9 March 2021

M&G plc full year 2020 results

Strong and resilient performance in a challenging environment, foundations laid for future growth, pivot to sustainable investing

John Foley, Chief Executive, said:

"In our first year as an independent company, we have delivered a strong and resilient performance in one of the most challenging operating environments ever.

"This demonstrates the value of our diversified and integrated business model, both to customers and clients, and to shareholders.

"We laid the foundations for M&G's return to growth, including actions to fix Retail Asset Management and the creation of M&G Wealth following the acquisition of Ascentric.

"As responsible stewards of £367.2 billion in Assets Under Management and Administration (AUMA), we are also pivoting the entire company to sustainable investing - a shift which we believe will benefit customers, clients and shareholders, as well as wider society and the planet.

"Our balance sheet has remained robust throughout the COVID-19 pandemic and capital generation was strong at £995 million for the year.

"We remain committed to our ambitious three-year £2.2 billion target for total capital generation to the end of 2022 and to our current policy of a stable or increasing dividend.

"I want to thank all my colleagues for their resolve and commitment in the face of the pandemic, as they continue to serve our customers and clients from the safety of their homes."

Financial highlights

- Adjusted operating profit before tax of £788 million, now reflecting the first full year of listed infrastructure costs
- IFRS profit after tax up to £1,142 million
- Total capital generation of £995 million
- Shareholder Solvency II coverage ratio strengthens to 182%, its highest level since independence
- Ordinary dividend of 12.23p per share, in line with our policy of a stable or increasing dividend

Operational highlights

- AUMA up to £367.2 billion, principally reflecting the acquisition of Ascentric in September
- Net outflows of £6.6 billion in Savings and Asset Management. Institutional Asset Management inflows of £5.1bn were offset by outflows in Retail Asset Management driven by weak investment performance
- Improvement in the investment performance of the retail fund range in the second half with 66%[1] of AUMA above median over six months
- Continued strong investment performance from the £143.2 billion With-Profits Fund at 6.6% p.a.[2] over the past five years
- On track to achieve annual run-rate shareholder cost savings of £145 million through business transformation and modernisation in 2022

Outlook

- Strong balance sheet of the Heritage business underpins capital generation and dividend policy
- Launch of new sustainable private assets capability, opening up further opportunities for growth
- Strong pipeline of new propositions, including PruFund Planet, a sustainable version of market-leading PruFund

Performance highlights	2020	2019
Adjusted operating profit before tax (£m)	**788**	1,149
IFRS profit after tax (£m)	**1,142**	1,065
Assets under management and administration (£bn)	**367.2**	351.5
Savings and Asset Management net client flows (£bn)	**(6.6)**	(1.3)
Total capital generation (£m)	**995**	1,509
Shareholder Solvency II coverage ratio (%)	**182**	176

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Notes to Editors

[1] As at 31 December 2020.
[2] Based on the main life fund (OBMG) return for the 5 years to end of 2020. The return is net of 30bps p.a. approximate deduction for fees. Note that the actual return for the fund will be slightly different post hypothecation.

1. The results in this preliminary announcement are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and are based on the consolidated financial statements of M&G plc.
2. All key performance measures relate to continuing operations[3].
3. The shareholder view and regulatory view of the Solvency II coverage ratio as at 31 December 2020 assumes transitional measures on technical provisions which have been recalculated using management's estimate of the impact of operating and market conditions at the valuation date.
4. Total number of M&G plc shares in issue as at 31 December 2020 was 2,599,906,866.
5. A Q&A webcast will be hosted by John Foley (CEO) and Clare Bousfield (CFO) on Tuesday 9 March at 08:45 GMT. You can register for the Q&A and view the investor presentation here (the presentation will be available from 07:00 GMT): https://mngresults.connectid.cloud/register.
   Dial in: UK freephone 0800 640 6441/ All other locations +44 203 936 2999
   Participant code: 595189
6. **Ordinary dividend to be paid in April 2021**

Ex-dividend date	March 18, 2021
Record date	March 19, 2021
Payment of dividend	April 28, 2021

7. **About M&G plc**
   M&G plc is a leading international savings and investments business, managing money for both individual savers and institutional investors in 28 markets. As at 31 December 2020, we have £367.2 billion of AUMA, around 5.3 million retail customers and more than 800 institutional clients. With a heritage dating back more than 170 years, M&G plc has a long history of innovation in savings and investments, combining asset management and insurance expertise to offer a wide range of solutions. We serve our savings and insurance customers under the Prudential brand in the UK and Europe and for asset management in South Africa, and under the M&G Investments brand for asset management clients globally.
8. **Additional Information**
   M&G plc, a company incorporated in the United Kingdom, is the direct parent company of The Prudential Assurance Company Limited. The Prudential Assurance Company Limited is not affiliated in any manner with Prudential Financial, Inc., a company whose principal place of business is in the United States of America or Prudential plc, an international group incorporated in the United Kingdom.
9. **Forward-Looking Statements**
   This announcement may contain certain 'forward-looking statements' with respect to M&G plc and its affiliates (the "M&G Group"), its plans, its current goals and expectations relating to its future financial condition, performance, results, operating environment, strategy and objectives. Statements that are not historical facts, including statements about M&G plc's beliefs and expectations and including, without limitation, statements containing the words 'may', 'will', 'should', 'continue', 'aims', 'estimates', 'projects', 'believes', 'intends', 'expects', 'plans', 'seeks', 'outlook' and 'anticipates', and words of similar meaning, are forward-looking statements. These statements are based on plans, estimates and projections as at the time they are made, and therefore persons reading this announcement are cautioned against placing undue reliance on forward-looking statements.
   By their nature, all forward-looking statements involve inherent assumptions, risk and uncertainty, as they generally relate to future events and circumstances that may be beyond the M&G Group's control. A number of important factors could cause M&G plc's actual future financial condition or performance or other indicated results to differ materially from those indicated in any forward-looking statement.
   Such factors include, but are not limited to, UK domestic and global economic and business conditions (including the political, legal and economic effects of the UK's decision to leave the European Union); market-related conditions and risk, including fluctuations in interest rates and exchange rates, the potential for a sustained low-interest rate environment, corporate liquidity risk and the future trading value of the shares of M&G plc; investment portfolio-related risks, such as the performance of financial markets generally; the policies and actions of regulatory authorities, including, for example, new government initiatives; the impact of competition, economic uncertainty, inflation and deflation; the effect on M&G plc's business and results from, in particular, mortality and morbidity trends, longevity assumptions, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; the impact of internal projects and other strategic actions, such as transformation programmes, failing to meet their objectives; the impact of operational risks, including risk associated with third party arrangements, reliance on third party distribution channels and disruption to the availability, confidentiality or integrity of M&G plc's IT systems (or those of its suppliers); the impact of changes in capital, solvency standards, accounting standards or relevant regulatory frameworks, and tax and other legislation and regulations in the jurisdictions in which the M&G Group operates; and the impact of legal and regulatory actions, investigations and disputes. These and other important factors may, for example, result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits.
   Any forward-looking statements contained in this document speak only as of the date on which they are made. M&G plc expressly disclaims any obligation to update any of the forward-looking statements contained in this document or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the UK Prospectus Rules, the UK Listing Rules, the UK Disclosure and Transparency Rules, or other applicable laws and regulations. Nothing in this announcement shall be construed as a profit forecast, or an offer to sell or the solicitation of an offer to buy any securities. LEI: 254900TWUJUQ44TQJY84 Classification: 3.1 Additional regulated information required to be disclosed under the laws of a Member State

[3] Continuing operations in 2019 excluded our Asia insurance operations and treasury services provided to Prudential plc which are presented as discontinued operations.

Chief Executive's review

A foundational year

In less than ideal conditions, we have achieved much in our first full year as an independent business, laying the foundations for our return to sustainable growth.

Throughout the COVID-19 pandemic, M&G continued to deliver on our commitments to customers, clients and shareholders, thanks to our diversified and integrated business model and the resolve of my colleagues.

We also laid the foundations for M&G's return to growth, including fixing Retail Asset Management and the acceleration of our expansion into UK wealth management.

Above all, we are pivoting the entire business to sustainable investing, so that as the stewards of the long-term savings of millions of people, we can make an even bigger difference to people and the planet.

A strong and resilient performance

In an extremely challenging operating environment, total AUMA ended the year 4% higher at £367.2 billion.

Adjusted operating profit before tax was £788 million, a good outcome given that, as an independent company, we incurred Head Office and debt interest costs for the first full year.

Our shareholder Solvency II coverage ratio strengthened to 182%, higher than its pre-crisis levels, higher even than its level at our market listing, and well above our risk tolerance.

Despite market volatility, total capital generation was £995 million for the year.

We remain committed to our policy of a stable or increasing dividend and to our ambitious three-year total capital generation target of £2.2 billion. However, the COVID-19 pandemic is not over yet and financial markets have continued to be relatively volatile, so we need to be mindful that markets can drive large changes in capital generation in a short period of time.

Strength through diversification

This strong and resilient financial performance owes much to our diversified and integrated business model.

As asset owner, our proactive management of the Heritage business underpinned our earnings and our dividend policy.

In Asset Management, our Institutional business grew attracting £5.1 billion of net client inflows in 2020, driven by strong investment performance and continued investment innovation.

Total AUMA on behalf of external institutional clients grew 11% to £85.5 billion. Revenue margins strengthened by two basis points during the year as clients moved more assets into higher-value strategies.

The success of the Institutional business helped to partially offset another difficult year in Retail Asset Management. Redemptions increased during the year due to weak investment performance of some of our larger funds.

In Retail Savings, net client inflows into PruFund, our market-leading smoothed solution for UK savers, remained positive at £400 million, but were down on the previous year mainly due to pandemic-related restrictions on face-to-face advice. Withdrawals were stable.

The £143.2 billion With-Profits Fund, which underpins PruFund, continued to generate strong financial outcomes. Over the five years to the end of 2020, the With-Profits Fund produced net investment returns of 6.6% p.a.[4].

Our people

The passion and resolve of all colleagues has been critical to our operational resilience throughout the COVID-19 pandemic. I am extremely proud of how, together, we responded to the challenge.

The new vaccines give us hope for a return to some kind of normality. In the meantime, our priority remains the well-being and safety of colleagues while they continue to serve customers and clients.

As the pandemic spread around the globe, we responded swiftly and effectively. Within two weeks in March, almost all of our circa 6,000 staff were equipped to work safely from home, wherever in the world they are based.

We put no colleague on furlough and received no financial assistance from governments.

Flexible working patterns and allowances for equipment helped our colleagues to remain productive and safe while serving our customers and clients from their homes.

We encouraged colleagues to prioritise care for dependents and help for their local communities. M&G donated more than £1.3 million to charities and non-profit groups helping those worst affected by the COVID-19 pandemic.

The Group Executive Committee and I are profoundly grateful to colleagues for their passionate commitment to customers and clients and to our business during these difficult times.

Fixing Retail Asset Management

In August, we set out what we were doing to reinvigorate our retail funds business and we have made good progress.

We have begun the revamp of the product range, refreshing some funds and consolidating others.

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[4] Based on the main life fund (OBMG) return for the 5 years to end of 2020. The return is net of 30bps p.a. approximate deduction for fees. Note that the actual return for the fund will be slightly different post hypothecation.

Chief Executive's review (continued)

Our new propositions like the Climate Solutions Fund launched in November, are aimed at the growing market for sustainable savings and investment strategies.

We also cut fees across our UK retail fund range to be more competitive, while passing on the benefit of economies of scale to European clients.

To improve fund performance, we have introduced institutional investment disciplines, moved to team-oriented management and bolstered data modelling.

Performance of our mutual fund range markedly improved in the second half of 2020, with 66% of funds, weighted by size, performing above median on a 6-month basis, and 78% on a 3-month basis (as at 31 December 2020).

Over time, we are confident that these measures will help us to retain assets and return to net inflows.

M&G Wealth

In September, we acquired the Ascentric adviser business from insurer Royal London, accelerating our expansion into the fast growing market for UK wealth management services.

Ascentric brought £15.5 billion of new AUMA, as well as 95,000 new customers and relationships with more than 4,000 advisers.

Critically, it gave us an important component for our integrated wealth business: an adviser platform on which their customers' long-term savings can be consolidated and administered.

In the autumn, we formally combined Ascentric with our two restricted advisory arms, Prudential Financial Planning and The Advice Partnership, as well as the reinvigorated M&G direct funds business.

Together, they form M&G Wealth. With £28 billion of AUMA, we see M&G Wealth as a powerful new force in UK wealth management.

Our aim is to put PruFund, our market-leading smoothed solution for UK customers, on to the M&G Wealth platform, opening up access to the proposition to a wider group of advisers and savers.

Sustainable investing

It is our belief that a sustainably-run and well-governed company will deliver better overall outcomes for customers and clients, and stronger, more resilient returns to shareholders.

We are embedding the principles of sustainability across our business, with ambitious corporate targets on net zero carbon emissions and on diversity and inclusion.

On our client investment portfolios, we are committed to achieving net zero carbon emissions by 2050, in line with the Paris Agreement.

We see the rapid growth in sustainable investing and environmental, social and governance (ESG) strategies as a permanent, structural change in the behaviour of customers and clients.

Only active investment managers are equipped to deliver the full benefits of sustainable investing, through exclusion and the active direction of capital for impact.

M&G has a long history as a responsible steward of savers' capital and we are well-placed to champion sustainable investing because of our combination as asset owner and asset manager.

It gives us a number of competitive advantages, including our ability as asset owner to direct capital to sustainable opportunities and its sponsorship of innovation in investment.

An example of this is the With-Profits Fund's allocation of £5 billion to a new innovative private assets strategy which aims to make a positive contribution to society and the environment.

To implement this strategy, we formed a new global team of private asset investors called Catalyst, whose job is to identify sustainable investment opportunities among new and emerging private companies.

Catalyst is one in a series of innovations in this field, which included the launch of the Climate Solutions Fund in November.

Later this year, we will launch a sustainable version of PruFund, our market-leading smoothed solution for UK retail savers.

Further modernisation

We continued with our five year digital transformation programme to strengthen the operations of the Heritage business, to improve outcomes for our 5.3 million retail customers, and to achieve business efficiencies.

We have now moved the accounts of more than 800,000 customers from a mix of legacy systems on to the administration platform of our strategic IT partner Diligenta, part of Tata Consultancy Services.

In addition, we increased the number of Prudential customers with online access to detailed and up-to-the-moment information on their accounts through the MyPru application, a real innovation in our digital service.

Across the IT estate, our goal is to simplify, and we remain on track to reduce the number of applications by c.50%.

Adoption of a digital-first approach to business was accelerated by the demands of the COVID-19 pandemic.

We introduced restricted financial advice via video calls to UK savers who cannot or do not wish to leave their homes. This raised the productivity of our advisers, while cutting our carbon emissions by 80% over the year.

The transformation programme remains on track to deliver annual run-rate shareholder cost savings of £145 million in 2022.

Chief Executive's review (continued)

In 2020, we identified further savings from modernisation as we reshaped the business in the face of the pandemic.

In line with our priority of supporting colleague well-being during the crisis, we dropped our target for a 10% reduction in staff costs during the year.

Nonetheless, 250 colleagues took voluntary redundancy and we continue to seek to reduce costs.

Ready for growth

Our growth strategy is to leverage the asset owner and asset manager combination, while modernising our business, the targeted acquisition of new capabilities, and further innovation.

We are doing this while pivoting the entire business to the rapidly growing global market for sustainable investing.

As this report shows, we laid firm foundations for future growth by resetting parts of the business and strengthening others, while still meeting our commitments to customers, clients, colleagues and shareholders.

In Europe, we expanded our sub-advisory business. A PruFund-like proposition is operationally ready for European clients. We are working on the necessary approvals for its distribution.

International operations were strengthened with a new investment hub in Chicago and a new fixed income team. We also opened a European asset management desk to Brexit-proof our Asset Management business.

We agreed to take majority control of our South African operation, which has £12 billion of AUMA.

In Institutional, aside from winning £13 billion of new mandates, we began the repatriation of £25 billion of North American and Asian With-Profits Fund mandates from our former parent, Prudential plc.

Alongside this, we created a greater sense of One M&G among colleagues, built around shared values and collaboration.

I led a company-wide programme on culture and conduct to ensure our people live up to our values of care and integrity.

Positive outlook

The foundational work we have undertaken over the past 12 months means that we are well-positioned to seize the structural growth opportunities in our markets.

Demand for high-value savings and investment solutions will continue to be driven for many decades by ageing populations, the widening savings gap, low interest rates and the shift to sustainable investing.

In the UK, we will complete the revamp of our retail funds offering and continue to expand M&G Wealth by adding to the range of propositions and tax wrappers.

Internationally, we will deepen our relationships with our European partners to obtain a greater share of investment wallet, while growing our investment capabilities in Singapore and the US.

Above all, we will champion sustainable investing, with a series of innovations for customers and clients, including PruFund Planet, the sustainable version of our market-leading smoothed savings solution.

Our financial focus will remain on capital generation to create long-term value for shareholders and to underpin our policy of a stable or increasing dividend.

We will also continue with the work to improve the operational efficiency of our entire business through further modernisation, while balancing this against the need to invest for growth.

As ever, there will be headwinds. But the resilience of the M&G business model has been demonstrated by the demands of the COVID-19 pandemic and I am confident we are now in a much stronger position to return to growth.

Business and financial review

Despite financial markets operating in extremely volatile and adverse conditions, our financial performance benefitted from our strong balance sheet and diversified earnings resulting from the combination of being an asset manager and an asset owner.

Adjusted operating profit before tax of £788 million (2019: £1,149 million) demonstrates our ability to deliver strong returns even in a challenging environment. Total AUMA increased to £367.2 billion (2019: £351.5 billion). The completion of the acquisition of Ascentric in the third quarter, positive market movements and strong net inflows in our Institutional Asset Management business, together outweighed the impact of net client outflows in our Retail Asset Management business. The net client inflows in our Institutional Asset Management business reflect consistently strong investment performance and the attractive range of innovative client solutions, while Retail Asset Management net client flows were impacted by market volatility and the recent underperformance of some of our larger funds.

We remain committed to achieving £145 million of annual run-rate shareholder cost savings by full-year 2022 through our five year investment in digital transformation. Recognising the headwinds we are experiencing in our Retail Asset Management business, we will continue to drive operational efficiencies to enable us to counter the margin pressure the industry is experiencing. As we do this, we'll carefully balance savings potential with investment requirements and cost to achieve.

Throughout the year, we also demonstrated our proactive approach to capital management, with total capital generation of £995 million (2019: £1,509 million) as we coupled the stable and recurring nature of our underlying capital generation from our operating segments with management actions to protect our balance sheet.This strong performance led to an increase in our shareholder Solvency II coverage ratio to 182% (2019: 176%), after paying dividends of £562 million in the period. Whilst the economic outlook remains uncertain, this result demonstrates our focus on proactively and efficiently managing our balance sheet, and our commitment to deliver our ambitious three-year cumulative total capital generation target of £2.2 billion to the end of 2022.

Parent Company liquidity remained at comfortable levels and has not been adversely affected by the global crisis, with cash and liquid assets of £1.0 billion at the end of 2020.

We paid dividends of £410 million on 29 May 2020, comprising an ordinary dividend of 11.92 pence per share and a special demerger dividend of 3.85 pence per share. In addition, we paid an interim ordinary dividend of £152 million equal to 6.00 pence per share, in line with our policy of paying one-third of the previous year total dividend, on 30 September 2020. A second interim dividend of £310 million equal to 12.23 pence per share will be paid on 28 April 2021.

The audit tender process was concluded in the last quarter and we announced our intention to appoint PwC as new external auditor effective for the period commencing 1 January 2022. This will allow them to review the prior year comparative data in advance of the first effective reporting period under IFRS 17 in 2023.

Overview

Adjusted operating profit before tax to IFRS profit after tax

The following table shows a reconciliation of adjusted operating profit before tax to IFRS profit after tax from continuing operations:

	For the year ended 31 December	
£m	**2020**	2019
Asset Management fee based revenues	**988**	1,033
Other fee based revenues	**232**	254
Total fee based revenues	**1,220**	1,287
Annuity margin	**438**	458
With-profits shareholder transfer net of hedging gains/(losses)	**251**	242
Adjusted operating income	**1,909**	1,987
Asset Management operating expenses	**(672)**	(652)
Other operating expenses	**(348)**	(311)
Adjusted operating expenses	**(1,020)**	(963)
Other shareholder (loss)/profit	**(111)**	110
Share of profit from joint ventures and associates	**10**	15
Adjusted operating profit before tax	**788**	1,149
Short-term fluctuations in investment returns	**678**	298
Profit on disposal of business and corporate transactions	**—**	53
Restructuring and other costs [i]	**(73)**	(198)
IFRS profit attributable to non-controlling interests	**4**	3
IFRS profit before tax attributable to equity holders from continuing operations	**1,397**	1,305
Tax charge attributable to equity holders	**(255)**	(240)
IFRS profit after tax attributable to equity holders from continuing operations	**1,142**	1,065

[i] Restructuring costs excluded from adjusted operating profit relate to merger and transformation costs of £73 million for the year ended 31 December 2020 (2019 : £62m). In 2019 restructuring costs also included rebranding and other change in control costs allocated to the shareholders. Additional restructuring costs are included in the analysis of administrative and other expenses in Note 5 to the IFRS financial information.

Overview (continued)

The following table shows adjusted operating profit before tax split by segment and source of earnings:

£m	For the year ended 31 December 2020	2019
Asset Management	**316**	381
With-profits	**44**	55
Other	**(28)**	38
Savings and Asset Management	**332**	474
With-profits	**207**	187
Annuities	**438**	458
Other	**54**	107
Heritage	**699**	752
Corporate Centre	**(243)**	(77)
Adjusted operating profit before tax	**788**	1,149

Adjusted operating profit before tax was £788 million for the year ended 31 December 2020 (2019: £1,149 million).The results included the first full year of listed infrastructure costs, with £167 million of finance costs in relation to the subordinated debt, £101 million of head office costs and £15 million foreign exchange gain in respect of the US dollar subordinated debt. The 2019 result benefitted from changes made to the staff pension schemes of £64 million which were not repeated in 2020.The fall in fee-based revenue resulted from net client outflows in Retail Asset Management during 2020, particularly in the international wholesale channel, and industry-wide pressure on margins.

IFRS profit after tax

IFRS profit after tax attributable to equity holders from continuing operations increased to £1,142 million compared to £1,065 million for the year ended 31 December 2019.The fall in adjusted operating profit before tax was offset by the combined positive impact of a £380 million increase in short-term fluctuations in investment returns and a £125 million reduction in restructuring costs, less a £15 million increase in the equity holders tax charge. Short-term fluctuations primarily comprise gains on equity hedges of £235 million, a benefit of £118 million from interest rate swaps purchased to protect the Solvency II capital position and a £435 million increase from fair value movements on surplus annuity assets. These gains have been partially offset by the strengthening of the credit risk allowance for shareholder-backed annuities by £117 million, in anticipation of short-term deterioration in the number of company defaults and downgrades due to the current market conditions arising from the COVID-19 pandemic.

Equity holders' effective tax rate for the year ended 31 December 2020 was 18.3% compared to 18.4% for the year ended 31 December 2019. Excluding non-recurring items, the equity holders' effective tax rate was 18.8% (2019: 20.2%). The equity holders' effective tax rate of 18.3% was lower than the UK statutory rate of 19% (2019: 19%) primarily due to beneficial impacts arising from adjustments to prior periods tax charges and non-taxable income during the period, partially offset by the detrimental impact of non-deductible expenses. Our approach to tax is to act responsibly and transparently in all of our tax affairs. We understand the importance to governments and societies of paying the right amount of tax at the right time in the right place. The Group complies with statutory obligations in all the jurisdictions in which we operate and seeks to have an open and effective relationship with tax authorities.

Capital generation

The following table shows an analysis of total capital generation:

£m	For the year ended 31 December 2020	2019
Savings and Asset Management underlying capital generation	**417**	414
Heritage underlying capital generation	**446**	459
Corporate Centre underlying capital generation	**(286)**	(91)
Underlying capital generation	**577**	782
Other operating capital generation	**735**	494
Operating capital generation	**1,312**	1,276
Market movements	**(118)**	538
Restructuring and other	**(73)**	(133)
Tax	**(126)**	(172)
Total capital generation	**995**	1,509

Total capital generation was £995 million for the year ended 31 December 2020 (2019: £1,509 million), reflecting improved operating capital generation but also the impact of negative market movements in the period, compared to the positive market movements experienced in 2019.

We analyse operating capital generation by considering both the contribution from underlying capital generation, which includes the expected surplus capital from the life insurance business, as well as the adjusted operating profit before tax and associated capital movements from other business and also the capital generated from other operating items.

Overview (continued)

Underlying capital generation fell to £577 million (2019: £782 million), primarily due to the expected impact of the first full year of listed infrastructure costs in the Corporate Centre, with the underlying result from our operating segments remaining broadly stable. This reduction, however, was offset by a larger benefit from other operating items of £735 million (2019: £494 million), resulting in an increase in operating capital generation to £1,312 million (2019: £1,276 million).

Other operating capital generation was driven by a £408 million (2019: £157 million) benefit from management actions, along with £167 million (2019: £214 million) due to assumption changes, which includes £242 million arising from longevity assumption releases. The impact from model changes, experience variances and other items was £160 million (2019: £123 million) which includes an increased contribution from the Corporate Centre of £88 million (2019: £68 million reduction), partially offset by a reduced impact within Heritage. The change in Corporate Centre primarily reflects the impact of updates to the measurement approach of the Group's leases under Solvency II, while the 2019 result allowed for the establishment of operational risk capital for the new Head Office function.

The adverse economic conditions experienced during 2020 reduced total capital generation by £118 million, whereas the 2019 result benefitted from £538 million of positive market movements. The 2020 market movements are net of a positive impact of £346 million from equity and interest rate hedges, which protect the Group's capital position.

Capital position[5]

The Group's Solvency II surplus increased to £4.8 billion as at 31 December 2020 (2019: £4.5 billion), equivalent to a shareholder Solvency II coverage ratio of 182% (2019: 176%), driven by total capital generation of £995 million offset by reductions of £562 million for dividends paid to shareholders and £121 million from other capital movements.

Our With-Profits Fund continues to have a strong Solvency II coverage ratio of 242%. While this is lower than the 267% as at 31 December 2019, it reflects the increased cost of options and guarantees and the distribution of £1.0 billion of excess surplus in the fund to our with-profits policyholders announced in February 2020.

The regulatory Solvency II coverage ratio of the Group as at 31 December 2020 was 144% (2019: 143%). This view of solvency combines the shareholder position and the With-Profits Fund, but excludes all surplus within the With-Profits Fund.

Financing and liquidity

The following table shows key financing and liquidity information:

	For the year ended 31 December	
£m	**2020**	2019
Parent Company cash and liquid assets	**1,040**	1,274
Nominal value of debt	**3,216**	3,227
Leverage ratio	**30 %**	31 %

The key metric we use to manage our debt is the leverage ratio, defined as the nominal value of debt as a percentage of the Group's shareholder Solvency II own funds. For further detail on Group's shareholder Solvency II own funds see the supplementary information. During 2020 our leverage ratio improved to 30% (2019: 31%).

The following table shows the movement in cash and liquid assets held by the Parent Company during the period:

	For the year ended 31 December	
£m	**2020**	2019
Opening cash and liquid assets at 1 January	**1,274**	18
Cash remittances from subsidiaries	**737**	477
Special dividends from subsidiaries	**—**	1,177
Substitution of subordinated liabilities	**—**	3,241
Corporate costs	**(45)**	(37)
Interest paid on core structural borrowings	**(189)**	(22)
Cash dividends paid to equity holders	**(562)**	(543)
Final dividend paid to equity holders prior to demerger	**—**	(2,968)
Acquisition of subsidiaries	**(86)**	(86)
Acquisition of own shares	**(105)**	—
Other shareholder income	**16**	17
Closing cash and liquid assets at 31 December [i]	**1,040**	1,274

[i] Closing cash and liquid assets at 31 December 2020 included a £1,001 million (2019; £1,200 million) inter-company loan asset with Prudential Capital plc, which acts as the Group's treasury function.

Movements in cash and liquid assets held by the Parent Company for the year ended 31 December 2020 represent the remittances and payments that will arise in the normal course of business. In comparison, the year ended 31 December 2019 included significant cash flows related to the Demerger. Total cash and liquid assets have remained stable with cash remittances of £737 million (2019: £477 million) received from our subsidiaries more than covering the cash dividend payments to equity holders of £562 million (2019: £543 million and interest paid on structural borrowings of £189 million (2019: £22 million).

[5] The shareholder, With-Profits Fund, and regulatory views of the Solvency II position presented above assume transitional measures on technical provisions which have been recalculated using management's estimate of the impact of operating and market conditions as at the valuation date.

Savings and Asset Management

Savings and Asset Management financial performance was impacted by net client outflows in Retail Asset Management and industry wide pressure on retail margins. Our Institutional business performed well with net client inflows following continued strong investment performance and highlighting the appeal of our range of innovative investment solutions.

Assets under management and administration and net client flows

	Net client flows		AUMA[i]	
	For the year ended 31 December		As at 31 December	
£bn	**2020**	2019	**2020**	2019
Retail Savings	**0.4**	6.2	**81.8**	63.5
of which: PruFund	**0.4**	6.4	**55.5**	53.8
Retail Asset Management	**(12.1)**	(7.4)	**64.2**	74.9
Institutional Asset Management	**5.1**	(0.1)	**85.5**	76.8
Other	**—**	—	**0.8**	0.7
Total Savings and Asset Management[i]	**(6.6)**	(1.3)	**232.3**	215.9

[i] Included in total AUMA of £232.3 billion (2019: £215.9 billion) is £6.5 billion (2019: £6.4 billion) of assets under advice.

Retail Savings AUMA increased 29% to £81.8 billion over the year to 31 December 2020, primarily as a result of the acquisition of Ascentric, which increased AUMA by £16.1 billion. Net client inflows of £0.4 billion experienced by Retail Savings were lower than 2019 with economic uncertainty and market volatility impacting investor sentiment across the retail savings market in 2020. In addition, COVID-19 restrictions severely limited the extent to which advisers were able to interact face to face with customers during the year leading to a significant reduction in new business sales.

PruFund AUMA increased 3% as a result of positive investment returns and net client inflows of £0.4 billion.

Retail Asset Management AUMA decreased 14% to £64.2 billion over the year with net client flows impacted by the volatile global markets and ongoing underperformance in some of our established funds, particularly in our international wholesale channel. Overall net client outflows increased to £12.1 billion (2019: £7.4 billion) and were particularly high in the first quarter of 2020 at £5.6 billion but levelled off as investor sentiment improved in the last quarter with the approval of COVID-19 vaccines. Performance improved markedly in the final quarter with 78% of wholesale assets above peer group medians in the three months to December 2020. We continue to reinvigorate our Retail Asset Management proposition to improve investment performance, offer greater value for money and evolve our fund range in order to diversify and increase client flows. In December, we launched three sustainable multi-asset fund ranges, cautious, balanced and growth, which aim to deliver total return within explicit volatility limits while also making a positive contribution to solving some of the world's major social and environmental challenges.

Our further investment in building investment capabilities in Asia over the past year enabled us to win several new mandates from our With-Profits Fund, and to repatriate the management of those assets during the year. The most significant being a £9 billion mandate to manage Asian and Japanese equities, with a further £2 billion expected to transition by early 2021. Additionally, the M&G fixed income team was awarded a £12 billion US fixed income mandate from our With-Profits Fund in Q4, of which £11 billion has already transitioned with the remainder expected to complete in early 2021.

Institutional Asset Management AUMA increased 11% to £85.5 billion during the year, driven by strong net client inflows of £5.1 billion and is now the largest component of our Savings and Asset Management AUMA. Consistently strong investment performance has driven £3.3 billion of net client inflows into our public debt propositions. A further £0.7 billion of net client inflows was received into our infrastructure offering and £0.6 billion of net client inflows into our real estate propositions in 2020. We continued to broaden our investment capabilities offering bespoke investment solutions to our clients, which are less affected by market volatility and offer good margins. Leveraging our strong position in the UK we aim to expand our business capabilities internationally.

Our expertise in private assets, which offers private fixed income, alternatives, real estate and infrastructure equity offerings, is a key component of our institutional investment capability and represents a resilient, high-margin source of revenues. It also underpins our ability to launch Catalyst, a team formed to manage a £5 billion mandate from our With-Profits Fund aimed at delivering positive societal impact through innovation as well as investing on behalf of the external institutional investors seeking private credit exposure. Our private assets under management increased 11% to £67.2 billion of AUMA as at 31 December 2020 (2019: £60.3 billion).

Savings and Asset Management (continued)

Adjusted operating profit before tax

The following table shows an analysis of adjusted operating profit before tax:

	For the year ended 31 December	
£m	**2020**	2019
Asset Management fee based revenues	**988**	1,033
Other fee based revenues	**158**	158
Total fee based revenues	**1,146**	1,191
With-profits shareholder transfer net of hedging gains/(losses)	**44**	55
Adjusted operating income	**1,190**	1,246
Asset Management operating expenses	**(672)**	(652)
Other operating expenses	**(168)**	(165)
Adjusted operating expenses	**(840)**	(817)
Other shareholder (loss)/profit	**(28)**	30
Share of profit from joint ventures and associates	**10**	15
Adjusted operating profit before tax	**332**	474

The following table shows adjusted operating profit before tax split by source of earnings:

	For the year ended 31 December	
£m	**2020**	2019
Asset Management	**316**	381
With-profits	**44**	55
Other	**(28)**	38
Adjusted operating profit before tax	**332**	474

Adjusted operating profit before tax from our Asset Management activities decreased to £316 million in the year ended 31 December 2020 (2019: £381 million) driven by a 4% reduction in fee based revenues to £988 million (2019: £1,033 million). The reduction in average AUMA in Retail Asset Management, combined with the downward pressure on retail margins, resulted in lower fee based revenues of £466 million during the year (2019: £584 million). The lower pricing structure applied to our UK OEIC fund ranges in August 2019 contributed to a £19m reduction whilst the suspension of the M&G Property Portfolio Fund in December 2019 lead to a further £13 million reduction in fee based revenues in 2020. In contrast, revenue earned by Institutional Asset Management increased to £480 million (2019: £429 million) as a result of higher average AUMA and improved revenue margins. Asset Management adjusted operating expenses, excluding the £35 million one-off benefit resulting from changes to the Group's defined benefit pension schemes in 2019, reduced by £15 million over the year, driven by lower facilities costs and lower travel and entertainment costs.

The Asset Management average fee margin of 50 basis points (bps) was 7 bps lower at 31 December 2020 compared to 31 December 2019 reflecting the continued industry wide pressure on fees in Retail Asset Management. Average revenue margins in the Institutional Asset Management business were 2 bps higher at 28 bps, compared to 26 bps at 31 December 2019, reflecting our focus on the provision of high-margin, innovative investment solutions for clients. This focus has resulted in favourable changes to our product mix, with net client flows out of our lower margin products and into these more specialised, higher margin solutions.

The cost/income ratio for the Asset Management business was 71% (2019: 64%), with the increase largely driven by the reduction in Retail Asset Management revenue and also the non-recurrence in 2020 of the £35 million past service credit.

The with-profits shareholder transfer, driven by PruFund, decreased to £54 million (2019: £73 million) as a result of the downward unit price adjustment for the fall in financial markets at the start of 2020, which was not fully mitigated by later upward price adjustments in the fourth quarter. In addition there were fair value losses of £10 million (2019: £18 million loss) on the derivative instruments used to mitigate the equity risk to shareholders.

The other shareholder loss in the year to 31 December 2020 is driven by items impacted by the market volatility in 2020, including a £16 million reduction on investment return on seed capital investments and a £5 million reduction in share of profit from associate. In addition, 2020 includes an expected £4m loss on Ascentric business acquired in the year. We expect Ascentric to strengthen our investment proposition by increasing our tax wrapper offerings and distribution footprint in the platform market. As we integrate Ascentric, build scale, automate operations and improve efficiency we expect the short term impact on Savings and Assets Management earnings to be limited.

Savings and Asset Management (continued)

Capital generation

The following table shows an analysis of operating capital generation:

	For the year ended 31 December	
£m	**2020**	2019
Asset Management underlying capital generation	**308**	379
With-profits underlying capital generation	**88**	—
of which: in-force	**100**	61
of which: new business	**(12)**	(61)
Other underlying	**21**	35
Underlying capital generation	**417**	414
Other operating capital generation	**83**	45
Operating capital generation	**500**	459

Underlying capital generation for the year ended 31 December 2020 was stable at £417 million (2019: £414 million). Whilst the contribution from our Asset Management business fell to £308 million (2019: £379 million) in line with the reduction in adjusted operating profit before tax, this was offset by higher underlying capital generated from with-profits in-force business and lower new business strain. The with-profits in-force business capital generation of £100 million (2019: £61 million) was driven by the expected growth in future shareholder transfers which was greater in 2020 on higher opening asset values, while new business strain fell to £12 million (2019: £61 million) mostly reflecting lower PruFund net client inflows, amongst other movements.

Other operating capital generation of £83 million (2019: £45 million) primarily reflected changes in the modelling and assumptions relating to underlying capital requirements in respect of PruFund business, and also a beneficial impact of £31 million from the extension of our equity hedging programme.

Heritage

Underlying performance of our Heritage business remained strong, continuing to provide a stable and sizeable underpin to our earnings.

The AUMA reduction of £0.3 billion to £133.7 billion at 31 December 2020 (2019: £134.0 billion) was driven by net client outflows, of £6.6 billion (2019: £7.6 billion net outflow), which were in line with expectations, offset by favourable market movements of £6.3 billion.

Adjusted operating profit before tax

The following table shows an analysis of adjusted operating profit before tax:

£m	For the year ended 31 December 2020	2019
Fee based revenues	**74**	96
Annuity margin	**438**	458
With-profits shareholder transfer net of hedging gains/(losses)	**207**	187
Adjusted operating income	**719**	741
Adjusted operating expenses	**(79)**	(87)
Other shareholder profit	**59**	98
Adjusted operating profit before tax	**699**	752

The following table shows adjusted operating profit before tax split by source of earnings:

£m	For the year ended 31 December 2020	2019
With-profits	**207**	187
Shareholder annuities	**438**	458
Other	**54**	107
Adjusted operating profit before tax	**699**	752

The shareholder transfer relating to traditional with-profit business increased to £254 million (2019: £251 million), offset by £47 million (2019: £64 million) of fair value losses on the derivative instruments used to mitigate equity risk to shareholders.

Adjusted operating expenses decreased by £8m during the year, in line with expectations as the Heritage business runs off. Other shareholder profit primarily relates to insurance reserve releases as we complete the review of a number of legacy remediation programmes.

The following table provides further analysis of the annuity margin:

£m	For the year ended 31 December 2020	2019
Return on excess assets and margin release	**188**	216
Asset trading and portfolio management actions	**59**	110
Longevity assumption changes	**217**	126
Other	**(26)**	6
Annuity margin	**438**	458

Longevity assumption changes resulted in a benefit of £217 million in the year ended 31 December 2020, primarily driven by updates to current mortality assumptions, along with a marginal impact from moving from the CMI 17 mortality improvements model to the CMI 18 model, adopted using the Group's own calibration. The 2019 result included a £126 million benefit in relation to changing from the CMI 16 to the CMI 17 model. We continue to monitor the impacts of COVID-19 on our longevity assumptions.

Recurring sources of earnings from the annuity book, primarily the return on assets held to back capital requirements and the release of the margins held in respect of credit risk, mortality and expenses, decreased by 13% to £188 million (2019: £216 million). This mainly reflects a lower level of excess assets on the annuity portfolio following the payment of dividends to the Parent Company and decreasing bond yields during the year.

During the year, we also earned £59 million from asset trading and portfolio management actions (2019: £110 million) which includes the loss arising on the sale of a property in 2020 due to the impact on the valuation of annuity liabilities.

The credit quality of fixed income assets in the annuity portfolio remain strong.

Over 98% of the debt securities held by the shareholder annuity portfolio are investment grade and only 15% are BBB. In addition 81% of the shareholder annuity portfolio is held in debt securities either categorised as risk-free or secured (including cash).

We experienced limited downgrades over the year with only c.4% of bonds in the shareholder annuity portfolio subject to a downgrade which changed the letter rating.

Heritage (continued)

Capital generation

The following table shows an analysis of operating capital generation:

	For the year ended 31 December	
£m	**2020**	2019
With-profits underlying capital generation	**105**	71
Shareholder annuity and other underlying capital generation	**341**	388
Underlying capital generation	**446**	459
Model improvements	**(19)**	142
Assumption changes	**185**	207
Management actions	**374**	167
Other incl experience variances	**24**	1
Other operating capital generation	**564**	517
Operating capital generation	**1,010**	976

Traditional with-profits business generated underlying capital of £105 million during 2020 (2019: £71 million). Similar to Savings and Asset Management with-profits business, this was driven by the expected growth in future shareholder transfers which was greater in 2020 on higher opening asset values. There also continued to be significant underlying capital generation from the shareholder annuity and other business, contributing £341 million (2019: £388 million).

Other operating capital generation increased to £564 million (2019: £517 million). The 2020 result includes a significant benefit from a series of management actions taken to strengthen the balance sheet, which increased surplus by £374 million (2019: £167 million). This included a contribution of £272 million from asset trading and optimisation, as well as a £62 million capital release to reflect the reduced risk of legacy remediation programmes now coming to completion. However, the £142 million benefit from model improvements in 2019 was not repeated in the 2020 results.

The impact of assumption changes primarily relates to the positive impact of £242 million from the longevity assumption updates described in the adjusted operating profit before tax section, offset by a reduction from other assumptions of £57 million. The 2019 result included a benefit of £105 million from changes to longevity assumptions coupled with a positive impact from expense assumption changes of £88 million.

Consolidated income statement

For the year ended 31 December 2020

	Note	For the year ended 31 December 2020 £m	2019 £m
Gross premiums earned		**5,796**	11,074
Outward reinsurance premiums		**(927)**	115
Earned premiums, net of reinsurance		**4,869**	11,189
Investment return		**9,255**	19,619
Fee income	4	**1,031**	1,286
Other income		**61**	35
Total revenue, net of reinsurance from continuing operations		**15,216**	32,129
Benefits and claims	11	**(12,674)**	(24,375)
Outward reinsurers' share of benefit and claims	11	**1,477**	431
Movement in unallocated surplus of the With-Profits Fund	11	**433**	(2,549)
Benefits and claims and movement in unallocated surplus of the With-Profits Fund, net of reinsurance from continuing operations		**(10,764)**	(26,493)
Administrative and other expenses	5	**(2,734)**	(2,876)
Movements in third party interest in consolidated funds		**109**	(1,005)
Finance costs	5	**(167)**	(28)
Total charges, net of reinsurance from continuing operations		**(13,556)**	(30,402)
Share of (loss)/profit from joint ventures and associates		**(55)**	18
Profit before tax from continuing operations [i]		**1,605**	1,745
Tax charge attributable to policyholders' returns	6	**(208)**	(440)
Profit before tax attributable to equity holders from continuing operations		**1,397**	1,305
Total tax charge	6	**(463)**	(680)
Less tax charge attributable to policyholders' returns	6	**208**	440
Tax charge attributable to equity holders	6	**(255)**	(240)
Profit after tax attributable to equity holders from continuing operations		**1,142**	1,065
Profit after tax for the year attributable to equity holders from discontinued operations		**—**	58
Profit for the year		**1,142**	1,123
Attributable to equity holders of M&G plc:			
From continuing operations		**1,138**	1,062
From discontinued operations		**—**	58
Attributable to non-controlling interests:			
From continuing operations		**4**	3
Profit for the year		**1,142**	1,123
Earnings per share from continuing operations:			
Basic (pence per share)	7	**44.4**	40.9
Diluted (pence per share)	7	**44.0**	40.8
Earnings per share:			
Basic (pence per share)	7	**44.4**	43.1
Diluted (pence per share)	7	**44.0**	43.0

[i] This measure is the profit before tax measure under IFRS but it is not the result attributable to equity holders. This is principally because the corporate taxes of the Group include those on the income of consolidated with-profits and unit-linked funds that, through adjustments to benefits, are borne by policyholders. These amounts are required to be included in the tax charge of the company under IFRS. Consequently, profit before tax is not representative of pre-tax profits attributable to equity holders. Profit before tax is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of the With-Profits Fund after adjusting for taxes borne by policyholders.

Consolidated statement of comprehensive income

For the year ended 31 December 2020

	For the year ended 31 December	
	2020	2019
	£m	£m
Profit for the year	**1,142**	1,123
Less: profit from discontinued operations	**—**	58
Profit for the year from continuing operations	**1,142**	1,065
Items that may be reclassified subsequently to profit or loss:		
Exchange movements arising on foreign operations	**3**	(7)
	3	(7)
Items that will not be reclassified to profit or loss:		
Loss on remeasurement of defined benefit pension schemes	**(117)**	(206)
Transfer in of net defined benefit pension asset	**—**	15
Tax on remeasurement of defined benefit pension schemes	**23**	31
	(94)	(160)
Add amount transferred to unallocated surplus of the With-Profits Fund, net of related tax	**13**	155
Other comprehensive income on items that will not be reclassified to profit or loss	**(81)**	(5)
Other comprehensive income for the year, net of related tax from continuing operations	**(78)**	(12)
Total comprehensive income for the year from continuing operations	**1,064**	1,053
Profit after tax from discontinued operations	**—**	58
Total comprehensive income from discontinued operations	**—**	58
Total comprehensive income for the year	**1,064**	1,111
Attributable to equity holders of M&G plc:		
From continuing operations	**1,060**	1,050
From discontinued operations	**—**	58
Attributable to non-controlling interests:		
From continuing operations	**4**	3
Total comprehensive income for the year	**1,064**	1,111

Consolidated statement of financial position

As at 31 December 2020

	Note	As at 31 December 2020 £m	2019 £m
Assets			
Goodwill and intangible assets		**1,495**	1,439
Deferred acquisition costs		**98**	104
Investment in joint ventures and associates accounted for using the equity method		**456**	524
Property, plant and equipment		**2,066**	1,505
Investment property		**19,106**	19,136
Defined benefit pension asset	9	**58**	77
Deferred tax assets	6	**108**	78
Reinsurance assets	11	**11,761**	11,958
Loans		**6,031**	5,954
Derivative assets		**5,705**	3,962
Equity securities and pooled investment funds		**68,419**	72,388
Deposits		**17,629**	14,221
Debt securities		**85,439**	85,434
Current tax assets		**418**	375
Accrued investment income and other debtors		**3,023**	2,923
Assets held for sale [i]		**138**	119
Cash and cash equivalents		**6,776**	6,046
Total assets		**228,726**	226,243
Equity			
Share capital	10	**130**	130
Share premium reserve	10	**370**	370
Shares held by employee benefit trust		**(117)**	(26)
Treasury shares		**(1)**	(1)
Retained earnings		**16,853**	16,342
Other reserves		**(11,658)**	(11,690)
Equity attributable to equity holders of M&G plc		**5,577**	5,125
Non-controlling interests		**8**	6
Total equity		**5,585**	5,131
Liabilities			
Insurance contract liabilities	11	**76,650**	78,480
Investment contract liabilities with discretionary participation features	11	**79,623**	78,048
Investment contract liabilities without discretionary participation features	11	**15,547**	15,651
Unallocated surplus of the With-Profits Fund	11	**15,621**	16,072
Third party interest in consolidated funds		**13,265**	11,643
Subordinated liabilities and other borrowings	12	**8,267**	7,499
Defined benefit pension liability	9	**170**	28
Deferred tax liabilities	6	**916**	1,065
Current tax liabilities		**276**	298
Derivative liabilities		**3,460**	2,204
Lease liabilities		**354**	360
Other financial liabilities		**3,391**	3,517
Provisions		**235**	326
Accruals, deferred income and other liabilities		**5,291**	5,921
Liabilities of operations held for sale [i]		**75**	—
Total liabilities		**223,141**	221,112
Total equity and liabilities		**228,726**	226,243

[i] Assets held for sale on the consolidated statement of financial position as at 31 December 2020 includes £18m (2019: £88m) of seed capital classified as held for sale as it is expected to be divested within 12 months and £24m of investment property classified as held for sale (2019: £17m). Additionally £96m (2019: £14m) of assets held for sale and £75m (2019: £nil) of liabilities of operations held for sale are in relation to the Group's consolidated infrastructure capital private equity vehicles.

Consolidated statement of changes in equity

For the year ended 31 December 2020

	Share capital £m	Share premium £m	Shares held by employee benefit trust £m	Treasury shares £m	Retained earnings £m	Other reserves £m	Total equity attributable to equity holders of M&G plc £m	Non-controlling interests £m	Total equity £m
As at 1 January 2019	130	370	—	—	20,157	(11,728)	8,929	5	8,934
Profit for the year from continuing operations	—	—	—	—	1,062	—	1,062	3	1,065
Profit for the year from discontinued operations	—	—	—	—	58	—	58	—	58
Other comprehensive income for the year from continuing operations	—	—	—	—	(5)	(7)	(12)	—	(12)
Total comprehensive income for the year	—	—	—	—	1,115	(7)	1,108	3	1,111
Dividends paid to non-controlling interests	—	—	—	—	—	—	—	(2)	(2)
Transactions with equity holders[i]	—	—	—	—	(4,935)	—	(4,935)	—	(4,935)
Vested employee share-based payments	—	—	2	—	(2)	—	—	—	—
Expense recognised in respect of share-based payments	—	—	—	—	—	40	40	—	40
Shares acquired by employee trusts	—	—	(28)	—	—	—	(28)	—	(28)
Treasury shares acquired by subsidiary companies	—	—	—	(1)	—	—	(1)	—	(1)
Tax effect of items recognised directly in equity	—	—	—	—	99	5	104	—	104
Other movements	—	—	—	—	(92)	—	(92)	—	(92)
Net (decrease)/ Increase in equity	—	—	(26)	(1)	(3,815)	38	(3,804)	1	(3,803)
As at 31 December 2019	130	370	(26)	(1)	16,342	(11,690)	5,125	6	5,131
As at 1 January 2020	**130**	**370**	**(26)**	**(1)**	**16,342**	**(11,690)**	**5,125**	**6**	**5,131**
Profit for the year from continuing operations	—	—	—	—	**1,138**	—	**1,138**	**4**	**1,142**
Other comprehensive income for the year from continuing operations	—	—	—	—	**(81)**	**3**	**(78)**	—	**(78)**
Total comprehensive income for the year	—	—	—	—	**1,057**	**3**	**1,060**	**4**	**1,064**
Dividends paid to non-controlling interests	—	—	—	—	—	—	—	**(2)**	**(2)**
Transactions with equity holders	—	—	—	—	**(562)**	—	**(562)**	—	**(562)**
Shares distributed by employee trusts	—	—	**14**	—	**(14)**	—	—	—	—
Vested employee share-based payments	—	—	—	—	**17**	**(17)**	—	—	—
Expense recognised in respect of share-based payments	—	—	—	—	—	**51**	**51**	—	**51**
Shares acquired by employee trusts	—	—	**(105)**	—	—	—	**(105)**	—	**(105)**
Tax effect of items recognised directly in equity	—	—	—	—	**13**	**(5)**	**8**	—	**8**
Net (decrease)/increase in equity	—	—	**(91)**	—	**511**	**32**	**452**	**2**	**454**
As at 31 December 2020	**130**	**370**	**(117)**	**(1)**	**16,853**	**(11,658)**	**5,577**	**8**	**5,585**

[i] There was a distribution in kind of £570m, which represents the difference between fair value of the subordinated notes at initial recognition and the actual cash transferred by Prudential plc in respect of the notes on substitution of the debt.

Consolidated statement of cash flows

For the year ended 31 December 2020

	Note	For the year ended 31 December 2020 £m	2019 £m
Cash flows from operating activities:			
Profit before tax from continuing operations		**1,605**	1,745
Profit before tax from discontinued operations		**—**	88
Non-cash and other movements in operating assets and liabilities included in profit before tax:			
Investments		**399**	(14,918)
Other non-investment and non-cash assets		**(133)**	(8,613)
Policyholder liabilities (including unallocated surplus)		**(895)**	23,037
Other liabilities (including operational borrowings)		**1,902**	(841)
Interest income, interest expense and dividend income		**(3,884)**	(4,798)
Other non-cash items		**229**	417
Operating cash items:			
Interest receipts and payments		**2,282**	2,595
Dividend receipts		**1,704**	2,107
Tax paid [i]		**(633)**	(613)
Net cash flows from operating activities [ii]		**2,576**	206
Cash flows from investing activities:			
Purchases of property, plant and equipment		**(821)**	(393)
Proceeds from disposal of property, plant and equipment		**—**	8
Investment in subsidiaries [iii]		**(136)**	(95)
Cash inflow from disposal of subsidiaries [iv]		**—**	98
Net cash flows from investing activities		**(957)**	(382)
Cash flows from financing activities:			
Interest paid		**(189)**	(22)
Lease repayments		**(24)**	(25)
Substitution of subordinated liabilities		**—**	3,219
Shares purchased by employee benefit trust		**(105)**	—
Dividends paid	8	**(562)**	(3,516)
Net cash flows from financing activities		**(880)**	(344)
Net increase/(decrease) in cash and cash equivalents		**739**	(520)
Cash and cash equivalents at 1 January		**6,046**	6,570
Effect of exchange rate changes on cash and cash equivalents		**(9)**	(4)
Cash and cash equivalents at 31 December		**6,776**	6,046

[i] Tax paid for the year ended 31 December 2020 includes £264m (2019: £228m) paid on profits taxable at policyholder rather than shareholder rates.

[ii] Cash flows in respect of other borrowings of the With-Profits Fund, which principally relate to consolidated investment funds, are included within cash flows from operating activities.

[iii] Investment in subsidiaries includes total cash consideration in respect of the acquisition of Ascentric of £86m, of which £49m represented a repayment of loan to Royal London. The remaining amounts represents further investment by the Group's consolidated infrastructure capital private equity vehicles.

[iv] Cash inflow from disposal of subsidiaries reflects the net cash flow from the disposal of Prudential Vietnam Finance Company Limited in 2019.

1 Basis of preparation and significant accounting policies

1.1 Basis of preparation

The consolidated results in this preliminary announcement have been taken from the M&G plc Group's 2020 Annual Report and Accounts which will be available on the Company's website on 24 March 2021.

The consolidated financial statements have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 and in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board (''IASB'') adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union ("EU"), with interpretations issued by the IFRS Interpretations Committee (''IFRICs''). The consolidated financial statements have been prepared under the historical cost basis except for investment property measured at fair value, certain financial assets and financial liabilities (including derivative instruments) that are measured at fair value through profit and loss ("FVTPL"), insurance contract liabilities that are measured in accordance with the requirements of IFRS 4: Insurance contracts, and defined benefit assets and liabilities, measured at the fair value of plan assets less the present value of the defined benefit obligations. Assets and disposal groups held for sale are stated at the lower of the previous carrying amount and fair value less costs to sell.

The basis of preparation and significant accounting policies applicable to the consolidated financial statements can be found in the basis of preparation and significant accounting policies section of the 2020 Annual Report and Accounts.

The preliminary announcement for the year ended 31 December 2020 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. The statutory results under IFRS for full-year 2020 and 2019 have been audited by KPMG LLP (''KPMG''). KPMG have reported on the 2020 consolidated financial statements and their audit report is unqualified and does not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

On 2 July 2018, Voyager Dallas Holding Company Limited, as the Company was known at the time, was incorporated and domiciled in the UK as a subsidiary of Prudential plc. The Company was set up to act as holding company for the UK and Europe savings and investments business of Prudential plc. On 3 July 2018, the Company changed its name to M&G Prudential Limited. On 23 November 2018 the Company issued share capital as consideration to Prudential plc for the acquisition of The Prudential Assurance Company Limited (''PAC''), M&G Group Limited, Prudential Financial Services Limited and Prudential Property Services Limited. On 24 July 2019, the Company was re-registered as a public limited company and changed its name to M&G Prudential plc. On 16 September 2019, the Company changed its name to M&G plc. On 20 September 2019, the Company acquired Prudential Capital Holdings Company Limited, and its subsidiaries, Prudential Capital plc ("PruCap") and Prudential Capital (Singapore) Pte. Limited, from Prudential plc. On 21 October 2019, the Company demerged from Prudential plc and listed on the London Stock Exchange.

All acquisition of entities under common control prior to demerger from Prudential plc have been accounted for under merger accounting principles. Under merger accounting, the results and statement of financial position for entities acquired prior to demerger are presented as if the entities had always been combined.

Unless otherwise noted, the consolidated financial statements are presented in million pounds sterling (£m), the Group's functional and presentation currency.

Going concern

The Directors have reasonable expectation that the Group as a whole has adequate resources to continue in operational existence over a period of at least twelve months from the date of approval of the consolidated financial statements.

To satisfy themselves of the appropriateness of the use of the going concern assumptions in relation to the consolidated financial statements, the Directors have considered the liquidity projections of the Group, including the impact of applying specific liquidity stresses. The Directors also considered the ability of the Group to access external funding sources and the management actions that could be used to manage liquidity.

In addition, the Directors also gave particular attention to the solvency projections of the Group under a base scenario and its sensitivity to various individual economic stresses and certain stressed scenarios, which included a pessimistic COVID-19 scenario and a severe Brexit scenario.

The results of the assessment demonstrated the ability of the Group to meet all obligations and future business requirements for the foreseeable future. In addition, the assessment demonstrated that the Group was able to remain above its regulatory solvency requirements in a stressed scenario.

For this reason, the Directors continue to adopt the going concern basis in preparing the consolidated financial statements.

Adjusted operating profit before tax

Adjusted operating profit before tax is the Group's non-GAAP alternative performance measure, which complements IFRS GAAP measures and is key to decision-making and the internal performance management of operating segments.

Adjusted operating profit before tax includes IFRS profit from continuing operations only.

For the Group's fee based business, adjusted operating profit before tax includes fees received from customers and operating costs for the business including overheads, expenses required to meet regulatory requirements and regular business development/restructuring and other costs. Costs associated with fundamental one-off Group-wide restructuring and transformation are not included in adjusted operating profit before tax.

For the Group's business written in the With-Profits Fund, adjusted operating profit before tax includes the statutory transfer to shareholders gross of attributable shareholder tax. Derivative instruments are held to mitigate the risk to the shareholder of lower future shareholder transfers, and can be separated into two types:

I. Cash flow hedges[6]: those instruments that are held to mitigate volatility in the Group's IFRS results by being explicitly matched to the expected future shareholder transfers.

II. Capital hedges: instruments that hedge the economic present value of shareholder transfers on a Solvency II basis, to optimise the capital position.

[6] These cash flow hedges do not constitute hedge accounting arrangements under IAS 39.

1 Basis of preparation and significant accounting policies (continued)

1.1 Basis of preparation (continued)

The realised gains or losses on the cash flow hedges are allocated to adjusted operating profit before tax in line with emergence of the corresponding shareholder transfer within IFRS profit. Any short-term temporary movements in the fair value of these instruments, not relating to the current year's shareholder transfer, are excluded from adjusted operating profit before tax. As the capital hedges do not explicitly hedge future IFRS profits, all movements in the fair value of these instruments are excluded from adjusted operating profit before tax.

For the Group's shareholder annuity products written by the Heritage segment, adjusted operating profit before tax excludes the impact of short-term components of credit risk provisioning, the impact of credit risk experience variances over the period, and total fair value movement on surplus assets backing the shareholder annuity capital, that are not reflective of the longer-term performance of the business.

Certain adjustments that are considered to be non-recurring or strategic, or due to short-term movements not reflective of longer-term performance are made to IFRS profit before tax. Adjustments are in respect of short-term fluctuations in investment returns, costs associated with fundamental one-off Group-wide restructuring and transformation, profits or losses arising on corporate transactions and profit/(loss) before tax from discontinued operations.

1.2 New accounting pronouncements

1.2.1 New accounting pronouncements adopted by the Group

In preparing these consolidated financial statements the Group has adopted the following standards, interpretations and amendments that became effective during the year:

Effective from 1 January 2020:

– Amendments to IFRS 3: Definition of a Business

– Amendments to IFRS 7, IFRS 9 and IAS 39: Interest Rate Benchmark Reform

– Amendments to IAS 1 and IAS 8: Definition of Material

– Conceptual Framework for Financial Reporting issued on 29 March 2018

Effective from 1 June 2020:

– COVID-19-Related Rent Concessions - Amendments to IFRS 16

None of the above interpretations and amendments to standards are considered to have a material effect on these consolidated financial statements.

1.2.2 New accounting pronouncements not yet effective

The following standards, interpretations and amendments have been issued but are not yet effective for the Group. This is not intended to be a complete list as only those standards, interpretations and amendments that could have an impact upon the consolidated financial statements are discussed.

IFRS 9: Financial Instruments (endorsed by the EU)

In July 2014, the IASB published IFRS 9: Financial Instruments (IFRS 9) which is mandatorily effective for annual periods beginning on or after 1 January 2018, except as described below, with early application permitted.

IFRS 9 replaces the existing standard, IAS 39: Financial Instruments-Recognition and Measurement. The standard provides new principles for determining classification and measurement of financial instruments, introduces a new forward-looking impairment model based on expected losses (replacing the existing incurred loss model) and provides new guidance on application of hedge accounting.

In September 2016, the IASB published amendments to IFRS 4, "Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts" to address the temporary consequences of the different effective dates of IFRS 9 and IFRS 17: Insurance Contracts. The amendments include an optional temporary exemption from applying IFRS 9 and the associated amendments until IFRS 17 comes into effect. This temporary exemption is available to companies whose predominant activity is to issue insurance contracts based on meeting the eligibility criteria as at 31 December 2015 as set out in the amendments. In June 2020, the IASB amended IFRS 17 so that the revised effective date of the standard is for periods beginning on or after 1 January 2023. The IASB also confirmed through this amendment that IFRS 9 could be delayed for insurers to keep the effective dates of IFRS 9 and IFRS 17 aligned.

As the Group met the required eligibility criteria for temporary exemption, the adoption of IFRS 9 has been deferred to coincide with the adoption of IFRS 17.

The Group is assessing the impact of IFRS 9 and implementing this standard in conjunction with IFRS 17. The adoption of IFRS 9 may result in the reclassification of certain of the Group's financial assets, resulting in a change in measurement basis from amortised cost to fair value. Furthermore, a revised impairment approach based on expected credit losses will need to be developed for financial assets that will continue to be carried at amortised cost. The Group is currently assessing the scope of assets to which these requirements will apply.

The Group does not currently apply hedge accounting.

Presented below are disclosures required by the amendments to IFRS 4 for entities deferring the adoption of IFRS 9. These are provided to enable users to compare results with those entities that have adopted IFRS 9. As required by the amendment, the table shows the fair value of the Group's directly held financial assets at 31 December 2020, distinguishing those financial assets which have contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI") as defined by IFRS 9.

1 Basis of preparation and significant accounting policies (continued)

1.2 New accounting pronouncements (continued)

	Financial assets that pass the SPPI test [i]		All other financial assets, net of derivative liabilities	
	Fair value as at 31 December 2020	**Movement in fair value during the year**	**Fair value as at 31 December 2020**	**Movement in fair value during the year**
Financial assets on the consolidated statement of financial position	**£m**	**£m**	**£m**	**£m**
Loans	**2,647**	**(14)**	**3,475**	**33**
Derivative assets - net of derivative liabilities	**—**	**—**	**2,245**	**1,527**
Equity securities and pooled investment funds	**—**	**—**	**68,419**	**(533)**
Deposits	**17,629**	**—**	**—**	**—**
Debt securities	**—**	**—**	**85,439**	**4,092**
Accrued investment income and other debtors	**3,023**	**—**	**—**	**—**
Cash and cash equivalents	**6,776**	**—**	**—**	**—**
Total financial assets, net of derivative liabilities	**30,075**	**(14)**	**159,578**	**5,119**

[i] Financial assets classified as held for trading or that are managed and whose performance is evaluated on a fair value basis do not require an SPPI test to be performed. These assets are reported in All other financial assets.

	Financial assets that pass the SPPI test [i]		All other financial assets, net of derivative liabilities	
	Fair value as at 31 December 2019	Movement in fair value during the year	Fair value as at 31 December 2019	Movement in fair value during the year
Financial assets on the consolidated statement of financial position	£m	£m	£m	£m
Loans	2,658	18	3,389	131
Derivative assets - net of derivative liabilities	—	—	1,758	1,402
Equity securities and pooled investment funds	—	—	72,388	8,826
Deposits	14,221	—	—	—
Debt securities	—	—	85,434	4,240
Accrued investment income and other debtors	2,923	—	—	—
Cash and cash equivalents	6,046	—	—	—
Total financial assets, net of derivative liabilities	25,848	18	162,969	14,599

IFRS 17: Insurance Contracts (not yet endorsed by the EU)

In May 2017, the IASB issued IFRS 17: Insurance Contracts ("IFRS 17") to replace the existing interim standard, IFRS 4: Insurance Contracts. The standard initially applied to annual periods beginning on or after 1 January 2021, subsequently, the IASB issued an exposure draft in June 2019 that proposed to delay the effective date to 1 January 2022. Thereafter, in March 2020, the IASB decided to delay the effective date further to 1 January 2023, which was duly affected through an amendment in the standard in June 2020. Early application is permitted; provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. The Group intends to adopt the new standard on its mandatory effective date, alongside the adoption of IFRS 9.

The Group has an ongoing project to implement IFRS 17 which is continuing to develop technical interpretations and the related operational capabilities to implement the standard by the revised adoption date of 1 January 2023. The impact from adoption of the standard cannot be quantified at this stage. However it will lead to significant changes to the presentation and disclosure in the consolidated financial statements.

Other

In addition to the above, the following new accounting pronouncements have also been issued and are not yet effective:

- Interest Rate Benchmark Reform – Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16), issued in August 2020 and effective from 1 January 2021
- Reference to the Conceptual Framework (Amendments to IFRS 3), issued in May 2020 and effective from 1 January 2022
- Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16), issued in May 2020 and effective from 1 January 2022
- Onerous Contracts – Costs of Fulfilling a Contract (Amendments to IAS 37), issued in March 2018 and effective from 1 January 2022
- Classification of Liabilities as Current or Non-current (Amendments to IFRS 1), issued in January 2020 and effective from 1 January 2023
- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – (Amendments to IFRS 10 and IAS 28), issued in December 2015 and effective date pending completion of the research project on equity method accounting
- The Disclosure Initiative: Accounting Policy Requirements (Amendments to IAS 1), issued in February 2021 and effective from 1 January 2023
- Definition of accounting estimates (Amendments to IAS 8), issued in February 2021 and effective from 1 January 2023

The Group is currently assessing the impact of these requirements on the consolidated financial statements.

2 Group structure and products

2.1 Transactions relating to corporate restructure

2.1.1 Transfer of ownership of The Prudential Assurance Company Limited and M&G Group Limited

As part of an internal restructure on 23 July 2020, ownership of M&G Group Limited ("MGG") and The Prudential Assurance Company Limited ("PAC"), was transferred from the Company to M&G Group Regulated Entity Holding Company Limited, a direct subsidiary of the Company. The transfer was at fair value in a share for share exchange. As this is an intra-group transaction, there is no impact on the consolidated financial statements.

2.1.2 Transfer of ownership of Prudential Capital Public Limited Company

On 31 August 2020, the Company acquired Prudential Capital Public Limited Company via an in specie dividend from Prudential Capital Holdings Company Limited, a direct subsidiary of the Company. As this is an intra-group transaction, there is no impact on the consolidated financial statements.

2.2 Corporate transactions

2.2.1 Proposed sale of annuity portfolio to Rothesay Life PLC

On 14 March 2018, Prudential plc announced the reinsurance of £12,149m (as at 31 December 2017) of PAC shareholder-backed annuity portfolio to Rothesay Life PLC by way of a collateralised reinsurance arrangement followed by an insurance business transfer scheme (the "Scheme") under Part VII of Financial Services and Markets Act 2000. The terms of the reinsurance arrangement transferred substantially all of the economic risk and capital requirements associated with the annuity portfolio to Rothesay Life PLC, subject to a residual counterparty credit risk attaching to reinsurance receivables.

On 17 May 2019, the independent expert who was appointed to report to the High Court concluded that the transfer would have no material adverse effect on the security of benefits or the reasonable benefit expectations of PAC's policyholders. However, on 16 August 2019, the High Court declined to sanction the Scheme. PAC and Rothesay Life PLC have successfully appealed that decision in the Court of Appeal. There will now need to be a further sanction hearing in the High Court to decide if the transfer should proceed. The date of the sanction hearing has not yet been set and the associated process has not been clarified. As such the assets and liabilities associated with the annuity portfolio have not been classified as held for sale in these consolidated financial statements. The High Court's judgment has no direct impact on the reinsurance with Rothesay Life PLC.

2.2.2 Ascentric Acquisition

On 27 May 2020, the Group announced an agreement with Royal London to acquire its digital wrap and wealth management platform, for UK independent financial advisers, which comprises Wrap IFA Services Limited (''Wrap IFA'') and all of its subsidiaries together referred to as Ascentric.

The acquisition of Ascentric completed on 1 September 2020 following change of control approval from the FCA. Following acquisition, Wrap IFA is a wholly-owned subsidiary of M&G Group Regulated Entity Holding Company Limited, a wholly-owned subsidiary of the Company.

As at the acquisition date, the consideration, net assets acquired and resulting goodwill and intangible assets from the acquisition were as follows:

	£m
Total cash consideration	86
Less loan repayment	(49)
Consideration to gain control	**37**
Fair value of net assets acquired:	
Accrued income and other debtors	15
Cash and cash equivalents	51
Total assets	**66**
Subordinated liabilities and other borrowings	49
Provisions	2
Accruals, deferred income and other creditors	6
Total liabilities	**57**
Intangible assets acquired[i]	7
Goodwill	21
Total goodwill and intangible assets	**28**

[i] Intangible assets relate to the existing customer relationships in place at the date of acquisition.

As part of the transaction, an amount of £49m was paid to Royal London on behalf of one of the acquired subsidiaries to allow it to repay its existing loan to its previous parent. This does not form part of the purchase consideration.

The goodwill of £21m arising from the acquisition represents the benefits of the acquisition in complementing M&G's strategy to grow its business and expand its range of services for financial advisers and their clients. Ascentric's well-established digital wealth management presence will complement and strengthen M&G's position in the UK savings market where the company sees demand for advice and investment solutions continuing to grow. None of the goodwill recognised is expected to be deductible for income tax purposes.

The revenue and loss before tax included in the consolidated statement of comprehensive income since 1 September 2020 was £12m and £7m respectively. The revenue and loss before tax for the year ended 31 December 2020 for Ascentric was £34m and £15m respectively.

2 Group structure and products (continued)

2.3 Insurance and investment products

2.3 Insurance and investment contracts written by the Group's insurance entities

A description of the main contract types written by the Group's insurance entities is provided below.

The Group's with-profits contracts are written in the With-Profits Fund in which policyholders share in the profit of the fund. There are three with-profits sub-funds: the With-Profits Sub-Fund ("WPSF"), the Defined Charge Participating Sub-Fund ("DCPSF") and the Scottish Amicable Insurance Fund ("SAIF").

Shareholder-backed business represents all insurance and investment contracts in the Group other than contracts written in the With-Profits Fund. The profit on these contracts accrues directly to the Group's shareholders.

2.3.1 With-profits contracts

With-profits contracts provide returns to policyholders through bonuses that are smoothed to reduce the impact of volatility of the investment performance of the assets in the fund.

2.3.1.1 Conventional and accumulating with-profits contracts written in WPSF and DCPSF

Conventional and accumulating with-profits policyholders receive their share of profit by way of regular and final bonuses.

Regular bonus rates are determined for each type of policy primarily by targeting the bonus level at a prudent proportion of the long-term expected future investment return on underlying assets, reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholder transfers.

In normal investment conditions, the Group expects changes in regular bonus rates to be gradual over time. However, the Group retains the discretion whether or not to declare a regular bonus each year, and there is no limit on the amount by which regular bonus rates can change.

A final bonus which is normally declared annually, may be added when a claim is paid. The rates of final bonus usually vary by type of policy and by reference to the period, usually a year, in which the policy commences or each premium is paid. These rates are determined by reference to the asset shares of representative sample policies and are subject to smoothing.

Regular bonuses are typically declared once a year, and once credited are guaranteed in accordance with the terms of the particular product. Final bonus rates are guaranteed only until the next bonus declaration.

Contracts are predominantly written in the WPSF, where the shareholders are entitled to an amount up to one-ninth of the bonus declared, which is payable as a cash transfer from the With-Profits Fund.

For the business written in the DCPSF, the charges accrue to shareholders who also meet the corresponding expenses. Profits arising in the DCPSF are attributed wholly to DCPSF policyholders. The shareholders' profit arises as the difference between charges and expenses.

2.3.1.2 With-profits contracts with a PruFund investment option ("PruFund contracts")

These are a range of with-profits contracts offering policyholders a choice of investment profiles ("PruFund funds"). Unlike the with-profits contracts described above, no regular or final bonuses are declared. Instead, policyholders participate in profits by means of an increase in their investment, which grows in line with an Expected Growth Rate ("EGR"). The EGR is adjusted for significant market movements.

The EGR may be applied for each of the different PruFund funds within the range, varying depending on the individual asset mix of that fund. The applicable EGR, net of the relevant charges, is applied to calculate the 'smoothed unit value' of policyholder funds. The EGRs are reviewed and updated quarterly, with the smoothed unit value calculated daily. In normal investment conditions, the EGR is expected to reflect PAC's view of how the funds will perform over the longer term.

Policyholders are protected from some of the extreme short-term ups and downs of direct investments by using an established smoothing process. Prescribed adjustments are made to the smoothed unit value if it moves outside a specified range relative to the value of the underlying assets.

PruFund contracts are predominantly written in the WPSF, where the shareholder is entitled to an amount up to one-ninth of the difference between the smoothed unit value on withdrawal and the initial investment. The DCPSF also contains PruFund contracts, and for these contracts the shareholders receive profits or losses arising from the difference between the charges and expenses on this business.

2.3.1.3 SAIF with-profits contracts

SAIF is a ring-fenced with-profits sub-fund. No new business is written in SAIF, although regular premiums and top-ups are still being collected on in-force policies. The fund is solely for the benefit of policyholders of SAIF. Shareholders have no entitlement to the profits of this fund. The process of determining policyholder bonuses of SAIF with-profits policies is similar to that for the with-profits policies of the WPSF. In addition, the surplus assets in SAIF are allocated to policies in an orderly and equitable distribution over time as enhancements to policyholder benefits.

The Group's main exposure to guaranteed annuity options arises through contracts in SAIF. More detail on the provisions held in respect of guaranteed annuity options is provided in Note 11.1.1.

2.3.2 Unit-linked contracts

Unit-linked contracts are contracts where the value of the policy is linked to the value of underlying investments (such as collective investment schemes, internal investment pools or other property) or fluctuations in the value of underlying investments or indices. Investment risk associated with the product is primarily borne by the policyholder. Some unit-linked contracts provide an element of insurance coverage, such as a benefit payable on death in excess of the value of the units, and these contracts are classified as insurance contracts and accounted for under IFRS 4 (see Note 11).

Charges are deducted from the unit-linked funds for investment and administration services, and for certain contracts, insurance coverage. Benefits payable will depend on the price of the units prevailing at the time of surrender, death or the maturity of the product.

2 Group structure and products (continued)

2.3 Insurance and investment products (continued)

2.3.3 Annuities

Annuities are contracts which offer policyholders a regular income over the policyholder's life, in exchange for an upfront premium, and may be immediate or deferred. For immediate annuities, the regular income starts immediately after the premium payment, but for deferred annuities, the regular income is delayed until a specified date in the future. There are various types of annuity contracts written across the Group: level, fixed increase, inflation-linked (referred to as 'non-profit annuities') and with-profits annuities. Some non-profit annuities have been written in the With-Profits Fund, and profits relating to this business accrue to the With-Profits Fund.

- Level annuities: provide a regular (for example, monthly) fixed annuity payment over the policyholder's life.
- Fixed increase annuities: provide for a regular annuity payment which incorporates automatic increases in annuity payments by fixed amounts over the policyholder's life.
- Inflation-linked annuities: provide for a regular annuity payment to which an additional amount is added periodically based on the increase in an inflation index.
- With-profits annuities: are written in the With-Profits Fund. These combine the income features of annuity contracts with the investment smoothing features of with-profits products and enable policyholders to obtain exposure to investment return on the With-Profits Fund.

3 Segmental analysis

The Group's operating segments are defined and presented in accordance with IFRS 8: Operating Segments on the basis of the Group's management reporting structure and its financial management information. The Group's primary reporting format is by customer type, with supplementary information being given by product type. The Chief Operating Decision Maker for the Group is the Group Executive Committee.

3.1 Operating segments

The Group's operating segments are:

Savings and Asset Management

The Group's Savings and Asset Management business provides a range of retirement, savings and investment management solutions to its retail and institutional customers and clients. The Group's retirement and savings products are distributed to retail customers through the wrap platform, intermediaries and advisors, and include the Retirement Account (a combined individual pension and income drawdown product), individual pensions, ISAs, collective investments and a range of on-shore and off-shore bonds.

All of the Group's products that give access to the PruFund investment proposition are included in the Savings and Asset Management segment. The PruFund investment proposition gives retail customers access to savings contracts with smoothed investment returns and a wide choice of investment profiles. Unlike the conventional and accumulating with-profits contracts in the Group's Heritage business, no regular or final bonuses are declared. Instead, policyholders participate in profits by means of an increase in their investment, which grows in line with an EGR.

The Group's investment management capability is offered to both retail customers and institutional clients. The Group's retail customers invest through either UK domiciled Open Ended Investment Companies ("OEICs") or Luxembourg domiciled Sociétés d'Investissement à Capital Variable ("SICAVs") and have access to a broad range of actively managed investment products, including Equities, Fixed Income, Multi-Asset and Real Estate. The Group serves these customers through its many business-to-business relationships both in the UK and overseas, which include independent financial advisers, high-street banks and wealth managers. The Group's institutional investors, include pension funds, insurance companies and banks from around the world, who invest through segregated mandates and pooled funds into a diverse range of Fixed Income and Real Estate investment products and services.

The Savings and Asset Management segment also earns investment management revenues from the significant proportion of Heritage assets it manages.

Heritage

The Group's Heritage business includes individual and corporate pensions, annuities, life, savings and investment products. The majority of the products in the Heritage business are closed to new customers but may accept further contributions from existing policyholders[7]. The annuity contracts include: level annuities, which provide a fixed annuity payment; fixed increase annuities, which incorporate a periodic automatic fixed increase in annuity payments; and inflation-linked annuities, which incorporate a periodic increase based on a defined inflation index. Some inflation-linked annuities have minimum and/or maximum increases relative to the corresponding inflation index.

The life products in Heritage are primarily whole of life assurance, endowment assurances, term assurance contracts, lifetime mortgages, income protection, and critical illness products. Investment products include unit-linked contracts and the Prudential bond offering, which mainly consists of single-premium-invested whole of life policies, where the customer has the option of taking ad-hoc withdrawals, regular income or the option of fully surrendering their bond.

Some of the Group's Heritage products written through conventional and accumulating with-profits contracts, in the With-Profits Sub-Fund, provide returns to policyholders through 'regular' and 'final' bonuses that reflect a smoothed investment return.

The Heritage business includes the closed Scottish Amicable Insurance Fund ("SAIF") with-profits sub-fund. This fund is solely for the benefit of policyholders of SAIF. Shareholders have no entitlement to the profits of this fund although they are entitled to asset management fees on it. It also includes the Defined Charge Participating sub-fund ("DCPSF"), which consists of two types of business:

(i) the Defined Charge Participating business, primarily business reinsured from Prudential International Assurance plc; and

(ii) the with-profits annuities transferred from Equitable Life Assurance Society on 31 December 2007.

[7] The Group accepts new members to existing Corporate Pensions schemes and writes a small number of new annuity policies with customers who have a pension issued by PAC.

3 Segmental analysis (continued)

3.1 Operating segments (continued)

The Groups other reportable segment is:

Corporate Centre
Corporate Centre includes central corporate costs incurred by the M&G Group functions and debt costs.

3.2 Adjusted operating profit before tax methodology

Adjusted operating profit before tax is the Group's non-GAAP alternative performance measure, which complements IFRS GAAP measures and is key to decision making and the internal performance management of operating segments.

Adjusted operating profit before tax includes IFRS profit from continuing operations only.

For the Group's fee based business, adjusted operating profit before tax includes fees received from customers and operating costs for the business including overheads, expenses required to meet regulatory requirements and regular business development/restructuring and other costs. Costs associated with fundamental one-off Group-wide restructuring and transformation are not included in adjusted operating profit before tax.

For the Group's business written in the With-Profits Fund, adjusted operating profit before tax includes the statutory transfer to shareholders gross of attributable shareholder tax. Derivative instruments are held to mitigate the risk to the shareholder of lower future shareholder transfers, and can be separated into two types:

(i) Cash flow hedges[8]: those instruments that are held to mitigate volatility in the Group's IFRS results by being explicitly matched to the expected future shareholder transfers.

(ii) Capital hedges: instruments that hedge the economic present value of shareholder transfers on a Solvency II basis, to optimise the capital position.

The realised gains or losses on the cash flow hedges are allocated to adjusted operating profit before tax in line with emergence of the corresponding shareholder transfer within IFRS profit. Any short-term temporary movements in the fair value of these instruments, not relating to the current year's shareholder transfer are excluded from adjusted operating profit before tax. As the capital hedges do not explicitly hedge future IFRS profits, all movements in the fair value of these instruments are excluded from adjusted operating profit before tax.

For the Group's shareholder annuity products written by the Heritage segment, adjusted operating profit before tax excludes the impact of short-term components of credit risk provisioning, the impact of credit risk experience variances over the period, and total fair value movements on surplus assets backing the shareholder annuity capital, that are not reflective of the longer-term performance of the business.

Certain adjustments that are considered to be non-recurring or strategic, or due to short-term movements not reflective of longer-term performance are made to IFRS profit before tax. Adjustments are in respect of short-term fluctuations in investment returns, costs associated with fundamental one-off Group-wide restructuring and transformation, profits or losses arising on corporate transactions and profit/(loss) before tax from discontinued operations.

The key adjusting items between IFRS profit before tax from continuing operations and adjusted operating profit before tax are:

Short-term fluctuations in investment returns
The adjustment for short-term fluctuations in investment returns represents:

(i) Short-term temporary movements in the fair value of instruments held to mitigate equity risk in the with-profits shareholder transfer, including both cash flow and capital hedges.

(ii) Total fair value movements on other capital hedges, which are held solely to optimise the Solvency II capital position.

(ii) Total fair value movements on surplus assets backing the shareholder annuity capital, and the impact of short term credit risk provisioning and experience variances over the period which are not reflective of the longer-term performance of the business, specifically:

- The impact of credit risk provisioning for short-term adverse credit risk experience;
- The impact of credit risk provisioning for actual upgrades and downgrades relative to best estimate assumptions. This is calculated by reference to current interest rates;
- Credit experience reflecting the impact of defaults and other similar experience, such as asset exchanges arising from debt restructuring;
- The impact of market movements on bond portfolio weightings and the subsequent impact on credit provisions.

Items relating to investment returns which are included in adjusted operating profit before tax are:

- The net impact of movements in the value of policyholder liabilities and fair value of the assets backing these liabilities, excluding the items included in short-term fluctuations above. The fair value movements of the assets backing the liabilities are closely correlated with the related change in liabilities;
- The unwind of the credit risk premium, which is the opening value of the assets multiplied by the credit risk premium assumption, with an adjustment for claims paid over the year. The credit risk premium assumption is the difference between the total long-term credit allowance and a best estimate credit allowance (both of which allow for the combination of defaults and downgrades);
- Actual income received in the year, such as coupon payments, redemption payments and rental income, on surplus assets backing the shareholder annuity capital, less an allowance for expenses;

[8] These cash flow hedges do not constitute hedge accounting arrangements under IAS 39.

3 Segmental analysis (continued)

3.2 Adjusted operating profit before tax methodology (continued)

– The net effect of changes to the valuation rate of interest due to asset trading and portfolio rebalancing;

– The impact of changes in the long-term component of credit provisioning.

Profit/(Loss) on disposal of businesses and corporate transactions

There were no adjusting items for the year ended 31 December 2020. In the year ended 31 December 2019 £53m resulted from the reinsurance of £12bn of annuities to Rothesay Life in anticipation of sale, which is considered to be non-recurring in nature and is therefore excluded from IFRS adjusted operating profit before tax.The gain on disposal of Prudential Vietnam Finance Company is not included in the reconciliation of adjusted operating profit to IFRS profit from continuing operations as it is presented in profit from discontinued operations in the consolidated income statement for the year ended 31 December 2019.

Restructuring and other costs

Restructuring and other costs primarily reflect the shareholder allocation of costs associated with the merger, transformation, rebranding and other change in control costs. These costs represent fundamental one-off Group-wide restructuring and transformation and are therefore excluded from adjusted operating profit before tax.

3.3 Analysis of Group adjusted operating profit before tax by segment

	For the year ended 31 December 2020			
	Savings and Asset Management £m	Heritage £m	Corporate Centre £m	Total continuing operations £m
Fee based revenues [i]	**1,146**	**74**	**—**	**1,220**
Annuity margin	**—**	**438**	**—**	**438**
With-profits shareholder transfer net of hedging gains/(losses) [ii]	**44**	**207**	**—**	**251**
Adjusted operating income	**1,190**	**719**	**—**	**1,909**
Adjusted operating expenses	**(840)**	**(79)**	**(101)**	**(1,020)**
Other shareholder profit/(loss)	**(28)**	**59**	**(142)**	**(111)**
Share of profit from joint ventures and associates [iii]	**10**	**—**	**—**	**10**
Adjusted operating profit/(loss) before tax	**332**	**699**	**(243)**	**788**
Short-term fluctuations in investment returns	**58**	**620**	**—**	**678**
Profit on disposal of businesses and corporate transactions	**—**	**—**	**—**	**—**
Restructuring costs [iv]	**(51)**	**(22)**	**—**	**(73)**
IFRS profit/(loss) before tax and non-controlling interests attributable to equity holders from continuing operations	**339**	**1,297**	**(243)**	**1,393**
IFRS profit attributable to non-controlling interests	**4**	**—**	**—**	**4**
Profit/(loss) before tax attributable to equity holders from continuing operations	**343**	**1,297**	**(243)**	**1,397**

[i] Of the fee based revenues, £114m (2019: £110m) relates to revenues that Savings and Asset Management earned from the Heritage segment, and other presentational differences. These amounts are excluded from the analysis of fee income by segment in Note 4.

[ii] The with-profits shareholder transfer is paid to the shareholder net of tax. The shareholder transfer amount is grossed up for tax purposes with regard to adjusted operating profit.

[iii] Excludes adjusted operating profit from joint ventures in the With-Profits Fund.

[iv] Restructuring and other costs excluded from adjusted operating profit relate solely to merger, transformation, rebranding and other change in control costs allocated to the shareholder. Additional restructuring costs are included in the analysis of administrative and other expenses in Note 5.

3 Segmental analysis (continued)

3.3 Analysis of Group adjusted operating profit before tax by segment from continuing operations (continued)

	For the year ended 31 December 2019			
	Savings and Asset Management	Heritage	Corporate Centre	Total continuing operations
	£m	£m	£m	£m
Fee based revenues [i]	1,191	96	—	1,287
Annuity margin	—	458	—	458
With-profits shareholder transfer net of hedging gains/(losses) [ii]	55	187	—	242
Adjusted operating income	1,246	741	—	1,987
Adjusted operating expenses	(817)	(87)	(59)	(963)
Other shareholder profit/(loss)	30	98	(18)	110
Share of profit from joint ventures and associates [iii]	15	—	—	15
Adjusted operating profit/(loss) before tax	474	752	(77)	1,149
Short-term fluctuations in investment returns	(59)	357	—	298
Profit on disposal of businesses and corporate transactions	—	53	—	53
Restructuring costs [iv]	(52)	(98)	(48)	(198)
IFRS profit/(loss) before tax and non-controlling interests attributable to equity holders from continuing operations	363	1,064	(125)	1,302
IFRS profit attributable to non-controlling interests	3	—	—	3
Profit/(loss) before tax attributable to equity holders from continuing operations	366	1,064	(125)	1,305

The Group has a widely diversified customer base. There are no customers whose revenue represents greater than 10% of fee based revenue.

Each reportable segment reports adjusted operating income as its measure of revenue. Fee based revenues represents asset management charges, transactional charges and annual management charges on unit-linked business. The annuity margin reflects the margin earned on annuity business and includes net earned premiums, claims and benefits paid, net investment return for assets backing the liabilities, net investment income for surplus assets backing the annuity capital, actuarial reserving changes, investment management expenses and administrative expenses. The with-profits shareholder transfer reflects the statutory transfer gross of attributable tax net of hedging gains or losses on cash flow hedges held to match those transfers.

Adjusted operating expenses includes shareholders operating expenses incurred outside of the annuity and with-profits portfolios. Other shareholder profit/(loss) includes non-recurring costs, movements in provisions that are an expense to the shareholder and shareholder investment return earned outside of the annuity portfolio. Share of profit from joint ventures and associates represents the Group's share of the operating profits of Prudential Portfolio Managers South Africa (PTY) Limited, which is accounted for under the equity method.

4 Fee income

The following table disaggregates management fee revenue by segment:

	For the year ended 31 December	
	2020	2019
	£m	£m
Savings and Asset Management:		
Management fees	**910**	1,198
Rebates	**(34)**	(45)
Total management fees, less rebates	**876**	1,153
Performance fees	**42**	18
Investment contracts without discretionary participation features	**32**	30
Platform fees	**11**	—
Other fees and commissions	**55**	60
Total Savings and Asset Management fee income	**1,016**	1,261
Heritage:		
Investment contracts without discretionary participation features	**15**	25
Total Heritage fee income	**15**	25
Total fee income from continuing operations	**1,031**	1,286

5 Administrative and other expenses

	For the year ended 31 December	
	2020	2019
	£m	£m
Staff and employment costs [i]	**650**	454
Acquisition costs incurred:		
Insurance contracts	**145**	183
Other contracts	**27**	21
Acquisition costs deferred:		
Insurance contracts	**(11)**	(15)
Other contracts	**(2)**	(1)
Amortisation of deferred acquisition costs:		
Insurance contracts	**7**	7
Other contracts	**9**	10
Impairment of deferred acquisition costs	**3**	—
Depreciation of property, plant and equipment	**109**	97
Amortisation of intangible assets	**19**	11
Impairment of goodwill and intangible assets	**16**	23
Impairment of property, plant and equipment	**98**	—
Restructuring costs	**148**	201
Expenses under arrangements with reinsurers	**—**	112
Interest expense	**153**	154
Commission expense	**224**	263
Investment management fees	**191**	221
Property-related costs	**215**	152
Other expenses	**733**	983
Total administrative and other expenses from continuing operations	**2,734**	2,876

[i] Staff and employment costs for the year ended 31 December 2019 include a benefit of £117m resulting from changes to the Group's defined benefit pension schemes.

In addition to the interest expense shown above of £153m (2019: £154m), the interest expense incurred in respect of subordinated liabilities for the year ended 31 December 2020 was £167m (2019: £28m). This is shown as finance costs in the consolidated income statement. Total finance costs incurred for the year ended 31 December 2020 were £320m (2019: £182m).

6 Tax

6.1 Tax charged to the consolidated income statement from continuing operations

	For the year ended 31 December	
	2020	2019
	£m	£m
The total tax charge comprises:		
Current tax		
Current year	**581**	689
Adjustments in respect of prior years	**17**	(171)
Total current tax	**598**	518
Deferred tax:		
Origination and reversal of temporary differences in the year	**(123)**	165
Adjustments in respect of prior years	**(12)**	(3)
Total deferred tax	**(135)**	162
Total tax charge	**463**	680

The tax charge above, comprising current and deferred tax, can be analysed as follows:

	For the year ended 31 December	
	2020	2019
	£m	£m
UK tax	**392**	600
Overseas tax	**71**	80
Total tax charge	**463**	680

6 Tax (continued)

6.1 Tax charged to the consolidated income statement from continuing operations (continued)

6.1.1 Allocation of profit before tax and tax charge between equity holders and policyholders

The profit before tax from continuing operations reflected in the consolidated income statement for the year ended 31 December 2020 of £1,605m (2019: £1,745m) comprises profit attributable to equity holders and pre-tax profit attributable to policyholders of unit-linked and with-profits funds and unallocated surplus of the With-Profits Fund. This is the formal measure of profit before tax under IFRS but it is not the result attributable to equity holders. This is principally because the corporate taxes of the Group include those on the income of consolidated with-profits and unit-linked funds that, through adjustments to benefits, are borne by policyholders. These amounts are required to be included in the tax charge of the Company under IAS 12. Consequently, this measure of profit before all taxes is not representative of pre-tax profits attributable to equity holders.

The tax charge attributable to policyholder returns is removed from the Group's total profit before tax in arriving at the Group's profit before tax attributable to equity holders. As the net of tax profits attributable to policyholders is zero, the Group's pre-tax profit attributable to policyholders is an amount equal and opposite to the tax charge attributable to policyholders included in the total tax charge.

	For the year ended 31 December					
	2020			2019		
	Equity holders	Policyholders	Total	Equity holders	Policyholders	Total
	£m	£m	£m	£m	£m	£m
Profit before tax from continuing operations	**1,397**	**208**	**1,605**	1,305	440	1,745
Tax charge from continuing operations	**(255)**	**(208)**	**(463)**	(240)	(440)	(680)
Profit after tax for the year from continuing operations	**1,142**	**—**	**1,142**	1,065	—	1,065

6.1.2 Tax reconciliation

	For the year ended 31 December 2020			For the year ended 31 December 2019		
	Equity holders	Policyholders	Total	Equity holders	Policyholders	Total
	£m	£m	£m	£m	£m	£m
Profit before tax from continuing operations	**1,397**	**208**	**1,605**	1,305	440	1,745
Tax charge based on the standard UK corporation tax rate of 19% (2019: 19%)	**265**	**40**	**305**	248	84	332
Impact of profits earned in jurisdictions with different statutory rates to the UK (weighted average rate for equity holders is 19.0% (2019: 19.1%))	**1**	**—**	**1**	1	—	1
Recurring items						
Different basis of taxation - policyholders	**—**	**150**	**150**	—	507	507
Deductions not allowable for tax purposes	**16**	**—**	**16**	14	—	14
Effects of results of joint ventures and associates [i]	**(2)**	**—**	**(2)**	(3)	—	(3)
Income and gains not taxable or taxable at concessionary rates [ii]	**(15)**	**—**	**(15)**	—	—	—
Changes in recognition of deferred tax and effect of unrecognised tax losses	**(3)**	**—**	**(3)**	—	—	—
Other	**—**	**—**	**—**	3	—	3
Non recurring items						
Adjustments in relation to prior periods	**(13)**	**18**	**5**	(23)	(151)	(174)
Changes in local statutory tax rates or laws [iii]	**6**	**—**	**6**	—	—	—
Tax charge from continuing operations	**255**	**208**	**463**	240	440	680

[i] Profit before tax includes the Group's share of profits after tax from the joint ventures and associates. Therefore, the actual tax charge does not include tax arising from profit or loss of joint ventures and associates and is reflected as a reconciling item.

[ii] Pre-tax amounts recognised in the income statement are capital in nature for tax purposes and are non-taxable.

[iii] The standard rate of Corporation Tax in the UK was due to change from 19% to 17% with effect from 1 April 2020. 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 did not take place and the corresponding UK deferred tax balances previously reflected at 17% were revalued to 19%.

The Group's profits are taxed at different rates depending on the country or territory in which the profits arise. The key applicable tax rate for 2020 is the UK Corporation tax rate of 19% as the majority of the Group's profits are earned and taxed in the UK.

6 Tax (continued)

6.1 Tax charged to the consolidated income statement from continuing operations (continued)

6.1.3 Factors that may impact the future tax rate

The majority of the Group's profits are generated in the UK. Taking into account recurring tax adjusting items, the underlying effective tax rate for equity holders' portion of profits is expected to be marginally higher than the statutory rate in the UK.

6.1.4 Use of accounting estimates and judgements

The calculation of the Group's tax charge involves a degree of estimation and judgement. The two principal areas of judgement that could impact the reported tax position are the recognition and measurement of deferred tax assets and the level of provisioning for uncertain tax positions.

The recognition of a deferred tax asset relies on an assessment of the probability of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

The provisions for uncertain tax positions cover a wide range of issues, only a fraction of these are expected to be subject to challenge by a tax authority at any point in time. The Group engages constructively and transparently with tax authorities with a view to early resolution of uncertain tax matters. Estimated positions are based on the probability of potential challenge within certain jurisdictions and the possible outcome based on relevant facts and circumstances. The judgements and estimates made to recognise and measure the effect of uncertain tax positions are reassessed whenever circumstances change or when there is new information that affects those judgements.

The Group does not consider there to be a significant risk of a material adjustment in the next financial year to the deferred and current tax balances from either recognition and measurement of deferred tax assets or the level of provisioning for uncertain tax positions.

6.2 Deferred tax

Deferred tax assets and liabilities

Under IAS12, deferred tax is measured at the tax rates that are expected to apply to the period when the asset is realised or the liability settled, based on tax rates (and laws) that have been enacted or are substantively enacted at the end of the reporting period. Deferred tax assets are recognised as recoverable only to the extent it is considered probable, based on all available evidence, that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted or tax losses utilised. Deferred tax assets and liabilities are only offset when there is both a legal right to set-off and an intention to settle on a net basis.

Deferred tax in the statement of financial position

The deferred tax balances arise in the following parts of the Group:

	Deferred tax assets		Deferred tax liabilities	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
UK	**92**	76	**(700)**	(824)
Overseas	**16**	2	**(216)**	(241)
As at 31 December	**108**	78	**(916)**	(1,065)

6.2.1 Unrecognised deferred tax

Tax losses and temporary differences

At the end of the reporting period, the Group's continuing operations have unused tax losses of £547m (2019: £542m) and temporary differences of £49m (2019: £nil) for which no deferred tax asset is being recognised. The Group's unused tax losses primarily relate to capital losses in the UK of £539m (2019: £542m). No deferred tax asset is recognised on the unused tax losses of £547m as it is considered not probable that future taxable UK capital gains or other appropriate profits will be available against which they can be utilised. Under UK law, capital losses can be carried forward indefinitely. The Group's temporary differences of £49m primarily relates to capital allowances acquired as part of the Ascentric transaction during 2020. No deferred tax asset is recognised on these amounts due to a potential restriction on the capital allowances only being available to offset against future profits generated by the acquired group of entities' existing trade for which it is not considered probable that future sufficient taxable profits will be available.

Group investments in subsidiaries, branches and investments

Retained earnings of overseas subsidiaries are expected to be re-invested indefinitely or remitted to the UK free from further taxation by virtue of parent company exemptions on dividends from subsidiaries and on capital gains on disposal. Consequentially, the Group does not consider there to be any significant taxable temporary differences associated with investments in subsidiaries, branches, associates and joint arrangements.

6.3 Change in proposed corporation tax rate

On 3 March 2021, the UK Government announced a proposal to increase the rate of UK corporation tax from 19% to 25% with effect from 1 April 2023. Changes in tax laws and rates may affect recorded deferred tax assets and liabilities and our effective tax rate in the future. We expect that, in line with the rate increase proposed, there will be an increase to our effective tax rate for periods from 2023 onwards. In addition, we expect a change to the carrying values of our deferred tax assets and liabilities, the impact of which is not considered significant primarily due to the majority of the UK deferred tax balances being measured at a policyholder rate of tax which is unaffected by the announcement.

7 Earnings per share

Basic earnings per share for the year ended 31 December 2020 was 44.4p (2019: 43.1p) and diluted earnings per share was 44.0p (2019: 43.0p). Basic earnings per share is based on the weighted average ordinary shares in issue after deducting treasury shares and shares held by the employee benefit trust. Diluted EPS is based on the potential future shares in issue resulting from exercise of options under the various share-based payment schemes in addition to the weighted average ordinary shares in issue.

7 Earnings per share (continued)

The following table shows details of basic and diluted earnings per share:

	For the year ended 31 December					
	2020			2019		
	Continuing operations	Discontinued operations	Total	Continuing operations	Discontinued operations	Total
	£m	£m	£m	£m	£m	£m
Profit attributable to equity holders of M&G plc	**1,138**	**—**	**1,138**	1,062	58	1,120

	For the year ended 31 December	
	2020	2019
	Millions	Millions
Weighted average number of ordinary shares outstanding	**2,563**	2,597
Dilutive effect of share options and awards	**24**	4
Weighted average number of diluted ordinary shares outstanding	**2,587**	2,601

	For the year ended 31 December					
	2020			2019		
	Continuing operations	Discontinued operations	Total	Continuing operations	Discontinued operations	Total
	Pence per share	Pence per share	Pence per share	Pence per share	Pence per share	Pence per share
Basic earnings per share	**44.4**	**—**	**44.4**	40.9	2.2	43.1
Diluted earnings per share	**44.0**	**—**	**44.0**	40.8	2.2	43.0

8 Dividends

8.1 Dividends

	For the year ended 31 December 2020		For the year ended 31 December 2019	
	Pence per share	£m	Pence per share	£m
Dividends relating to reporting period:				
First interim dividend - Ordinary	**6.00**	**152**	—	—
Second interim dividend - Ordinary	**12.23**	**310**	11.92	310
Interim dividends - Special dividends	**—**	**—**	3.85	100
Total		**462**		410
Dividends paid in reporting period:				
Prior year's interim dividend - Ordinary	**11.92**	**310**	—	—
Prior year's interim dividend- Special dividends	**3.85**	**100**	—	—
First interim dividend - Ordinary	**6.00**	**152**	—	—
Total		**562**		—

Subsequent to 31 December 2020, the Board has declared a second interim dividend for 2020 of 12.23 pence per ordinary share and, an estimated £310m in total. The dividend is expected to be paid on 28 April 2021 and will be recorded as an appropriation of retained earnings in the Company financial statements at the time that it is paid.

8.2 Transactions with equity holders

For the year ended 31 December 2019 dividends included amounts paid to Prudential plc by M&G plc post incorporation on 2 July 2018 up to the date of demerger of £1,392m, of which, £849m were non-cash in specie dividends and £543m in cash. A final dividend was paid to Prudential plc prior to demerger on 18 October 2019 of £2,968m.

Prudential Capital Holdings Company Limited was transferred on 20 September 2019 from Prudential plc, and paid a £5m dividend prior to this.

9 Defined benefit pension schemes

9.1 Background and summary economic and IAS 19 financial

The Group operates three defined benefit pension schemes, which historically have been funded by the Group and Prudential plc. The largest defined benefit scheme as at 31 December 2020 is the Prudential Staff Pension Scheme ("PSPS"), which accounts for 81% (2019: 82%) of the present value of the defined benefit pension obligation.

The Group also operates two smaller defined benefit pension schemes that were originally established by the M&G ("M&GGPS") and Scottish Amicable ("SASPS") businesses.

9 Defined benefit pension schemes (continued)

9.1 Background and summary economic and IAS 19 financial positions (continued)

Under IAS 19: Employee Benefits and IFRIC 14: IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, the Group can only recognise a surplus to the extent that it is able to access the surplus either through an unconditional right of refund or through reduced future contributions relating to ongoing service of active members. The Group has no unconditional right of refund to any surplus in PSPS. Accordingly, PSPS's net economic pension surplus is restricted up to the present value of the Group's economic benefit, which is calculated as the difference between the estimated future cost of service for active members and the estimated future ongoing contributions. In contrast, the Group is able to access the surplus of SASPS and M&GGPS through an unconditional right of refund. Therefore, the surplus resulting from the schemes (if any) would be recognised in full. As at 31 December 2020 the SASPS and M&GGPS schemes are in deficit based on the IAS 19 valuation.

Until 30 June 2019, the PSPS net economic pension surplus was attributed 70% to the With-Profits Fund and 30% to Prudential plc which is now external to the Group. On 30 June 2019, in preparation for demerger, the 30% attributable to Prudential plc was formally reallocated to the Group's shareholders, and the full value of the scheme surplus allowable under IFRIC 14 was attributed to the Group from this date. This resulted in an incremental pension surplus of £15m recognised on the consolidated statement of financial position of the Group, with the corresponding gain recognised in the consolidated statement of comprehensive income during 2019.

The IAS 19 net surplus/deficit for M&GGPS is lower than its net economic surplus/deficit position, as the pension scheme has investments in insurance policies issued by Prudential Pensions Limited, a subsidiary of the Group, through which it invests in certain pooled funds. Under IAS 19, insurance policies issued by a related party do not qualify as plan assets. The SASPS net economic pension deficit is attributed 40% to the With-Profits Fund and 60% to the Group's shareholders.

9.1.1 Changes to scheme rules

In January 2019, following consultation, the Group reached agreement that pensionable salary increases for the members of all the three defined benefit schemes who earn in excess of £35,000 would be capped after 30 September 2019. Pension benefits will still relate to how many years employees have been active scheme members, as they did previously, as long as the employees remain working for the Group.

The pension scheme valuations for the schemes incorporate the effect of these changes in scheme rules, and the impact was included as a past service credit within the income statement in 2019 in line with the requirements of Plan Amendment, Curtailment or Settlement - Amendments to IAS 19.

The pension assets and liabilities for the defined benefit pension schemes are as follows:

	As at 31 December 2020			
	PSPS	SASPS	M&GGPS	Total
	£m	£m	£m	£m
Fair value of plan assets	7,884	967	742	9,593
Present value of defined benefit obligation	(7,109)	(1,073)	(605)	(8,787)
Effect of restriction on surplus	(717)	—	—	(717)
Net economic pension surplus/(deficit) [i]	58	(106)	137	89
Eliminate group issued insurance policies	—	—	(201)	(201)
Net total pension surplus/(deficit)	58	(106)	(64)	(112)

	As at 31 December 2020			
	PSPS	SASPS	M&GGPS	Total
	£m	£m	£m	£m
Attributable to:				
Shareholder-backed business	17	(64)	(64)	(111)
With-Profits Fund	41	(42)	—	(1)
Net total pension surplus/(deficit)	58	(106)	(64)	(112)

	As at 31 December 2019			
	PSPS	SASPS	M&GGPS	Total
	£m	£m	£m	£m
Fair value of plan assets	7,447	867	663	8,977
Present value of defined benefit obligation	(6,520)	(895)	(489)	(7,904)
Effect of restriction on surplus	(887)	—	—	(887)
Net economic pension surplus/(deficit) [i]	40	(28)	174	186
Eliminate group issued insurance policies	—	—	(137)	(137)
Net pension surplus/(deficit) attributable to the Group	40	(28)	37	49

9 Defined benefit pension schemes (continued)

9.1 Background and summary economic and IAS 19 financial positions (continued)

	As at 31 December 2019			
	PSPS	SASPS	M&GGPS	Total
	£m	£m	£m	£m
Attributable to:				
Shareholder-backed business	12	(17)	37	32
With-Profits Fund	28	(11)	—	17
Net total pension surplus/(deficit)	40	(28)	37	49

[i] The economic basis reflects the position of the defined benefit schemes from the perspective of the pension schemes, adjusted for the effect of IFRIC 14 for the derecognition of PSPS's unrecognisable surplus and before adjusting for any non-qualifying assets.

10 Issued share capital and share premium

10.1 Issued share capital

	For the year ended 31 December			
	2020		2019	
Issued shares of 5p fully paid	**Number of ordinary shares**	**Share capital**	Number of ordinary shares	Share capital
		£m		£m
At 1 January	**2,599,906,866**	**130**	2,597,930,000	130
Bonus issue	**—**	**—**	1,976,866	—
At 31 December	**2,599,906,866**	**130**	2,599,906,866	130

Amounts recorded in share capital represent the nominal value of shares issued with any difference between proceeds received on issue of shares, net of issue costs, and the nominal value of shares issued being credited to the share premium account. On 18 October 2019, in preparation of demerger, 1,976,866 bonus shares were issued at par value of 5 pence per share by utilising the share premium reserve. The share premium reserve at 31 December 2020 was £370m (2019: £370m).

11 Policyholder liabilities and unallocated surplus

11.1 Determination of insurance and investment contract liabilities for different components of business

Note 2.3 describes the different types of insurance and investment contracts across the business. A description relating to the determination of the policyholder liabilities and the key assumptions for each component of business is set out below:

11.1.1 With-profits business

The With-Profits Fund mainly contains with-profits contracts but also contains some non-profit business (annuities, unit-linked, and term assurances). The liabilities of the With-Profits Fund are accounted for on a realistic basis in accordance with the requirements of FRS 27 Life Assurance. The basis is consistent with the rules for the determination of reserves on the realistic basis under the Solvency I capital regime. Though no longer in force for regulatory purposes, these rules continue to be applied to determine with-profits contract liabilities in accordance with IFRS 4 Insurance Contracts. In aggregate, the regime has the effect of placing a market-consistent value on the liabilities of with-profits contracts, which reflects the amounts expected to be paid based on the current value of investments held by the With-Profits Fund and current circumstances. Non-profit business written in the With-Profits Fund is valued consistently with equivalent business written in the shareholder-backed funds, and profit on this business which has accrued to policyholders is included as part of the with-profits contract liability. No policyholder liability is held in respect of future enhancements to with-profits liabilities from non-profit business.

The with-profits contracts are a combination of insurance and investment contracts with discretionary participation features, as defined by IFRS 4. The realistic basis requires the value of with-profits policyholder liabilities to be calculated as the sum of:

(i) A with-profits benefits reserve ("WPBR")

(ii) Future policy-related liabilities ("FPRL")

The WPBR is primarily based on the retrospective calculation of accumulated asset shares with adjustments to reflect future policyholder benefits and other charges and expenses. Asset shares broadly reflect the policyholders' share of the With-Profits Fund assets attributable to their policies. For certain classes of business, the WPBR is instead calculated using a prospective bonus reserve valuation, valuing future claims and expenses using the expected future bonus rates.

The FPRL is comprised of other components of the liability including a market-consistent valuation of costs of guarantees, options and smoothing, less any related charges, and this amount is determined using stochastic modelling techniques.

Assumptions used for the realistic, market-consistent valuation of with-profits business typically do not contain margins, whereas those used for the valuation of other classes of business (for example, annuities) contain margins of prudence within the assumptions. The main assumptions used in the prospective elements of the with-profits policyholder liabilities are below:

- Assumptions relating to persistency and the take-up of options offered under certain with-profits contracts are set based on the results of the most recent experience analysis looking at the experience over recent years of the relevant business;
- Management actions under which the fund is managed in different scenarios;

11 Policyholder liabilities and unallocated surplus (continued)

11.1 Determination of insurance and investment contract liabilities for different components of business (continued)

- Maintenance and, for some classes of business, termination expense assumptions are expressed as per policy amounts. They are set based on the expenses incurred during the year, including an allowance for ongoing investment expenses, and are allocated between entities and product groups in accordance with the Group's internal cost allocation model;
- Expense inflation assumptions are set consistent with the economic basis and based on the inflation swap spot curve;
- The contract liabilities for with-profits business also require assumptions for mortality. These are set based on the results of recent experience analysis.

On 25 October 2019, a reinsurance arrangement with Prudential Hong Kong Limited, a subsidiary of Prudential plc, which covered £1,078m of the non-profit annuity business contained within the With-Profits Fund, was terminated as part of demerger activities. As at 31 December 2020 and 31 December 2019, there are no significant external reinsurance arrangements in place in respect of the With-Profits Fund's liabilities.

Unallocated surplus

The unallocated surplus of the With-Profits Fund represents the excess of the fund's assets over policyholder liabilities that have yet to be appropriated between policyholders and shareholders. The unallocated surplus is recorded wholly as a liability with no allocation to equity. The annual excess/(shortfall) of income over expenditure of the With-Profits Fund, after declaration and attribution of the cost of bonuses to policyholders and shareholders, is transferred to/(from) the unallocated surplus each year through a charge/(credit) to the consolidated income statement. The balance retained in the unallocated surplus represents cumulative income arising on the with-profits business that has not been allocated to policyholders or shareholders.

With-profits options and guarantees

Certain policies written in the Group's With-Profits Fund give potentially valuable guarantees to policyholders, or options to change policy benefits which can be exercised at the policyholders' discretion.

Most with-profits contracts give a guaranteed minimum payment on a specified date or range of dates or on death if before that date or dates. For pensions products, the specified date is the policyholder's chosen retirement date or a range of dates around that date. For endowment contracts, guarantees apply at the maturity date of the contract. For with-profits bonds it is often a specified anniversary of commencement, in some cases with further dates thereafter.

The main types of options and guarantees offered for with-profits contracts are as follows:

- For conventional with-profits contracts, including endowment assurance contracts and whole of-life assurance contracts, payouts are guaranteed at the sum assured together with any declared regular bonus;
- Conventional with-profits deferred annuity contracts have a basic annuity per annum to which bonuses are added. At maturity, the cash claim value will reflect the current cost of providing the deferred annuity. Regular bonuses when added to with-profits contracts usually increase the guaranteed amount;
- For unitised with-profits contracts and cash accumulation contracts the guaranteed payout is the initial investment (adjusted for any withdrawals, where appropriate), less charges, plus any regular bonuses declared. If benefits are taken at a date other than when the guarantee applies, a market value reduction may be applied to reflect the difference between the accumulated value of the units and the market value of the underlying assets;
- For certain unitised with-profits contracts and cash accumulation contracts, policyholders have the option to defer their retirement date when they reach maturity, and the terminal bonus granted at that point is guaranteed;
- For with-profits annuity contracts, there is a guaranteed minimum annuity payment below which benefit payments cannot fall over the lifetime of the policies;
- Certain pensions products have guaranteed annuity options at retirement, where the policyholder has the option to take the benefit in the form of an annuity at a guaranteed conversion rate.

Determination of bonuses

Profit recognition for traditional with-profits business written in the WPSF is in line with the declaration of bonuses. Determining discretionary bonuses for traditional types of with-profits business requires the PAC Board to apply significant judgement, including in particular the following:

- Determining what constitutes fair treatment of customers;
- Determining the process for the smoothing of investment returns;
- Determining at what level to set bonuses to ensure that they are competitive.

The overall rate of return on investments and the expectation of future investment returns are the most important influences in bonus rates, subject to the smoothing described below. The Group determines the assumptions to apply in respect of these factors, including the effects of reasonably likely changes in key assumptions, in the context of the overarching discretionary and smoothing framework that applies to its with-profits business.

The Group's approach, in applying significant judgement and discretion in relation to determining bonus rates, is consistent with the Principles and Practices of Financial Management ("PPFM") that explains how the With-Profits Fund is managed. In accordance with industry-wide regulatory requirements, the PAC Board has appointed:

- A Chief Actuary who provides the PAC Board with all actuarial advice.
- A With-Profits Actuary whose specific duty is to advise the PAC Board on the reasonableness and proportionality of the manner in which its discretion has been exercised in applying the PPFM and the manner in which any conflicting interests have been addressed.

11 Policyholder liabilities and unallocated surplus (continued)

11.1 Determination of insurance and investment contract liabilities for different components of business (continued)

– A With-Profits Committee of independent individuals, which assesses the degree of compliance with the PPFM and the manner in which conflicting interests and rights have been addressed.

In determining bonus rates for the with-profits policies, smoothing is applied to the allocation of the overall earnings of the With-Profits Fund, of which the investment return is a significant element. The degree of smoothing is illustrated numerically in the following table, which allows comparison of the relatively "smoothed" level of policyholder bonuses declared as part of the surplus for distribution with the more volatile movement in investment return and other items of income and expenditure of the WPSF.

	For the year ended 31 December	
	2020	2019
	£m	£m
Net income of the WPSF fund:		
Investment return	**5,719**	13,910
Claims incurred	**(9,430)**	(9,106)
Movement in policyholder liabilities	**(364)**	(11,535)
Add back policyholder bonus for the year (as shown below)	**2,258**	2,375
Claims incurred and movement in policyholder liabilities (including change for provision for asset shares and excluding policyholder bonuses)	**(7,536)**	(18,266)
Earned premiums, net of reinsurance	**5,494**	11,755
Other income	**9**	35
Acquisition costs and other expenditure	**(1,250)**	(1,837)
Share of (losses)/profits from investment joint ventures	**(64)**	3
Tax charge	**(297)**	(413)
Net income of the fund before movement in unallocated surplus of the With-Profits Fund	**2,075**	5,187
Movement in unallocated surplus of the With-Profits Fund	**433**	(2,549)
Surplus for distribution for the year	**2,508**	2,638
Surplus for distribution for the year allocated as follows:		
Policyholders' bonus (as shown above)	**2,258**	2,375
Shareholders' transfers [i]	**250**	263
Surplus for distribution for the year	**2,508**	2,638

[i] Shareholder transfers for most business in the WPSF are one ninth of the cost of bonus declared to policyholders.

11.1.2 Unit-linked business

For unit-linked contracts, the attaching liability reflects the unit value obligation and, in the case of contracts with significant insurance risk which are therefore classified as insurance contracts, a provision for expense and mortality risk. The latter component is determined by applying mortality assumptions on a basis that is appropriate for the policyholder profile. To calculate the non-unit reserves for unit-linked insurance contracts, assumptions are set for maintenance expenses, the unit growth rate and the valuation interest rate. The valuation interest rate is derived from the yields of assets representative of the returns that will be earned on the assets backing these liabilities.

For those contracts where the level of insurance risk is insignificant, the assets and liabilities arising under the contracts are distinguished between those that relate to the financial instrument liability, and the deferred acquisition costs and deferred income that relate to investment management. Deferred acquisition costs and deferred income are recognised in line with the level of service provision.

Certain parts of the unit-linked business are reinsured externally, either by way of fund reinsurance or by reinsuring specific risk benefits. The reinsurance asset in respect of these reinsurance arrangements is valued in a manner consistent with the valuation of the underlying liabilities.

11.1.3 Annuities and other long-term business

The majority of the policyholder liabilities in the "annuities and other long-term business" component relate to annuity contracts. The annuity liabilities are calculated as the expected value of future annuity payments and expenses, discounted by a valuation interest rate, having prudent regard to the assumptions used.

As described in Note 2, on 14 March 2018, part of the annuity liability was reinsured externally to Rothesay Life PLC. In addition, some of the longevity risk in respect of the remaining annuity business is reinsured externally. The reinsurance asset in respect of these reinsurance arrangements is valued in a manner consistent with the valuation of the underlying liabilities.

The key assumptions used to calculate the policyholder liability in respect of annuity business are as follows:

Mortality

Mortality assumptions for annuity business are set in light of recent population and internal experience, with an allowance for expected future mortality improvements. Given the long-term nature of annuity business, annuitant mortality 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 Group's portfolio.

11 Policyholder liabilities and unallocated surplus (continued)

11.1 Determination of insurance and investment contract liabilities for different components of business (continued)

The mortality improvements observed in recent population data have been considered as part of the judgement exercised in setting the mortality basis for 2020. New mortality projection models are released annually by the Continuous Mortality Investigation ("CMI"). The CMI tables used are adjusted as appropriate each year to reflect anticipated mortality improvements, including an appropriate margin for prudence. The CMI 2018 model does not take into account higher mortality improvements observed during 2019, and the Group has therefore adopted a stronger than default calibration of CMI 2018 model. The mortality improvement assumptions used are summarised in the table below:

Period ended	Model version	Long-term improvement rate [i]	Smoothing parameter (Sk) [ii]
31 December 2020	**CMI 2018**	**For males: 2.25% pa For females: 2.00% pa**	**For males: 7.75 For females: 8.25**
31 December 2019	CMI 2017	For males: 2.25% pa For females: 2.00% pa	For males: 7.5 For females: 7.75

[i] As at 31 December 2020 and 31 December 2019, the long-term improvement rates shown reflected a 0.5% increase to all future improvement rates as a margin for prudence.

[ii] The smoothing parameter controls the amount of smoothing by calendar year when determining the level of initial mortality improvements.

An increase in mortality rates has been observed during 2020 due to the COVID-19 pandemic and may be expected to continue to some extent over the short term, particularly in relation to the annuitant population which has a higher average age than the non-annuitant population. However, the longer term implications for mortality rates amongst the annuitant population are unknown at this stage. While no change has been made to the annuitant mortality assumptions directly as a result of COVID-19, this is an area the Group continues to monitor.

The mortality assumptions for in-force vested annuities also cover annuities in deferment.

Valuation interest rates

Valuation interest rates used to discount the liabilities are based on the yields as at the valuation date on the assets backing the policyholder liabilities. For fixed interest securities, the internal rate of return of the assets backing the liabilities is used. Investment properties are valued using the redemption yield. An adjustment is made to the yield on non risk-free fixed interest securities and property to reflect credit risk. The credit risk allowance comprises an amount for long-term best estimate defaults and downgrades, a provision for credit risk premium, and where appropriate an additional short-term allowance.

The credit risk allowance for the Group's shareholder-backed annuity business as at 31 December 2020 was 46bps per annum (2019: 37 bps) corresponding to a net of reinsurance reserve of £862m (2019: £701m). For the annuity business written in the With-Profits Fund, this amount was 43bps (2019: 33 bps) corresponding to a net of reinsurance reserve of £406m (2019: £324m). This increase is primarily due to strengthening the short-term provision, in anticipation of short-term deterioration in the number of company default and downgrades due to the current market conditions arising from the COVID-19 pandemic.

Expenses

Maintenance expense assumptions are expressed as per policy amounts. They are set based on forecast expense levels, including an allowance for ongoing investment management expenses and are allocated between entities and product groups in accordance with the Group's internal cost allocation model. A margin for prudence is added to this amount. Expense inflation assumptions are set consistent with the economic basis and based on the inflation swap spot curve.

The following tables show the movement in policyholder liabilities and unallocated surplus of the With-Profits Fund by component of business. The analysis includes the impact of premiums, claims and investment movements on policyholder liabilities. The impact does not represent premiums, claims, and investment movements as reported in the consolidated income statement. For example, the premiums shown below will exclude any deductions for fees/charges, as the table only shows the impact on the insurance and investment contract liabilities and unallocated surplus of the With-Profits Fund. Claims (surrenders, maturities and deaths) represent the liability released rather than the claim amount paid to the policyholder.

11 Policyholder liabilities and unallocated surplus (continued)

11.2 Analysis of movements in policyholder liabilities and unallocated surplus of the With-Profits Fund

		Shareholder-backed funds and subsidiaries				
	With-profits sub-funds[i]	Unit-linked liabilities	Annuity and other long-term business	Total	Reinsurance asset	Net total
	£m	£m	£m	£m	£m	£m
As at 1 January 2019	124,228	20,717	20,384	165,329	(2,812)	162,517
Comprising:						
Insurance contract liabilities	43,775	5,219	20,304	69,298		
Investment contract liabilities with DPF	67,018	—	20	67,038		
Investment contract liabilities without DPF	2	15,498	60	15,560		
Unallocated surplus of the With-Profits Fund	13,433	—	—	13,433		
Net Flows:						
Premiums	11,745	890	287	12,922		
Surrenders	(4,987)	(2,667)	(444)	(8,098)		
Maturities/deaths	(4,522)	(606)	(1,948)	(7,076)		
Net flows	2,236	(2,383)	(2,105)	(2,252)		
Reclassification of reinsured UK annuity contracts as held for sale	—	—	10,502	10,502		
Disposal of Hong Kong subsidiaries	(44)	(9)	53	—		
Shareholders' transfers post-tax	(263)	—	—	(263)		
Switches	(156)	156	—	—		
Investment-related items and other movements [ii]	10,925	2,513	1,613	15,051		
Foreign exchange differences	(112)	—	(4)	(116)		
As at 31 December 2019/As at 1 January 2020	**136,814**	**20,994**	**30,443**	**188,251**	**(11,958)**	**176,293**
Comprising:						
Insurance contract liabilities	**42,717**	**5,396**	**30,367**	**78,480**		
Investment contract liabilities with DPF	**78,022**	**—**	**26**	**78,048**		
Investment contract liabilities without DPF	**3**	**15,598**	**50**	**15,651**		
Unallocated surplus of the With-Profits Fund	**16,072**	**—**	**—**	**16,072**		
Net Flows:						
Premiums	**5,500**	**1,632**	**161**	**7,293**		
Surrenders	**(5,730)**	**(2,214)**	**(81)**	**(8,025)**		
Maturities/deaths	**(4,114)**	**(603)**	**(2,077)**	**(6,794)**		
Net flows	**(4,344)**	**(1,185)**	**(1,997)**	**(7,526)**		
Shareholders' transfers post-tax	**(250)**	**—**	**—**	**(250)**		
Switches	**(81)**	**81**	**—**	**—**		
Investment-related items and other movements [ii]	**4,220**	**509**	**2,153**	**6,882**		
Foreign exchange differences	**28**	**56**	**—**	**84**		
As at 31 December 2020	**136,387**	**20,455**	**30,599**	**187,441**	**(11,761)**	**175,680**
Comprising:						
Insurance contract liabilities	**41,172**	**4,987**	**30,491**	**76,650**		
Investment contract liabilities with DPF	**79,592**	**—**	**31**	**79,623**		
Investment contract liabilities without DPF	**2**	**15,468**	**77**	**15,547**		
Unallocated surplus of the With-Profits Fund	**15,621**	**—**	**—**	**15,621**		

[i] Includes the WPSF, the DCPSF and the SAIF, including the non-profit business written within these funds.

[ii] Investment related items and other movements include the impact of assumption changes. For the shareholder-backed business, assumption changes, including credit downgrade/default provisioning and annuitant mortality, decreased policyholder liabilities by £238m for the year ended 31 December 2020 (2019: £340m decrease). For the With-Profits Fund, the impact of assumption changes for the year ended 31 December 2020 was a decrease in policyholder liabilities of £339m (2019: £239m decrease), which was offset by a corresponding increase in unallocated surplus of the With-Profits Fund. The assumption change impacts have been amended from those reported in the 31 December 2019 Annual Report & Accounts with no impact on the movement table presented above.

11 Policyholder liabilities and unallocated surplus (continued)

11.2 Analysis of movements in policyholder liabilities and unallocated surplus of the With-Profits Fund (continued)

Further analysis of the movement in the Group's insurance contract liabilities, reinsurance asset, investment contract liabilities and unallocated surplus of the With-Profits Fund is provided below. The movement in these items is predominantly allocated to the "benefits and claims and movement in unallocated surplus of the With-Profits Fund, net of reinsurance" line in the consolidated income statement, although certain movements such as premiums received and claims paid on investment contracts without DPF, are not charged to the consolidated income statement.

	Insurance contracts £m	Investment Contracts [ii] £m	Unallocated surplus of the With-Profits Fund £m	Reinsurers' Share [iii] £m
As at 1 January 2019	69,298	82,598	13,433	(2,812)
Income and expense included in the consolidated income statement	(1,063)	12,688	2,549	1,356
Other movements including amounts included in other comprehensive income [i]	10,311	(1,583)	136	(10,502)
Foreign exchange translation differences	(66)	(4)	(46)	—
As at 31 December 2019/As at 1 January 2020	**78,480**	**93,699**	**16,072**	**(11,958)**
Income and expense included in the income statement	**(1,884)**	**2,280**	**(433)**	**203**
Other movements including amounts included in other comprehensive income [i]	**19**	**(865)**	**(11)**	**(4)**
Foreign exchange translation differences	**35**	**56**	**(7)**	**(2)**
As at 31 December 2020	**76,650**	**95,170**	**15,621**	**(11,761)**

[i] Other movements including amounts included in other comprehensive income include premiums received and claims paid on investment contracts without discretionary participating features, which are taken directly to the consolidated statement of financial position in accordance with IAS 39; changes in the unallocated surplus of the With-Profits Fund resulting from actuarial gains and losses on the Group's defined benefit pension schemes, which are recognised directly in other comprehensive income and balance sheet reallocations. The amount for balance sheet reallocations for the year ended 31 December 2019 includes the reclassification of the reinsured UK annuity business out of held for sale, together with reclassifications between insurance contract liabilities and the unallocated surplus of the With-Profits Fund.

[ii] This comprises investment contracts with discretionary participation features of £79,623m as at 31 December 2020 (2019: £78,048m) and investment contracts without discretionary participation features of £15,547m as at 31 December 2020 (2019: £15,651m).

[iii] Includes reinsurers' share of claims outstanding of £149m as at 31 December 2020 (2019: £156m).

The below tables show the "Benefits and claims and movement in unallocated surplus of the With-Profits Fund, net of reinsurance" as shown in the consolidated income statement. "Benefits and claims and movement in unallocated surplus of the With-Profits Fund, net of reinsurance" comprises of the movement charged to the consolidated income statement presented in the table above, and the benefits and claims paid over the period, net of amounts attributable to reinsurers.

	For the year ended 31 December 2020		
	Policyholder liabilities [i] £m	Unallocated surplus of the With-Profits Fund £m	Reinsurance asset £m
Movement in policyholder liabilities and unallocated surplus of the With-Profits Fund included in consolidated income statement	**(396)**	**433**	**—**
Movement in reinsurance asset included in consolidated income statement	**—**	**—**	**(203)**
Benefits and claims paid	**(12,278)**	**—**	**—**
Benefits and claims attributable to external reinsurers	**—**	**—**	**1,680**
Benefits and claims and movement in unallocated surplus of the With-Profits Fund, net of reinsurance, as shown in consolidated income statement	**(12,674)**	**433**	**1,477**

[i] Policyholder liabilities includes insurance contract liabilities and investment contract liabilities.

	For the year ended 31 December 2019		
	Policyholder liabilities [i] £m	Unallocated surplus of the With-Profits Fund £m	Reinsurance asset £m
Movement in policyholder liabilities and unallocated surplus of the With-Profits Fund included in condensed consolidated income statement	(11,625)	(2,549)	—
Movement in reinsurance asset included in consolidated income statement	—	—	(1,356)
Benefits and claims paid	(12,750)	—	—
Benefits and claims attributable to external reinsurers	—	—	1,787
Benefits and claims and movement in unallocated surplus of the With-Profits Fund, net of reinsurance as shown in consolidated income statement	(24,375)	(2,549)	431

12 Subordinated liabilities and other borrowings

	As at 31 December	
	2020	2019
	£m	£m
Subordinated liabilities	**3,729**	3,767
Operational borrowings	**157**	130
Borrowings attributable to the With-Profits Fund	**4,381**	3,602
Total subordinated liabilities and other borrowings	**8,267**	7,499

12.1 Subordinated liabilities

The Group's subordinated liabilities consist of subordinated notes which were transferred from Prudential plc on 18 October 2019 and were recorded at fair value on initial recognition. The transfer of the subordinated liabilities was achieved by substituting the Company in place of Prudential plc as issuer of the debt, as permitted under the terms and conditions of each applicable instrument. All costs related to the transaction were borne by Prudential plc.

	As at 31 December 2020		As at 31 December 2019	
	Principal amount	**Carrying value**	Principal amount	Carrying value
		£m		£m
5.625% sterling fixed rate due 20 October 2051	**£750m**	**856**	£750m	862
6.25% sterling fixed rate due 20 October 2068	**£500m**	**608**	£500m	608
6.50% US dollar fixed rate due 20 October 2048	**$500m**	**425**	$500m	448
6.34% sterling fixed rate due 19 December 2063	**£700m**	**853**	£700m	856
5.56% sterling fixed rate due 20 July 2055	**£600m**	**680**	£600m	684
3.875% sterling fixed rate due 20 July 2049	**£300m**	**307**	£300m	309
Total subordinated liabilities		**3,729**		3,767

Subordinated notes issued by the Company rank below its senior obligations and ahead of its preference shares and ordinary share capital.

A description of the key features of each of the Group's subordinated notes as at 31 December 2020 is as follows:

	5.625% Sterling fixed rate	**6.25% Sterling fixed rate**	**6.50% US Dollar fixed rate**	**6.34% Sterling fixed rate**	**5.56% Sterling fixed rate**	**3.875% Sterling fixed rate**
Principal amount	£750m	£500m	$500m	£700m	£600m	£300m
Issue date[i]	1 October 2018	1 October 2018	1 October 2018	16 December 2013 (amended 10 June 2019)	9 June 2015 (amended 10 June 2019)	8 July 2019
Maturity date	20 October 2051	20 October 2068	20 October 2048	19 December 2063	20 July 2055	20 July 2049
Callable at par at the option of the Company from	20 October 2031 (and each semi-annual interest payment date thereafter)	20 October 2048 (and each semi-annual interest payment date thereafter)	20 October 2028 (and each semi-annual interest payment date thereafter)	19 December 2043 (and each semi-annual interest payment date thereafter)	20 July 2035 (and each semi-annual interest payment date thereafter)	20 July 2024, 20 July 2029 (and each semi-annual interest payment date thereafter)
Solvency II own funds treatment	Tier 2	Tier 2	Tier 2	Tier 2	Tier 2	Tier 2

[i] The subordinated notes were issued by Prudential plc rather than by the Company.

As at 31 December 2020, the principal amount of all subordinated liabilities is expected to be settled after more than 12 months and accrued interest of £42m (2019: £41m) is expected to be settled within 12 months.

12 Subordinated liabilities and other borrowings (continued)

12.1 Subordinated liabilities (continued)

12.1.1 Movement in subordinated liabilities

The following table reconciles the movement in subordinated liabilities in the year:

	2020 **£m**	2019 £m
At 1 January	**3,767**	—
Fair value on initial recognition	**—**	3,789
Amortisation	**(23)**	(9)
Foreign exchange movements	**(15)**	(13)
At 31 December	**3,729**	3,767

The subordinated liabilities were recognised at fair value on initial recognition, however the cash received in respect of these liabilities from Prudential plc was £3,219m. The difference was treated as a distribution in kind in accordance with the requirements of section 845 of the Companies Act 2006.

There were no repayments of principal on these loans during the year. The amortisation of premium on the loans based on an effective interest rate and the foreign exchange movement on the translation of the subordinated liabilities denominated in US dollar are both non-cash items.

13 Fair value methodology

13.1 Determination of fair value hierarchy

The fair values of assets and liabilities for which fair valuation is required under IFRS are determined by the use of current market bid prices for exchange-quoted investments, by using quotations from independent third parties such as brokers and pricing services, or by using appropriate valuation techniques. Fair value is the amount for which an asset could be exchanged or a liability settled in an arm's length transaction.

To provide further information on the approach used to determine and measure the fair value of certain assets and liabilities, the following fair value hierarchy categorisation has been used. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

Level 1 - quoted prices (unadjusted) in active markets for identical assets and liabilities

Level 1 principally includes exchange-listed equities, mutual funds with quoted prices, exchange-traded derivatives such as futures and options, and national government bonds, unless there is evidence that trading in a given instrument is so infrequent that the market could not be considered active. It also includes other financial instruments where there is clear evidence that the year-end valuation is based on a traded price in an active market.

Level 2 - inputs other than quoted prices included within level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices)

Level 2 principally includes corporate bonds and other non-national government debt securities which are valued using observable inputs, together with over-the-counter derivatives such as forward exchange contracts and non-quoted investment funds valued with observable inputs. It also includes investment contract liabilities without DPF that are valued using observable inputs.

Level 3 - significant inputs for the asset or liability are not based on observable market data (unobservable inputs)

Level 3 principally includes investments in private equity funds, directly held investment properties and investments in property funds which are exposed to bespoke properties or risks and investments which are internally valued or subject to a significant number of unobservable assumptions. It also includes debt securities which are rarely traded or traded only in privately negotiated transactions and hence where it is difficult to assert that their valuations have been based on observable market data.

13 Fair value methodology (continued)

13.2 Fair value hierarchy for assets measured at fair value in the consolidated statement of financial position

The tables below present the Group's assets measured at fair value by level of the fair value hierarchy for each component of business.

	As at 31 December 2020			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
With-profits:				
Investment property	—	—	17,167	17,167
Loans	—	—	1,443	1,443
Derivative assets	112	4,698	—	4,810
Equity securities and pooled investment funds	43,920	3,560	7,562	55,042
Debt securities	19,443	30,563	5,637	55,643
Total with-profits	63,475	38,821	31,809	134,105
Unit-linked:				
Investment property	—	—	409	409
Derivative assets	3	5	—	8
Equity securities and pooled investment funds	11,941	349	889	13,179
Debt securities	2,633	5,868	5	8,506
Total unit-linked	14,577	6,222	1,303	22,102
Annuity and other long-term business:				
Investment property	—	—	1,530	1,530
Loans	—	—	1,777	1,777
Derivative assets	—	778	—	778
Equity securities and pooled investment funds	2	—	2	4
Debt securities	3,141	10,191	6,942	20,274
Total annuity and other long-term business	3,143	10,969	10,251	24,363
Other:				
Derivative assets	—	109	—	109
Equity securities and pooled investment funds	189	—	5	194
Debt securities	801	215	—	1,016
Total other	990	324	5	1,319
Group:				
Investment property	—	—	19,106	19,106
Loans	—	—	3,220	3,220
Derivative assets	115	5,590	—	5,705
Equity securities and pooled investment funds	56,052	3,909	8,458	68,419
Debt securities	26,018	46,837	12,584	85,439
Total assets at fair value	82,185	56,336	43,368	181,889

13 Fair value methodology (continued)

13.2 Fair value hierarchy for assets measured at fair value in the consolidated statement of financial position (continued)

	As at 31 December 2019			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
With-profits:				
Investment property	—	—	17,039	17,039
Loans	—	—	1,602	1,602
Derivative assets	67	3,225	—	3,292
Equity securities and pooled investment funds	48,532	2,219	7,154	57,905
Debt securities	21,913	28,430	5,008	55,351
Total with-profits	70,512	33,874	30,803	135,189
Unit-linked:				
Investment property	—	—	453	453
Derivative assets	3	3	—	6
Equity securities and pooled investment funds	12,968	352	987	14,307
Debt securities	2,382	5,908	—	8,290
Total unit-linked	15,353	6,263	1,440	23,056
Annuity and other long-term business:				
Investment property	—	—	1,644	1,644
Loans	—	—	1,737	1,737
Derivative assets	—	603	—	603
Equity securities and pooled investment funds	27	—	2	29
Debt securities	4,361	9,810	6,207	20,378
Total annuity and other long-term business	4,388	10,413	9,590	24,391
Other:				
Derivative assets	—	61	—	61
Equity securities and pooled investment funds	129	—	18	147
Debt securities	880	535	—	1,415
Total other	1,009	596	18	1,623
Group:				
Investment property	—	—	19,136	19,136
Loans	—	—	3,339	3,339
Derivative assets	70	3,892	—	3,962
Equity securities and pooled investment funds	61,656	2,571	8,161	72,388
Debt securities	29,536	44,683	11,215	85,434
Total assets at fair value	91,262	51,146	41,851	184,259

13 Fair value methodology (continued)

13.3 Fair value hierarchy for liabilities measured at fair value in the consolidated statement of financial position

The tables below present the Group's liabilities measured at fair value by level of the fair value hierarchy:

	As at 31 December 2020			
	Level 1	**Level 2**	**Level 3**	**Total**
	£m	**£m**	**£m**	**£m**
Investment contract liabilities without discretionary participation features	**—**	**15,547**	**—**	**15,547**
Third-party interest in consolidated funds	**7,972**	**3,886**	**1,407**	**13,265**
Subordinated liabilities and other borrowings	**—**	**—**	**1,301**	**1,301**
Derivative liabilities	**37**	**3,423**	**—**	**3,460**
Accruals, deferred income and other liabilities	**—**	**—**	**409**	**409**
Total liabilities at fair value	**8,009**	**22,856**	**3,117**	**33,982**

	As at 31 December 2019			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Investment contract liabilities without discretionary participation features	—	15,651	—	15,651
Third-party interest in consolidated funds	6,897	3,611	1,135	11,643
Subordinated liabilities and other borrowings	—	—	1,422	1,422
Derivative liabilities	32	2,172	—	2,204
Accruals, deferred income and other liabilities	—	—	390	390
Total liabilities at fair value	6,929	21,434	2,947	31,310

14 Contingencies and related obligations

14.1 Litigation, tax and regulatory matters

In addition to the regulatory provisions held in relation to annuity past sales practices and the litigation in respect of portfolio dividend tax, the Group is involved in various litigation and regulatory issues. While the outcome of such litigation and regulatory issues cannot be predicted with certainty, the Directors believe that their ultimate outcome will not have a material adverse effect on the Group's financial condition, results of operations, or cash flows.

14.2 Guarantees

Guarantee funds provide for payments to be made to policyholders on behalf of insolvent life insurance companies and are financed by payments assessed on solvent insurance companies based on location, volume and types of business. The estimated reserve for future guarantee fund assessments is not significant, and adequate reserves are available for all anticipated payments for known insolvencies.

M&G plc has acted as a guarantor for the 10 Fenchurch Avenue lease between Saxon Land B.V. and M&G Corporate Services Limited.

M&G plc has acted as a guarantor for M&G Regulated Entity Holding Company Limited to Royal London for any obligations under the transaction documents for the purchase of Ascentric. This guarantee will remain in place for a year following completion on 1 September 2020.

The Group has also provided other guarantees and commitments to third parties entered into in the normal course of business, but the Group does not consider that the amounts involved are significant.

14.3 Support for the With-Profits Fund by shareholders

PAC is liable to meet its obligations to with-profits policyholders even if the assets of the with-profits sub-funds are insufficient to do so. The assets, represented by the unallocated surplus of the With-Profits Fund, in excess of amounts expected to be paid for future terminal bonuses and related shareholder transfers ("the excess assets") in the with-profits sub-funds could be materially depleted over time by, for example, a significant or sustained equity market downturn. In the unlikely circumstance that the depletion of the excess assets within the with-profits sub-funds was such that the Group's ability to satisfy policyholders' reasonable expectations was adversely affected, or otherwise not able to meet its obligations to treat the with-profits policyholders fairly, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders' funds to the with-profits sub-funds to provide financial support.

The following matters are of relevance with respect to the With-Profits Fund:

14.3.1 Pension mis-selling review

The Pensions mis-selling review covers customers who were sold personal pensions between 29 April 1988 and 30 June 1994, and who were advised to transfer out, not join, or opt out of their employer's Defined Benefit Pension Scheme. During the initial review some customers were issued with guarantees that redress will be calculated on retirement or transfer of their policies. The provision continues to cover these customers.

Whilst PAC believed it met the requirements of the FSA (the UK insurance regulator) to issue offers of redress to all impacted customers by 30 June 2002, there is a population of customers who, whilst an attempt was made at the time to invite them to participate in the review, may not have received their invitation. These customers have been re-engaged, to ensure they have the opportunity to take part in the review. The provision also covers this population. Currently, a provision amounting to £303m as at 31 December 2020 (2019: £420m) is being held in relation to this within insurance contract liabilities.

14 Contingencies and related obligations (continued)

14.3 Support for the With-Profits Fund by shareholders (continued)

The key assumptions underlying the provisions are:

- average cost of redressal per customer;
- proportion of provision (reserve rate) held for soft close cases (where all reasonable steps have been taken to contact the customer but the customer has not engaged with the review).

Sensitivities of the value of the provision to a change in assumptions are as follows:

		As at 31 December	
		2020	2019
Assumption	**Change in assumption**	**£m**	£m
Average cost of redressal	increase/decrease by 10%	**+/- 10**	+/- 20
Reserve rate for soft closed cases	increase/decrease by 10%	**+/- 30**	+/- 30

Costs arising from this review are met by the excess assets of the with-profits sub-fund and hence have not been charged to the asset shares used in the determination of policyholder bonus rates. An assurance was given that these deductions from excess assets would not impact PAC's bonus or investment policy for policies within the with-profits sub-funds that were in force at 31 December 2003. This assurance does not apply to new business since 1 January 2004. In the unlikely event that such deductions would affect the bonus or investment policy for the relevant policies, the assurance provides that support would be made available to the sub-fund from PAC's shareholder resources for as long as the situation continued, so as to ensure that PAC's policyholders were not disadvantaged. PAC's comfort in its ability to make such support available was supported by related intra-group arrangements between Prudential plc and PAC, which formalised the circumstances in which capital support would be made available to PAC by Prudential plc. These intra-group arrangements terminated on 21 October 2019, following the demerger of M&G plc from Prudential plc, at which time intra-group arrangements formalising the circumstances in which M&G plc would make capital support available to PAC became effective.

14.3.2 With-profits options and guarantees

Certain policies within the With-Profits Fund give potentially valuable guarantees to policyholders, or options to change policy benefits which can be exercised at the policyholders' discretion. These options and guarantees are valued as part of the policyholder liabilities. Please refer to Note 11.1.1 for further details on these options and guarantees.

15 Post balance sheet events

On 5 March 2021, M&G FA Limited, a wholly owned subsidiary of the Group agreed to acquire a further 0.13% of the share capital of Prudential Portfolio Managers (South Africa) (Pty) Ltd ('PPMSA') for a cash consideration of £0.2m. The transaction is expected to complete by mid-2021, subject to necessary regulatory, exchange control and competition approvals in South Africa and Namibia.

The transaction would result in M&G FA Limited's holding in PPMSA to increase from 49.99% to 50.12%. The Group currently accounts for the investment as an associate using the equity method. Following the transaction, the Group will control PPMSA and it will be consolidated in the Group financial statements.

Furthermore, it is intended that M&G Group Limited will provide a guarantee in respect of an existing bank facility of the transaction counterparty amounting to ZAR 220m, which will be secured against a further 7% shareholding that the seller retains in PPMSA.

There are no other post balance sheet events to report.

Supplementary information

Overview of the Group's key performance measures

The Group measures its financial performance using a number of key performance measures ("KPM"). Two of these measures, referred to as alternative performance measures ("APM"), are derived from the financial statements prepared in accordance with the IFRS financial reporting framework or the Solvency II requirements, but are not defined under IFRS or Solvency II. The APMs are used to complement and not to substitute the disclosures prepared in accordance with IFRS and Solvency II, and provide additional information on the long-term performance of the Group.

All information included in this section is unaudited.

The Group's KPMs are summarised below, along with which of these measures are considered APMs by the Group. All of the measures in this section are presented on a continuing operations basis.

Key performance measure	Type	Definition
IFRS profit after tax	KPM	IFRS profit after tax demonstrates to our shareholders the financial performance of the Group during the year on an IFRS basis.
Adjusted operating profit before tax	APM, KPM	Adjusted operating profit before tax is the Group's non-GAAP alternative performance measure, which complements IFRS profit before tax. Certain adjustments that are considered to be non-recurring or strategic, or due to short-term movements not reflective of longer-term performance are made to IFRS profit before tax. Adjustments are in respect of short-term fluctuations in investment returns, costs associated with fundamental one-off Group-wide restructuring and transformation, profits or losses arising on corporate transactions and profit/(loss) before tax from discontinued operations. The adjusted operating profit methodology is described in Note 3.2, along with a reconciliation of adjusted operating profit before tax to IFRS profit after tax.
Savings and Asset Management net client flows	KPM	Savings and Asset Management net client flows represent gross inflows less gross outflows. Gross inflows are new funds from clients and customers. Gross outflows are money withdrawn by customer and clients during the period.
Assets under management and/or administration ("AUMA")	KPM	Closing AUMA represents the total market value of all financial assets managed, administered or advised on behalf of customers and clients at the end of each period. Assets managed by the Group include those managed on behalf of our individual customers and institutional and retail clients. Assets administered by the Group includes assets which we provide investment management services for, in addition to assets we administer where the customer has elected to invest in a third-party investment manager. Assets under advice are advisory portfolios where clients receive investment recommendations such as Strategic Asset Allocation & model portfolios but retain discretion over executing the advice.
Shareholder Solvency II coverage ratio	APM, KPM	The regulatory Solvency II capital position considers the Group's overall own funds and solvency capital requirement ("SCR"). The shareholder Solvency II coverage ratio is the ratio of own funds to SCR, excluding the contribution to own funds and SCR from the Group's ring-fenced With-Profits Fund. The shareholder Solvency II coverage ratio is described in the "Solvency II capital position" section.
Total capital generation	KPM	Surplus capital is the amount by which own funds exceed SCR under Solvency II. Total capital generation is the total change in Solvency II surplus capital before dividends and capital movements, and capital generated from discontinued operations.
Operating capital generation	KPM	Operating capital generation is the total capital generation before tax, adjusted to exclude market movements relative to those expected under long-term assumptions and to remove other non-operating items, including shareholder restructuring and other costs.

Supplementary information (continued)

Adjusted operating profit before tax

(i) Adjusted operating profit/(loss) before tax by segment

	For the year ended 31 December							
	Savings and Asset Management		Heritage		Corporate Centre		Total	
	2020	2019	**2020**	2019	**2020**	2019	**2020**	2019
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
Fee based revenues	**1,146**	1,191	**74**	96	**—**	—	**1,220**	1,287
Annuity margin	**—**	—	**438**	458	**—**	—	**438**	458
With-profits shareholder transfer net of hedging gains/(losses)	**44**	55	**207**	187	**—**	—	**251**	242
Adjusted operating income	**1,190**	1,246	**719**	741	**—**	—	**1,909**	1,987
Adjusted operating expenses	**(840)**	(817)	**(79)**	(87)	**(101)**	(59)	**(1,020)**	(963)
Other shareholder (loss)/profit	**(28)**	30	**59**	98	**(142)**	(18)	**(111)**	110
Share of profit from joint ventures and associates [i]	**10**	15	**—**	—	**—**	—	**10**	15
Adjusted operating profit/(loss) before tax	**332**	474	**699**	752	**(243)**	(77)	**788**	1,149

[i] Excludes adjusted operating profit before tax from joint ventures in the With-Profits Fund.

(ii) Adjusted operating profit/(loss) before tax by segment and source

	Savings and Asset management			Heritage			Corporate Centre
	Asset Management	With-profits	Other	Annuities	With-profits	Other	Other
For the year ended 31 December 2020	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Asset Management fee based revenues	**988**	**—**	**—**	**—**	**—**	**—**	**—**
Other fee based revenues	**—**	**—**	**158**	**—**	**—**	**74**	**—**
Fee based revenues	**988**	**—**	**158**	**—**	**—**	**74**	**—**
Annuity margin	**—**	**—**	**—**	**438**	**—**	**—**	**—**
With-profits shareholder transfer net of hedging gains/(losses)	**—**	**44**	**—**	**—**	**207**	**—**	**—**
Adjusted operating income	**988**	**44**	**158**	**438**	**207**	**74**	**—**
Asset Management operating expenses	**(672)**	**—**	**—**	**—**	**—**	**—**	**—**
Other operating expenses	**—**	**—**	**(168)**	**—**	**—**	**(79)**	**(101)**
Adjusted operating expenses	**(672)**	**—**	**(168)**	**—**	**—**	**(79)**	**(101)**
Other shareholder (loss)/profit	**—**	**—**	**(28)**	**—**	**—**	**59**	**(142)**
Share of profit from joint ventures and associates	**—**	**—**	**10**	**—**	**—**	**—**	**—**
Adjusted operating profit/(loss) before tax	**316**	**44**	**(28)**	**438**	**207**	**54**	**(243)**

Supplementary information (continued)

Adjusted operating profit before tax (continued)

(ii) Adjusted operating profit before tax by segment and source

	Savings and Asset management			Heritage			Corporate Centre
	Asset Management	With-profits	Other	Annuities	With-profits	Other	Other
For the year ended 31 December 2019	£m	£m	£m	£m	£m	£m	£m
Asset Management fee based revenues	1,033	—	—	—	—	—	—
Other fee based revenues	—	—	158	—	—	96	—
Fee based revenues	1,033	—	158	—	—	96	—
Annuity margin	—	—	—	458	—	—	—
With-profits shareholder transfer net of hedging gains/(losses)	—	55	—	—	187	—	—
Adjusted operating income	1,033	55	158	458	187	96	—
Asset management operating expenses	(652)	—	—	—	—	—	—
Other operating expenses	—	—	(165)	—	—	(87)	(59)
Adjusted operating expenses	(652)	—	(165)	—	—	(87)	(59)
Other shareholder profit/(loss)	—	—	30	—	—	98	(18)
Share of profit from joint ventures and associates	—	—	15	—	—	—	—
Adjusted operating profit/(loss) before tax	381	55	38	458	187	107	(77)

Adjusted operating profit before tax arising from annuity margin is further analysed in the table below:

	For the year ended 31 December	
	2020	2019
	£m	£m
Return on excess assets and margin release	**188**	216
Asset trading and other optimisation	**59**	110
Longevity assumption changes	**217**	126
Mismatching profits/ (losses) [i]	**38**	55
Other assumption and model changes [ii]	**(52)**	32
Experience variances and model improvements	**19**	4
Other provisions and reserves	**(31)**	(85)
Annuity margin	**438**	458

[i] Mismatching profits/losses of £38m for the year ended 31 December 2020 (2019: £55m) relates to short-term mismatches between the value of annuity liabilities and the long-term assets backing these liabilities due to the impact of market movements.

[ii] Other assumptions and model changes of £(52)m for the year ended 31 December 2020 (2019: £32m) include assumption changes other than those relating to longevity, including the impact of expense assumption changes and the impact of improvements to models.

Adjusted operating profit before tax arising from other Savings and Asset Management is further analysed in the table below:

	For the year ended 31 December	
	2020	2019
	£m	£m
International business [i]	**20**	42
Investment income [ii]	**5**	25
Other	**(53)**	(29)
Other Savings and Asset Management	**(28)**	38

[i] International business includes our share of profits from our asset management associate in South Africa and profits from our European savings businesses.

[ii] Investment income includes income arising in Asset Management, primarily in respect of seed capital investments.

Supplementary information (continued)

Adjusted operating profit before tax (continued)

(iii) Reconciliation of adjusted operating profit before tax to IFRS profit after tax from continuing operations

	For the year ended 31 December	
	2020	2019
	£m	£m
Adjusted operating profit before tax	**788**	1,149
Short-term fluctuations in investment returns	**678**	298
Profit on disposal of business and corporate transactions	**—**	53
Restructuring and other costs	**(73)**	(198)
IFRS profit attributable to non-controlling interests	**4**	3
IFRS profit before tax attributable to equity holders from continuing operations	**1,397**	1,305
Tax charge attributable to equity holders from continuing operations	**(255)**	(240)
IFRS profit after tax attributable to equity holders from continuing operations	**1,142**	1,065

Assets under management and administration ("AUMA") and net client flows

(i) Detailed AUMA and net client flows

	For the year ended 31 December 2020					
	As at 31 December 2019	**Gross inflows**	**Gross outflows**	**Net client flows**	**Market/ Other movements**	**As at 31 December 2020**
	£bn	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**
Institutional Asset Management	**76.8**	**13.0**	**(7.9)**	**5.1**	**3.6**	**85.5**
Retail Asset Management	**74.9**	**15.0**	**(27.1)**	**(12.1)**	**1.4**	**64.2**
Retail Savings	**63.5**	**6.8**	**(6.4)**	**0.4**	**17.9**	**81.8**
of which: PruFund	**53.8**	**5.2**	**(4.8)**	**0.4**	**1.3**	**55.5**
Other	**0.7**	**—**	**—**	**—**	**0.1**	**0.8**
Total Savings and Asset Management [ii]	**215.9**	**34.8**	**(41.4)**	**(6.6)**	**23.0**	**232.3**
Shareholder annuities	**35.5**	**—**	**(1.8)**	**(1.8)**	**1.6**	**35.3**
Traditional with-profits	**84.8**	**0.3**	**(5.0)**	**(4.7)**	**4.2**	**84.3**
Other	**13.7**	**0.1**	**(0.2)**	**(0.1)**	**0.5**	**14.1**
Total Heritage	**134.0**	**0.4**	**(7.0)**	**(6.6)**	**6.3**	**133.7**
Corporate assets	**1.6**	**—**	**—**	**—**	**(0.4)**	**1.2**
Group total	**351.5**	**35.2**	**(48.4)**	**(13.2)**	**28.9**	**367.2**

	For the year ended 31 December 2019					
	As at 31 December 2018	Gross inflows	Gross outflows	Net client flows	Market/ Other movements	As at 31 December 2019
	£bn	£bn	£bn	£bn	£bn	£bn
Institutional Asset Management	70.5	10.7	(10.8)	(0.1)	6.4	76.8
Retail Asset Management [i]	76.4	21.2	(28.6)	(7.4)	5.9	74.9
Retail Savings	50.6	11.0	(4.8)	6.2	6.7	63.5
of which: PruFund	43.0	10.2	(3.8)	6.4	4.4	53.8
Other	0.2	—	—	—	0.5	0.7
Total Savings and Asset Management [ii]	197.7	42.9	(44.2)	(1.3)	19.5	215.9
Shareholder annuities	24.9	0.2	(2.3)	(2.1)	12.7	35.5
Traditional with-profits	84.6	0.6	(5.7)	(5.1)	5.3	84.8
Other	14.0	(0.2)	(0.2)	(0.4)	0.1	13.7
Total Heritage	123.5	0.6	(8.2)	(7.6)	18.1	134.0
Corporate assets	—	—	—	—	1.6	1.6
Group total	321.2	43.5	(52.4)	(8.9)	39.2	351.5

i Approx. £3bn of the gross inflows and gross outflows in Retail Asset Management were in relation to the establishment of the Luxembourg SICAV fund range, in which the Spanish Traspasos regime was used to migrate non-Sterling assets from OEICS to newly created SICAVs, and due to the reregistration of assets as a result of M&A in the GFI (Global Financial Institutions) space.

ii Included in total AUMA of £232.3 billion (2019: £215.9 billion) is £6.5 billion (2019: £6.4 billion) of assets under advice.

Supplementary information (continued)

Assets under management and administration ("AUMA") and net client flows (continued)

(ii) AUMA by asset class

	For the year ended 31 December 2020								
	On balance sheet AUMA [i]					External AUMA			Total
	With-profits	**Unit-linked**	**Shareholder -backed annuities and other long-term business**	**Corporate assets**	**Total on balance sheet AUMA**	**Retail**	**Institutional**	**Total external AUMA**	**Total AUMA**
	£bn	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**
Investment property	**12.4**	**0.4**	**1.5**	**—**	**14.3**	**1.5**	**12.9**	**14.4**	**28.7**
Reinsurance assets	**—**	**0.1**	**11.6**	**—**	**11.7**	**—**	**—**	**—**	**11.7**
Loans	**1.6**	**—**	**2.3**	**—**	**3.9**	**—**	**11.5**	**11.5**	**15.4**
Derivatives [ii]	**2.7**	**—**	**(0.3)**	**—**	**2.4**	**(0.1)**	**(0.2)**	**(0.3)**	**2.1**
Equity securities and pooled investment funds	**65.1**	**11.2**	**—**	**—**	**76.3**	**25.7**	**6.1**	**31.8**	**108.1**
Deposits	**13.4**	**1.0**	**1.2**	**—**	**15.6**	**—**	**—**	**—**	**15.6**
Debt Securities	**43.4**	**2.8**	**20.2**	**1.0**	**67.4**	**35.0**	**52.7**	**87.7**	**155.1**
of which Corporate	**31.7**	**1.7**	**14.1**	**1.0**	**48.5**	**20.2**	**32.2**	**52.4**	**100.9**
of which Government	**9.0**	**1.0**	**5.3**	**—**	**15.3**	**13.7**	**12.2**	**25.9**	**41.2**
of which ABS	**2.7**	**0.1**	**0.8**	**—**	**3.6**	**1.1**	**8.3**	**9.4**	**13.0**
Cash and cash equivalents	**3.6**	**0.2**	**1.0**	**0.9**	**5.7**	**2.1**	**2.5**	**4.6**	**10.3**
Other	**1.0**	**0.1**	**0.2**	**—**	**1.3**	**—**	**—**	**—**	**1.3**
Other AUMA									**18.9**
Total [iii]	**143.2**	**15.8**	**37.7**	**1.9**	**198.6**	**64.2**	**85.5**	**149.7**	**367.2**

i On balance sheet AUMA does not consolidated funds included in the segmented statement of financial position by business type.

ii Derivatives assets are shown net of derivative liabilities.

iii Included in total AUMA of £367.2 billion (2019: £351.5 billion) is £6.5 billion (2019: £6.4 billion)of assets under advice.

	For the year ended 31 December 2019								
	On balance sheet AUMA [i]					External AUMA			Total
	With-profits	Unit-linked	Shareholder-backed annuities and other long-term business	Corporate assets	Total on balance sheet AUMA	Retail	Institutional	Total external AUMA	Total AUMA
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Investment property	10.7	0.5	1.6	—	12.8	1.8	12.4	14.2	27.0
Reinsurance assets	—	0.1	11.8	—	11.9	—	—	—	11.9
Loans	1.6	—	2.3	—	3.9	—	10.9	10.9	14.8
Derivatives [ii]	2.6	(0.1)	(0.5)	—	2.0	0.2	(1.0)	(0.8)	1.2
Equity securities and pooled investment funds	61.8	11.3	—	—	73.1	31.7	4.9	36.6	109.7
Deposits	11.9	1.1	0.9	—	13.9	1.8	3.5	5.3	19.2
Debt Securities	48.2	2.8	21.3	1.4	73.7	39.0	45.9	84.9	158.6
of which Corporate	36.9	1.9	14.8	1.4	55.0	21.4	29.7	51.1	106.1
of which Government	7.6	0.8	5.7	—	14.1	16.3	6.8	23.1	37.2
Of which ABS	3.7	0.1	0.8	—	4.6	1.3	9.4	10.7	15.3
Cash and Cash equivalents	3.1	0.2	0.8	—	4.1	0.4	0.2	0.6	4.7
Other	1.1	0.1	0.2	1.0	2.4	—	—	—	2.4
Other AUMA									2.0
Total [iii]	141.0	16.0	38.4	2.4	197.8	74.9	76.8	151.7	351.5

Supplementary information (continued)

Assets under management and administration ("AUMA") and net client flows (continued)

(iii) AUMA by geography

AUMA by geography is based on the country of the underlying customer or client.

	For the year ended 31 December	
	2020	2019
	£bn	£bn
UK	**306.9**	287.0
Europe	**44.6**	49.0
Asia-Pacific	**9.6**	8.3
Middle East and Africa	**5.2**	6.1
Americas	**0.9**	1.1
Total AUMA [i]	**367.2**	351.5

[i] Included in total AUMA of £367.2 billion (2019: £351.5 billion) is £6.5 billion (2019: £6.4 billion) of assets under advice.

Solvency II capital position

Solvency II overview

The Group is supervised as an insurance group by the Prudential Regulation Authority. Individual insurance undertakings within the Group are also subject to the supervision of the Prudential Regulation Authority (or other supervisory authorities) on a solo basis under Solvency II.

The Solvency II surplus represents the aggregated capital (own funds) held by the Group less the SCR. Own funds is the Solvency II measure of capital available to meet losses, and is based on the assets less liabilities of the Group, subject to certain restrictions and adjustments. The SCR is calculated using the Group's Internal Model, which calculates the SCR as the 99.5th percentile (or 1-in-200) worst outcome over the coming year, out of 100,000 equally likely scenarios, allowing for the dependency between the risks the business is exposed to.

Estimated reconciliation of IFRS shareholders' equity to Group Solvency II own funds

	As at 31 December	
	2020	2019
	£bn	£bn
IFRS shareholders' equity	**5.6**	5.1
Add back unallocated surplus of the With-Profits Fund	**15.6**	16.1
Deduct goodwill and intangible assets	**(1.3)**	(1.3)
Net impact of valuing policyholder liabilities and reinsurance assets on Solvency II basis	**0.3**	0.3
Impact of introducing Solvency II risk margin (net of transitional measures)	**(1.5)**	(1.5)
Impact of measuring assets and liabilities in line with Solvency II principles	**(0.1)**	(0.1)
Recognise own shares	**0.1**	—
Other	**(0.1)**	0.1
Solvency II excess of assets over liabilities	**18.6**	18.7
Subordinated debt capital	**4.0**	3.8
Ring-fenced fund restrictions	**(7.0)**	(7.6)
Deduct own shares	**(0.1)**	—
Solvency II eligible own funds	**15.5**	14.9

The key items in the reconciliation are explained below:

- Unallocated surplus of the With-Profits Fund: this amount is treated as a liability under IFRS, but considered surplus assets under Solvency II.
- Goodwill and intangible assets: these assets are not recognised under Solvency II as they are not readily available to meet emerging losses.
- Policyholder liability and reinsurance asset valuation differences: there are significant differences in the valuation of technical provisions between IFRS and Solvency II. The most material differences relate to the exclusion of prudent margins in longevity assumptions under Solvency II, and also the use of different discount rates, both in relation to the valuation of annuity liabilities.
- Solvency II risk margin (net of transitional measures): the risk margin is a significant component of technical provisions required to be held under Solvency II. These additional requirements are partially mitigated by transitional measures which allow the impact to be gradually introduced over a period of 16 years from the introduction of Solvency II on 1 January 2016.
- Subordinated debt capital: subordinated debt is treated as a liability in the IFRS financial statements and in determining the excess of assets over liabilities in the Solvency II balance sheet. However, for Solvency II own funds, the debt can be treated as capital.
- Ring-fenced fund restrictions: any excess of the own funds over the solvency capital requirement from the With-Profits Fund is restricted as these amounts are not available to meet losses elsewhere in the Group.

Supplementary information (continued)

Solvency II capital position (continued)

Composition of own funds

The Group's total estimated and unaudited own funds are analysed by Tier as follows:

	As at 31 December	
	2020	2019
	£bn	£bn
Tier 1 (unrestricted)	**11.4**	11.1
Tier 1 (restricted)	**—**	—
Tier 2	**4.0**	3.8
Tier 3	**0.1**	—
Total own funds	**15.5**	14.9

The Group's Tier 2 capital consists of subordinated debt instruments. The terms of these instruments allow them to be treated as capital for the purposes of Solvency II. The instruments were originally issued by Prudential plc, and subsequently substituted to the Company, as permitted under the terms and conditions of each applicable instrument, prior to demerger. The details of the Group's subordinated liabilities are shown in Note 12. The Solvency II value of the debt differs to the IFRS carrying value due to a different basis of measurement on the respective balance sheets.

The Group's Tier 3 capital of £0.1bn (2019: £nil) relates to deferred tax asset balances.

Estimated shareholder view of the Solvency II capital position

The Group focuses on a shareholder view of the Solvency II capital position, which is considered to provide a more relevant reflection of the capital strength of the Group.

The estimated and unaudited shareholder Solvency II capital position for the Group is shown below:

	As at 31 December	
	2020	2019
	£bn	£bn
Shareholder Solvency II own funds	**10.6**	10.3
Shareholder Solvency II SCR	**(5.8)**	(5.8)
Solvency II surplus	**4.8**	4.5
Shareholder Solvency II coverage ratio [i]	**182 %**	176 %

[i] Shareholder Solvency II coverage ratio has been calculated using unrounded figures.

The Group's shareholder Solvency II capital position excludes the contribution to own funds and SCR from the ring-fenced With-Profits Fund. Further information on the ring-fenced With-Profits Fund's capital position is provided in the ''Estimated With-Profits Fund view of the Solvency II capital position" section.

In accordance with the Solvency II requirements, these results include:

- A SCR which has been calculated using the Group's Internal Model.
- Transitional measures, which are presented assuming a recalculation as at the valuation date, using management's estimate of the impact of operating and market conditions. As at 31 December 2020, the recalculated transitional measures do not align to the latest approved regulatory position and therefore the estimated and unaudited Solvency II capital position will differ to the position disclosed in the formal regulatory Quantitative Reporting Templates and Group Solvency and Financial Condition Report.
- A matching adjustment for non-profit annuities, based on approval from the Prudential Regulation Authority.
- M&G Group Limited and other undertakings carrying out financial activities consolidated under local sectoral or notional sectoral capital requirements.

Supplementary information (continued)

Solvency II capital position (continued)

Breakdown of the shareholder Solvency II SCR by risk type

Group shareholder undiversified risk capital	As at 31 December 2020 £bn	2019 £bn
Equity	**1.5**	1.4
Property	**0.9**	0.9
Interest rate	**0.4**	0.4
Credit	**3.5**	3.8
Currency	**0.9**	0.8
Longevity	**2.1**	1.6
Lapse	**0.2**	0.2
Operational and expense	**1.6**	1.5
Sectoral [i]	**0.5**	0.5
Total undiversified	**11.6**	11.1
Diversification, deferred tax, and other	**(5.8)**	(5.3)
Shareholder SCR	**5.8**	5.8

[i] Includes entities included within the Group's Solvency II capital position on a sectoral or notional sectoral basis, the most material of which is M&G Group Limited.

Sensitivity analysis of the Group's Solvency II surplus and shareholder Solvency II coverage ratio

The estimated sensitivity of the Group's Solvency II surplus and shareholder Solvency II coverage ratio to significant changes in market conditions are shown below. All sensitivities are presented after an assumed recalculation of transitional measures.

	As at 31 December 2020		As at 31 December 2019	
	Surplus £bn	Shareholder coverage ratio %	Surplus £bn	Shareholder coverage ratio %
Base (as reported)	**4.8**	**182 %**	4.5	176 %
20% instantaneous fall in equity markets	**4.3**	**175 %**	4.0	170 %
20% instantaneous fall in property markets	**4.4**	**175 %**	4.1	171 %
50 bp reduction in interest rates	**4.6**	**173 %**	4.4	170 %
100 bp widening in credit spreads	**4.3**	**178 %**	4.0	172 %
20% credit asset downgrade [i]	**4.4**	**175 %**	4.2	170 %

[i] Average impact of one full letter downgrade across 20% of assets exposed to credit risk.

Estimated With-Profits Fund view of the Solvency II capital position

The With-Profits Fund view of the Solvency II capital position represents the standalone capital strength of the Group's ring-fenced With-Profits Fund. This view of Solvency II capital takes into account the assets, liabilities, and risk exposures within the ring-fenced With-Profits Fund, which includes the WPSF, SAIF and DCPSF.

The estimated and unaudited Solvency II capital position for the Group under the With-Profits Fund view is shown below:

	As at 31 December 2020 £bn	2019 £bn
With-Profits Fund Solvency II own funds	**11.9**	12.2
With-Profits Fund Solvency II SCR	**(4.9)**	(4.6)
With-Profits Fund Solvency II surplus	**7.0**	7.6
With-Profits Fund Solvency II coverage ratio [i]	**242 %**	267 %

[i] With-Profits Fund Solvency II coverage ratio has been calculated using unrounded figures.

Estimated regulatory view of the Solvency II capital position

The estimated and unaudited Solvency II capital position for the Group under the "regulatory" view is shown below:

	As at 31 December 2020 £bn	2019 £bn
Solvency II own funds	**15.5**	14.9
Solvency II SCR	**(10.7)**	(10.4)
Solvency II surplus	**4.8**	4.5
Solvency II coverage ratio [i]	**144 %**	143 %

[i] Solvency II coverage ratio has been calculated using unrounded figures.

Supplementary information (continued)

Capital generation

The level of surplus capital is an important financial consideration for the Group. Capital generation measures the change in surplus capital during the reporting period, and is therefore considered a key measure for the Group. It is integral to the running and monitoring of the business, capital allocation and investment decisions, and ultimately the Group's dividend policy.

The overall change in Solvency II surplus capital over the period is analysed as follows:

Total capital generation is the total change in Solvency II surplus capital before dividends and capital movements and capital generated from discontinued operations.

Operating capital generation is the total capital generation before tax, adjusted to exclude market movements relative to those expected under long-term assumptions and to remove other non-operating items, including shareholder restructuring and other costs as defined under adjusted operating profit before tax. It has two components:

i. Underlying capital generation, which includes: the underlying expected surplus capital from the in-force life insurance business; the change in surplus capital as a result of writing new life insurance business; the adjusted operating profit before tax and associated regulatory capital movements from Asset Management; and other items, including head office expenses and debt interest costs.

ii. Other operating capital generation, which includes non-market related experience variances, assumption changes, modelling changes and other movements.

Dividends and capital movements primarily represent external dividends paid to shareholders and changes to the capital structure of the Group, such as issuing or repaying debt instruments. Also included within capital movements are the Solvency II impact of the Group's share-based payment awards over and above the amount expensed in respect of those awards, and the surplus utilised or generated from transactions relating to the acquisition of business as defined by IFRS.

The expected surplus capital from the in-force life insurance business is calculated on the assumption of real-world investment returns, which are determined by reference to the risk-free rate plus a risk premium based on the mix of assets held for the relevant business. For with-profits business, the assumed average return was 4.30% for the year ended 31 December 2020 and (2019: 4.28%). For annuity business, the assumed average return on assets backing capital was 2.09% for the year ended 31 December 2020 (2019 : 2.44%).

The Group's capital generation results in respect of the years ended 31 December 2020 and 31 December 2019 are shown below alongside a reconciliation of the total movement in the Group's Solvency II surplus. The reconciliation is presented showing the impact on the shareholder Solvency II own funds and SCR, which excludes the contribution to own funds and SCR from the Group's ring-fenced With-Profits Fund. The shareholder Solvency II capital position, and how this reconciles to the regulatory capital position, is described in detail in the previous section of this supplementary information.

The capital generation results and comparatives have adopted a basis of preparation consistent with the IFRS consolidated financial statements. In particular:

- The capital generated from the Prudential Vietnam Finance Company Limited and the capital impact arising on disposal of this entity during 2019, have been reflected within capital generated from discontinued operations.
- Merger accounting principles have been applied as described in the Note 1.1 of the IFRS financial statements, meaning that PruCap and its subsidiaries, and 10FA India Private Limited have been included within the Group's capital generation results from 1 January 2019. The movement in capital attributable to the discontinued corporate treasury activity of PruCap has been included within capital generated from discontinued operations. .

	For the year ended 31 December							
	Savings and Asset Management		Heritage		Corporate Centre		Total	
	2020	2019	**2020**	2019	**2020**	2019	**2020**	2019
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
Underlying capital generation	**417**	414	**446**	459	**(286)**	(91)	**577**	782
Other operating capital generation	**83**	45	**564**	517	**88**	(68)	**735**	494
Operating capital generation	**500**	459	**1,010**	976	**(198)**	(159)	**1,312**	1,276
Market movements							**(118)**	538
Restructuring and other							**(73)**	(133)
Tax							**(126)**	(172)
Total capital generation							**995**	1,509

Supplementary information (continued)

Capital generation (continued)

Reconciliation of movement in Group Solvency II surplus		For the year ended 31 December 2020 Own funds[i] £m	2020 SCR[i] £m	2020 Surplus £m	2019 Own funds[i] £m	2019 SCR[i] £m	2019 Surplus £m
Underlying capital generation							
Savings and Asset Management	Asset Management	**316**	**(8)**	**308**	381	(2)	379
	With-profits	**163**	**(75)**	**88**	130	(130)	—
	– *of which: In-force*	**151**	**(51)**	**100**	96	(35)	61
	– *of which: New business*	**12**	**(24)**	**(12)**	34	(95)	(61)
	Other	**26**	**(5)**	**21**	37	(2)	35
	Savings and Asset Management underlying capital generation	**505**	**(88)**	**417**	548	(134)	414
Heritage	With-profits	**100**	**5**	**105**	71	—	71
	Shareholder annuity and other	**193**	**148**	**341**	255	133	388
	Heritage underlying capital generation	**293**	**153**	**446**	326	133	459
Corporate	Interest and head office costs	**(289)**	**3**	**(286)**	(95)	4	(91)
Underlying capital generation		**509**	**68**	**577**	779	3	782
Other operating capital generation							
	Savings and Asset Management[ii]	**27**	**56**	**83**	29	16	45
	Heritage	**297**	**267**	**564**	222	295	517
	Corporate Centre[ii]	**82**	**6**	**88**	28	(96)	(68)
Operating capital generation		**915**	**397**	**1,312**	1,058	218	1,276
	Market movements	**283**	**(401)**	**(118)**	983	(445)	538
	Restructuring and other	**(73)**	**—**	**(73)**	(168)	35	(133)
	Tax	**(159)**	**33**	**(126)**	(139)	(33)	(172)
Total capital generation		**966**	**29**	**995**	1,734	(225)	1,509
Capital generation from discontinued operations		**—**	**—**	**—**	70	88	158
Total capital generation including discontinued operations		**966**	**29**	**995**	1,804	(137)	1,667
Dividends and capital movements		**(644)**	**(39)**	**(683)**	(1,213)	2	(1,211)
Total increase/(decrease) in Solvency II surplus		**322**	**(10)**	**312**	591	(135)	456

[i] Own funds and SCR movements shown as per the shareholder Solvency II capital position, and do not include the own funds and SCR in respect of the ring-fenced With-Profits Fund.

[ii] Other operating capital generation for Savings and Asset Management and the Corporate Centre include the impact of operating investment variances, which were previously presented within underlying capital generation. This change reflects that these items will fluctuate with market conditions. The results for the year ended 31 December 2019 have been restated in light of this change, which has no impact on operating capital generation or total capital generation.

Financial ratios

Included in this section are details of how some of the financial ratios used to help analyse the performance of the Asset Management business are calculated.

(i) Cost/income ratio

Cost/income ratio is a measure of cost efficiency which analyses costs as a percentage of revenue.

	For the year ended 31 December 2020 £m	2019 £m
Total Asset Management operating expenses	**672**	652
Adjustment for revaluations[i]	**2**	(7)
Total Asset Management adjusted costs	**674**	645
Total Asset Management fee based revenue	**988**	1,033
Less: Performance fees	**(42)**	(20)
Total Asset Management underlying fee based revenue	**946**	1,013
Cost/income ratio (%)	**71 %**	64 %

[i] Reflects the revaluation of provisions relating to performance based awards that are linked to underlying fund performance. M&G Group hold units in the underlying funds to hedge the exposure on these awards.

Supplementary information (continued)

Financial ratios (continued)

(ii) Average fee margin

This represents the average fee revenue yield on fee business and demonstrates the margin being earned on the assets we manage or administer.

	For the year ended 31 December					
	2020			2019		
	Average AUMA [i]	Revenue [ii]	Revenue margin [iii]	Average AUMA [i]	Revenue [ii]	Revenue margin [iii]
	£bn	£m	bps	£bn	£m	bps
Retail Asset Management	**93**	**466**	**50**	102	584	57
Institutional Asset Management	**171**	**480**	**28**	165	429	26
Total Asset Management	**264**	**946**	**36**	267	1,013	38

[i] Average AUMA represents the average total market value of all financial assets managed and administered on behalf of customers during the financial period. Average AUMA is calculated using a 13-point average of monthly closing AUMA for full-year periods.

[ii] Fee margin is calculated by annualising underlying fee based revenues earned, which excludes performance fees, in the period divided by average AUMA for the period. Revenue includes £227m of internal revenue (2019: £205m), of which £188m are included in Institutional Asset Management and £39m in Retail Asset Management.

[iii] Fee margin relates to the total margin for internal and external revenue. Retail Asset Management external revenue margin is 70 bps (2019: 77 bps) and Institutional Asset Management external revenue margin is 37 bps (2019: 35 bps). Total Asset Management internal revenue margin is 18 bps (2019: 17 bps).

Credit risk

The Group's exposure to credit risk primarily arises from the annuity portfolio, which holds large amounts of investments on which a certain level of defaults and downgrades are expected.

While the with-profits and unit-linked funds have large holdings of assets subject to credit risk, the shareholder results of the Group are not directly exposed to credit defaults on assets held in these components. The direct exposure of the Group's shareholders' equity to credit default risk in the 'Other' component is small in the context of the Group. However, the shareholder is indirectly exposed to credit risk on these components through lower shareholder transfers in respect of the with-profits business and lower charges levied in respect of the 'unit-linked' and 'other' components of the business.

Debt securities

Debt securities held in respect of annuities and other long term business are analysed below by asset class:

	As at 31 December	
	2020	2019
	£m	£m
Government bonds	**5,354**	5,678
Corporate bonds	**14,113**	13,909
Asset-backed securities	**807**	791
Total debt securities	**20,274**	20,378

Debt securities held in respect of annuities and other long term business are analysed below according to external credit ratings[9] issued, with equivalent ratings issued by different ratings agencies grouped together. Standard & Poor's ratings have been used where available. For securities where Standard & Poor's ratings are not immediately available those produced by Moody's and then Fitch have been used as an alternative. Debt securities are internally rated where no external credit rating is available.

	As at 31 December	
	2020	2019
	£m	£m
AAA	**2,274**	2,548
AA+ to AA-	**7,202**	7,357
A+ to A-	**6,639**	7,352
BBB+ to BBB-	**3,484**	2,647
Below BBB-	**675**	474
Total debt securities	**20,274**	20,378

In the table above, AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB ratings. Financial assets which fall outside this range are classified as below BBB.

[9] The credit ratings, information or data contained in this report which are attributed and specifically provided by Standard & Poor's, Moody's and Fitch Solutions and their respective affiliates and suppliers ("Content Providers") is referred to here as the "Content". Reproduction of any content in any form is prohibited except with the prior written permission of the relevant party. The Content Providers do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. The Content Providers expressly disclaim liability for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold any such investment or security, nor does it address the suitability of an investment or security and should not be relied on as investment advice.

Supplementary information (continued)

Credit risk (continued)

Asset-backed securities

The annuities and other long term business has holdings in asset-backed securities ("ABS") which are presented within debt securities on the consolidated statement of financial position. These holdings in ABS comprise residential mortgage-backed securities ("RMBS"), commercial mortgage-backed securities ("CMBS"), collateralised debt obligations ("CDO") funds and other asset-backed securities. At 31 December 2020 the annuities and other longer term business holding in asset-backed securities was £807m (2019: £791m). The majority of these asset backed securities are UK securities.

Exposure to sovereign debt

The exposure of annuity and other long term business to sovereign debt is analysed as follows:

	As at 31 December	
	2020	2019
	£m	£m
Spain	**57**	47
France	**22**	—
Germany	**137**	188
Total Eurozone	**216**	235
United Kingdom	**1,949**	2,075
Other	**180**	158
Total	**2,345**	2,468

This table does not include non-central sovereign debt (Quasi sovereign, Supranational and other public sector debt), therefore does not agree to Government debt balance within the debt securities by industry disclosures that follow.

Exposure to debt securities issued by banks

The exposure of annuities and other long term business to debt securities issued by banks is shown below by type of debt and also by economy. Subordinated debt is a fixed interest debt that ranks below other debt in order of priority for repayment if the issuer is liquidated.

Holders are compensated for the added risk through higher rates of interest. The senior debt ranks above subordinated debt in the event of liquidation, whereas covered senior debt is also backed by other assets in the event of insolvency. These debt tier classifications are consistent with the treatment of capital for regulatory purposes.

As at 31 December 2020	**Senior debt**			**Subordinated debt**		
	Covered	**Senior**	**Total senior debt**	**Tier 2**	**Total subordinated debt**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
France	**12**	**34**	**46**	**—**	**—**	**46**
Germany	**3**	**—**	**3**	**90**	**90**	**93**
Netherlands	**—**	**45**	**45**	**—**	**—**	**45**
Total Eurozone	**15**	**79**	**94**	**90**	**90**	**184**
United Kingdom	**409**	**190**	**599**	**72**	**72**	**671**
United States	**—**	**247**	**247**	**33**	**33**	**280**
Other	**—**	**23**	**23**	**36**	**36**	**59**
Total	**424**	**539**	**963**	**231**	**231**	**1,194**

As at 31 December 2019	Senior debt			Subordinated debt		
	Covered	Senior	Total senior debt	Tier 2	Total subordinated debt	Total
	£m	£m	£m	£m	£m	£m
France	16	16	32	—	—	32
Germany	3	—	3	83	83	86
Netherlands	—	23	23	—	—	23
Total Eurozone	19	39	58	83	83	141
United Kingdom	420	229	649	69	69	718
United States	—	230	230	30	30	260
Other	—	10	10	36	36	46
Total	439	508	947	218	218	1,165

Supplementary information (continued)

Credit risk (continued)

Exposure of debt securities by sector

The exposure of annuities and other long term business to debt securities is analysed below by sector:

	As at 31 December	
	2020	2019
	£m	£m
Financial	**6,317**	5,905
Government	**5,354**	5,678
Real Estate	**3,036**	2,673
Utilities	**2,727**	2,886
Consumer	**967**	1,045
Industrial	**709**	820
Communications	**431**	428
Other	**733**	943
Total	**20,274**	20,378