Registered number 02313262

Prudential Capital Public Limited Company

Annual Report and Financial Statements

For the year ended 31 December 2019

Incorporated and Registered in England and Wales

Registered Office: 10 Fenchurch Avenue, London, EC3M 5AG

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Company Information

Directors	C J Bousfield	(appointed on 16 March 2020)
	J M B Daniels	
	D W King	
	E Wenusch	
	R P Newby	
	K L Jones	(resigned on 18 October 2019)
Company Secretary	M&G Management Services Limited	
Registered Office	10 Fenchurch Avenue London EC3M 5AG	
Registered number	02313262	
Independent Auditor	KPMG LLP 15 Canada Square Canary Wharf London E14 5GL	

Strategic Report

Business review

The Company is a wholly owned subsidiary of Prudential Capital Holding Company Limited ('PCHCL'). On 20 September 2019, PCHCL was sold by Prudential plc to M&G plc. The Company's ultimate parent is M&G plc following the demerger of M&G plc from Prudential plc, on 21 October 2019.

The Company, and fellow direct subsidiaries of PCHCL, form the Prudential Capital business. This business has the following three strategic objectives:

- to provide professional treasury services to the M&G plc group (the 'Group');
- to operate a first-class wholesale and capital markets interface; and
- to provide liquidity and collateral management within a tightly controlled risk framework.

The Company generates revenue from a portfolio of loans and debt securities, acting as a securities lending agent and operating a cash and foreign exchange management business for the Group and its clients. During 2019 the business remained focused on the management of its existing asset portfolio, and management of Prudential plc group liquidity until demerger and thereafter M&G plc group liquidity.

During 2020, the Company expects the securities lending agent, and cash and foreign exchange management business to be transferred to another company in the Group. The primary focus of the Company will continue to be management of Group liquidity, including collateral management, and the generation of revenue from the loans and debt securities portfolio.

The profit after tax for the 2019 financial year was £28,275,000 (2018: £39,894,000). Further details of the results for the year are set out in the Profit and Loss Account and Other Comprehensive Income on page 12.

COVID-19

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. COVID-19 has caused significant numbers of people to become sick and others to die globally. This has resulted in substantial isolation where people may only leave their homes for critical journeys (i.e. to shop for food or if identified as a key worker). The outbreak has not only prompted widespread health concerns, but has caused recent deteriorations 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 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. The Company's clients are predominantly fellow Group undertakings, for which treasury, financial markets interface, liquidity and collateral management services continue to be supplied successfully.

COVID-19 is expected to result in a deterioration in financial performance over 2020, with ongoing volatility in valuation of financial instruments held by the Company. In particular the debt securities portfolio, including the derivative financial instruments used to manage related interest rate and foreign exchange rate exposures, are overall expected to experience downward pressure in valuations.

Whilst full financial implications are not yet known, based on the Company's current strong financial and liquidity position, the Directors believe the Company is in a position to withstand the financial impact of the pandemic. Further details of post balance sheet events affecting the Company are set out in Note 23.

Strategic report (continued)

European referendum

Reflecting the UK's decision to leave the European Union ('EU') on 31 January 2020 and following the referendum result of 2016, the wider Group had already taken several steps to minimise potential disruption to its clients, protect their interests and provide as much certainty and clarity as possible. The Group continues to monitor political and regulatory developments on the negotiations during the transition period and is ready to adjust or activate contingency plans, where necessary. The Company is fully integrated into this planning.

Principal risks and uncertainties

The Company is subject to the Group's internal control and risk management processes as detailed in the M&G plc's Group Governance Framework and Risk Management Framework. The control procedures and systems established within the Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. As such, they provide strong but not absolute assurance against material misstatement or loss, and focus on optimising the levels of risk and reward with the aim of achieving the business objectives.

The Risk Management Framework requires all business units and functions within the Group, including the Company, to establish processes for identifying, evaluating and managing key risks. The framework operates based on the concept of three lines of defence: risk management, risk oversight and independent assurance.

The Company's results and financial condition are exposed to both financial and non-financial risks. The key risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

Financial risk

The Company is exposed to financial risk through its financial assets and liabilities. The key financial risk factors affecting the Company are market, credit and liquidity risks. These financial risks and the management thereof are discussed in Note 21.

Non-financial risk

The Company has limited exposure to business environment, strategic, operational and group risk.

a) Business environment risk

Business environment risk is the risk of exposures to forces in the external environment that could significantly change the fundamentals that drive the business's overall objectives and strategy.

Changes in government policy, legislation (including tax) or regulatory interpretation applying to companies in the financial services sector, which in some circumstances may be applied retrospectively, may adversely affect the Company's activities and, consequently, its reported results and financing requirements.

While the Company is not a regulated entity, it is the responsibility of all staff in the wider regulated Group that regulatory levels of compliance are achieved. The Group has a suitably resourced compliance function, which assists the business to ensure ongoing adherence with new and existing regulations.

The Group also requires that all of its agreements with third parties are properly documented with legal advice taken internally or, where appropriate, from one of the law firms on the Group's approved panel by an authorised individual.

Strategic report (continued)

Non-financial risk (continued)

b) Strategic risk

Strategic risk is the risk of ineffective, inefficient or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Group's capabilities.

The Company has little exposure to strategic risk, however any changes in the regulatory and market environment or strategic decisions of associated companies, could play a role in forcing the senior management to take decisions which could affect the Company's performance.

c) Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events.

The Company's systems and processes incorporate controls which are designed to manage and mitigate the operational risks associated with its activities.

d) Group risk

Group risk is the risk of a direct or indirect loss arising from a connection with a related undertaking.

Group risk is present from the consequences of risks arising from other parts of the Group in addition to those risks arising from the Company's own activities. The independent capitalisation of the Company as well as the risk management processes and internal control mechanisms within the Company ensure Group risk is appropriately managed.

Section 172(1) Statement

Section 172 of the Companies Act 2006 requires Directors of the Company to act in the way he or she considers, in good faith, would most likely promote the success of the Company for the benefit of its members as a whole. In doing this, section 172 requires a director to have regard, amongst other matters, to the:

- likely consequences of any decisions in the long-term;
- interests of the Company's employees;
- need to foster the Company's business relationships with suppliers, customers and others;
- impact of the Company's operations on the community and environment;
- desirability of the Company maintaining a reputation for high standards of business conduct, and
- need to act fairly as between members of the Company.

In discharging section 172 duties the Company has regard to the factors set out above. The Company also recognises the matters considered by the Directors can have unique characteristics. This can require the board to have regard to additional factors which are relevant to the specific matter under consideration. There is an acknowledgement from the board that the relative importance of each factor considered will vary depending on the decision being taken. Across all the board's decisions, the Company is mindful of its purpose, statutory obligations, strategic priorities and alignment with the Group's overarching culture, vision and values.

Strategic report (continued)

Section 172(1) Statement (continued)

As is normal for large companies, the Company delegates authority for day-to-day management to an Executive Committee (‘PruCap Executive Committee’) who in turn charges management with execution of the business strategy and related policies. The PruCap Executive Committee review at each regular meeting, financial and operational performance as well as liquidity, collateral management, key risks, compliance, and statutory reporting. The PruCap Executive Committee and Group management also reviews other areas over the course of the financial year including the Company’s business strategy; diversity and inclusivity; environmental matters; corporate responsibility and governance; legal and other stakeholder-related matters. This is done through the consideration and discussion of reports which are sent in advance of each respective meeting and through decision making in various forums, including the Group’s ‘Finance, Capital & Liquidity Committee’ (that oversees the wider capital, liquidity and risk appetite activities of the Group), the PruCap Executive Committee, the Company board and other Group committees.

The Company’s key stakeholders are its ultimate beneficial owner, M&G plc, related Group entities, employees and those groups which represent the interests of wider society. The views and impact of the Company’s activities on those stakeholders are an important consideration for the Directors when making relevant decisions. While there are cases where the Directors engage directly with stakeholders on certain issues, the size and spread of Group stakeholders means other stakeholder engagement takes place at various Group committees. The Company finds that as well as being a more efficient and effective approach, this also helps the Company achieve a greater positive impact on environmental, social and other issues than by working in isolation.

Engagement with Group entity stakeholders occurs primarily in the Group’s wider governance forums, particularly those outlined above. Engagement with employees generally occurs through formal and informal meetings, and technology enabled platforms. Examples of initiatives the Company’s employees participate in include the annual staff engagement survey, town hall events for the treasury department, onsite access to Directors in the office, and Group investment in people policies and ongoing related consultations.

During the period, the Directors received information to help understand the interests and views of the Company’s key stakeholders and other relevant factors when making decisions. This has allowed the Directors to understand the nature of the Company stakeholders’ concerns and to comply with section 172 of the Companies Act 2006 to promote the success of the Company.

Principal Decisions

Set out below are some examples of how the Company have had regard to the matters set out in section 172(1)(a)-(f) when discharging it’s section 172 duty and the effect of that on decisions taken by the Company. The Company defines principal decisions as both those that are material to the Company, but also those that are significant to any key stakeholders. In making the following principal decisions, the Directors considered the relevant impact on stakeholders as well as the need to maintain a reputation for high standards of business conduct:

Principal decision 1 – Investment & Risk Appetite Planning

On 20 September 2019, the Prudential Capital group of companies (including the immediate parent company Prudential Capital Holding Company Limited, fellow subsidiary Prudential Capital (Singapore) Pte. Ltd, and the Company) were sold by Prudential plc to M&G plc. The Prudential Capital group became the treasury function for the M&G plc group, following the demerger from Prudential plc on 21 October 2019.

Strategic report (continued)

Principal decision 1 – Investment & Risk Appetite Planning (continued)

As part of the wider group separation project, the Directors prepared a detailed step plan and cash flow forecasts to facilitate the Company exiting investment positions and other financial and legal arrangements with the now unrelated Prudential plc group, including repayment of borrowings from Prudential plc. The Directors implemented a reduction in investment risk, including exit of external bridge loan investments and sale of various debt securities (i.e. those with credit ratings lower than Standard & Poor's A- and a significant portion of asset-backed and corporate securities). These actions ensured the Prudential Capital business was well positioned to provide the M&G plc group with liquidity, collateral management and other treasury services following the demerger.

Principal decision 2 – Dividends to Parent

Each year the Directors make an assessment of the strength of the Company's balance sheet and future prospects relative to uncertainties in the external environment and makes decisions about the payment of dividends. In 2019, the Company decided to pay an interim dividend of £5,000,000. In making this decision the Directors, assisted by Group committees received detailed financial planning materials and considered a range of factors. These factors included any impact on the Company in the short to medium term as well as the long-term viability of the Company; its expected cash flow and financing requirements (including strength of the capital position); and the ongoing need for strategic investment in the Company's business, the activities of Group subsidiaries, including the workforce and the expectations of the ultimate parent, M&G plc.

This report was approved by the board and signed on its behalf.

R P Newby
Director

5 June 2020

Directors' Report

The Directors present their annual report and the financial statements for the year ended 31 December 2019.

Directors

The Directors who served during the year were:

J M B Daniels
D W King
E Wenusch
R P Newby
K L Jones (resigned on 18 October 2019)

Following the year end, C J Bousfield was appointed a director on 16 March 2020.

Results

The profit for the year, after taxation, amounted to £28,275,000 (2018: £39,894,000).

Dividends paid

Interim dividends paid in the year amounted to £5,000,000 (2018: £30,000,000). The Directors do not recommend the payment of a final dividend (2018: £Nil).

Post balance sheet events

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. The outbreak has not only prompted widespread health concerns, but has caused recent deteriorations 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.

COVID-19 is expected to result in a deterioration in financial performance over 2020, with ongoing volatility in valuation of financial instruments held by the Company. In particular the debt securities portfolio, including the derivative financial instruments used to manage related interest rate and foreign exchange rate exposures, are overall expected to experience downward pressure in valuations. The impact of COVID-19 is also discussed in the Strategic Report on page 2.

Going concern

The Directors have a reasonable expectation that the Company has adequate resources to continue its operations for a period of at least 12 months from the date that the financial statements are approved. The key method for assessing going concern is through the business planning process which considers profitability, liquidity and solvency. The business planning process considers the Company's business activities, together with factors likely to affect its future development, successful performance and position, and key risks in the current economic climate. These plans have been updated to take into consideration the current information available in respect of the COVID-19 outbreak, acknowledging that information in respect of the outbreak and its outcome are highly uncertain. Due to the uncertainty regarding COVID-19, additional stress tests have been carried out to test the Company's resilience to an increased severity than is currently being experienced and actions available to the Company to mitigate or reduce the impact.

On the basis of the assessment described, the Directors have adopted the going concern basis of accounting in preparing the Company's financial statements for the year ended 31 December 2019.

Political contributions

There were no political contributions during the period (2018: £nil).

Directors' Report (continued)

Qualifying third party indemnity provisions

The ultimate parent company, Prudential plc until demerger on 21 October 2019, and M&G plc thereafter, has arranged appropriate insurance cover in respect of legal action against Directors and senior managers of companies within the group. In addition, the Articles of Association of the Company provide for the Directors, officers and employees of the Company to be indemnified in respect of liabilities incurred as a result of their office. The ultimate parent company also provides protections for Directors and senior managers of companies within the group against personal financial exposure they may incur in their capacity as such. These include qualifying third-party indemnity provisions (as defined by the relevant Companies Act) for the benefits of directors of the ultimate parent company, including, where applicable, in their capacity as a director of the Company and other companies within the group. These indemnities were in force during 2019 and remain in force.

Disclosure of information to auditors

Each of the persons who are Directors at the time when this Directors' Report is approved has confirmed that:

- so far as that director is aware, there is no relevant audit information of which the Company's independent auditor is unaware; and
- that director has taken all the steps that ought to have been taken as a director in order to be aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Auditor

In accordance with Section 489 of the Companies Act 2006, a resolution for the re-appointment of KPMG LLP as auditor of the company is to be proposed at the forthcoming Annual General Meeting.

This report was approved by the board and signed on its behalf.

R P Newby
Director

5 June 2020

Statement of Directors Responsibilities in respect of the Strategic Report, Directors' Report and the Financial Statements

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with applicable law and United Kingdom Accounting Standards ('United Kingdom Generally Accepted Accounting Practice'), including Financial Reporting Standard 101 'Reduced Disclosure Framework'.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of their profit or loss for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the Company financial statements;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of the Company financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of Company financial statements may differ from legislation in other jurisdictions.

Independent Auditor's Report to the Members of Prudential Capital Public Limited Company

Opinion

We have audited the financial statements of Prudential Capital Public Limited Company ("the Company") for the year ended 31 December 2019 which comprise the Profit and loss account and Other Comprehensive Income, Balance Sheet, Statement of Changes in Equity and related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. In our evaluation of the Directors' conclusions, we considered the inherent risks to the Company's business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

Strategic report and Directors' report

The Directors are responsible for the strategic report and the Directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the [strategic report and the] Directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the Directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Independent Auditor's Report to the Members of Prudential Capital Public Limited Company (continued)

Matters on which we are required to report by exception

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

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

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 9, the Directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

William Greenfield.

William Greenfield (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
Canary Wharf
London E14 5GL
5 June 2020

Profit and Loss Account and Other Comprehensive Income For the year ended 31 December 2019

	Notes	2019 £'000	2018 £'000
Interest receivable	2	**57,478**	78,373
Interest payable and similar charges	3	**(48,812)**	(71,033)
Net interest		**8,666**	7,340
Other operating (losses)/income	4	**(69,012)**	79,546
Operating expenses	5, 6, 7	**(27,568)**	(29,802)
Operating (loss)/profit on ordinary activities before tax		**(87,914)**	57,084
Unrealised gains/(losses) on measurement to fair value	8	**123,029**	(7,406)
Profit on ordinary activities for the year before taxation		**35,115**	49,678
Tax charge on ordinary activities	9	**(6,840)**	(9,784)
Total profit for the financial year		**28,275**	39,894

The accompanying notes and information on pages 15 to 35 form an integral part of the financial statements.

Balance Sheet
At 31 December 2019

	Note	2019 £'000	2019 £'000	2018 £'000	2018 £'000
Fixed assets					
Loan investments	10		**-**		-
Debt securities	11		**1,363,687**		1,883,605
			1,363,687		1,883,605
Current assets					
Debtors	12	**139,963**		447,764	
Derivative assets	13	**73,399**		572,523	
Cash and cash equivalents	14	**378,957**		1,784,080	
		592,319		2,804,367	
Current liabilities					
Creditors - amounts falling due within one year	15	**(1,887,794)**		(4,637,293)	
Net current liabilities	16		**(1,295,475)**		(1,832,926)
Total assets less current liabilities			**68,212**		50,679
Provisions for liabilities and charges	17		**(6,917)**		(12,662)
Net assets			**61,295**		38,017
Capital and reserves					
Called up share capital	18		**10,000**		10,000
Profit and loss account			**51,295**		28,017
Shareholders' funds – equity interests			**61,295**		38,017

The financial statements were approved and authorised for issue by the board and were signed on its behalf by:

R P Newby
Director

5 June 2020

The accompanying notes and information on pages 15 to 35 form an integral part of the financial statements.

Statement of Changes in Equity

	Called Up Share Capital	Profit And Loss Account	Total Equity
	£'000	£'000	£'000
Balance at 1 January 2018	**10,000**	**18,100**	**28,100**
Profit or loss	-	39,894	39,894
Total comprehensive income for the period	**-**	**39,894**	**39,894**
Dividends paid (note 18)	-	(30,000)	(30,000)
SAYE share-based payments	-	23	23
Total transactions with shareholder	**-**	**(29,977)**	**(29,977)**
Balance at 31 December 2018	**10,000**	**28,017**	**38,017**
Balance at 1 January 2019	**10,000**	**28,017**	**38,017**
Profit or loss	-	28,275	28,275
Total comprehensive income for the period	**-**	**28,275**	**28,275**
Dividends paid (note 18)	-	(5,000)	(5,000)
SAYE share-based payments	-	3	3
Total transactions with shareholder	**-**	**(4,997)**	**(4,997)**
Balance at 31 December 2019	**10,000**	**51,295**	**61,295**

The accompanying notes and information on pages 15 to 35 form an integral part of the financial statements.

Notes to the Financial Statements

1. Accounting policies

1.1 Basis of preparation of financial statements

Prudential Capital Public Limited Company (the 'Company') is a company incorporated in England and Wales and domiciled in the United Kingdom.

The financial statements have been prepared on the historical cost as modified by a fair value basis for derivative financial instruments, financial instruments classified as fair value through the profit or loss and liabilities for cash-settled share based payments.

The financial statements have been prepared in accordance with FRS101, Part 15 of the Companies Act 2006 and Schedule 1 of The Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008.

The Company has applied the exemptions available under FRS101 in respect of the following disclosures:

- the requirement of IAS 7 to present a statement of cash flows;
- the requirement of IAS 24 to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member;
- the requirement of paragraph 17 of IAS 24 to disclosure key management personnel compensation;
- the requirements of IAS 8 to disclose the effect of new but not effective IFRS standards; and
- the requirements of paragraph 10(d), 10(f), 16, 38A, 38B, 40A, 40B, 40C, 40D, 111 and 134-136 of IAS 1 Presentation of Financial Statements.

The Company's ultimate parent undertaking, M&G plc, includes the Company in its consolidated financial statements. The consolidated financial statements of M&G plc are prepared in accordance with International Financial Reporting Standards and are available to the public from the Company Secretary, at 10 Fenchurch Avenue, London, EC3M 5AG.

Prior to the 21 October 2019 demerger of M&G plc group from the Prudential plc group, the ultimate parent company was Prudential plc. In the notes to the financial statements, reference to 'group' relates to the Prudential plc group until 21 October 2019, and thereafter the M&G plc group.

As the consolidated financial statements of the Group include the equivalent disclosures the Company has also taken the exemption under FRS101 available in respect of the following disclosures:-

- the requirements of paragraphs 45(b) and 46–52 of IFRS 2: Share Based Payments.

The Company proposes to continue to adopt the reduced disclosure framework of FRS 101 in its next financial statements.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements. Various new accounting standards and pronouncements became effective on 1 January 2019, but none of these had a material impact on the financial statements.

Notes to the Financial Statements (continued)

1.2 Going concern

The Directors have a reasonable expectation that the Company has adequate resources to continue its operations for a period of at least 12 months from the date that the financial statements are approved. The key method for assessing going concern is through the business planning process which considers profitability, liquidity and solvency. The business planning process considers the Company's business activities, together with factors likely to affect its future development, successful performance and position, and key risks in the current economic climate. These plans have been updated to take into consideration the current information available in respect of the COVID-19 outbreak, acknowledging that information in respect of the outbreak and its outcome are highly uncertain.

Due to the uncertainty regarding COVID-19, additional stress tests have been carried out to test the Company's resilience to an increased severity than is currently being experienced and actions available to the Company to mitigate or reduce the impact. COVID-19 has impacted financial markets and increased fair value volatility of the Company's debt securities portfolio, including the derivative financial instruments used to manage related interest rate and foreign exchange rate exposures. Accordingly, a letter of support has been obtained from the ultimate parent company, M&G plc, stating M&G plc is willing to provide financial support to the Company if needed.

Furthermore, following the UK's decision to leave the European Union ('EU') on 31 January 2020 and the referendum result of 2016, the wider Group had taken several steps to minimise potential disruption to its clients, protect their interests and provide as much certainty and clarity as possible. The Group continues to monitor political and regulatory developments on the negotiations during the transition period and is ready to adjust or activate contingency plans, where necessary. The Company is fully integrated into this planning.

The Company has a net current liabilities position as a result of using short-term borrowings, received from its ultimate parent company M&G plc (2018: Prudential plc), to purchase debt securities that are intended to be held to expected maturity. The debt securities consist of high quality bonds and UK gilts (see note 11) which are liquid and can be readily converted into cash.

On the basis of the assessment described, the Directors have adopted the going concern basis of accounting in preparing the Company's financial statements for the year ended 31 December 2019.

1.3 Financial instruments

(i) Recognition and initial measurement

Trade receivables are initially recognised when they are originated. All other financial assets and financial liabilities are initially recognised when the Company becomes a party to the contractual provisions of the instrument.

A financial asset (unless it is a trade receivable without a significant financing component) or financial liability is initially measured at fair value plus, for an item not at fair value through profit and loss ('FVTPL'), transaction costs that are directly attributable to its acquisition or issue. A trade receivable without a significant financing component is initially measured at the transaction price.

Notes to the Financial Statements (continued)

1.3 Financial instruments (continued)

(ii) Classification and subsequent measurement

Financial assets

(a) Classification

On initial recognition, a financial asset is classified as measured at: amortised cost; fair value through other comprehensive income or FVTPL.

Financial assets are not reclassified subsequent to their initial recognition unless the Company changes its business model for managing financial assets in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

A financial asset is measured at amortised cost if it meets both of the following conditions:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Loan investments, trade and other debtors are measured at amortised cost.

All financial assets not classified as measured at amortised cost are measured at FVTPL. This includes all derivative financial assets. On initial recognition, the Company may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise. Investments in debt securities are irrevocably designated at FVTPL.

Cash and cash equivalents comprise cash at bank balances, short term deposits and reverse repurchase transactions.

(b) Subsequent measurement and gains and losses

Financial assets at FVTPL - these assets are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognised in profit or loss.

Financial assets at amortised cost - these assets are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognised in profit or loss. Any gain or loss on derecognition is recognised in profit or loss.

Financial liabilities and equity

Financial instruments issued by the Company are treated as equity only to the extent that they meet the following two conditions:

(a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company; and

(b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in these financial statements for called up share capital and share premium account exclude amounts in relation to those shares.

Notes to the Financial Statements (continued)

1.3 Financial instruments (continued)

(ii) Classification and subsequent measurement (continued)

Financial liabilities and equity *(continued)*

Financial liabilities are classified as measured at amortised cost or FVTPL. A financial liability is classified as at FVTPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognised in profit or loss. Other financial liabilities are subsequently measured at amortised cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognised in profit or loss. Any gain or loss on derecognition is also recognised in profit or loss.

(iii) Derivative financial instruments

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss.

(iv) Impairment

The Company recognises loss allowances for expected credit losses ('ECLs') on financial assets measured at amortised cost, and contract assets (as defined in IFRS 15 'Revenue from Contracts with Customers').

The Company measures loss allowances at an amount equal to lifetime ECL, except for loan investments and bank balances for which credit risk (i.e. the risk of default occurring over the expected life of the financial instrument) has not increased significantly since initial recognition which are measured as 12-month ECL.

Loss allowances for trade receivables and contract assets are always measured at an amount equal to lifetime ECL

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECL, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Company's historical experience and informed credit assessment and including forward-looking information.

The Company considers loan investments to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Company considers this to be equivalent of BBB- or higher per rating agency Standard & Poor's.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument.

12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date (or a shorter period if the expected life of the instrument is less than 12 months). The maximum period considered when estimating ECLs is the maximum contractual period over which the Company is exposed to credit risk.

Measurement of ECLs
ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Company expects to receive). ECLs are discounted at the effective interest rate of the financial asset.

Credit-impaired financial assets
At each reporting date, the Company assesses whether financial assets carried at amortised cost are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Notes to the Financial Statements (continued)

1.3 Financial instruments (continued)

(iv) Impairment (continued)

Write-offs
The gross carrying amount of a financial asset is written off (either partially or in full) to the extent that there is no realistic prospect of recovery.

1.4 Foreign currency transactions

Functional and presentation currency
The Company's functional and presentational currency is GBP.

Transaction and balances
Foreign currency transactions are translated into sterling at average rates of exchange during the year. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated to the functional currency at foreign exchange rates ruling at the dates the fair value was determined. Foreign exchange differences arising on translation are recognised in the profit or loss account.

1.5 Dividends

Dividends paid to shareholders are recognised when approved.

1.6 Interest

Interest income and interest payable is recognised in profit or loss as it accrues, using the effective interest method.

1.7 Tax

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in equity or other comprehensive income, in which case it is recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future are not provided for. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

1.8 Share-based payments

All share based payments made to employees for services rendered, for which the ultimate parent company (M&G plc) has the obligation to settle, are measured based on the fair value of the equity instrument granted. The fair value takes into account the impact of market based vesting conditions and non-vesting conditions, but excludes any impact of non-market based vesting conditions. The related share based payment expense is recognised over the vesting period. The fair value may be determined using an option pricing model such as Black-Scholes or a Monte Carlo Simulation where appropriate, taking into account the terms and conditions of the award.

Notes to the Financial Statements (continued)

1.8 Share-based payments (continued)

Following the demerger, for share-based payments that are equity-settled, the fair value of services rendered is based on the fair value of the equity instrument at the date of demerger (or the grant date for schemes beginning after demerger date) which is not remeasured subsequently. The equity-settled share based payment expense is based on the number of equity instruments expected to vest over the vesting period, with the corresponding entry to equity.

A cancellation of an award without the grant of a replacement equity instrument is accounted for as an acceleration of vesting. Accordingly, any share based expense that would have been recognised over the remaining vesting period is recognised immediately.

Where replacement equity instruments are granted to employees in place of the cancelled equity instruments, the replacement award is treated as a modification of the original award. At the point of replacement, the awards are remeasured to the fair value at the date of replacement, which forms the basis of recognising the expense over the remaining vesting period.

Prior to demerger the Company, as part of the wider Prudential plc group, offered share award and option plans which included both equity-settled and cash-settled plans. Schemes are accounted for as cash-settled where the Company has the obligation to settle with the recipients. The fair value of the amount payable is recognised as an expense, with a corresponding increase in liabilities, over the period in which the employees become unconditionally entitled to payment. The liability is remeasured at each balance sheet date and at settlement date. Any changes in the fair value of the liability are recognised as staff costs in profit or loss.

1.9 Pension costs

Certain Company employees are members of the M&G Group Pension Scheme or the Prudential Staff Pension Scheme, both of which operate defined benefit schemes. The Company is unable to identify its share of the underlying assets and liabilities of either scheme on a consistent and reasonable basis and therefore as required by IAS 26 'Accounting and Reporting by Retirement Benefit Plans' accounts for them as if they were defined contribution schemes. Contributions are charged to the profit and loss account as they become payable under the rules of the scheme.

1.10 Provisions

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event, that can be reliably measured and it is probable that an outflow of economic benefits will be required to settle the obligation.

1.11 Long-term incentive plan ('LTIP')

Long-term incentive plans are long-term bonus schemes earned over three years, linked to the business performance. Long-term incentive plans are measured on an undiscounted basis and are expensed over the three year period. A liability is recognised for the amount expected to be paid under long term incentive plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

Notes to the Financial Statements (continued)

2. Interest receivable

	2019 £'000	2018 £'000
Interest receivable on loan investments	**141**	2,911
Interest receivable on debt securities	**17,224**	22,817
Interest and fees receivable on derivatives	**21,015**	26,784
Interest receivable from group undertakings	**9,666**	18,171
Interest receivable on bank and short-term deposits	**9,432**	7,690
	57,478	78,373

3. Interest payable and similar charges

	2019 £'000	2018 £'000
Interest payable to group undertakings	**29,697**	39,100
Interest and fees payable on derivatives	**18,482**	30,267
Impairment (gains) / losses on investments	**(235)**	1,296
Other interest payable	**868**	370
	48,812	71,033

4. Other operating (losses) / income

	2019 £'000	2018 £'000
Fees (payable) / receivable on loan investments	**(3,073)**	394
Management fees from fellow group undertakings	**27,447**	32,990
Realised gains on debt securities	**9,768**	12,012
Realised (losses) / gains on derivatives	**(102,840)**	74
Foreign exchange (losses) / gains	**(322)**	33,798
Other investment income	**8**	278
	(69,012)	79,546

5. Expenses and auditor's remuneration

Amounts receivable by the Company's auditor in respect of the audit of the Company's financial statements is £70,000 (2018: £155,560).

Amounts receivable by the Company's auditor in respect of services to the Company and its associates, other than the audit of the Company's financial statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis in the consolidated financial statements of the Company's ultimate parent, M&G plc.

6. Staff numbers and costs

The aggregate payroll costs, including Directors' remuneration, were as follows:

	2019 £'000	2018 £'000
Wages and salaries	**6,572**	6,608
Share based payments (see note 20)	**2,303**	2,328
Social security costs	**885**	1,413
Pension scheme costs (see note 1.9)	**827**	886
	10,587	11,235

The average number of staff employed by the Company, including the Directors, was 25 (2018: 30).

Notes to the Financial Statements (continued)

7. Directors' emoluments

The aggregate emoluments of the Directors of the Company for qualifying services total £762,000 (2018: £1,172,000). Directors' emoluments are based upon the apportionment of time spent providing qualifying services as Directors for the Company. Additional director emolument disclosures are made in the financial statements of the immediate parent company, Prudential Capital Holding Company Limited.

8. Unrealised gains / (losses) on measurement to fair value

	2019	2018
	£'000	£'000
Unrealised gains / (losses) on debt securities	**41,998**	(35,819)
Unrealised gains on derivatives	**81,031**	28,413
	123,029	(7,406)

9. Tax

(a) Analysis of tax charge for the year

	2019	2018
	£'000	£'000
Current tax		
Current tax on profit for the year	**(6,165)**	(8,081)
Adjustments in respect of prior years	**194**	(48)
Total current tax	**(5,971)**	(8,129)
Deferred tax		
Current year	**(1,121)**	(1,697)
Adjustments in respect of previous years	**162**	42
Effect of changes in tax rate	**90**	-
Total deferred tax	**(869)**	(1,655)
Total tax	**(6,840)**	(9,784)

(b) Factors affecting tax charge for the period

The standard rate of Corporation Tax in the UK was due to change from 19% to 17% with effect from 1 April 2020. Deferred tax is provided at the tax rates enacted at the balance sheet date applicable to when the temporary differences are expected to reverse. Following the budget announcement on 11 March 2020, the repeal of the legislation to reduce the tax rate was substantively enacted on 17 March 2020. Accordingly, the reduction in tax rate will no longer take place. The impact of this post balance sheet event will be to increase the closing deferred tax asset from £3,408,000 to £3,809,000.

Notes to the Financial Statements (continued)

9. Tax (continued)

(b) Factors affecting tax charge for the period (continued)

	2019 £'000	2018 £'000
Profit on ordinary activities before tax	**35,115**	49,678
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 19% (2018: 19%)	**(6,672)**	(9,439)
Effects of:		
Tax rate changes	**90**	189
Share options	**(612)**	-
Expenses not deductible	**(2)**	(528)
Adjustments in respect of previous years	**356**	(6)
Total tax charge	**(6,840)**	(9,784)

10. Loan investments

Loan investments are stated at amortised cost less provision for impairment.

	2019 £'000	2018 £'000
Amortised cost	**-**	3,990
Specific impairment provisions	**-**	(3,990)
Net book value	**-**	-

After recovering £234,571 (note 3), loan investments of £3,755,086 were written off in December 2019.

11. Debt securities

Debt securities, which are designated as fair value through profit and loss, comprise the following:

	Amortised Cost[1]		**Fair Value**	
	2019 £'000	2018 £'000	**2019 £'000**	2018 £'000
Government gilts	**678,770**	712,428	**920,631**	919,908
Residential mortgage-backed securities	**102,177**	238,971	**102,031**	237,838
Commercial mortgage-backed securities	**-**	2,959	**-**	2,952
Other asset-backed securities	**23,781**	198,783	**23,703**	198,381
Corporates	**312,944**	526,447	**317,322**	524,526
	1,117,672	1,679,588	**1,363,687**	1,883,605

[1] Amortised cost of the debt securities net of any provision made for impairment.

Notes to the Financial Statements (continued)

11. Debt securities (continued)

The following table summarises the securities detailed above by rating. Standard & Poor's ('S&P') ratings have been used where available. For securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative.

	2019	2018
	£'000	£'000
AAA	**237,700**	617,684
AA+ to AA-	**1,032,676**	1,088,109
A+ to A-	**93,311**	148,100
BBB+ to BBB-	**-**	29,712
	1,363,687	1,883,605

The analysis by listing status is as follows:

	2019	2018
	£'000	£'000
Listed	**1,320,897**	1,839,857
Unlisted	**42,790**	43,748
	1,363,687	1,883,605

Details of debt securities pledged by the Company as collateral to counterparties in respect of its over-the-counter ('OTC') derivative positions and borrowings under repurchase agreements are detailed in note 21.

12. Debtors

	2019	2018
	£'000	£'000
Amounts owed by group undertakings	**68,577**	363,897
Cash collateral posted in respect of OTC derivative and repo positions	**61,370**	33,217
Other debtors	**66**	34,650
Corporation tax	**-**	272
Deferred tax asset	**3,408**	4,277
Interest receivable	**6,410**	11,344
Accrued income	**132**	107
	139,963	447,764

Total debtors includes an amount of £Nil (2018: £2,221,499) which is due after more than one year.

Amounts owed by group undertakings includes an amount of £Nil (2018: £114,190,372) which has been pledged as collateral to a group counterparty under a guarantee arrangement (see notes 19 and 21).

13. Derivative assets

	2019	2018
	£'000	£'000
Derivative assets	**73,399**	572,523

Derivative assets includes an amount of £13,068,407 (2018: £461,572,398) which relates to derivative transactions undertaken with group counterparties.

Notes to the Financial Statements (continued)

14. Cash and cash equivalents

Cash and cash equivalents consist of cash at bank, short term deposits held with banks and other short-term highly liquid investments with less than 90 days maturity from the date of acquisition.

	2019	2018
	£'000	£'000
Cash at bank and in hand	**23,957**	84,080
Secured deposits made under reverse repurchase agreements	**355,000**	1,700,000
	378,957	1,784,080

At 31 December 2019 UK Gilts with a total fair value of £356,977,842 (2018: £1.7 billion) were pledged as collateral to the Company by external counterparties in respect of deposits made under reverse repurchase arrangements.

15. Creditors: amounts falling due within one year

	2019	2018
	£'000	£'000
Amounts owed to group undertakings	**1,250,334**	3,571,766
Obligations under repurchase agreement	**200,055**	-
Cash collateral received in respect of OTC derivative positions	**46,100**	31,649
Derivative liabilities	**379,742**	991,480
Bank overdraft	**-**	30,663
Interest payable	**4,988**	10,601
Corporation tax	**2,338**	-
Accruals and deferred income	**4,237**	1,134
	1,887,794	4,637,293

At 31 December 2019 UK Gilts with a total fair value of £187,308,052 (2018: £Nil) and cash of £13,188,000 (2018: £Nil) were posted as collateral by the Company to external counterparties in respect of obligations under repurchase arrangements.

16. Net current liabilities

Net current liabilities arise as a result of the Company using short-term borrowings, received from its ultimate parent company M&G plc (2018: Prudential plc), to purchase debt securities that are intended to be held to expected maturity. The debt securities consist of high quality bonds and UK gilts (see note 11) which are liquid and can be readily converted into cash.

Notes to the Financial Statements (continued)

17. Provisions for liabilities and charges

	2019	2018
	£'000	£'000
Balance at 1 January	**12,662**	20,726
Amount utilised during the year	**(8,852)**	(13,073)
Amount transferred to group undertaking	**(3,036)**	-
Provision made during the year	**6,143**	5,009
Balance at 31 December	**6,917**	12,662

The provisions relate to deferred cash awards (2018: deferred cash awards and Prudential plc share awards) made to certain employees under the Prudential Capital Incentive Plan. In 2019 the share award obligations were transferred to the new ultimate parent, M&G plc. The share awards are restricted for three years before they can be released, subject to close periods, to the employee who must not be under a period of notice at the time of vesting and must still be in employment of the Company. In calculating the provision, the Company has made the assumption that all share awards will vest over the next three years.

18. Share capital

	2019	2018
	£'000	£'000
Allotted, issued and fully paid		
10 million ordinary shares of £1 each	**10,000**	10,000

The Company has paid dividend of £5 million during the year 2019 (£2018: £30 million) on the issued ordinary share capital.

19. Commitments

Financial commitments

At the year end the Company had entered into commitments to provide loan facilities as follows:

	2019	2018
	£'000	£'000
Commitments to group undertakings	**39,970**	44,334
Commitments to external counterparties	**140,615**	155,905
	180,585	200,239

The commitments were entered into in the normal course of business and the Directors do not expect a material adverse impact on the operations to arise from them.

Off balance sheet arrangements

The Company has provided credit protection on the UK Government under credit default swaps. The total notional exposure amounted to £269 million (2018: £280 million).

Prior to demerger of M&G plc from Prudential plc, and ceasing to be effective on 25 September 2019, the Company had provided a guarantee to The Prudential Assurance Company Limited, a related group counterparty, under which it provided collateral of £530 million in the form of loans made to the Prudential plc group and debt securities. The value of collateral pledged under this guarantee (see note 21) was subject to haircut adjustments.

Notes to the Financial Statements (continued)

19. Commitments (continued)

Effective 21 October 2019, the Company has provided a guarantee to The Prudential Assurance Company Limited, a related Group counterparty, under which it provides collateral of £250 million in the form of debt securities. The value of collateral pledged under this guarantee (see note 21) is subject to haircut adjustments.

The Company has seconded several employees to M&G Investment Management Limited, a fellow Group undertaking, to provide services to that company in relation to its role as agent for securities lending activities on behalf of The Prudential Assurance Company Limited and certain funds managed / operated by Link Fund Solutions Limited (formerly Capita Financial Managers Limited).

The Company has provided an indemnity to The Prudential Assurance Company Limited in respect of losses arising from the securities lending activity which is uncapped for credit and market risks and capped at £7.5 million per annum for operational losses. The Company has also provided an indemnity to M&G Investment Management Limited and the trustee / depositary of the relevant funds managed / operated by Link Fund Solutions Limited in respect of losses arising from the securities lending activity which is uncapped for credit and market risks. Operational losses are capped at £3 million per annum for the funds managed / operated by Link Fund Solutions Limited. Losses relating to retrospective changes in tax legislation are not covered by the indemnities.

20. Share-based payments

a) Description of the plans

The Company operates various share-based payment schemes that award M&G plc schemes to participants upon meeting the required vesting conditions. Details of those schemes are stated below:

Discretionary schemes:

Long-term Incentive Plan ('LTIP')

Long-term incentive plans are long-term bonus schemes earned over three years, linked to the business performance.

Group Deferred Bonus Plan ('GDBP')

Under these plans, a participant's annual bonus is paid in the form of a share award that vests after 3 years. There are no performance conditions associated with this plan.

Restricted Share Plan ('RSP')

Prior to demerger, all discretionary schemes were based on Prudential plc awards. At the point of demerger and subsequent listing of M&G plc, all outstanding discretionary awards were replaced with equivalent awards based on M&G plc shares. The scheme rules for the awards remain the same in principle, for which the market-based performance condition will now be based on the performance of M&G plc.

In accordance with IFRS 2, the replacement awards have been accounted for as a modification of the previous scheme and the expense in relation to the scheme will continue to be recorded over the remaining vesting period.

Up until the point of demerger, the discretionary schemes were treated as cash-settled as the Company had the obligation to settle the awards. At the point of demerger, the schemes were converted to equity-settled as the obligation to settle the awards rests with M&G plc.

Notes to the Financial Statements (continued)

20. Share-based payments (continued)

Approved schemes:

Save As You Earn ('SAYE') plans

The Company operates Save-as-you-earn (SAYE) plans, which allow eligible employees the opportunity to save a monthly amount from their salaries, over either a three or five year period, which can be used to purchase shares in M&G plc at a predetermined price subject to the employee remains in employment for three years after the grant date of the options and that the employee satisfying the monthly savings requirement.

Share Incentive Plan ('SIP')

In addition, to celebrate the demerger, all eligible employees were provided with M&G plc shares with a value of £2,000. The awards vest subject to the employee remaining in employment for 2 years.

All approved schemes are accounted for as equity-settled as the awards would be settled in M&G plc shares.

b) Outstanding options and awards

The historical share based payment schemes that operated prior to demerger were cancelled with all participants treated as good leavers. This resulted in an incremental gain of £474,064 recorded at the date of demerger.

Movements in outstanding options and awards under the Company's share-based compensation plans from demerger to 31 December 2019:

	Outstanding options under SAYE schemes	**Awards outstanding under incentive plans**
	2019	**2019**
Outstanding as at 21 October	-	3,790,176
Granted	141,838	-
Exercised / Vested	-	(940,010)
Outstanding as at 31 December	141,838	2,850,166
Options immediately exercisable at 31 December	-	-

The following table provides a summary of the range of exercise prices for the SAYE options. The awards under the other schemes do not have an exercise price:

	Number outstanding	**Weighted average remaining contractual life (years)**	**Weighted average exercise prices (£)**	**Number exercisable**
£1 - £2	141,838	2.92	1.84	-

Notes to the Financial Statements (continued)

20. Share-based payments (continued)

c) Fair value of options and awards

The fair value of all awards, except for the LTIP award and the SAYE options, is based on the M&G plc share price at the date of grant.

The determination of the fair value of the LTIP award and the SAYE options requires the use of various assumptions which are disclosed below:

	LTIP	**SAYE options**
Dividends yield (%)	-	7.30%
Expected volatility (%)	22.50%	20.00%
Risk-free interest rate (%)	0.80%	0.80%
Expected option life (years)	-	3.00
Weighted average exercise price (£)	-	1.84
Weighted average share price at grant date (£)	2.18	2.44
Weighted average fair value at grant date (£)	0.21	0.33

The Company uses the Black-Scholes model to value the SAYE options whereas the LTIP performance conditions are valued using a Monte-Carlo model. In determining the fair value of options granted the historic volatility of the share price of suitable peers and a risk-free rate determined by reference to swap rates was also considered.

d) Share-based payment expense charged to the income statement

Total expenses recognised in the year in the financial statements relating to share-based compensation is as follows:

	2019 £000	2018 £000
Equity settled share-based payment expense	**3**	23
Cash settled share-based payment expense	**2,300**	2,305
	2,303	2,328

21. Financial instruments

Financial risk management objectives and policies
The Company's business involves the acceptance and management of risks.

The Company's exposure to financial risks associated with financial instruments held in the ordinary course of business includes:

Credit risk
Credit risk is the risk that a counterparty or an issuer of securities, which the Company holds in its asset portfolio, defaults or another party fails to perform according to the terms of the contract.

The acceptance of credit risk is a significant part of the Company's business. Credit risk is controlled by the credit experience of the Company and M&G plc. The Company's maximum exposure to credit risk of financial instruments before any allowance for collateral is represented by the carrying value of financial instruments on the balance sheet that have exposures to credit risk, comprising cash at bank and cash equivalents, deposits, debt securities, loans and derivative assets.

Notes to the Financial Statements (continued)

21. Financial instruments (continued)

The following table details the group loans, debt securities and cash collateral pledged or received by the Company in respect of its activities.

	Group Loan Receivables	Debt securities		Cash	
	Pledged £'000	Pledged £'000	Received £'000	Pledged £'000	Received £'000
31 December 2019					
OTC derivative positions	-	333,002	1,939	48,182	46,100
Reverse Repo trades	-	-	356,978	-	-
Repo trades	-	187,308	-	13,188	-
Group guarantees (note 19)	-	266,857	-	-	-
	-	**787,167**	**358,917**	**61,370**	**46,100**
31 December 2018					
OTC derivative positions	-	903,584	64,013	33,217	31,649
Reverse Repo trades	-	-	1,700,000	-	-
Repo trades	-	-	-	-	-
Group guarantees (note 19)	114,190	439,209	-	-	-
	114,190	**1,342,793**	**1,764,013**	**33,217**	**31,649**

The Company has also provided credit protection on the UK Government under credit default swaps. The total notional exposure amounted to £269 million (2018: £280 million).

Cash is placed with banks and financial institutions which are regulated and rated by rating agencies.

Market risk
Market risk is the risk that changes in market prices, such as interest rates and foreign exchange rates will affect the Company's income or the value of its holdings of financial instruments.

The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign rate risk, including foreign exchange forward contracts and interest rate swaps.

Market risk – Interest rate risk
A one basis point increase in interest rates at the balance sheet date would have increased the profit before taxation by £129,000 (2018: £317,000). A one basis point decrease in interest rates at the balance sheet date would have decreased the profit before taxation by an equal amount.

The Company is also exposed to basis risk between nominal and real UK Gilt yields and nominal and real swap rates. An increase of one basis point in the spread between these rates would have increased the profit before taxation by approximately £1.6 million (2018: £1.6 million). A decrease of one basis point in the spread between these rates would have decreased the profit before taxation by an equal amount.

The above interest rate calculations assume that the change occurred at the balance sheet date and had been applied to risk exposures at that date.

Market risk - Currency risk
The Company's net exposure to currency risk is as follows:

	GBP £'000	USD £'000	EUR £'000	Other £'000	Total £'000
31 December 2019					
Net exposure	54,406	2,973	3,515	401	61,295
31 December 2018					
Net exposure	32,622	4,509	1,773	(887)	38,017

Notes to the Financial Statements (continued)

21. Financial instruments (continued)

Sensitivity analysis

A 5 percent weakening of the US dollar and euro currencies against pound sterling at 31 December 2019 would have decreased profit before tax by the amounts shown below. A 5 percent strengthening of the US dollar and euro currencies against pound sterling at 31 December 2019 would have increased profit before tax by the equal and opposite of the amounts shown below. These calculations assume that the change occurred at the balance sheet date and had been applied to risk exposures at that date. This analysis assumes that all other variables, in particular other exchange rates and interest rates, remain constant.

	Impact on profit before taxation £'000
2019	
USD	(155)
EUR	(320)
2018	
USD	(215)
EUR	(85)

Market risk - Liquidity risk

Liquidity risk is the risk that the Company may be unable to meet payment of obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates.

Liquidity management in the Company and the wider group seeks to ensure that, even under adverse conditions, the Company has access to funds necessary to cover maturing liabilities.

The following table sets out the contractual maturities for financial liabilities, excluding derivative liabilities that are separately presented. The financial liabilities are included in the column relating to the contractual maturities at the undiscounted cash flows (including contractual interest payments) due to be paid assuming conditions are consistent with those of year end.

	Total carrying value £'000	Contractual cash flows £'000	1 year or less £'000	After 1 year to 5 years £'000	No stated maturity £'000
2019					
Amounts owed to group undertakings	1,250,334	1,250,334	1,250,334	-	-
Obligations under repurchase agreements	200,055	200,055	200,055	-	-
Other creditors	57,663	57,663	-	-	57,663
	1,508,052	1,508,052	1,450,389	-	57,663
2018					
Amounts owed to group undertakings	3,571,766	3,571,766	3,571,766	-	-
Obligations under repurchase agreements	-	-	-	-	-
Other creditors	74,047	74,047	-	-	74,047
	3,645,813	3,645,813	3,571,766	-	74,047

The following table shows the gross and net derivatives positions together with a maturity profile of the net derivative position:

	Carrying value of derivatives			Maturity profile of net derivative position				
	Derivative assets £'000	Derivative liabilities £'000	Net derivative position £'000	Total expected cash flows £'000	1 year or less £'000	After 1 year to 3 years £'000	After 3 years to 5 years £'000	After 5 years £'000
2019	73,399	(379,742)	(306,343)	(365,466)	143	(11,958)	(10,054)	(343,597)
2018	572,523	(991,480)	(418,957)	(104,824)	(23,106)	(8,347)	(8,836)	(64,535)

Notes to the Financial Statements (continued)

21. Financial instruments (continued)

Offsetting assets and liabilities

The Company's derivative instruments and repurchase agreements are subject to master netting arrangements and collateral arrangements. A master netting arrangement with a counterparty creates a right of offset for amounts due to and due from the same counterparty that is enforceable in the event of default or bankruptcy. The Company recognises amounts subject to master netting arrangements on a gross basis within the balance sheet.

The following table presents the gross and net information about the Company's financial instruments which are subject to master netting arrangements.

	Gross amount included in Balance Sheet £'000	Financial Instruments £'000	Cash Collateral £'000	Securities Collateral £'000	Net Amount £'000
2019					
Financial assets					
Derivative assets	73,399	(11,464)	(45,760)	(1,939)	14,236
Reverse repurchase agreements	355,000	-	-	(356,978)	(1,978)
	428,399	(11,464)	(45,760)	(358,917)	12,258
Financial liabilities					
Derivative liabilities	(379,742)	11,464	46,048	312,614	(9,616)
Repurchase agreements	(200,055)	-	13,188	187,308	441
	(579,797)	11,464	59,236	499,922	(9,175)
2018					
Financial assets					
Derivative assets	572,523	(79,318)	(30,747)	(519)	461,939
Reverse repurchase agreements	1,700,000	-	-	(1,700,000)	-
	2,272,523	(79,318)	(30,747)	(1,700,519)	461,939
Financial liabilities					
Derivative liabilities	(991,480)	79,318	32,405	859,862	(19,895)
Repurchase agreements	-	-	-	-	-
	(991,480)	79,318	32,405	859,862	(19,895)

In the table above, the amounts of assets and liabilities presented in the balance sheet are offset first by financial instruments that have the right of offset under master netting arrangements with any remaining amount reduced by the amount of cash and securities collateral. The actual amount of collateral may be greater than amounts presented in the table.

Assets and liabilities – Classification and measurement

The fair values of the financial instruments for which fair valuation is required under IFRS are determined by the use of current market prices for exchange-quoted investments, or by using quotations from independent third parties, such as brokers and pricing services or by using appropriate valuation techniques.

The estimated fair value of derivative financial instruments reflects the estimated amount the Company would receive or pay in an arm's length transaction. This amount is determined using valuations from independent third parties or valued internally using standard market practices.

The carrying amount of the Company's other financial assets and financial liabilities as at 31 December 2019 and 31 December 2018 is a reasonable approximation of their fair values.

Notes to the Financial Statements (continued)

21. Financial instruments (continued)

The classification of the Company's assets and liabilities, and the corresponding accounting carrying values reflect the requirements of IFRS.

	At fair value through profit & loss £'000	Amortised cost £'000	Total carrying amount £'000
2019			
Debt securities	1,363,687	-	1,363,687
Amounts owed by group undertakings	-	68,577	68,577
Other debtors	-	71,386	71,386
Derivative assets	73,399	-	73,399
Cash and cash equivalents	-	378,957	378,957
	1.437,086	518,920	1,956,006
Amounts owed to group undertakings	-	(1,250,334)	(1,250,334)
Obligations under repurchase agreements	-	(200,055)	(200,055)
Derivative liabilities	(379,742)	-	(379,742)
Provisions	-	(6,917)	(6,917)
Other liabilities	-	(57,663)	(57,663)
	(379,742)	(1,514,969)	(1,894,711)
2018			
Debt securities	1,883,605	-	1,883,605
Amounts owed by group undertakings	-	363,897	363,897
Other debtors	-	83,867	83,867
Derivative assets	572,523	-	572,523
Cash and cash equivalents	-	1,784,080	1,784,080
	2,456,128	2,231,844	4,687,972
Amounts owed to group undertakings	-	(3,571,766)	(3,571,766)
Obligations under repurchase agreements	-	-	-
Derivative liabilities	(991,480)	-	(991,480)
Provisions	-	(12,662)	(12,662)
Other liabilities	-	(74,047)	(74,047)
	(991,480)	(3,658,475)	(4,649,955)

IFRS 13 Fair value hierarchy

The table below shows financial instruments carried at fair value analysed by the level of the IFRS 13 'Fair Value Measurement' defined fair value hierarchy. The different levels have been defined as follows:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

Level 3: inputs for the asset or liability valuation that are not based on observable market data.

Following the demerger, the M&G plc group has implemented a new policy for classifying financial instruments within the fair value hierarchy, which has been applied by the Company. Compared with the policy previously applied, it is more granular and data-driven, with a more prescriptive definition of an active market. In addition, the extent to which inputs for derivative instruments are considered observable has been refined.

Notes to the Financial Statements (continued)

21. Financial instruments (continued)

The policy has been applied consistently within these financial statements and accordingly the 2018 comparative table below has been restated. The principal impacts of restating the 2018 comparatives were:

- reclassification of £919,908,000 debt securities, from level 1 to level 2;
- reclassification of £427,386,000 derivative assets, from level 3 to level 2; and
- reclassification of £427,296,000 derivative liabilities, from level 3 to level 2.

During the year debt securities with a carrying amount of £834,684,000 (2018: £Nil) were transferred from Level 2 to Level 1 because there were sufficient quoted prices in the respective debt securities markets. There were no other transfers in or out of level 1, level 2 and level 3 (2018: £Nil).

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
2019				
Debt securities	834,684	529,003	-	1,363,687
Derivative assets	-	73,399	-	73,399
Total assets	834,684	602,402	-	1,437,086
Derivative liabilities	-	(379,742)	-	(379,742)
2018 (restated)				
Debt securities	-	1,883,605	-	1,883,605
Derivative assets	-	572,523	-	572,523
Total assets	-	2,456,128	-	2,456,128
Derivative liabilities	-	(991,480)	-	(991,480)

22. Related party transactions

The Company has taken advantage of the exemption under paragraph 8(k) of Financial Reporting Standard 101 (FRS101) from disclosing transactions with other subsidiary undertakings of the group.

23. Post balance sheet events

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. The outbreak has not only prompted widespread health concerns, but has caused recent deteriorations 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.

COVID-19 is expected to result in a deterioration in financial performance over 2020, with ongoing volatility in valuation of financial instruments held by the Company. In particular the debt securities portfolio, including the derivative financial instruments used to manage related interest rate and foreign exchange rate exposures, are overall expected to experience downward pressure in valuations.

Post balance sheet events that may affect future tax charges are outlined in note 9(b).

24. Immediate and ultimate parent company

The immediate parent company is Prudential Capital Holding Company Limited and the ultimate parent company is M&G plc, both are registered at 10 Fenchurch Avenue, London, EC3M 5AG, and incorporated in England and Wales.

Notes to the Financial Statements (continued)

24. Immediate and ultimate parent company (continued)

M&G plc prepares consolidated financial statements, copies of which can be obtained from the Company Secretary of the registered office at 10 Fenchurch Avenue, London, EC3M 5AG.

Prior to demerger of M&G plc from Prudential plc on 21 October 2019, the ultimate parent company was Prudential plc. Copies of consolidated financial statements for Prudential plc can be obtained from the registered office 1 Angel Court London EC2R 7AG.