the significant transformation programme being undertaken by the business (see section C.6.3).

For the with-profits fund, material volumes of non-guaranteed PruFund new business are anticipated in future years under the business plan. Expense charges are fixed for this business, meaning that expense risk for this line of business may become increasingly significant in the future. However, for the with-profits fund as a whole, expense risk is expected to remain broadly unchanged as the increase in expense risk from PruFund business is offset by the run-off of the in-force book.

### C.1.2 Risk mitigation

Longevity risk is predominantly managed through:

- detailed assessments of actual mortality experience which are used to determine best estimate assumptions;
- longevity research; and
- longevity reinsurance arrangements, assessed against principles and guidance provided in the Reinsurance Appraisal Framework.

Other underwriting risks such as persistency risk and expense risk are also subject to regular reviews and actions, with frequency and intensity proportionate to the materiality of the risk. Expense risk in particular is a key management focus, driven by the ongoing transformation programme.

Performing a number of longevity, persistency and expense stress tests also supports the Company's understanding of the key drivers of its underwriting risk exposure.

## C.2 Market risk

### C.2.1 Risk exposure

The Company is exposed to equity, property, currency and interest rate risk as a result of its business operations, of which equity risk is the most significant. The charts below set out the Company's exposures (as a % of the undiversified SCR) to each of these risks.

**Figure 22: Shareholder undiversified market risk SCR as at 31 December 2019**

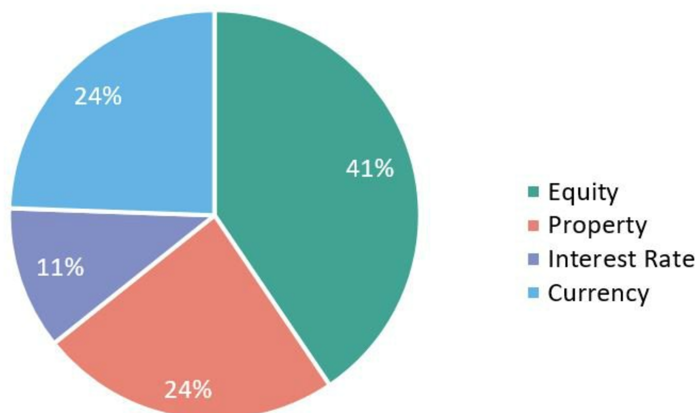
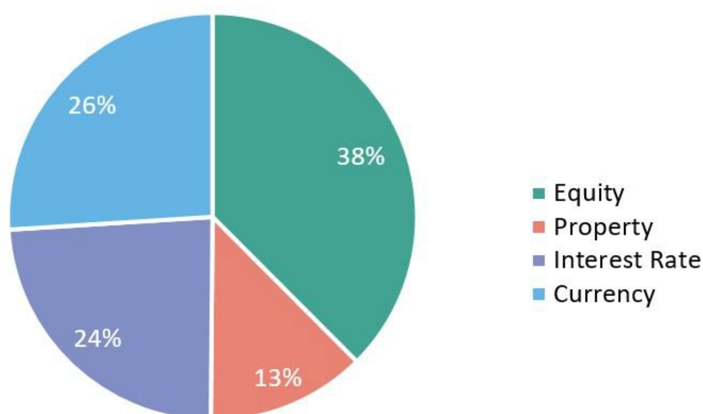



**Figure 23: With-profits fund undiversified market risk SCR as at 31 December 2019**




For the Company's shareholder business, the key sources of market risk are equity, property, interest rate and currency risks arising in respect of shareholder transfers from the Company's with-profits fund and also on surplus funds held in the shareholder fund. Additional market risk exposure includes interest rate risk and the property risk on the non-profit annuity book, the 'no negative equity' guarantee on lifetime mortgage loans, the value of management charges on unit-linked business and the risk of additional deficit funding contributions to the defined benefit staff pension schemes as the Company is responsible for ensuring such schemes (which are closed to new members) remain adequately funded to meet their expected future liabilities.

The Company's with-profits fund is also exposed to market risks as adverse changes in the value of the assets backing the policyholder asset shares may lead to an increase in the expected cost of policyholder guarantees. This risk is largely borne by the with-profits fund itself, though shareholder support may be required in extreme circumstances where the fund has insufficient resources to support the risk.

### C.2.2 Risk mitigation

A robust market risk framework (defined at the M&G plc level) supports the effective risk management of market risk and includes:

- a market risk policy, appetite statements and risk limits and triggers covering key market risk exposures (e.g. interest rate sensitivity);
- asset and liability management programmes, including monitoring of projected liability cash-flows to achieve close asset-liability matching;
- a quality of capital framework for the Company, which defines a set of principles for determining the optimal asset features to back components of the Company's shareholder balance sheet;

- a framework covering the triggering of an application to recalculate the Solvency II transitional measures on technical provisions (‘TMTP’), which mitigates changes in risk margin due to interest rates (amongst other factors);
- monitoring of the impact of market movements on solvency coverage relative to risk appetite;
- regular reviews of strategic asset allocations (‘SAAs’), investment and hedging strategies;
- use of derivatives to hedge equities, interest rates and currency risks where appropriate;
- regular stress and scenario testing to monitor and assess market risk exposures; and
- the use of limits set out in Investment Management Agreements (‘IMAs’) and Fund guidelines, which are subject to periodic review.

## C.3 Credit risk

### C.3.1 Risk exposure

The Company is exposed to credit risk relating to the substantial volumes of corporate bonds and other fixed income investments held in the asset portfolios backing the non-profit annuity business, on the surplus funds held in the shareholder fund and also in relation to the shareholder transfers from the with-profits fund.

There are also substantial volumes of similar assets held in the with-profits fund, the risk of which is largely borne by the with-profits policyholders (and the with-profits inherited estate, i.e. the assets in excess of that amount which the Company expects to pay out to meet its obligations to policyholders), but which can impact the Company by reducing the size of shareholder transfers and, in extremis, requiring capital support.

The Company is also exposed to counterparty risk arising from reinsurance and derivative counterparties, and from placing cash with counterparties.

Rothesay Life is a significant counterparty for the Company, reinsuring £12.4 billion (as at 31 December 2019) of annuity liabilities. An application to complete a Part VII transfer of these liabilities to Rothesay Life, which would substantially eliminate this counterparty exposure, has been rejected by the High Court. Rothesay Life and the Company have lodged an appeal against this decision, as discussed in Section A1.4.2.

The Company’s reinsurance counterparty exposure to Rothesay Life is fully collateralised with assets that must meet certain eligibility criteria and are held in a custody account.

### C.3.2 Risk mitigation

The Company operates a robust credit and counterparty risk framework (defined at the M&G plc level) which includes:

- policy, standards, appetite statements, limits and triggers (including relevant governance and controls);
- investment constraints and limits on the asset portfolios, in relation to credit rating, seniority, sector and issuer, via IMA, SAA and the Large Risk Approval Process;
- monitoring of current exposures in relation to appetite, limits and triggers and a range of forward-looking indicators, with reporting to and oversight by relevant Committees;
- investment constraints on counterparties in particular for derivatives, reinsurance and cash (Reinsurance Counterparty Framework, Large Risks Approval Process, Counterparty Rating and Limits Framework);
- robust credit rating processes;
- ad hoc deep dive reviews; and
- regular stress and scenario testing, with particular focus on the potential impact of higher than expected downgrades and credit spread widening.

## C.4 Liquidity risk

### C.4.1 Risk exposure

The Company is exposed to two types of liquidity risk:

- treasury liquidity risk is the risk of loss for the Company's business, or of adverse changes in its financial situation, resulting from its inability to generate sufficient cash resources to meet financial obligations (e.g. claims, creditors and other corporate costs as they fall due); and

- fund liquidity risk is the risk of being unable to meet liabilities arising from a mismatch in liquidity of the underlying assets and the frequency of liability requirements of the fund. This risk relates to third party funds managed on behalf of customers and clients.

While the Company is not directly exposed to fund liquidity risk, it is exposed to indirect effects of this risk materialising, such as an impact on persistency and reputation.

The Company is exposed to treasury liquidity risk through for example:

- higher than expected customer withdrawals or collateral requirements, and/or lower than expected market liquidity for assets in its with-profits and unit-linked funds;

- ineffective asset/liability matching or higher than expected credit defaults for non-profit annuity business, leading to a mismatch between cash received from the Company's investments and annuity payments to its customers; and

- higher than expected cash outflows from the shareholder business, e.g. due to tax or collateral requirements.

### C.4.2 Risk mitigation

Liquidity risk is managed through a robust Liquidity Risk Management Framework, including relevant governance and controls, which includes:

- liquidity risk policies, which set out the approach to the management of both treasury and fund liquidity risk. Compliance with the policies is the subject of an annual attestation process;
- a Liquidity Risk Management Plan;
- a Liquidity Contingency Plan, which sets out the procedures to be followed if a material liquidity risk event arises or is expected to arise;
- asset and liability management programmes, including monitoring of projected liability cash flows to achieve close asset-liability matching;
- quarterly monitoring of exposures, under base and stress scenarios, against specific triggers and limits for the with-profits, annuity and unit linked funds for a range of time horizons; and
- additional monitoring and controls to satisfy Solvency II matching adjustment requirements, including an annual reverse stress test exercise, and an Eligible Collateral Coverage Ratio, reported quarterly, which captures the increased risk that collateral requirements cannot be met due to matching adjustment constraints.

In addition, to manage liquidity risk in those unit-linked funds which may be inherently more illiquid, in particular property funds, deferral clauses are in place which allow the deferral of cash payments to withdrawing customers in extreme adverse liquidity scenarios. For the Company's subsidiary, Prudential Pensions Limited ('PPL'), this clause was utilised on its UK Property fund in 2019 due to the fund manager (M&G Real Estate) receiving a large number of redemption requests. Fund liquidity continues to attract internal and external (including regulatory) focus for the Company, the Group and the industry more generally.

### C.4.3 Expected Profit Included in Future Premiums

The Company is required to calculate and report the expected profit included in future premiums ('EPIFP') included within its own funds, in accordance with Article 260 of the Delegated Regulation. This calculation requires an assessment of the impact of an increase in insurance liabilities (excluding the risk margin) if future premiums relating to in-force business were not received, regardless of the legal or contractual rights of the policyholder to discontinue the policy. The calculation is carried out at the level of homogeneous risk groups, as defined in Article 35 of the Delegated Regulation.

At 31 December 2019, EPIFP was £76.4 million (2018: £45.4 million), the increase over the year being due to strong investment returns reducing the cost of guarantees and new business written, mainly PruFund.

## C.5 Operational risk

### C.5.1 Risk exposure

Operational risk is the risk of financial and non-financial impacts resulting from inadequate or failed internal processes, or from personnel and systems. Operational failures can also give rise to financial risk exposures, for example through process failures in the management of market and credit risk. Overall, the Company has no appetite for material impacts (direct or indirect), including non-financial impacts, suffered as a result of failing to develop, implement and monitor appropriate controls to manage such operational risks.

### C.5.2 Risk mitigation

The operational risk profile of the business continues to evolve in line with the Company's strategy and the business environment in which the Company operates. The Company manages and mitigates operational risk via the following methods:

- an operational risk framework and system that delivers processes and tools to identify, assess, manage and report operational risk exposures;
- establishment of additional policies and standards which cover specific operational risk exposures, such as third party risk and technology risk;
- internal and external incident lessons learned reviews;
- a comprehensive suite of operational risk management information and key risk indicators, including trend monitoring;
- corporate insurance programmes to limit the financial impact of operational risks;
- a scenario analysis process for determining operational risk capital requirements, which focuses on extreme, yet plausible events;
- regular testing of elements of the business continuity and disaster recovery plans;
- implementation of a new integrated control framework, a new product approval process and change management standards; and
- development and implementation of an enhanced operational resilience framework. This involves
  - defining key business services with articulation of the end-to-end process, and value chain of activities, which make up such services;
  - determining appropriate impact tolerances for the key business services;
  - enhancing the testing of such services to assess, and where necessary enhance, the ability of the services to withstand and absorb operational disruption; and
  - operating on the presumption that operational disruptions will occur, it is not 'if' but 'when'.

## C.6 Other material risks

### C.6.1 Business environment, environment and market forces risk

The key dimensions to business environment risk which could adversely impact the Company's ability to deliver its business strategy and have implications for the profitability of its business model, are economic, political, competition and Environmental, Social and Governance ('ESG').

**Economic factors:** Changes in global economic conditions can impact the Company directly; for example by leading to poor returns on investments and increasing the cost of guarantees the Company has made to customers. They can also have an indirect impact. For example, economic pressures could lead to decreased savings, reducing the propensity for people to buy the Company's products. In particular, in addition to the obvious human cost, consumers, businesses and governments are already counting the economic cost of the COVID-19 outbreak, necessitating governments across the world to intervene  with rescue and stimulus packages at unprecedented levels. The virus could not only impact global growth in the short term, but could lead to a sustained period of economic stagnation. Business continuity and resilience plans have been implemented to mitigate the impacts from the pandemic.

Global economic conditions may also impact on regulatory risk for the Company by changing prevailing political attitudes towards regulation.

**Political:** In contrast to the parliamentary stasis in 2019, the result of the recent General Election provides the government with a strong mandate to progress its agenda, including the UK's withdrawal from the EU. However, economic uncertainty will persist whilst the outcome of the UK/EU negotiations, notably the agreement or otherwise to a trade deal, remains unclear. There is a Brexit programme in place to identify and mitigate risks to the Company, including in the event of a no-deal outcome. More generally, global political risks look set to remain heightened, affecting consumer and market confidence, and potentially increasing market volatility and the risk of a downturn in economic activity.

**Competition:** The markets in which the Company operates are highly competitive with several factors affecting the Company's ability to sell its products and maintain its profitability. Key considerations include; price and yields offered; financial strength and ratings; investment performance and historic bonus levels; brand strength and name recognition; developing demographic trends and customers' needs and expectations in terms of product, delivery and service. Competition is expected to intensify in response to consumer demand, technological advances, the need for economies of scale and new market entrants. In particular, the emergence of advance technologies is providing an impetus for companies to rethink their existing operating models and how they interact with their customers.

**ESG:** Given the long term nature of the Company's investment horizons, it is potentially more exposed to the long term implications of climate change risks. A range of stress tests have been developed to assess the potential impacts of climate change on the business and help inform appropriate mitigating actions. In the short term, the Company's stakeholders increasingly expect responsible investment principles to be adopted to demonstrate that ESG considerations (including climate change) are effectively integrated into investment decisions, fiduciary and stewardship duties, and corporate values. The failure to have an appropriate ESG position could impact the Company's reputation and attractiveness to customers.

The annual strategic planning process, which is subject to oversight by the Risk function and Board, considers the potential impact of the wider business environment and, throughout the year, there is regular monitoring of and reporting on the delivery of the plan.

### C.6.2 Investment performance and risk

The investment objectives and risk profiles of funds are communicated to customers. A failure to deliver against these objectives (including sustained underperformance of funds), maintain risk profiles that are consistent with customers' expectations, or ensure fund liquidity profiles are appropriate for expected redemptions may lead to poor customer outcomes and result in fund outflows. If these risks materialise the Company's profitability, reputation and plans for growth may be impacted.

For investment risk, the Company has no appetite for fund risk profiles to be inconsistent on a persistent basis with the expectations communicated to customers. For investment performance risk, while accepting that in active management there inevitably will be periods where performance varies, the

Company has no appetite for a failure to deliver against the investment performance objective set for any of its funds over the investment horizon indicated to customers.

Investment performance and risk is not modelled in the Solvency II Internal Model, but is governed by the Group's Savings and Investment Risk Policy and a 3LOD risk model with clear responsibility and oversight of investment performance and risk in the respective Lines of Defence. This includes an Independent Risk and Performance area, reporting directly to the CRRO, and established oversight and escalation forums.

Funds are managed in line with prescribed mandates, with breaches of mandate and temporary exemption requests monitored by relevant committees, notably the Executive Investment Committee. The investment performance of key funds is regularly monitored and reported to senior management, and Executive and Board Committees.

Further information on the management of investment performance risk and investment risk is set out in Section C.7.4.

### C.6.3 Strategic risk/transformation execution

Strategic risk is the risk of loss to the business or failure to maximise opportunity resulting from the ineffective development or implementation of business strategy, including failing to implement appropriate customer propositions. Whilst the demerger from Prudential plc presents a significant opportunity for the Company to leverage scale, financial strength and complementary product and distribution capabilities as part of M&G plc, it also carries strategic risk.

In particular, there are a number of significant transformation programmes underway to deliver the strategy for growth, improve customer outcomes and strengthen resilience and the control environment. A failure to deliver these programmes within timelines, scope and cost may have a material impact on the Company's business model and ability to deliver the strategy.

Strong project governance is in place for all aspects of the transformation programme (including oversight by the Risk function) with reporting and escalation to management and the Board. There is a suite of metrics to monitor and report the delivery, cost and benefits of the transformation programmes, and regular deep dive assessments of the programmes, individually and collectively.

### C.6.4 Technology and security risk including data privacy

There is a high dependency on technology to operate effectively and to meet the growing digital needs of the Company and its customers. The sustained loss or unavailability of key hardware/software, inadequate information security arrangements and inappropriate deployment of digital solutions could result in an inability to meet requirements, leading to unfair customer outcomes, increased costs and/or regulator and reputational damage.

Cyber related risks, including attempts by external parties to disrupt, inappropriately access and obtain customer data and funds will remain an ongoing threat. As the Group, including the Company, increases its digital presence and profile, this risk will continue to be significant. Significant work and investment are ongoing to maintain, test and upgrade the IT environment, processes and controls to maintain IT resilience and the Company's ability to prevent, detect and recover from security incidents.

Data Privacy is also a key area of risk focus and a potential source of customer, regulatory and reputational risk. A range of activities are underway and planned to align, enhance and fully embed data privacy across the new Group, including the Company, in all the jurisdictions in which it operates.

### C.6.5 Proposition concentration

The key savings proposition, PruFund, accounts for a high proportion of the Company's total sales. This makes PruFund's continuing success important to the Company's business model and plans. Further, the Company is also heavily reliant on the intermediated channel for savings solutions sales.

The Company has launched a number of new products, including the PruFolio range of funds, to broaden the offering to customers and reduce concentration to PruFund. Work is ongoing to develop new propositions and expand into international markets to further reduce PruFund dependency over

time, and to deliver a more diversified distribution strategy through digital transformation. However, this will take time to significantly change the proposition and distribution mix.

### C.6.6 People risk

The Company's success is dependent on, among other things, the ability to attract, retain and develop highly qualified diverse professional people with the right mix of skills to support the strategy. As the Company continues to implement its transformation programme and deliver its target cost reductions, people risk is heightened in a number of areas including industrial relations, business stretch (especially key subject matter experts), employee well-being and morale and pay and benefit practices. Behavioural risk (including regulatory conduct risk) presents a growing challenge with the risk of employees deviating from expected behaviours requiring close oversight and management.

Competition for top talent is expected to remain intense, and the Company must continue to focus on the identification and retention of key individuals, and the succession planning for those individuals, within the context of the skills and experience the business requires to be successful in the future. Investment in leadership and manager development will be critical.

The GGF includes policies for Diversity and Inclusion, Employee Relations, Talent and Resourcing, Remuneration, and Performance and Learning, and there is regular reporting to management and Board covering, for example, the succession plans for critical talent, the management of industrial relations and the progress of initiatives around pay, culture and diversity.

### C.6.7 Reputational risk

Reputational Risk is a pervasive risk that can be triggered by any other key risks or in its own right. The Company's reputation is the sum of its stakeholders' perceptions, which are shaped by the nature of stakeholder expectations and the Company's ability to meet them. Consequently, there is a risk that through its activities, behaviours or communications, it fails to meet stakeholder expectations in ways which adversely impact trust and reputation. Failure to effectively manage reputational risk could therefore have an adverse impact on its revenues and cost base, its ability to attract and retain the best staff and could also result in regulatory intervention or action.

Reputational risk is a significant risk, arising not just from process failures but also from people's behaviours and from an inability to communicate effectively. The creation of the M&G plc as a standalone listed entity also increases the potential for scrutiny and reputational risk.

The Company is facing an increasing range and severity of reputational events. Furthermore, past and current decisions could pose reputational threats in the future. A number of factors mean that such pressures will increase, including the rising interest of customers, regulators or investors in ESG issues, and social media providing the means for opinions to be stated and shared instantaneously.

In recognition of this, the Group has developed a bespoke Reputational Risk Management Framework and established a dedicated Reputational Risk Team, reporting directly to the CRRO. Reputational risks are also required to be considered as part of all key business decisions.

### C.6.8 Regulatory compliance

The Company operates in highly regulated markets and interacts with a number of regulators, in an environment where the nature and focus of regulation and laws remain fluid. A number of national and international regulatory developments are in progress, with a continuing focus on solvency and capital standards, financial crime prevention, conduct of business (including fair customer outcomes and value for money requirements), data privacy and systemic risks. Changes in UK government policy, legislation (including tax), regulation or regulatory interpretation applying to the Company may adversely affect the Company's product range, distribution channels, capital requirements and, consequently, reported results and financing requirements. Such risks are heightened in a post-Brexit world as the UK potentially seeks to diverge from current EU regulations. There are also a number of ongoing policy initiatives and regulatory developments that are having, and will continue to have, an impact on the way the Company is supervised.

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

with applicable legislation and regulations is therefore of utmost importance. Significant progress has been made in closing historical regulatory issues including those identified through the Legacy Review and the Thematic Review of Annuity Sales Practices. However, the legacy book remains an area of considerable management and regulatory scrutiny.

The new Group structure itself also increases the risk of conflicts of interest (e.g. between asset owner and asset manager) and is a key focus for the regulators. As set out in Section B, the Board operates within the overall ambit of the GGF, which sets out the respective roles and responsibilities as between the Group and the Company and other Group companies, which allows for the appropriate management of potential conflicts of interest.

The Group has robust Regulatory Compliance, Financial Crime Prevention and Conflict of Interest Policies and a dedicated Compliance function, including a specialised Financial Crime Compliance team, to provide guidance to and oversight of the business in relation to regulatory compliance and conflicts of interest. The function carries out routine monitoring and deep dive activities to assess the delivery of fair customer outcomes and compliance with regulations, including anti-money laundering, and also monitors and responds to national and global regulatory developments.

### C.6.9 Group risk

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

Being a member of the wider Group can provide significant advantages for the Company in terms of diversification of risk, financial strength, technical expertise and management experience. It can also give rise to risks; for example, if the guarantee of financial support given by the parent were removed, or from particular transactions arising from an impaired affiliate within the Group.

The Company’s main intra-group exposures include its reliance on asset management services provided by M&G Group Limited, which is governed by IMAs, and a limited number of loans or guarantees provided by M&G plc to the Company, the largest of these being a parental capital support agreement.

The governance arrangements, risk management policies and processes, and internal control mechanisms within the Company ensure group risk is appropriately managed, including any potential conflicts of interest.

## C.7 Any other information

### C.7.1 Special Purpose Vehicles

There are no special purpose vehicles that fall into the definition under Article 211 of Solvency II Directive.

### C.7.2 Risk sensitivity

Stress and scenario testing is embedded in the RMF. It is performed in order to:

- assess the Company’s ability to withstand significant deterioration in financial and non-financial conditions;
- provide feedback to decision making processes by identifying areas of potential business failure;
- demonstrate to external stakeholders that the Company has adequate capital and liquidity levels;
- demonstrate that the Company has appropriate and plausible management actions available to cover potential losses incurred during extreme, but plausible events; and
- to assist in the monitoring of adherence to the Company’s risk appetite.

Stress tests are performed both with and without any allowance for the TMTP granted by the PRA being recalculated. Stress tests are performed separately for the Company's with-profits funds and shareholder-backed business.

To evaluate the Company's resilience to significant deteriorations in market and credit conditions and other shock events, the quantifiable risks facing the Company as described in the sections above are assessed via stress scenarios of varying severities. In addition, annually the Company derives a reverse stress test which gives the directors an understanding of the type and strength of scenario expected to result in business plan failure. The Company also maintains a Risk Appetite Framework which includes an assessment of the Company's ability to withstand a specified level of shock and still cover its solvency capital requirements.

Mitigating management actions designed to maintain or restore key capital, liquidity and solvency metrics to the Company's approved risk appetite are available to the Company in times of stress. As such, these actions will be available in the scenarios tested and will assist in maintaining the viability of the Company over the three-year plan period.

The methodology and assumptions applied to calculate the balance sheets in the stress scenarios are consistent with those applied when valuing the reported balance sheet, except that the movement in stressed own funds is calculated using the proxy models within the Solvency II Internal Capital Model rather than the full valuation models.

**Sensitivity Analysis**

The following estimated sensitivities of the Company Solvency II capital position are provided as an indication of the sensitivity of the surplus to economic stresses as at 31 December 2019.

**Figure 24: Solvency II sensitivities**

| | Shareholder Solvency | | With-profit Solvency | | Regulatory Solvency | |
|---|---|---|---|---|---|---|
| | £m | Ratio (%) | £m | Ratio (%) | £m | Ratio (%) |
| **Base surplus at 31 December 2019** | 3,057 | 159% | 7,628 | 267% | 3,057 | 131% |
| Impact of: | | | | | | |
| 20% instantaneous fall in equity markets | (452) | (7)% | (237) | (1)% | (452) | (4)% |
| 50 basis points reduction in interest rates | (128) | (6)% | 310 | (3)% | (128) | (3)% |
| 100 basis points increase in credit spreads | (502) | (7)% | (603) | (6)% | (502) | (4)% |
| 20% credit asset downgrades | (324) | (7)% | (204) | (7)% | (324) | (4)% |
| 20% instantaneous fall in property values | (366) | (6)% | (113) | (1)% | (366) | (3)% |
| | | | | | | |
| **Base surplus at 31 December 2018** | 3,691 | 172% | 5,458 | 231% | 3,691 | 140% |
| Impact of: | | | | | | |
| 20% instantaneous fall in equity markets | (297) | (4)% | (285) | (7)% | (297) | (3)% |
| 50 basis points reduction in interest rates | (99) | (6)% | 395 | 1% | (99) | (4)% |
| 100 basis points increase in credit spreads | (366) | (2)% | (557) | (9)% | (366) | (2)% |
| 20% credit asset downgrades | (352) | (8)% | (214) | (6)% | (352) | (4)% |
| 20% instantaneous fall in property values | (364) | (6)% | (149) | (3)% | (364) | (4)% |

A description of each sensitivity is as follows:

- The equity sensitivity reflects a 20% instantaneous fall in all global equity markets.
- The property sensitivity reflects a 20% instantaneous fall in all global property markets, including both residential and commercial exposures.
- The interest rate sensitivity reflects a 50 basis points reduction in the gross redemption yield on all fixed interest securities and the real yield on all variable securities. A 50 basis point

reduction in all points of all swap curves which form the basis of the valuation interest rates. The adjustment for credit risk is unchanged from that allowed for in the base results.

– In the credit spread sensitivity corporate bond yields for A rated investments have increased by 100bps. The yields for other corporate bonds have increased by a proportion of 100bps where the proportion is equal to the base spread for the relevant rating divided by the base spread for the A rated bonds. There is no change in gilt and approved security yields and there is no change to the default assumptions or ratings.

– The credit asset downgrade stress reflects a full letter downgrade on 20% of all assets for which the credit rating is a determinant of the capital requirements.

**Shareholder fund sensitivities**

The scenario assessments for the shareholder-backed business make no allowance for any management actions but do allow for recalculation of the TMTP.

The results from stress testing show that the Company's shareholder business remains exposed to market risks including through downwards interest rate movements, equity and property shocks, and to credit risk through downgrades in the credit portfolio and/or spread widening. The exposures largely arise in respect of the non-profit annuity business and the shareholder transfers. In practice, a number of these exposures could occur together.

However, consideration of the coincidence of risks through combined and reverse stress testing has shown that it would take a strong event (comprising simultaneous market and credit shocks) to reduce the capital coverage ratio below 100%. At 100% capital coverage, the Company would still have sufficient capital to withstand a 1 in 200 year event.

The Company' shareholder business is also exposed to insurance risks through, in particular, longevity and expenses.

**With-profits fund sensitivities**

The sensitivity analysis above allows for predetermined management actions but does not reflect all possible management actions which could be taken in future. The analysis allows for recalculation of the TMTP in each stress scenario.

The results from stress testing show that the Company's with-profits fund is also exposed to market risks through downwards interest rate movements and equity shocks, and to credit risk through downgrades in the credit portfolio and/or spread widening.

In practice, a number of these exposures could occur together. Consideration of the coincidence of risks through combined stress testing has shown that it would take an extremely strong event (comprising simultaneous strong market and credit shocks) to reduce the capital coverage ratio below 100%.

The Company's with-profits fund is further exposed to insurance risk through longevity, expenses and persistency.

A range of additional stress and scenario testing are also run as a matter of course to support understanding of the key drivers of the Company's material risk exposures.

### C.7.3 Risk concentration

The Company's review of significant risk concentration encompasses a review of its exposure to various balance sheet asset classes, individual counterparties, groups of interconnected individual counterparties, specific geographical areas, industry sectors and currencies.

The Company complies with the Group's Global Counterparty Limits Framework which limits significant concentration risks arising from various balance sheet asset classes. These asset classes are assigned a notional weighting derived to reflect the relative riskiness of each asset class.

The Company also has in place a process whereby invested credit and counterparty credit risk outside the scope of the Group's Limits is limited on a single name basis. Under this process, the CRRO's approval is required for the undertaking of new or additional exposure greater than predefined thresholds. These thresholds are defined for the Company and vary by asset class/counterpart exposure and by credit rating. Timebound exemptions from these thresholds may be approved by the CRRO based on the merits of the individual cases.

As at 31 December 2019, the four largest counterparties the shareholder-backed business had exposure to are:

- Rothesay Life;
- United Kingdom of Great Britain and Northern Ireland government;
- European Investment Bank; and
- Jetty Finance DAC.

As at 31 December 2018, the four largest counterparties the shareholder-backed business had exposure to were:

- Rothesay Life;
- United Kingdom of Great Britain and Northern Ireland government;
- United States of America; and
- HSBC Holdings plc.

As at 31 December 2019, the four largest counterparties the with-profits fund had exposure to are:

- United Kingdom of Great Britain and Northern Ireland government;
- Citigroup Inc;
- Banco Santander SA; and
- United States of America.

As at 31 December 2018, the four largest counterparties the with-profits fund had exposure to were:

- United Kingdom of Great Britain and Northern Ireland government;
- European Investment Bank;
- HSBC Holdings plc; and
- Federal Republic of Germany.

### C.7.4 Prudent Person Principle

The Prudent Person Principle requires that the Company only makes investments on behalf of customers that a "prudent person" would make. In order to comply with this principle, the Company has to be able to identify, understand, measure and monitor any risks arising from its investment portfolios, as well as demonstrate that it carries out these activities appropriately.

Risk factors relevant to investment strategy are detected via a number of different processes, principally through the Company's risk identification process. These risk factors are overseen under the Company's Investment Risk Oversight Framework, which ensures that the Company's investment risks are managed effectively and efficiently, and within risk appetite. The Framework focuses on the integrity and effectiveness of the investment processes, governance and controls, as well as appropriateness of resourcing and compliance of processes with applicable regulatory requirements (including the Prudent Person Principles set out in the Solvency II Directive).

The Company outsources investment management to both intra-group and external asset managers. That business is governed by a common governance framework. The following information provides details on the approach the Company applies to the Prudent Person Principle when making investment decisions:

- Group policies provide a group-wide framework for the oversight of financing and investment activities. They are designed to provide general, prudent and principle-based guidance for both shareholder-backed business and policyholder-backed business. In particular, they are designed to ensure that investment decisions are taken with appropriate cognisance and consideration of the risks involved, with clear sight of the customer outcome objectives, and robust challenge;

- the Savings and Investment Policy covers all aspects of overseeing investment risk across the Group, including for the Company, and includes minimum standards, controls and requirements for risk management. The framework is supported by further documents including specific policies that cover credit, market, insurance, liquidity, operational and investment risk as well as lower level operating standards and approved limits. From time to time, additional relevant risk factors may be identified through the Company's risk identification processes. These will be taken into account as appropriate depending on their nature, level of materiality and transience, and will be monitored through the Investment Risk Oversight Framework;
- the UK Investment Policy specifically sets out the group-wide framework for management and oversight of investment performance and investment related risk. It aims to ensure that all of the Group's entities, including the Company, have appropriate procedures in place to manage, monitor and report on the investment risk that they have taken on;

- the Dealing Controls Policy sets out the controls in relation to all trading operations, including the operational controls around derivative collateral management. The policy also sets out uniform controls across all asset classes (including non-listed and securitised investments) and clarifies the responsibility of business areas to ensure full compliance with all local regulations and requirements; and

- the Company oversees its asset managers through monitoring compliance with IMAs and investment mandates. These are structured in order to ensure that, in line with the Prudent Person Principle, appropriate activities for identifying, understanding, measuring and monitoring relevant risks are carried out. Where these activities are carried out on a delegated basis by an asset manager, the Company carries out due diligence to confirm that the level of compliance with the requirements of the Prudent Person Principle remains appropriate. The Company updates and maintains IMAs and investment mandates in line with changes in investment strategy.

The Company continues to review its Prudent Person Principle approach to ensure its ongoing adequacy in light of the PRA's recent consultation paper setting out the Regulator's expectations relating to a firm's investment strategy, investment risk management, and governance system.

## D Valuation for solvency purposes

This section provides a description of the bases, methods and main assumptions used in the valuation of assets (section D.1), technical provisions (section D.2) and other liabilities (section D.3) under Solvency II and an explanation of differences to values in the UK GAAP financial statements.

Recognition of assets and liabilities under Solvency II is the same as for UK GAAP, except for contingent liabilities which are recognised as liabilities under Solvency II if material. However, the measurement of these assets and liabilities can differ under the two metrics.

The 31 December 2019 Solvency II balance sheet incorporates no changes to the recognition of assets and other non-insurance liabilities, compared to the 31 December 2018 Solvency II balance sheet, other than in relation to Pension Benefit surpluses which prior to 31 December 2019 were assumed to be valued at nil rather than equal to their IFRS valuation. Further detail is set out in section D.3.2.2.

The 2019 balance sheet valued under both UK GAAP and Solvency II basis, together with a reconciliation of the key differences is summarised in Figure 25 below, whilst further details of the valuation of specific types of assets and liabilities is contained in sections D1 to D4.

**Figure 25: Solvency II and UK GAAP balance sheets for the year-ended 31 December 2019**

| | Statutory accounts - UK GAAP | Presentation differences (note a) | Ring-fenced funds (note b) | Other valuation differences (note c) | 2019 Solvency II | 2018 Solvency II |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| **Assets** | | | | | | |
| Deferred acquisition cost and intangible assets | 27 | | — | (27) | — | — |
| Investments (other than participations)[1] | 150,772 | (21,011) | 221 | | 129,982 | 140,104 |
| Participations | 5,498 | 17,201 | | (4) | 22,695 | 4,089 |
| Assets held for index-linked and unit-linked contracts | 14,427 | (6,516) | | | 7,911 | 7,765 |
| Loans and mortgages | 3,508 | 11,923 | 64 | 41 | 15,536 | 11,038 |
| Reinsurance recoverable | 17,567 | | (4) | 497 | 18,060 | 18,644 |
| Cash and cash equivalents | 3,332 | (1,963) | 126 | | 1,495 | 1,305 |
| Other[2] | 1,981 | 366 | (10) | — | 2,337 | 2,882 |
| **Total assets** | **197,112** | **—** | **397** | **507** | **198,016** | **185,827** |
| **Liabilities** | | | | | | |
| Fund for Future Appropriations | 16,153 | | (16,153) | | — | |
| Technical provisions | 164,063 | | (121,911) | (42,152) | — | 98 |
| Best estimate | | 192 | 122,153 | 42,368 | 164,713 | 154,459 |
| Risk margin | | | 1,027 | 430 | 1,457 | 1,587 |
| Other liabilities | | | | | — | — |
| Deferred tax liabilities | 820 | | — | (23) | 797 | 608 |
| Debts owed to credit institutions | 3,330 | — | 346 | | 3,676 | 2,709 |
| Financial liabilities other than debts owed to credit institutions | 92 | (46) | | | 46 | 61 |
| Other[3] | 7,040 | (146) | (262) | 264 | 6,896 | 7,845 |
| **Total liabilities** | **191,498** | **—** | **(14,800)** | **887** | **177,585** | **167,367** |
| **Excess of assets over liabilities** | **5,614** | **—** | **15,197** | **(380)** | **20,431** | **18,460** |

[1] The breakdown of these Investments are detailed further in D.1.2.3. figure 26.
[2] Other assets include Property, plant and equipment held for own use, Insurance and intermediary receivables, Reinsurance receivables and Receivables (trade, not insurance), and Pension benefit surplus. The breakdown of these are detailed in D1.2.7 figure 27.
[3] Other liabilities includes Provisions other than technical provisions, Pension benefit obligations, Derivatives liabilities, Deposits from reinsurers, Insurance and intermediaries payable, Reinsurance payables, Payables (trade, not insurance) and Contingent liabilities. The breakdown of these are detailed in Section D.3.2 Figure 32.

Notes:

(a) *Presentation differences* represent movements between line items with no overall impact on excess of assets over liabilities.

The main differences include a reclassification of £18,256 million of collective investment in which the Company's holdings exceed 20% which are classified as participations under Solvency II. This is offset by £1,055 million in relation to debts owed to the parent company reported as receivables (trade not insurance) in Solvency II. There was also £6,516 million relating to assets held by the index-linked funds which are presented together in a single line on the UK GAAP statutory accounts balance sheet rather than within each individual asset/liability category. These amounts reported as index-linked funds for the statutory accounts do not meet the Solvency II definition of index-linked

and accordingly are reported in the various individual asset and liability categories. The other large difference of £11,923 million within loans and mortgages mostly relates to the movement of reverse repos which are treated as investments for UK GAAP in the table above but moved to loans and mortgages for Solvency II.

(b) *Ring-fenced funds* represent the impact on the balance sheet of changes in value and presentation of the policyholder assets and liabilities before any restrictions are applied.

For UK GAAP purposes, although the individual assets and liabilities are valued, the overall impact of ring-fenced funds on UK GAAP shareholders' funds is not significant. The UK GAAP technical provisions of £121,911 million are removed and replaced by a Solvency II best estimate liability of £122,153 million. The £15,197 million represents the excess of assets over liabilities on a Solvency II basis before any restrictions are applied and includes the amount attributable to shareholders for the value of future shareholder transfers from the with-profits business.

(c) *Other valuation differences* primarily represent the differences in valuation methods under UK GAAP and on a Solvency II basis. The comparison of excess of assets over liabilities on a Solvency II basis to UK GAAP is set out within Section E.1.4.

Valuation differences for deferred acquisition cost and intangible assets, participations, loans and mortgages and other assets are explained in Section D.1.2.2. The valuation differences for reinsurance recoverables are explained in Section D.2.8. Valuation differences for technical provisions, best estimate and risk margin are explained in Section D.2.1. Valuation differences for deferred tax liabilities and other liabilities are explained in Section D.3.2.

## D.1 Valuation of assets for Solvency II

### D.1.1 Determination of fair value

Within the Solvency II balance sheet, assets are valued using valuation methods that are consistent with the valuation approach set out in the Solvency II Directive. There have been no significant changes in the valuation basis of assets in the Solvency II balance sheet in 2019.

A change has been made to the treatment of the pension surplus, which relates to the Prudential Staff Pension Scheme and amounted to £28 million at year-end 2019. Previously the treatment has been to take no credit for this within the Solvency II balance sheet and correspondingly not to recognise any capital requirement in stress as the scheme remains in surplus. For year-end 2019 the approach has been updated to include the UK GAAP surplus of £28 million on the Solvency II balance sheet, therefore increasing Own Funds, with a matching increase applied to the Solvency Capital Requirement (unaudited). The increase in the SCR is needed as the surplus would not be accessible within the nine months window set out within the Solvency II regulations and therefore it must be eliminated under stress.

The overall principle when valuing assets and liabilities under Solvency II is to use a fair value, as set out in Article 75 of the Directive.

When valuing assets and liabilities in accordance with Solvency II, the valuation hierarchy set out below is followed:

***(a) Quoted market prices in active markets for the same assets or liabilities***

As the default valuation method, assets and liabilities are valued using quoted market prices in active markets for the same assets or liabilities, where available.

The investments of the Company which are valued using this method include exchange listed equities, mutual funds with quoted prices, exchange traded derivatives such as futures and options, and certain national government and corporate bonds.

At 31 December 2019 £107 billion of financial assets were valued using this approach.

***(b) Valuation methods using quoted market prices in active markets for similar assets and liabilities with adjustments to reflect differences***

Where quoted market prices in active markets for the same assets or liabilities are not available, quoted market prices in active markets for similar assets and liabilities with adjustments to reflect factors specific to the asset or liability such as condition or volume or level of activity in the markets.

There are a limited number of financial assets valued in this manner. At 31 December 2019 £0.7 billion of financial assets valued using this approach, primarily foreign exchange forwards.

For (a) and (b), the Company applies a number of criteria in determining whether a market is considered 'active'. These include, but are not limited to, consideration of whether there is observable trading activity, a price or consensus price on the measurement date.

Where assets cannot be valued based on quoted market prices in active markets of the same or similar assets, alternative valuation methods are used, as described in (c) and (d) below.

***(c) Alternative valuation methods - using inputs that are observable in the market***

Where possible, the alternative valuation method uses significant inputs into the valuation that are observable for the asset directly (i.e. as prices) or indirectly (i.e. derived from prices). At 31 December 2019 £33.1 billion of financial assets were valued using this approach. Where we have observable inputs, we use the observable price and do not adjust further for the effect of future uncertain events.

A significant proportion of the Company's assets in this category are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing services or quotes from third-party brokers. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

Pricing services, where available, are used to obtain third-party broker quotes.

When prices are not available from pricing services, quotes are sourced directly from brokers. The Company seeks to obtain a number of quotes from different brokers so as to obtain the most comprehensive information available on their executability. Where quotes are sourced directly from brokers, the price used in the valuation is normally selected from one of the quotes based on a number of factors, including the timeliness and regularity of the quotes and the accuracy of the quotes considering the spreads provided. The selected quote is the one which best represents an executable quote for the security at the measurement date.

Generally, no adjustment is made to the prices obtained from independent third parties. Adjustment is made in only limited circumstances, where it is determined that the third-party valuations obtained do not reflect fair value (e.g. either because the value is stale and/or the values are extremely diverse in range). These are usually securities which are distressed or that could be subject to a debt restructure or where reliable market prices are no longer available due to an inactive market or market dislocation.

In these instances, prices are derived using internal valuation techniques including those as described below, with the objective of arriving at a fair value measurement that reflects the price at which an orderly transaction would take place between market participants on the measurement date.

The techniques used require a number of assumptions relating to variables such as credit risk and interest rates. Examples of such variables include an average credit spread based on the corporate bond universe and the relevant duration of the asset being valued. The input assumptions are determined based on the best available information at the measurement dates.

The majority of such securities were valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to judgement.

### *d) Alternative valuation methods - inputs not based on observable market data*

Investments valued using valuation techniques with inputs not based on observable market data include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions e.g. market illiquidity. These principally include investments in private equity funds, directly held investment properties and investments in property funds which are exposed to bespoke properties or risks and investments which are internally valued or subject to a significant number of unobservable assumptions. It also includes debt securities which are rarely traded or traded only in privately negotiated transactions and hence where it is difficult to assert that their valuations have been based on observable market data.

The valuation techniques used include comparison to recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used priority is given to publicly available prices from independent sources when available, but overall the source of pricing is chosen with the objective of arriving at a fair value measurement that reflects the price at which an orderly transaction would take place between market participants on the measurement date.

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

In some cases the disclosed value cannot be realised in immediate settlement of the financial instrument.

The models above involve judgement over future events for example credit ratings and future house price growth.

As at 31 December 2019, the Company held £31.5 billion of assets, net of liabilities, at fair value which were valued in this manner.

Included within these net assets and liabilities are:

- £0.4 billion holding in an investment fund that invests in a portfolio of buy-to-let mortgages and other loans financed largely by external third-party (non-recourse) borrowings. The Company's exposure is limited to the investments held by the WPSF, rather than to the individual loans and borrowings themselves. The fair value movements of these loans and borrowings have no effect on shareholders' profit and equity. The most significant non-observable inputs to the mortgage fair value are the level of future defaults and prepayments by the mortgage holders.

- £8.7 billion of investment properties, which are externally valued by professionally qualified external valuers using the Royal Institution of Chartered Surveyors ('RICS') valuation standards. An 'income capitalisation' technique is predominantly applied for these properties. This technique calculates the value through the yield and rental value depending on factors such as the lease length, building quality, covenant and location. The variables used are compared to recent transactions with similar features to those of the Company's investment properties. As the comparisons are not with properties that are virtually identical to the Company's investment properties, adjustments are made by the valuers where appropriate to the variables used. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of the properties.

- Debt securities of £10.3 billion as at 31 December 2019, which were either valued on a discounted cash flow method with an internally developed discount rate or using other valuation methodologies including enterprise valuation and estimated recovery (such as liquidators reports). These investments mainly comprise investments in private placement loans, income strips and unquoted corporate bonds:

Private placement loans with a value of £8.9 billion: these loans are secured on various assets and are valued using a discounted cash flow model. The discount rate is made up of a risk-free rate and a credit spread. The risk-free rate is taken from an appropriate gilt of comparable duration and the spread is taken from a basket of comparable securities. The valuations are sensitive to movements in the discount rate applied.

Income strips with a value of £0.4 billion: the income strips are valued using a discounted cash flow model where the discount rate is made up of a risk-free rate and a spread. The risk-free rate is taken from an appropriate gilt of comparable duration and the spread is taken from a basket of comparable securities. The valuations are sensitive to movements in the discount rate applied.

Unquoted corporate bonds valued using broker quotes of £1.1 billion, which are sensitive to those quotes.

- Equity securities and pooled investment funds with a value of £9.4 billion: these investments predominantly comprise interests in partnerships, venture capital funds and private equity funds as well as investments in property funds which are exposed to bespoke properties or risks. The private equity and venture capital investments in both debt and equity securities were valued internally using discounted cash flows based on management information available for these investments. The significant unobservable inputs include the determination of expected future cash flows on the investments being valued, determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The valuation is performed in accordance with International Private Equity and Venture Capital Association Valuation guidelines. These investments were principally held by investment funds that are managed on behalf of third parties.

- Equity release mortgage loans of £1.6 billion as at 31 December 2019 and a corresponding liability of £0.4 billion which were valued internally using discounted cash flow models. The inputs that are significant to the valuation of these investments are primarily the economic assumptions, being the discount rate (risk-free rate plus a liquidity premium) and property values. During 2019, there was a change to the deferment rate assumption which resulted in an increase in assumed property values at redemption.

  The most significant unobservable inputs relate to the discount rate, the current property value, the assumed future property growth and the assumed future annual property rental yield.

The Company regularly assesses asset valuation uncertainty, with formal reporting of the range of uncertainty for each asset class including asset whose values are not based on observable market data. This is discussed further in Section D.4. The analysis performed for recent periods has demonstrated that the fair values used by the Company lie within a reasonable range.

The majority of the unobservable assets are held in the Company's with-profits funds, and therefore a change in value does not directly impact the solvency of the company since the contribution from Ring Fenced Funds is restricted.

### D.1.2 Valuation bases under Solvency II compared with UK GAAP

#### D.1.2.1 Deferred acquisition costs and intangibles

Deferred acquisition costs and other intangible assets such as distribution rights and software are recognised at cost less amortisation under UK GAAP in the Company's statutory accounts but have no value for Solvency II purposes.

#### D.1.2.2 Deferred tax assets

Deferred tax assets, other than the carry forward of unused tax credits and losses, are calculated based upon the differences between the values given to assets and liabilities for tax purposes and their values in the Solvency II balance sheet. The principles of UK GAAP are applied to calculate the extent of deferred tax applicable to those value differences. Changes in the valuation of underlying assets or liabilities will give rise to a change in deferred tax balances. Recoverability is assessed on the basis of the balances held and consideration is given to the probability of taxable profit being available against which the underlying recoverable can be offset.

There is no deferred tax asset on the Solvency II balance sheet as at 31 December 2019.

### D.1.2.3 Investments (other than participations)

Investments (other than participations) comprise the following asset classes as included in the Solvency II balance sheet:

**Figure 26: Investments (other than participations) for the year-ended 31 December 2019**

| | 2019<br>£m | 2018<br>£m |
|---|---|---|
| Property (other than for own use) | 8,733 | 9,240 |
| Equities | 35,919 | 30,994 |
| Bonds | 66,032 | 65,814 |
| Collateralised securities | 4,506 | 5,759 |
| Collective investment undertakings | 9,767 | 22,589 |
| Derivatives | 3,845 | 2,503 |
| Deposits other than cash equivalents | 1,180 | 1,444 |
| **Total** | **129,982** | **138,343** |

All of these categories of investments are valued at fair value on both the Solvency II balance sheet and the Company's UK GAAP financial statements.

### D.1.2.4 Holdings in related undertakings including Participations

Article 13 of the Solvency II Directive defines a 'participation' as the ownership, direct or by way of control, of 20 per cent or more of the voting rights or capital of an undertaking. Undertakings will also be treated as participations where significant influence is effectively exercised by the parent.

Under Solvency II rules the adjusted equity method is applied to all investments in subsidiary undertakings. The adjusted equity method is based on the excess of assets over liabilities for each subsidiary, with the subsidiaries' individual assets and liabilities valued in accordance with the Solvency II Directive. Where the related undertaking is an insurance undertaking technical provisions are valued in accordance with Articles 76 to 85 of the directive.

Included within the value of participations is the impact of transitional measures, as applicable to participations which are insurance undertakings. These items are covered further in Section D.2.4.

The solvency capital requirement ('SCR') related to participations that are insurance undertakings are not included within the participation line in the balance sheet, and are included in the Company's SCR.

### D.1.2.5 Assets held for index-linked and unit-linked contracts

These assets are held to cover linked liabilities where the policyholders bear the investment risk of the assets. Under both UK GAAP and Solvency II these assets are recorded in aggregate as a single line entry on the balance sheet. The individual assets and non-insurance liabilities of the linked business are valued in accordance with the Solvency II principles set out in this section.

The difference between UK GAAP and Solvency II relates to the different definitions of index-linked between the two bases. For Solvency II reporting, business is only classified as index-linked where the policyholder bears the risk and not where risks are borne by the shareholder. For UK GAAP all index-linked business is classified as index-linked business, irrespective of the sharing of risks. There is also a difference in relation to investment contracts without discretionary participation features, where amounts due from reinsurers are reported as reinsurance under Solvency II but as investments under UK GAAP.

### D.1.2.6 Loans and mortgages

Loans and mortgages include interests in residential and commercial mortgage portfolios, the Company's loans to individuals (e.g. policy loans) and other loans, as well as reverse repos.

Under UK GAAP, these loans are accounted for at amortised cost net of impairment, except for equity release mortgages which have been designated at fair value through profit or loss as the loan portfolio is managed and evaluated on a fair value basis.

Under Solvency II all loans and mortgages are valued at fair value. Loans and mortgages are not actively traded, and the valuation is therefore determined by discounting the cash flows expected to be received. Section D.1.1(d) provides further detail on the approach, for those loans and mortgages where the valuation relies upon inputs that are not based on observable market data.

#### D.1.2.7 Other assets

Other assets comprise the following asset classes as included in the Solvency II balance sheet:

**Figure 27: Other assets at 31 December 2019**

| | 2019<br>£m | 2018<br>£m |
|---|---|---|
| Insurance and intermediaries receivables | 19 | 21 |
| Reinsurance receivables | 153 | 153 |
| Receivables (trade, not insurance) | 2,137 | 2,564 |
| Pension surplus assets | 28 | — |
| Other | — | 144 |
| **Total** | **2,337** | **2,882** |

The residual other assets in the Solvency II balance sheet are measured at fair value determined using alternative valuation methods that are market consistent and represents the realisable value of individual assets on transfer to third party. If the UK GAAP value is a good proxy for fair value no adjustment is made.

The Prudential Staff Pension Scheme defined benefit pension scheme has a small surplus on a UK GAAP basis and the treatment has previously been to take no credit for this within Own Funds on the Solvency II balance sheet and correspondingly not to recognise any capital requirement in stress as the scheme remains in surplus.

For 2019 year end the approach has been updated to reflect the UK GAAP surplus of £28 million within the Solvency II balance sheet, therefore increasing Own Funds as shown in the table above, with a matching increase applied to the Solvency Capital Requirement since the surplus would not be accessible within the nine months window set out within the Solvency II regulations and must be eliminated under stress.

#### D.1.2.8 Leasing

The Company's operating and finance lease arrangements relate principally to properties. Further information on the Company's leasing arrangements is provided in Section A.4.2.

## D.2 Technical provisions

To the extent these disclosures relate to the risk margin, transitional measures and/or the Solvency Capital Requirement, they are not subject to audit and have not been audited.

### D.2.1 Overview

As a general principle, technical provisions are valued at the amount for which they could theoretically be transferred to a third party in an arm's length transaction. The technical provisions consist of the best estimate liability and the risk margin, reduced by the TMTPs where relevant.

The best estimate liability corresponds to the probability-weighted average of future cash-flows, taking account of the time value of money (i.e. the expected present value of future cash-flows), using the risk-free interest rate term structure published by the European Insurance and Occupational Pensions Authority with allowance for a matching adjustment where relevant. The calculation of the best estimate liability is based upon up-to-date and credible information and realistic assumptions (derived from data

analysis and expert judgement) and is performed using appropriate actuarial and statistical methods. The cash-flow projections used in the calculation of the best estimate liability take account of all the cash in- and out-flows required to settle the insurance obligations over their lifetime. The cash-flows included in the best estimate liability calculation are derived after applying Solvency II "contract boundary" rules, which determine whether future cash-flows can be recognised as part of the in-force business. The best estimate liability is calculated before deduction of the amounts recoverable from reinsurance contracts. Those amounts are calculated separately (see Section D.2.8).

The "contract boundary rules" define:

- When a policy is first included in the cash-flows;
- Which premiums should be allowed for in the cash-flows; and
- When a policy should no longer be included in the cash-flows.

The risk margin is calculated in line with Solvency II requirements, and aims to ensure that the total technical provisions are equivalent to the cost of ceding the insurance obligations to a third party. The calculation assumes a 6 per cent per annum cost of capital and applies to non-hedgeable risks only, with no diversification between the risks in different legal entities. This calculation includes simplified methods and requires assumptions as to the run-off profile of non-hedgeable capital requirements for each line of business in each entity, in line with Article 58 of the Delegated Regulation, rather than a full projection of solvency capital requirements ('SCR'). The SCR for each non-hedgeable risk is assumed to run-off in-line with suitable profiles which differ depending on the types of non-hedgeable risks. The SCR each year is aggregated using a simplified correlation matrix.

The main risks are detailed in Section C.

The present value of the transfers to the shareholder fund are not part of the technical provisions. However, charges to asset shares in respect of shareholder transfers are allowed for in the calculation of future policy related liabilities. The present value of future transfers are also included in this calculation to determine restrictions to the surplus on certain ring-fenced funds.

***Technical provisions at 31 December 2019***

**Figure 28: Value of technical provisions 31 December 2019**

| | 2019 | | | | | 2018 |
|---|---|---|---|---|---|---|
| | Solvency II | | | | | Solvency II |
| | Best estimate liability £m | Risk margin £m | Regulatory TMTP £m | Technical Provisions £m | UKGAAP £m | Technical Provisions £m |
| Insurance with-profit participation | 103,317 | 1,151 | (719) | 103,749 | 119,786 | 94,502 |
| Index-linked and unit-linked insurance | 13,613 | 97 | (75) | 13,635 | 21,731 | 12,851 |
| Other life insurance | 40,155 | 2,903 | (1,918) | 41,140 | 31,947 | 42,238 |
| Accepted reinsurance - insurance with-profit participation | 6,688 | 4 | — | 6,691 | 6,719 | 5,512 |
| Accepted reinsurance - other life insurance | 796 | 60 | (45) | 812 | 52 | 816 |
| Health insurance | (3) | — | — | (3) | (18) | (15) |
| Non-life business* | 145 | — | — | 145 | 145 | 142 |
| **Total** | **164,712** | **4,215** | **(2,758)** | **166,170** | **180,362** | **156,045** |

*For consistency with the presentation of the Solvency II BEL, we have included the £145m non-life liability in the UK GAAP column. In the balance sheet in figure 25 the non-life liability is included in the other row.

The TMTP has been recalculated at 31 December 2019 following approval from the PRA (see Section D.2.4.1 for further details on the TMTP).

The main differences in technical provisions between the UK GAAP financial statements and Solvency II are:

(a) UK GAAP recognises surplus assets in with-profits funds as "Fund for future appropriations" on the balance sheet, but for Solvency II they are not included as a liability within the technical provisions. This contributes £16.2 billion of the difference for the Insurance with-profit participation row.

Other differences in the insurance with-profit participation row and also the accepted reinsurance with-profit participation row include:

- Future enhancements to asset shares in respect of WPSF non-profit business, £0.7 billion, are not recognised under UK GAAP but are for Solvency II;

- Solvency II recognises tax on future shareholder transfers, £0.3 billion, whereas the UK GAAP liabilities do not;

- Under UK GAAP, the liabilities for closed with-profits funds (i.e. PAC's SAIF sub-fund) are increased to exhaust the surplus in the fund. There is no equivalent adjustment under Solvency II. This contributes £0.3 billion of the difference for the Insurance with-profit participation row.

(b) UK GAAP includes index linked policies such as annuities (£8.1 billion) in the 'index linked and unit-linked insurance' category, whilst under Solvency II, index linked only captures those amounts where the policyholder bears the entire risk exposure and index linked annuities are instead included in the "Other life insurance" line.

(c) The UK GAAP liabilities do not include an explicit risk margin as the allowance for risk is included within the non-economic assumptions. The risk margin (£4.2 billion) is explicit under Solvency II, but is partially mitigated by allowance for transitional measures (i.e. TMTP £(2.8) billion) which smooths the impact from the previous Solvency I regime. The risk margin net of TMTP is £1.5 billion at 31 December 2019. The TMTP is run-off in a straight line over 16 years, but can be recalculated if there has been a significant change in the risk profile of the business since the previous calculation.

(d) The method of calculation and the assumptions used to value non-profit liabilities (primarily shown in the 'Other life insurance' row in figure 28), differ between Solvency II and UK GAAP.

Non-economic assumptions contain margins for risk and uncertainty under UK GAAP compared to the best estimate assumptions applied under Solvency II. This also includes the present value of future profits, and the impact of contract boundaries, which are not allowed for under UK GAAP. This results in £2.9 billion higher liabilities for UK GAAP.

Economic assumptions including the discount rate tend to be more prudent under Solvency II compared to UK GAAP, leading to an offsetting £2.5 billion difference.

(e) The UK GAAP insurance contract liabilities include £0.7 billion of outstanding claims which are shown as Insurance and intermediary payables under Solvency II.

***Reinsurance recoverables at 31 December 2019***

The following table shows the reinsurance recoverables with comparisons to the previous year.

**Figure 29: Value of reinsurance recoverables 31 December 2019**

| | 2019 | 2018 |
|---|---|---|
| | SII £m | SII £m |
| Insurance with-profit participation | — | (1) |
| Index-linked and unit-linked insurance | 5,751 | 5,079 |
| Other life insurance | 12,165 | 13,414 |
| Accepted reinsurance - insurance with-profit participation | (1) | — |
| Accepted reinsurance - other life insurance | — | 10 |
| Non-life business | 145 | 142 |
| **Total** | **18,060** | **18,644** |
| **UK GAAP Total** | **17,567** | **18,255** |
| Largest Exposure (Rothesay Life) | 12,444 | 12,465 |

The Company primarily uses reinsurance to manage insurance risk exposure, particularly in respect of longevity risk.

In the Solvency II balance sheet, the full expected cost of claims is included within the technical provisions and the corresponding reinsurance recoverables are shown as an asset.

The valuation methods and assumptions for reinsurance recoverables are consistent with the methods and assumptions for the corresponding technical provisions. The value of the reinsurance recoverable asset is the Company's best estimate of future reinsurance cash flows, where this figure allows for the probability of partial or total default by the reinsurer. In accordance with Article 61 of the Delegation Regulations, a simplified approach to calculating the counterparty default adjustment has been adopted.

The reduction in reinsurance recoverables from 2018 to 2019 is mostly as a result of the Hong Kong recapture, which resulted in the removal of the reinsurance recoverable of £1.1 billion from the Solvency II balance sheet with a corresponding charge to reinsurance recoverable 'change in long-term business provision' as described in section A.1.4.6. This movement is partially offset by the positive returns on reassured unit reserves over the year.

The difference in the value of reinsurance recoverables between Solvency II and the UK GAAP financial statements mainly stem from the same sources as for the gross liability above. Further reinsurance specific differences are:

- Reinsurers' share of value of technical provisions. This is calculated on a basis consistent with the underlying technical provisions and, for Solvency II, includes an allowance for the probability of reinsurer default; and
- Reclassification of reinsurers' share of investment contracts liabilities without discretionary participation features. For the purposes of the financial statements, the Company applies deposit accounting for investment contracts without discretionary participation features (as defined under UK GAAP) and accordingly presents the reinsurers' share of its liabilities within investments.

The most significant reinsurance treaty covers the reinsurance of £12.4 billion of non-profit annuities to Rothesay Life. There are also several longevity swap treaties with a number of different reinsurance companies, including Hannover Re and Munich Life Re and Swiss Re.

### D.2.2 Solvency II Technical Provisions methodology and assumptions

Further details of the methodology and assumptions used for each material line of business are discussed below. The methods chosen for each line of business are proportionate to the nature, scale and complexity of the underlying risks.
The key assumptions required in the valuation of technical provisions are:

(i) economic assumptions, most of which are published by the European Insurance and Occupational Pensions Authority and set by reference to market data at the valuation date;
(ii) non-economic assumptions, used to derive non-market related best estimate liability cash-flows (for example future claims and expenses); and
(iii) assumptions in respect of dynamic management actions and policyholder behaviour.

#### D.2.2.1 Economic assumptions

The principle economic assumption is the risk-free interest rate term structure. The risk-free curves at which best estimate liability cash-flows are discounted are specified by the European Insurance and Occupational Pensions Authority. These curves are based on market swap rates, with an adjustment to "credit risk". The resulting 10-year risk-free spot rates for the material currencies are given below, after the credit risk adjustment.

**Figure 30: 10 year risk-free rates at 31 December 2019 (with comparison to 31 December 2018)**

| Currency | 31 December 2019 | 31 December 2018 | Change |
|---|---|---|---|
| British Pound | 0.91% | 1.34% | (0.43)% |
| Euro | 0.11% | 0.73% | (0.61)% |
| United States Dollar | 1.78% | 2.55% | (0.77)% |

For most non-profit annuity business, a matching adjustment is applied to the risk-free curve to discount the best estimate liability cash-flows (see Section D.2.4.3). In line with Solvency II requirements, the matching adjustment is not applied when calculating the risk margin. The matching adjustment calibration for shareholder annuities at 31 December 2019 allowed for 49 basis points ('bps') (2018: 55 bps) per annum of credit provision. The equivalent calibration for With-profits Fund annuities at 31 December 2019 allowed for 52 basis points ('bps') (2018: 54 bps) per annum of credit provision.

#### D.2.2.2 Non-economic assumptions

Persistency, mortality and expense assumptions are derived from analysis of recent historical experience data, and also reflect expected future experience. Where relevant and material, allowance is also made for the way in which policyholder behaviour is expected to vary in line with economic conditions.

Assumptions are set at realistic, best-estimate levels. If experience varies from the assumptions the result would impact the available Capital the Company holds to meet its obligations.

### D.2.3 Details on methodology and assumptions by lines of business

#### D.2.3.1 Participating business

The best estimate liability for participating business is, in most cases, calculated based on a retrospective calculation of accumulated asset shares, adjusted to reflect any future policy-related liabilities and other outgoings that cannot be charged to asset shares (for example, the excess of projected expenses over any fixed charges). Asset shares broadly reflect the policyholders' share of the participating fund assets attributable to their policies. For some business, a retrospective asset share calculation is not appropriate (for example, business where expected future benefit payments are not based on asset shares) and a prospective valuation approach is used, based on discounting expected future benefit and expense cash-flows.

Asset shares methodology, principles and practices are detailed in the Company's Principles and Practices of Financial Management ('PPFM') document. In setting the 2019 mortality basis, the best estimate assumptions have been updated for 2019 to include additional England and Wales population data, and the allowance for future improvement rates is updated from CMI 2016 default for both males and females to CMI 2017 for males with a stronger calibration for females, and with a 1.75% long-term rate for males, and a 1.50% long-term rate for females.

The future policy related liabilities include a market-consistent stochastic valuation of the cost of all material guarantees, options and smoothing, less any related charges. The stochastic projections allow

for realistic management actions consistent with the operation of the participating funds. Examples of these management actions include:

- *Dynamic adjustments to reversionary and terminal bonus rates.* This includes adjusting reversionary bonuses to target a specified range of terminal bonus cushion at maturity, or to maintain the solvency ratio of the participating fund in stressed conditions. For terminal bonuses, smoothing rules apply, limiting the year-on-year change for the same bonus series.
- *Market value reductions.* For some accumulating with-profits policies, market value reductions may apply, subject to certain limits.
- *Dynamic investment strategy.* Switching into lower-risk assets to maintain the solvency of the fund in stressed conditions.
- *Dynamic new business strategy.* Restricting the volume of new business written to maintain the solvency of the fund in stressed conditions.

In addition, an amount is held with respect to historical pensions mis-selling. The Pensions Mis-selling Review ("PMR") covers customers who were sold personal pensions between 29 April 1988 and 30 June 1994, and who were advised to transfer out, not join, or opt out of their employer's Defined Benefit Pension Scheme. The provision in respect of the PMR covers the expected cost of redress payable to the residual 20,000 Prudential customers who fall within the scope of the Review. All affected customers have now been invited to take part in the review.

Whilst the Company believed it met the requirements of the FSA (the UK insurance regulator at the time) to issue offers of redress to all impacted customers by 30 June 2002, there is a population of customers who, whilst an attempt was made at the time, to invite them to participate in the review, may not have received their invitation. These customers are being re-engaged to ensure that they have the opportunity to take part in the review.

At 31 December 2019, the pension mis-selling amount included within the best estimate liability was £420 million (2018: £777 million).

The decrease in provision reflects utilisation of the provision in respect of redress paid and rectification costs incurred and the impact of updating assumptions for future redress payments to more accurately reflect expectations for the remaining population.

#### D.2.3.2 Non-profit annuity business

The best estimate liability for non-profit annuity business is a discounted value (including a matching adjustment where relevant) of expected future annuity payments and associated expenses. The key assumptions relate to mortality rates, including expectations of future mortality improvements, and the discount rate. This is calculated as the risk free rate, plus a matching adjustment on relevant business. The matching adjustment calibration is prescribed by the European Insurance and Occupational Pensions Authority (see Section D.2.4.3).

Some index-linked non-profit annuity business contains a guarantee that the annuity payment will not reduce during periods of deflation. A simulation method (i.e. stochastic model) was used to determine the associated embedded guarantee cost. A provision is held for this guarantee, which is calculated by comparing to backing assets with a similar guarantee.

Longevity assumptions for the annuity business are set in light of recent population and internal experience, with an allowance for expected future longevity improvements. Given the long-term nature of annuity business, longevity remains a significant assumption in determining policyholder liabilities.

In setting the 2019 longevity basis, the best estimate assumption has been updated for 2019 to include additional England and Wales population data, and the allowance for future improvement rates is updated from CMI 2016 default for both males and females to CMI 2017 default for males with a stronger calibration for females, and with a 1.75% long-term rate for males, and a 1.50% long-term rate for females.

From April 1987, pension schemes were able to "contract out" of the State Earnings Related Pension Scheme, enabling companies and members to pay lower National Insurance Contributions, but their schemes had to provide a minimum level of benefit, the Guaranteed Minimum Pension ('GMP'). Recent court cases have confirmed that there is a requirement for GMPs to be equalised between male and female members / policyholders. The Company has included £55 million within the best estimate liability for the expected costs of equalisation, however there is uncertainty as to the extent to which the judgements apply to schemes other than active defined benefit schemes and therefore the extent to

which the Company may be responsible for achieving this across its product lines. However a base balance sheet provision for the with-profits fund of £30 million has been introduced to reflect the cost of redress for schemes written in the with-profits funds.

The Pension Age Equalisation provision has decreased from £99 million shareholder and £13 million SAIF in 2018, to £54 million shareholder and £8 million SAIF at YE 2019. This was driven by both a partial release of the provision, and a reduction to the utilisation as costs were incurred.

#### D.2.3.3 Unit-linked business

The best estimate liability for these contracts reflects both the value of policyholder unit funds and the non-unit liability. The non-unit liability can be negative, and reflects the discounted value of fee income from the unit funds less allowances for expenses and the cost of insurance benefits. Assumptions are also made for expected mortality and morbidity experience, as relevant, where the products include insurance riders, and also expected persistency.

Some unit-linked business contains a financial guarantee. A simulation method (i.e. stochastic model) is used to determine the associated guarantee cost.

#### D.2.3.4 Other business

For 'other business' the best estimate liability is calculated as the present value of expected future benefit payments and associated expenses less the value of expected future premium income. Assumptions are made for expected persistency and mortality/morbidity experience, as relevant.

Included within other business is an immaterial amount of non-life legacy business which is fully reinsured.

### D.2.4 Long-term guarantee measures on technical provisions

#### D.2.4.1 Transitional measures

The Company's technical provisions at 31 December 2019 include transitional measures on technical provisions ('TMTP'), in accordance with Article 308d of Directive 2009/138/EC. The TMTP is unaudited. The impact of these transitional measures is to increase the Company's Solvency II surplus by £1,482 million (2018: £1,572 million).

The transitional measures are considered high-quality capital, and are a core part of the Solvency II reporting regime. The Company has received the necessary approvals from the Prudential Regulation Authority ('PRA') in respect of the transitional measures.

The TMTP has been recalculated as at 31 December 2019. This is in line with the formal requirement for firms to undertake a recalculation at the end of every 24 months, following the commencement of the TMTP measure on 1 January 2016. The PRA granted written permission for this recalculation of the TMTP on 31 December 2019.

The 31 December 2019 technical provisions do not include a transitional measure on the risk-free interest rate term structure.

#### D.2.4.2 Volatility adjustment

The Company has not applied a Volatility Adjustment as at 31 December 2019.

#### D.2.4.3 Matching adjustment

The matching adjustment referred to in Article 77b of Directive 2009/138/EC has been applied to most of the Company's non-profit annuities.

An adjustment may be applied to the risk-free interest rate term structure if the conditions in Article 77b of the Solvency II Directive are met and approval has been obtained. The risk-free yield curve used to discount most of the Company's non-profit annuity liability cash-flows is increased to include a matching adjustment, as approved by the PRA. The matching adjustment is calculated by reference to the credit spreads on the assigned portfolio of assets, with deductions for the "fundamental spread" (i.e. credit

risk allowance) as published by the European Insurance and Occupational Pensions Authority and for cash-flow mismatch allowances.

Separate portfolios of assets are held for the Company's With-profits Fund-backed and shareholder-backed non-profit annuities (see D.2.2.1 for details of credit provision).

#### D.2.4.4 Impact of transitional measures and long-term guarantees

The impact of the transitional measures for technical provisions ('TMTP'), which is unaudited, and the matching adjustment ('MA') on the Company's Solvency II results at 31 December 2019 are shown in the table below:

**Figure 31: Impact on Solvency II results of excluding the TMTP, VA and MA at 31 December 2019**

| | As reported in QRTs £m | Impact of removing TMTP £m | Impact of removing MA £m | Total excluding TMTP and MA £m | Impact of removing TMTP, and MA £m |
|---|---|---|---|---|---|
| Technical Provisions | 166,170 | 2,758 | 2,910 | 171,837 | 5,667 |
| Basic Own Funds | 12,803 | (1,249) | (1,477) | 10,076 | (2,726) |
| Own Funds eligible to cover SCR | 12,803 | (1,249) | (1,477) | 10,076 | (2,726) |
| Solvency Capital Requirement (SCR) | 9,745 | 232 | 3,367 | 13,344 | 3,599 |
| Own Funds eligible to cover MCR | 12,803 | (1,249) | (1,477) | 10,076 | (2,726) |
| Minimum Capital Requirement (MCR) | 2,436 | 58 | 842 | 3,336 | 900 |
| Solvency Ratio | 131% | n/a | n/a | 76% | n/a |

### D.2.5 Assumption changes

Changes to the assumptions used at 31 December 2019 in the Company's calculation of technical provisions include:

- changes to the matching adjustment allowance to reflect the asset mix and market conditions at 31 December 2019;
- changes to renewal expense assumptions to reflect forecast expense experience, allowing for planned transformation activity, and the impact of the reinsurance contract with Rothesay Life which remains in place;
- changes to investment expense assumptions to reflect changes in strategic asset allocation;
- changes to persistency assumptions to reflect the results of the most recent experience investigation;
- changes to best estimate annuitant longevity assumptions to reflect emerging data; and
- market-driven changes to economic parameters, including changes to risk-free rates as shown in Section D.2.2.1.

### D.2.6 Level of uncertainty

The valuation of technical provisions relies upon the Company's best estimate of future liability cash-flows, including the projection of the future level of the solvency capital requirement in the calculation of the risk margin. These cash-flows are derived using best estimate assumptions, which are set using a combination of experience data, market data and expert judgement.

Uncertainty exists in the technical provisions as to whether the actual future cash-flows will match those expected under the Company's best estimate assumptions. Over time, experience may differ from the best estimate assumptions or the Company's forward-looking expectations may evolve, such that assumptions will be updated with a consequent change in the value of future technical provisions.

The best estimate assumptions include assumptions about future economic conditions, for example interest rates and expense inflation levels; and assumptions about future non-economic experience,

for example, longevity, mortality and policyholder behaviour. Assumptions are also made about future management actions.

Each assumption is set at the Company's best estimate of future experience and approved by the Board Audit Committee. However, each assumption is by its very nature assumed and so the actual future experience is not certain.

## D.3 Valuation of other liabilities

### D.3.1 Valuation of other liabilities

Other liabilities for solvency purposes are valued separately using valuation methods that are consistent with the valuation approach set out in the Solvency II Directives. Unless otherwise stated, valuation of other liabilities is carried out in conformity with UK GAAP, where this is consistent with the objectives of Solvency II.

### D.3.2 Valuation bases under Solvency II compared to UK GAAP

The valuation basis of material classes of other liabilities are described below:

***Debts owed to credit institutions***
Debts owed to credit institutions in the UK GAAP financial statements are valued at amortised cost but are valued at fair value for the Solvency II balance sheet. For year ended 31 December 2019 the value under both methods was the same. The major component of debt liabilities are over-the-counter derivatives collateral creditors and obligations under securities lending.

***Deferred tax liabilities***
Deferred tax liabilities are calculated based upon the differences between the values given to liabilities in the Solvency II balance sheet and their values for tax purposes. The UK GAAP principles of FRS 102 section 29 are applied to calculate the extent of deferred tax applicable to those value differences. Changes in the valuation of underlying liabilities between UK GAAP and Solvency II (as described elsewhere in Section D) give rise to deferred tax value differences. Further information on deferred tax valuation differences is provided in Section D.1.2.2 above under the heading 'Deferred tax assets'.

The aggregate (£23 million) of the other valuation differences for deferred tax between UK GAAP and Solvency II represents the change in the value of the net deferred tax principally as a result of valuation changes relating to the establishment of the risk margin and movement in technical provisions.

The net deferred tax liability of £797 million principally relates to unrealised gains on investments. Tax on these gains will mainly fall due when the underlying assets are sold.

***Other liabilities***
**Figure 32: Other liabilities for the year-ended 31 December 2019**

| | 2019<br>£m | 2018<br>£m |
|---|---:|---:|
| Provisions other than technical provisions | 159 | 401 |
| Pension benefit obligations | 28 | 79 |
| Derivatives | 1,812 | 2,172 |
| Insurance and intermediaries payable | 638 | 598 |
| Reinsurance payables | 84 | 119 |
| Payables (trade, not insurance) | 3,945 | 1,432 |
| Other liabilities | 230 | 1,382 |
| **Total** | **6,896** | **6,183** |

Insurance and intermediaries payable, reinsurance payables, payables (trade, not insurance) and other liabilities are measured at fair value determined using alternative valuation methods that are market consistent and represent the value to settle the liabilities with the third party. Where the UK GAAP valuation is a good proxy for fair value no adjustment is made.

***Provisions other than technical provisions***
The provisions other than technical provisions of £159 million include a provision for review of past annuity sales after utilisation during the year of £100 million (2018: £324 million). The Company has agreed with the Financial Conduct Authority ('FCA') to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review is examining whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. A gross provision of £400 million, before costs incurred, was established at 31 December 2017 to cover the costs of undertaking the review and any related redress and following a reassessment, no change was made in 2018 and an increase of £33 million was recognised in 2019. The ultimate amount that will be expended by the Company on the review will remain uncertain until the project is completed.

The key assumptions underlying the provision are average cost of redress per customer and cost of rectification per customer. An increase in the average cost of redress per customer for outstanding cases of 10% would result in the provision recognised increasing by £7 million. An increase in the total outstanding cost of rectification of 20% would result in the provision recognised increasing by £7 million.

In connection with the FCA findings that led to Prudential agreeing to conduct the TRASP past business review, on 30 September 2019 the FCA fined the Company £24 million in respect of failures related to non-advised sales of annuities. This was fully settled during 2019.

***Derivative liabilities***
Derivative liabilities are valued using quoted prices if exchange listed, quotations from third parties or valued internally using the discounted cash flow method in line with standard market consistent valuation techniques, but are subject to independent assessment against external counterparties' valuations.

***Pension benefit obligations***
i) Background

The Company does not have any individually material obligations in respect of defined contribution plans, other long-term employee benefits or termination benefits.

The Company operates and has significant obligations in respect of the defined benefit pension schemes.

The largest scheme is the Prudential Staff Pension Scheme ('PSPS'). This scheme is primarily a defined benefit scheme but no employees with employment offers after 31 July 2003 are eligible for membership of the defined benefit section of the Scheme. They are instead enrolled in the defined contribution section of the scheme.

There is a smaller defined benefit scheme, Scottish Amicable Staff Pension Scheme ('SASPS') relating to staff formerly employed by the Scottish Amicable Life Assurance Society (which the Company acquired in 1997 along with the associated scheme).

At 31 December 2019, the underlying PSPS liabilities account for 82 per cent (2018: 82 per cent) of the aggregate liabilities of the Group's defined benefit schemes.

ii) Valuation and approach

The table below provides an overview of the underlying surplus or deficit for each scheme and the values recognised by the Company. The valuation reported by the Company is the same under UK GAAP and on the Solvency II base balance sheet.

**Figure 33: Valuations of pension schemes at 31 December 2019**

| 2019 £m | Underlying surplus/ (deficit) | PAC share of Surplus |
|---|---|---|
| PSPS | 927 | 28 |
| SASPS | (28) | (28) |
| **Total** | **899** | **—** |

The surplus (or deficit) in PSPS and SASPS are apportioned in accordance with FRS 102.28 Employee benefits, by way of stated policy:

- 70% of the surplus in PSPS is allocated to the with-profits fund of the Company. Until 30 June 2019, the remaining 30% was allocated to Prudential plc, the previous parent company. As from 30 June 2019, 30% is allocated to M&G Prudential Services Limited, a fellow subsidiary undertaking of the M&G plc group.
- 40% of the deficit and related costs of SASPS is allocated to the with-profits fund of the Company. Until 30 June 2019, the remaining 60% was allocated to Prudential Financial Services Limited, a fellow subsidiary undertaking of the M&G plc group. As from 30 June 2019, 60% is allocated to the shareholder fund of the Company.

A full actuarial valuation is required for defined benefit pension schemes every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. The actuarial valuation differs from the FRS 102 accounting basis valuation in a number of respects, including the discount rate assumption where FRS 102 prescribes a rate based on high-quality corporate bonds while a prudent assumption is typically used for the actuarial valuation.

The Company utilises the projected unit credit method to calculate the defined benefit obligation. This method sees each year of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. Estimated future cash flows are then discounted at a high-quality corporate bond rate, adjusted to allow for the difference in duration between the bond index and the pension liabilities where appropriate, to determine its present value. These calculations are performed by independent actuaries.

Under FRS 102 a surplus is only recognised to the extent that the Company is able to access the surplus either through an unconditional right of refund to the surplus or through reduced future contributions relating to ongoing service, which have been substantively enacted or contractually agreed. Further, the UK GAAP financial position recorded, reflects the higher of any underlying FRS 102 deficit and any obligation for committed deficit funding where applicable.

The Company has no unconditional right of refund to any surplus in PSPS. Accordingly, the PSPS surplus is restricted to the present value of the economic benefit to the Company, derived as the difference between the estimated projected future service cost for active members, and the estimated projected future employer contributions.

In contrast to the PSPS Scheme, the Company is able to access the surplus of SASPS and therefore the amount recognised within UKGAAP for this scheme is the FRS102 valuation amount (either a surplus or deficit).

iii) Significant changes during 2019

In January 2019, following consultation, the Company reached agreement that salary increases for defined benefit scheme members who earn in excess of £35,000 will no longer be pensionable after 30 September 2019. Pension benefits will still relate to how many years they have been active scheme members, as they do now, as long as they remain working for the Company. The impact of this is a past service credit of £66m in the with-profits fund and is reflected in the 2019 results.

These changes contributed to the reduction in the SASPS deficit. However, the UK GAAP surplus recognised for the PSPS reduced as it was expected that there would be a lower future cost of service for active members as a result of the changes.

*iv) Methodology and assumptions*
The FRS 102 valuation prescribes market-based assumptions for the valuation of assets and liabilities. Within the market-based framework, the FRS 102 prescribes that the discount rate for liabilities should be based on high quality corporate bonds (interpreted as corporate bonds with a credit rating of AA).

The actuarial assumptions used in determining the benefit obligations and the net periodic benefit costs for the year-ended 31 December 2019 were as follows:

**Figure 34: Pension scheme actuarial assumptions**

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | PSPS % | SASPS % | PSPS % | SASPS % |
| Discount rate[1] | **2.1** | **2.1** | 2.8 | 2.8 |
| Rate of increase in salaries | **3.1** | **3.0** | 3.3 | 3.3 |
| Rate of inflation[2] | | | | |
| Retail prices index (RPI) | **3.1** | **3.0** | 3.3 | 3.3 |
| Consumer prices index (CPI) | **2.1** | **2.0** | 2.3 | 2.3 |
| Rate of increase of pensions in payment for inflation: | | | | |
| PSPS: | | | | |
| Guaranteed (maximum 5%) | **2.5** | **N/A** | 2.5 | N/A |
| Guaranteed (maximum 2.5%) | **2.5** | **N/A** | 2.5 | N/A |
| Discretionary | **2.5** | **N/A** | 2.5 | N/A |
| SASPS | **N/A** | **3.0** | N/A | 3.3 |

[1] The discount rate has been determined by reference to an 'AA' corporate bond index, adjusted where applicable, to allow for the difference in duration between the index and the pension liabilities.
[2] The rate of inflation reflects the long-term assumption for the UK RPI or CPI depending on the tranche of the schemes.

The current mortality assumptions used as at 31 December 2019 were amended to be specific to each scheme, instead of being based upon the largest scheme (PSPS). The mortality assumptions are adjusted to make allowance for future improvements in longevity. As at 31 December 2019, this allowance was based on the CMI 2017 mortality improvements model with improvement factors of 1.75% for males and 1.50% for females. As at 31 December 2018 this allowance was based on the CMI 2015 model with improvement factors of 1.75% for males and 1.50% for females.

*v) Underlying investments of the schemes*
On the 'economic basis', after including the underlying assets represented by the investments in Prudential insurance policies as scheme assets, the plans' assets at 31 December comprise the following investments:

**Figure 35: Plan assets**

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | £m | % | £m | % |
| Equities | | | | |
| UK | **8** | **—%** | 8 | —% |
| Overseas | **25** | **1%** | 204 | 3% |
| Bonds | | | | |
| Government | **5,111** | **61%** | 4,943 | 63% |
| Corporate | **2,122** | **25%** | 1,932 | 24% |
| Asset-backed securities | **298** | **4%** | 263 | 3% |
| Derivatives | **187** | **2%** | 97 | 1% |
| Properties | **211** | **3%** | 207 | 3% |
| Other assets | **352** | **4%** | 227 | 3% |
| **Total value of assets** | **8,314** | **100%** | 7,881 | 100% |
| Of which relate to PSPS | **7,447** | | 7,075 | |
| Of which relate to SASPS | **867** | | 806 | |

***Contingent liabilities***
Under UK GAAP, contingent liabilities (as determined in accordance with FRS 102) are disclosed but not recognised. For the Solvency II balance sheet, contingent liabilities (under the same definition as UK GAAP) are required to be recognised where they are material. The material contingent liabilities are recognised on the Solvency II balance sheet as the probability-weighted average of future cash-flows required to settle the contingent liability over the lifetime of that liability, discounted at a relevant risk-free interest rate structure.

For the year ended 31 December 2019 the Company has no contingent liabilities recognised on the Solvency II balance sheet. For the prior year there was a contingent liability of £31 million in relation to a legal case recognised on the Solvency II balance sheet. The claim related to a financial restructuring carried out by a borrower in one of the Company's investments. The Court handed down judgement in favour of the Company in November 2017. Further appeal was dismissed in 2019.

***Leases***
There are no material liabilities recognised on the Solvency II balance sheet arising as a result of operating and finance leasing arrangements of the Company. Further information on the leasing arrangements of the Company is disclosed in Section A.4.2.

## D.4 Alternative methods for valuation

The use of alternative methods for valuation by the Company are discussed in Sections D.1 to D.3 above.

Valuation uncertainty refers to the variability of the fair value measurement that exists at any given reporting date/time for a financial instrument or portfolio of positions. Valuation uncertainty arises because the realisable value of an asset can take a range of possible values at a single point in time. The width of the range will vary between asset classes, depending on the valuation technique used, with the degree of valuation uncertainty being lower for highly liquid listed securities and higher for hard-to-value or illiquid assets where prices are not readily available.

The Independent Price Verification Group Wide Operating standards prescribe minimum standards that should be applied in valuation of financial assets including those managed by third parties.

The standards include establishing valuation and oversight committees and setting appropriate IPV policies, procedures and controls around the independent verification of asset prices, pricing parameters and valuation model inputs. The standards require documentation of the process for

assessing valuation uncertainty, including the controls surrounding valuation models and an understanding of the model assumptions and limitations.

The Group has developed Group-wide Independent Price Verification procedures - which covers all investment asset classes owned by the Company, and set minimum requirements for the governance surrounding valuation pricing. These standards require that processes are established to verify the accuracy and independence of model inputs and market prices provided by third parties. Where mark to market valuations are not available from independent price sources, the Independent Price Verification standards set minimum requirements for alternative methodologies including mark to model valuations.

The Group's valuation policies, procedures and analysis for instruments valued using alternative valuation methods with significant unobservable inputs are overseen by committees as part of the Company's wider financial reporting governance processes. The procedures undertaken include approval of valuation methodologies, verification processes, and resolution of significant or complex valuation issues. In undertaking these activities, the Group makes use of the extensive expertise of its asset management functions. In addition, the Group has minimum standards for independent price verification to ensure valuation accuracy is regularly independently verified. Adherence to this policy is monitored.

The analysis of investment pricing performed for recent periods has demonstrated that the fair values used by the Company lie within a reasonable range.

## D.5 Any other information

There is no other material information regarding the Company's valuation of assets and liabilities for solvency purposes other than those disclosed in the sections above.

# E Capital management

## E.1 Own funds

### E.1.1 Objectives, policies and processes for managing own funds

The Company manages its Solvency II own funds as its measure of capital. The Company's own funds at 31 December 2019 in the regulatory template are £12,803 million. A reconciliation from the Solvency II capital position published in the Financial Statements to the Solvency II capital position disclosed in the regulatory template is provided in Section E.1.2 below. The Company's basic, available and eligible own funds to cover the Company's solvency capital requirement and minimum capital requirement at 31 December 2019 are shown in Section E.1.3 below.

The Company manages its Solvency II capital to ensure that sufficient own funds are available on an ongoing basis to meet regulatory capital requirements.

The Company prepares a medium term capital plan as part of its business planning process. The business plan is prepared annually on a rolling basis and covers a three-year period. There were no material changes in the objectives, policies or processes for managing the Company's own funds during the year.

### E.1.2 Shareholder Solvency II capital position

***Reconciliation of Solvency II capital position published in the Annual Report to the QRTs***

The Company disclosed the estimated Solvency II capital surplus, as at 31 December 2019 in the Company's 2019 Financial Statements of £3,057 million, consistent with the disclosures in this document. This includes the impact of a recalculated TMTP and was calculated as being own funds of £12,803 million less SCR £9,745 million.

A reconciliation of the Solvency II shareholder position to the Solvency II position disclosed in the 2019 regulatory templates (S.23.01.01 and S.25.03.21) is shown in the table below.

**Figure 36: Reconciliation of Solvency II capital position published in the Annual Report to the QRTs 31 December 2019**

| Company | Available Capital £m | Required Capital £m | Surplus £m | Coverage Ratio % |
|---|---|---|---|---|
| PAC shareholder Solvency II capital position (pre dividend) as disclosed in the Annual Report | 8,235 | (5,178) | 3,057 | 159% |
| PAC policyholder Solvency II capital position as disclosed in the Annual Report | 12,196 | (4,568) | 7,628 | 267% |
| Ring-fenced funds consolidation of own funds limited to SCR balances | (7,628) | — | (7,628) | —% |
| **Solvency II capital position as disclosed in templates S.23.01.01 and S.25.03.21** | 12,803 | (9,745) | 3,057 | 131% |

### E.1.3 Analysis of the components of own funds

The following components make up the Company's basic, available and eligible own funds amounts. The Company has no ancillary own funds.

**Figure 37: Analysis of components of own funds for the year-ended 31 December 2019**

| | Total 2019 £m | Tier 1 unrestricted £m | Total 2018 £m |
|---|---|---|---|
| Ordinary share capital[(b)] | 330 | 330 | 330 |
| Surplus funds[(c)] | 13,223 | 13,223 | 10,642 |
| Reconciliation reserve[(d)] | (750) | (750) | 2,029 |
| **Total eligible own funds to meet the SCR[(a)]** | 12,803 | 12,803 | 13,001 |
| **Total eligible own funds to meet the minimum SCR [(a)]** | **12,803** | **12,803** | **13,001** |

(a) As at 31 December 2019, the Company has no ancillary own funds and hence the Company's basic own funds are equal to the total available own funds. The eligible own funds are derived by applying Solvency II tiering limits to the tiered available own funds.

(b) Ordinary share capital
The Company's ordinary share capital represents the nominal value of 25p for each fully paid equity share issued. As the ordinary share capital is available or can be called upon to fully absorb losses it is categorised as Tier 1.

(c) Surplus funds
Surplus funds arise from the Company's with-profit funds (i.e. surplus funds arise from certain of the Company's ring-fenced funds). The value of surplus funds reported represents the excess of assets over liabilities (excluding the risk margin) of those ring-fenced funds after deducting the present value of the expected future shareholder transfers (net of any related tax borne by the funds). Having considered the features of Tier 1 own fund instruments set out in Article 71 of the Commission Delegated Regulation (EU) 2015/35 and the guidance in the PRA Supervisory Statement SS13/15 (Solvency II: surplus funds) the Company has classified surplus funds under Tier 1.

In accordance with the template S.23.01.01 (Own Funds) presentation requirements, the value of surplus funds reported on the template is prior to ring-fencing related restrictions being applied. The related restrictions are included as a deduction in the Reconciliation Reserve under "Restrictions applied to own funds due to ring-fencing". As such, the contribution of surplus funds towards the Company's own funds is lower than that reported on the face of the Own Funds template.

(d) Reconciliation reserve
The reconciliation reserve represents the residual value of excess of assets over liabilities after deducting (i) equity share capital comprising ordinary share capital and (ii) surplus funds and the restriction applied to own funds due to ring fencing. The reduction in reconciliation reserve from £2,029 million to a loss of £750 million is mainly due to dividends paid to Prudential plc prior to de-merger and increases in the ring-fenced fund restriction.

The reconciliation reserve is volatile as it captures all changes in the shareholder fund and the movement in the ring-fenced fund restriction.

The following table shows the reasons for the changes in the Own Funds between 31 December 2018 and 31 December 2019 and prior year comparatives.

**Figure 38: Analysis of change in own funds for the year-ended 31 December 2019**

| £m | Shareholder | Policyholder | Regulatory |
|---|---|---|---|
| **Underlying own funds generation** | | | |
| With-profits | 202 | | 202 |
| - of which: In-force | 167 | | 167 |
| - of which: New business | 34 | | 34 |
| Shareholder annuity & other | 280 | | 280 |
| Ring-fenced with-profits fund | | 825 | 825 |
| **Total Underlying own funds generation** | **482** | **825** | **1,306** |
| Other operating own funds generation | 196 | 699 | 895 |
| **Total operating own funds generation** | **678** | **1,523** | **2,201** |
| Market movements | 989 | 1,017 | 2,006 |
| Restructuring | (55) | — | (55) |
| Tax | (192) | 18 | (174) |
| **Total Own Funds Generation from continuing operations** | **1,421** | **2,558** | **3,979** |
| Own Funds Generation from discontinued operations | 49 | — | 49 |
| **Total Own Funds Generation** | **1,470** | **2,558** | **4,028** |
| Dividends & capital movements | (2,057) | — | (2,057) |
| Change in with-profits ring-fenced funds restrictions * | | — | (2,169) |
| **Total Movement in Own Funds** | **(587)** | **2,558** | **(198)** |

* The contribution of the ring-fenced With-Profits Fund to Group own funds is limited to that required to cover the fund's capital requirements (see section E.2).

The main movements in the Shareholder Own Funds are largely due to:

- £482 million underlying own funds generation comprised of expected surplus from in-force business primarily reflecting the expected real world return on shareholder transfers and return on surplus assets and release of credit reserves on non-profit annuity business, and the contribution from new business, mainly PruFund.
- Other operating capital generation of £196 million is primarily due to changes in non-market assumptions, in particular updates to the longevity and renewal expense and IME assumptions.
- £989 million increase due to market movements, reflecting strong investment returns over the period.
- £55 million primarily from restructuring costs of £110 million, partially offset by the £53 million release of reserve and premium refund associated with the Rothesay annuity transaction.
- £192 million reduction due to the additional tax charge incurred over the period.
- £50 million from capital generated from discontinued operations, primarily the sale of the Vietnamese subsidiary. This is prior to the £97 million dividend to M&G plc included in the dividend line below.
- £(2,057) million relating to dividend payments made to M&G Plc and Prudential Plc. For detials see A.1.4.9.

The main movements in the With-Profits Fund Own Funds are largely due to:

- Underlying capital generation of £825 million comprised of £571 million from the expected surplus from in-force business, primarily the expected return on the excess of assets over liabilities in the With-Profits Fund, and £254 million from new business written during the period, reflecting the future margins expected over the lifetime of that business.

- Other operating capital generation of £699 million includes £230 million of model changes, £199 million of updates to non-market assumptions (primarily longevity) and £157 million of non-market experience.
- Market movements of £1,017 million, reflecting strong investment returns in the period which reduced future costs of guarantees and smoothing, and gains on surplus assets held.
- The change in ring-fenced fund restrictions reflects that surplus of the with-profits fund is not available to cover losses elsewhere in the Group. Own funds are therefore only recognised to the extent required to cover the SCR of the with-profits fund. This figure therefore also includes the £389 million of increased Solvency Capital requirements of the fund during the year.

No changes are currently expected in the composition of the Company's capital. The Company is funded by ordinary share capital of £330 million and it is not expected that the capital will be redeemed, that there will be further capital injections, or that capital will be raised by any other means. Since 31 December 2019 a dividend has been approved which will contribute to a reduction to the reconciliation reserve in 2020. This is discussed in A.5.3. Based on the Business Plan the Company is expected to generate Solvency II capital prior to any dividend payments.

### E.1.4 Reconciliation of UK GAAP shareholder's equity to Solvency II for the year-ended 31 December 2019

The 'excess of assets over liabilities' on the Solvency II balance sheet is not equivalent to own funds as a number of adjustments are made on the own funds template to restrict the valuation.

The reconciliation of the Company's UK GAAP shareholders' equity to the excess of assets over liabilities on the Solvency II balance sheet and to the Solvency II eligible own funds value of the Company is shown in Figure 39 below:

**Figure 39: Analysis of components of own funds for the year-ended 31 December 2019**

| | 2019<br>£m | 2018<br>£m |
|---|---|---|
| **UK with-profits funds** | | |
| Fund for future appropriations | 16,153 | 13,487 |
| Value of shareholder transfers | (2,739) | (2,394) |
| Impact of risk margin (net of TMTP) | (1,027) | (1,005) |
| Other valuation differences | (191) | (451) |
| **With Profits Ring Fenced Fund - Estimated Solvency II Own Funds** | **12,196** | **9,637** |
| **Other long term business** | | |
| Shareholders' equity | 5,613 | 6,877 |
| Impact of risk margin (net of TMTP) | (430) | (581) |
| Value of shareholder transfers | 2,739 | 2,394 |
| Asset valuation differences | 507 | 250 |
| Other valuation differences | (217) | (193) |
| Increase in value of net deferred tax liabilities (resulting from valuation differences above) | 23 | 76 |
| **Excess of assets over liabilities as recorded in the Solvency II balance sheet** | **20,431** | **18,460** |
| Restrictions on ring-fenced funds | (7,628) | (5,458) |
| **Eligible own funds at 31 December 2019** | **12,803** | **13,002** |

### E.1.5 Restrictions

*(Unaudited)*

***Restriction to own funds arising from ring-fenced funds***

The Company has considered the specific provisions of national law, insolvency law, contract law and product regulation of the insurance subsidiary's jurisdiction of operations in determining the appropriate treatment of ring-fenced funds.

For ring-fenced funds, own funds are adjusted to reflect that the funds have a reduced capacity to fully absorb losses on a going-concern basis due to their lack of fungibility within the insurance company. The contribution to own funds from a ring-fenced fund is restricted such that the contribution to own funds from the ring-fenced fund is equal to the notional SCR for that ring-fenced fund. The impact of ring-fenced funds on the Company's solvency position in shown in Figure 39 above.

## E.2 Solvency Capital Requirement ('SCR') and Minimum Capital Requirement ('MCR')

*(Unaudited)*

### E.2.1 Overview

The SCR is the amount of capital Solvency II regulations require the Company to hold. It is calculated based on ensuring that the Company has enough capital to meet its obligations in the event of a 1-in-200 year risk scenario occurring.

For the purpose of Solvency II regulatory reporting and disclosures, risk management, and calculation of any free surplus generation, the Company has approval to use an internal model for calculating the solvency capital requirement (‘SCR’). The assets and liabilities are valued on a Solvency II basis.

### E.2.2 Components of SCR

At 31 December 2019, the SCR was £9,745 million (2018: £9,309 million). The PRA has the power to impose a capital add-on to the SCR where it believes the SCR may be insufficient. It has not done so for the Company.

Figure 40 below shows the undiversified SCR by risk components and the benefit of diversification in relation to the Company at 31 December 2019.

**Figure 40: SCR for the Company at 31 December 2019**

| Risk component | Shareholder SCR £m | With-Profits Fund SCR £m | Total SCR £m |
|---|---|---|---|
| Interest rate risk | 377 | 1,102 | 1,479 |
| Equity risk | 1,368 | 1,750 | 3,118 |
| Property risk | 802 | 584 | 1,386 |
| Spread risk | 3,375 | 2,214 | 5,588 |
| Concentration risk | — | — | — |
| Currency risk (incl. FX translation) | 825 | 1,206 | 2,031 |
| *Diversification between market risks* | (2,006) | (3,295) | (5,301) |
| Counterparty | 246 | 51 | 297 |
| Mortality risk | 10 | 16 | 25 |
| Longevity risk | 1,572 | 1,983 | 3,556 |
| Disability-morbidity risk | 30 | — | 30 |
| Mass lapse | 146 | 15 | 161 |
| Other lapse risk | — | 1,251 | 1,251 |
| Expense risk | 541 | 1,013 | 1,554 |
| Life catastrophe | 15 | 3 | 18 |
| *Diversification between insurance risks* | (1,290) | (2,074) | (3,364) |
| Non-life underwriting risk | — | — | — |
| Operational risk | 822 | 502 | 1,324 |
| Loss-absorbing capacity of deferred tax | (371) | (714) | (1,085) |
| Other adjustments | — | — | — |
| **Total undiversified components** | **6,462** | **5,608** | **12,069** |
| **Diversification between market and underwriting risks** | **(1,284)** | **(1,040)** | **(2,324)** |
| **Total SCR** | **5,178** | **4,568** | **9,745** |
| **MCR** | **1,294** | **1,142** | **2,436** |

The table above illustrates that a significant proportion of the Company's capital requirements relate to market risk exposures, in particular credit and equity risks, as well as longevity risk. Overall there remains significant diversification benefit between the diverse mix of risks.

The minimum capital requirement ('MCR') is a formulaic calculation, which is subject to a cap and a floor that are both expressed relative to the SCR. At 31 December 2019, the Company's MCR was £2,436 million. The inputs used to calculate the MCR are detailed in Quantitative Reporting Template S.28.02.01.

The MCR is currently 25 per cent of the SCR (2018: 25 per cent).

The following table shows the reasons for the changes in the Company SCR between 31 December 2018 and 31 December 2019.

**Figure 41: Movement in SCR**

| £m | Shareholder | With-Profits Fund | Regulatory |
|---|---|---|---|
| **Underlying SCR movements** | | | |
| With-profits | (131) | | (131) |
| - of which: In-force | (35) | | (35) |
| - of which: New business | (95) | | (95) |
| Shareholder annuity & other | 131 | | 131 |
| Ring-fenced with-profits fund | | 122 | 122 |
| **Total Underlying SCR movements** | **—** | **122** | **122** |
| Other operating SCR movements | 301 | 89 | 391 |
| **Total operating SCR movements** | **302** | **211** | **512** |
| Market movements | (445) | (600) | (1,044) |
| Restructuring | 35 | — | 35 |
| Tax | 43 | — | 43 |
| **Total SCR movements from continuing operations** | **(65)** | **(389)** | **(454)** |
| SCR movements from discontinued operations | 16 | — | 16 |
| **Total SCR movements from continuing operations** | **(49)** | **(389)** | **(438)** |
| Dividends & capital movements | 2 | — | 2 |
| Change in with-profits ring-fenced funds restrictions | | | |
| **Total Movement in SCR** | **(47)** | **(389)** | **(436)** |

Note that in the above table, the SCR is presented as negative, therefore a positive value above represents a fall in the SCR and therefore an increase in surplus.

The reasons for the movement in the Shareholder business are:

- No underlying SCR movement due to offsetting impacts from the reduction in capital as the business runs off and the increase in capital as new business, mainly PruFund, is written.

- Other operating SCR movement of £301 million primarily due to model changes (£146 million), management actions of £134 million which mainly reflects the increase in surplus from asset optimisation and other trading (£144 million), release of capital from an additional tranche of equity hedges purchased (£80 million) partially offset by the impact of an increase in With-Profits equity exposures over the period (c.£(100) million).

- £445 million reduction in SCR due to market movements over the period (44bps reduction in yields; 18% increase in equities and credit spreads have narrowed by 35bps), an increase in capital from the present value of future shareholder transfers (PVST) due to the increases in asset share values and returns on other shareholder assets, offset by a reduction in capital following the reduction in the value of the equity hedges.

- £35 million reduction in SCR from the recognition of the restructuring cost in the base balance sheet.

- £43 million reduction in SCR due to the additional capacity available to offset future tax credits against past tax charges.

- £16 million from capital generated from discontinued operations, primarily the sale of the Vietnamese subsidiary.

The reasons for the movement in the With-Profits Fund business are:

- a reduction of £122 million during the period which reflects a £304 million release of capital requirements as the in-force business runs off, offset by £182 million additional capital requirements in respect of new business written over the period.

- Other operating items released a further £89 million of capital requirements, primarily as a result of model developments and management actions.

- Market movements increased capital requirements by £600 million, primarily driven by falls in interest rates, and to a lesser extent increases in equity markets and narrowing of credit spreads.

## E.3 Use of the duration-based equity risk sub-module in the calculation of the SCR

*(Unaudited)*

The Company has not used the duration-based equity risk sub-module in the calculation of its SCR as it is a standard formula approach and not applicable to an internal model firm.

## E.4 Differences between the standard formula and the internal model

*(Unaudited)*

### E.4.1 Overview

The Company's internal model, which is consistent with the requirements of the Solvency II Directive, is a key risk management tool and refers to the collection of systems and processes used to identify, monitor and quantify risks for the purpose of calculating the Solvency II solvency capital requirement and economic capital requirements. This is a risk-based measure and, compared to the standard formula (as described below), has the advantage of better reflecting the specifics of the Company's business and risks.

The standard formula capital refers to the capital that is calculated in line with the standard formula rules provided by the Solvency II Directive. Even though the standard formula, as part of Solvency II, represents a risk-based measure, it is based on a set of prescribed parameters, calibrated for European insurers and therefore it does not fully reflect the characteristics of the Company and the specific structure and risks the Company is exposed to.

One of the tests for approval of the Internal Model relates to the ability of the Company to demonstrate on an ongoing basis that the Internal Model is widely used and plays an important role in the system of governance ('the use test'). Satisfying this test demonstrates to the PRA (and other supervisory authorities) that management have confidence in the Internal Model and are actively using its outputs. For the Company, the framework for use test compliance is part of the Internal Model governance framework (refer to section B.3.3). It sets out areas of risk-based decision making or risk-related considerations where the Internal Model should be considered to demonstrate that it is widely embedded and is used within the business. These areas include reserving and regulatory capital; strategic and business planning; capital management; investment strategy; external relations; risk management; product management; and remuneration. Evidence of use in these areas by the Company throughout 2019 has been demonstrated as part of an annual attestation process, as required by the framework.

### E.4.2 Internal model application

The Company applied to use an internal model in late June 2015. In early December 2015, the application was approved by the Prudential Regulation Authority ('PRA').

This was followed by a number of applications to the PRA for a major model change ('MMC') to the internal model:

i. In December 2018, the Company applied to the PRA for a MMC that was approved and implemented from 2019 Q2 reporting and comprised of the following:
    - Changes to the UK credit model, including the design of the fundamental spread model (used to set the level of credit risk reflected in the matching adjustment under stress for the annuity books), the addition of a term structure to credit spread stresses, and the correlations between downgrade / default risk and other non-credit risks;
    - Updates to the deferred tax model, to reflect the loss-absorbing capacity of shareholder tax liabilities arising from the with-profits fund.

ii. In May 2019, the Company applied to the PRA for a MMC to convert the existing Prudential plc Group Solvency II Internal Model into approval for an M&G plc model. This focused on changes to the governance and risk management frameworks around the model at the point of demerger in October 2019. Approval was given to use a full Internal Model under Article 231 of the Directive (and Commission Delegated Regulation (EU) 2015/35 Article 347) to calculate the:
    - Consolidated M&G plc SCR; and
    - Solo entity SCR for each applicable EEA based insurance entity, namely:
        - The Prudential Assurance Company Ltd ('PAC');
        - Prudential Pensions Ltd ('PPL'); and
        - Prudential International Assurance Ltd ('PIA').

The Company's internal model was previously described as "partial" because the Prudential plc Group's US insurance companies were aggregated into the Group SCR using method 2: deduction and aggregation. However, since M&G plc demerged from Prudential Group plc in October 2019, the internal model is now described as "full" as the US insurance companies no longer reside within M&G plc.

As required in Article 101 of Directive 2009/138/EC, the solvency capital requirement from the approved internal model is calculated as the value-at-risk of the basic own funds of an (re)insurance undertaking at a confidence level of 99.5 per cent over a one-year period. The main risk categories allowed for in the internal model are shown in Section E.2.2. Within these categories, underlying "risk drivers" are specified as the result of an annual risk identification process. A model is defined and calibrated for each underlying risk driver and these are combined with an appropriate dependency structure and simulated to generate multiple thousands of combined risk scenarios. These risk scenarios are applied to all the assets and liabilities of the Company (for each entity within the scope of the internal model) to generate a wide range of possible outcomes. For simplicity, and to avoid circularity, the risk margin is held constant in all these risk scenarios. The resulting probability distribution is used to calculate the internal model solvency capital requirement, by subtracting the 99.5$^{th}$ worst percentile outcome from the unstressed balance sheet.

The data used in the internal model covers the following:
- liability data;
- asset data
- finance data;
- operational risk data;
- policyholder data;
- data used in setting assumptions, including demographic, economic and other; and
- other relevant data required by the internal model and technical provisions.

The quality of the data is subject to the internal model data quality framework to ensure the accuracy, completeness, appropriateness and timeliness of the data.

### E.4.3 Internal model vs standard formula

Key differences between the calculation of the internal model SCR and the standard formula SCR include:

- Whereas the standard formula stresses and correlations are prescribed, the internal model risk scenarios reflect the Company's specific risk profile and are derived from a combination of data analysis and expert judgement, subject to the internal model tests and standards required by the Solvency II Directive (see further detail in Figure 42 below).
- Although the same broad risk categories are used to group risk drivers in the internal model, the internal model risk drivers within each category are typically much more granular than the broad risk categories considered under the standard formula. For example, the internal model risk drivers typically vary by country, as well as by other attributes of the risk, whereas many of the standard formula stresses do not vary by country.
- The internal model also covers some risks that are not included in the standard formula (for example, equity implied volatility risk, interest rate implied volatility risk and government bond spread risk).
- The internal model SCR is derived by combining underlying risk drivers together into combined stress scenarios, and then ranking the outcomes of applying these stress scenarios to the Company's balance sheet to derive the 99.5$^{th}$ worst percentile outcome. Conversely, the standard formula SCR is derived by calculating the impact on the balance sheet of each prescribed stress separately and then aggregating these outcomes using prescribed correlation matrices. Therefore, the internal model allows for the impact on the balance sheet of combinations of risks occurring together, whereas the standard formula does not allow for interaction effects when risks occur simultaneously.
- The internal model allows for the matching adjustment ring-fence to vary in each risk scenario, reflecting changes in the value of the corresponding liabilities. Therefore, diversification is allowed for between risks inside and risks outside the matching adjustment portfolio. Conversely, because the standard formula does not consider the impacts of combinations of risks occurring together, it requires that no diversification is recognised between risks inside the matching adjustment portfolio and risks outside the matching adjustment portfolio.

**Figure 42: Overview of standard formula and internal model differences**

| Risk category | Standard formula | Internal model |
|---|---|---|
| Equity | Stresses vary between "Type 1" (listed EEA and OECD stocks) and "Type 2" (other countries, unlisted equities and alternative equity investments). A symmetric adjustment is applied to the level of stress to smooth out significant movements in markets close to the calculation date. | The model includes more granular stresses with calibrations set for each main equity benchmark index. At least one equity index is calibrated for each relevant global economy. Private equity, infrastructure equity and hedge funds are modelled using specific calibrations. Equity implied volatility is also modelled. No symmetric adjustment is applied. |
| Credit | For corporate bonds, loans and non-exempt sovereign bonds, credit risk is modelled by stressing credit spreads, with stresses varying by rating and duration bucket. European sovereign bonds are exempt from stress. Stresses on assets with an element of securitisation and no credit rating. The matching adjustment is allowed for by a factor-based reduction of the spread stresses by rating. | Credit spreads, ratings migrations, defaults and fundamental spreads (for the UK matching adjustment portfolio) are all explicitly modelled. The spread stresses vary by credit rating, with calibrations differentiated by economy, product and duration bucket where appropriate. Internal credit assessments are used for bonds and loans without an agency rating and to uplift stresses for assets where structuring introduces additional risk. Spread stresses are applied to sovereign bonds, taking into account the credit risk of the issuing government. The matching adjustment is calculated dynamically based on the bond yields and fundamental spread being modelled in each risk scenario. |

| | | |
|---|---|---|
| Yields | Interest rate stresses are defined as bi-directional stresses to the base risk-free curve which vary by term but not by country. | Stresses are calibrated for each relevant global economy, and stresses to the shapes of risk-free yield curves are modelled using an industry-standard 'principle component' methodology. Stressed curves are re-extrapolated beyond the last liquid point for each economy using the methodology specified by EIOPA. Interest rate implied volatility and inflation risk are also modelled. |
| Property | There is a single property stress applied globally to the value of all assets classified as property. | Property stresses are differentiated by type of property, with separate calibrations for commercial and residential property. The model also separates the risks relating to contractually fixed rental income from that relating to capital growth where this is relevant for the matching adjustment. |
| Currency | A pair of up and down stresses is applied to the non-GBP net asset value in each business, and then aggregated. This approach also implicitly captures any asset-liability currency mismatch in each country. | A calibration is derived for each currency relative to GBP. Currency outcomes are simulated and used to translate all assets and liabilities into sterling in each risk scenario, thereby including the effect of currency "translation" as well as asset-liability currency mismatches within countries. |
| Concentration | The capital charge is based on the relative size of individual exposures as a proportion of the overall asset portfolio. Some non-EEA sovereigns are included, depending on their credit rating. | A similar approach is used as for the standard formula, with a more risk-based approach adopted for Asia sovereigns. |
| Counterparty default risk | Counterparty default risk is calculated taking into account the loss-given-default and probability of default, using fixed factors. Separate parameters and different aggregation approaches are applied for Type 1 exposures (e.g. derivatives, reinsurance, deposits) compared to Type 2 exposures (e.g. receivables from intermediaries). | A stochastic portfolio model (calibrated by credit rating) is used to capture counterparty risk, allowing for stochastic default and recovery rates. The model allows for counterparty exposures to increase under stressed conditions arising from other market and insurance risks. |
| Lapse | Policyholder lapse rates are stressed in both directions and a mass lapse stress is also applied. The capital charge is based on the largest of these impacts. The stresses are fixed for all countries and products (except for "group policies" which have a higher capital charge). | The lapse calibration is more granular and includes stresses to lapse assumptions and mass lapses. The stresses vary by product type as appropriate. |
| Longevity | A downward stress to mortality rates is applied to all relevant business. | The longevity calibration is more granular and includes stresses to base mortality rates and longevity trend assumptions separately. Calibrations are differentiated by gender, different blocks of business as appropriate, and other risk factors. |
| Mortality & Life catastrophe | An increase in best estimate mortality rates and an instantaneous catastrophe risk stress are applied to all relevant business. | The mortality calibration allows for stresses to both best estimate mortality rates and catastrophe risks. |

| | | |
|---|---|---|
| Morbidity | An increase in long-term morbidity rates is applied, including a reduction in morbidity recovery rates. The same stresses apply for all relevant business. | An increase to the best estimate morbidity rates for all future years. |
| Expense | Both the level of expenses and level of expense inflation are stressed under the standard formula. The same stresses apply to all business. | Expense level and expense inflation risks are modelled, with stresses calibrated by product type where appropriate. |
| Operational | Operational risk is calculated using a factor based approach applied to premiums, technical provisions and unit linked expenses. | Individual operational risks are assessed bottom-up, and modelled using a frequency-severity model. These are combined with correlation assumptions to produce aggregate probability distributions of potential operational losses. |

### E.4.4 Probability Distribution used in Internal Model

The internal model calibrations are primarily based on historical data, with expert judgements applied where required.

## E.5 Non-compliance with the MCR and the SCR

The Company's SCR and MCR have been met during 2019.

## E.6 Any other information

There is no other material information regarding the Company's capital management other than those disclosed in the sections above.

# Appendix A - List of subsidiaries and related undertakings

The following is a list of subsidiaries and related undertakings of the Company at 31 December 2019.

(i) Direct subsidiary undertakings

**Investment**

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Cardinal Distribution Park Management Limited | Ordinary Shares | 66% | United Kingdom | 5th Floor Cavendish House, 39 Waterloo Street, Birmingham, B2 5PP, UK |
| Carraway Guildford General Partner Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Carraway Guildford Limited Partnership | Limited partnership interest | 50% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| CJPT Real Estate Inc. | Ordinary Shares | 100% | Canada | 180 Dundas Street West, Toronto, M5G 1Z8, Canada |
| Cribbs Causeway JV Limited | Ordinary Shares | 50% | United Kingdom | 40 Broadway, London, SW1H 0BT, UK |
| Cribbs Mall Nominee (1) Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Edger Investments Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Edinburgh Park (Management) Limited | Private company limited by guarantee | 100% | Scotland | 1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL, UK |
| EF IV Schoolhill GP Limited | Ordinary Shares | 100% | UK | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Fort Kinnaird Limited Partnership | Limited Partnership Interest | 50% | UK | York House, 45 Seymour Street, London, W1H 7LX, UK |
| Foudry Properties Limited | Ordinary Shares | 50% | United Kingdom | Clearwater Court, Vastern Road, Reading RG1 8DB, UK |
| The Greenpark (Reading) Limited Partnership | Limited Partnership Interest | 50% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Manchester JV Limited | Ordinary Shares | 50% | United Kingdom | 40 Broadway, London, SW1H 0BU, UK |
| Manchester Nominee (1) Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Minster Court Estate Management Limited | A Ordinary Shares and B Ordinary Shares | 56% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| NAPI REIT, Inc | Ordinary Shares | 99% | USA | 7 St. Paul Street, Suit 820, Baltimore MD 21202, USA |
| Optimus Point Management Company Limited | Ordinary Shares | 52% | United Kingdom | Barrat House Cartwright Way, Bardon Hill, Coalville, LE67 1UF, UK |
| Pacus (UK) Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| PPMC First Nominees Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |

| | | | | |
|---|---|---|---|---|
| Prudential Investment (Luxembourg) 2 S.à.r.l. | Ordinary shares | 100% | Luxembourg | 16 Boulevard Royal, L-2449, Luxembourg, Luxembourg |
| Prudential Loan Investments SCSp | Limited partnership interest | 100% | Luxembourg | 1, Rue Hildegard von Bingen, L-1282 Luxembourg |
| PAP Trustee Pty Limited | Unclassified Shares | 100% | Australia | Level 17 Tower One, International Towers, Barangaroo, Sydney, NSW 2000, Australia |
| Prudential Real Estate Investments 1 Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential Real Estate Investments 2 Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential Real Estate Investments 3 Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prutec Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| PVM Partnerships Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Schoolhill Sarl | Ordinary Shares | 100% | Luxembourg | 20, rue de la Poste, Luxembourg |
| Smithfield Limited | Has both £1.00 Ordinary Shares and $1.00 Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Three Snowhill Birmingham S.a.r.l. | Ordinary Shares | 100% | Luxembourg | 5, rue Guilllaume Kroll, L-1882, Luxembourg |
| Two Snowhill Birmingham S.a.r.l. | Ordinary shares | 100% | Luxembourg | 5, rue Guilllaume Kroll, L-1882, Luxembourg |
| Vanquish Properties LP Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, JE1 1ST, Jersey |
| Wessex Gate Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Westwacker Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |

**Insurance**

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Prudential International Assurance plc | Ordinary Shares | 100% | Ireland | Montague House, Adelaide Road, Dublin 2, D02 K039, Ireland |
| Prudential Pensions Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |

**Pension**

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Prudential Corporate Pensions Trustee Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |

### Holding company

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Prudential Holborn Life Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |

### Mortgage lending

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Prudential Lifetime Mortgages Limited | Ordinary & Preference Shares | 100% | United Kingdom | Craigforth, Stirling, FK9 4UE, UK |

### Financing

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Scottish Amicable Finance Limited | Ordinary Shares | 100% | United Kingdom | Craigforth, Stirling, FK9 4UE, UK |

### Service

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Prudential International Management Services Limited | Ordinary Shares | 100% | Ireland | Montague House, Adelaide Road, Dublin 2, D02 K039, Ireland |

### In liquidation

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Prudential Property Investments Limited | Ordinary Shares and Redeemable Preference Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |

(ii) Other subsidiaries, associated undertakings, joint ventures and significant holdings

### Investment

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| ANRP II (AIV VI FC), L.P. | Limited Partnership Interest | 43% | Cayman Islands | Cayman Corporate Centre, 27 Hospital Road, George Town, KY 9008, Cayman Islands |
| BWAT Retail Nominee (1) Limited | A Ordinary Shares | 50% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |

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|---|---|---|---|---|
| BWAT Retail Nominee (2) Limited | A Ordinary Shares | 50% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Carraway Guildford (Nominee A) Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, Jersey, JE1 1ST |
| Carraway Guildford (Nominee B) Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, Jersey, JE1 1ST |
| Carraway Guildford Investments Unit Trust | Ordinary Shares | 100% | Jersey | 13 Castle Street, St Helier, JE4 5UT, Jersey |
| Centaurus Retail LLP | Limited Partnership Interest | 50% | United Kingdom | 40 Broadway, London, SW1H 0BU, UK |
| Centre Capital Non-Qualified Investors IV AIV Orion, L.P. | Limited partnership interest | 46% | USA | Corporation Service Company, 2711 Centerville Rd., Suite 400, Wilmington, DE, 19808, United States |
| Centre Capital Non-Qualified Investors IV AIV-ELS, L.P. | Limited partnership interest | 46% | USA | Corporation Service Company, 2711 Centerville Rd., Suite 400, Wilmington, DE, 19808, United States |
| Centre Capital Non-Qualified Investors IV, L.P. | Limited partnership interest | 45% | USA | Corporation Service Company, 2711 Centerville Rd., Suite 400, Wilmington, DE, 19808, United States |
| Centre Capital Non-Qualified Investors V AIV-ELS LP | Limited partnership interest | 37% | USA | Corporation Service Company, 2711 Centerville Rd., Suite 400, Wilmington, DE, 19808, United States |
| Centre Capital Non-Qualified Investors V LP | Limited partnership interest | 33% | USA | Corporation Service Company, 2711 Centerville Rd., Suite 400, Wilmington, DE, 19808, United States |
| CJPT Real Estate No. 1 Trust | Ordinary Shares | 100% | Canada | 180 Dundas Street West, Toronto, M5G 1Z8, Canada |
| CJPT Real Estate No. 2 Trust | Ordinary Shares | 100% | Canada | 180 Dundas Street West, Toronto, M5G 1Z8, Canada |
| LF Prudential European QIS Fund | Ordinary Shares | 83% | United Kingdom | 65 Gresham Street, London, EC2V 7NQ, UK |
| LF Prudential Japanese QIS Fund | Ordinary Shares | 87% | United Kingdom | 65 Gresham Street, London, EC2V 7NQ, UK |
| LF Prudential North American QIS Fund | Ordinary Shares | 91% | United Kingdom | 65 Gresham Street, London, EC2V 7NQ, UK |
| LF Prudential Pacific Markets Trust Fund | Ordinary Shares | 88% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| LF Prudential UK Growth QIS Fund | Ordinary Shares | 93% | United Kingdom | 65 Gresham Street, London, EC2V 7NQ, UK |
| Cribbs Causeway Merchants Association Limited | Limited by Guarantee | 20% | United Kingdom | The Mall at Cribbs Causeway, Bristol, BS34 5DG, UK |
| Eastspring Investments - Asian Local Bond Fund | Ordinary shares | 97% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments - Asian Smaller Companies Fund | Ordinary shares | 100% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments - Asian Total Return Bond Fund | Ordinary shares | 94% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments - Developed and Emerging Asia Equity Fund | Ordinary shares | 98% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |

| | | | | |
|---|---|---|---|---|
| Eastspring Investments - Global Emerging Markets Dynamic Fund | Ordinary shares | 94% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments US Equity Income Fund | Ordinary shares | 100% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments - Japan Equity Fund | Ordinary shares | 87% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments SICAV-FIS Africa Equity FUND | Ordinary shares | 100% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments - Global Emerging Markets Customized Equity Fund | Ordinary Shares | 99% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments - Japan Smaller Companies Fund | Ordinary Shares | 60% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Eastspring Investments Asian Bond Fund | Ordinary Shares | 34% | Luxembourg | 26, Boulevard Royal, L-2449, Luxembourg |
| Folios III Designated Activity Company | Ordinary Shares | 49% | Ireland | Fourth Floor, 76 Lower Baggot Street, Dublin 2, Ireland |
| Folios IV Designated Activity Company | Ordinary Shares | 77% | Ireland | Fourth Floor, 76 Lower Baggot Street, Dublin 2, Ireland |
| Fort Kinnaird GP Limited | Ordinary Shares | 50% | UK | York House, 45 Seymour Street, London, W1H 7LX, UK |
| Infracapital Partners LP | Limited partnership interest | 33% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Infracapital Partners II LP | Limited partnership interest | 26% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Lion Credit Opportunity Fund Public Limited Company - Credit Opportunity Fund XV | Ordinary Shares | 96% | Ireland | 53 Merrion Square South, Dublin 2, D02 PR63, Ireland |
| MCF S.r.l. | Ordinary shares | 45% | Italy | Via Montenapoleone 29 CAP, 20121, Milan, Italy |
| M&G Asia Property Fund | A Class Shares | 56% | Luxembourg | 16, Boulevard Royal, Luxembourg, L-2449, Luxembourg |
| M&G Corporate Bond Fund | Ordinary shares | 32% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| M&G Dividend Fund | Ordinary shares | 54% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| M&G European Credit Investment Fund | Ordinary Shares | 20% | Luxembourg | 80, route d'Esch, L-1470, Luxembourg |
| M&G European High Yield Credit Investment Fund | Ordinary Shares | 75% | Luxembourg | 80, route d'Esch, L-1470, Luxembourg |
| M&G European Property Fund SICAV-FIS | Ordinary Shares | 38% | Luxembourg | 16 Boulevard Royal, Luxembourg, L-2449, Luxembourg |
| M&G European Select Fund | Ordinary Shares | 38% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| M&G Gilt & Fixed Interest Income Fund | Ordinary shares | 24% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| M&G Global Convertibles Fund | Ordinary Shares | 65% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| M&G Positive Impact Fund Total | Ordinary Shares | 36% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |

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|---|---|---|---|---|
| M&G UK Property Fund | Ordinary Shares | 100% | Luxembourg | 16, Boulevard Royal, L-2449, Luxembourg |
| M&G UK Residential Property Fund | Limited Partnership Interest | 58% | Luxembourg | 34-38, avenue de la Liberté, L-1931, Luxembourg |
| M&G UK Companies Financing Fund II LP | Limited partnership interest | 48% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| M&G Credit Income Investment Trust plc | Ordinary Shares | 24% | UK | Beaufort House, 51 New North Road, Exeter, EX4 4EP, UK |
| M&G European Loan Fund Ltd | Ordinary Shares | 26% | Ireland | Block D, Iveagh Court, Harcourt Road, Dublin, 2 Ireland |
| M&G Pan European Select Smaller Companies Fund | Units | 25% | UK | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| M&G Smaller Companies Fund | Ordinary Shares | 42% | UK | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| M&G Sustainable Multi Asset Fund | Ordinary Shares | 87% | UK | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Old Kingsway LP | Limited Partnership Interest | 100% | USA | 2711 Centreville Road, Suite 400, Wilmington, DE 19808, USA |
| PPM America Private Equity Fund III LP | Limited Partnership Interest | 50% | USA | 874 Walker Road, Suite C, City of Dover, County of Kent, State of Delaware 19904, United States |
| PPM America Private Equity Fund IV LP | Limited Partnership Interest | 50% | USA | 874 Walker Road, Suite C, City of Dover, County of Kent, State of Delaware 19904, United States |
| PPM America Private Equity Fund V LP | Limited Partnership Interest | 50% | USA | 874 Walker Road, Suite C, City of Dover, County of Kent, State of Delaware 19904, United States |
| PPM America Private Equity Fund VI LP | Limited Partnership Interest | 40% | USA | 874 Walker Road, Suite C, City of Dover, County of Kent, State of Delaware 19904, United States |
| PPM America Private Equity Fund VII LP | Limited Partnership Interest | 46% | USA | 874 Walker Road, Suite C, City of Dover, County of Kent, State of Delaware 19904, United States |
| PPM Funds - PPM Floating Rate Income Fund | Ordinary Shares | 99% | USA | C/O PPM America, Inc., West Wacker Drive, Suite 1200, 60606, Chicago, USA |
| PPM High Yield Core Fund | Ordinary Shares | 99% | USA | C/O PPM America, Inc., West Wacker Drive, Suite 1200, 60606, Chicago, USA |
| PPM Small Cap Value Fund | Ordinary Shares | 86% | USA | C/O PPM America, Inc., West Wacker Drive, Suite 1200, 60606, Chicago, USA |
| Property Partners (Two Rivers) Limited | Ordinary Shares | 50% | United Kingdom | Bow Bells House, 1 Bread Street, London, EC4M 9HH, UK |
| Prudential Credit Opportunities SCSp | Ordinary shares | 100% | Luxembourg | 1, Rue Hildegard von Bingen, L-1282 Luxembourg |
| Prudential Dynamic 20-55 Portfolio | Ordinary Shares | 27% | United Kingdom | 17 Rochester Row, London, SW1P 1QT, UK |

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| Prudential Dynamic 40-80 Portfolio | Ordinary Shares | 25% | United Kingdom | 17 Rochester Row, London, SW1P 1QT, UK |
| Prudential Dynamic 0-30 Portfolio | Ordinary Shares | 20% | United Kingdom | 17 Rochester Row, London, SW1P 1QT, UK |
| Prudential Dynamic 60-100 Portfolio | Ordinary Shares | 23% | United Kingdom | 17 Rochester Row, London, SW1P 1QT, UK |
| Prudential Dynamic Focused 0-30 Portfolio | Ordinary Shares | 48% | United Kingdom | 17 Rochester Row, London, SW1P 1QT, UK |
| Prudential Dynamic Focused 20 - 55 Portfolio | Ordinary Shares | 24% | United Kingdom | 17 Rochester Row, London, SW1P 1QT, UK |
| Prudential Equity Release Mortgages Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential Greenfield LP | Limited partnership interest | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential/M&G UK Companies Financing Fund LP | Limited partnership interest | 34% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential UK Real Estate Limited Partnership | Limited Partnership Interest | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential UK Real Estate Nominee 1 Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential UK Real Estate Nominee 2 Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential UK Real Estate General Partner Limited | Ordinary Shares | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Prudential Loan Investments 1 S.a.r.l | Ordinary Shares | 100% | Luxembourg | 1, Rue Hildegard von Bingen, L-1282 Luxembourg |
| Randolph Street LP | Limited Partnership Interest | 100% | USA | 2711 Centreville Road, Suite 400, Wilmington, DE 19808, USA |
| Sectordate Limited | Ordinary Shares | 33% | United Kingdom | 1st Floor Cavendish House, 39 Waterloo Street, Birmingham, B2 5PP, UK |
| Selly Oak Shopping Park Limited Partnership | Limited Partnership Interest | 100% | United Kingdom | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| SMLLC | Limited Partnership Interest | 100% | USA | 251 Little Falls Drive, Wilmington, DE 19808, USA |
| St Edward Homes Limited | Ordinary Shares | 50% | United Kingdom | Berkeley House, 19 Portsmouth Road, Surrey, KT11 1JG, UK |
| Silver?eet Capital 2004 LP | Limited Partnership Interest | 100% | Guernsey | 1 Royal Plaza, St Peter Port, GY1 2HL, Guernsey |
| Silver?eet Capital 2005 LP | Limited Partnership Interest | 100% | Guernsey | 1 Royal Plaza, St Peter Port, GY1 2HL, Guernsey |
| Silver?eet Capital 2006 LP | Limited Partnership Interest | 100% | Guernsey | 1 Royal Plaza, St Peter Port, GY1 2HL, Guernsey |
| Silver?eet Capital 2009 LP | Limited Partnership Interest | 100% | Guernsey | 1 Royal Plaza, St Peter Port, GY1 2HL, Guernsey |

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|---|---|---|---|---|
| Silver?eet Capital 2011/12 LP | Limited Partnership Interest | 100 % | Guernsey | 1 Royal Plaza, St Peter Port, GY1 2HL, Guernsey |
| Silverfleet Capital II WPLF LP | Limited Partnership Interest | 100 % | Guernsey | 1 Carter Lane, London, EC4V 5ER, UK |
| The Car Auction Unit Trust | Ordinary shares | 50 % | Guernsey | Dorey Court, Admiral Park, St. Peter Port, GY1 2HT, Guernsey |
| St Edward Homes Partnership | Limited Partnership Interest | 50 % | United Kingdom | Berkeley House, 19 Portsmouth Road, Surrey, KT11 1JG, UK |
| The Project Hoxton LP | Limited Partnership Interest | 100% | UK | 12 Throgmorton Avenue, London, EC2N 2DL, UK |
| The Strand Property Unit Trust | Limited Partnership Interest | 50% | Jersey | Liberte house, 19-23 La Motte Street, St Helier, JE2 4SY, Jersey |
| The Two Rivers Trust | Ordinary shares | 50% | Jersey | Liberte house, 19-23 La Motte Street, St Helier, JE2 4SY, Jersey |
| Vanquish Properties GP Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, JE1 1ST, Jersey |
| Vanquish Properties GP Nominee A Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, JE1 1ST, Jersey |
| Vanquish Properties GP Nominee 1 Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, JE1 1ST, Jersey |
| Vanquish Properties GP Nominee 2 Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, JE1 1ST, Jersey |
| Vanquish Properties GP Nominee 3 Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, JE1 1ST, Jersey |
| Vanquish Properties GP Nominee 4 Limited | Ordinary Shares | 100% | Jersey | IFC 5, St Helier, JE1 1ST, Jersey |
| Vanquish Properties (UK) Limited Partnership | Limited Partnership Interest | 100% | UK | 10 Fenchurch Avenue, London, EC3M 5AG, UK |
| Wynnefield Private Equity Partners II, L.P. | Limited Partnership Interest | 99 % | USA | 1209 Orange Street, Wilmington, DE 19801, USA |

**Service**

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Prudential Polska sp. z.o.o | Ordinary Shares | 100% | Poland | 02-670 Warszawa, Pulawska 182, Poland |

**In liquidation**

| Name | Classes of Shares held | Proportion held | Country of Incorporation | Address |
|---|---|---|---|---|
| Fashion Square ECO LP (in liquidation) | Limited Partnership Interest | 50% | USA | 1209 Orange Street, Wilmington, DE 19801, USA |

## QIS Waiver

The Financial Conduct Authority, on the application of The Prudential Assurance Company Limited (the firm), made a direction on 30 December 2019 under section 138A of the Financial Services and Markets Act 2000. The effect of the direction is to enable the firm to contract to pay benefits under linked long term contracts relating to;

(i) Ex-Prudential Holborn Life Limited ('PHL') funds in The Prudential Assurance Company Limited ('PAC') (Prudential European, Prudential International, Prudential Managed, Prudential Strategic Growth, Prudential Japanese, Prudential North American and Prudential Equity (Life only);

(ii) Ex-Scottish Amicable Life ('SAL') funds in PAC (Prudential European, Prudential International, Prudential Managed, Prudential Japanese, Prudential North American and Prudential Equity (Life only);

(iii) Ex-Scottish Amicable Life ('SAL') funds in PAC (Prudential European, Prudential International, Prudential Managed, Prudential Japanese, Prudential North American and Prudential Equity (Pension only);

(iv) Ex-M&G funds in PAC (Pru Equity Pension fund (ex M&G), Pru Equity Life fund (ex M&G), Pru Managed life fund (ex M&G) Pru Managed pension fund (ex M&G) and Pru Personal Pension fund (ex M&G) (Life & Pension); and

(v) PAC fund (Prufund Managed Fund) which are themselves determined, either wholly or partly, by reference to units in the LF Prudential European QIS Fund, LF Prudential Japanese QIS Fund, LF Prudential North American QIS Fund, and LF Prudential UK Growth QIS Fund provided that each of these funds comply with the requirements of provisions implementing the Directive 2009/65/EC or would do if they were subject to those provisions and with certain other conditions.

## Statement of directors' responsibilities

The Directors of The Prudential Assurance Company Limited acknowledge their responsibility for preparing the Solo SFCR in all material respects in accordance with the PRA rules and Solvency II Regulations.

The directors are satisfied that:

(a) throughout the financial year to 31 December 2019, the Company has complied in all material respects with the requirements of the PRA rules and the Solvency II Regulations as applicable at the level of the Company; and

(b) it is reasonable to believe that in respect of the period from 31 December 2019 to the date of the publication of the SFCR, the Company has continued to comply and therefore will continue to comply for the remainder of the financial year to 31 December 2020.

Signed on behalf of the Board of Directors

Paul Cooper
Director
23 April 2020

## Independent Auditor's Report

**Report of the external independent auditor to the Directors of The Prudential Assurance Company Limited ('the Company') pursuant to Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook applicable to Solvency II firms**

**Report on the Audit of the Relevant Elements of the Solvency and Financial Condition Report**

**Opinion**

Except as stated below, we have audited the following documents prepared by The Prudential Assurance Company Limited as at 31 December 2019:

– The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of The Prudential Assurance Company Limited as at 31 December 2019, ('**the Narrative Disclosures subject to audit**'); and

– Company templates S.02.01.02, S.12.01.02, S.17.01.02, S.22.01.21, S.23.01.01 and S.28.02.01 ('**the Templates subject to audit**').

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the '**Relevant Elements of the Solvency and Financial Condition Report**'.

We are not required to audit, nor have we audited, and as a consequence do not express an opinion on the Other Information which comprises:

– information contained within the Relevant Elements of the Solvency and Financial Condition Report set out about above which are, or derive from the Solvency Capital Requirement, as identified in the Appendix to this report;

– The 'Business and performance', 'System of governance' and 'Risk profile' sections of the Solvency and Financial Condition Report;

– Company templates S.05.01.02, S.19.01.21, S.25.02.21;

– Information calculated in accordance with the previous regime used in the calculation of the transitional measure on technical provisions, and as a consequence all information relating to the transitional measures on technical provisions as set out in the Appendix to this report where disclosed;

– the written acknowledgement by the directors of their responsibilities, including for the preparation of the solvency and financial condition report ('**the Responsibility Statement**').

To the extent the information subject to audit in the Relevant Elements of the Solvency and Financial Condition Report includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

In our opinion, the information subject to audit in the Relevant Elements of the Solvency and Financial Condition Report of The Prudential Assurance Company Limited as at 31 December 2019 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

**Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Relevant Elements of the Solvency and Financial Condition Report* section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the Solvency and Financial Condition Report in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Emphasis of Matter - special purpose basis of accounting**

We draw attention to the 'Valuation for solvency purposes' and other relevant disclosures sections of the Solvency and Financial Condition Report, which describe the basis of accounting. The Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority. As a result, the Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

**Going concern**

The Directors have prepared the Solvency and Financial Condition Report on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the Solvency and Financial Condition Report (the going concern period).

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the Solvency and Financial Condition Report. In our evaluation of the Directors' conclusions, we considered the inherent risks to the Company's business model, including the impact of Brexit, and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the company will continue in operation.

**Other Information**

The directors are responsible for the Other Information.

Our opinion on the Relevant Elements of the Solvency and Financial Condition Report does not cover the Other Information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the Solvency and Financial Condition Report, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the Relevant Elements of the Solvency and Financial Condition Report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the Relevant Elements of the Solvency and Financial Condition Report 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 in this regard.

**Responsibilities of directors for the Solvency and Financial Condition Report**

The Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations, which have been modified by the modifications, and supplemented by the approvals and determinations made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based.

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of a Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error; 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 they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

**Auditor’s Responsibilities for the Audit of the Relevant Elements of the Solvency and Financial Condition Report**

It is our responsibility to form an independent opinion as to whether the Relevant Elements of the Solvency and Financial Condition Report are prepared, in all material respects, with financial reporting provisions of the PRA Rules and Solvency II regulations on which it they based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Our objectives are to obtain reasonable assurance about whether the Relevant Elements of the Solvency and Financial Condition Report are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but it 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 decision making or the judgement of the users taken on the basis of the Relevant Elements of the Solvency and Financial Condition Report.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council’s website at: www.frc.org.uk/auditorsresponsibilities.

**Other Matters**

The Company has authority to calculate its Solvency Capital Requirement using an internal model ("the Model") approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRARules), we are not required to audit the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.

**Report on Other Legal and Regulatory Requirements**

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook we are also required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of The Prudential Assurance Company Limited statutory financial statements. 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 in this regard.

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

This report of the external auditor is made solely to the company’s directors, as its governing body, in accordance with the requirement in Rule 4.1(2) of the External Audit Part of the PRARulebook and the terms of our engagement. We acknowledge that the directors are required to submit the report

to the PRA, to enable the PRA to verify that an auditor's report has been commissioned by the Company's directors and issued in accordance with the requirement set out in Rule 4.1(2) of the External Audit Part of the PRA Rulebook and to facilitate the discharge by the PRA of its regulatory functions in respect of the company, conferred on the PRA by or under the Financial Services and Markets Act 2000.

Our audit has been undertaken so that we might state to the Company's directors those matters we are required to state to them in an auditor's report issued pursuant to Rule 4.1(2) and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company through its governing body, for our audit, for this report, or for the opinions we have formed.

**Ben Priestley**
**for and on behalf of KPMG LLP**
Chartered Accountants
15 Canada Square
Canary Wharf
London
E14 5GL

23 April 2020

**Appendix - relevant elements of the Solvency and Financial Condition Report that are not subject to audit**

**Solo internal model**

The relevant elements of the Solvency and Financial Condition Report that are not subject to audit comprise:

The following elements of template S.02.01.02:
- Row R0090: Amount of transitional measure on technical provisions in relation to the technical provisions of Prudential Pensions Limited  and the amount of risk margin in relation to the technical provisions of Prudential International Assurance plc and Prudential Pensions Limited
- Row R0550: Technical provisions - non-life (excluding health) - risk margin
- Row R0590: Technical provisions - health (similar to non-life) - risk margin
- Row R0640: Technical provisions - health (similar to life) - risk margin
- Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
- Row R0720: Technical provisions - Index-linked and unit-linked - risk margin

The following elements of template S.12.01.02
- Row R0100: Technical provisions calculated as a sum of BE and RM - Risk margin
- Rows R0110 to R0130 - Amount of transitional measure on technical provisions

The following elements of template S.17.01.02
- Row R0280: Technical provisions calculated as a sum of BE and RM - Risk margin
- Rows R0290 to R0310 - Amount of transitional measure on technical provisions

The following elements of template S.22.01.21
- Column C0030 - Impact of transitional measure on technical provisions
- Row R0010 - Technical provisions
- Row R0020 - Adjustment for restricted own fund items in respect of ring fenced funds of the Company
- Row R0090 - Solvency Capital Requirement

The following elements of template S.23.01.01
- Row R0580: SCR
- Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

The following elements of template S.28.02.01
- Row R0310: SCR

Elements of the Narrative Disclosures subject to audit identified as ‘Unaudited’.

# Quantitative Reporting Templates (QRTs)
## S.02.01.02 Balance Sheet
All amounts are in £'000

| | | Solvency II value |
|---|---|---|
| | **Assets** | C0010 |
| R0030 | Intangible assets | — |
| R0040 | Deferred tax assets | — |
| R0050 | Pension benefit surplus | 28,560 |
| R0060 | Property, plant & equipment held for own use | 540 |
| R0070 | Investments (other than assets held for index-linked and unit-linked contracts) | 152,676,770 |
| R0080 | Property (other than for own use) | 8,732,965 |
| R0090 | Holdings in related undertakings, including participations | 22,694,835 |
| R0100 | Equities | 35,919,309 |
| R0110 | Equities - listed | 35,913,423 |
| R0120 | Equities - unlisted | 5,887 |
| R0130 | Bonds | 70,537,975 |
| R0140 | Government Bonds | 13,500,816 |
| R0150 | Corporate Bonds | 52,531,533 |
| R0160 | Structured notes | — |
| R0170 | Collateralised securities | 4,505,626 |
| R0180 | Collective Investments Undertakings | 9,766,959 |
| R0190 | Derivatives | 3,845,049 |
| R0200 | Deposits other than cash equivalents | 1,179,677 |
| R0210 | Other investments | — |
| R0220 | Assets held for index-linked and unit-linked contracts | 7,911,391 |
| R0230 | Loans and mortgages | 15,535,669 |
| R0240 | Loans on policies | 2,107 |
| R0250 | Loans and mortgages to individuals | 1,611,718 |
| R0260 | Other loans and mortgages | 13,921,844 |
| R0270 | Reinsurance recoverables from: | 18,059,593 |
| R0280 | Non-life and health similar to non-life | 145,313 |
| R0290 | Non-life excluding health | 145,313 |
| R0300 | Health similar to non-life | — |
| R0310 | Life and health similar to life, excluding index-linked and unit-linked | 12,163,437 |
| R0320 | Health similar to life | (247) |
| R0330 | Life excluding health and index-linked and unit-linked | 12,163,684 |
| R0340 | Life index-linked and unit-linked | 5,750,844 |
| R0350 | Deposits to cedants | — |
| R0360 | Insurance and intermediaries receivables | 19,055 |
| R0370 | Reinsurance receivables | 8,474 |
| R0380 | Receivables (trade, not insurance) | 2,280,854 |
| R0390 | Own shares (held directly) | — |
| R0400 | Amounts due in respect of own fund items or initial fund called up but not yet paid in | — |
| R0410 | Cash and cash equivalents | 1,494,914 |
| R0420 | Any other assets, not elsewhere shown | — |
| R0500 | **Total assets** | 198,015,820 |

## S.02.01.02 Balance Sheet

| | | Solvency II value |
|---|---|---|
| | **Liabilities** | C0010 |
| R0510 | Technical provisions - non-life | 145,361 |
| R0520 | Technical provisions - non-life (excluding health) | 145,361 |
| R0530 | TP calculated as a whole | — |
| R0540 | Best Estimate | 145,361 |
| R0550 | Risk margin | — |
| R0560 | Technical provisions - health (similar to non-life) | — |
| R0570 | TP calculated as a whole | — |
| R0580 | Best Estimate | — |
| R0590 | Risk margin | — |
| R0600 | Technical provisions - life (excluding index-linked and unit-linked) | 152,388,905 |
| R0610 | Technical provisions - health (similar to life) | (2,798) |
| R0620 | TP calculated as a whole | — |
| R0630 | Best Estimate | (3,051) |
| R0640 | Risk margin | 253 |
| R0650 | Technical provisions - life (excluding health and index-linked and unit-linked) | 152,391,703 |
| R0660 | TP calculated as a whole | — |
| R0670 | Best Estimate | 150,956,313 |
| R0680 | Risk margin | 1,435,390 |
| R0690 | Technical provisions - index-linked and unit-linked | 13,635,367 |
| R0700 | TP calculated as a whole | — |
| R0710 | Best Estimate | 13,613,476 |
| R0720 | Risk margin | 21,891 |
| R0740 | Contingent liabilities | — |
| R0750 | Provisions other than technical provisions | 158,593 |
| R0760 | Pension benefit obligations | 28,101 |
| R0770 | Deposits from reinsurers | 230,502 |
| R0780 | Deferred tax liabilities | 796,632 |
| R0790 | Derivatives | 1,812,254 |
| R0800 | Debts owed to credit institutions | 3,675,971 |
| R0810 | Financial liabilities other than debts owed to credit institutions | 45,797 |
| R0820 | Insurance & intermediaries payables | 638,370 |
| R0830 | Reinsurance payables | 84,001 |
| R0840 | Payables (trade, not insurance) | 3,945,344 |
| R0850 | Subordinated liabilities | — |
| R0860 | Subordinated liabilities not in BOF | — |
| R0870 | Subordinated liabilities in BOF | — |
| R0880 | Any other liabilities, not elsewhere shown | — |
| R0900 | **Total liabilities** | 177,585,198 |
| | | |
| R1000 | **Excess of assets over liabilities** | 20,430,622 |

## S.05.01.02 Premiums claims and expenses by line of business

Unaudited

All amounts are in £'000

| | Non-life | Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance) | | | | | | Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance) | | | | | | Line of business for: accepted non-proportional reinsurance | | | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Medical expense insurance | Income protection insurance | Workers' compensation insurance | Motor vehicle liability insurance | Other motor insurance | Marine, aviation and transport insurance | Fire and other damage to property insurance | General liability insurance | Credit and suretyship insurance | Legal expenses insurance | Assistance | Misc. financial loss | Health | Casualty | Marine, aviation and transport | Property | |
| | | C0010 | C0020 | C0030 | C0040 | C0050 | C0060 | C0070 | C0080 | C0090 | C0100 | C0110 | C0120 | C0130 | C0140 | C0150 | C0160 | C0200 |
| | **Premiums written** | | | | | | | | | | | | | | | | | |
| R0110 | *Gross - Direct Business* | | | | | | | | | | | | | | | | | — |
| R0120 | *Gross - Proportional reinsurance accepted* | | | | | | | | | | | | | | | | | — |
| R0130 | *Gross - Non-proportional reinsurance accepted* | | | | | | | | | | | | | | | | | — |
| R0140 | *Reinsurers' share* | | | | | | | | | | | | | | | | | — |
| R0200 | *Net* | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| | **Premiums earned** | | | | | | | | | | | | | | | | | |
| R0210 | *Gross - Direct Business* | | | | | | | | | | | | | | | | | — |
| R0220 | *Gross - Proportional reinsurance accepted* | | | | | | | | | | | | | | | | | — |
| R0230 | *Gross - Non-proportional reinsurance accepted* | | | | | | | | | | | | | | | | | — |
| R0240 | *Reinsurers' share* | | | | | | | | | | | | | | | | | — |
| R0300 | *Net* | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| | **Claims incurred** | | | | | | | | | | | | | | | | | |
| R0310 | *Gross - Direct Business* | | | | (8,550) | | | | (5,803) | | | | | | | | | (14,353) |
| R0320 | *Gross - Proportional reinsurance accepted* | | | | | | | | | | | | | | | | | — |
| R0330 | *Gross - Non-proportional reinsurance accepted* | | | | | | | | | | | | | | | | | — |
| R0340 | *Reinsurers' share* | | | | (8,550) | | | | (5,803) | | | | | | | | | (14,353) |
| R0400 | *Net* | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| | **Changes in other technical provisions** | | | | | | | | | | | | | | | | | |
| R0410 | *Gross - Direct Business* | | | | | | | | | | | | | | | | | — |
| R0420 | *Gross - Proportional reinsurance accepted* | | | | | | | | | | | | | | | | | — |
| R0430 | *Gross - Non-proportional reinsurance accepted* | | | | | | | | | | | | | | | | | — |
| R0440 | *Reinsurers' share* | | | | | | | | | | | | | | | | | — |
| R0500 | *Net* | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — | — |
| R0550 | **Expenses incurred** | | | | | | | | | | | | | | | | | — |
| R1200 | **Other expenses** | | | | | | | | | | | | | | | | | |
| R1300 | **Total expenses** | | | | | | | | | | | | | | | | | — |

## S.05.01.02 Premiums claims and expenses by line of business

| | Life | Line of Business for: life insurance obligations | | | | | | Life reinsurance obligations | | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Health insurance | Insurance with profit participation | Index-linked and unit-linked insurance | Other life insurance | Annuities stemming from non-life insurance contracts and relating to health insurance obligations | Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations | Health reinsurance | Life reinsurance | |
| | | C0210 | C0220 | C0230 | C0240 | C0250 | C0260 | C0270 | C0280 | C0300 |
| | **Premiums written** | | | | | | | | | |
| R1410 | *Gross* | 16,003 | 9,391,310 | 474,314 | 417,862 | | | — | 1,071,153 | 11,370,641 |
| R1420 | *Reinsurers' share* | 1,754 | 418 | 368,450 | (145,601) | | | — | 522 | 225,543 |
| R1500 | *Net* | 14,248 | 9,390,892 | 105,864 | 563,463 | | | — | 1,070,631 | 11,145,098 |
| | **Premiums earned** | | | | | | | | | |
| R1510 | *Gross* | 16,003 | 9,411,367 | 474,314 | 417,862 | | | — | 1,051,096 | 11,370,641 |
| R1520 | *Reinsurers' share* | 1,754 | 940 | 368,450 | (145,601) | | | — | — | 225,543 |
| R1600 | *Net* | 14,248 | 9,410,427 | 105,864 | 563,463 | | | — | 1,051,096 | 11,145,098 |
| | **Claims incurred** | | | | | | | | | |
| R1610 | *Gross* | 5,418 | 7,931,351 | 1,495,490 | 3,339,377 | | | — | 467,095 | 13,238,731 |
| R1620 | *Reinsurers' share* | 2,964 | 1,073 | 477,840 | 1,749,475 | | | — | 845 | 2,232,197 |
| R1700 | *Net* | 2,454 | 7,930,278 | 1,017,650 | 1,589,902 | | | — | 466,250 | 11,006,534 |
| | **Changes in other technical provisions** | | | | | | | | | |
| R1710 | *Gross* | 7,122 | (9,236,708) | (643,222) | 489,222 | | | — | (1,310,863) | (10,694,449) |
| R1720 | *Reinsurers' share* | (11,595) | (2,628) | (672,645) | 1,380,992 | | | — | 1,010 | 695,135 |
| R1800 | *Net* | 18,717 | (9,234,080) | 29,422 | (891,770) | | | — | (1,311,872) | (11,389,584) |
| R1900 | **Expenses incurred** | 1,952 | 704,108 | 114,190 | 244,446 | | | — | 29,310 | 1,094,006 |
| R2500 | **Other expenses** | | | | | | | | | (20,172) |
| R2600 | **Total expenses** | | | | | | | | | 1,073,833 |

## S.12.01.02 Life and Health SLT Technical Provisions

All amounts are in £'000

| | | Insurance with profit participation | Index-linked and unit-linked insurance | | | Other life insurance | | | Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations | Accepted reinsurance | Total (Life other than health insurance, including Unit-Linked) | Health insurance (direct business) | | | Annuities stemming from non-life insurance contracts and relating to health insurance obligations | Health reinsurance (reinsurance accepted) | Total (Health similar to life insurance) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Contracts without options and guarantees | Contracts with options or guarantees | | Contracts without options and guarantees | Contracts with options or guarantees | | | | | Contracts without options and guarantees | Contracts with options or guarantees | | | |
| | | C0020 | C0030 | C0040 | C0050 | C0060 | C0070 | C0080 | C0090 | C0100 | C0150 | C0160 | C0170 | C0180 | C0190 | C0200 | C0210 |
| R0010 | Technical provisions calculated as a whole | — | — | | | — | | | — | — | — | — | | | — | — | — |
| R0020 | Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated | — | — | | | — | | | — | — | — | — | | | — | — | — |
| | Technical provisions calculated as a sum of BE and RM | | | | | | | | | | | | | | | | |
| | Best estimate | | | | | | | | | | | | | | | | |
| R0030 | Gross Best Estimate | 103,316,921 | | 13,060,345 | 553,131 | | 26,901,417 | 13,253,853 | — | 7,484,122 | 164,569,789 | | 4,260 | (7,311) | — | — | (3,051) |
| R0080 | Total Recoverables from reinsurance/SPV and Finite | — | | 5,750,845 | (1) | | 8,974,359 | 3,190,311 | — | (986) | 17,914,527 | | (247) | — | — | — | (247) |
| R0090 | Best estimate minus recoverables from | 103,316,921 | | 7,309,500 | 553,132 | | 17,927,058 | 10,063,542 | — | 7,485,109 | 146,655,262 | | 4,507 | (7,311) | — | — | (2,804) |
| R0100 | Risk margin | 1,150,969 | 96,949 | | | 2,902,986 | | | — | 63,992 | 4,214,896 | 253 | | | — | — | 253 |
| | Amount of the transitional on Technical Provisions | | | | | | | | | | | | | | | | |
| R0110 | Technical Provisions calculated as a whole | — | — | | | — | | | — | — | — | — | | | — | — | — |
| R0120 | Best estimate | — | | — | — | | — | — | — | — | — | | — | — | — | — | — |
| R0130 | Risk margin | (719,296) | (75,058) | | | (1,918,426) | | | — | (44,836) | (2,757,615) | — | | | — | — | — |
| R0200 | Technical provisions - total | 103,748,594 | 13,635,367 | | | 41,139,831 | | | — | 7,503,279 | 166,027,070 | (2,798) | | | — | — | (2,798) |

## S.17.01.02 Non-Life Technical Provisions
All amounts are in £'000

| | | Direct business and accepted proportional reinsurance | | | | Direct business and accepted proportional reinsurance | | | | Direct business and accepted proportional reinsurance | | | | Accepted non-proportional reinsurance | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Medical expense insurance | Income protection insurance | Workers' compensation insurance | Motor vehicle liability insurance | Other motor insurance | Marine, aviation and transport insurance | Fire and other damage to property insurance | General liability insurance | Credit and suretyship insurance | Legal expenses insurance | Assistance | Miscellaneous financial loss | Non-proportional health reinsurance | Non-proportional casualty reinsurance | Non-proportional marine, aviation and transport reinsurance | Non-proportional property reinsurance | Total Non-Life obligation |
| | | C0020 | C0030 | C0040 | C0050 | C0060 | C0070 | C0080 | C0090 | C0100 | C0110 | C0120 | C0130 | C0140 | C0150 | C0160 | C0170 | C0180 |
| R0010 | **Technical provisions calculated as a whole** | | | | | | | | | | | | | | | | | — |
| R0050 | Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default | | | | | | | | | | | | | | | | | — |
| | **Technical provisions calculated as a sum of BE and RM** | | | | | | | | | | | | | | | | | |
| | **Best estimate** | | | | | | | | | | | | | | | | | |
| | **Premium provisions** | | | | | | | | | | | | | | | | | |
| R0060 | Gross | | | | | | | | | | | | | | | | | — |
| R0140 | Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default | | | | | | | | | | | | | | | | | — |
| R0150 | **Net Best Estimate of Premium Provisions** | | | | | | | | | | | | | | | | | — |
| | **Claims provisions** | | | | | | | | | | | | | | | | | |
| R0160 | Gross | | | | 27,991 | | | | 117,371 | | | | | | | | | 145,361 |
| R0240 | Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default | | | | 27,979 | | | | 117,334 | | | | | | | | | 145,313 |
| R0250 | **Net Best Estimate of Claims Provisions** | | | | 12 | | | | 37 | | | | | | | | | 49 |
| R0260 | **Total best estimate - gross** | | | | 27,991 | | | | 117,371 | | | | | | | | | 145,361 |
| R0270 | **Total best estimate - net** | | | | 12 | | | | 37 | | | | | | | | | 49 |
| R0280 | **Risk margin** | | | | — | | | | — | | | | | | | | | — |
| | **Amount of the transitional on Technical Provisions** | | | | | | | | | | | | | | | | | |
| R0290 | Technical Provisions calculated as a whole | | | | | | | | | | | | | | | | | — |
| R0300 | Best estimate | | | | | | | | | | | | | | | | | — |
| R0310 | Risk margin | | | | | | | | | | | | | | | | | — |
| R0320 | **Technical provisions - total** | | | | 27,991 | | | | 117,371 | | | | | | | | | 145,361 |
| R0330 | **Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total** | | | | 27,979 | | | | 117,334 | | | | | | | | | 145,313 |
| R0340 | **Technical provisions minus recoverables from reinsurance/ SPV and Finite Re - total** | | | | 12 | | | | 37 | | | | | | | | | 49 |

## S.19.01.21 Non-Life insurance claims

Unaudited

All amounts are in £'000

| Z0010 | Accident year / underwriting year | — |
|---|---|---|

**Gross Claims Paid (non-cumulative)**

(absolute amount)

| | Year | C0010 | C0020 | C0030 | C0040 | C0050 | C0060 | C0070 | C0080 | C0090 | C0100 | C0110 | | C0170 | C0180 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Development year | | | | | | | | | | | | | |
| | | — | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 & + | | In Current year | Sum of years (cumulative) |
| R0100 | Prior | | | | | | | | | | | 3,087 | | 3,087 | 3,087 |
| R0160 | N-9 | | | | | | | | | | | | | | |
| R0170 | N-8 | | | | | | | | | | | | | | |
| R0180 | N-7 | | | | | | | | | | | | | | |
| R0190 | N-6 | | | | | | | | | | | | | | |
| R0200 | N-5 | | | | | | | | | | | | | | |
| R0210 | N-4 | | | | | | | | | | | | | | |
| R0220 | N-3 | | | | | | | | | | | | | | |
| R0230 | N-2 | | | | | | | | | | | | | | |
| R0240 | N-1 | | | | | | | | | | | | | | |
| R0250 | N | | | | | | | | | | | | | | |
| R0260 | | | | | | | | | | | | | Total | | |

**Gross undiscounted Best Estimate Claims Provisions**

(absolute amount)

| | Year | C0200 | C0210 | C0220 | C0230 | C0240 | C0250 | C0260 | C0270 | C0280 | C0290 | C0300 | | C0360 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Development year | | | | | | | | | | | | |
| | | — | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 & + | | Year end (discounted data) |
| R0100 | Prior | | | | | | | | | | | 145,361 | | 116,594 |
| R0160 | N-9 | | | | | | | | | | | | | |
| R0170 | N-8 | | | | | | | | | | | | | |
| R0180 | N-7 | | | | | | | | | | | | | |
| R0190 | N-6 | | | | | | | | | | | | | |
| R0200 | N-5 | | | | | | | | | | | | | |
| R0210 | N-4 | | | | | | | | | | | | | |
| R0220 | N-3 | | | | | | | | | | | | | |
| R0230 | N-2 | | | | | | | | | | | | | |
| R0240 | N-1 | | | | | | | | | | | | | |
| R0250 | N | | | | | | | | | | | | | |
| R0260 | | | | | | | | | | | | | Total | |

## S.22.01.21 Impact of long term guarantees measures and transitionals

All amounts are in £'000

| | | Amount with Long Term Guarantee measures and transitionals | Impact of transitional on technical provisions | Impact of transitional on interest rate | Impact of volatility adjustment set to zero | Impact of matching adjustment set to zero |
|---|---|---|---|---|---|---|
| | | C0010 | C0030 | C0050 | C0070 | C0090 |
| R0010 | **Technical provisions** | 166,169,634 | 2,757,615 | — | — | 2,909,753 |
| R0020 | **Basic own funds** | 12,802,907 | (1,249,069) | — | — | (1,477,397) |
| R0050 | **Eligible own funds to meet Solvency Capital Requirement** | 12,802,907 | (1,249,069) | — | — | (1,477,397) |
| R0090 | **Solvency Capital Requirement** | 9,745,453 | 232,025 | — | — | 3,366,889 |
| R0100 | **Eligible own funds to meet Minimum Capital Requirement** | 12,802,907 | (1,249,069) | — | — | (1,477,397) |
| R0110 | **Minimum Capital Requirement** | 2,436,363 | 58,006 | — | — | 841,722 |

## S.23.01.01 Own Funds

All amounts are in £'000

| | Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35 | Total | Tier 1 unrestricted | Tier 1 restricted | Tier 2 | Tier 3 |
|---|---|---|---|---|---|---|
| | | C0010 | C0020 | C0030 | C0040 | C0050 |
| R0010 | Ordinary share capital (gross of own shares) | 329,517 | 329,517 | | — | |
| R0030 | Share premium account related to ordinary share capital | — | — | | — | |
| R0040 | Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type | — | — | | — | |
| R0050 | Subordinated mutual member accounts | — | | — | — | — |
| R0070 | Surplus funds | 13,222,990 | 13,222,990 | | | |
| R0090 | Preference shares | — | | — | — | — |
| R0110 | Share premium account related to preference shares | — | | — | — | — |
| R0130 | Reconciliation reserve | (749,600) | (749,600) | | | |
| R0140 | Subordinated liabilities | — | | — | — | — |
| R0160 | An amount equal to the value of net deferred tax assets | — | | | | — |
| R0180 | Other own fund items approved by the supervisory authority as basic own funds not specified above | — | — | — | — | — |
| | **Own funds from the financial statements that should not be represented by the reconciliation reserve** | | | | | |
| R0220 | Own funds from the financial statements that should not be represented by the reconciliation reserve and do | — | | | | |
| | **Deductions** | | | | | |
| R0230 | Deductions for participations in financial and credit institutions | — | — | — | — | |
| R0290 | Total basic own funds after deductions | 12,802,907 | 12,802,907 | — | — | — |
| | **Ancillary own funds** | | | | | |
| R0300 | Unpaid and uncalled ordinary share capital callable on demand | — | | | — | |
| R0310 | Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual | — | | | — | |
| R0320 | Unpaid and uncalled preference shares callable on demand | — | | | — | — |
| R0330 | A legally binding commitment to subscribe and pay for subordinated liabilities on demand | — | | | — | — |
| R0340 | Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC | — | | | — | |
| R0350 | Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC | — | | | — | — |
| R0360 | Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC | — | | | — | |
| R0370 | Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/ | — | | | — | — |
| R0390 | Other ancillary own funds | — | | | — | — |
| R0400 | **Total ancillary own funds** | — | | | — | — |
| | **Available and eligible own funds** | | | | | |
| R0500 | Total available own funds to meet the SCR | 12,802,907 | 12,802,907 | — | — | — |
| R0510 | Total available own funds to meet the MCR | 12,802,907 | 12,802,907 | — | — | |
| R0540 | Total eligible own funds to meet the SCR | 12,802,907 | 12,802,907 | — | — | — |
| R0550 | Total eligible own funds to meet the MCR | 12,802,907 | 12,802,907 | — | — | |
| R0580 | **SCR** | 9,745,453 | | | | |
| R0600 | **MCR** | 2,436,363 | | | | |
| R0620 | **Ratio of Eligible own funds to SCR** | 131% | | | | |
| R0640 | **Ratio of Eligible own funds to MCR** | 525% | | | | |

| | Reconcilliation reserve | C0060 |
|---|---|---|
| R0700 | Excess of assets over liabilities | 20,430,622 |
| R0710 | Own shares (held directly and indirectly) | — |
| R0720 | Foreseeable dividends, distributions and charges | — |
| R0730 | Other basic own fund items | 13,552,507 |
| R0740 | Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds | 7,627,716 |
| R0760 | **Reconciliation reserve** | (749,600) |
| | **Expected profits** | |
| R0770 | Expected profits included in future premiums (EPIFP) - Life business | 76,372 |
| R0780 | Expected profits included in future premiums (EPIFP) - Non- life business | — |
| R0790 | **Total Expected profits included in future premiums (EPIFP)** | 76,372 |

## S.25.03.21 Solvency Capital Requirement – for undertakings on full internal models

Unaudited

All amounts are in £'000

| | Unique number of component | Component description | Calculation of the Solvency Capital Requirement |
|---|---|---|---|
| Row | C0010 | C0020 | C0030 |
| 1 | 103 | Interest rate risk | 1,479,335 |
| 2 | 104 | Equity risk | 3,118,211 |
| 3 | 106 | Property risk | 1,385,824 |
| 4 | 107 | Spread risk | 5,588,308 |
| 5 | 108 | Concentration risk | — |
| 6 | 109 | Currency risk | 2,031,196 |
| 7 | 110 | Other market risk | — |
| 8 | 199 | Diversification within market risk | (5,300,732) |
| 9 | 203 | Other counterparty risk | 297,131 |
| 10 | 301 | Mortality risk | 25,250 |
| 11 | 302 | Longevity risk | 3,555,509 |
| 12 | 303 | Disability-morbidity risk | 30,457 |
| 13 | 304 | Mass lapse | 161,218 |
| 14 | 305 | Other lapse risk | 1,250,969 |
| 15 | 306 | Expense risk | 1,553,627 |
| 16 | 308 | Life catastrophe risk | 17,683 |
| 17 | 309 | Other life underwriting risk | — |
| 18 | 399 | Diversification within life underwriting risk | (3,363,508) |
| 19 | 505 | Other non-life underwriting risk | — |
| 20 | 701 | Operational risk | 1,323,937 |
| 21 | 801 | Other risks | — |
| 22 | 802 | Loss-absorbing capacity of technical provisions | — |
| 23 | 803 | Loss-absorbing capacity of deferred taxes | (1,085,023) |
| 24 | 804 | Other adjustments | — |

## S.25.03.21 Solvency Capital Requirement – for undertakings on full internal models

Unaudited

All amounts are in £'000

| | Calculation of Solvency Capital Requirement | C0100 |
|---|---|---|
| R0110 | Total undiversified components | 12,069,392 |
| R0060 | Diversification | (2,323,940) |
| R0160 | Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC | — |
| R0200 | Solvency capital requirement excluding capital add-on | 9,745,453 |
| R0210 | Capital add-ons already set | — |
| R0220 | Solvency capital requirement | 9,745,453 |
| | **Other information on SCR** | |
| R0300 | Amount/estimate of the overall loss-absorbing capacity of technical provisions | (19,429,861) |
| R0310 | Amount/estimate of the overall loss-absorbing capacity of deferred taxes | (1,085,023) |
| R0410 | Total amount of Notional Solvency Capital Requirements for remaining part | 1,899,061 |
| R0420 | Total amount of Notional Solvency Capital Requirement for ring fenced funds | 2,519,935 |
| R0430 | Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios | 5,326,456 |
| R0440 | Diversification effects due to RFF nSCR aggregation for article 304 | — |
| | **Approach to tax rate** | |
| R0590 | Approach based on average tax rate | Yes |
| | **Calculation of loss absorbing capacity of deferred taxes** | |
| R0640 | Amount/estimate of LAC DT | (1,085,023) |
| R0650 | Amount/estimate of LAC DT justified by reversion of deferred tax liabilities | (799,174) |
| R0660 | Amount/estimate of LAC DT justified by reference to probable future taxable economic profit | (83,339) |
| R0670 | Amount/estimate of AC DT justified by carry back, current year | (202,510) |
| R0680 | Amount/estimate of LAC DT justified by carry back, future years | — |
| R0690 | Amount/estimate of Maximum LAC DT | (1,240,947) |

## S.28.02.01 Minimum Capital Requirement – Both life and non-life insurance activity

All amounts are in £'000

| | | Non-life activities | Life activities |
|---|---|---|---|
| | | MCR(NL,NL) Result | MCR(NL,L) Result |
| | | C0010 | C0020 |
| R0010 | **Linear formula component for non-life insurance and reinsurance obligations** | 5 | — |

| | | Non-life activities | | Life activities | |
|---|---|---|---|---|---|
| | | Net (of reinsurance/ SPV) best estimate and TP calculated as a whole | Net (of reinsurance) written premiums in the last 12 months | Net (of reinsurance/ SPV) best estimate and TP calculated as a whole | Net (of reinsurance) written premiums in the last 12 months |
| | | C0030 | C0040 | C0050 | C0060 |
| R0020 | Medical expense insurance and proportional reinsurance | — | — | — | — |
| R0030 | Income protection insurance and proportional reinsurance | — | — | — | — |
| R0040 | Workers' compensation insurance and proportional reinsurance | — | — | — | — |
| R0050 | Motor vehicle liability insurance and proportional reinsurance | 12 | — | — | — |
| R0060 | Other motor insurance and proportional reinsurance | — | — | — | — |
| R0070 | Marine, aviation and transport insurance and proportional reinsurance | — | — | — | — |
| R0080 | Fire and other damage to property insurance and proportional reinsurance | — | — | — | — |
| R0090 | General liability insurance and proportional reinsurance | 37 | — | — | — |
| R0100 | Credit and suretyship insurance and proportional reinsurance | — | — | — | — |
| R0110 | Legal expenses insurance and proportional reinsurance | — | — | — | — |
| R0120 | Assistance and proportional reinsurance | — | — | — | — |
| R0130 | Miscellaneous financial loss insurance and proportional reinsurance | — | — | — | — |
| R0140 | Non-proportional health reinsurance | — | — | — | — |
| R0150 | Non-proportional casualty reinsurance | — | — | — | — |
| R0160 | Non-proportional marine, aviation and transport reinsurance | — | — | — | — |
| R0170 | Non-proportional property reinsurance | — | — | — | — |

| | | MCR(L,NL) Result | MCR(L,L) Result |
|---|---|---|---|
| | | C0070 | C0080 |
| R0200 | **Linear formula component for life insurance and reinsurance obligations** | — | (2,909,983) |

| | | Net (of reinsurance/ SPV) best estimate and TP calculated as a whole | Net (of reinsurance /SPV) total capital at risk | Net (of reinsurance/ SPV) best estimate and TP calculated as a whole | Net (of reinsurance/ SPV) total capital at risk |
|---|---|---|---|---|---|
| | | C0090 | C0100 | C0110 | C0120 |
| R0210 | Obligations with profit participation - guaranteed benefits | — | | 24,052,939 | |
| R0220 | Obligations with profit participation - future discretionary benefits | — | | 85,952,928 | |
| R0230 | Index-linked and unit-linked insurance obligations | — | | 7,862,632 | |
| R0240 | Other life (re)insurance and health (re)insurance obligations | — | | 28,783,958 | |
| R0250 | Total capital at risk for all life (re)insurance obligations | | — | | 14,440,706 |

| | **Overall MCR calculation** | C0130 |
|---|---|---|
| R0300 | Linear MCR | (2,909,979) |
| R0310 | SCR | 9,745,453 |
| R0320 | MCR cap | 4,385,454 |
| R0330 | MCR floor | 2,436,363 |
| R0340 | Combined MCR | 2,436,363 |
| R0350 | Absolute floor of the MCR | 3,187 |
| R0400 | **Minimum Capital Requirement** | 2,436,363 |

| | **Notional non-life and life MCR calculation** | C0140 | C0150 |
|---|---|---|---|
| R0500 | Notional linear MCR | 5 | (2,909,983) |
| R0510 | Notional SCR excluding add-on (annual or latest calculation) | (16) | 9,745,469 |
| R0520 | Notional MCR cap | (7) | 4,385,461 |
| R0530 | Notional MCR floor | (4) | 2,436,367 |
| R0540 | Notional combined MCR | (7) | 2,436,367 |
| R0550 | Absolute floor of the notional MCR | 3,187 | 3,187 |
| R0560 | **Notional MCR** | 3,187 | 2,436,367 |