

Registered No: 992726

PRUDENTIAL PENSIONS LIMITED

Annual Report and Financial Statements for the year ended 31 December 2020

PRUDENTIAL PENSIONS LIMITED

Incorporated and registered in England and Wales. Registered No. 992726.
Registered office: 10 Fenchurch Avenue, London EC3M 5AG.

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PRUDENTIAL PENSIONS LIMITED

Directors (in office at date of approval of the financial statements)

Ms C J Bousfield
Mr P D Cooper
Mr R S Bowie (Chairman)

Secretary

M&G Management Services Limited

Auditor

KPMG LLP, London

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2020

Principal activity

The principal activity of Prudential Pensions Limited ('the Company') in the course of 2020 was transacting long-term insurance business in the United Kingdom. This activity is expected to continue in 2021.

The Company is a wholly owned subsidiary undertaking of The Prudential Assurance Company Limited, a company registered in England and Wales. The Company has taken advantage of disclosure exemptions under the Companies Act 2006 (the 'Act') and therefore group financial statements and a group business review are not prepared. Accordingly, the financial statements present information about the Company as an individual undertaking and are not consolidated.

The Prudential Assurance Company Limited is a wholly owned subsidiary of M&G Group Regulated Entity Holding Company Limited. Ownership of The Prudential Assurance Company Limited has been transferred from M&G plc ('the Group') to M&G Group Regulated Entity Holding Company Limited, effective from 23 July 2020. M&G Group Regulated Entity Holding Company Limited's principal activity is that of an intermediate holding company with subsidiaries engaged in underwriting long-term insurance business and asset management. The Company's ultimate parent company is M&G plc.

Business review

Market review and strategy

The Company accepts reinsurance from both The Prudential Assurance Company Limited, its immediate parent company, and external parties in respect of corporate pension schemes. In addition, the Company sells direct investment-only business to group pension schemes. Most of the Company's products are unit-linked products. The Company has a small book of annuities reassured to The Prudential Assurance Company Limited.

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

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

2020 has seen us operate against an extremely challenging economic backdrop as we have all globally contended with the COVID-19 pandemic. Whilst the economic outlook remains uncertain, particularly once government support schemes are withdrawn, the rollout of the vaccination programmes worldwide has had a positive impact on market sentiment.

The Company continues to make good progress on its transformation programme. This involves modernising the business so that it is fit for the digital era through significant investment in new administration systems and digitalisation.

The transfer of a significant number of policies from a mix of complex legacy systems on to the strategic administration platform BaNCS managed by Diligenta, the UK subsidiary of Tata Consultancy Services, was a notable achievement in this area. The Company, as part of M&G plc, has continued to strengthen its strategic outsourcing relationship with Diligenta.

M&G plc and its subsidiary entities, including the Company, have embarked on a journey to make sustainability core to the whole business, from the impact the Company has on the planet and communities, to the opportunity to influence others through leading by example. In March 2020, M&G plc made company-wide commitments to both diversity and inclusion and climate change, including a pledge to reach carbon net zero as a corporate entity by 2030 and to achieve net zero carbon emissions on its total book of assets under management and administration by 2050 – in line with the Paris Agreement. As part of M&G plc, the Company shares the same commitment for its investment portfolio, which is now informing the investment policy and asset allocation decisions of the Company.

As the Company's business is entirely UK based, it is not directly impacted by the implementation of Brexit on 1 January 2021.

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)Key Performance Indicators and measurement

The following table sets out the key performance indicators for the Company. These are considered to be the key metrics for the Company.

Key Performance Indicators	2020	2019	Change
	£'000	£'000	%
Profit on ordinary activities before tax	3,623	8,620	(58.0)%
Shareholder funds	76,632	74,439	2.9 %
Assets held to cover linked liabilities	11,177,431	11,073,321	0.9 %
Estimated Solvency II capital surplus	35,242	39,170	(10.0)%

Profit on ordinary activities before tax has decreased primarily due to a £3.6m reduction in Annual Management Charge ('AMC') income net of rebates from £11m in 2019 to £7.4m in 2020. The lower AMC income reflects lower unit-linked investments during 2020, due to both a number of exits and the adverse market conditions during 2020. At 31 December 2020, the value of the assets held have increased overall. This reflects both a recovery in the market in late 2020 and some large single premium receipts from the Company's direct group pension business in the last quarter.

The Company is regulated under Solvency II and supervised as an insurance company by the Prudential Regulation Authority ('PRA'). The Company has been granted approval by the PRA to calculate its SCR based on its Internal Model, which reflects the key risks the Company is exposed to, the most significant of which are insurance risk (primarily expense risk and persistency risk).

The reduction in the estimated Solvency II capital surplus (calculated on a regulatory Transition Measure on Technical Provisions ('TMTP') basis) is primarily due to a decrease in the present value of future profits ('PVFP'), along with increases in Risk Margin and Solvency Capital Requirement ('SCR'). The decrease in PVFP is primarily driven by an increase in renewal expense assumptions and a fall in the risk-free yield curve, increasing the present value of expenses, partially offset by a reduction in investment management expenses and the impact of model changes. The Solvency II basis is covered in more detail in Note 15.

Section 172(1) Statement

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

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

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

As is normal for large companies, authority for day-to-day management is delegated to the Chief Executive who in turn charges management with execution of the business strategy and related policies. The Directors review at each regular Board meeting: financial and operational performance, risk, compliance and regulatory reporting. The Board also reviews other areas over the course of the financial year including the Company's business strategy; financial reporting; key risks; stakeholder-related matters; and governance, compliance and legal matters. This is done through the consideration and discussion of reports which are sent in advance of each Board meeting and through presentations to the Board.

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

The Company's key stakeholders are its ultimate beneficial owner M&G plc and its stakeholder groups. The views and the impact of the Company's activities on those stakeholders are an important consideration for the Directors when making relevant decisions. While there are cases where the Board itself judges that it should engage directly with certain stakeholder groups or on certain issues, for example, interaction with regulators, the size and spread of both the Company's stakeholders and the Group means that other stakeholder engagement takes place at Group level. We find that as well as being a more efficient and effective approach, this also helps us achieve a greater positive impact on environmental, social and other issues than by working alone as an individual company.

During the period the Board received information to help them understand the interests and views of the Company's key stakeholders and other relevant factors when making decisions. This information was distributed in a range of different formats including in reports and presentations on the Company's financial and operational performance; non-financial key performance indicators; risk and the outcomes of specific pieces of engagement (for example, the results of customer surveys and focus groups). As a result of this the Board has had an overview of engagement with stakeholders and other relevant factors which allows it to understand the nature of the stakeholders' concerns and to comply with the section 172 duty to promote the success of the Company.

Principal decisions

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

Principal decision 1 – Decision not to pay a Dividend

Each year the Board makes an assessment of the strength of the Company's Statement of Financial Position and future prospects relative to uncertainties in the external environment and makes decisions about the payment of dividends. In determining whether a dividend should be paid, considerations were made in respect of: the current solvency position; the Company's position relative to its risk appetite; the resilience of the Company's balance sheet; quality of capital and liquidity; distributable reserves; and the ongoing need for strategic investment in the Company's business, including the workforce. The base solvency and liquidity position of the Company continued to be strong. However, due to the current sensitivity of the solvency position to expense and persistency stresses, the Board agreed the proposal not to make a dividend payment to its sole shareholder, The Prudential Assurance Company Limited, over Q4 2020. The Board also agreed the recommendation to undertake work over the coming year to understand, and identify options to mitigate if required, risk exposures to expenses and persistency.

Principal decision 2 - Own Risk and Solvency Assessment ('ORSA')

During the year, the Board reviewed and approved the 2020 ORSA report for submission to the Regulators. The ORSA presented a current and forward-looking view of the risk landscape and solvency profile of the Company's business reflecting both the ongoing strategic change, the COVID-19 environment, and the wider challenging global and domestic business environments. The ORSA was also built around three key existing processes, i.e. strategy and business planning, risk management and capital management and it was produced with involvement from key stakeholders, including Risk and Resilience, Compliance and Finance.

Principal risks and uncertainties

As a provider of savings and retirement solutions, the Company's business involves the managed acceptance of risk. The Company is subject to the Group's internal control and risk management processes as detailed in the Group Governance Framework (GGF) and associated Group Risk Management Framework (RMF). The control procedures and systems established within the Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. The Company takes on exposure to risks where there is adequate reward, and risks can be appropriately quantified and managed to safeguard the Company's ability to meet commitments to customers, comply with regulations, and protect its reputation.

The RMF requires all entities within the Group, including the Company, to establish processes for identifying, measuring, managing, monitoring and reporting key risks. The RMF sets out the processes required to manage

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

risk within agreed appetite levels which are aligned to delivering the Group and Company strategy. The RMF is approved by the Group Risk Committee and operates based on the concept of three lines of defence: (1) risk identification and management; (2) risk oversight, advice and challenge; and (3) independent assurance.

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

Financial risks

The Company's exposure to financial risk is limited due to the nature of the unit-linked business where policyholder liabilities are essentially the same as the net asset values backing those liabilities. The Company has a small amount of annuity business, but this is reinsured internally within the Group and, as such, the financial risk resides with the reinsurer. The financial risk factors affecting the Company include expense risk, persistency risk, market risk, credit risk and liquidity risk. These financial risks are discussed further in Note 22.

Non-financial risks

The Company is exposed to a wide range of non-financial risks.

(a) Operational risk

Operational risk is the risk of financial and non-financial impact (for example, regulatory and reputational) resulting from inadequate or failed internal processes, or from personnel and systems, or from external events, excluding external events covered under business environment risk. Operational failures can also give rise to financial risk exposures; for example, through process failures in the management of market and credit risk.

Operational risk is primarily measured and monitored through the Integrated Control Framework and Risk and Control Self Assessment ('RCSA') process, which provides a framework to assess the effectiveness of operational controls across the Group. The framework is further supported by a comprehensive suite of non-financial risk appetites and limits, key risk indicators and operational risk management information. Operational risk is managed through an operational risk framework and system that delivers processes and tools to identify, assess, manage and report operational risk exposures supported by additional policies and standards covering specific operational risk exposures.

The Company does not actively seek to take operational risk to generate returns, instead it accepts a level of risk that means the controls in place should prevent material impacts but should also not excessively restrict business activities.

Operational resilience is the preparedness and ability to anticipate, prevent, respond to, recover and learn from operational disruptions (whether unforeseen or not). Demonstrating resilience means upholding the continuity, performance and integrity of business services during times of disruption, planning on the basis of when, not if, disruptions occur. As part of the Group, the Company's operational resilience has been tested by the COVID-19 pandemic throughout 2020 with impacts continuing to be pro-actively managed. Business continuity and resilience plans were implemented in February 2020 to ensure the safety and well-being of colleagues and continuity of services to customers and clients including the implementation of working from home for the vast majority of colleagues. Whilst no new operational risks have been identified, risk priorities have changed with increased focus on: outsourcing oversight, engagement and monitoring; data security and privacy; cybercrime attacks and fraud attempts; market volatility and internal controls.

Key operational risk exposures include, but are not limited to the following:

(i) Technology and data risk

The Company has a high dependency on technology and the loss or sustained unavailability of key hardware or software, inadequate information security arrangements and ineffective use of digital solutions could impact the Company's ability to operate effectively. Furthermore, regulatory scrutiny of, and reputational damage from, issues arising from the processing of customer data, and the security and resilience of technology and processes are expected to remain high.

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

(ii) Third party suppliers

Like many of its peers, the Company is increasingly dependent on third parties for critical activities such as customer engagement, investment management, fund administration and technology. Serious failings in the delivery and/or persistent underperformance of third party supplier arrangements could impact the delivery of services to customers. Concentrations of operational risk can arise where there is a key dependency or a single (or small number) of vendors to provide critical services.

(iii) Change risk

There are a number of significant change and transformation programmes underway to deliver the Company's strategy for growth, improve customer experiences and outcomes, strengthen resilience and control environment and support scalable growth. A failure to deliver these programmes within timelines, scope and cost may impact the business model and ability to deliver strategy.

(b) Business environment and market forces risk

Changing customer preferences and economic and political conditions could adversely impact the Company's ability to deliver its strategy and have implications for the profitability of its business model. The markets in which the Company operates are highly competitive whilst customer needs and expectations are changing rapidly. Economic factors, including those resulting from Brexit and the COVID-19 pandemic, may impact the demand for products and the ability to generate an appropriate return. In addition, increased geopolitical risks and policy uncertainty may impact the Company's products, investments and operating model.

Competition is expected to intensify in response to consumer demand, technological advances, the need for economies of scale, regulatory actions and new market entrants.

The Company is aligned to the Group Business plan and monitors and reports on the delivery of the plan. The business plan is a group wide process which is a result of the annual strategic planning process which considers the potential impact of the wider business environment.

The Company continues to diversify its savings and investments business to respond to developing customer needs in terms of products, distribution and servicing, and a significant digital transformation programme is being undertaken to deliver a more diversified distribution strategy.

(c) Sustainability

Stakeholders increasingly expect the Company to meet the needs of the present without compromising the ability of future generations to meet their own needs. In addition, sustainability, including issues concerning the climate, diversity and inclusion, corporate governance and biodiversity, is crucial to the success of the Company and that of the companies in which the Company invests. A failure to address and embed sustainability within the Company's products, business and operating model could adversely impact profitability, reputation and plans for growth.

Sustainability risks, along with other risk types, are identified, assessed and managed under the Risk Management Framework. Consideration of ESG risk is built into the decision making processes and a requirement of key strategic board risk assessment papers. Climate Change Risk is being integrated into the Company's scenario analysis process with both top down and bottom up consideration over a range of time horizons.

(d) Investment performance and risk

The investment objectives and risk profiles of funds and segregated mandates are communicated to customers. A failure to deliver against these objectives (including sustained underperformance of funds), maintain risk profiles that are consistent with customers' expectations, or ensure that fund liquidity profiles are appropriate for expected redemptions may all lead to poor customer outcomes and result in fund outflows. If these risks materialise for larger funds or a range of funds then profitability, reputation and plans for growth may be impacted. Fund liquidity will remain a key theme as regulatory and market developments impact funds' investments in unquoted and hard to trade assets. The impact of the COVID-19 pandemic may continue to cause sharp movements in market values, interest rates, dividend levels, rental income and defaults, all of which

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

could adversely impact investment performance and fund flows. While market volatility persists and customer confidence remains low, there is a risk of further deterioration of fund flows.

For investments a dedicated Investment Office establishes the asset allocation and agrees investment mandates with fund managers. Fund managers are accountable for the performance of the funds they manage and the management of the risks to the funds. There is regular monitoring to identify, measure and oversee investment performance, investment risk and fund liquidity risks. Such activities feed into established oversight and escalation forums.

(e) People risk

The success of the Company is highly dependent on the Group's ability to attract, retain and develop highly qualified professional people with the right mix of skills and behaviours to support the business strategy and culture.

As part of a large and listed public company, and as the Group continues to implement its change programme and respond to the COVID-19 pandemic, people risk and associated reputational impact is heightened in a number of areas including pay practices, staff workloads and morale, the conduct of individuals or groups of individuals and industrial relations (internally and that of key third party providers).

The HR Framework includes policies for Diversity and Inclusion, Employee Relations, Talent and Resourcing, Remuneration, and Performance and Learning. The framework is designed to align staff objectives and remuneration to business strategy and culture. The Company (as part of the Group) continues to increase investment in leadership and manager development in order to be successful and drive the right culture, behaviour and norms in today's fast changing world.

The management and Group Board receive regular reporting on people issues and developments, for example, the succession plans for critical talent, the management of industrial relations, pay, culture and diversity.

The Company (as part of the Group) conducts regular surveys to better understand colleagues' views on the Group's business and culture, the findings of which drive actions to improve the experience of staff. The Risk and Resilience team has also begun monitoring and reporting a series of indicators of behavioural risk.

The COVID-19 pandemic led to a rapid scaling up in remote working capacity and capability which has placed significantly greater reliance on virtual environments and introduced changes in working practices. This has heightened risks in areas including staff morale and well-being. These, and other risks, are being monitored and managed through bespoke incident management procedures with staff safety and well-being at the forefront of the Company's response to the pandemic.

(f) Regulatory compliance

The Company operates in highly regulated markets and interacts with a number of regulators across the globe, in an environment where the nature and focus of regulation and laws remain fluid. There are currently a large number of national and international regulatory initiatives in progress, with a continuing focus on solvency and capital standards, conduct of business and systemic risks. The consequences of non-compliance can be wide ranging and include customer detriment, reputational damage, fines and restrictions on operations or products.

Accountability for compliance with regulatory and legal requirements sits with senior management. The Compliance function supports the Company by coordinating regulatory activities, including interactions with regulators, recognising the obligation of the Company to meet its distinct regulatory requirements and to take decisions independently in the interests of their customers.

The function provides guidance to, and oversight of, the Company in relation to regulatory compliance and conflicts of interest, and carries out routine monitoring and deep dive activities to assess compliance with regulations and legislation. National regulatory developments are monitored and form part of the Group's engagement with government policy teams and regulators, which includes updates on responses to the changes.

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

(g) Reputational risk

The Company's reputation is the sum of its stakeholders' perceptions, which are shaped by the nature of their expectations and the Company's ability to meet them. These are influenced heavily by the reputation of the Group's other brands and entities. Consequently, there is a risk that through activities, behaviours or communications, the Company, or other companies in the Group, fail to meet stakeholder expectations in ways which adversely impact trust and reputation. Failure to effectively manage reputational risk could therefore have an adverse impact on revenues and cost base, the ability to attract and retain the best staff and could also result in regulatory intervention or action.

The Reputational Risk Management Framework and dedicated Reputational Risk team monitor and report on reputational risks utilising a suite of metrics to monitor stakeholder groups. In addition, embedded reputational risk champions perform an active role in the identification and monitoring of key reputational risks and drivers. Champions also support the Company in creating processes that include full consideration of reputational risks in key decisions.

COVID-19 and the ongoing socio-political climate, together with an increase in activities being undertaken by the business means that we could face an increasing range and severity of reputational events. A number of factors mean that such pressures will increase, including the greater focus of customers, regulators and investors on ESG issues and social media providing the means for opinions to be stated and shared instantaneously.

On behalf of the Board of directors



Ms H G Archbold
On behalf of M&G Management Services Limited
Company Secretary
4 March 2021

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2020

Incorporated and registered in England and Wales. Registered no. 992726

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2020.

Likely developments, business strategies and prospects

Likely future developments in the business of the Company are discussed in the strategic report in accordance with Section 414C(11) of the Act.

Ultimate parent company

The Company is a wholly owned subsidiary undertaking of The Prudential Assurance Company Limited. The Prudential Assurance Company Limited is a wholly owned subsidiary of its intermediate parent M&G Group Regulated Entity Holding Company Ltd. The Company's ultimate parent company, M&G plc, is a public limited company, limited by shares, incorporated and registered in England and Wales.

Statement of corporate governance arrangements for large private companies

In accordance with the Companies (Miscellaneous Reporting) Regulations 2018 the Board confirms that it has established and maintained its own corporate governance arrangements, supported and monitored by the Group Secretariat function to ensure that they are appropriate for a regulated subsidiary within a listed company group.

No specific governance code has been applied to the Company in the 2020 year, as it has an established set of governance procedures and practices. It is a regulated entity and so follows certain regulatory requirements and is working within the established system of internal controls and risk management. The overall risk appetite and tolerance set for the Company is set making reference to all relevant Group policies and limits.

The below describe some of the Company's governance arrangements in place during the reporting year:

- Composition of Board - comprised of an independent Non-executive Chairman, alongside executives who are employees of the Group. The operational management of the Company is delegated to the CEO.
- Director Appointment - all directors are appointed only following regulatory approval and internal approval processes.
- Company Secretary - the Company Secretariat function comprises of appropriately qualified and experienced Company Secretaries who are responsible for ensuring that ongoing governance principles and processes are adhered to.
- Terms of Reference - the Board has in place Terms of Reference which have been followed in 2020 and are periodically reviewed.

Other disclosures

There have been no material issues of concern in relation to the Company's governance arrangements and practices raised to the Board or its Company Secretary.

Stakeholder relationships and engagement

For details of the Company's engagement with its stakeholders please see the Section 172 Statement on pages 3-4.

Corporate responsibility

The Company is a wholly owned subsidiary within the Group and Corporate Responsibility ('CR') is integral to the way the Group does business.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

The Group, of which the Company is a part, has developed a Group Governance Framework which is underpinned by a Material Subsidiary Corporate Governance Manual. This encompasses all key policies and procedures.

As a business that provides savings, income, investment and protection products and services, social value is created through the day-to-day operations. The Group provides customers with ways to help manage uncertainty and build a more secure future. In seeking to match the long-term liabilities the Group has towards its customers with similarly long-term financial assets, it provides capital that finances businesses, builds infrastructure and fosters growth in both developed and developing markets.

The Group's sustainable approach to business is reinforced by the Group-wide CR strategy. The Group has a clearly defined overarching social purpose with flagship programmes (urban regeneration; economic empowerment; and skills and education) to support each pillar of the Group's strategy.

The Group's social purpose is to help empower a million people to build better futures for themselves, their families and their communities over the next three years. The Group's ambition is to build inclusive and resilient communities through urban regeneration, economic empowerment and skills and education. Social mobility is our core focus and we want to use community investment to help break down the barriers that prevent people from living the life they want. The Group do this by investing in essential needs for communities to thrive, strengthening social networks and equipping people with the skills, tools and opportunities to be financially secure.

The Group establish long-term relationships with charity partners to improve lives, build communities and provide support, not only through funding, but also with the experience and expertise of our colleagues. The projects we support are sustainable and we work closely with our partners to ensure that our programmes continuously improve.

These themes demonstrate the Group's CR commitments and principles to its stakeholders and provide clarity to its businesses, including the Company, on where they should focus their CR efforts and resources in the context of their individual markets.

The M&G plc Board discusses the Group's performance in the areas of social and environmental management at least once a year and also reviews and approves the Group's corporate responsibility report and strategy on an annual basis.

Post balance sheet events

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 when the change is substantially enacted. 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. It is considered that there will not be a significant impact on the deferred tax assets and liabilities as a result of this proposal.

Financial performance and dividends

The state of affairs of the Company at 31 December 2020 is shown in the Statement of Financial Position on page 22. The Statement of Comprehensive Income appears on pages 19 to 20. No interim dividend was paid in the year (2019: £15m). The directors have not proposed a final dividend for the year (2019: £nil).

Financial instruments

The Company's exposure to financial risk is limited due to the nature of the unit-linked business where policyholder liabilities are essentially the same as the net asset values backing those liabilities. The financial risk factors affecting the Company include expense risk, market risk, persistency risk, liquidity risk and credit risk. Information on the financial risk management objectives and policies of the Company and the exposure of the Company to the financial risk factors is given in Note 22.

Share capital

There were no changes in the Company's share capital during 2020.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)

Directors

The present directors are shown on page 1. Mr R S Bowie was appointed as a director and chairman on 4 February 2021. Mr P D Cooper was appointed as a director on 2 March 2020. Mr K Davies and Mr P Spencer resigned as directors on 28 February 2020 and 5 February 2021 respectively. There have been no further changes.

Disclosure to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Act.

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor, KPMG LLP, will be deemed to be reappointed and will therefore continue in office.

On 28 October 2020, the Company approved the appointment of PricewaterhouseCoopers LLP as its auditor for the year ending 31 December 2022, subject to shareholder approval at the M&G plc 2022 Annual General Meeting.

Directors' and officers' protection

M&G plc has arranged appropriate insurance cover in respect of legal action against directors and senior managers of companies within the M&G plc Group. In addition, the Articles of Association of the Company provide for the directors, officers and employees of the Company to be indemnified in respect of liabilities incurred as a result of their office. M&G plc also provides protections for directors and senior managers of companies within the Group against personal financial exposure they may incur in their capacity. These include qualifying third party indemnity provisions (as defined by the relevant Companies Act) for the benefit of directors of M&G plc, including, where applicable, in their capacity as a director of the Company and other companies within the Group. These indemnities were in force during 2020 and remain in force.

Going concern

As described in the Basis of Preparation section of the Accounting Policies at note 1, an assessment of the Company's prospects has been carried out. The Board has also performed a robust assessment of the principal and emerging risks facing the Company, and is satisfied that the Company will be able to continue in operation and meet its liabilities as they fall due for a period of at least 12 months from the date of approval of the financial statements.

Greenhouse gas emissions

The Company has availed itself of the exemption afforded at section 20A of Schedule 7A of The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018, and relies on disclosures regarding greenhouse gas emissions and energy consumption made by the ultimate parent undertaking, M&G plc, in their consolidated financial statements.

On behalf of the Board of directors



Ms H G Archbold
On behalf of M&G Management Services Limited
Company Secretary
4 March 2021

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE STRATEGIC REPORT, THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

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

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101, *Reduced Disclosure Framework*.

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

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

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

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



Independent auditor's report

to the members of Prudential Pensions Limited

1. Our opinion is unmodified

We have audited the financial statements of Prudential Pensions Limited (“the Company”) for the year ended 31 December 2020 which comprise the statement of comprehensive income, statement of changes in equity, statement of financial position and the related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of Company’s affairs as at 31 December 2020 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework*; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (“ISAs (UK)”) and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit Committee.

We were appointed as auditor by the shareholders on October 1999. The period of total uninterrupted engagement is for the 22 financial years ended 31 December 2020.

We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview

Materiality: £20m (2019: £25m)

financial statements as a whole 0.18% (2019: 0.22%) of total assets

Risks of material misstatement vs 2019

Recurring risks	Valuation of investments that require judgement	▲
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2. Key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (unchanged from 2019), in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures.

These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
<p>Valuation of investments that require judgement</p> <p>2020: £441 million (2019: £524 million)</p> <p>The risk has increased compared to the prior year.</p> <p>Refer to page 25 (accounting policy) and pages 36 to 44 (financial disclosures).</p>	<p>Subjective valuation:</p> <p>The areas that involved significant audit effort and judgement in were the valuation of unlisted Net Asset Value ('NAV') funds.</p> <p>We consider the risk to have increased in the current year due to the higher degree of estimation uncertainty resulting from the economic conditions and their outlook caused by the COVID-19 pandemic.</p> <p>For these positions an observable price was not readily available and therefore involved the application of expert judgement in the valuations adopted is required.</p> <p>The effect of these matters is that, as part of our risk assessment, we determined that the valuation of investments that require judgement has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. Note 21B discloses the sensitivity estimated by the Company.</p>	<p>Our procedures included:</p> <p>We performed the tests below rather than seeking to rely on any of the Company's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed substantive procedures described.</p> <ul style="list-style-type: none"> – Tests of detail: – Independently obtaining the most recent NAV statements to assess the appropriateness of the fair value of the unlisted funds. – Performing a retrospective test over the NAV valuation to assess if the fund valuation reported in the audited financial statements in the prior year were materially consistent with the NAV valuation statements available at the time. – Assessing transparency: Assessing whether the Company's disclosures in relation to the valuation of investments that require judgement are compliant with the relevant accounting requirements and appropriately present the sensitivities in the valuations based on alternative outcomes. <p>Our result</p> <p>We found valuation of investments that require judgement to be acceptable (2019 : acceptable).</p>

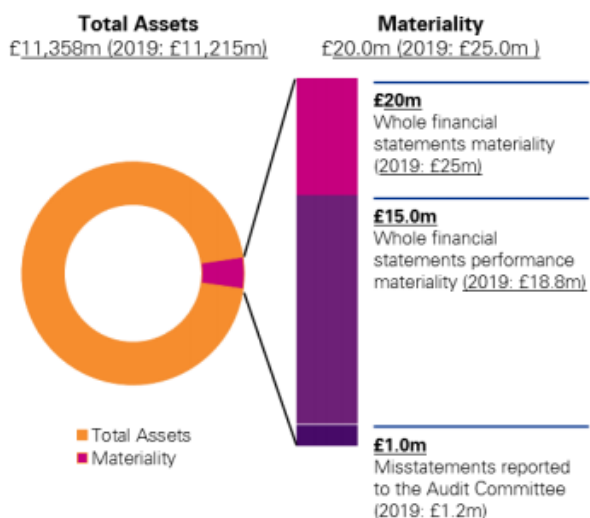
3. Our application of materiality and an overview of the scope of our audit

Prudential Pensions Limited is part of a group headed by M&G plc. Materiality of £20 million (2019: £25 million), as communicated by the group audit team, has been applied to the audit of the Company. This is lower than the materiality that we would otherwise have determined and represents 0.18% (2019: 0.22%) of total assets.

In line with our audit methodology, our procedures on individual account balances and disclosures were performed to a lower threshold, performance materiality, so as to reduce to an acceptable level the risk that individually immaterial misstatements in individual account balances add up to a material amount across the financial statements as a whole. Performance materiality was set at 75% (2019: 75%) of materiality for the financial statements as a whole, which equates to £15m (2019: £18.75m). We applied this percentage in our determination of performance materiality because we did not identify any factors indicating an elevated level of risk.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £1 million (2019: £1.2 million), in addition to other identified misstatements that warranted reporting on qualitative grounds

Our audit of the Company was undertaken to the materiality level specified above.



4. Going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company’s financial position means that this is realistic. They have also concluded that there are no material uncertainties that

could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements (“the going concern period”).

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

We used our knowledge of the Company, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Company’s financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Company’s available financial resources and solvency over this period were adverse impacts arising from fluctuations or negative trends in the economic environment which affect the valuations of the Company’s investments that require judgement.

We also considered less predictable but realistic second order impacts, such as failure of counterparties who have transactions with the Company (such as banks and reinsurers) to meet commitments that could give risk to a negative impact on the Company’s financial position, increased liquidity which also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline and the impact of Brexit on the economic environment and the resulting impact on the Company’s capital resources.

We considered whether these risks could plausibly affect the solvency and liquidity in the going concern period by comparing severe, but plausible downside scenarios that could arise from these risks individually and collectively against the level of available financial resources indicated by the Company’s financial forecasts.

We considered whether the going concern disclosure in note 1 to the financial statements gives a full and accurate description of the Directors’ assessment of going concern including the identified risks and dependencies, and related sensitivities.

Our conclusions based on this work,

— we consider that the directors’ use of the going concern basis of accounting in the preparation of the financial statements is appropriate;

— we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for the going concern period; and

— we have nothing material to add or draw attention to in relation to the Directors' statement in note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Company's use of that basis for the going concern period.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Company will continue in operation.

5. Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

To identify risks of material misstatement due to fraud ("fraud risks") we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. Our risk assessment procedures included:

— Enquiring of directors, the audit committee, internal audit, legal, risk and compliance and inspection of policy documentation as to the Company's high-level policies and procedures to prevent and detect fraud, including the internal audit function, and the Company's channel for "whistleblowing", as well as whether they have knowledge of any actual, suspected or alleged fraud;

— using analytical procedures to identify any usual or unexpected relationships;
— Reading Board, Audit Committee and risk committee meeting minutes; and
— Inspecting correspondence with regulators to identify instances or suspected instances of fraud.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, and taking into account our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, in particular the risk that management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements such as

the valuation of investments that require judgment. On this audit we do not believe there is a fraud risk related to revenue recognition because there is limited judgement involved in the determination of all material revenue streams as the amounts are contractually derived and therefore the audit evidence supporting these balances is straightforward to obtain.

We did not identify any additional fraud risks.

We also performed procedures including:

— Assessing significant accounting estimate for bias; and
— Identifying journal entries and other adjustments to test based on risk criteria and comparing the identified entries to supporting documentation. These included those posted by unauthorised personnel, those posted with unusual dates or descriptions and those posted with unusual account combinations.

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Company's regulatory and legal correspondence and have discussed the directors and other management the policies and procedures regarding compliance with laws and regulations.

As the Company is regulated, our assessment of risks involved gaining an understanding of the control environment including the entity's procedures for complying with regulatory requirements.

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We communicated identified laws and regulations throughout our team and remained alert to any indications of noncompliance throughout the audit. The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items. Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the

financial statements, for instance through the imposition of fines or litigation or the loss of the Company's license to operate. We identified regulatory capital and liquidity as those most likely to have such an effect recognising the financial and regulated nature of the Company's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

6. We have nothing to report on the other strategic report and the directors' report

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

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

- we have not identified material misstatements in those reports;
- in our opinion the information given in the strategic report and the directors' report for the

financial year is consistent with the financial statements; and

- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

7. We have nothing to report on the other matters on which we are required to report by exception

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

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

We have nothing to report in these respects.

8. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 12, the Directors are responsible for the preparation of the financial statements including being satisfied that they give a true and fair view. They are also responsible for: such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

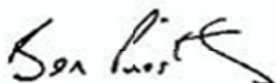
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance,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

reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

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

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

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



Ben Priestley (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

Canary Wharf

London

E14 5GL

4 March 2021

PRUDENTIAL PENSIONS LIMITED**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2020**

<u>Long-term Business Technical Account</u>	<u>2020</u>	<u>2019</u>	
	£'000	£'000	Note
Investment income	678,917	668,026	3
Unrealised gains on investments	93,101	701,451	3
Other technical income	21,694	12,609	3
	<u>793,712</u>	<u>1,382,086</u>	
Change in other technical provisions, net of reinsurance			
Long-term business provision, net of reinsurance			
- gross amount	1,221	2,621	
- reinsurers' share	(1,221)	(2,621)	
	<u>—</u>	<u>—</u>	14
Change in technical provisions for linked liabilities	(768,384)	(1,368,177)	14
	<u>(768,384)</u>	<u>(1,368,177)</u>	
Net Operating Expenses			
- Acquisition costs	(199)	(109)	
- Administrative expenses	(4,420)	(3,443)	
Investment expenses and charges	(14,436)	(3,272)	3
Foreign exchange (losses)/gains	(1,128)	2,935	3
Interest payable	—	(3)	3
Tax attributable to long-term business	(2,880)	(1,627)	4
	<u>(23,063)</u>	<u>(5,519)</u>	
Balance on the long-term business technical account	<u>2,265</u>	<u>8,390</u>	

All of the amounts above are in respect of continuing operations.

The accounting policies on pages 23 to 27 along with the accompanying notes on pages 27 to 46 form an integral part of these financial statements.

PRUDENTIAL PENSIONS LIMITED**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2020 (continued)**

<u>Non-Technical Account</u>	2020	2019	Note
	£'000	£'000	
Balance on the long-term business technical account	2,265	8,390	
Tax attributable to the balance on the long-term business technical account	1,447	47	4
Balance on the long-term business technical account before tax	3,712	8,437	
Investment income	—	191	3
Investment expenses and charges	(89)	(8)	3
Operating profit on ordinary activities before tax	3,623	8,620	
Tax on profit on ordinary activities	(1,430)	(82)	4
Profit and comprehensive income for the financial year	2,193	8,538	

All of the amounts above are in respect of continuing operations.

The accounting policies on pages 23 to 27 along with the accompanying notes on pages 27 to 46 form an integral part of these financial statements.

PRUDENTIAL PENSIONS LIMITED**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2020**

	Share Capital £'000	Capital Redemption Reserve £'000	Profit & Loss Account £'000	Total £'000
Balance at 1 January 2019	6,000	4,088	70,813	80,901
Profit for the year	—	—	8,538	8,538
Total comprehensive income for the year	—	—	8,538	8,538
Total distribution to owners, recognised directly in equity	—	—	(15,000)	(15,000)
Balance at 31 December 2019	6,000	4,088	64,351	74,439
Balance at 1 January 2020	6,000	4,088	64,351	74,439
Profit for the year	—	—	2,193	2,193
Total comprehensive income for the year	—	—	2,193	2,193
Total distribution to owners, recognised directly in equity	—	—	—	—
Balance at 31 December 2020	6,000	4,088	66,544	76,632

The accounting policies on pages 23 to 27 along with the accompanying notes on pages 27 to 46 form an integral part of these financial statements.

PRUDENTIAL PENSIONS LIMITED**STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2020**

	<u>2020</u> £'000	<u>2019</u> £'000	Note
Assets			
Investments			
Other financial investments	107,532	73,264	8
Assets held to cover linked liabilities	11,177,431	11,073,321	9
Reinsurers' share of technical provisions			
Long-term business provision	51,084	52,305	16
Debtors			
Other debtors	14,801	6,640	10
Other assets			
Cash at bank and in hand	7,205	9,328	11
Prepayments and accrued income	130	130	
Total assets	<u>11,358,183</u>	<u>11,214,988</u>	
Equity and liabilities			
Capital and reserves			
Share capital	6,000	6,000	13
Capital redemption reserve	4,088	4,088	
Profit and loss account	66,544	64,351	
Total shareholders' funds attributable to equity interests	<u>76,632</u>	<u>74,439</u>	
Technical provisions			
Long-term business provision	51,164	52,385	16
Technical provisions for linked liabilities	11,177,431	11,073,321	14
Provisions for other risks and charges			
Deferred taxation	754	1,040	4
Creditors			
Other creditors including taxation and social security	52,202	13,803	17
Total equity and liabilities	<u>11,358,183</u>	<u>11,214,988</u>	

The financial statements on pages 19 to 46 were approved by the board of directors on 4 March 2021.

The accounting policies on pages 23 to 27 along with the accompanying notes on pages 27 to 46 form an integral part of these financial statements.



Mr P D Cooper
Director
4 March 2021

NOTES ON THE FINANCIAL STATEMENTS

1. Accounting Policies

A. Company information

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

The address of its registered office is 10 Fenchurch Avenue, London EC3M 5AG.

B. Basis of preparation

The Company is exempt by virtue of s400 of the Companies Act 2006 from the requirement to prepare group financial statements. These financial statements present information about the Company as an individual undertaking and are not consolidated.

These financial statements were prepared in accordance with Financial Reporting Standard 101 *Reduced Disclosure Framework* (FRS 101), Part 15 of the Companies Act 2006 and Schedule 3 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 (Adopted IFRSs).

The immediate parent company is The Prudential Assurance Company Limited. The Company's ultimate parent undertaking, M&G plc, includes the Company in its consolidated financial statements. The consolidated financial statements of M&G plc are prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 (Adopted IFRSs). Copies of these accounts can be obtained from the Company Secretary at 10 Fenchurch Avenue, London EC3M 5AG.

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- Cash Flow Statement and related notes;
- Comparative period reconciliations for share capital;
- Disclosures in respect of transactions between wholly owned subsidiaries within the Group;
- The effects of new but not yet effective accounting standards;
- Disclosures in respect of the compensation of Key Management Personnel; and
- Disclosures in respect of revenue from contracts with customers.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The area involving a higher degree of judgement or complexity is in the classification between insurance and investment contracts. The area where assumptions and estimates are significant to the financial statements is in the determination of fair value of financial investments, in Note 21 B.

The directors have a reasonable expectation that the Company will be able to continue in operational existence for the foreseeable future and thus continue to adopt the going concern basis of accounting in preparing the financial statements. This conclusion has been based upon the following:

- The Company is a subsidiary within the M&G plc group ('the Group') and it, its parent company and the ultimate parent company are continuing to trade profitably and there are no plans for liquidation in the foreseeable future. The Prudential Assurance Company Limited and the Company have put in place intra-group arrangements to formalise circumstances in which capital support would be made available to the Company. The drawdown of support would be triggered by a breach of pre-specified solvency conditions in the Company. While it is considered unlikely that such support will be required, the arrangements are intended to provide additional comfort to the Company and its policyholders.

NOTES ON THE FINANCIAL STATEMENTS (continued)

- The Company has a satisfactory capital surplus, well in excess of the regulatory capital requirement (as shown in Note 15) and no debt financing. In addition, consideration has also been given to the Company's performance, the market in which it operates, its strategy and risks and uncertainties, as set out in the Strategic Report, and the management of financial risk as set out in Note 22, including its exposure to liquidity risk and credit risk.
- To satisfy themselves of the appropriateness of the use of the going concern assumption in relation to these financial statements, the directors have assessed the future prospects of the Company, by considering the business plan that includes cash flow forecasts for at least the next 12 months from the date of signing these financial statements, various market scenarios as well as changes in the Company's principal risks. In addition, the directors have also considered the results of reasonably plausible severe downside scenarios to assess the potential implications on the Company's solvency and liquidity. The results of these assessments demonstrated the ability of the Company to meet all obligations and future business requirements. In addition, these assessments demonstrated that the Company was able to remain above its regulatory solvency requirements in reasonably plausible severe downside scenarios.

For these reasons, the directors continue to adopt the going concern basis in preparing these financial statements.

C. Long-term business

As permitted by IFRS 4 *Insurance contracts*, insurance contracts are accounted for under previously applied UK GAAP and therefore the modified statutory basis of reporting has continued to be applied.

The measurement basis of assets and liabilities of long-term business contracts is dependent upon the classification of the contracts under FRS 101 as either insurance contracts, if the level of insurance risk is significant, or investment contracts if the risk is insignificant. The Company's contracts are mainly unit-linked contracts which are investment contracts without discretionary participation features ('DPF'). The Company also has a small amount of non-profit annuity business.

Investment contracts without DPF are accounted for as financial liabilities under IFRS 9 as they are closer in nature to a deposit-style arrangement between the investors and the Company. Premiums and withdrawals for these contracts are recorded within the Statement of Financial Position as a movement on the investors' liability and the long-term business technical account reflects the fee income accounted for under IFRS 15, expenses, and taxation on these contracts. The liabilities for investment contracts without DPF are included in Technical Provisions for Linked Liabilities in the Statement of Financial Position.

The long-term business provision is determined by the Company's directors based on advice from the Company's actuarial function, who determined the provision using recognised actuarial methods, with due regard to the actuarial principles laid down in Directive 2013/58/EU. Provisions are predominantly calculated by the net premium valuation method. Discount rates are derived based on gilt yields of a duration consistent with that of the underlying business.

D. Reinsurance

The Company seeks to reduce loss exposure by reinsuring certain levels of risk in various areas of exposure with other insurance companies or reinsurers. The measurement of reinsurance assets is consistent with the measurement of the underlying direct insurance contracts. An asset or liability is recognised in the Statement of Financial Position representing premiums due to or payments due from reinsurers and the share of benefits and claims recoverable from reinsurers.

NOTES ON THE FINANCIAL STATEMENTS (continued)

E. Classification of instruments issued by the Company

Having adopted FRS 101, IAS 32 is being applied to financial instruments issued by the Company and are treated as equity only to the extent that they meet the following two conditions:

- (i) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company; and
- (ii) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

F. Financial instruments - recognition and measurement

Financial assets

Recognition and initial measurement

On initial recognition, a financial asset is classified and measured at either amortised cost or fair value through profit or loss ('FVTPL') less, for a financial asset not measured at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

Classification and subsequent measurement

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

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

All financial assets that do not meet the criteria for being measured at amortised cost, as described above, are measured at FVTPL. This includes assets that are held-for-trading or are part of a portfolio that is managed on a fair value basis. Derivatives are included in this category.

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

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

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

Financial liabilities

Financial liabilities are classified as measured at amortised cost (using the effective interest method) or FVTPL. A financial liability is classified as at FVTPL if it is in respect of an investment contract without participation features, held-for-trading or a derivative. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognised in profit or loss. Other financial liabilities are subsequently measured at amortised cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognised in profit or loss. Any gain or loss on de-recognition is also recognised in profit or loss.

NOTES ON THE FINANCIAL STATEMENTS (continued)

G. Financial assets - impairment

Impairment is recognised on financial assets measured at amortised cost based on expected credit losses ('ECL').

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

The impact of any collateral and financial guarantees is taken into account when determining ECL.

ECLs are discounted at the effective interest rate of the financial asset.

A financial instrument is considered to have low credit risk where it has an external credit rating of 'investment grade'. The Company has determined that the cash balances and deposits with credit institutions are considered to have low credit risk and therefore impairment is based on a 12 month ECL for these assets, where material. Loss allowances for trade receivables and contract assets are always measured at an amount equal to lifetime ECLs, where material.

H. Premiums and claims

For unit-linked business, premiums are accounted for when the liabilities arising from the premiums are recognised. Premiums exclude any taxes or duties based on premiums.

Claims paid include maturities, annuities, surrenders and deaths. Maturity claims are accounted for on the policy maturity date. Annuity claims are accounted for when the annuity becomes due for payment. Surrender claims are accounted for when paid and death claims when notified.

Accounting for investment contracts without DPF reflects the deposit nature of the arrangement with premiums and claims reflected as deposits and withdrawals taken directly to the Statement of Financial Position as a movement on the investors' liability with the long-term technical account reflecting fee income, expenses, and taxation on these contracts.

Investment income and realised and unrealised gains in respect of long-term business are included in the long-term business technical account. Other investment income and realised and unrealised gains are included in the non-technical account.

Realised gains are determined as the difference between net proceeds on disposal and the purchase price. Movements in unrealised gains comprise the change in the value of investments held at the Statement of Financial Position date and the reversal of unrealised investment gains and losses recognised in earlier accounting periods in respect of investment disposals.

I. Securities lending and reverse repurchase agreements

The Company is party to various securities lending agreements and repurchase agreements under which securities are transferred to third parties on a short-term basis. The transferred securities are not de-recognised; rather, they continue to be recognised within the appropriate investment classification. The Company's policy is that collateral in excess of 100% of the fair value of securities loaned is required from all securities' borrowers and typically consists of cash, debt securities, equity securities or letters of credit.

In cases where the Company takes possession of the collateral under its securities lending programme, including cash collateral which is not legally separated from the Company, the collateral and corresponding obligation to return such collateral, is recognised as a financial liability in the Statement of Financial Position.

The Company is also party to various reverse repurchase agreements under which securities are purchased from third parties with an obligation to resell the securities. The securities are not recognised as investments in the Statement of Financial Position. The right to receive the return of any cash paid as purchase consideration plus interest is recognised as a financial asset in the Statement of Financial Position.

NOTES ON THE FINANCIAL STATEMENTS (continued)

J. Tax

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

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

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the Statement of Financial Position date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

K. Foreign currencies

Monetary foreign currency assets and liabilities are translated at the year end exchange rates and foreign currency transactions are translated into the functional currency using the spot exchange rates at the dates of the transactions. Exchange differences are included in the statement of comprehensive income.

2. Analysis of premiums

Gross Premiums

Premiums comprise corporate pension business where investment risk is borne by policyholders and which are transacted within the UK. All direct single and regular premiums are group pension business. Premiums for 2020 and 2019 are nil as all business is investment contracts without discretionary participation features and is deposit accounted for, as described in the accounting policies.

	<u>2020</u> £'000	<u>2019</u> £'000
Single premiums – Pensions – Investment-linked contracts		
Direct	1,042,281	339,474
External reinsurance accepted	43,145	30,977
Intragroup reinsurance accepted	<u>292,487</u>	<u>266,150</u>
	<u>1,377,913</u>	<u>636,601</u>

Premiums received include those contracts excluded from premium income in the technical account because they are accounted for as deposits. These are investment contracts without discretionary participation features and carry no significant insurance risk.

NOTES ON THE FINANCIAL STATEMENTS (continued)

3. Revenue and investment return

The revenue and investment return derive from financial instrument classifications as follows:

	Long-term business technical account		
	2020	2020	2020
	£'000	£'000	£'000
	At fair value through profit or loss	Amortised cost	Total
Investment income			
Income from listed investments	203,064	—	203,064
Income from other investments	4,860	133	4,993
Gains on the realisation of investments at fair value through profit or loss other than derivatives	466,557	—	466,557
Gains on the realisation of derivatives	4,303	—	4,303
	<u>678,784</u>	<u>133</u>	<u>678,917</u>
Investment expenses and charges			
Investment managers' expenses	(14,434)	(2)	(14,436)
Unrealised gains on investments			
Debt securities	1,264	—	1,264
Linked assets - other than derivatives	90,434	—	90,434
Linked assets - derivatives	1,403	—	1,403
	<u>93,101</u>	<u>—</u>	<u>93,101</u>
Foreign exchange losses	(1,128)	—	(1,128)
Fee income from investment contracts	21,694	—	21,694
Bank interest paid	—	—	—
Total revenue and investment return	<u>778,017</u>	<u>131</u>	<u>778,148</u>

	Non-technical account		
	2020	2020	2020
	£'000	£'000	£'000
	At fair value through profit or loss	Amortised cost	Total
Investment income			
Income from other investments	—	—	—
	—	—	—
Investment expenses and charges			
Investment managers' expenses	—	(91)	(91)
Total revenue and investment return	<u>—</u>	<u>(91)</u>	<u>(91)</u>

NOTES ON THE FINANCIAL STATEMENTS (continued)

	Long-term business technical account		
	<u>2019</u>	<u>2019</u>	<u>2019</u>
	£'000	£'000	£'000
	At fair value through profit or loss	Amortised cost	Total
Investment income			
Income from listed investments	267,054	—	267,054
Income from other investments	9,000	600	9,600
Gains on the realisation of investments at fair value through profit or loss other than derivatives	394,962	—	394,962
Losses on the realisation of derivatives	(3,590)	—	(3,590)
	<u>667,426</u>	<u>600</u>	<u>668,026</u>
Investment expenses and charges			
Investment managers' expenses	(3,218)	(54)	(3,272)
Unrealised losses on investments			
Debt securities	1,104	—	1,104
Linked assets - other than derivatives	697,949	—	697,949
Linked assets - derivatives	2,398	—	2,398
	<u>701,451</u>	<u>—</u>	<u>701,451</u>
Foreign exchange losses	2,935	—	2,935
Fee income from investment contracts	12,609	—	12,609
Intra-group interest paid	—	(3)	(3)
Total revenue and investment return	<u>1,381,203</u>	<u>543</u>	<u>1,381,746</u>

	Non-technical account		
	<u>2019</u>	<u>2019</u>	<u>2019</u>
	£'000	£'000	£'000
	At fair value through profit or loss	Amortised cost	Total
Investment income			
Income from other investments	—	191	191
	—	191	191
Investment expenses and charges			
Investment managers' expenses	—	(8)	(8)
Total revenue and investment return	<u>—</u>	<u>183</u>	<u>183</u>

NOTES ON THE FINANCIAL STATEMENTS (continued)

4. Tax

(a) Tax charged

	Long-term business technical account		Non-technical account	
	2020 £'000	2019 £'000	2020 £'000	2019 £'000
Current tax				
UK Corporation tax on profits for the year	1,102	1,996	(17)	35
Adjustments in respect of previous years	631	(1,566)	—	—
	<u>1,733</u>	<u>430</u>	<u>(17)</u>	<u>35</u>
Foreign tax	1,433	1,593	—	—
Total current tax	<u>3,166</u>	<u>2,023</u>	<u>(17)</u>	<u>35</u>
Deferred tax				
Origination and reversal of temporary difference	(176)	(397)	—	—
Effect of changes in tax rate	(110)	1	—	—
Tax charge on profit on ordinary activities	<u>2,880</u>	<u>1,627</u>	<u>(17)</u>	<u>35</u>

Shareholders' attributable tax in respect of the long-term business

Current tax	1,733	443
Deferred tax	(286)	(396)
	<u>1,447</u>	<u>47</u>
Total	<u>1,430</u>	<u>82</u>

(b) Factors affecting tax charge for period

Deferred tax is provided at the rate applicable when the temporary differences are expected to reverse. In March 2020, the UK Government announced that the main rate of corporation tax was to remain at 19% for the financial years 2020 and 2021 rather than reducing it to 17% from 1 April 2020 as previously anticipated.

Other than the effects of permanent differences and adjustments in respect of previous periods, it is not expected that the tax charge will deviate from that calculated by applying the standard rate of corporation tax to the profit before tax of the Company.

	2020 £'000	2019 £'000
Profit on ordinary activities before tax	<u>3,623</u>	<u>8,620</u>
Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 19% (2019: 19%)	689	1,638
Effects of		
Adjustments to current tax in respect of previous periods	631	(1,555)
Impact of changes in local statutory tax rates	110	(1)
Total tax charge for the period	<u>1,430</u>	<u>82</u>

(c) Statement of Financial Position

The UK Government made substantial changes to the rules relating to the taxation of life insurance companies, effective from 1 January 2013. A deferred tax liability has been recognised for the adjustment that arises on transition to the new regime. This adjustment is required to be spread and taxed over a 10 year period.

NOTES ON THE FINANCIAL STATEMENTS (continued)

	<u>2020</u> £'000	<u>2019</u> £'000
Provision for deferred tax		
Transitional adjustments	<u>754</u>	<u>1,040</u>
Undiscounted provision for deferred tax liability	<u>754</u>	<u>1,040</u>
Deferred tax liability at start of the period	<u>1,040</u>	<u>1,436</u>
Deferred tax credited in technical/non-technical account for the period	<u>(286)</u>	<u>(396)</u>
Deferred tax liability at the end of period	<u>754</u>	<u>1,040</u>

5. Staff costs

The Company has no employees (2019: Nil). Included within net operating expenses are amounts paid in return for management services provided to the Company by other group companies. The majority of employees in the UK are employed by Prudential Distribution Limited, a service company within the Group.

6. Directors' emoluments

During the year the directors of the Company received the following emoluments in respect of work on behalf of the Company:

	<u>2020</u> £'000	<u>2019</u> £'000
Aggregate emoluments and benefits	<u>15</u>	<u>15</u>

The Company's directors perform services for other group companies. These costs are not included in the amounts charged to the Company as shown in the table above. Emoluments are reported for directors who are deemed to work for the Company i.e. provide qualifying services in accordance with Schedule 5 of the Regulations. An assessment has been made of the proportion of each director's time that relates to this Company, and the emoluments reported above reflect this. None of the directors received shares under long-term incentive schemes in 2020 (2019: nil), and no director exercised share options in either 2020 or 2019. No director (2019: none) was entitled to retirement funds under a defined contribution pension scheme.

7. Auditor's remuneration

	<u>2020</u> £'000	<u>2019</u> £'000
Audit of these financial statements	<u>473</u>	<u>86</u>

8. Other financial investments

	Cost		Carrying value	
	<u>2020</u> £'000	<u>2019</u> £'000	<u>2020</u> £'000	<u>2019</u> £'000
Debt securities and other fixed income securities	<u>19,843</u>	<u>19,843</u>	<u>25,932</u>	<u>24,668</u>
Deposits with credit institutions	<u>81,600</u>	<u>48,596</u>	<u>81,600</u>	<u>48,596</u>
	<u>101,443</u>	<u>68,439</u>	<u>107,532</u>	<u>73,264</u>

All debt securities and other fixed income securities are listed on a recognised UK investment exchange. There has been no change to the cost of debt securities and other fixed income securities between 2020 and 2019.

NOTES ON THE FINANCIAL STATEMENTS (continued)

9. Assets held to cover linked liabilities

	<u>2020</u>	<u>2019</u>
	£'000	£'000
Shares and other variable yield securities	5,284,183	5,333,363
British government securities - fixed income	1,182,266	926,867
British government securities - index-linked	230,278	207,314
Debentures and loan stocks	3,435,792	3,717,133
Provincial and municipal stocks	317,258	347,151
Deposits with credit institutions	617,700	440,600
Derivatives	6,382	4,438
Other assets	103,572	96,455
Assets held to cover linked liabilities – carrying value	<u>11,177,431</u>	<u>11,073,321</u>
Assets held to cover linked liabilities - cost	<u>9,794,784</u>	<u>9,783,054</u>

Included within shares and other variable yield securities is a Fond commun de placement called M&G UK Property Fund FCP - FIS, which at 31 December 2020 was 97.99% owned by Prudential Pensions Limited (2019: 98.22%). The value of the investment in this fund at 31 December 2020 was £440.5m (2019: £524.3m). The registered office of this investment is 34-38 Avenue de la Liberté, L-1930 Luxembourg.

Included within other investments are derivatives owned by the fund to offset currency movements. These can have a negative valuation.

The above assets account for the bulk of investment income analysed in note 3. Deposits with credit institutions and other unlisted securities account for other investment income.

10. Other debtors

All debtors are due within one year.

	<u>2020</u>	<u>2019</u>
	£'000	£'000
Debtors arising from reinsurance operations	6,243	864
Amounts owed by group undertakings	—	799
Other debtors	8,558	4,977
	<u>14,801</u>	<u>6,640</u>

Debtors arising from reinsurance operations have increased primarily due to a £5.4m increase in an intra-group reinsurance debtor due to timing of the settlement. Other debtors have increased primarily due to a £1.5m increase in seed capital and a £1.3m increase in other debtors due to timing.

11. Bank current accounts

Under the terms of the Company's arrangements with the Group's main UK banker, the bank has a right of set-off between credit balances (other than those of long-term business funds) and all overdrawn balances of those Group undertakings with similar arrangements.

12. Assets attributable to the long-term business fund

Of the total amount of assets shown on the Statement of Financial Position, £11,327m (2019: £11,184m) is attributable to the long-term business fund.

13. Share capital

	<u>2020</u>	<u>2019</u>
	£'000	£'000
Issued and fully paid		
6 million ordinary shares (2019: 6 million) of £1 each	<u>6,000</u>	<u>6,000</u>

There has been no change to the share capital in the year.

NOTES ON THE FINANCIAL STATEMENTS (continued)

14. Policyholder liabilities

	Long-term business provision net of reinsurance £'000	Provision for linked liabilities net of reinsurance £'000
Balance at 1 January 2019	80	11,223,917
Movement in technical provisions for year		
Gross amount	(2,621)	1,368,177
Reinsurers' share	2,621	—
Deposits received from policyholders under investment contracts	—	636,940
Payments made to policyholders of investment contracts	—	(2,155,713)
As at 31 December 2019/1 January 2020	80	11,073,321
Movement in technical provisions for year		
Gross amount	(1,221)	768,384
Reinsurers' share	1,221	—
Deposits received from policyholders under investment contracts	—	1,377,913
Payments made to policyholders of investment contracts	—	(2,042,187)
Balance at 31 December 2020	80	11,177,431

All of the reinsurer's share of technical provisions for long-term business relates to reinsurance agreements with other Group companies. There are no gains or losses arising from these reinsurance agreements.

NOTES ON THE FINANCIAL STATEMENTS (continued)

15. Capital requirements and management

The Company's estimated and unaudited shareholder Solvency II surplus at 31 December 2020 is £35m (2019: £39m), as calculated on a regulatory Transition Measure on Technical Provisions ('TMTP') basis. Own Funds is the Solvency II measure of assets less liabilities.

The Solvency II Pillar I capital requirements at 31 December 2020 have been calculated using the Company's Internal Capital Model. The method used to calculate the capital has been to:

- (i) identify the major risks to which the business is exposed;
- (ii) specify a probability distribution which defines the full range of outcomes for each risk, including the 99.5% (or 1-in-200) worst outcome that the directors believe could occur over the coming year;
- (iii) specify an appropriate dependency structure between each of the risks;
- (iv) use stochastic modelling to generate up to 100,000 equally likely risk scenarios where each risk is simulated at the same time, having regard to the probability distribution for each risk and the dependency between different risks;
- (v) calculate the change in the available capital over a one year period in each scenario; and
- (vi) set the capital as the change in the available capital in the 99.5th worst scenario.

The Company manages its own funds to ensure that sufficient own funds are available on an ongoing basis to meet regulatory capital requirements. This is achieved by targeting a capital buffer in excess of regulatory capital requirements. This buffer is intended to absorb the impact of stressed market conditions and thus make the regulatory Statement of Financial Position resilient to stresses that affect the Company's shareholder-backed business, and is calibrated such that following a stress event (at the calibrated likelihood) the business remains able to cover its Solvency II Solvency Capital Requirement ('SCR').

The estimated and unaudited Solvency II capital position for the Company as at 31 December 2020 and 2019 is shown below:

	<u>2020</u>	<u>2019</u>
	Unaudited	Unaudited
	£'000	£'000
Solvency II Own Funds	85,065	86,999
Solvency II SCR	(49,823)	(47,829)
Solvency II surplus	<u>35,242</u>	<u>39,170</u>
Solvency II capital ratio	171%	182%

The Company's Solvency II capital requirement has been met during the year and during the comparative year.

NOTES ON THE FINANCIAL STATEMENTS (continued)

16. Long-term business provision

The long-term business provision comprises a provision for annuity business.

For annuity business, the provisions are the present value of the annuity payments and expenses. The calculation of the provisions requires a number of actuarial assumptions regarding future experience to be made. The assumptions are set by the Directors having regard to actuarial advice and based on analysis of relevant past and current data and information on anticipated future trends.

Valuation interest rates and expense inflation have been amended in line with changes in market yields. Renewal expenses, mortality rates and mortality improvement rates have also been amended.

The reinsurers' share of the long-term business provision relates to cessions to The Prudential Assurance Company Limited, the immediate parent company.

The provision for annuity business has been calculated on the following bases:

	2020	2019
Discount Rate assumption pre-2019	1.429% for annuities	2.078% for annuities
Discount Rate assumption post-2019	1.429% for annuities	2.078% for annuities
Expense Inflation	3.29% gross	3.32% gross
Renewal expenses:		
Reassured annuity business	£24.89 per policy p.a. plus third party (TCS) costs	£32.23 per policy p.a. plus third party (TCS) costs
Annuity mortality	Mortality assumptions for UK non-profit annuity business are set in light of recent population and internal experience. The assumptions used are based on England & Wales General Population mortality tables (E&W_Reference_Population for males/females), with an allowance for expected future mortality improvements. Where annuities have been sold on an enhanced basis to impaired lives, an adjustment is made for the additional expected mortality.	Mortality assumptions for UK non-profit annuity business are set in light of recent population and internal experience. The assumptions used are based on England & Wales General Population mortality tables (E&W_Reference_Population for males/females), with an allowance for expected future mortality improvements. Where annuities have been sold on an enhanced basis to impaired lives, an adjustment is made for the additional expected mortality.
	Future mortality improvements: Calibration of CMI2018 with a long term rate of 1.75% for males and 1.50% for females, an Sk parameter of 7.75 for males and 8.25 for females, plus 0.5% constant increase to per annum improvement rates.	Future mortality improvements: Calibration of CMI2017 with a long term rate of 1.75% for males and 1.50% for females, an Sk parameter of 7.50 for males and 7.75 for females, plus 0.5% constant increase to per annum improvement rates.

17. Creditors

All creditors are due within one year.

	2020	2019
	£'000	£'000
Creditors arising from reinsurance operations	142	133
Amounts due to group undertakings	3,377	1,238
Tax payable	477	1,372
Sundry creditors	48,206	11,060
	52,202	13,803

Creditors have increased primarily due to an increase of £27m in outstanding claims settled post-year end and an increase of £11m in AMC rebates due as a result of timing of settlement.

NOTES ON THE FINANCIAL STATEMENTS (continued)

18. Charges

In the normal course of business, certain reinsurance liabilities are secured by a floating charge, ranking these liabilities equally with amounts due under unsecured direct (non-reinsurance) policies, over the long-term insurance assets of the Company. Amounts secured by charges of this nature were £5,673.2m, £289.1m, £76.3m, £36.4m, and £23.9m, representing liabilities to five different customers (2019: £5,516.9m, £293.0m, £94.2m, £41.8m, £18.2m and £4.8m representing liabilities to six different customers).

19. Guarantees and Commitments

At present, the Company has not provided any guarantees or commitments to third parties that have been entered into in the normal course of business. From time to time the Company may enter into these arrangements, however the Directors do not consider the amounts to be significant.

20. Immediate and ultimate parent company

The immediate parent company is The Prudential Assurance Company Limited. On 23 July 2020 the immediate parent company's legal ownership was transferred from its previous parent company M&G plc to a new holding company M&G Group Regulated Entity Holding Company Limited which is a subsidiary of M&G plc.

The ultimate parent of the Company is therefore M&G plc. M&G plc is the only group including the Company in its consolidated financial statements. Copies of its accounts can be obtained from the Company Secretary at 10 Fenchurch Avenue, London EC3M 5AG.

21. Financial Assets and Financial Liabilities

A. Financial assets and financial liabilities – classification and measurement

Under IFRS 9, financial assets and financial liabilities are valued at either FVTPL or amortised cost.

2020

	Fair value through profit or loss £'000	Amortised Cost £'000	Total carrying value £'000	Fair value where applicable £'000
Financial Assets				
Deposits with credit institutions	—	81,600	81,600	81,600
Debt securities	25,932	—	25,932	25,932
Assets held to cover linked liabilities	11,177,431	—	11,177,431	11,177,431
Other debtors	—	14,801	14,801	14,801
Cash at bank and in hand	—	7,205	7,205	7,205
Accrued investment income	—	130	130	130
Total	11,203,363	103,736	11,307,099	11,307,099
Financial Liabilities				
Investment contracts without discretionary participating features	11,177,431	—	11,177,431	11,177,431
Deferred tax liabilities	—	754	754	754
Other creditors	—	52,063	52,063	52,063
Total	11,177,431	52,817	11,230,248	11,230,248

NOTES ON THE FINANCIAL STATEMENTS (continued)

2019	Fair value through profit or loss	Amortised Cost	Total carrying value	Fair value where applicable
	£'000	£'000	£'000	£'000
Financial Assets				
Deposits with credit institutions	—	48,596	48,596	48,596
Debt securities	24,668	—	24,668	24,668
Assets held to cover linked liabilities	11,073,321	—	11,073,321	11,073,321
Other debtors	—	6,640	6,640	6,640
Cash at bank and in hand	—	9,327	9,327	9,327
Accrued investment income	—	129	129	129
Total	<u>11,097,989</u>	<u>64,692</u>	<u>11,162,681</u>	<u>11,162,681</u>
Financial Liabilities				
Investment contracts without discretionary participating features	11,073,321	—	11,073,321	11,073,321
Deferred tax liabilities	—	1,040	1,040	1,040
Other creditors	—	13,670	13,670	13,670
Total	<u>11,073,321</u>	<u>14,710</u>	<u>11,088,031</u>	<u>11,088,031</u>

B. Financial assets and financial liabilities - determination of fair value

The fair values of the financial assets and liabilities as included in the table above have been determined on the following bases.

The fair values of the financial instruments are determined by the use of current market bid prices for quoted investments, or by using quotations from independent third-parties, such as brokers and pricing services or by using appropriate valuation techniques. Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades and financial investments for which markets are no longer active as a result of market conditions e.g. market illiquidity. The valuation techniques used include comparison to recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used priority is given to publicly available prices from independent sources, when available but overall, the source of pricing is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date.

The fair value estimates are made at a specific point in time, based upon available market information and judgements about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial instrument being fair valued. In some cases the fair value estimates cannot be substantiated by comparison to independent markets, nor can the disclosed value be realised in immediate settlement of the financial instrument.

Financial assets held at amortised cost have been shown net of provisions for impairment. The fair value of deposits has been estimated from discounted cash flows expected to be received. The rate of discount used was the market rate of interest.

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

The fair value of investment contracts is based on the fair value of the assets held within the linked funds.

NOTES ON THE FINANCIAL STATEMENTS (continued)

The fair value of other financial liabilities is determined using discounted cash flows of the amounts expected to be paid.

Level 1, 2 and 3 fair value measurement hierarchy of financial instruments

The table below includes financial instruments carried at fair value analysed by level of the fair value hierarchy, as defined in accordance with IFRS (and also includes loans carried at amortised cost in the balance sheet but for which the fair value is disclosed in the financial statements). This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement. The Company's policy is to recognise transfers into and transfers out of levels at the end of each half year except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer.

The classification criteria and its application to the Company can be summarised as follows:

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

Where there is sufficient evidence that the instruments were trading in an active market at the period end they are classified as Level 1. Level 1 principally includes exchange listed equities, mutual funds with quoted prices, exchange traded derivatives such as futures and options, and certain national government and corporate bonds.

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 less frequently traded national government debt securities which are valued using observable inputs, together with over-the-counter derivatives such as forward exchange contracts, certain loans that use observable inputs 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 that are not based on observable market data (unobservable inputs)

Level 3 principally includes investments in unlisted funds and debt securities which are exposed to bespoke properties or risks.

NOTES ON THE FINANCIAL STATEMENTS (continued)

	31 December 2020			
	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Unit-linked				
Equity securities	4,843,182	303	440,698	5,284,183
Debt securities	1,918,843	3,241,748	5,003	5,165,594
Derivative assets	3,348	4,740	—	8,088
Derivative liabilities	(176)	(1,530)	—	(1,706)
Total financial investments, net of derivative liabilities	6,765,197	3,245,261	445,701	10,456,159
Investment contracts without discretionary participation features held at fair value	—	(11,177,431)	—	(11,177,431)
Total	6,765,197	(7,932,170)	445,701	(721,272)
Non-linked				
Debt securities	25,932	—	—	25,932
Total	25,932	—	—	25,932
Company total				
Equity securities	4,843,182	303	440,698	5,284,183
Debt securities	1,944,775	3,241,748	5,003	5,191,526
Derivative assets	3,348	4,740	—	8,088
Derivative liabilities	(176)	(1,530)	—	(1,706)
Total financial investments, net of derivative liabilities	6,791,129	3,245,261	445,701	10,482,091
Investment contracts without discretionary participation features held at fair value	—	(11,177,431)	—	(11,177,431)
Total	6,791,129	(7,932,170)	445,701	(695,340)

NOTES ON THE FINANCIAL STATEMENTS (continued)

	31 December 2019			
	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Unit-linked				
Equity securities	4,808,060	1,031	524,272	5,333,363
Debt securities	1,255,274	3,943,191	—	5,198,465
Derivative assets	1,771	2,933	—	4,704
Derivative liabilities	(2)	(265)	—	(267)
Total financial investments, net of derivative liabilities:	6,065,103	3,946,890	524,272	10,536,265
Investment contracts without discretionary participation features held at fair value	—	(11,073,321)	—	(11,073,321)
Total	6,065,103	(7,126,431)	524,272	(537,056)
Non-linked				
Debt securities	24,668	—	—	24,668
Total	24,668	—	—	24,668
Company total				
Equity securities	4,808,060	1,031	524,272	5,333,363
Debt securities	1,279,942	3,943,191	—	5,223,133
Derivative assets	1,771	2,933	—	4,704
Derivative liabilities	(2)	(265)	—	(267)
Total financial investments, net of derivative liabilities	6,089,771	3,946,890	524,272	10,560,933
Investment contracts without discretionary participation features held at fair value	—	(11,073,321)	—	(11,073,321)
Total	6,089,771	(7,126,431)	524,272	(512,388)

Additional disclosures required by IFRS 13 for items within Level 3

Reconciliation of movements in level 3 financial instruments measured at fair value

The following information reconciles the value of level 3 financial instruments at 1 January to that presented at 31 December. Total gains and losses recorded in the long-term technical account in the period represents realised gains and losses, including interest and dividend income, unrealised gains and losses on financial instruments classified at fair value through profit or loss and foreign exchange movements on overseas investments. All of these amounts are included within “investment income” and “unrealised gains/(losses)” in the long-term technical account. Level 3 items consist of a mixture of one property fund, securitised assets and equities.

NOTES ON THE FINANCIAL STATEMENTS (continued)

Reconciliation of Level 3 opening to closing balances 2020

2020	At 1 Jan 2020	Total losses in long-term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2020
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Unit-linked Equity securities	524,272	(24,861)	—	(58,900)	187	—	440,698
Debt securities	—	—	—	—	5,003	—	5,003
Total	524,272	(24,861)		(58,900)	5,190	—	445,701

Reconciliation of Level 3 opening to closing balances 2019

2019	At 1 Jan 2019	Total losses in long-term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2019
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Unit-linked Equity securities	675,252	(38,320)	—	(112,660)	—	—	524,272

As at 1 January 2020, £524.3m of level 3 assets were held (2019: £675.3m). During 2020, £5.2m of transfers were made into level 3 (2019: £nil) and there were sales of level 3 items of £58.9m (2019: £112.7m).

Of the total loss in the long-term technical account of £24.9m (2019: loss of £38.3m), the unrealised loss on level 3 equity securities for 2020 was £36.0m (2019: loss of £64.3m). As stated above this is included within "unrealised gains/(losses)" in the long-term technical account.

As at 31 December 2020, the Company held £440.7m (2019: £524.3m) of equity investments classified as level 3 in the fair value hierarchy of which £440.5m (2020: £524.3m) comprised of investments in a property fund. These investments are valued using net asset value less redemption costs. A 10% increase in the net asset value of these investments would increase the fair value of the investments by £44m (2019: increase of £52m); a decrease of 10% would have an equal, but opposite, effect.

As at 31 December 2020, the Company held £5.0m (2019: £nil) of debt securities classified as level 3 in the fair value hierarchy which comprise unquoted debt securities valued using broker quotes. For such instruments, the Company has determined that the unobservable input is the fair value itself, therefore sensitivity has been assessed by applying a reasonable discount/premium to the valuation. An increase of 10% would result in the fair value of these debt securities increasing by £0.5m; a decrease of 10% would have an equal, but opposite, effect.

C. Market risk

The financial assets and financial liabilities attaching to the Company's life assurance business are, to varying degrees, subject to market risk that may have a material effect on the profit or loss and shareholders' funds. Market risk is the risk that the fair value or future cash flows of a financial instrument or, in the case of liabilities of insurance contracts, their carrying value, will fluctuate because of changes in market prices.

Market risk comprises three types of risk, namely:

- Interest rate risk: due to changes in market interest rates;
- Currency risk: due to changes in foreign exchange rates; and
- Other price risk: due to fluctuations in market prices (other than those arising from interest rate risk or currency risk).

NOTES ON THE FINANCIAL STATEMENTS (continued)

Due to the matching of policyholder liabilities to attaching asset value movements the unit-linked business is not directly affected by market risk. The principal factor affecting the results is investment performance through fund management fees.

(i) Interest rate risk

Due to the matching of policyholder liabilities to attaching asset value movements the unit-linked business within the Company is not directly sensitive to interest rate movements and so these assets are excluded from the tables below.

The following table shows an analysis of the classes of financial assets with direct exposure to interest rate risk where the Company still retains a risk. Each applicable class of the Company's assets are analysed between those exposed to fair value interest rate risk and those exposed to cash flow interest rate risk.

2020	Fair value interest rate risk £'000	Cash flow interest rate risk £'000	Total £'000
Financial Assets			
Deposits with credit institutions	—	81,600	81,600
Debt securities	25,932	—	25,932
Cash at bank and in hand	—	7,205	7,205
	<u>25,932</u>	<u>88,805</u>	<u>114,737</u>

2019	Fair value interest rate risk £'000	Cash flow interest rate risk £'000	Total £'000
Financial Assets			
Deposits with credit institutions	—	48,596	48,596
Debt securities	24,668	—	24,668
Cash at bank and in hand	—	9,327	9,327
	<u>24,668</u>	<u>57,923</u>	<u>82,591</u>

The estimated sensitivity of the Company to a movement in interest rates (including assumed investment returns for all asset classes, market values of debt securities and all risk discount rates) of 1% and 2% is as follows:

	31 December 2020			
	Fall of 1% £'000	Fall of 2% £'000	Rise of 1% £'000	Rise of 2% £'000
Carrying value of debt securities	2,910	5,820	(2,910)	(5,820)
Interest on deposits with credit institutions	(35)	(35)	718	1,436
Related tax effects	(546)	(1,099)	416	833
Net sensitivity of profit after tax and shareholders' funds	<u>2,329</u>	<u>4,686</u>	<u>(1,776)</u>	<u>(3,551)</u>

	31 December 2019			
	Fall of 1% £'000	Fall of 2% £'000	Rise of 1% £'000	Rise of 2% £'000
Carrying value of debt securities	2,987	5,973	(2,987)	(5,973)
Interest on deposits with credit institutions	(426)	(426)	579	1,159
Related tax effects	(435)	(943)	409	818
Net sensitivity of profit after tax and shareholders' funds	<u>2,126</u>	<u>4,604</u>	<u>(1,999)</u>	<u>(3,996)</u>

(ii) Currency risk

Due to the matching of policyholder liabilities to attaching asset value, movements in the unit-linked business are not directly sensitive to currency risk. Outside of the unit-linked business, no assets or liabilities are held in currencies other than the functional currency, Sterling.

NOTES ON THE FINANCIAL STATEMENTS (continued)

(iii) Other price risk

Due to the matching of policyholder liabilities to attaching asset value movements the unit-linked business is not directly sensitive to other price risk. The Company does not hold any investment property outside of the unit-linked funds. The Company holds no equity securities outside of the unit-linked funds (2019: £nil), and so is not exposed to other price risk.

D. Liquidity analysis

Contractual maturities

Maturity profile for investment contracts and durations of long-term business contracts on an undiscounted basis

The majority of the in force business consists of pooled investment vehicles used for pension scheme business which by nature do not have any contractual repricing or maturity dates, as the benefits are the realisation values of the units held in the internal linked funds and may be surrendered at any time.

The long-term business contracts are annuity contracts which have no maturity date. The liabilities for these contracts are wholly reassured so the maturity profile for the liability is matched by the profile for the asset and so no liquidity risk arises from these contracts.

All remaining financial liabilities are held as creditors which will be settled within one year, as disclosed at note 17.

E. Credit risk

Due to the matching of policyholder liabilities to attaching asset value movements there is minimal credit risk for the Company on the unit-linked contracts as the risks are borne by the policyholders.

Debtors arising from reinsurance operations relate principally to reinsurance agreements with The Prudential Assurance Company Limited, the immediate parent company. The Prudential Assurance Company Limited has a strong credit rating.

Debt securities

Debt securities are analysed below according to external credit ratings 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.

	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
As at 31 December 2020	£000	£000	£000	£000	£000	£000	£000
Unit-linked	310,197	1,800,501	1,016,048	1,887,858	112,376	38,614	5,165,594
Other	—	25,932	—	—	—	—	25,932
Total debt securities	310,197	1,826,433	1,016,048	1,887,858	112,376	38,614	5,191,526
				Restated BBB+ to BBB-			
As at 31 December 2019	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
	£000	£000	£000	£000	£000	£000	£000
Unit-linked	423,753	1,620,103	1,097,029	1,916,221	74,783	66,575	5,198,465
Other	—	24,668	—	—	—	—	24,668
Total debt securities	423,753	1,644,772	1,097,029	1,916,221	74,783	66,575	5,223,133

NOTES ON THE FINANCIAL STATEMENTS (continued)

The 2019 comparatives have been restated to include ratings for unit-linked debt securities in line with the 2020 presentation. These were previously excluded from the table.

Reverse repurchase agreements

At 31 December 2020, the Company had entered into reverse repurchase transactions under which it purchased securities and had taken on the obligation to resell the securities. The value of these transactions at 31 December 2020 was £699.3m (2019: £489.2m). The fair value of the collateral held in respect of these transactions was £713.3m (2019: £499.0m).

During 2020 and 2019 the Company did not take possession of any other collateral held as security.

Collateral and pledges under derivative transactions

At 31 December 2020, the Company had pledged £0.3m (2019: £nil) for liabilities and held collateral of £nil (2019: £1.6m) in respect of over-the-counter derivative transactions.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and repurchase agreements.

22. Risk management

The Company's business involves the acceptance and management of risk. The Company has in place a risk management process, which is undertaken in accordance with the RMF.

A number of risk factors affect the Company's operating results and financial condition. The financial risk categories affecting the Company's financial instruments and insurance assets and liabilities are set out below:

Risk Type:	Definition:
Market risk	The risk of loss, or of adverse change in the Company's financial situation, or that of its customers and clients, resulting, directly or indirectly, from fluctuations in the level or volatility of market prices of assets and liabilities.
Credit risk	The risk of loss or of adverse change in the Company's financial situation, or that of its customers and clients, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors in the form of default or other significant credit event (e.g. downgrade or spread widening).
Insurance risk	The risk of loss or of adverse change in the Company's financial situation, or that of its customers and clients, resulting from changes in the level, trend or volatility of a number of insurance risk drivers as set out below.
Liquidity risk	Treasury liquidity risk is the risk of loss for the Company's business, or of adverse changes in its financial situation, resulting from its inability to generate sufficient cash resources to meet financial obligations (for example claims, creditors and other corporate costs as they fall due). Fund liquidity risk is the risk of being unable to meet liabilities arising from a mismatch in liquidity of the underlying assets and the frequency of liability requirements of the fund.

The Company's exposure to financial risk is limited due to the nature of the unit-linked business where policyholder liabilities are essentially the same as the net asset values backing those liabilities.

A significant part of the Company's profit is related to the fund management charges on its unit-linked products, which are proportionately dependent on the asset values in the funds under management ('FUM'). Any adverse impact on the current and expected future asset returns is therefore likely to impact the Company's profitability by reducing the value of FUM and management charges collected.

Market risk

The key sources of market risk for the Company are equity risk, property risk, interest rate risk and currency risk. Market risk primarily arises in relation to the income generated from management charges. Falls in the values of equities and property, changes in interest rates and fluctuations in currencies can negatively impact asset values, and therefore the value of charges.

NOTES ON THE FINANCIAL STATEMENTS (continued)

Market risk is managed through a robust market risk framework which includes: policies, risk appetite statements and risk limits and triggers covering key market risk exposures; asset and liability management programmes; a quality of capital framework; strategic asset allocations; investment and hedging strategies; and investment constraints.

Credit risk

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

Credit risk is managed through a robust credit and counterparty framework which includes: policies, standards, appetite statements, limits and triggers (including relevant governance and controls); investment constraints and limits on the asset portfolios, in relation to credit rating, seniority, sector and issuer, and counterparties in particular for derivatives, reinsurance and cash; and a robust credit rating process.

Insurance risk

The Company is exposed to expense and persistency risk as a result of its insurance business operations. The Company fully reinsures its longevity risk and has very limited exposure to mortality and morbidity risk.

The Company is exposed to persistency risk i.e. the risk of unexpected changes in policyholder rates of exit. The Company's persistency assumptions are based on past experience and also include expected trends in future persistency rates. If actual levels of policyholder exits are significantly higher than assumed, then the Company's profitability could be negatively impacted due to a reduction in expected income from management charges.

The Company's business is exposed to expense risk, i.e. the risk that expenses (including future expense inflation) could be higher than anticipated.

Insurance risk is managed through the savings and investment risk policy and through risk appetite statements. Persistency risk and expense risk are subject to close monitoring and assumptions are periodically reviewed, with frequency and intensity proportionate to the materiality of the risk.

Liquidity risk

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

- higher than expected customer withdrawals or collateral requirements, and/or lower than expected market liquidity for assets in its unit-linked funds; and
- higher than expected cash outflows from the shareholder business, e.g. due to tax or collateral requirements.

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

- liquidity risk policies, which set out the approach to the management of both treasury and fund liquidity risk. Compliance with the policies is the subject of an annual attestation process;
- a Liquidity Contingency Plan, which sets out the procedures to be followed if a material liquidity risk event arises or is expected to arise;
- asset and liability management programmes; and
- quarterly monitoring of exposures, under base and stress scenarios, against specific triggers and limits for the unit linked funds for a range of time horizons.

In addition, to manage liquidity risk in unit-linked funds which are inherently more illiquid, in particular property funds, deferral clauses are in place which allow the deferral of cash payments to withdrawing customers in extreme adverse liquidity scenarios. Liquidity risk, however, cannot be completely eliminated for unit-linked funds, in particular over the short term, where market volatility can result in mass withdrawals over a short period of time.

NOTES ON THE FINANCIAL STATEMENTS (continued)

The Company's M&G Pooled Pensions UK Property Fund remains in deferral since May 2019 and customers are impacted by the suspension of the M&G Property Portfolio as announced on 4 December 2019. Throughout 2020, both fund teams made substantial progress in raising cash through asset sales. Asset disposals are in line with both funds' respective strategies, with an aim to return to normal operation as soon as possible.

Impairment methodology

The impairment allowance calculation is based on Group's counterparty default risk calibration used for Solvency II. The counterparty default risk uses a default state model and a recovery rate model which is run through 1 million scenarios to generate a probability distribution of losses.

This produces a loss rate reflecting the default losses as a percentage of exposure for various stresses over a 12 month period. These rates have been applied to the balances as at 31 December 2020 to derive the Expected Credit Losses ('ECL').

The impact of collateral and financial guarantees has been considered, where relevant, in the determination of ECL.

The Company held cash and deposits with credit institutions balances of £88.8m at 31 December 2020 (2019: £57.9m). These balances are held with bank and financial institution counterparties.

A 12 month ECL has been calculated in respect of these balances. This reflects the short maturities of the exposures. The Company considers that its cash and cash equivalents have low credit risk based on the external credit ratings of the counterparties.

23. Post balance sheet events

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 when the change is substantially enacted. 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. It is considered that there will not be a significant impact on the deferred tax assets and liabilities as a result of this proposal.