M&G

IFRS 17 Market Update

7 December 2022

IFRS 17 Market Update

Disclaimer

Key messages

1	**IFRS 17 does not change M&G's strategy, solvency, capital mgmt. framework or dividend policy**
2	**IFRS Shareholder Equity expected to increase** at the transition date[1]
3	**IFRS leverage ratio expected to fall**, no change expected to leverage measured on a SII basis
4	Volatility related to **assumption changes (e.g. longevity) is removed from Annuities AOP[2]** result
5	Profit signature of **With-Profits business (including PruFund) no longer back-end loaded**

1. 1st January 2023; 2. Adjusted Operating Profit; assumption changes will be absorbed by the Contractual Service Margin (CSM) and gradually released to AOP over the remaining lifetime of the insurance contracts

Setting the scene for M&G

IFRS 17 does not affect our strategy and capital management framework

IFRS 17

- International accounting standard for insurance contracts
- It applies to all M&G insurance businesses in the UK and Europe
- Effective date: 1 January 2023
- Next M&G IFRS 17 market update: June 2023
- First set of IFRS 17 financial statements[1]: HY 2023 Results

NO CHANGE

- Business strategy and priorities
- Capital Management Framework
- OCG[2] financial target (£2.5bn over 2022-24)
- Dividend policy
- SII coverage ratio, SII target range[3], and SII leverage ratio[4]
- Asset Management earnings

CHANGE

- IFRS Equity and Insurance Liabilities, and IFRS leverage
- With-Profits[5] and Annuities IFRS profit signature

1. Including comparative results; 2. Operating Capital Generation; 3. The Solvency II target range is 160-190%; at HY 2022 the SII coverage ratio was 214%; 4. 34% at HY 2022, or 31% on a pro forma basis; 5. Both PruFund and Traditional With-Profits

Only a few KPIs are affected by the implementation of IFRS 17

The impact is concentrated in the Retail & Savings segment

Measure	Change (Y/N)
AUMA and net flows	N[1]
IFRS profitability	Y
IFRS balance sheet	Y
Solvency II capital generation	N
Solvency II capital position	N

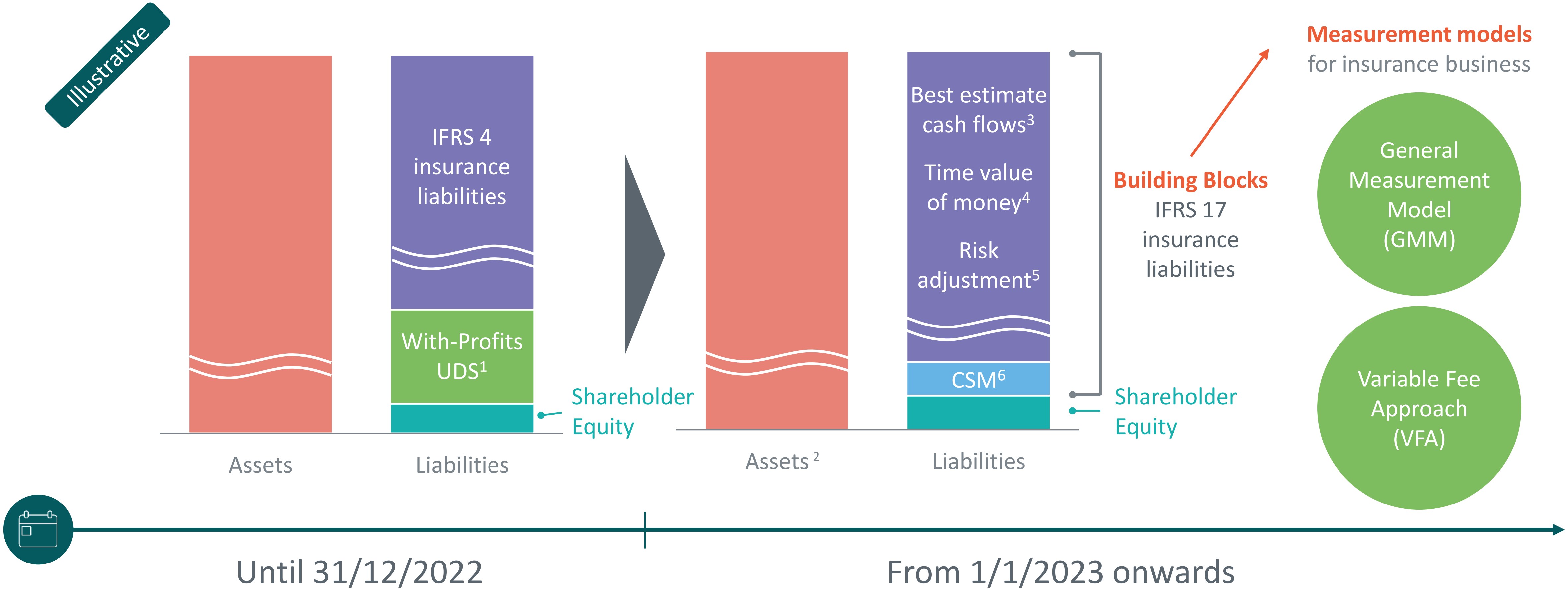
P&L elements impacted

Asset Management
AM Revenues
AM Costs
Performance fees
Investment income and minority interest
Total Asset Management AOP
Retail & Savings
Wealth
o/w With-Profits (PruFund UK)
Heritage (With-Profits and Annuities)
Other Retail & Savings
Total Retail & Savings AOP
Corporate Centre
Total Corporate Centre AOP
Total Adjusted Operating Profit

1. The implementation of IFRS 9, with effective date 1 January 2023, will have a non-material impact on AUMA

IFRS 17 in a nutshell: Fulfilment value liabilities and the CSM

Two main measurement models to calculate the CSM, GMM and VFA



Note: Charts are illustrative. 1. Unallocated Distributable Surplus; 2. The implementation of IFRS 9, with effective date 1 January 2023, will have non-material impact on Assets; 3. Current unbiased probability weighted estimate of future cash flows; 4. Discounted future cash flows using 'Top-down' or 'Bottom-up' rate that takes into account illiquidity premium; 5. Reflects compensation for uncertainty on non-financial risks based on a defined confidence level; 6. Contractual Service Margin

Introducing the measurement models for insurance business

GMM applies to our Shareholder Annuities book and VFA to With-Profits

	M&G application	Common features	Differences
GMM: General Measurement Model	**Annuities** and other insurance contracts	• Building Block approach to calculate the CSM (best estimate cash flows and time value of money) • CSM spreads over time the recognition of profits • Non-market assumptions changes are absorbed by the CSM • The risk adjustment is calculated with the confidence level approach	• Impact of market assumption changes is immediately reflected through the P&L • Top down approach to the liability discount rate
VFA: Variable Fee Approach	**With-Profits** (Traditional and PruFund) and unit-linked business		• Impact of market assumption changes is absorbed by the CSM and released over time • Bottom up approach to the liability discount rate (risk free + illiquidity premium)

Note: The slide outlines the M&G specific application of GMM and VFA measurement models. Common features and differences refer to the application of the two different measurement models at M&G plc

Transition

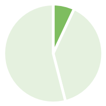
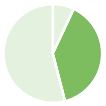
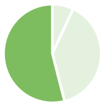
Approach to transition will influence future profit recognition

M&G will use a blend of three approaches to determine the opening CSM

IFRS 17 allows three approaches to determine the **CSM opening balance**

Whenever possible we apply the **fully retrospective** or the **modified retrospective** approach

The choice to apply the **fair value approach** is primarily driven by data restrictions and availability

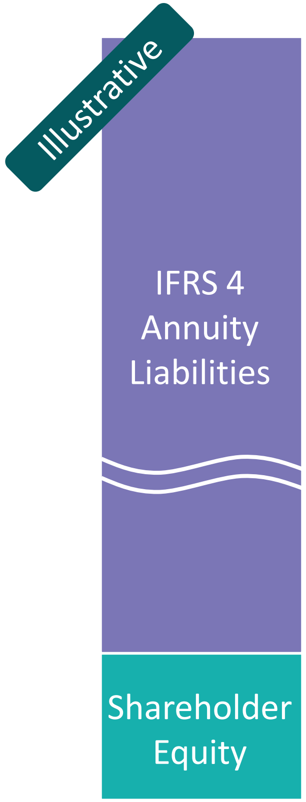
	Fully retrospective	Modified retrospective	Fair Value
Approach	Recognise and measure each group of contracts as if IFRS 17 had always applied It implies the calculation of the CSM at the date the insurance contracts were originally issued and subsequent roll forward to the date of transition	The application of prescribed and narrow simplifications to achieve the closest possible outcome to the retrospective approach by using reasonable and supportable information without undue cost and effort	The CSM is determined as the difference between the "fair value" of the insurance liabilities[1] and the IFRS 17 fulfilment cash flows (Best Estimate + Risk Adjustment) at the transition date
M&G application	Part of PruFund business	Remaining PruFund policies and part of Traditional With-Profits business	Remaining Traditional With-Profits, annuities and unit-linked
% of insurance liabilities applied[2]			

1. Calculated according to the IFRS 13 "Fair Value Measurement" principle; 2. Estimated impact ahead of the transition date

Impact of transition on Shareholder Annuities

Different profit recognition lowers Shareholder Equity and creates the CSM

IFRS 4 - Shareholder Balance Sheet



- IFRS 4 annuity liabilities are calculated as the expected value of future annuity payments and expenses, discounted by a valuation interest rate
- Prudent assumptions are used to determine the value of the insurance liability

Shareholder Equity includes profits recognised in previous years

IFRS 17 - Shareholder Balance Sheet

Fulfilment cash flows include the present value of best estimate liabilities plus the risk adjustment for non-financial risks

- The CSM represents unearned profits under IFRS 17 based on transition calculations
- Under IFRS 4 most profits would have been recognised as Shareholder Equity upfront
- Unearned profits will emerge through the life of insurance contracts (as CSM releases) as services are provided to customers

Reduction in Equity at transition largely due to the CSM set up

Note: Charts are for illustrative purposes only

Impact of transition on the With-Profits Fund

c.10% of the IFRS With-Profits Fund surplus recognised as Shareholder Equity

IFRS 4 - Shareholder Balance Sheet

- IFRS 4 With-Profits liabilities are calculated with a market consistent value approach
- Amount expected to be paid based on the current value of investments held by the WPF[2]
- No up-front shareholder value is capitalised in respect of the WPF[2] surplus

- Excess WPF[2] assets over policyholder liabilities
- Recorded as a liability, with no benefit to Shareholder Equity

IFRS 17 - Shareholder Balance Sheet

Fulfilment cash flows include:

- The present value of best estimate liabilities plus the risk adjustment for non-financial risks, and
- The share of the IFRS WPF[2] surplus that is notionally attributed to current and future policyholders

- The CSM represents unearned profits under IFRS 17 based on transition calculations
- These profits will emerge through the life of insurance contracts as services are provided to customers

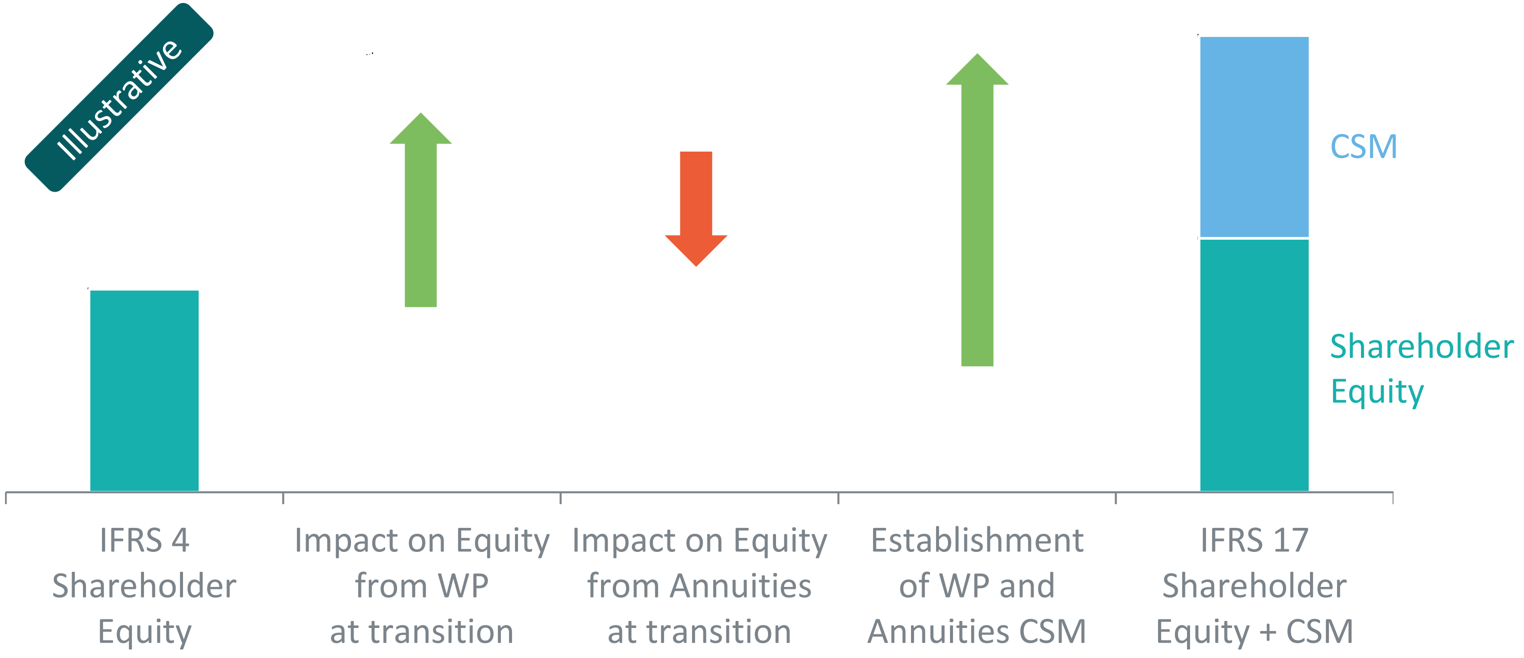
- c.10% of the IFRS WPF[2] surplus is notionally attributed to shareholders and is included in Shareholder Equity
- However, shareholders have no immediate mechanism for accessing the surplus

Note: Charts are for illustrative purposes
1. Unallocated Distributable Surplus; 2. With-Profits Fund

Reconciliation between IFRS 4 and IFRS 17 Shareholder Equity

Shareholder Equity expected to increase thanks to With-Profits surplus

Illustrative example[1] of Shareholder Equity change and CSM at transition



- **Shareholder Equity expected to increase at transition** as the reduction driven by the annuity portfolio is more than offset by the recognition of part of the IFRS With-Profits surplus as Shareholder Equity
- Establishment of CSM gives **greater transparency of unearned profits** previously embedded within policyholder liabilities and UDS[2]
- The **release of CSM over time** better matches the provision of insurance services to customers with the recognition of profits (and associated increase in Shareholder Equity)

1. Size of bars and arrows in the chart are for illustrative purposes only
2. Unallocated Distributable Surplus

How the CSM will work after transition

The CSM spreads profit recognition over the lifetime of contracts

CSM as calculated at transition date

⊕	1	New business (no Day 1 profit)
⊕	2	Interest accreted on the CSM during the period
⊕ ⊖	3	Changes in cash flows relating to future service (e.g. change in market and non-market assumption)
⊖	4	Amount of CSM recognised as profit earned during the period

CSM at the end of the period

Updated CSM represents the profits that remain unearned at the balance sheet date and relate to future services yet to be provided

1 The CSM increases to reflect the expected profit on **new business acquired during the period**

2

- The carrying amount of the CSM increases during the reporting period to reflect the time value of money
- The **yield is determined** by using the discount **rate applied on initial recognition for GMM** and **rate used in current balance sheet for VFA**

3

- **CSM absorbs changes** in fulfilment cash flows related to future services driven **by non-market experience and assumptions**
- It also absorbs **market movements** related to liabilities measured under the **VFA measurement model**
- Market movements affecting liabilities measured under the GMM directly impact the P&L in the period they occur

4 The **release to profit and loss** will decrease the CSM and will represent the services provided in the reporting period

Note: ⊕ Increase in CSM ⊖ Decrease in CSM

Profitability under IFRS 17

AOP remains the key indicator for the IFRS underlying performance

Key changes to Annuities and With-Profits

Adjusted Operating Profit

- AOP will continue to be the primary KPI for **M&G's long-term financial performance** on a IFRS basis
- **The definition of AOP is currently being refined for IFRS 17**, to ensure that it continues to provide an accurate reflection of M&G's underlying business performance
- **Any update to the methodology** will be communicated ahead of HY 2023 reporting

Shareholder Annuities

- New concept of **CSM release** introduced, which will become the main profit driver within AOP
- **Risk adjustment release** will also become new contributor to AOP
- **Credit releases** will continue to be recognised in AOP
- **Returns on excess assets** and **asset trading** will remain as sources of AOP, but quantum will be different to IFRS 4
- **Non-market assumptions** (e.g. longevity and expenses) and **long-term impact of experience variances** will be absorbed by the CSM and released to AOP over the remaining lifetime of the contracts

With-Profits

- New concept of **CSM release** introduced, which will become the main profit driver within AOP replacing shareholder transfers
- **Risk adjustment release** will also become new contributor to AOP
- Profits will be **spread through the life of the products** instead of being recognised only when shareholder transfers are paid (i.e. usually when customers withdraw their savings)
- The impact of **market movements and changes in assumptions** will generally be absorbed by the CSM, and released over the remaining contract lifetime; market movements could also, to a lesser extent, impact surplus assets[1]

1. They will not flow through AOP

Shareholder Annuities: Changes from IFRS 4 to IFRS 17

CSM absorbs assumption changes reducing volatility from longevity

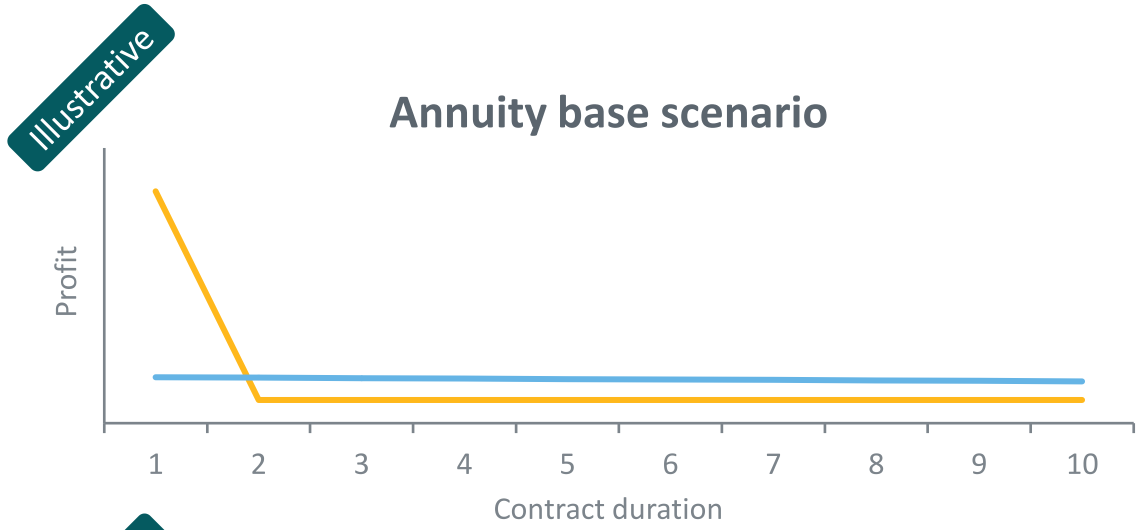
Sources of earnings		Historical IFRS 4 results 2019	2020	2021	Assessment of expected changes from IFRS 4 to IFRS 17	Expected impact
CSM release		-	-	-	New source of earnings based on quantum of CSM at transition and new business (if any)	↑
Return on excess assets and margin release		216	188	172	• Creation of CSM reduces quantum of excess assets and, in turn, of returns • Different assumptions on margin releases partly offset by risk adjustment releases	↘
Asset trading & optimisation		110	59	10	Remains as a source of earnings but liability discount rates will more closely align to SII Different valuation methodology might affect AOP contribution, impact varies case-by-case	↑ ↓
Longevity assumptions		126	217	125	Largely eliminated as changes in assumptions are absorbed by the CSM; the increase or decrease in the CSM will feed through to AOP over time as opposed to recognising all impact on Day 1	↓
Other Annuities	Assumption and model changes	32	(52)	10	Largely eliminated, similarly to longevity, changes are absorbed by the CSM[1]	✕
Other Annuities	Mismatching profits	55	38	(6)	Largely eliminated due to specific adjustment to the discount rate	✕
Other Annuities	Experience variances	4	19	12	• Variances that are fully incurred in period are recognised in AOP (e.g. expenses) • Variances with longer-term implications are absorbed by CSM (e.g. mortality, typically positive[2])	↘
Other Annuities	Other provision and reserves	(85)	(31)	46	Change in future cashflows absorbed by CSM	↑ ↓
Shareholder Annuities AOP		**458**	**438**	**369**		
Other non-Annuities AOP		107	59	46	Minimal change expected	
Shareholder Annuities & Other AOP		**565**	**497**	**415**		

Legend

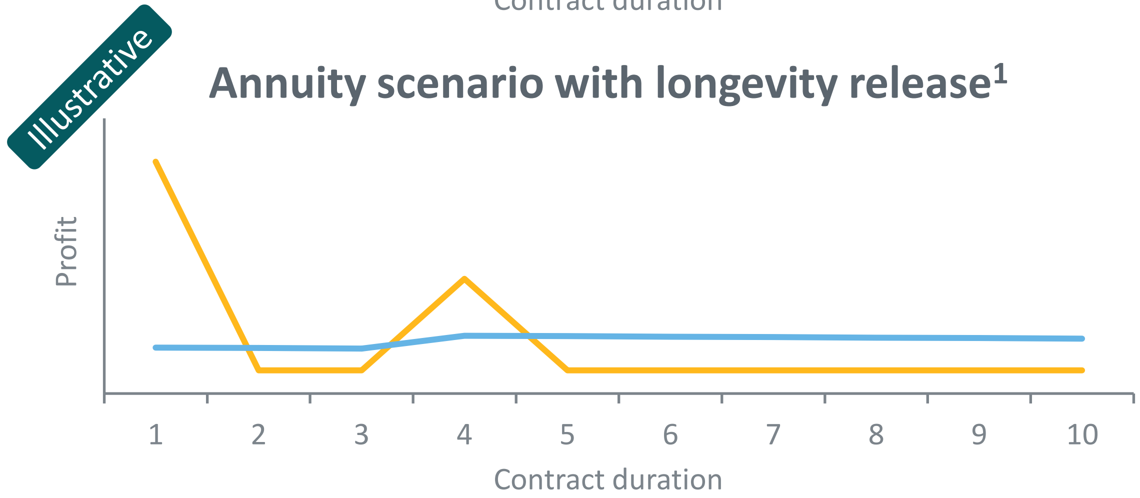
- ↑ Change expected to lead to an improvement in AOP
- ↓ Change expected to lead to a deterioration in AOP
- ✕ AOP contribution likely minimal going forward

1. Excluding economic assumption changes (e.g. inflation) that are not absorbed by the CSM but are excluded from AOP definition; 2. Based on experience over the 2019-2021 period

Shareholder Annuities: Profit signature
Illustrative example



IFRS 4	Earnings are frontloaded as Year 1 includes release of profit margin in the premium; lower profits emerging in later years are mainly driven by investment and longevity margins
IFRS 17	Smooth profit recognition over time through the amortisation of the CSM



IFRS 4	Any release in longevity reserves is immediately and fully recognised as profits in the same period it is triggered
IFRS 17	The CSM absorbs the favourable change in expected future cash flows. The higher CSM leads to higher profit over the subsequent periods due to a larger CSM amortisation

1. Longevity reviews can also be negative

With-Profits (including PruFund): Changes from IFRS 4 to IFRS 17
CSM releases replace shareholder transfers as primary AOP driver

Sources of earnings	2019	2020	2021	Assessment of expected changes from IFRS 4 to IFRS 17	Expected impact
	Historical IFRS 4 results				
CSM release and risk adjustment unwind	-	-	-	New source of earnings based on quantum of CSM at transition and new business (PruFund)	↑
Shareholder transfers	324	308	366	Under IFRS 17 profit recognition will be driven by CSM releases; SHT[2] will no longer impact AOP but will continue to reflect cash generation from the With-Profits business	↓
Hedging[1]	(82)	(57)	(60)	Equity hedges on SHT[2] that mature over the period will no longer affect AOP, in line with the treatment of actual SHT[2] (these hedges typically had a negative impact[3] on AOP)	↑
Other (including PruFund expense overrun)	-	(30)	(38)	Will continue to include the in-year impact of non-market experience variances	↑↓
With-Profits (including PruFund) AOP	**242**	**221**	**268**		

New sources of IFRS 17 earnings / losses[4]

Under IFRS 17, c.10% of the IFRS WPF[5] surplus is notionally attributed to shareholders and included in Shareholder Equity

▶

In any period this surplus can change, leading to a proportional impact on Shareholder Equity that is recognised through the P&L

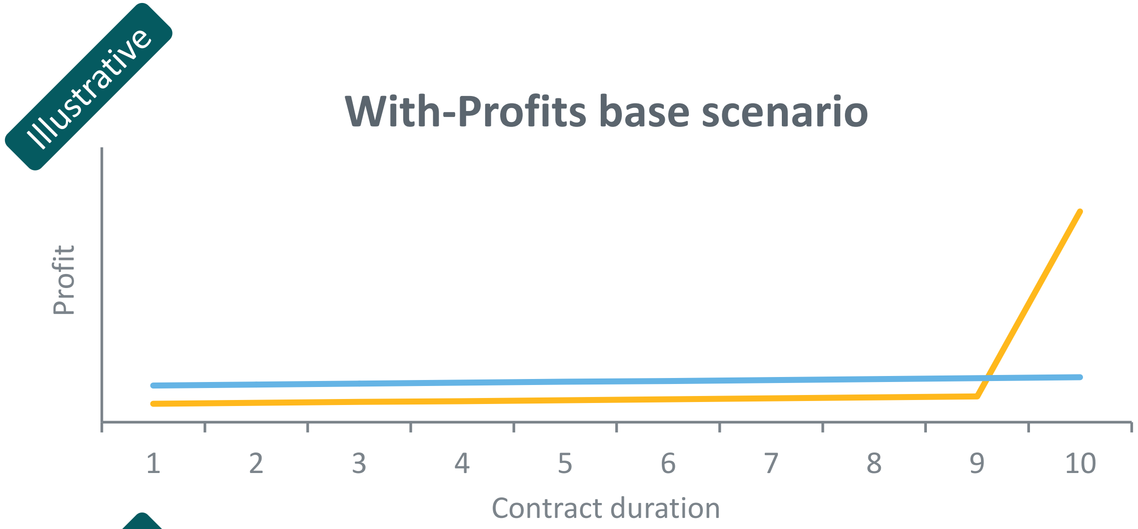
▶

Variables impacting the IFRS WPF[5] surplus that are not representative of M&G's underlying business, e.g. market movements, will be allocated to the non-operating result

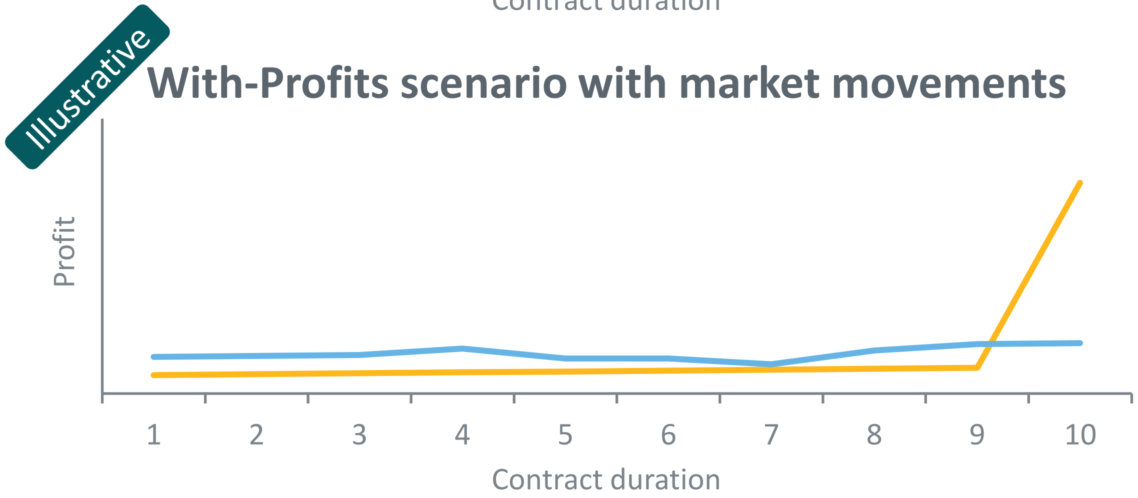
1. Realised in-year result in line with the emergence of shareholder transfers. All other movements on hedges are excluded from AOP; 2. Shareholder transfers; 3. Assuming positive medium-term equity markets growth;
4. AOP definition currently being reviewed and will determine the treatment of these earnings; 5. With-Profits Fund

With-Profits (including PruFund): Profit signature

Illustrative example



IFRS 4	Profits equal shareholder share of distributions (shareholder transfers) which emerge when customers withdraw their savings, either in part or fully (back-end loaded profit signature)
IFRS 17	Profits driven by amortisation of CSM over time Profit recognition is spread over the lifetime of the contract and shows an accelerated profile compared to IFRS 4



IFRS 4	The cumulative impact of market movements over the duration of the contract emerges only when customers withdraw their savings (being a primary factor in determining the quantum of SHT[1])
IFRS 17	Applying the VFA measurement model, the impact of market movements is absorbed by the CSM in the year it occurs, and then released over time

1. Shareholder transfers

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5 Profit signature of **With-Profits business (including PruFund) no longer back-end loaded**

1. 1st January 2023; 2. Adjusted Operating Profit; assumption changes will be absorbed by the Contractual Service Margin (CSM) and gradually released to AOP over the remaining lifetime of the insurance contracts

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