# Prudential Pensions 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 20 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*

Prudential Pensions Limited ('PPL', 'the Company') was established in 1971, as a UK insurance subsidiary to The Prudential Assurance Company Limited ('PAC'). PAC is a wholly owned subsidiary of M&G plc ('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 Company accepts reinsurance from both The Prudential Assurance Company Limited, its immediate parent company, and external parties in respect of corporate pension schemes. In addition, the Company sells direct investment-only business to group pension schemes. Most of the Company's products are unit-linked products. The Company has a small book of annuities reassured to The Prudential Assurance Company Limited.

Reinsurance accepted consists of life insurance, pension products and pension annuities. The Company remains focused on maximising value from the opportunity afforded by the fast growing need for retirement solutions.

Direct investment-only clients largely invest money into the Company on behalf of defined benefit pension schemes. The key determinant of success and retention is delivery of good investment performance. The Company is further exposed to changes in the marketplace, such as competitors' fund offerings for the traditional defined benefit book, and actively monitors those changes.

### *Business and performance*

#### Demerger from Prudential plc

On 21 October 2019, M&G plc de-merged 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 M&G plc Group and the Prudential Group 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 parent company, PAC, forms a much larger portion of the new M&G plc Group compared to when part of Prudential plc.

#### Performance of business

The Company's long-term products mainly consist of unit-linked pensions business and some pension annuities which are wholly reinsured to PAC. The Company continues to focus on securing new members and incremental business from its current portfolio of customers and on additional voluntary contribution plans within the public sector.

The performance of the Company for the year ended 31 December 2019, as provided in Section A, is described using the Company's results as presented in its financial statements.

Operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns, which gives a more relevant measure of the performance of the business.

Operating profit is equal to the operating profit on ordinary activities before tax as shown in the statutory financial statements, less any realised or unrealised gains or losses on the Company's non-linked UK gilt investments which are defined as non operating.

The Company’s total operating profit before tax in 2019 was £8.6 million (2018: £7.6 million). This increase is primarily due to a reduction in the expense base in 2019.

The Company’s total non-operating result has increased by £1.5 million to a profit of £1.1 million in 2019 (2018: loss of £0.4 million), driven by an increase in the value of the Company’s non-linked investments. The Company holds non-linked UK gilts, which have increased in value over the period due to ongoing low interest rates.

The Company paid a dividend of £15 million during the period (2018: £nil).

The slight reduction in the estimated Solvency II capital surplus to £39.2 million (2018: £39.8 million) is primarily due to the 2019 profit after tax of £8.5 million emerging, along with reductions in Risk Margin and Solvency Capital Requirement ('SCR') being offset by the payment of the £15 million dividend.

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 A5.3.

***System of governance***

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 Company keeps its governance structures under constant review to ensure they suit the needs of the business and stakeholders. 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 majority of 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 the best estimate liability and a risk margin reduced by the "transitional measures on technical provisions" where relevant.
(ii) The assets and other liabilities are valued at the amount for which they could be exchanged between knowledgeable and willing parties in an arm's length transaction. The assets are valued separately using methods that are consistent with this principle in accordance with the valuation approaches set out in the Solvency II Directive.

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 has been granted approval by the Prudential Regulation Authority to calculate its Solvency Capital Requirement ('SCR') based on its internal model. At 31 December 2019, the SCR was £47.8 million (2018: £50.3 million). The minimum capital requirement ('MCR') is currently 45% (2018: 45%) of the SCR, £22.6 million at 31 December 2019 (2018: £22.6 million). The Company's SCR and MCR have been met at all times throughout 2019 and 2018. At 31 December 2019, the Company's Solvency II surplus was £39.2 million (2018: £39.8 million). The reduction in Solvency II surplus is primarily due to the profit after tax emerging, along with reductions in Risk Margin and SCR being offset by the payment of the £15 million dividend.

The PPL SCR reduced by £2.5 million in the year to 31 December 2019 driven primarily by the expected run-off of in-force business over the year, and also new business written and economic impacts.

Additional information on the components of the Company’s own funds and SCR is provided in section E.

# A Business and performance

## A1 Business

### A1.1 Overview

***Name and legal form***

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

The Company is a wholly owned subsidiary of The Prudential Assurance Company Limited ('PAC'), a company registered in England and Wales. PAC is a wholly owned subsidiary of M&G plc. M&G plc became the ultimate parent of the Company following a de-merger 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 and is the parent company of the M&G plc Group ('the Group'). 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 address of the registered office of the Company, PAC 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, PAC and M&G Prudential was:
Governors House
Laurence Pountney Hill
London
EC4R 0HH

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

***Supervisory authority***

The Company is supervised and authorised by the Prudential Regulation Authority ('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
Canary Wharf
London
E14 5GL
United Kingdom

The Company has taken the exemption provided by PS25/18 to not have an audit opinion on its SFCR.

***Holders of qualifying holdings***

As at 31 December 2019, PAC is the only holder of qualifying holdings in PPL (being holdings of 10% or more of the voting rights).

## A1.2 Company structure

***Material subsidiaries of the Company***

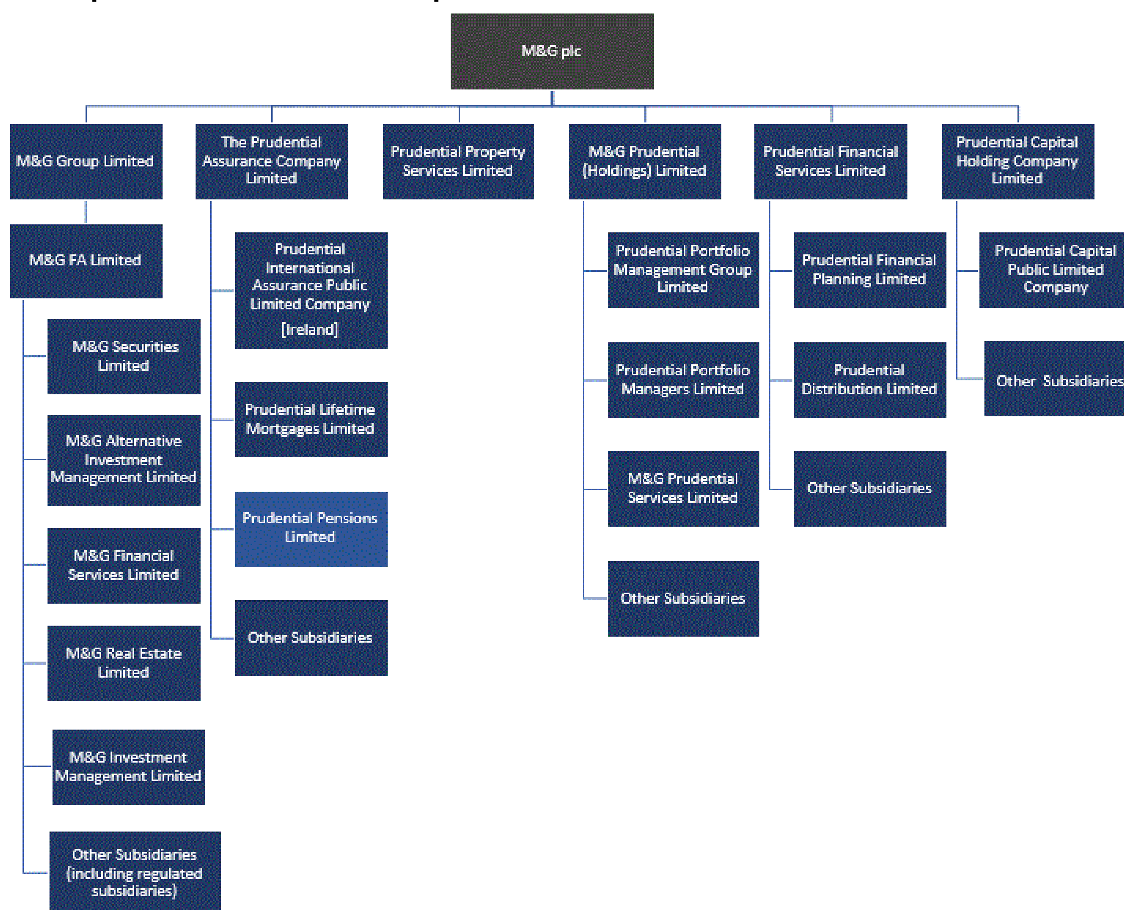
The only material subsidiary of the company is a Fond commun de placement collective investment fund called M&G UK Property Fund FCP-FIS, which is 98.22% owned by the Company. This subsidiary is held within the Company's unit-linked investment funds and enables the Company to manage funds that invest in property.

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

The Company is part of the M&G plc Group and is a subsidiary of PAC which is the principal insurance company within the Group. A PAC and M&G plc group SFCR will be submitted to the PRA in April 2020.

Figure 1 below shows, in simplified form, the direct subsidiary undertakings of the ultimate parent company, M&G plc (shares held directly or via nominees) and its significant subsidiaries as at 31 December 2019.

**Figure 1: Simplified structure of M&G plc as at 31 December 2019**



## A1.3 Business and performance

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

The Company transacts long-term insurance business in the United Kingdom ('UK'). All of PPL's products are long-term insurance products consisting of pension products and pension annuities. All of the products offered by the company are non-participating products.

Business transacted is mainly into its unit-linked funds. Approximately two thirds of the Company's unit-linked assets are from business written directly with defined benefit trustees. The remainder of the Company's unit-linked assets are due to a reassurance of defined contribution corporate pension customers from PAC. The majority of the unit-linked corporate pension business written by PAC is reassured to the Company.

PPL has a small amount of non-profit annuity business, the best estimate liability for which is £53 million gross of reinsurance (2018: £56 million). This represents 0.5% of the Company's technical provisions at 31 December 2019 (2018: 0.5%). These annuities are fully reassured to PAC and PPL is closed to new pension annuity business.

## A1.4 Significant business or other events that have had a material impact on the Company over the reporting period

### A1.4.1 M&G Prudential Demerger

On 21 October 2019, following a prior announcement of intentions to demerge in March 2018, M&G plc (the UK & Europe business of Prudential plc) de-merged from Prudential plc, resulting in two separately-listed companies. There have been no significant changes to the role or activities of PPL as a result of the demerger.

## A2 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.

Operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns, which gives a more relevant measure of the performance of the business.

Operating profit is equal to the operating profit on ordinary activities before tax as shown in the statutory financial statements, less any realised or unrealised gains or losses on the Company's non-linked UK gilt investments which are defined as non operating. Given the linkage between the movement of technical provisions and the movement in investments for unit-linked technical provisions, the Company has defined operating profit as its underwriting performance as discussed in this section.

The core discussion of the investment performance of the Company in Section A3 is by reference to short-term fluctuations in investment returns, being defined as the Company's non-operating result.

An analysis of premiums, claims and expenses is given in Section A5.2 below.

### A2.1 Operating profit overview

**Figure 2: Profit for the year-ended 31 December 2019**

| | 2019<br>£m | 2018<br>£m | Change<br>% |
|---|---|---|---|
| **Operating profit based on longer-term investment returns** | **7.5** | **8.0** | **(7)** |
| Short-term fluctuations in investment returns | 1.1 | (0.4) | **360** |
| **Profit before tax attributable to shareholders** | **8.6** | **7.6** | **27** |

The operating profit is attributable to the Company's unit-linked insurance business. As noted in section A1.3, the Company has written some non-profit annuity business which is fully reassured to PAC and therefore does not contribute towards operating profit.

The short-term fluctuations in investment returns reflects the unrealised gains and losses achieved on the Company's non-linked UK gilt investments as a result of interest rate movements during the period.

## A3 Investment performance

### A3.1 Short-term fluctuations

As explained in Section A2, short-term fluctuations equates to the Company's return on its non-linked UK gilt investments.

### A3.2 Investment management expenses

The investment management expenses incurred by the Company's operations, including those that were paid to the Company's asset management operations, totalled £15.4 million (2018: £16.2 million). The reduction in 2019 is primarily due to a reduction in expense fee rates.

Investment expenses and charges of £3.2 million (2018: £5.2 million), as shown in Figure 3, section A5.1, includes income of £12.2 million (2018: £11.0 million) which partially offsets the gross investment management expenses of £15.4 million (2018: £16.2 million) and represents the income received by PPL from PAC for accepting reassured business.

An analysis of investment return in the income statement by asset class is given in Section A5.2.2.

## A4 Performance of other activities

### A4.1 Investments in subsidiaries

As stated in Section A1.2, the Company's only subsidiary is a Fond commun de placement collective investment fund. This investment is held within the Company's unit-linked investments, and therefore is subject to changes in investment as policyholders move in and out of the fund.

## A5 Any other information

### A5.1 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 £8.6 million (2018: £7.6 million), representing operating profit of £7.5 million (2018: £8.0 million), as set out in Figure 2 and discussed in Section A2.1, and non-operating profit of £1.1 million (2018: loss of £0.4 million). Analysis of profit before tax is shown in Figure 3 below by nature of revenue and charges, on a UK GAAP basis.

**Figure 3: Total revenue and charges for the year-ended 31 December 2019**

| | 2019<br>£m | 2018<br>£m |
|---|---|---|
| Investment income | 668.2 | 940.1 |
| Unrealised gains / (losses) on investments | 701.5 | (1,340.3) |
| Other technical income | 12.6 | 15.1 |
| **Total revenue, net of reinsurance** | **1,382.3** | **(385.1)** |
| Change in provision for claims - gross amount | (2.6) | 7.7 |
| Change in provision for claims - reinsurers' share | 2.6 | (7.7) |
| Change in technical provisions for linked liabilities | (1,368.2) | 403.4 |
| Net operating expenses | (3.6) | (1.5) |
| Investment expenses and charges | (3.2) | (5.2) |
| Foreign exchange gains / (losses) | 2.9 | (1.9) |
| Foreign taxation | (1.6) | (2.1) |
| **Profit on ordinary activities before tax** | **8.6** | **7.6** |

### A5.2 Premiums, claims and investment return

#### A5.2.1 Comparison of gross earned premiums and benefits and claims with the prior period

**Figure 4: Premiums and claims by Solvency II line of business for the year-ended 31 December 2019**

| | Index-linked and unit-linked insurance | Other life insurance | Accepted life insurance | Total 2019 | Total 2018 |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| Premiums earned - gross | 278.7 | — | 358.2 | 636.9 | 835.9 |
| Claims net of reinsurance | (1,696.8) | — | (446.3) | (2,143.1) | (1,381.4) |
| Changes in other long-term business and technical provisions | 801.0 | — | (663.0) | 138.0 | 948.8 |

Further to the requirements clarified in the "Commission Implementing Regulation (EU) 2017/2190" regulation dated 24 November 2017, premium and claim figures are included for investment contracts without discretionary participation features in S.05.01.

All of the Company's unit-linked insurance products are deemed to be investment-only products and therefore, in the Company's financial statements, deposit accounting adjustments are made to remove these premiums and claims.

Deposits received in 2019 were £620.2 million (2018: £835.9 million). The reduction of £215.7 million is primarily due to the largest premiums by corporate pension scheme being smaller in value in 2019 than 2018.

The Company made payments to policyholders of investment contracts of £2,119.7 million (2018: £1,381.4 million). The increase of £738.3 million is mainly attributable to one large corporate pension scheme exit in 2019 compared to 2018.

The Company's other life insurance business consists of an annuity product which is closed to new business. Claims of £4.8 million (2018: £4.9 million) were paid to policyholders, but this was fully recovered from PAC as part of a reassurance agreement.

### A5.2.2 Investment return by asset class

**Figure 5: Investment return for the year-ended 31 December 2019**

| | 2019 | 2018 |
|---|---|---|
| | £m | £m |
| **Income** | | |
| Equity securities and portfolio holdings in unit trusts | 307.1 | 664.6 |
| Debt securities | 354.7 | 268.4 |
| Other investments | 6.3 | 7.1 |
| **Total income** | **668.1** | **940.1** |
| **Investment appreciation / (depreciation) and other investment return** | | |
| Equity securities and portfolio holdings in unit trusts | 423.4 | (931.4) |
| Debt securities | 275.7 | (407.4) |
| Other investments | 2.4 | (1.6) |
| **Total investment appreciation / (depreciation) and other investment return** | **701.5** | **(1,340.4)** |
| Exchange (loss) / gains | 2.9 | (2.0) |
| **Total investment return** | **1,372.5** | **(402.3)** |

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 and loss.

During 2019 there has been an increase in total investment return which is mainly due to investment appreciation on equity and debt securities as a result of market movements.

### A5.3 Post balance sheet events

**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, have 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 182%. 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, as events unfold.

# B System of governance

## B1 General information on the system of governance

### B1.1 Board governance

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, Prudential Pensions Limited ('PPL', ‘the Company’) is a wholly owned subsidiary of The Prudential Assurance Company Limited (‘PAC’), which is a subsidiary of M&G plc, the parent company of the M&G plc Group ('the Group').

### B1.2 Decision making

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 de-merged Group and its stakeholders, and fully comply with the UK Corporate Governance Code.

The 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, 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 has an independent non-executive Chairman. The quorum for the Board consists of at least two members, which must include the Chairman. 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 as at 31 December 2019 is detailed in Figure 6 below:

**Figure 6: PPL Board membership as at 31 December 2019**

| PPL Board members | Role |
|---|---|
| **Paul Spencer** | Chairman and Independent Non-Executive Director ('NED') (SMF 9) |
| **Clare Bousfield** | Chief Executive Officer (‘CEO’), PPL and Chief Finance Officer (‘CFO’) M&G plc (SMF 1 and SMF 3) |
| **Keith Davies** | Chief Risk and Resilience Officer (‘CRRO’), M&G plc (SMF 3 and SMF 4) |

**PPL Key Function Holders**

John Foley, CEO of M&G plc and Clare Bousfield, CEO of PPL and CFO of M&G plc are Group Entity Senior Managers of PPL (SMF7) and (SMF1 and SM3) respectively. As a Solvency II entity, the Company is required to identify its Key Functions and name Key Function Holders (KFHs), i.e., the senior managers within the Company in charge of those Key Functions. The Company's KFHs are set out below:

- CEO - Clare Bousfield (SMF3)
- 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 (SMF4)
- Investments - David King (SMF18)
- Money Laundering - Catherine Fleuty (SMF17)
- Operations - Roddy Thomson (SMF24)
- Risk & Resilience - Keith Davies (SMF3 & SMF4)

**Note**: Keith Davies, Director of PPL and M&G plc's CRRO, resigned in February 2020. Paul Cooper, CFO for PAC has subsequently been appointed as a director of PPL. 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.

***Material changes to the system of governance***

At the date of this report there have been no material changes to the Company's system of governance which is considered appropriate for the nature, scale and complexity of the risks inherent in the Company's current business. Such governance arrangements, however, remain subject to on-going review post demerger as transformation continues and to ensure compliance with best practice.

## B1.3 Responsibility of the PPL Board and PAC 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.

**PPL Board**

The Board principal responsibilities are detailed in Figure 7 below:

**Figure 7: PPL Board responsibilities**

| Responsibility | Terms of Reference |
|---|---|
| **Strategy and Business Plan** | adopting the Group strategy, long-term objectives, annual budgets and business plan and approving any Company specific subsidiary business plan; and<br>monitoring the implementation of the Company's strategy and long-term objectives, annual budgets and business plan and overseeing any corrective action taken by the Company. |
| **Internal Control and Risk Management** | monitoring whether an effective system of internal control and risk management is in place, maintained and reviewed annually;<br>adopting the Group risk appetite, risk framework and policies and approving any Company specific subsidiary risk appetite, risk framework and policies;<br>overseeing that the overall risk appetite and tolerance of the Company adheres to the Group risk framework, policies and limits;<br>reviewing and approving, where applicable, material disclosures to, and regular reporting required by, regulators; and<br>adopting the Group internal model governance and major model changes and approving any Company specific major model changes. |

| | |
|---|---|
| **Solvency and Finance** | approving the Company's Annual Report and Financial Statements;<br>reviewing the overall financial condition of the Company, and any relevant credit ratings and regulatory capital requirements;<br>approving payment of dividends;<br>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 other matters that require referral to PAC or the Group under the GGF.<br>approving any significant changes to the Company's investment strategy, including any significant changes to Investment Management Agreements; and<br>approving liquidity and funding requirements. |

### Board Committees

As a wholly-owned subsidiary of PAC, the PAC Board Audit Committee ('BAC') and Board Risk & Capital Committee ('BRCC') have responsibility for matters such as the integrity of the financial statements, the effectiveness of internal control and risk management systems and the effectiveness of risk and capital management for all financial and non-financial risks, where there may be an impact on the Company. The role of the BAC and BRCC is summarised in figure 8 below.

**Figure 8: Summary of the role of BAC and BRCC as at 31 December 2019**

| Committee | Role of Committee |
|---|---|
| **Board Audit Committee ('BAC')** | As part of its wider PAC responsibilities, the BAC assists the PPL 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')** | As part of its wider PAC responsibilities, the BRCC assists the PPL 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. |

The key functional control areas of Risk, Internal Audit, Compliance and Actuarial report to the 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 B3-B6.

## B1.4 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 members of the Committee are all independent NEDs.

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. The PRA has defined these as Board members, Executive Committee members, Key Function Holders under

Solvency II, Senior Manager Functions, Material Risk Takers 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.

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 PPL;
- 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.

## B1.5 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 A1.4.1.

## B2 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 Financial Conduct Authority ('FCA') as holding Senior Management Functions ('SMFs'), including approved NEDs;
- all persons defined as KFH's 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.

## B2.1 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.

### B2.2 Fit and proper assessment

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.

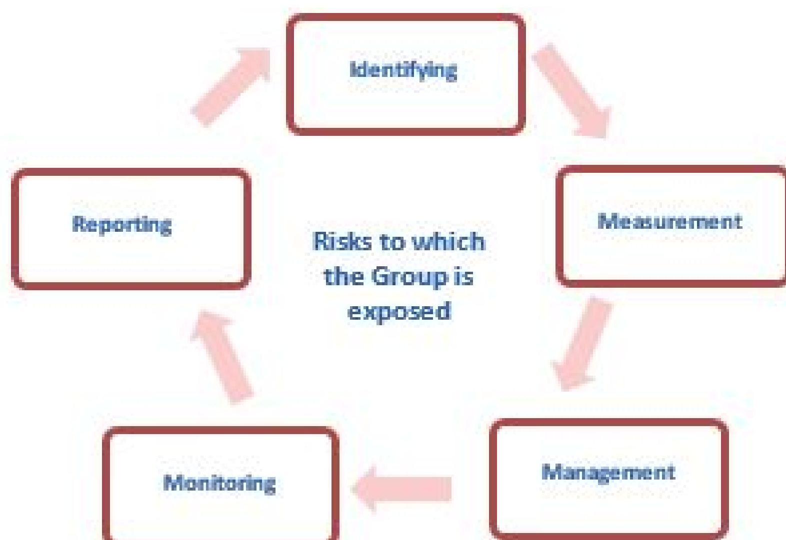
The Company will notify the PRA and FCA of any change in the fit and proper status of SMFs (including, should instances arise, where individuals have been replaced because they are no longer fit and proper), and of any breaches to conduct rules by SMFs and certified individuals.

## B3 Risk management system including the Own Risk and Solvency Assessment

### B3.1 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.

**Figure 9: Risk Management Cycle**




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.

***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, promote 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's parent company, PAC, 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 10: Three Lines of Defence**

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 challenge and oversight 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 ERC. 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 9, 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 B3.4.

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

## B3.2 The Risk function

***Risk Management System***

Within the 3LOD model, the Risk function (known internally as 'Risk and Resilience') is part of the 2nd 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 1st LOD 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 1st LOD, 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.

## B3.3 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 on 14 November 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.

### B3.4 Own risk and solvency assessment

The ORSA is the Company's ongoing processes 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 Group'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 11 below. Embedding of the ORSA drives the top-down understanding of the risks to the Company and ensures the central focus of the Internal Model in decision making.

**Figure 11: High level overview of ORSA responsibilities**

| Stakeholder | Roles/ Responsibilities |
|---|---|
| PPL Board | Steer and challenge throughout the ORSA process; approve the ORSA report. |
| 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. |

## B4 Internal control system

### B4.1 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 the 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.

### B4.2 Compliance function

Similar to 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.

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.

## B5 Internal audit function

Internal Audit operates as the 3rd LOD 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 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, as part of PAC, 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 Board meetings and also PAC'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.

## B6 Actuarial function

The Chief Actuary for the Company and PAC, 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, including those for the Company, 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, which covers the Company, 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, which also covers the Company, 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, which also covers the Company, 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, which also covers the Company 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.

## B7 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, through PAC, 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. 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.

## B8 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 life fund accounting. The Audit Committees at M&G plc Group and subsidiary level, 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

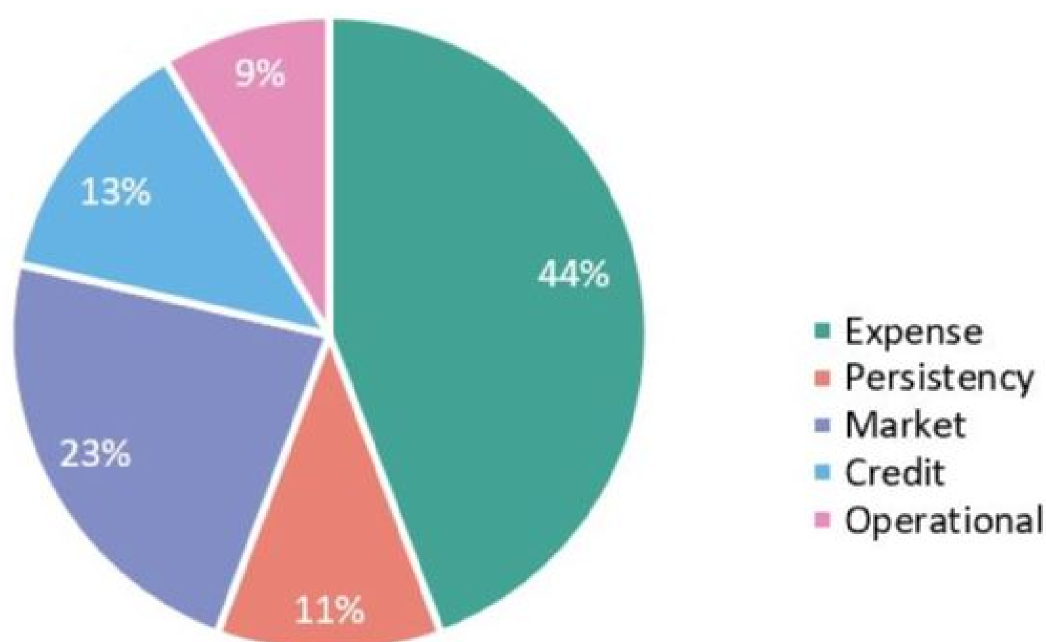
Under the Solvency II regime, companies are required to calculate capital requirements in line with Solvency II regulations. Companies are also required to form their own internal assessment of the capital needed to ensure that they can meet liabilities as they fall due, allowing for the risks that they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

As a writer of unit-linked business, the Company's profits arise from the charges earned over the lifetime of the business, offset by the expenses of administering the business. Due to the nature of the Company's unit-linked business, whereby policyholder liabilities are essentially the same as the net asset values backing those liabilities, its exposure to financial risk is limited. Nevertheless, the business does have some exposure to underwriting or insurance (i.e. persistency and expense) risk, market (i.e. investment return) risk and operational risk. The Company has limited exposure to credit risk due to the close matching of policyholder liabilities to attaching asset value movements.

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 the Company. Detailed information on the SCR allocation is set out in Section E2.

**Figure 12: The undiversified SCR risks for PPL at 31 December 2019.**




The key risk exposures are discussed in the following sections:

- Underwriting risk, often described as insurance risk, which includes persistency and expense risk (refer to Section C1). The company has no longevity risk exposure;
- Market risk, which includes equity, interest rate and currency risks (refer to Section C2);
- Credit and counterparty risk (refer to Section C3);
- Liquidity risk (refer to Section C4);
- Operational risk (refer to Section C5); and
- Other material risks (refer to Section C6).

In December 2018, the Group 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.

## C1 Underwriting risk

### C1.1 Risk exposure

The Company is exposed to expense and persistency risk as a result of its insurance business operations.

**Persistency risk**

The company is also exposed to persistency risk i.e. the risk of unexpected changes in policyholder rates of exit. The Company's persistency assumptions are based on past experience and also include expected trends in future persistency rates. If actual levels of policyholder exits are significantly higher than assumed, then the Company's profitability could be negatively impacted due to a reduction in expected income from management charges. However, from a solvency perspective, the Company is exposed to reductions in the assumed levels of future exits. Although this has the effect of increasing expected future profits, this is more than offset by corresponding increases in the Solvency II SCR and risk margin.

**Expense risk**

The Company's business 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).

### C1.2 Risk mitigation

Persistency risk and expense risk are subject to close monitoring and assumptions are periodically reviewed, with frequency and intensity proportionate to the materiality of the risk. Performing a number of persistency and expense stress tests also supports the Company's understanding of the key drivers of its underwriting risk exposure. For in-force business, management actions to reduce persistency exposures are limited, although the Company has a customer retention strategy in place.

## C2 Market risk

### C2.1 Risk exposure

Market risk is the risk of loss, or of adverse changes in the Company's financial situation resulting, directly or indirectly, from fluctuations in the level or volatility of market prices of assets and liabilities. Market risk includes but is not limited to: equity risk, interest rate risk, inflation risk, currency risk, property risk, and alternative investments risk.

The continued uncertainty in global economic, political and markets outlooks, have increased market risk (e.g. increased volatility) and this could adversely affect the Company's solvency and profitability, principally through a fall in the Company's funds under management due to reduced investment returns and adverse movements in foreign currency exchange rates (for overseas investment funds).

### C2.2 Risk mitigation

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

- a market risk policy and appetite statements;
- 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, investment and hedging strategies;
- 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.

## C3 Credit and counterparty risk

### C3.1 Risk exposure

Due to the matching of policyholder liabilities to attaching asset value movements the unit-linked business is not directly affected by credit risk. However, as a large proportion of the Company’s income is earned via fund management charges expressed as a percentage of funds under management, a fall in value as a result of credit defaults or credit spread widening could adversely affect the Company’s solvency and profitability. The Company is directly exposed to credit-related losses in the event of non-performance by counterparties.

### C3.2 Risk mitigation

A robust credit risk framework (defined at the M&G plc level) supports the effective risk management of credit risk, and includes credit risk policies, standards, appetite statements, limits and triggers (including relevant governance, processes and controls).

## C4 Liquidity risk

### C4.1 Risk exposure and mitigation

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 the 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.

### C4.2 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 Contingency Plan, which sets out the procedures to be followed if a material liquidity risk event arises or is expected to arise; and
- quarterly monitoring of exposures, under base and stress scenarios, against specific triggers and limits for unit-linked funds for a range of time horizons.

In addition, to manage liquidity risk in unit-linked funds which are 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. This clause was utilised on the Company's 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.

Liquidity risk for the Company cannot be completely eliminated for unit-linked funds, in particular over the short term where withdrawal experience can be volatile, e.g. as a result of market uncertainty.

## C5 Operational risk

### C5.1 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.

### C5.2 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'.

## C6 Other material risks

### C6.1 Business environment, environment and market forces risk

Changing economic, political, social, environmental and market conditions, as well as changing customer needs and expectations, could adversely impact the Company's ability to deliver its business strategy and have implications for the profitability of its business model. Such risks include:

**Economic factors**: Changes in global economic conditions can impact the Company directly; for example by leading to poor returns on investments. 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; 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.

**Environmental, Social and Governance ('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.

### C6.2 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 C7.4.

### C6.3 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.

### C6.4 People risk

The Company's success is dependent on the Group's ability to attract, retain and develop highly qualified diverse professional people with the right mix of skills and behaviours to support the business. As the Company continues to implement its transformation programme, the risk of employee conduct challenges and reputational impact is heightened.

## C6.5 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.

## C6.6 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 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.

## C6.7 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.

### C6.8 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 a 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 parental capital support agreement from PAC.

The independent capitalisation of the Company and 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.

## C7 Any other information

### C7.1 Special Purpose Vehicles

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

### C7.2 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 including environmental impacts such as climate change;
- 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.

To evaluate the Company's resilience to significant deterioration in market and credit conditions and other shock events, the quantifiable risks facing the Company as described in the sections above are grouped together into severe but plausible scenarios. In addition, the Company undertakes an annual reverse stress test which gives the directors an understanding of the maximum resilience to extremely

severe adverse scenarios. 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.

In considering these scenarios, the impacts of mitigating management actions designed to maintain or restore key capital, liquidity and solvency metrics to the Company's approved risk appetite are considered. In the scenarios tested, sufficient actions were available to management to maintain the viability of the Company over the three-year period under assessment.

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**

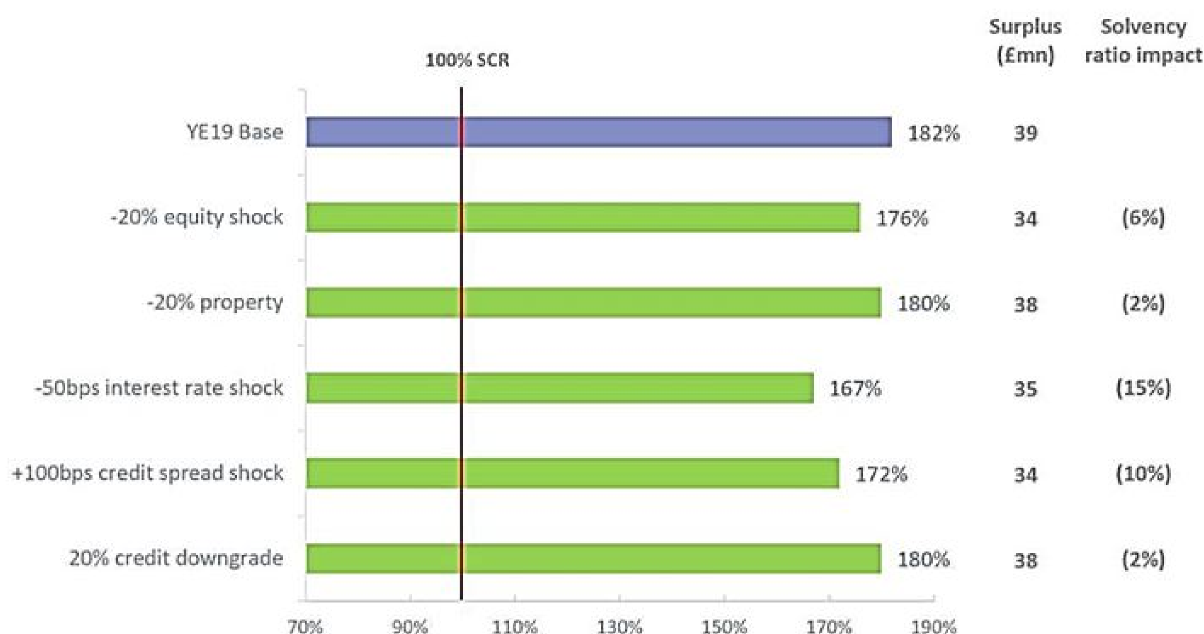
Stress test results confirm that the Company is relatively insensitive to adverse market events, which is consistent with the fact that unit-linked policyholders bear most of the market risk, and is most materially exposed to expense and persistency risks.

In practice, the Company would expect a number of events to occur simultaneously. The analysis has shown that it would take relatively severe events to reduce the capital coverage ratio below 100%. At 100% capital coverage, the Company would have sufficient capital to withstand a 1 in 200 year event.

The Company also has the ability to call down up to £15m under a Capital Support Agreement ('CSA') provided by PAC if the Company's SCR coverage ratio falls below 105%.

The sensitivity of the Company's balance sheet to a range of individual and combined stresses is set out in Figure 13 below driven off the FY19 actual solvency position.

**Figure 13: Sensitivity of the Company's balance sheet to a range of stresses**




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.

### C.7.3 Risk concentration

The Company has limited exposure to concentration risk due to the close matching of policyholder liabilities to attaching asset value movements.

### 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 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 to 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 Investment Risk Oversight Framework covers all aspects of overseeing investment risk management 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 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

## D1 Valuation of assets for Solvency II

### D1.1 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.

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 £8.6 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 £2.7 million of financial assets were valued using this approach; these consist of foreign exchange forwards.

For (a) and (b), the Company applies a number of criteria in determining whether a market is considered 'active'. These include:

- There is a price on the measurement date and the asset is a constituent of a well-established index;
- There is observable trading activity as of the measurement date - this is deemed to be that the instrument has traded on 7 out of the 10 trading days prior to the reporting date (excludes weekends and public holidays);
- Most government bonds issued by G7 countries (being UK, US, Canada, France, Germany, Italy, Japan) are considered to have active markets; and
- For corporate bonds, the criteria include that a consensus price should exist at the measurement date, there should be a low bid-ask spread and low dispersion of broker quotes.

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, the Company did not hold any financial assets which were valued using this approach.

***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 property funds which are exposed to bespoke properties or risks.

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. In accordance with the Company's Group Risk Framework, the estimated fair value of derivative financial instruments valued internally using standard market practices are subject to assessment against external counterparties' valuations.

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 £524 million of assets, net of liabilities, at fair value which were valued in this manner. These principally include investments in property funds which are exposed to bespoke properties or risks.

The 2019 balance sheet valued under both the statutory accounts basis (UK GAAP) and the Solvency II basis is summarised in Figure 14 below.

**Figure 14: Solvency II and UK GAAP balance sheets for the year-ended 31 December 2019, with 2018 comparatives**

| | Solvency II (2019)<br><br>£m | Financial Statements (2019)<br><br>£m | Difference (2019)<br><br>£m | Solvency II (2018)<br><br>£m | Financial Statements (2018)<br><br>£m | Difference (2018)<br><br>£m |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Investments (other than participations) | 73.4 | 73.4 | — | 91.8 | 91.8 | — |
| Assets held in index-linked and unit-linked funds | 9,105.8 | 11,073.3 | (1,967.5) | 9,474.3 | 11,223.9 | (1,749.6) |
| Reinsurance recoverable | 2,020.1 | 52.3 | 1,967.8 | 1,805.6 | 54.9 | 1,750.7 |
| Cash and cash equivalents | 9.3 | 9.3 | — | 10.3 | 10.3 | — |
| Other assets | 7.3 | 7.4 | (0.1) | 3.1 | 3.3 | (0.2) |
| **Total assets** | **11,215.9** | **11,215.7** | **0.2** | **11,385.1** | **11,384.2** | **0.9** |
| **Liabilities** | | | | | | |
| Technical provisions | 11,110.9 | 11,125.7 | (14.8) | 11,269 | 11,278.9 | (9.9) |
| Deferred taxation | 3.6 | 1.1 | 2.5 | 3.3 | 1.5 | 1.8 |
| Other liabilities | 14.5 | 14.5 | — | 22.8 | 22.8 | — |
| **Total liabilities** | **11,129.0** | **11,141.3** | **(12.3)** | **11,295.1** | **11,303.2** | **(8.1)** |
| **Excesses of assets over liabilities** | **86.9** | **74.4** | **12.5** | **90.0** | **81.0** | **9.0** |

***Investments (other than participations)***

This is mainly a non-linked UK gilt that the Company owns along with cash on deposit the Company has placed at the reporting date. There are no adjustments made between Solvency II and the financial statements for these items.

***Assets held in index-linked and unit-linked funds***

The difference primarily relates to a Companies Act presentation difference for investment contracts without discretionary participation features. For the Solvency II balance sheet these items are reported as reinsurance but in the UK GAAP financial statements they are classified as investments.

There is also a £0.3m value difference in the amount reclassified due to minor differences in the longevity and expense assumptions and valuation interest rate used between the financial statements and Solvency II.

***Reinsurance recoverable***

The difference in value of reinsurance recoverable between Solvency II and the financial statements stems from the reclassification of reinsurer's share of investment contracts liabilities. For the purposes of the financial statements, the Company applies deposit accounting for investment contracts and accordingly presents reinsurer's share of its liabilities within investments.

***Cash and cash equivalents***

No adjustments are made between Solvency II and the financial statements.

*Other assets*

The reduction in other assets of £0.1 million relates to reclassification of assets under Solvency II.

## D1.2 Valuation bases under Solvency II compared with UK GAAP

The only investments that materially change in value between Solvency II and UK GAAP are the reclassification of external reassurance in the unit-linked funds.

*Assets held for unit-linked contracts*

These assets are held to cover linked liabilities, whereby 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 difference between UK GAAP and Solvency II, which is primarily due to a Companies Act presentational difference, relates to reinsurance in relation to investment contracts without discretionary participation features, which is treated as reinsurance under Solvency II but as an investment under UK GAAP. There is also a £0.3m value difference in the amount reclassified due to minor differences in the longevity and expense assumptions and valuation interest rate used between the financial statements and Solvency II.

*Deferred tax asset*

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 or 31 December 2018.

*Other assets*

Other assets in the Solvency II balance sheet are measured at fair value determined using alternate valuation methods that are market consistent and represents the realisable value of individual assets on transfer to a third party.

*Investments (other than participations)*

As described above, these mainly consist of a UK gilt holding and cash on deposit. The UK gilt is valued using external market prices. The cash on deposit is typically placed for less than one week, and its value is the amount of cash that was placed.

# D2 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.

## D2.1 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 “transitional measures on technical provisions” ('TMTP') 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 European Insurance and Occupational Pensions Authority. 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 takes 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 D2.8).

The "contract boundary rules" apply to the Company, and these 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. 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 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.

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

**Figure 15: Value of technical provisions at 31 December 2019**

| | 31/12/19 | | | | | 31/12/18 |
|---|---|---|---|---|---|---|
| | Best estimate liability | Risk margin | TMTPs | Total Technical Provisions | IFRS | Total |
| | £m | £m | £m | £m | | £m |
| Other life insurance | 52.9 | — | — | 52.9 | 52.3 | 56.3 |
| Unit-linked insurance | 5,540.0 | 15.7 | (5.2) | 5,550.6 | 5,566.0 | 6,353.1 |
| Accepted life reinsurance | 5,500.6 | 10.1 | (3.3) | 5,507.4 | 5,507.4 | 4,859.6 |
| **Total** | **11,093.5** | **25.9** | **(8.5)** | **11,110.9** | **11,125.7** | **11,269.0** |

The TMTP has been recalculated at 31 December 2019 following approval from the PRA (see Section D2.4.1 for further details on the TMTP).

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

(a) Amounts not recognised under Solvency II are the present value of future profits and contract boundaries, which have a £(42)m and £10m impact respectively.

(b) The IFRS liabilities are valued using a basis that includes margins for risk and uncertainty within the non-economic assumptions (mortality, morbidity, persistency and expenses) as well as different economic assumptions to the Solvency II technical provisions. The method of calculation can also differ between the bases:
   - longevity assumptions for non-profit annuity business contain margins under IFRS compared to the best estimate assumptions applied under Solvency II; and

- IFRS liability cash flows for non-profit annuity business are valued using a discount rate derived from the yield on the corresponding assets minus a prudent allowance for defaults of 40 bps at 31 December 2019. Under Solvency II, the discount rate is expressed as a risk free yield.

(c) The IFRS liabilities do not include an explicit risk margin as the allowance for risk is included within the non-economic assumptions. The risk margin is explicit under Solvency II. The impact of the transitional measures for technical provisions is to smooth the transition from the previous Solvency I regime. It is run-off in a straight line over 16 years. The transitional measures for technical provisions has been offset against this explicit risk margin.

Additional provisions under Solvency II include the risk margin which, as discussed above, does not exist for IFRS. This aims to ensure that total technical provisions (the best estimate and the risk margin) are equivalent to the cost of ceding the insurance obligations to a third party.

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

**Figure 16: Value of reinsurance recoverables at 31 December 2019 and 31 December 2018**

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

| | 31/12/2019 | | 31/12/2018 |
|---|---|---|---|
| | SII | IFRS | SII |
| | £m | £m | £m |
| Other life insurance | 52.6 | 52.3 | 56.0 |
| Accepted life reinsurance | 1,967.5 | 1,967.5 | 1,749.6 |
| **Total** | **2,020.1** | **2,019.8** | **1,805.6** |

The Company primarily uses reinsurance to manage insurance risk exposure.

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 (see sections D2.2 and D2.3). 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 difference in the value of reinsurance recoverables between Solvency II and the financial statements stems from the 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.

## D2.2 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 policyholder behaviour.

#### D2.2.1 Economic assumptions

The principal 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 rate is given below, after the credit risk adjustment.

**Figure 17: 10 year risk-free rates at 31 December 2019 (with comparison to 31 December 2018)**

| Currency | 31/12/2019 | 31/12/2018 | Change |
|---|---|---|---|
| British Pound | 0.91% | 1.34% | (0.43)% |

#### D2.2.2 Non-economic assumptions

Persistency, mortality and expense assumptions are derived from analysis of recent historic experience data, and also reflect expected future experience.

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.

### D2.3 Details on methodology and assumptions by lines of business

#### D2.3.1 Unit-linked business

The best estimate liability for these contracts reflects both the value of the 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.

Some unit-linked business contains a financial guarantee that the price of the cash funds will not fall. This is only 0.01 per cent of the total unit-linked best estimate liability.

#### D2.3.2 Non-profit annuity business

The best estimate liability for non-profit annuity business is a discounted value 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.

Longevity assumptions for non-profit annuity business are set in light of recent population and internal experience. The assumptions used are based on population mortality rates, with an allowance for expected future mortality improvements. Given the long-term nature of annuity business, longevity remains a significant assumption in determining policyholder liabilities. The assumptions used reference recent population mortality data, with specific risk factors applied on a per policy basis to reflect the features of the Company's portfolio.

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.

## D2.4 Long-term guarantee measures on technical provisions

### D2.4.1 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 £8.5 million (2018: £3.9 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 to recalculate 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.

### D2.4.2 Volatility Adjustment

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

### D2.4.3 Matching Adjustment

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

### D2.4.4 Impact of transitional measures and long-term guarantees

The impact of the TMTP on the Company's Solvency II results at 31 December 2019 is shown in the table below:

**Figure 18: Impact on Solvency II metrics of TMTP at 31 December 2019**

| | As reported in QRTs | Impact of removing TMTP | Total excluding TMTP |
|---|---|---|---|
| | £m | £m | £m |
| Technical provisions | 11,110.9 | 8.5 | 11,119.4 |
| Basic own funds | 87.0 | (7.0) | 80.0 |
| Own funds eligible to cover SCR | 87.0 | (7.0) | 80.0 |
| Solvency capital required | 47.8 | 1.2 | 49.1 |
| Minimum capital required | 21.5 | 0.5 | 22.1 |
| Solvency Ratio | 182% | (19)% | 163% |

## D2.5 Assumption changes

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

- changes to renewal expense assumptions to reflect forecast expense experience;
- 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 D2.2.1.

## D2.6 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, and mortality.

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.

## D3 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 international accounting standards, where this is consistent with the objectives of Solvency II.

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

***Deferred tax liabilities***

The Company reported deferred tax liabilities of £3.6m under Solvency II (£1.1m under UK GAAP) at 31 December 2019. 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 principles of FRS 101 are applied to calculate the extent of deferred taxes applicable to those value differences. Changes in the valuation of underlying liabilities between UK GAAP and Solvency II give rise to deferred tax value differences.

***Other liabilities***

Other liabilities include reinsurance payables, payables (trade, not insurance), and other liabilities not shown elsewhere. There are no material valuation differences between the 2019 Solvency II and the 2019 financial statements in respect of other liabilities.

## D4 Alternative methods for valuation

The company currently does not use alternative methods for valuation.

## D5 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

## E1 Own funds

### E1.1 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 £87.0 million (2018: £90.0 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 E1.2 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 E1.3 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 projected capital position 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.

### E1.2 Solvency II Capital position

The table below shows the PPL Solvency II surplus at 31 December 2019 and 31 December 2018 as disclosed in the Company's 2019 Annual Report and Financial Statements;

**Figure 19: PPL surplus at 31 December 2019 and 31 December 2018**

| | 2019 | 2018 |
|---|---|---|
| | £m | £m |
| **Own Funds** | 87.0 | 90.0 |
| **SCR** | 47.8 | 50.3 |
| **Surplus** | 39.2 | 39.8 |
| **SCR Coverage %** | 182% | 179% |

The Company's Solvency II surplus position has decreased by £0.6m between 31 December 2018 and 31 December 2019. The 31 December 2019 figures above are consistent with the information submitted within the Solvency II Pillar III templates Own Funds (S.23.01.01) and SCR (S.25.03.21).

### E1.3 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 20: Analysis of components of own funds for the year-ended 31 December 2019**

| | 2019 | | 2018 |
|---|---|---|---|
| | Total | Tier 1 unrestricted | Total |
| | £m | £m | £m |
| Ordinary share capital (b) | 6.0 | 6.0 | 6.0 |
| Reconciliation reserve (c) | 81.0 | 84.0 | 84.0 |
| **Total eligible own funds to meet the SCR** (a) | 87.0 | 90.0 | 90.0 |
| **Total eligible own funds to meet the MCR** (a) | 87.0 | 90.0 | 90.0 |

(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. The Company's tier 1 restricted available own funds have not exceeded the tiering limits and hence the Company's total available own funds are equal to the total eligible own funds. The Company's own funds before adjustments principally comprises equity share capital and retained earnings attributable to equity shareholders calculated in the reconciliation reserves.
(b) Ordinary share capital. The Company's ordinary share capital comprises of 6,000,000 ordinary shares of £1 each fully paid.
(c) Reconciliation reserve. The reconciliation reserve represents the residual of excess of assets over liabilities after deducting ordinary share capital.

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

**Figure 21: Analysis of changes in the own funds for the year-ended 31 December 2019**

| PPL | £m |
|---|---|
| **Total Underlying own funds generation** | **9** |
| Other operating own funds generation | (8) |
| **Total operating own funds generation** | **1** |
| Market movements | 13 |
| Restructuring | — |
| Tax | (2) |
| **Total Own Funds Generation** | **12** |
| Dividends & capital movements | (15) |
| **Total Movement in Own Funds** | **(3)** |

The key drivers of the change in Own Funds are:

- £9m from Underlying Own Funds movements, more specifically:
  - a £10m increase in surplus from in-force business; and
  - a £1m fall from New Business being sold.
- £(8)m from other Operating movements, more specifically:
  - £(4)m due to model improvements;
  - £4m due to changes in non-market assumptions, mostly due to an update in expected IMEs and renewal expenses; and
  - £(8)m due to non-market experience, mainly persistency experience.
- £13m from Market movements, more specifically:
  - £15m due to equity markets having increased by circa 18% since 31 December 2018;
  - £(7)m due to yields having fallen by circa 44bps and credit spreads having narrowed by circa 35bps;
  - £2m due to inflation being 20 bps lower than expected; and
  - £4m due to the TMTP biennial recalculation.
- £(2)m from the additional tax charge incurred over the period.
- £(15)m from a dividend paid from PPL to PAC.

### E1.4 Reconciliation of UK GAAP shareholder's equity to Solvency II for the year ended 31 December 2019

The following table shows the differences between UK GAAP shareholder's equity and Solvency II own funds.

**Figure 22: Differences between UK GAAP shareholder's equity and SII own funds for the year ended 31 December 2019**

| | 2019 | 2018 |
|---|---|---|
| | £m | £m |
| **Shareholder's equity in financial statements at 31 December** | 74.4 | 80.9 |
| Valuation differences | 32.6 | 30.5 |
| Impact of risk margin (net of TMTP) | (17.4) | (19.6) |
| Change in value of deferred tax asset (resulting from valuation differences above) | (2.6) | (1.8) |
| **Excess of assets over liabilities as recorded in the Solvency II Balance Sheet** | **87.0** | **90.0** |

## E2 Solvency Capital Requirement ('SCR') and Minimum Capital Requirement ('MCR')

### E2.1 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 SCR. The assets and liabilities are valued on a Solvency II basis.

### E2.2 Components of SCR

At 31 December 2019, the SCR was £47.8 million (2018: £50.3m). The PRA has the power to impose a capital add-on to the SCR where they feel the SCR may be insufficient. They have not done so for PPL.

Figure 23 below shows the undiversified SCR by risk components and the benefit of diversification in relation to the Company at 31 December 2019. A comparison column at 31 December 2018 is included.

**Figure 23: SCR for the Company at 31 December 2019**

| | 31/12/19 | 31/12/2018 | Differences |
|---|---|---|---|
| | £m | £m | £m |
| Equity | 16.8 | 16.6 | 0.2 |
| Property | 2.2 | 2.5 | (0.2) |
| Yield Curve | 3.7 | 3.4 | 0.3 |
| Credit | 15.4 | 11.7 | 3.7 |
| Currency | 6.1 | 7.5 | (1.3) |
| Diversification between market risks | (13.9) | (14.7) | 0.8 |
| Counterparty | 0.1 | 0.3 | (0.2) |
| Expense | 55.3 | 51.3 | 4.0 |
| Mass Lapse | 6.5 | 7.3 | (0.8) |
| Other Lapse | 7.1 | 16.1 | (9.1) |
| Diversification between insurance risks | (37.7) | (53.9) | 16.2 |
| **Operational** | 10.9 | 17.3 | (6.4) |
| **Other adjustments** | — | — | — |
| LACDT | (7.9) | (7.3) | (0.6) |
| **Total (pre-diversification)** | **64.7** | **58.1** | 6.7 |
| Diversification Benefit | (16.9) | (7.8) | (9.1) |
| **Diversified capital** | **47.8** | **50.3** | (2.4) |

The 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 £21.5 million. The inputs used to calculate the MCR are detailed in Quantitative Reporting Template S.28.01.01.

The MCR is currently 45% of the SCR (2018: 45%).

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

**Figure 24: Movements in the SCR for the Company between 31 December 2018 and 31 December 2019**

| PPL | £m |
|---|---|
| **Total Underlying SCR movements** | **(4)** |
| Other operating SCR movements | (4) |
| **Total operating SCR movements** | **(9)** |
| Market movements | 7 |
| Restructuring | — |
| Tax | — |
| **Total SCR generation** | **(2)** |
| Dividends & capital movements | — |
| **Total Movement in SCR** | **(2)** |

The £2m decrease in SCR over the period is driven by a combination of:

- £4m reduction including:
  - £7m fall from the capital releases as the in-force business runs off; and
  - £2m increase from New Business written over the period;
- £7m increase from market movements; and
- £4m reduction in surplus from other movements.

## E3 Use of the duration-based equity risk sub-module in the calculation of the SCR

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.

## E4 Differences between the standard formula and the internal model

### E4.1 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 SCR 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 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.

The Company's internal model is used in areas where risk-based decision making or risk-related considerations are required, such as capital management, investment strategy, product development and management.

### E4.2 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. The first MMC application was made in 2016 and approved by the PRA to be effective for full year 2016 reporting onwards. This 2016 MMC application covered the implementation of approved out-of-model capital overlays directly into the internal model.
ii. The Company applied to the PRA for a further MMC to the internal model in 2017, which was approved by the PRA and was implemented from 2018 Q2 reporting onwards. The changes during 2018 comprised of the following:
    - Revisions to the calibration of Interest Rate Risk to remove floors in the distribution;
    - Revisions to the calibration and modelling of Longevity Trend Risk ('LTR') and a reduction in Current Mortality Risk ('CMR') / LTR intra-longevity correlation.
iii. 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, 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 UK deferred tax model, to reflect the loss-absorbing capacity of shareholder tax liabilities arising from the with-profits fund, and also a revised approach

to consider the impact of the risk margin and UK transitional measure on technical provisions (‘TMTP’) together, rather than as two separate items.

iv. 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 M&G plc 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 SCR for Prudential Pensions Limited (‘PPL’) as well as for;
   - Consolidated M&G plc SCR; and
   - Solo entity SCR for each applicable EEA based insurance entity, namely:
     - The Prudential Assurance Company Limited (‘PAC’);
     - Prudential International Assurance Limited (‘PIA’).

The Company’s internal model was previously described as “partial” because the Prudential plc's US insurance companies were aggregated into the Group SCR using method 2: deduction and aggregation. However, since M&G plc de-merged from Prudential 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 E2.2. 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.

### E4.3 Internal model vs standard formula

The key differences between the calculation of the internal model SCR and the standard model SCR include:

- Whereas the standard model 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 24 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 model. 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 model stresses do not vary by country.

- The internal model also covers some risks that are not included in the standard model (for example, 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 99.5th worst percentile outcome. Conversely, the standard model 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 model does not allow for interaction effects when risks occur simultaneously.

**Figure 25: Overview of standard model and internal model differences**

| Risk category | Standard Model | 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. | Credit spreads, ratings migrations, and defaults 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. |
| 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. |

| | | |
|---|---|---|
| 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. |
| 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. |
| 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. |
| Expense | Both the level of expenses and level of expense inflation are stressed under the standard model. 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

### E4.4.1 Changes to market risk distributions

The assumptions underlying the Solvency Capital Requirement associated with market risks are reviewed annually. In 2019, due to the demerger, this review was undertaken in the first half of the year and the changes implemented for the valuation at 30 June 2019.

The SCR calibrations for market risks are driven primarily by historical data, with expert judgements applied where required. Historical data analysis was refreshed using market data up to 30 April 2019, corresponding to ten months of additional data since the prior calibration exercise, instead of the typical twelve.

The addition of an extra ten months of data did not lead to the need for calibration updates for most of the market risk drivers, as the relative change in 1-in-200 stresses was less than the 5% threshold after which changes would be made. The exceptions to this relate to:

i. Interest rate level risk where, given the sensitivity of the business to yields, the 5% threshold after which changes would be made is not applied; and
ii. An update to the calibration of credit downgrade risk to adapt to changes in the underlying data supplied by the vendor, Moody's. This captures additional ratings transition data, as well as a restatement of historical defaults and transitions due to changes to the methodology that Moody's use to determine its entity-level rating and default statistics.

### E4.4.2 Changes to non-market risk distributions

Non-market risk distributions have been recalibrated as appropriate to reflect up-to-date data and expert judgements. The changes to non-market risk distributions since 31 December 2018 are listed below:

(i) For practical reasons, the longevity trend risk ('LTR') model is calibrated to the best estimate assumptions at the previous year end; the year end 2018 LTR calibration was therefore based on the CMI 2015 model. The 2019 calibration has been updated to be based on CMI 2016, which was the best estimate trend assumption at year end 2018. The weakening in the best estimate assumption results in a strengthening for the year end 2019 calibration, as the difference between best estimate and worst case outcomes has increased. However, the previous calibration based on CMI 2015 had historic improvement rates up to 2012. The revised calibration based on CMI 2016 includes historic improvements up to 2015. Using the more recent historic improvements, which have been lower than previously expected, results in a small overall reduction in the strength of the calibration.
(ii) The operational risk exposures are updated annually based on a bottom-up scenario-based assessment involving risk and operations experts across the business.
(iii) Analysis of the impact of assumption changes and experience variances on own funds and capital was carried out in respect of lapse, expense, mortality, and morbidity risks. Other factors such as changes in regulation, internal business changes, and amendments made to the GWOS were also considered, but it was concluded that there was no new and material evidence to suggest that changes to the existing calibrations were required and the existing calibrations therefore remain reasonable.

## E5 Non-compliance with the MCR and with the SCR

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

## E6 Any other information

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

## Statement of directors' responsibilities

The directors of Prudential Pensions 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 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 so to comply and will continue so to comply for the remainder of the financial year to 31 December 2020.

Signed on behalf of the Board of Directors

P Cooper
Director
23 April 2020

## Templates provided in the SFCR implementing Technical Standard

### 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 | |
| R0060 | Property, plant & equipment held for own use | — |
| R0070 | Investments (other than assets held for index-linked and unit-linked contracts) | 24,798 |
| R0080 | Property (other than for own use) | — |
| R0090 | Holdings in related undertakings, including participations | — |
| R0100 | Equities | — |
| R0110 | Equities - listed | — |
| R0120 | Equities - unlisted | — |
| R0130 | Bonds | 24,798 |
| R0140 | Government Bonds | 24,798 |
| R0150 | Corporate Bonds | — |
| R0160 | Structured notes | — |
| R0170 | Collateralised securities | — |
| R0180 | Collective Investments Undertakings | — |
| R0190 | Derivatives | — |
| R0200 | Deposits other than cash equivalents | — |
| R0210 | Other investments | — |
| R0220 | Assets held for index-linked and unit-linked contracts | 9,105,848 |
| R0230 | Loans and mortgages | 48,600 |
| R0240 | Loans on policies | — |
| R0250 | Loans and mortgages to individuals | — |
| R0260 | Other loans and mortgages | 48,600 |
| R0270 | Reinsurance recoverables from: | 2,020,118 |
| R0280 | Non-life and health similar to non-life | — |
| R0290 | Non-life excluding health | — |
| R0300 | Health similar to non-life | — |
| R0310 | Life and health similar to life, excluding index-linked and unit-linked | 52,645 |
| R0320 | Health similar to life | — |
| R0330 | Life excluding health and index-linked and unit-linked | 52,645 |
| R0340 | Life index-linked and unit-linked | 1,967,473 |
| R0350 | Deposits to cedants | — |
| R0360 | Insurance and intermediaries receivables | — |
| R0370 | Reinsurance receivables | 864 |
| R0380 | Receivables (trade, not insurance) | 6,438 |
| 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 | 9,327 |
| R0420 | Any other assets, not elsewhere shown | — |
| R0500 | **Total assets** | 11,215,992 |

## S.02.01.02 Balance Sheet

| | | Solvency II value |
|---|---|---|
| | **Liabilities** | C0010 |
| R0510 | Technical provisions - non-life | — |
| R0520 | Technical provisions - non-life (excluding health) | — |
| R0530 | TP calculated as a whole | — |
| R0540 | Best Estimate | — |
| 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) | 52,919 |
| R0610 | Technical provisions - health (similar to life) | — |
| R0620 | TP calculated as a whole | — |
| R0630 | Best Estimate | — |
| R0640 | Risk margin | — |
| R0650 | Technical provisions - life (excluding health and index-linked and unit-linked) | 52,919 |
| R0660 | TP calculated as a whole | — |
| R0670 | Best Estimate | 52,919 |
| R0680 | Risk margin | 1 |
| R0690 | Technical provisions - index-linked and unit-linked | 11,057,962 |
| R0700 | TP calculated as a whole | — |
| R0710 | Best Estimate | 11,040,578 |
| R0720 | Risk margin | 17,384 |
| R0740 | Contingent liabilities | — |
| R0750 | Provisions other than technical provisions | — |
| R0760 | Pension benefit obligations | — |
| R0770 | Deposits from reinsurers | — |
| R0780 | Deferred tax liabilities | 3,644 |
| R0790 | Derivatives | — |
| R0800 | Debts owed to credit institutions | — |
| R0810 | Financial liabilities other than debts owed to credit institutions | — |
| R0820 | Insurance & intermediaries payables | — |
| R0830 | Reinsurance payables | 133 |
| R0840 | Payables (trade, not insurance) | 14,334 |
| R0850 | Subordinated liabilities | — |
| R0860 | Subordinated liabilities not in BOF | — |
| R0870 | Subordinated liabilities in BOF | — |
| R0880 | Any other liabilities, not elsewhere shown | — |
| R0900 | **Total liabilities** | 11,128,994 |
| | | |
| R1000 | **Excess of assets over liabilities** | 86,999 |

## S.05.01.02 Premiums claims and expenses by line of business

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: 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 | | | | — | | | | — | | | | | | | | | — |
| R0320 | Gross - Proportional reinsurance accepted | | | | | | | | | | | | | | | | | — |
| R0330 | Gross - Non-proportional reinsurance accepted | | | | | | | | | | | | | | | | | — |
| R0340 | Reinsurers' share | | | | — | | | | — | | | | | | | | | — |
| 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 | — | — | 278,747 | — | | | — | 358,193 | 636,940 |
| R1420 | Reinsurers' share | — | — | — | — | | | — | — | — |
| R1500 | Net | — | — | 278,747 | — | | | — | 358,193 | 636,940 |
| | Premiums earned | | | | | | | | | |
| R1510 | Gross | — | — | 278,747 | — | | | — | 358,193 | 636,940 |
| R1520 | Reinsurers' share | — | — | — | — | | | — | — | — |
| R1600 | Net | — | — | 278,747 | — | | | — | 358,193 | 636,940 |
| | Claims incurred | | | | | | | | | |
| R1610 | Gross | — | — | 1,696,775 | 4,769 | | | — | 446,329 | 2,147,873 |
| R1620 | Reinsurers' share | — | — | — | 4,769 | | | — | — | 4,769 |
| R1700 | Net | — | — | 1,696,775 | — | | | — | 446,329 | 2,143,104 |
| | Changes in other technical provisions | | | | | | | | | |
| R1710 | Gross | — | — | 800,995 | 2,621 | | | — | (663,008) | 140,608 |
| R1720 | Reinsurers' share | — | — | — | 2,621 | | | — | — | 2,621 |
| R1800 | Net | — | — | 800,995 | — | | | — | (663,008) | 137,987 |
| R1900 | Expenses incurred | — | — | 15,109 | — | | | — | — | 15,109 |
| R2500 | Other expenses | | | | | | | | | — |
| R2600 | Total expenses | | | | | | | | | 15,109 |

## 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 | — | | 5,539,423 | 575 | | 23,827 | 29,092 | — | 5,500,580 | 11,093,497 | | — | — | — | — | — |
| R0080 | Total Recoverables from reinsurance/SPV and Finite | — | | — | — | | 23,633 | 29,012 | — | 1,967,473 | 2,020,118 | | — | — | — | — | — |
| R0090 | Best estimate minus recoverables from | — | | 5,539,423 | 575 | | 194 | 80 | — | 3,533,106 | 9,073,378 | | — | — | — | — | — |
| R0100 | Risk margin | — | 15,748 | | | 1 | | | — | 10,120 | 25,869 | — | | | — | — | — |
| | Amount of the transitional on Technical Provisions | | | | | | | | | | | | | | | | |
| R0110 | Technical Provisions calculated as a whole | — | — | | | — | | | — | — | — | — | | | — | — | — |
| R0120 | Best estimate | — | | — | — | | — | — | — | — | — | | — | — | — | — | — |
| R0130 | Risk margin | — | (5,165) | | | — | | | — | (3,319) | (8,484) | — | | | — | — | — |
| R0200 | Technical provisions - total | — | 5,550,582 | | | 52,919 | | | — | 5,507,380 | 11,110,881 | — | | | — | — | — |

## 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** | 11,110,881 | 8,484 | — | — | — |
| R0020 | **Basic own funds** | 86,999 | (7,032) | — | — | — |
| R0050 | **Eligible own funds to meet Solvency Capital Requirement** | 86,999 | (7,032) | — | — | — |
| R0090 | **Solvency Capital Requirement** | 47,829 | 1,221 | — | — | — |
| R0100 | **Eligible own funds to meet Minimum Capital Requirement** | 86,999 | (7,032) | — | — | — |
| R0110 | **Minimum Capital Requirement** | 21,523 | 550 | — | — | — |

## 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) | 6,000 | 6,000 | | — | |
| 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 undertakings | — | — | | — | |
| R0050 | Subordinated mutual member accounts | — | | — | — | — |
| R0070 | Surplus funds | — | — | | | |
| R0090 | Preference shares | — | | — | — | — |
| R0110 | Share premium account related to preference shares | — | | — | — | — |
| R0130 | Reconciliation reserve | 80,999 | 80,999 | | | |
| 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 | — | — | — | — | — |
| R0220 | Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds | — | | | | |
| | Deductions | | | | | |
| R0230 | Deductions for participations in financial and credit institutions | — | — | — | — | |
| R0290 | Total basic own funds after deductions | 86,999 | 86,999 | — | — | — |
| | 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 and mutual - type undertakings, callable on demand | — | | | — | |
| 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/EC | — | | | — | — |
| R0390 | Other ancillary own funds | — | | | — | — |
| R0400 | Total ancillary own funds | — | | | — | — |
| | Available and eligible own funds | | | | | |
| R0500 | Total available own funds to meet the SCR | 86,999 | 86,999 | — | — | — |
| R0510 | Total available own funds to meet the MCR | 86,999 | 86,999 | — | — | |
| R0540 | Total eligible own funds to meet the SCR | 86,999 | 86,999 | — | — | — |
| R0550 | Total eligible own funds to meet the MCR | 86,999 | 86,999 | — | — | |
| R0580 | SCR | 47,829 | | | | |
| R0600 | MCR | 21,523 | | | | |
| R0620 | Ratio of Eligible own funds to SCR | 2 | | | | |
| R0640 | Ratio of Eligible own funds to MCR | 4 | | | | |

| | Reconciliation reserve | C0060 |
|---|---|---|
| R0700 | Excess of assets over liabilities | 86,999 |
| R0710 | Own shares (held directly and indirectly) | — |
| R0720 | Foreseeable dividends, distributions and charges | — |
| R0730 | Other basic own fund items | 6,000 |
| R0740 | Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds | — |
| R0760 | Reconciliation reserve | 80,999 |
| | Expected profits | |
| R0770 | Expected profits included in future premiums (EPIFP) - Life business | — |
| R0780 | Expected profits included in future premiums (EPIFP) - Non- life business | — |
| R0790 | Total Expected profits included in future premiums (EPIFP) | — |

## S.25.03.21 Solvency Capital Requirement - for undertakings on Full Internal Models

| Row | Unique number of component | Component description | Calculation of the Solvency Capital Requirement |
|---|---|---|---|
| | C0010 | C0020 | C0030 |
| 1 | 103 | Interest rate risk | 3,736 |
| 2 | 104 | Equity risk | 16,821 |
| 3 | 106 | Property risk | 2,244 |
| 4 | 107 | Spread risk | 15,421 |
| 5 | 108 | Concentration risk | 0 |
| 6 | 109 | Currency risk | 6,111 |
| 7 | 110 | Other market risk | 0 |
| 8 | 199 | Diversification within market risk | -13,891 |
| 9 | 203 | Other counterparty risk | 106 |
| 10 | 301 | Mortality risk | 0 |
| 11 | 302 | Longevity risk | 0 |
| 12 | 303 | Disability-morbidity risk | 0 |
| 13 | 304 | Mass lapse | 6,513 |
| 14 | 305 | Other lapse risk | 7,054 |
| 15 | 306 | Expense risk | 55,298 |
| 16 | 308 | Life catastrophe risk | 49 |
| 17 | 309 | Other life underwriting risk | 0 |
| 18 | 399 | Diversification within life underwriting risk | -37,701 |
| 19 | 505 | Other non-life underwriting risk | 0 |
| 20 | 701 | Operational risk | 10,898 |
| 21 | 801 | Other risks | 0 |
| 22 | 802 | Loss-absorbing capacity of technical | 0 |
| 23 | 803 | Loss-absorbing capacity of deferred taxes | -7,919 |
| 24 | 804 | Other adjustments | 0 |

**S.25.03.21**

**Solvency Capital Requirement - for undertakings on Full Internal Models**

| | **Calculation of Solvency Capital Requirement** | C0100 |
|---|---|---|
| R0110 | Total undiversified components | 64,741 |
| R0060 | Diversification | -16,912 |
| R0160 | Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC | 0 |
| R0200 | **Solvency capital requirement excluding capital add-on** | 47,829 |
| R0210 | Capital add-ons already set | 0 |

| | | |
|---|---|---|
| R0220 | **Solvency capital requirement** | 47,829 |

**Other information on SCR**

| | | |
|---|---|---|
| R0300 | Amount/estimate of the overall loss-absorbing capacity of technical provisions | 0 |
| R0310 | Amount/estimate of the overall loss-absorbing capacity ot deferred taxes | -7,919 |
| R0410 | Total amount of Notional Solvency Capital Requirements for remaining part | 47,829 |
| R0420 | Total amount of Notional Solvency Capital Requirement for ring fenced funds | 0 |
| R0430 | Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios | 0 |
| R0440 | Diversification effects due to RFF nSCR aggregation for article 304 | 0 |

| | **Approach to tax rate** | C0109 |
|---|---|---|
| R0590 | Approach based on average tax rate | Not applicable as LAC DT is not used |

| | **Calculation of loss absorbing capacity of deferred taxes** | **LAC DT**<br>C0130 |
|---|---|---|
| R0640 | Amount/estimate of LAC DT | 7,919 |
| R0650 | Amount/estimate of LAC DT justified by reversion of deferred tax liabilities | 4,254 |
| R0660 | Amount/estimate of LAC DT justified by reference to probable future taxable economic profit | 1,634 |
| R0670 | Amount/estimate of AC DT justified by carry back, current year | 2,031 |
| R0680 | Amount/estimate of LAC DT justified by carry back, future years | — |
| R0690 | Amount/estimate of Maximum LAC DT | 9,680 |

## S.28.01.01 Minimum Capital Requirement
## – Only life or non-life insurance or reinsurance activity
– All amounts are in £'000

| | | MCR(NL) Result |
|---|---|---|
| | | C0020 |
| R0010 | **Linear formula component for non-life insurance and reinsurance obligations** | — |

| | | Net (of reinsurance/ SPV) best estimate and TP calculated as a whole | Net (of reinsurance) written premiums in the last 12 months |
|---|---|---|---|
| | | 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 | — | — |
| 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 | — | — |
| 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) Result |
|---|---|---|
| | | C0080 |
| R0200 | **Linear formula component for life insurance and reinsurance obligations** | 63,544 |

| | | Net (of reinsurance/ SPV) best estimate and TP calculated as a whole | Net (of reinsurance/ SPV) total capital at risk |
|---|---|---|---|
| | | C0110 | C0120 |
| R0210 | Obligations with profit participation - guaranteed benefits | — | |
| R0220 | Obligations with profit participation - future discretionary benefits | — | |
| R0230 | Index-linked and unit-linked insurance obligations | 9,073,105 | |
| R0240 | Other life (re)insurance and health (re)insurance obligations | 274 | |
| R0250 | Total capital at risk for all life (re)insurance obligations | | 38,521 |

| | **Overall MCR calculation** | C0130 |
|---|---|---|
| R0300 | Linear MCR | 63,544 |
| R0310 | SCR | 47,829 |
| R0320 | MCR cap | 21,523 |
| R0330 | MCR floor | 11,957 |
| R0340 | Combined MCR | 21,523 |
| R0350 | Absolute floor of the MCR | 3,187 |
| R0400 | **Minimum Capital Requirement** | 21,523 |