Prudential Pensions Limited

Solvency and Financial Condition Report

31 December 2020

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Rounding convention
The information in the main body of the SFCR is presented in pound sterling and rounded to the nearest million, in line with the financial statements reported under UK GAAP. The information in the quantitative reporting templates (QRTs) contained as an appendix to this document are presented rounded to the nearest thousand pound sterling. Therefore, in the main body of the report, rounding differences of +/- one million can occur.

Summary

Purpose

The purpose of the Solvency and Financial Condition Report ("SFCR") is to provide information required by the Solvency II regulatory framework in respect of Prudential Pensions Limited ("PPL", "the Company") as at 31 December 2020. This report sets out aspects of the Company's business performance, system of governance, risk profile, valuation for solvency purposes and capital management. The SFCR has been prepared in accordance with the relevant Solvency II regulations.

This report has been prepared in compliance with the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009|138|EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) ("Delegated Regulation"), as amended from time to time, and also the relevant Prudential Regulation Authority ("PRA") rules. The structure of this report follows the structure set out in Annex XX and discloses the information referred to in Articles 292 to 298 of the Delegated Regulation. The report also contains narrative information in quantitative and qualitative form supplemented, where appropriate, with quantitative templates.

Readers will be aware that the Solvency II regime was adopted into the United Kingdom ("UK") legislative and regulatory framework on 1 January 2016, while the UK was still a Member State of the European Union ("EU"). We remind readers that this report has been prepared in accordance with Solvency II as enacted under UK legislation in 2016 and as subsequently amended from time to time. Now that the UK has left the EU, and a new trade deal has been agreed, the UK is awaiting a declaration from the EU that its adoption of the Solvency II regime into UK law is equivalent to current EU requirements. Added to this, HM Treasury and the PRA have been consulting widely on potential reforms to Solvency II, and this process is ongoing. For our UK businesses, we will follow guidance from the PRA , as our regulator, as it becomes available.

Company background

PPL was established in 1971, as a UK insurance subsidiary to The Prudential Assurance Company Limited ("PAC"). PAC is a wholly owned subsidiary of M&G 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.

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 which are wholly reinsured to PAC.

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

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

Business and performance

COVID-19

2020 has seen the Company 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 COVID-19 pandemic has had an impact on some parts of the Company and is therefore discussed throughout this report within the relevant sections.

Performance of business

Operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns, which gives a more relevant measure of the performance of the business. For the year ended 31 December 2020, total operating profit before tax in 2020 was £3.6 million (2019: £8.6 million). This reduction is primarily due to a reduction in Annual Management Charge ("AMC") income in 2020. The lower AMC income reflects lower unit-linked investments during 2020, due to both the 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’s total non-operating result increased by £0.2 million to a profit of £1.3 million in 2020 (2019: profit of £1.1 million), driven by a small increase in the value of the Company’s non-linked investments. The Company holds non-linked UK gilts, which have increased slightly in value over the period due to ongoing low interest rates.

No dividend has been paid in the year (2019: £15 million).

Further information on adjusted operating and UK GAAP profits is provided in Sections A.2 and A.3.1, and the Solvency II position including capital generation is set out in Section E.

A full description of the Company's key metrics and further commentary on these results is contained within the Business and Financial Review and Supplementary Information of the Company's 2020 Statutory accounts.

System of governance

The Company's Board is collectively responsible for the long-term success of the Company and for providing leadership within a framework of effective controls. The control environment enables the Board to identify significant risks and apply appropriate measures to manage and mitigate them.

The Company's governance structures have been designed to ensure they suit the needs of the business and stakeholders. The Board and Committees operate under approved terms of reference, which are reviewed on a periodic basis.

Further information on the Company's system of governance including information on the composition of its Board, key functions, risk management and internal control system is provided in Section B.

Risk profile

The Company generates value for shareholders by selectively taking exposure to risks that are adequately rewarded and that can be appropriately quantified and managed. The Company retains risks within a clearly defined risk appetite, which contributes to value creation and provides the ability to withstand the impact of an adverse stressed outcome.

The Company defines 'risk' as the uncertainty that it faces in successfully implementing its strategies and objectives. This includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the Company. As such, material risks will be retained selectively if there is value in doing so, and where it is consistent with the Company's risk appetite and philosophy towards risk-taking.

For retained risks, the Company ensures that it has the necessary capabilities, expertise, processes and controls to appropriately manage the exposure.

The impacts of COVID-19 have permeated throughout the Company's entire risk spectrum and while the Company's main risks remain broadly unchanged, current risk management priorities have been re-focused around operational, people, financial and investment performance risks in particular.

Further information on the main risks inherent in the business, how these risks are managed, and details of how the Company maintains an appropriate risk profile are provided in Section C. Risks covered include underwriting risk, market risk, credit risk, liquidity risk, operational risk, business environment and market forces risk, sustainability, investment performance and risk, people risk, regulation compliance and reputational risk. Sensitivity analysis of the Company's Solvency II coverage ratio to various stresses is provided in Section C.7.2.

Valuation for solvency purposes

For the purposes of Solvency II reporting, the Company applies the Solvency II valuation rules to value the majority of the assets and liabilities of the Company:

(i) As a general principle, technical provisions under Solvency II are valued at the amount for which they could theoretically be transferred immediately to a third party in an arm's length transaction. The technical provisions consist of the best estimate liability and a risk margin reduced by the "transitional measures on technical provisions" ("TMTP") where relevant.

(ii) The assets and other liabilities are valued at the amount for which they could be exchanged between knowledgeable and willing parties in an arm's length transaction. The assets are valued separately using methods that are consistent with this principle in accordance with the valuation approaches set out in the Solvency II regulations.

As at 31 December 2020 the Company's excess of assets over liabilities on a Solvency II basis was £85.1 million (2019: £87.0 million), which was £8.5 million higher than that reported under UK GAAP. This is as a result of valuation differences between the two bases.

Further information on the valuation of assets, technical provisions and other liabilities of the Company for solvency purposes is provided in Section D, including a discussion of the differences between Solvency II and the UK GAAP valuation bases.

Capital management

The Company manages its Solvency II own funds as its measure of capital. It manages its Solvency II capital to ensure that sufficient own funds are available on an ongoing basis to meet regulatory capital requirements.

The own funds eligible to cover the solvency capital requirements ("SCR") and minimum solvency capital requirements ("MCR") are £85.1 million and are all classified as Tier 1 unrestricted own funds. There are limits on the amount of own funds in different tiers that can be used to demonstrate solvency. Further details including restrictions on the type of own funds eligible to cover these requirements is contained in Section E.1.

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 market risk (primarily credit risk and equity risk), expense risk and persistency risk.

At 31 December 2020, the SCR was £49.8 million (2019: £47.8 million). The MCR is currently 45% (2019: 45%) of the SCR, £22.4 million at 31 December 2020 (2019: £21.5 million).

The Company's SCR and MCR have been met at all times throughout 2020. At 31 December 2020, the Company's Solvency II surplus was £35.2 million (2019: £39.2 million).

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

Shareholder view of solvency

The Company reports a shareholder view of solvency, which provides a view of the capital strength of the Company, per the table below. The numbers quoted in Figure 1 reflect the latest regulatory approved TMTP which was recalculated as at 31 March 2020.

Figure 1: Shareholder view of the Solvency II capital position

All figures in £m	31 December 2020	31 December 2019
Own Funds	**85**	87
SCR	**50**	48
Surplus	**35**	39
Solvency ratio (%)	**171 %**	182 %

The reduction in the estimated Solvency II capital surplus is primarily due to a decrease in the present value of future profits ("PVFP"), along with increases in Risk Margin and 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.

Reconciliation of the Solvency II capital position disclosed in the Statutory Accounts to the SFCR

There is no difference in the Solvency II capital position published in the Company's 2020 Statutory Accounts to the Solvency II capital position in the SFCR.

Sensitivity of solvency to matching adjustments and transitional measures

The Regulatory Solvency Ratio is underpinned by the use of transitional measures on technical provisions. Without these items the solvency ratio would change as set out in the table below.

Figure 2: Solvency Ratio without TMTP

Figures in £m	As reported	Without TMTP
Own Funds	85	76
SCR	50	52
Solvency ratio	171 %	147 %

Annually, the Company prepares a plan which includes the projected development of the solvency position. The plan allows for the reduction to the TMTP over the 16 year amortisation period to 2032.

A Business and performance

A.1 Business

A.1.1 Overview

Name and legal form

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

The Company is a wholly owned subsidiary of The Prudential Assurance Company Limited ("PAC"), a company registered in England and Wales. PAC s 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.

The registered office of the Company is:

10 Fenchurch Avenue
London
EC3M 5AG

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

Supervisory authority

The Company is supervised and authorised by the Prudential Regulation Authority ("PRA"), the Company's lead supervisor in accordance with the Financial Services and Markets Act 2000 (FSMA). The contact details are:

Prudential Regulation Authority
Bank of England
20 Moorgate
London
EC2R 6DA
United Kingdom

External auditor

The Company is audited by KPMG LLP. The contact details are:

KPMG LLP
15 Canada Square
Canary Wharf
London
E14 5GL
United Kingdom

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

Holders of qualifying holdings

As at 31 December 2020, PAC is the only holder of qualifying holdings in PPL (being holdings of 10% or more of the voting rights).

A.1.2 Company structure

A.1.2.1 Material subsidiaries of the Company

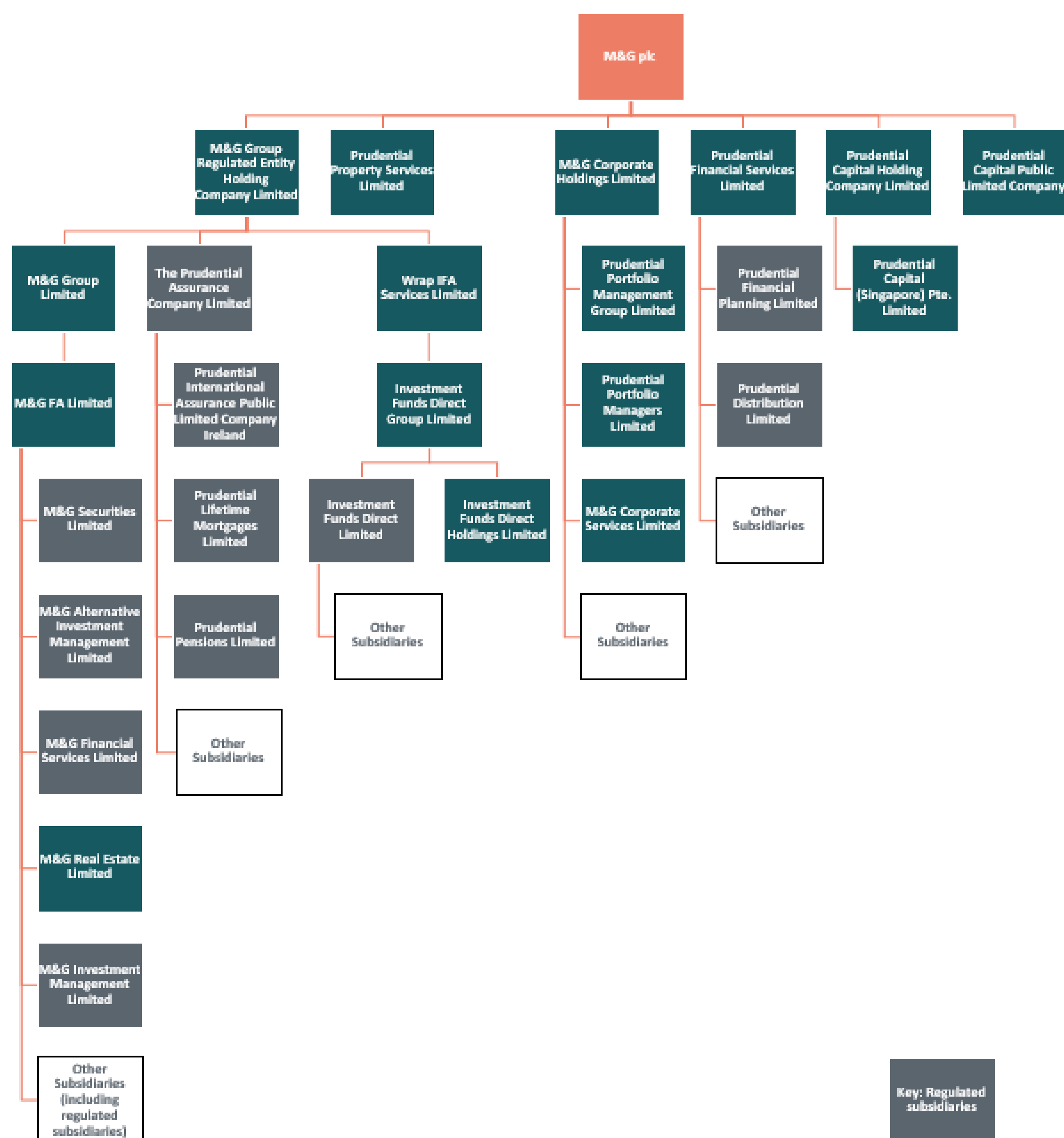
The only material subsidiary of the company is a Fond commun de placement collective investment fund called M&G UK Property Fund FCP-FIS, which is 97.99% owned by the Company (2019: 98.22%). This subsidiary is held within the Company's unit-linked investment funds and enables the Company to manage funds that invest in property.

A.1.2.2 Legal structure of the Company and related undertakings

The Company is part of the Group and is a subsidiary of PAC which is the principal insurance company within the Group. A PAC solo SFCR and a M&G plc Group SFCR will be submitted to the PRA in April 2021 and May 2021 respectively.

Figure 3 below shows, in simplified form, the direct subsidiary undertakings of the ultimate parent company, M&G plc and its significant subsidiaries as at 31 December 2020.

Figure 3: Simplified structure of M&G plc as at 31 December 2020



A.1.3 Business and performance

A.1.3.1 Material lines of business and material geographical areas

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

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

The Company has a small book of annuities reassured to The Prudential Assurance Company Limited.

PPL has a small amount of non-profit annuity business. These annuities are fully reassured to PAC and PPL is closed to new pension annuity business.

A.1.4 Significant business or other events that have had a material impact on the Company over the reporting period

A.1.4.1 The COVID-19 Pandemic

The COVID-19 pandemic has created unprecedented challenges for businesses and governments everywhere. Millions of people around the world have been affected by economic hardship, illness and the loss of people close to them. In the financial markets, global investor confidence was badly shaken in the first half of 2020, resulting in sharp falls in equity markets. The Company responded quickly at the start of the pandemic to mobilise resources and stand up business continuity protocols and also established an Executive Solvency Monitoring Group to provide additional oversight of financial risks.

In the second half of the year, there has been a marked recovery in both bond and equity markets, bolstered by supportive economic policies and positive news on vaccines for COVID-19, resulting in a similar Solvency II coverage ratio of 171% as at 31 December 2020 (2019: 182%). While the economic outlook continues to remain uncertain, particularly once government support schemes are withdrawn, the resilience of the Company's business model has been demonstrated by the demands of the COVID-19 pandemic and it continues at pace with its strategy.

The COVID-19 pandemic has had an impact on some parts of the Company and is therefore discussed throughout this report within the relevant sections.

A.1.4.2 United Kingdom's departure from the European Union ("Brexit")

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

A.1.4.3 Delivering sustainability

M&G plc and its subsidiary entities, including the Company, have put sustainability at the forefront of strategy, from the impact the Company has on the planet and communities, to the opportunity to influence others through leading by example. In November 2020, M&G plc made company-wide commitments to both diversity, 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.

A.2 Underwriting performance

The Company uses UK GAAP to prepare its solo entity statutory financial statements, and IFRS to report the results of the Company to M&G plc for inclusion in the Group results.

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

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

The core discussion of the investment performance of the Company in Section A.3 is by reference to short-term fluctuations in investment returns, being defined as the Company's non-operating result.

An analysis of premiums, claims and expenses is given in Section A.5.2 below.

A.2.1 Operating profit overview

Figure 4: UK GAAP profit for the year-ended 31 December 2020

	2020 £m	2019 £m	Change %
Operating profit based on longer-term investment returns	**2.3**	7.5	(69)%
Short-term fluctuations in investment returns	**1.3**	1.1	18 %
Profit before tax attributable to shareholders	**3.6**	8.6	(58)%

The operating profit is attributable to the Company's unit-linked insurance business. As noted in Section A.1.3, the Company has written some non-profit annuity business which is fully reassured to PAC and therefore does not contribute towards operating profit.

The fall in operating profit is primarily due to a reduction in the AMC income in 2020. The lower AMC income reflects lower unit-linked investments during 2020, due to both the number of exits and the adverse market conditions during 2020.

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

A.3 Investment performance

A.3.1 Short-term fluctuations

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

A.3.2 Investment management expenses

The investment management expenses incurred by the Company’s operations, including those that were paid to the Company’s asset management operations, totalled £14.5 million (2019: £15.4 million). The reduction in 2020 is primarily due to a reduction in the funds under management during the period.

In 2019, investment expenses and charges of £3.2 million, as shown in Figure 5 in Section A.5.1, included income of £12.2 million which partially offset against the gross investment management expenses of £15.4 million. In 2020, this income, totalling £12.8 million, is now excluded from investment expenses and charges and included in other technical income. It represents the income received by the Company from PAC for accepting reassured business. The investment expenses and charges of £14.5 million, as shown in Figure 5, Section A.5.1, are therefore wholly attributable to gross investment management expenses in 2020.

An analysis of investment return in the income statement by asset class is given in Section A.5.2.2.

A.4 Performance of other activities

A.4.1 Investments in subsidiaries

As stated in Section A.1.2, the Company’s only subsidiary is a Fond commun de placement collective investment fund. This investment is held within the Company’s unit-linked investments, and therefore is subject to changes in investment as policyholders move in and out of the fund.

A.5 Any other information

A.5.1 Additional analysis of profits before tax by nature of revenue and charges

Total profit before tax attributable to shareholders for the year-ended 2020 was £3.6 million (2019: £8.6 million), representing operating profit of £2.3 million (2019: £7.5 million), as set out in Figure 4 and discussed in Section A.2.1, and non-operating profit of £1.3 million (2019: profit of £1.1 million). Analysis of profit before tax is shown in Figure 5 below by nature of revenue and charges, on a UK GAAP basis.

Figure 5: Total revenue and charges for the year-ended 31 December 2020

All figures in £m	2020	2019
Investment income	**678.9**	668.2
Unrealised gains / (losses) on investments	**93.1**	701.5
Other technical income	**21.7**	12.6
Total revenue, net of reinsurance	**793.7**	1,382.3
Change in provision for claims - gross amount	**(1.2)**	(2.6)
Change in provision for claims - reinsurers' share	**1.2**	2.6
Change in technical provisions for linked liabilities	**(768.5)**	(1,368.2)
Net operating expenses	**(4.6)**	(3.6)
Investment expenses and charges	**(14.5)**	(3.2)
Foreign exchange gains / (losses)	**(1.1)**	2.9
Foreign taxation	**(1.4)**	(1.6)
Profit on ordinary activities before tax	**3.6**	8.6

A.5.2 Premiums, claims and investment return

A.5.2.1 Comparison of gross earned premiums and benefits and claims with the prior period

Figure 6: Premiums and claims by Solvency II line of business for the year-ended 31 December 2020

All figures in £m	Index-linked and unit-linked insurance	Other life insurance	Accepted life insurance	Total 2020	Total 2019
Premiums earned - gross	**1,085.4**		**292.5**	**1,377.9**	636.9
Claims net of reinsurance	**(1,556.2)**	**(4.5)**	**(477.1)**	**(2,033.3)**	(2,143.1)
Changes in other long-term business and technical provisions	**44.0**		**(157.0)**	**(113.0)**	138.0

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

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

Deposits received in 2020 were £1,377.9 million (2019: £636.9 million). The increase of £741 million is primarily due to large single premium receipts from the Company's direct group pension business in the last quarter.

The Company made payments to policyholders of investment contracts of £(2,033.3) million (2019: £(2,143.1) million). The decrease of £109.8 million is mainly attributable to larger corporate pension scheme exits in 2019 compared to 2020.

The Company's other life insurance business consists of an annuity product which is closed to new business. Claims of £4.5 million (2019: £4.8 million) were paid to policyholders, but this was fully recovered from PAC as part of a reassurance agreement.

A.5.2.2 Investment return by asset class

Figure 7: Investment return for the year-ended 31 December 2020

All figures in £m	2020	2019
Income		
Equity securities and portfolio holdings in unit trusts	**251.7**	307.1
Debt securities	**418.0**	354.7
Other investments	**9.2**	6.3
Total income	**678.9**	668.1
Investment appreciation / (depreciation) and other investment return		
Equity securities and portfolio holdings in unit trusts	**(52.3)**	423.4
Debt securities	**144.0**	275.7
Other investments	**1.4**	2.4
Total investment appreciation / (depreciation) and other investment return	**93.1**	701.5
Exchange (losses) / gains	**(1.1)**	2.9
Total investment return	**770.9**	1,372.5

Investment return principally comprises interest income, dividends and investment appreciation/depreciation (realised and unrealised gains and losses) on investments designated as fair value through profit and loss.

During 2020 there has been a decrease in total investment return which is mainly due to the depreciation on equity securities and reduction in appreciation of debt securities as a result of the adverse market conditions in 2020.

A.5.3 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.

B System of governance

B.1 General information on the system of governance

B.1.1 Overview

The PRA requires that firms have in place an effective system of governance which provides for the sound and prudent management of the business. The system of governance must include an adequate, transparent organisational structure with clear allocation and appropriate segregation of responsibilities.

The Company's Board is collectively responsible for the long-term success of the Company and for providing leadership within a framework of effective controls. The control environment enables the Board to identify significant risks and apply appropriate measures to manage and mitigate them. The Group and the Company's governance structures have been designed to ensure they are aligned to the needs of the Group and its stakeholders, and fully comply with the UK Corporate Governance Code.

The Board is authorised to exercise all the powers of the Company subject to complying with the Group Governance Framework ("GGF"). The GGF details the Group's approach to governance, risk management and internal controls, including policies that apply to the conduct of the Company and its employees, taking into account statutory, regulatory and other relevant matters. Compliance with the GGF, including the Risk Management Framework ("RMF"), is attested to annually.

B.1.2 Board and senior management

The Board has an independent non-executive Chairman. The quorum for the Board consists of at least two members, which must include the Chairman. The membership of the Board as at 31 December 2020 is detailed in Figure 8 below:

Figure 8: Board membership as at 31 December 2020

PPL Board members	Role
Paul Spencer	Chairman and Independent Non-Executive Director ("NED") (SMF 9)
Clare Bousfield	Chief Executive Officer ("CEO"), PPL and Chief Finance Officer ("CFO") M&G plc (SMF 1 and SMF 3)
Paul Cooper	Chief Financial Officer, PAC (SMF 2 and SMF 3)

Note: Ronnie Bowie replaced Paul Spencer as Chair of the Board and Independent Non-Executive Director on 4 February 2021.

The Board operates within the overall ambit of the GGF, which sets out the respective roles and responsibilities between the Group and the entities, allowing for the appropriate management of potential conflicts of interest, as well as the required interactions and two way flow of information, including requirements as to the upward and downward escalation of relevant issues.

Key Function Holders

Clare Bousfield is the CEO of PPL and reports to John Foley. John Foley, the Chief Executive of M&G plc, is a Group Entity Senior Manager (SMF7) of PPL. As a Solvency II entity, the Company is required to identify its key functions and name Key Function Holders ("KFHs"), the senior managers within the Company in charge of those key functions. The Company's KFHs are set out below:

- Actuarial - Jonathan Hughes (SMF 20)
- Compliance - David Nancarrow (SMF 16)
- Distribution - David Macmillan (SMF 18)
- Finance - Paul Cooper (SMF 2 and SMF 3)
- HR - Irene McDermott Brown (SMF 7)
- Internal Audit - Karen Connell (SMF 5)
- Investments - David King (SMF 18)
- Operations - Roddy Thomson (SMF 24)
- Risk - Guy Barton (SMF 4)

Note: Since 31 December 2020, Ronnie Bowie has been approved for SMF 9 - Chair of the governing body effective from 4 February. Karen Connell, as at 31 December 2020, is on maternity leave and her role is covered by Ian Robinson.

Material changes to the system of governance

No material changes have been made to the system of governance during 2020.

B.1.3 Responsibilities of the Board and PAC Board Committees

The Board and Committees operate under approved terms of reference, which are reviewed on a periodic basis.

The Board

The Board principal responsibilities are detailed in Figure 9 below**:**

Figure 9: Board responsibilities

Responsibility	Terms of Reference
Strategy and Business Plan	• adopting the Group strategy, long-term objectives, annual budgets and business plan and approving any Company specific subsidiary business plan; and • monitoring the implementation of the Company's strategy and long-term objectives, annual budgets and business plan and overseeing any corrective action taken by the Company.
Internal Control and Risk Management	• monitoring whether an effective system of internal control and risk management is in place, maintained and reviewed annually; • adopting the Group risk appetite, risk framework and policies and approving any Company specific subsidiary risk appetite, risk framework and policies; • overseeing that the overall risk appetite and tolerance of the Company adheres to the Group risk framework, policies and limits; • reviewing and approving, where applicable, material disclosures to, and regular reporting required by, regulators; and • adopting the Group internal model governance and major model changes and approving any Company specific major model changes.
Solvency and Finance	• approving the Company's Statutory Accounts and Financial Statements; • reviewing the overall financial condition of the Company, and any relevant credit ratings and regulatory capital requirements; • approving payment of dividends; • approving, subject to the GGF, the following matters; ◦ material changes to the Company's corporate structure, including decisions to cease operations in parts of the Company or to extend activities into new business or geographic areas; ◦ material changes to the Company's capital structure, including reduction of capital, share issues and the re-organisation or restructuring of capital; ◦ the raising of, or committing to, external finance and financing programmes; and ◦ material transactions and other matters that require referral to PAC or the Group under the GGF. • monitor the operation of long term funds to ensure the fair treatment of policyholders • approving any significant changes to the Company's investment strategy, including any significant changes to Investment Management Agreements; and • approving liquidity and funding requirements.

PAC Board Committees

As a wholly-owned subsidiary of PAC, the PAC Board Audit Committee ("BAC") and Board Risk & Capital Committee ("BRCC") have responsibility for matters such as the integrity of the financial statements, the effectiveness of internal control and risk management systems and the effectiveness of risk and capital management for all financial and non-financial risks, where there may be an impact on the Company. The role of the BAC and BRCC is summarised in Figure 10 below.

Figure 10: Summary of the role of BAC and BRCC as at 31 December 2020

Committee	Role of Committee
Board Audit Committee	As part of its wider PAC responsibilities, the BAC assists the Company's Board in meeting its responsibilities for the integrity of the Company's financial reporting, including the effectiveness of the internal control and risk management systems, and for monitoring the effectiveness and objectivity of the internal and external auditors. The BAC's membership is wholly independent.
Board Risk and Capital Committee	As part of its wider PAC responsibilities, the BRCC assists the Company's Board in meeting its responsibility for overseeing the effectiveness of risk and capital management for all financial and non-financial risks faced by the Company. The BRCC's membership is wholly independent.

The key functional control areas of Risk, Internal Audit, Compliance and Actuarial report to the Board Committees in accordance with each Committee's terms of reference. It is the responsibility of the BAC to review the resources of Internal Audit and Compliance through its review of annual plans and progress of their delivery during the year. The Actuarial function reports annually to the BRCC on the activities undertaken over the year and the Risk function reports on its activities on an ongoing basis to the BRCC. Further information on the key functions is given in Sections B.3 to B.6.

B.1.4 Board Remuneration

Remuneration Committee and strategy

The M&G plc Board has established a Remuneration Committee to ensure alignment of the Remuneration Policy and structures across the Group, including for the Company, with the Group's business strategy, risk management policies and appetite limits, conduct, culture and behaviours, sustainability and long-term interests of customers and shareholders. The members of the Committee are all independent NEDs.

The Remuneration Committee's responsibilities include, but are not limited to:

- establishing, approving and maintaining the principles and framework of the remuneration policies of the Group and ensuring compliance with those policies; and

- determining the design, implementation and operation of remuneration arrangements, including, where relevant, benefits and pension arrangements, for the Chair, the Directors, members of senior management, "identified staff" for all remuneration regulations that apply to the Group, including Material Risk Takers and other individuals identified as Solvency II Staff[1] under remuneration regulations that apply to the Group, and individuals whose total annual remuneration exceeds an amount determined by the Remuneration Committee from time to time.

[1]The PRA has defined these as Board members, Executive Committee members, Key Function Holders under Solvency II, Senior Manager Functions, Material Risk Takers

The Group's remuneration strategy and policy is to have in place remuneration structures and processes that adhere to the following principles:

- promote the long-term success of the Group and its companies, including the Company;
- attract, motivate and retain the best talent to help ensure the continued growth and success of the Group as a separately listed company;
- support the Group's purpose and values to build a safe, respectful and inclusive culture through remuneration policies and schemes that promote and reward good conduct and behaviours for the benefit of our customers and colleagues;
- align the interests of the Executive Directors, Senior Managers and employees with the interests of current and future shareholders and other stakeholders;
- strike an appropriate balance between short-term and long-term performance with strong linkage to Group performance, effective risk management, management of conflicts of interest, customer outcomes, the culture and values of the Group and long-term shareholder value creation;
- are simple and transparent, both externally and to colleagues; and
- are compliant with relevant remuneration regulation requirements.

The Group's Remuneration Policy was adopted in 2019 and is reviewed annually by the Group and Remuneration Committee.

Remuneration architecture

Remuneration structures are aligned to the Group's purpose and values, with clear linkage to the successful delivery of the Group's short and long-term strategic goals. Both fixed and variable remuneration is assessed against market data and internal benchmarks on an annual basis. Total remuneration is balanced so that the fixed component represents a sufficiently high proportion to avoid employees being overly dependent on the variable components, mitigating and the risk of inappropriate behaviours to the detriment of customer outcomes.

Variable remuneration may comprise short-term incentives (i.e. annual bonus, sales incentives for sales staff) and long-term incentive plan ("LTIP") awards.

Short-term incentives are determined by reference to a combination of financial and non-financial measures and individual performance objectives reflecting the level, nature and scope of an individual's role and the practice in the market in which the Group operates. Individual incentive outcomes must transparently reflect individual performance in accordance with the Group's performance management policy and process, adherence to risk management policies and conduct and behaviour, including reference to customer impacts and culture/values. The Group operates a discretionary short-term incentive policy, including the possibility of not paying an incentive, based on financial, non-financial and individual objectives criteria.

Short-term incentives are subject to the Group's deferral policy, with deferred awards granted over M&G plc shares and are subject to malus during the vesting period.

The Group does not allow the award of discretionary pension benefits. The Group's defined benefit schemes are closed to new members.

Remuneration for NEDs and the Chair

The remuneration of NEDs is determined in accordance with the Company's Articles of Association. Levels of remuneration for the Chair and all NEDs reflect the time commitment and responsibilities of the role.

All NEDs receive a basic fee for their duties as a Board member. The basic and any additional fees payable are periodically reviewed against market data, the time commitment and other requirements of the role. NEDs are not eligible to participate in short-term and long-term incentive plans and do not receive a pension allowance or participate in employee pension schemes. Travel and business expenses incurred in the normal course of business, for example, in relation to attendance at Board and Committee meetings, are met by the Company, including any tax liabilities arising in relation to such business expenses.

Remuneration governance

Governance processes provide robust and independent oversight of reward, effective management of any potential conflicts of interest. The design and operation of all remuneration policies and incentive schemes must be aligned with the Company's risk management principles and policies through the appropriate use of performance measures and targets and the discretion to adjust outcomes to reflect risk, compliance and conduct events.

The M&G plc Risk Committee provides independent input to the Remuneration Committee to help with the assessment of scheme design and outcomes to ensure that they are consistent with these principles and policies. A formal risk and compliance report, compiled by the Chief Risk and Resilience Officer ("CRRO") and approved by the M&G plc Risk Committee is submitted to the Committee annually to provide an assessment of:

- The appropriateness of scheme design for the coming year; and
- The effectiveness of the risk and control environment, material events and specific conduct and compliance issues over the 1 and 3 year performance periods of awards to enable the Remuneration Committee to determine if the outcome of schemes is appropriate or if any adjustments should be applied at scheme or individual level.

This report also includes formal input from PAC (including PPL as a wholly owned subsidiary) via a risk and compliance report, compiled by the Prudential UK Chief Risk Officer ("CRO") (who acts as PPL CRO) and approved by the BRCC. Input from the report is also used to assess whether there have been any events that warrant the consideration of malus and/or claw back on previously determined awards.

B.1.5 Material transactions with directors and shareholders

Transactions with Directors

In addition to remuneration for their role on the Board, executive officers and directors of the Company may, from time to time, purchase insurance or asset management products marketed by the Company and other companies within the Group, in the ordinary course of business on the same terms as those prevailing at the time for comparable transactions with other persons.

In accordance with the Companies Act 2006, directors are required to disclose any transactions that may represent a conflict of interest to their roles. In 2020, no such transactions have been disclosed.

Transactions with shareholders

Transactions with shareholders are described in Section A.1.3.1.

B.2 Fit and proper requirements

The Company ensures that Senior Managers are fit and proper to undertake their role through the implementation of a Fit and Proper Policy. The Fit and Proper Policy applies to:

- all persons approved by the PRA and/or Financial Conduct Authority ("FCA") as holding SMFs, including approved NEDs;
- all persons defined as KFH's and notified to the regulator;
- all persons defined as standard NEDs and notified to the regulator; and
- all persons defined as holding a Certification Function.

There is an annual certification exercise to demonstrate compliance with the GGF, which includes the Fit and Proper Policy, and the system of internal control.

B.2.1 Fit and proper criteria

All individuals to whom the Fit and Proper Policy applies fulfil the following requirements:

- competence and capability, i.e. that they have the necessary skills to carry out the function they are to perform;
- financial soundness; and
- propriety, including adherence to conduct rules.

There are five conduct rules which apply to all staff:

- acting with integrity;
- acting with due skill, care and diligence;
- being open and cooperative with regulators;
- paying due regard to the interest of customers; and
- observing proper standards of market conduct.

There are an additional three conduct rules that apply to SMFs, requiring Senior Managers to:

- take reasonable steps to ensure that the business of the firm within the function is controlled effectively;
- take reasonable steps to ensure that the business of the firm within the function complies with relevant regulatory requirements and standards; and
- ensure that where responsibilities are delegated, the delegation is to an appropriate person and is effectively overseen.

There is a further rule which applies to SMFs and NEDs, requiring any information of which the PRA or FCA would reasonably expect to be notified, to be appropriately disclosed.

B.2.2 Fit and proper assessment

The Company has processes for assessing the fitness and propriety of persons covered under the Fit and Proper Policy, in order that:

- during the recruitment phase and before any regulatory application is made an assessment of the person's fitness is conducted, including:
  - professional and formal qualifications;
  - knowledge and relevant experience;
  - basic criminology disclosure ("DBS") check;
  - credit check; and
  - regulatory references.
- the ongoing fitness and propriety of relevant individuals is assessed (at least annually), including:
  - self-disclosure questionnaires;
  - sample DBS/credit checks (ensuring full coverage on a rolling three year cycle);
  - an assessment of competency and capability to fulfil role; and
  - an assessment of compliance with the conduct rules.

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

B.3 Risk management system including the Own Risk and Solvency Assessment

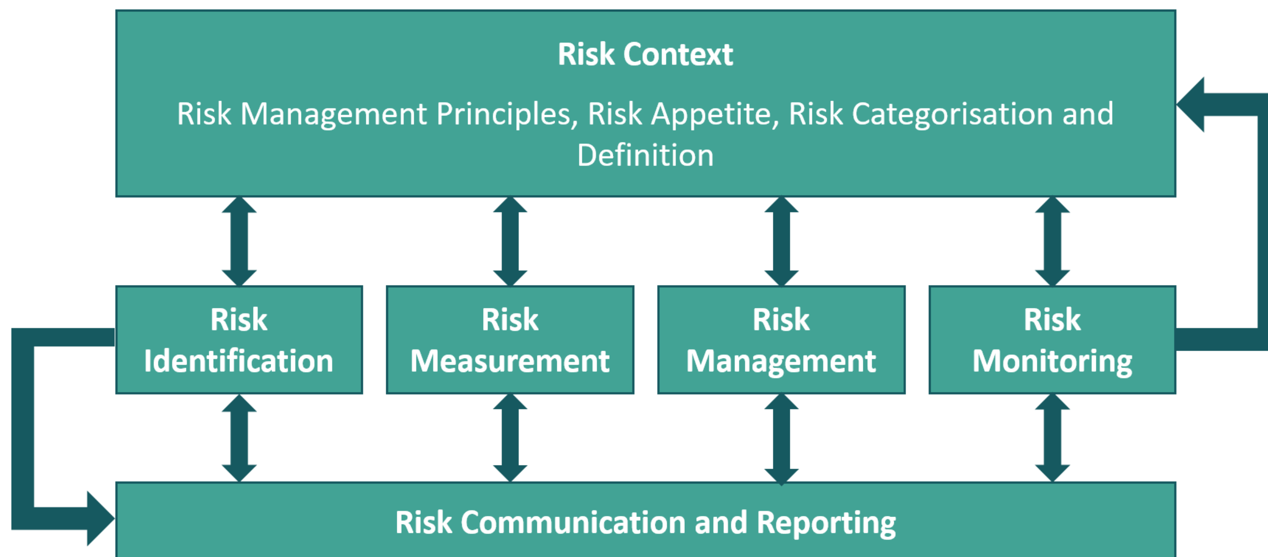
B.3.1 Risk governance, culture and the risk management cycle

Risk is defined as the uncertainty the Company faces in successfully implementing its strategies and objectives. This includes all internal and external events, acts or omissions that have the potential to threaten the success of the Company or the interests of its customers. As part of the Group's business operations, the Company takes on risks on behalf of shareholders and customers. The Company generates shareholder value by selectively taking exposure to risks where such risks are adequately rewarded, and

can be appropriately quantified and managed to safeguard the Company's ability to meet commitments to customers, comply with regulations, and protect its reputation.

To assist the Company's Board in discharging its responsibilities, the Group has implemented a comprehensive approach to identifying, measuring, managing, monitoring and reporting risks ('the risk management cycle'), supported by an embedded risk culture and strong risk governance. This is set out in the Group's RMF. The RMF is designed to manage risk within agreed appetite levels which are aligned to delivering the Group and Company strategy for shareholders and customers.

Figure 11: Risk Management Cycle



The key components of the Group RMF are described below.

B.3.1.1 Risk culture

Culture is a strategic priority of the Board, which recognises the importance of good culture in the way that the Company does business. Risk culture is a subset of broader organisational culture, which shapes the organisation-wide values that are used to prioritise risk management behaviours and practices.

The responsibility for instilling an appropriate corporate and risk culture within the Company lies with both the Group and Company Boards which, together with senior management, promote a responsible culture of risk management in four main ways:

- by the leadership and behaviours demonstrated by management;
- by requiring individuals to take responsibility for managing risk;
- by building skills and capabilities to support risk management; and
- by emphasising the importance of risk management in business decisions.

B.3.1.2 Risk committees

The Company's risk governance comprises the organisational structures, reporting relationships, delegations of authority, roles and responsibilities that the Company establishes to make decisions and control activities on risk-related matters. This encompasses individuals, key functions and committees involved in the management of risk.

The BRCC supports the Board in relation to these matters by providing leadership, direction and oversight of the Company's overall risk appetite in addition to guidance on risk tolerance and strategy. The Committee oversees and advises the Board on the current and potential future risk exposures of the Company, ensuring compliance with the RMF, monitoring its effectiveness and adherence to the various risk policies. The BRCC also supports the Board and management in embedding and maintaining a supportive culture in relation to the management of risk. The BAC assists the Board in meeting its responsibilities for the integrity of the Company's financial reporting, including its obligations for the effectiveness of the Company's internal controls and risk management systems. The responsibilities of the BRCC and BAC are set out in Figure 10 in Section B.1.3.
In addition, there are various executive risk forums to ensure risk issues are considered and escalated appropriately. In particular, the PAC Executive Risk Committee (ERC), is responsible for reviewing and considering specific risk and compliance matters and collectively offering its approval or providing support or advice to the CRO and the PAC Chief Compliance Officer (CCO) (who acts as CCO for PPL). This includes oversight of the RMF and risk and compliance policies, the ORSA, and validation of the Internal Model. In addition, the committee provides oversight and monitoring of key risk exposures against appetite and the internal control environment.

Matters are escalated to the BRCC by the Committee's Chair, the CRO and CCO, if appropriate to do so.

The system of internal control, including risk management, is based on the principles of 'Three Lines of Defence': 1) risk identification and management, 2) risk oversight, advice and challenge, and 3) independent assurance.

First line business areas identify and manage risks and are overseen by the second line Risk and Compliance functions. The second line Risk and Compliance functions are structurally independent of the first line, providing risk oversight, advice and challenge, as well as compliance and monitoring and assurance. Third line Internal Audit is empowered by the BAC to audit the design and effectiveness of internal controls, including the risk management system.

Figure 12: Three Lines of Defence

Line of Defence:	1LOD	2LOD	3LOD
Responsibility:	Risk Identification and Management	Oversight, Advice and Challenge	Assurance
	Be Accountable	Be Objective	Be Independent
Activity:	• Identify, own, manage and report risks • Execute business plan and strategy • Establish and maintain controls • Stress / scenario modelling • Operate within systems and controls • Ongoing self-assessment of control environment effectiveness	• Owner of Risk and Compliance Framework • Stress / scenario setting and oversight • Regulatory liaison • Proactive and Reactive Advice and guidance • Risk and Compliance monitoring and assurance of 1LOD activities • Risk and Compliance reporting	• Independent assurance of 1LOD and 2LOD • Independent 3LOD thematic reviews and risk and controls assessment

B.3.1.3 Risk categorisation and policies

The RMF is structured around a set of defined risks which serves as a reference point for the Group-wide application of the risk management cycle, in terms of risk policies, standards, risk appetite statements, limits and controls. Risk categories are prescribed at a minimum of two levels across the risk universe, and are consistent with the set of model inputs ('risk drivers') used in the Solvency II Internal Model. Risk policies are in place for all material risk categories.

Risk policies set out specific requirements to be applied in the management of each risk type. Policy requirements are typically principles based, and seek to address fundamental concepts rather than operational procedures. This allows business users to determine how to comply with the requirements in the most appropriate way for their part of the business commensurate with the level of risk. Risk policy requirements are attested to as part of the GGF and RMF annual attestation exercise.

B.3.1.4 Risk appetite and limits

The Group's risk appetite and tolerance to take on risk is specified through risk appetite statements and limits that are aligned to, and reviewed with respect to, its business model and strategy. Risk appetite is the amount and type of risk the Group, including the Company, is willing to accept in pursuit of its business objectives.

The Group has established aggregate risk appetite statements and limits for capital (regulatory and economic), liquidity and dividend volatility. The capital risk appetite is supported by a solvency intervention ladder which sets out management actions for implementation or consideration at different levels of regulatory solvency. Both the Group and the Company's expected ability to stay within appetite is assessed during the annual business planning process, with the actual position monitored and managed regularly throughout the year.

Risk appetite statements and accompanying limits are also in place for significant individual risks, including a comprehensive Group Approved Limits Framework ("GALF"). In combination, the individual appetite statements and limits are set such that the Group operates in line with the aggregate approved risk appetite statements even when the individual limits are fully utilised.

Risk exposures are monitored against appetite, both at individual and aggregate level, to ensure compliance with the GALF which, together with limit utilisation, form a core element of risk reporting to Board and Executive Risk Committees. Prescribed forward looking indicators are used to help inform whether a risk may move outside of limit together with appropriate management actions.

B.3.1.5 The risk management cycle

As set out in Figure 11, the risk management cycle is the ongoing process of identifying, measuring, managing, monitoring and reporting the risks to which the business is exposed in the context that it operates.

(i) Risk context

The Company articulates risk management principles, and sets the risk appetite statements, limits and triggers by which risk will be assessed and managed to set the context for risk management throughout the organisation. When establishing the context, the Company considers both the external and internal environment.

(ii) Risk identification

Risk identification is derived through a number of processes, in particular the annual top-down, emerging and bottom-up risk identification processes supported by an annual exercise of stress and scenario testing to assess the magnitude of risks. Each of these is designed to identify and assess risk from a different perspective to form an overall understanding of the Company's risk profile and how it has and is expected to evolve.

(iii) Risk measurement

Risks are measured using appropriate metrics as defined in the setting of risk appetite limits and indicators. Point-in-time measures are supplemented by quarterly sensitivities and stress and scenario testing. Reverse stress testing is also used to provide management with information on the resilience of the Company's balance sheet and sustainability of its profitability.

Operational and organisational risks, are less easily quantifiable; however, a risk incident ('Notifiable Events') process is in place to ensure that risk events are identified, assessed and managed in a timely manner. For all material incidents (whether losses, gains or near misses), a lessons learnt exercise is carried out.

(iv) Risk monitoring

Risk monitoring is an ongoing process to track the status of risks and is undertaken by both risk owners and through oversight and assurance activities undertaken by the Risk, Compliance and Internal Audit functions (for example, limits and transactions monitoring, assurance and lessons learned reviews, model validation reviews, risk deep dives and regulatory compliance monitoring).

(v) Risk management

Risks are evaluated, treated and managed against the defined risk appetite limits and indicators in order to establish whether the business is operating within risk appetite. Where risk appetite is exceeded, or close to being exceeded, management are expected to take action to appropriately treat the risk through mitigation, transfer, or avoidance, or to formally accept the risk. Key investment decisions and projects are subject to detailed risk reviews and go/no go decisions which fully consider all relevant risks and Risk's risk opinion. The resilience of the business and its ability to respond to and recover from major incidents is also regularly tested.

(vi) Risk communication and reporting

To ensure timely and appropriate decision making, the Board, its Committees and senior management are provided with accurate and timely risk reports and management information, including:

- regular management information driven off and aligned to the top-down risk identification process, prepared by the Risk function on behalf of the CRO, which is presented to the Board and Executive Risk Committees to enable oversight of such risks on an ongoing basis; and
- Own Risk and Solvency Assessment ("ORSA") reporting, further details of which are contained in Section B.3.4.

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

B.3.2 The Risk function

Within the Three Lines of Defence model, the Risk function is part of the second line and is responsible for risk oversight. The Risk function assists the Board to formulate and implement the approved GALF, risk management plans, risk policies, risk reporting and risk identification processes. Whilst the first line has responsibility for identification and management, any risks taken are constrained within clear parameters set by Risk. The Risk function also monitors and assesses the risk taking activities of the first line, challenging, where appropriate, the actions taken to manage and control risks and approving any significant changes to controls.

The Risk function's responsibilities include, but are not limited to:

- coordinating the identification and assessment of key risks to establish the risk profile used as a basis for setting qualitative risk appetite statements and quantitative limits, and the management information received by Risk Committees and the Board;
- independently monitoring and reporting that risk exposures are managed within appetite and limits and in line with specified parameters and policies, with regular Risk MI, including on Top Risks, to relevant Boards and Committees;
- providing overall coordination and oversight of risk management processes and systems;
- supporting the Board and management in embedding and maintaining a supportive culture in relation to risk management;
- testing the Group's internal controls and procedures for financial reporting;
- overseeing and validating that the development of the Internal Model is within the framework of model governance and remains fit for purpose;
- providing input and review of public and regulatory disclosures;
- performing the ORSA, risk assessing the business plan, undertaking stress and scenario testing including Reverse Stress Testing, and informing the key areas of risk based decision making;

In order to fulfil these responsibilities, the Risk function liaises with other functions (including Actuarial, Internal Audit and Compliance), to provide technical expertise and advice throughout the risk management cycle. The Risk function is also subject to an annual effectiveness review.

B.3.3 Internal model

The Solvency II Internal Model is a key risk management tool and refers to the systems and processes used to identify, monitor and quantify risks for the purpose of calculating the Solvency II capital requirement ("SCR", "Pillar I") and management's own assessment of economic capital ("ECap", "Pillar II") requirements.

To ensure that the Internal Model is, and continues to be, suitable to support this assessment of risk and capital, the Company has implemented a governance and control framework in relation to:

- **model use**: to provide assurance that the model is widely used in the business, playing an important role in the system of governance and decision making processes;
- **model change**: where changes to the Internal Model are required (e.g. due to a new risk or in response to regulatory feedback or a change in industry practice), these are implemented in a consistent and controlled manner with consideration of any potential implications;
- **model documentation**: the Internal Model documentation outlines the data, methodology, assumptions and judgements within the model, including highlighting the circumstances where the Model does not work effectively. This allows those relying on the model output to determine whether the key features of the model are reasonable; and
- **model validation**: to confirm that the capital requirements resulting from the Internal Model remain appropriate and provide assurance as to the reliability of the Internal Model to senior management and the Board. The Model Risk and Validation team within the Risk function provides independent assurance that the Internal Model remains fit for purpose and compliant, in all material respects, with all applicable rules through a risk-based programme of assurance activity, which also acts as an incentive for the model's ongoing improvement.

The Internal Model governance framework is implemented in accordance with the Internal Model Risk Policy which, in turn, is aligned with the relevant requirements of the Solvency II Directive. Further policies, operational standards and governance committees support the application of the Internal Model Risk Policy.

The Internal Model Governance Oversight Committee ("IMGOC") and the Technical Actuarial Committee ("TAC") have responsibility for ensuring that the Internal Model is, and continues to be, suitable to support the assessment of risk and capital and that it complies with all regulatory requirements. The IMGOC is responsible for the overall governance and oversight of the Internal Model. The TAC is responsible for setting the methodology for valuing the Group's capital requirements and for informing decisions on assumptions. The IMGOC and TAC report to the ERC and are chaired by the Prudential UK CRO and Chief Actuary respectively and report to the Board and Risk Committees as necessary on matters relating to the Internal Model.

There have been no material changes to the Internal Model Governance Framework over 2020.

B.3.4 Own Risk and Solvency Assessment

The ORSA is the Company's ongoing processes for identifying, assessing, controlling, monitoring and reporting the risks to which the business is exposed, and of assessing the own funds necessary to ensure that the Company's solvency needs are met at all times. Risk appetite and limits are the key controls that apply on the current and future risk profile, as a result of the Company's strategy and business plan, and ensure that the Company complies with its solvency requirements on a continuous basis under a reasonable range of scenarios. This process is documented and evidenced through an ORSA report.

The entirety of the ORSA processes are undertaken at least annually with a subset (in particular, those making up the risk management cycle) performed on a continuous basis as part of normal day-to-day risk management activity. An ad hoc ORSA may be triggered by a material change in the Company's risk profile with specific circumstances that could trigger an ad hoc ORSA being set out in the ORSA Policy. Where a trigger is activated, the CRO will decide on which ORSA processes are required to be performed and reported, including whether a revised ORSA Report, or equivalent, is required.

The ORSA report includes a current and forward looking assessment of both the capital and solvency position as well as the risk profile of the Company providing the means to understand the links between strategy, risk and capital. It combines the analysis performed by, and the outcomes of, the ongoing risk and capital management processes that are embedded and which have been reviewed by various Board and Executive Committees. It also provides a quantitative and qualitative assessment of the Company's risk profile and solvency needs on a forward looking basis incorporating the Company's strategy and business plan, including appropriate stress and scenario testing (including reverse stress testing). The scope of the ORSA report covers all the known risks of the Company.

The Risk function is responsible for the preparation of the ORSA report with input from key stakeholders as set out in Figure 13 below. Embedding of the ORSA drives the top-down understanding of the risks to the Company and ensures the central focus of the Internal Model in decision making.

Figure 13: High level overview of ORSA responsibilities

Stakeholder	Roles/ Responsibilities
Board	Ownership and oversight of ORSA processes; steer the processes and embed the outcomes of the processes into the overall decision making framework; approve the ORSA Report.
Prudential UK CRO	Ownership of the ORSA report.
Risk	Preparation of the ORSA report in collaboration with functional areas.
Finance	Preparation of quantitative inputs to the ORSA report.

B.4 Internal control system

B.4.1 Overview

The Company's system of internal control, as set out in the GGF, has a key role in the management of risks that are significant to the fulfilment of its business objectives. The purpose of the internal control system is to set the parameters and procedures that ensure the effectiveness and efficiency of operations, the reliability of reporting (both internal and external) and that help deliver the business strategy in a controlled way, meeting regulatory and other requirements. The key elements of the internal control system are:

- **Matters reserved for the Board**: approval of strategic decisions, subject to the GGF, including approving the Company's risk strategy, together with the setting of risk appetites and tolerances, is reserved for the Board;
- **Management/Delegated Authority**: the Company is managed in accordance with the authority delegated by the Board;
- **Lines of Responsibility**: Senior Managers have clearly defined lines of responsibility for their function and delegated authority;
- **Appropriate Recording**: transactions are appropriately recorded to permit the preparation of reliable financial statements;
- **Financial Reporting Control Procedures and Systems**: the internal control over the financial reporting environment includes procedures and systems which are regularly reviewed;
- **Protection of Assets**: the assets of the Company and its customers are appropriately protected;
- **Financial Crime (Fraud and Money Laundering)**: financial crime is prevented or detected; and
- **Risk Management**: the risks to which the Company is exposed are identified and managed.

In December 2019 a new Group-wide Integrated Control Framework was approved by the Board with the aim of implementing a single consistent enterprise-wide control framework with enhanced analytics and a clear focus on the most material controls. The framework is underpinned by industry-leading Governance, Internal Audit, Risk and Compliance software and an enhanced Operational Risk Framework, which establishes requirements for Risk & Control Self-Assessments (RCSA) to be completed and reviewed on at least a quarterly basis throughout the Group. This Framework is supported by the Group-wide "I Am Managing Risk" campaign.

The BAC supports the review of the adequacy and effectiveness of the internal control systems. This review is supported by the assurance work carried out by Internal Audit, Risk and Compliance.

B.4.2 Compliance function

Similar to the Risk function, the Compliance function is structurally independent of the 1st line. It provides dedicated support for and coordination of regulatory interactions across the business. The function also provides guidance, advice and feedback on regulation (current and future developments), as well as setting and advising on compliance standards and implementing a framework to ensure that conflicts are adequately identified, managed and overseen by the business. Routine monitoring and deep dive activities are carried out to assess compliance with regulatory principles, rules and expectations. The Compliance function reports to the DPPR, with the annual Compliance Plan and required resources agreed by the BAC.

The GGF includes the Regulatory Compliance Risk Policy, Conduct Risk Policy and the Conflicts of Interest Policy, which set out the principles and minimum requirements by which the Company conducts its business and the management of any conflicts of interest. Compliance policies are reviewed and attested to annually.

The policies support the implementation of the Group's risk management principles through requirements to:

- have an effective risk culture, promote appropriate conduct and deploy adequate and appropriate training, skills and resources in respect of regulatory compliance risk management;
- maintain an appropriate and transparent organisational structure with clear allocation of responsibilities and delegated authorities for the management of regulatory compliance risk;
- operate an effective risk management cycle to identify, measure, manage, monitor and report on regulatory compliance risks on an on-going basis;
- consider risk for individual conduct risks and the conduct risk profile in aggregate;
- embed conduct risk management within the culture and thinking of all employees;
- maintain a business that is compliant with applicable laws and regulatory rules and principles, such as Treating Customers Fairly and FCA principles for business.
- ensure that the Group complies with regulations that result from regulatory and business changes
- maintain honest, constructive and open relationships ensure good relationships with governments and regulators; and
- identify, report and manage conflicts of interest to protect the interests of the Group's customers, clients, investors, employees and the Group.

B.5 Internal audit function

Internal Audit operates as the third line in the Three Lines of Defence model, providing independent and objective assurance to the Board and Executive management on the adequacy of the design and effectiveness of the organisation's systems of internal control, including risk management, governance and operational processes, thereby helping the Board and Senior Management protect the assets, reputation and future sustainability of the Company.

Internal Audit is not restricted in scope in any way, is empowered by the BAC to audit all parts of the Company and has full access to any of the organisation's records, physical properties and personnel as necessary to discharge its responsibilities. In executing its responsibilities, Internal Audit adheres to:

- the Institute of Internal Auditors requirements as set out in the Institute of Internal Audit's 'Code of Ethics' and 'International Standards for the Professional Practice of Internal Auditing';
- the Chartered Institute of Internal Auditor's guidance on 'Effective Internal Audit in the Financial Services Sector' ("CIIA Code") as well as the European Confederation of Institutes of Internal Audit ("ECIIA") principal requirements for Internal Audit Functions in Insurance Companies under the Solvency II framework;
- the International Association of Insurance Supervisors ("IAIS") Core Principles;
- the requirements for Internal Audit Functions set out in the Solvency II Directive 2009/138/EC (Level 1 text) Article 47 and Delegated Regulation (EU) 2015/35 (Level 2 text) Article 271; and
- the requirements of the Senior Managers and Certification Regime ("SMCR") and the Group's Fit and Proper Policy.

Internal Audit has sufficient standing and authority within the Company to carry out its activities, supported by the following reporting lines in place to maintain Internal Audit's independence and objectivity in the discharge of its responsibilities:

- in accordance with the Internal Audit Charter, the Company, as part of PAC, has an Internal Audit team, led by the Prudential UK Audit Director who reports to the Chief Audit Officer ("CAO") as functional head. The CAO has direct access to the Chair of the M&G plc Board and Chair of the M&G plc Board Audit Committee and will periodically meet with the M&G plc Board Audit Committee without the presence of management;
- the Prudential UK Audit Director reports audit related matters to the BAC and communicates directly with the Committee through attendance at its meetings and periodically assesses and reports on the continued adequacy of the function's mandate, independence, objectivity, authority, responsibility and technical experience to enable it to accomplish its objectives;
- the Prudential UK Audit Director is empowered to attend and observe all or part of the Company's Board meetings and also PAC's Executive Committee and Board meetings and any other key management decision making committees and activities as appropriate;
- the Chief Operations Officer for Internal Audit, who is independent of the Prudential UK audit team, monitors and evaluates the function's adherence with all relevant Internal Audit standards of practice and audit methodology. The results of these assessments are presented directly to the BAC. An independent external assessment of the Internal Audit function is performed every 5 years in line with Internal Audit standards;
- the assessment of the adequacy and effectiveness of the Risk, Compliance and Finance functions is within the scope of Internal Audit. As such, Internal Audit is independent of these functions and is neither responsible for, nor part of, them;
- all Internal Audit personnel exhibit the highest level of professional objectivity in carrying out their duties, make a balanced assessment of all relevant circumstances, remain impartial and seek to avoid any professional or personal conflict of interest.

Internal Audit has no direct operational responsibility or authority over any business activity or personnel outside of the function; and

- like all areas, Internal Audit maintains a conflicts of interest register. Potential conflicts are recorded and monitored by the Chief Operations Officer for Internal Audit, including a quarterly review of reported conflicts to assess appropriate management oversight.

B.6 Actuarial function

The Chief Actuary for the Company and PAC, which is a PRA SMF role under the SMCR, is also the Actuarial Function Holder for the Company. The Chief Actuary team within the Risk function, and specified individuals within the wider business, are responsible for carrying out the tasks of the Actuarial function on behalf of the Chief Actuary.

The need for, and the scope of, the Actuarial function is defined in Article 48 of the Solvency II Directive. This sets out the tasks that the Actuarial function is responsible for. In addition to the tasks defined in Article 48, the Chief Actuary provides advice to the Prudential UK CRO in relation to a number of risk management responsibilities, in particular, relating to the calibration and calculation of the SCR. This ensures that the Actuarial function is embedded in the key stages of the risk management system in relation to the calculation of capital requirements. The primary activities undertaken by the Actuarial function to meet its responsibilities are summarised below.

Valuation of technical provisions

The Finance function proposes the valuation methodology and assumptions, and calculates the technical provisions. The Chief Actuary reviews the valuation methodology and assumptions, the models and data used in the calculation of the technical provisions and the resulting technical provisions, including those for the Company, and advises the BAC and BRCC accordingly. The report to these committees constitutes a component report of the overall Actuarial Function Report.

Underwriting

The Chief Actuary reviews and advises on all aspects of the underwriting arrangements on an ongoing basis. In addition, the Chief Actuary carries out an annual review of such arrangements focusing on different aspects each year, depending on previous reviews, recent business activities and any particular issues that he wishes to review further. The Chief Actuary provides an annual report to the BRCC, which covers the Company, expressing an opinion on the underwriting policy, identifying any deficiencies and providing recommendations. This constitutes a component report of the overall Actuarial Function Report.

Reinsurance arrangements

The Chief Actuary reviews and advises on the reinsurance arrangements on an ongoing basis. In addition, the Chief Actuary carries out an annual review of the reinsurance policy, focusing on different aspects each year, depending on previous reviews, recent business activities and any particular issues that he wishes to review further. The Chief Actuary provides an annual report to the BRCC, which also covers the Company, expressing an opinion on the adequacy of the reinsurance arrangements, identifying any deficiencies and providing recommendations. This constitutes a component report of the overall Actuarial Function Report.

Capital requirements

The Finance function proposes the valuation methodology and assumptions and calculates the SCR. The Chief Actuary reviews the valuation methodology and assumptions and the resulting SCR and advises the BAC and BRCC, which also covers the Company, accordingly. The Chief Actuary also chairs the TAC, the internal management committee with responsibility for internal capital model methodology and assumptions.

Actuarial function report

The Actuarial function provides a written report to the BRCC, which also covers the Company at least annually, to document the tasks that have been undertaken by the Actuarial function and their results, to identify any deficiencies and provide recommendations as to how such deficiencies should be remedied. This report summarises the tasks described above and highlights the key areas of focus following the Actuarial function's activities each year.

B.7 Outsourcing

The Company continues to rely upon third party suppliers and outsource partner arrangements, allowing it to focus on its core business strengths, reduce costs and manage its delivery risks. The Company recognises that the use of third party supplier and outsource partner arrangements can impact its risk profile, for example, where a material third party fails to provide a service, and there is the subsequent potential for significant interruption to business operations, poor customer outcomes, liability for losses and costs, reputational damage and regulatory breaches. The Company retains ultimate responsibility for any activity that is supplied or outsourced.

Outsourcing partners, in the UK and India, provide various business operations, including a significant part of the back office and customer facing operations as well as a number of IT support functions systems and services, and investment operations.

Services provided by other entities within M&G plc for the Company include fund/asset management provided by M&G Investments and treasury services provided by PruCap. A range of services (including finance and capital management, compliance, risk, HR, actuarial, internal audit and IT services) are also provided across the Group on a shared service basis.

A Third Party Risk Management Policy is used to manage third party risk across the Group. The approach set out in the policy addresses third party risks through the framework of a risk management lifecycle, including requirements to:

- consistently identify and categorise areas of third party risks;
- incorporate third party arrangements into strategic and operational business planning;
- consistently assess third party risks in line with applicable policies, standards and procedures;
- utilise scenario analysis to assess the impact and consequences of third party failures on operational resilience and continuing viability, with risk assessments linking the potential impact of risks to customer outcomes;
- monitor the third party risk profile relative to risk appetite;
- disclose applicable third party risks in financial reporting and to other relevant stakeholders; and
- regularly inform relevant Boards and Risk Committees of the aggregated third party risk profile, policy compliance and associated regulatory requirements.

B.8 Any other information

The M&G plc Board has considered the outcome of the risk management and internal control effectiveness review for 2020 which covered all material controls, including financial, operational and compliance controls, and the impact of the COVID-19 pandemic on the control environment. The review identified a number of actions to further enhance the risk management system and strengthen the overall control environment, with a particular focus on further embedding the new consolidated risk and control frameworks put in place across the Group over 2020.

The PAC Risk and Audit Committees collectively monitor outstanding actions and embedding plans in these and other areas, and ensure sufficient resource and focus is in place to resolve such actions within a reasonable timeframe.

C Risk profile

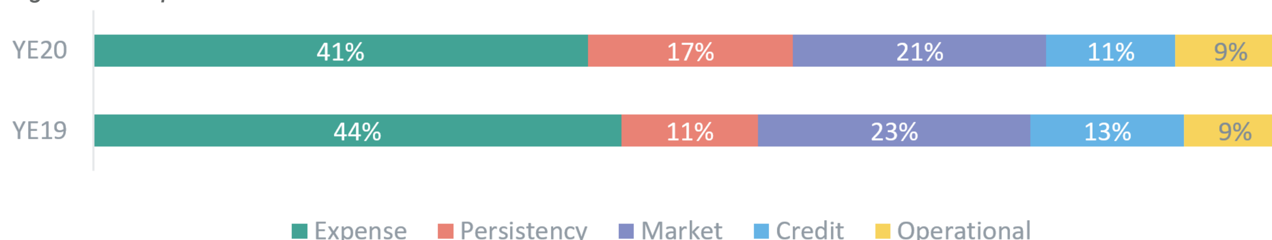
Under the Solvency II regime, companies are required to calculate capital requirements in line with Solvency II regulations. Companies are also required to form their own internal assessment of the capital needed to ensure that they can meet liabilities as they fall due, allowing for the risks that they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

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

The Company's Solvency II capital requirements are calculated using its Internal Model, which is based on the Company's assessment of the risks it faces.

The chart below show the undiversified SCR by risk category as at 31 December 2020 and 31 December 2019 for the Company. Detailed information on the SCR allocation is set out in Section E.2.

Figure 14 Comparison of undiversified SCR as at 31 December 2020 and 31 December 2019



For the measurement of financial risk, the undiversified SCR is used as a key assessment of the size of the financial risk the business is exposed to under severe ("1 in 200 year") stresses, with regular stress and scenario tests also applied regularly to the key financial exposures to understand the sensitivity of the overall Solvency II balance sheet to individual and combines risks. This is further supported by solvency monitoring and experience analysis.

The key risk exposures are discussed in the following sections:

- Underwriting risk, often described as insurance risk, which includes persistency and expense risk (refer to Section C.1). The company has no longevity risk exposure;
- Market risk, which includes equity, property, interest rate and currency risks (refer to Section C.2);
- Credit and counterparty risk (refer to Section C.3);
- Liquidity risk (refer to Section C.4);
- Operational risk (refer to Section C.5); and
- Other material risks (refer to Section C.6).

C.1 Underwriting risk

C.1.1 Risk exposure

Underwriting risk refers to the risk of loss or of adverse change in the financial situation of the business, or that of customers and clients, resulting from changes in the level, trend, or volatility of longevity, persistency, expense, mortality and morbidity experience. The Company fully reinsures its longevity risk to PAC and has very limited exposure to mortality and morbidity risk. Therefore the key exposures are to persistency risk and expense risk.

Persistency 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. However, from a solvency perspective, the Company is exposed to reductions in the assumed levels of future exits. Although this has the effect of increasing expected future profits, this is more than offset by corresponding increases in the Solvency II SCR and risk margin.

Expense risk

The Company is exposed to expense risk, i.e. the risk that expenses (including future expense inflation) could be higher than anticipated. However, this risk is expected to decrease as base costs are reduced as a result of the significant the change programme, a major Group-wide programme of investment to improve processes and systems.

C.1.2 Risk mitigation

Underwriting risk is managed in line with requirements set out in the Savings and Investment Risk policy, which also defines the Company's risk appetite in relation to insurance risk. 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.

C.2 Market risk

C.2.1 Risk exposure

Market risk refers to the risk of loss or adverse change in the financial situation of the business 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. The key types 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, lower interest rates and fluctuations in currencies can negatively impact asset values, and therefore the value of charges.

C.2.2 Risk mitigation

A robust market risk framework (defined at the Group level) which supports the effective risk management of market risks and includes the following:

- a market risk policy and appetite statements, limits and triggers (including relevant governance, processes and controls);
- a framework covering the triggering of an application to recalculate the Solvency II TMTP, which mitigates changes in risk margin due to interest rates (amongst other factors);
- monitoring of the impact of market movements on the solvency position relative to risk appetite;
- regular reviews of strategic asset allocations, investment and hedging strategies;
- regular stress and scenario testing to monitor and assess market risk exposures; and
- investment constraints and limits set out in Investment Management Agreements ("IMAs") and Fund guidelines, which are subject to periodic review.

C.3 Credit and counterparty risk

C.3.1 Risk exposure

Credit risk refers to the risk of loss or adverse change in the financial situation of the business, or that of 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). 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.

C.3.2 Risk mitigation

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

C.4 Liquidity risk

C.4.1 Risk exposure

The Company is exposed to two types of liquidity risk:

- treasury liquidity risk is the risk of loss for the Company's business, or of adverse changes in its financial situation, resulting from the its inability to generate sufficient cash resources to meet financial obligations (e.g. claims, creditors and other corporate costs as they fall due); and
- fund liquidity risk is the risk of being unable to meet liabilities arising from a mismatch in liquidity of the underlying assets and the frequency of liability requirements of the fund. This risk relates to third party funds managed on behalf of customers and clients.

While the Company is not directly exposed to fund liquidity risk, it is exposed to indirect effects of this risk materialising, such as an impact on persistency and reputation.

C.4.2 Risk mitigation

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

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

In addition, to manage liquidity risk in unit-linked funds which are inherently more illiquid, in particular property funds, deferral clauses are in place which allow the deferral of cash payments to withdrawing customers in extreme adverse liquidity scenarios. PPL'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. Fund liquidity is expected to remain a key theme as regulatory and market developments impact funds' investments in unquoted and hard to trade assets.

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

C.5 Operational risk

C.5.1 Risk exposure

Operational Risk is defined as 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 (as detailed in section C.6.1). Operational failures can also give rise to financial risk exposures, for example through process failures in the management of market and credit risk.

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 risk is primarily measured and monitored through the Risk and Controls Self Assessment ("RCSA") process as part of the Integrated Control Framework, which provides a Group-wide framework to assess inherent and residual risk exposure and the effectiveness of operational controls within the Company. In addition, to the extent that operational risks cannot be full mitigated, the Company holds capital against operational risk within the Internal Model SCR calculation.

Operational Resilience is the preparedness and ability to anticipate, prevent, respond to, recover and learn from operational disruptions (whether unforeseen or not). The Company's operational resilience has been tested by COVID-19 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:

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.

Third party suppliers
As detailed in Section B.7, like many of its peers, the Company is increasing 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.

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.

C.5.2 Risk mitigation

The operational risk profile of the business continues to evolve in line with the Company's strategy and the business environment in which the Company operates. The Company manages and mitigates operational risk via the following methods:

- an Integrated Control Framework and operational risk framework and system that delivers processes and tools to identify, assess, manage and report operational risk exposures;
- additional policies, standards and procedures which cover specific operational risk exposures, such as technology risk, change risk and third party risk;
- internal and external incident lessons learned reviews;
- corporate insurance programmes to limit the financial impact of operational risks;
- regular testing of elements of the business continuity and disaster recovery plans;
- strong project governance (including oversight) with reporting and escalation of risks to management and the Board;
- metrics to monitor and report on the delivery, costs and benefits of transformation programmes and regular deep dive assessments are conducted on transformation programmes, individually and collectively; and
- implementation of the operational resilience framework, including the Group Operational Resilience Policy. This involves:
  - defining key business services with articulation of the end-to-end process, and value chain of activities, which make up such services;
  - determining appropriate impact tolerances for the key business services;
  - enhancing the testing of such services to assess, and where necessary enhance, the ability of the services to withstand and absorb operational disruption; and
  - operating on the presumption that operational disruptions will occur, it is not 'if' but 'when'.

C.6 Other material risks

The Company is exposed to other material risks. These are consistent with and interrelate with the other material risks that the Group faces and as such the risk management and mitigation is established at a group level rather than having separate processes for the Company.

C.6.1 Business environment and market forces risk

Changing customer preferences and economic and political conditions, could adversely impact the Company's ability to deliver the strategy and have implications for the profitability of the 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.

The Group conducts an annual strategic planning process, which is subject to oversight by the Risk function and the Board, and results in an approved Group strategy which the Company is aligned to. The process considers the potential impact of the wider business environment and, throughout the year, the Company monitors and reports on the delivery of the plan.

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.6.2 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.

C.6.3 Investment performance and risk

The investment objectives and risk profiles of funds and segregated mandates are agreed with 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. 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 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 asset owner 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.

C.6.4 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, the Company's 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 of the 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 function 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 which put staff safety and well-being at the forefront of the Company's response to the pandemic.

C.6.5 Regulatory compliance

The Company operates in a highly regulated market and the Group interacts with regulators in an environment where the nature and focus of regulation and laws remain fluid. There are currently a large number of 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 co-ordinating 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.

C.6.6 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 (as part of the Group) 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.

C.7 Any other information

C.7.1 Special Purpose Vehicles

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

C.7.2 Risk sensitivity

Stress and scenario testing is embedded in the RMF. It is performed in order to:

- assess the Company's ability to withstand significant deterioration in financial and non-financial conditions including environmental impacts such as climate change;
- provide feedback to decision making processes by identifying areas of potential business failure;
- demonstrate to stakeholders that the Company has adequate capital and liquidity levels;
- demonstrate that the Company has appropriate and plausible management actions available to cover potential losses incurred during extreme, but plausible events; and
- assist in the monitoring of adherence to the Company's risk appetite.

To evaluate the Company's resilience to significant deterioration in market and credit conditions and other shock events, the quantifiable risks facing the Company as described in the sections above, are assessed via stress scenarios of varying severities. In addition, annually the Company derives a reverse stress test which gives the directors an understanding of the type and strength of scenario expected to result in the Own Funds falling below 100% of the SCR. The Company also maintains a Risk Appetite Framework which includes an assessment of the Company's ability to withstand a specified level of shock and still cover its SCR.

Mitigating management actions designed to maintain or restore key capital, liquidity and solvency metrics to the Company's approved risk appetite are available to the Company in times of stress. As such, these actions will be available in the scenarios tested and will assist in maintaining the viability of the Company over the plan period.

Stress tests are performed both with and without any allowance for the TMTP, granted by the PRA, being recalculated.

The methodology and assumptions applied to calculate the balance sheets in the stress scenarios are broadly consistent with those applied when valuing the reported balance sheet. However, the movement in stressed own funds is calculated using the proxy models within the Solvency II Internal Capital Model (ICM) rather than the full valuation models. The methodology and assumptions are subject to some accepted limitations with the stress testing methodology reviewed and approved on an annual basis to ensure it remains appropriate.

Sensitivity Analysis

The following estimated sensitivities of the Company Solvency II capital position are provided as an indication of the sensitivity of the surplus to economic stresses as at 31 December 2020.

Figure 15: Impact of sensitivities

	Solvency II sensitivities	Surplus (£m)	Solvency Ratio (%)
31 December 2020	**Base surplus (regulatory approved TMTP)**	**35**	**171 %**
	Base surplus (recalculated TMTP)	**34**	**168 %**
	20% instantaneous fall in equity markets	**27**	**157 %**
	50 basis points reduction in interest rates	**28**	**152 %**
	100 basis points increase in credit spreads	**28**	**156 %**
	20% credit asset downgrades	**33**	**165 %**
	20% instantaneous fall in property values	**33**	**166 %**
31 December 2019	**Base surplus**[1]	39	182 %
	20% instantaneous fall in equity markets	34	176 %
	50 basis points reduction in interest rates	35	167 %
	100 basis points increase in credit spreads	34	172 %
	20% credit asset downgrades	38	180 %
	20% instantaneous fall in property values	38	180 %

[1] At 31 December 2019 the regulatory approved TMTP and the recalculated TMTP were the same, having both been recalculated at 31 December 2019.

All sensitivities are presented relative to the recalculated TMTP reported results, and allowing for a further recalculation of TMTP, which would be subject to PRA approval.

A description of each sensitivity is as follows:

- The equity sensitivity reflects a 20% instantaneous fall in all global equity markets.
- The interest rate sensitivity reflects a 50 basis points reduction in the gross redemption yield on all fixed interest securities and the real yield on all variable securities. A 50 basis points reduction in all points of all swap curves which form the basis of the valuation interest rates. The adjustment for credit risk is unchanged from that allowed for in the base results.
- In the credit spread sensitivity corporate bond yields for A rated investments have increased by 100 basis points. The yields for other corporate bonds have increased by a proportion of 100 basis points where the proportion is equal to the base spread for the relevant rating divided by the base spread for the A rated bonds. There is no change in gilt and approved security yields and there is no change to the default assumptions or ratings.
- The credit asset downgrade stress reflects a full letter downgrade on 20% of all assets for which the credit rating is a determinant of the capital requirements.

- The property sensitivity reflects a 20% instantaneous fall in all global property markets, including both residential and commercial exposures.

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

Consideration of the coincidence of risks through combined and reverse stress testing has shown that it would take a strong market event including credit shocks to reduce the capital coverage ratio below 100%. At 100% capital coverage, the Company would have sufficient capital to withstand a 1 in 200 year event.

The Company has the ability to call down support under a Capital Support Agreement provided by PAC under certain defined circumstances providing additional solvency protection.

C.7.3 Risk concentration

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

C.7.4 Prudent Person Principle

The Prudent Person Principle requires that the Company only makes investments on behalf of customers that a 'prudent person' would make. In order to comply with this principle, the Company has to be able to identify, understand, measure and monitor any risks arising from its investment portfolios, as well as demonstrate that it carries out these activities appropriately.

Risk factors relevant to investment strategy are detected via a number of different processes, principally through the Company's risk identification process. These risk factors are primarily overseen under the RMF alongside other well established investment processes (e.g. such as the SAA), ensuring that the Company's investment risks are managed effectively and efficiently, and within risk appetite. The Framework focuses on the integrity and effectiveness of the investment processes, governance and controls, as well as appropriateness of resourcing and compliance of processes with applicable regulatory requirements (including the Prudent Person Principles set out in the Solvency II Directive).

The Company outsources investment management to both intra-group and to external asset managers. That business is governed by a common governance framework. The following information provides details on the approach the Company applies to the Prudent Person Principle when making investment decisions:

- Group policies provide a group-wide framework for the oversight of financing and investment activities. They are designed to provide general, prudent and principle-based guidance. In particular, they are designed to ensure that investment decisions are taken with appropriate cognisance and consideration of the risks involved, with clear sight of the customer outcome objectives, and robust challenge;
- the Savings and Investment Risk Policy covers all aspects of overseeing investment risk across the Group, specifically setting out the group-wide framework for management and oversight of investment performance and investment related risk which includes minimum standards, controls and requirements for risk management. It aims to ensure that all Group entities have appropriate procedures in place to manage, monitor and report on the investment risk that they have taken on both for individual risks and in aggregate;
- the Asset Owner Investment Policy and Asset Owner ESG Investment Policy together cover the asset owner specific aspects of investment risk, specifically setting out the framework for management and oversight of investment performance and investment related risk which including minimum standards controls and requirements for risk management;
- the framework is supported by further documents including specific policies that cover credit, market, insurance, liquidity, operational and investment risk as well as lower level operating standards and approved limits. From time to time, additional relevant risk factors may be identified through the Group's risk identification processes. These will be taken into account as appropriate depending on their nature, level of materiality and transience, and will be monitored;
- detailed Asset Owner Execution and Order Handling policies exist in relation to trading operations and set out the framework under which customer outcomes are achieved to ensure full compliance with all local regulations. These are supplemented by asset class procedures that detail operational controls; and
- the Company oversees its asset managers through monitoring compliance with IMAs and investment mandates. These are structured in order to ensure that, in line with the Prudent Person Principle, appropriate activities for identifying, understanding, measuring and monitoring relevant risks are carried out. Where these activities are carried out on a delegated basis by an asset manager, the Company carries out due diligence to confirm that the level of compliance with the requirements of the Prudent Person Principle remains appropriate. The Company updates and maintains IMAs and investment mandates in line with changes in investment strategy.

The Company has reviewed its Prudent Person Principle approach to ensure its ongoing adequacy in light of the PRA's Supervisory Statement (SS1/20 Solvency II: Prudent Person Principle) setting out the Regulator's expectations relating to a firm's investment strategy, investment risk management, and governance system.

D Valuation for solvency purposes

This section provides a description of the bases, methods and main assumptions used in the valuation of assets (Section D.1), technical provisions (Section D.2) and other liabilities (Section D.3) under Solvency II and an explanation of differences to values in the UK GAAP financial statements.

Recognition of assets and liabilities under Solvency II is the same as for UK GAAP, except for contingent liabilities which are recognised as liabilities under Solvency II if material. However, the measurement of these assets and liabilities can differ under the two metrics.

The 31 December 2020 Solvency II balance sheet incorporates no changes to the recognition of assets and other non-insurance liabilities, compared to the 31 December 2019 Solvency II balance sheet.

The 2020 balance sheet valued under both UK GAAP and Solvency II basis, together with a reconciliation of the key differences is summarised in Figure 16 below, whilst further details of the valuation of specific types of assets and liabilities is contained in Sections D.1 to D.4.

The 2020 balance sheet valued under both the statutory accounts basis (UK GAAP) and the Solvency II basis is summarised in Figure 16 below.

Figure 16: Solvency II and UK GAAP balance sheets for the year-ended 31 December 2020

All figures in £m	Solvency II (2020)	Financial Statements (2020)	Difference (2020)	Solvency II (2019)	Financial Statements (2019)	Difference (2019)
Assets						
Investments (other than participations)	**107.7**	**107.7**	**—**	73.4	73.4	—
Assets held in index-linked and unit-linked funds	**9,224.2**	**11,177.3**	**(1,953.1)**	9,105.8	11,073.3	(1,967.5)
Reinsurance recoverable	**2,003.9**	**51.1**	**1,952.8**	2,020.1	52.3	1,967.8
Cash and cash equivalents	**7.2**	**7.2**	**—**	9.3	9.3	—
Other assets	**15.3**	**15.6**	**(0.3)**	7.3	7.4	(0.1)
Total assets	**11,358.3**	**11,358.9**	**(0.6)**	11,216.0	11,215.7	0.2
Liabilities						
Technical provisions	**11,217.6**	**11,228.6**	**(11.0)**	11,110.9	11,125.7	(14.8)
Deferred taxation	**2.7**	**0.8**	**1.9**	3.6	1.1	2.5
Other liabilities	**52.9**	**52.9**	**—**	14.5	14.5	—
Total liabilities	**11,273.2**	**11,282.3**	**(9.1)**	11,129.0	11,141.3	(12.3)
Excesses of assets over liabilities	**85.1**	**76.6**	**8.5**	87.0	74.4	12.5

The differences between the values under Solvency II and in the UK GAAP financial statements are summarised below:

i. *Investments (other than participations)*

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

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

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

There is also a £0.3 million value difference in the amount reclassified due to minor differences in the longevity and expense assumptions and valuation interest rate used between the financial statements and Solvency II. Further information on these differences can be found in Section D.2.1.3.

iii. *Reinsurance recoverable*

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

iv. *Cash and cash equivalents*

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

v. *Other assets*

The reduction in other assets of £0.3 million relates to a reclassification of assets under Solvency II.

D.1 Valuation of assets for Solvency II

D.1.1 Determination of fair value

Within the Solvency II balance sheet, assets are valued using valuation methods that are consistent with the valuation approach set out in the Solvency II Directive. There have been no significant changes in the valuation basis of assets in the Solvency II balance sheet in 2020.

The overall principle when valuing assets and liabilities under Solvency II is to use a fair value, as set out in Article 75 of the Directive.

When valuing assets and liabilities in accordance with Solvency II, the valuation hierarchy set out below is followed:

(a) Quoted market prices in active markets for the same assets or liabilities

As the default valuation method, assets and liabilities are valued using quoted market prices in active markets for the same assets or liabilities, where available.

The investments of the Company which are valued using this method include exchange listed equities, mutual funds with quoted prices, exchange traded derivatives such as futures and options, and certain national government and corporate bonds.

At 31 December 2020 £7.7 billion (2019: £8.6 billion) of financial assets were valued using this approach.

(b) Valuation methods using quoted market prices in active markets for similar assets and liabilities with adjustments to reflect differences

Where quoted market prices in active markets for the same assets or liabilities are not available, assets and liabilities are valued using quoted market prices in active markets for similar assets and liabilities with adjustments to reflect factors specific to the asset or liability such as condition or volume or level of activity in the markets.

There are a limited number of financial assets valued in this manner. At 31 December 2020 £3.2 million (2019: £2.7 million) of financial assets were valued using this approach; these consist of foreign exchange forwards.

For (a) and (b), the Company applies a number of criteria in determining whether a market is considered 'active'. These include, but are not limited to, consideration of whether there is observable trading activity, a price or consensus price on the measurement date.

Where assets cannot be valued based on quoted market prices in active markets of the same or similar assets, alternative valuation methods are used, as described in (c) and (d) below.

(c) Alternative valuation methods - using inputs that are observable in the market

Where possible, the alternative valuation method uses significant inputs into the valuation that are observable for the asset directly (i.e. as prices) or indirectly (i.e. derived from prices). At 31 December 2020 £1.6 billion (2019: £nil) of financial assets which were valued using this approach.Where we have observable inputs, we use the observable price and do not adjust further for the effect of future uncertain events.

A significant proportion of the Company's assets in this category are corporate bonds. These assets, in line with market practice, are generally valued using independent pricing services or quotes from third-party brokers. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

Pricing services, where available, are used to obtain third-party broker quotes.

When prices are not available from pricing services, quotes are sourced directly from brokers. The Company seeks to obtain a number of quotes from different brokers so as to obtain the most comprehensive information available on their executability. Where quotes are sourced directly from brokers, the price used in the valuation is normally selected from one of the quotes based on a number of factors, including the timeliness and regularity of the quotes and the accuracy of the quotes considering the spreads provided. The selected quote is the one which best represents an executable quote for the security at the measurement date.

Generally, no adjustment is made to the prices obtained from independent third parties. Adjustment is made in only limited circumstances, where it is determined that the third-party valuations obtained do not reflect fair value (e.g. either because the value is stale and/or the values are extremely diverse in range). These are usually securities which are distressed or that could be subject to a debt restructure or where reliable market prices are no longer available due to an inactive market or market dislocation.

In these instances, prices are derived using internal valuation techniques including those as described below, with the objective of arriving at a fair value measurement that reflects the price at which an orderly transaction would take place between market participants on the measurement date.

The techniques used require a number of assumptions relating to variables such as credit risk and interest rates. Examples of such variables include an average credit spread based on the corporate bond universe and the relevant duration of the asset being valued. The input assumptions are determined based on the best available information at the measurement dates.

The majority of such securities were valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to judgement.

d) Alternative valuation methods - inputs not based on observable market data

Investments valued using valuation techniques with inputs not based on observable market data include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions e.g. market illiquidity. These principally include investments in property funds which are exposed to bespoke properties or risks.

The valuation techniques used include comparison to recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used, priority is given to publicly available prices from independent sources when available, but overall the source of pricing is chosen with the objective of arriving at a fair value measurement that reflects the price at which an orderly transaction would take place between market participants on the measurement date.

The fair value estimates are made at a specific point in time, based upon any available market information and judgements about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time a significant volume of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial instrument being fair valued.

In some cases the disclosed value cannot be realised in immediate settlement of the financial instrument.

The models above involve judgement over future events for example credit ratings and future house price growth.

As at 31 December 2020, the Company did not hold any assets, net of liabilities, at fair value (2019: £524 million) were valued in this manner. These principally include investments in property funds which are exposed to bespoke properties or risks.

D.1.2 Valuation bases under Solvency II compared with UK GAAP

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

D.1.2.1 Assets held for unit-linked contracts

These assets are held to cover linked liabilities, whereby the policyholders bear the investment risk of the assets. Under both UK GAAP and Solvency II these assets are recorded in aggregate as a single line entry on the balance sheet. The difference between UK GAAP and Solvency II, which is primarily due to a Companies Act presentational difference, relates to reinsurance in relation to investment contracts without discretionary participation features, which is treated as reinsurance under Solvency II but as an investment under UK GAAP. There is also a £0.3m value difference in the amount reclassified due to minor differences in the longevity and expense assumptions and valuation interest rate used between the financial statements and Solvency II.

D.1.2.2 Deferred tax asset

Deferred tax assets, other than the carry forward of unused tax credits and losses, are calculated based upon the differences between the values given to assets and liabilities for tax purposes and their values in the Solvency II balance sheet. The principles of UK GAAP are applied to calculate the extent of deferred tax applicable to those value differences. Changes in the valuation of underlying assets or liabilities will give rise to a change in deferred tax balances. Recoverability is assessed on the basis of the balances held and consideration is given to the probability of taxable profit being available against which the underlying recoverable can be offset.

There is no deferred tax asset on the Solvency II balance sheet as at 31 December 2020 or 31 December 2019.

D.1.2.3 Other assets

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

D.1.2.4 Investments (other than participations)

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

D.2 Technical provisions

To the extent these disclosures relate to the risk margin, transitional measures and/or the Solvency Capital Requirement, they are not subject to audit and have not been audited.

D.2.1 Overview

As a general principle, technical provisions are valued at the amount for which they could theoretically be transferred to a third party in an arm's length transaction. The technical provisions consist of the best estimate liability (BEL) and the risk margin, reduced by the TMTP where relevant.

D.2.1.1 BEL

The BEL corresponds to the probability-weighted average of future cash flows, taking account of the time value of money (i.e. the expected present value of future cash flows), using the risk-free interest rate term structure published by the PRA, (prior to 31 December 2020 the technical information was obtained from the European Insurance and Occupational Pensions Authority). The calculation of the best estimate liability is based upon up-to-date and credible information and realistic assumptions (derived from data analysis and expert judgement) and is performed using appropriate actuarial and statistical methods. The cash flow projections used in the calculation of the best estimate liability takes account of all the cash in and out flows required to settle the insurance obligations over their lifetime. The cash flows included in the best estimate liability calculation are derived after applying Solvency II "contract boundary" rules, which determine whether future cash flows can be recognised as part of the in-force business. The best estimate liability is calculated before deduction of the amounts recoverable from reinsurance contracts. Those amounts are calculated separately .

The "contract boundary" rules define:

- When a policy is first included in the cash flows;
- Which premiums should be allowed for in the cash flows; and
- When a policy should no longer be included in the cash flows.

D.2.1.2 Risk Margin

The risk margin is calculated in line with Solvency II requirements, and aims to ensure that the total technical provisions are equivalent to the cost of ceding the insurance obligations to a third party. The calculation assumes a 6 per cent per annum cost of capital and applies to non-hedgeable risks only.

This calculation includes simplified methods and requires assumptions as to the run-off profile of non-hedgeable capital requirements for each line of business, in line with the Solvency II regulations, rather than a full projection of SCR. The SCR for each non-hedgeable risk is assumed to run-off in-line with suitable profiles which differ depending on the types of non-hedgeable risks. The SCR each year is aggregated using a simplified correlation matrix.

The main risks are detailed in Section C.

D.2.1.3 Technical Provisions

Figure 17: Value of technical provisions at 31 December 2020

	31 December 2020					31 December 2019
All figures in £m	**Best estimate liability**	**Risk margin**	**TMTPs**	**Total Technical Provisions**	**UK GAAP**	Total
Other life insurance	**50.8**	**—**	**—**	**50.8**	**51.2**	52.9
Unit-linked insurance	**5,475.6**	**17.1**	**(6.3)**	**5,486.3**	**5,504.3**	5,550.6
Accepted life reinsurance	**5,673.2**	**11.6**	**(4.3)**	**5,680.5**	**5,673.2**	5,507.4
Total	**11,199.5**	**28.7**	**(10.6)**	**11,217.6**	**11,228.6**	11,110.9

The TMTP is based on the last approved regulatory recalculation, the most recent of which was performed at 31 March 2020 (see Section D.2.4.1 for further details on the TMTP).

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

(a) Amounts not recognised under Solvency II are the present value of future profits and contract boundaries, which have a £(37) million and £8 million impact respectively.

(b) The UK GAAP liabilities are valued using a basis that includes margins for risk and uncertainty within the non-economic assumptions (mortality, morbidity, persistency and expenses) as well as different economic assumptions to the Solvency II technical provisions. The method of calculation can also differ between the bases:

- Non-economic assumptions for non-profit annuity business contain margins under UK GAAP compared to the best estimate assumptions applied under Solvency II; and
- UK GAAP liability cash flows for non-profit annuity business are valued using a discount rate derived from the yield on the corresponding assets minus a prudent allowance for defaults of 43 bps at 31 December 2020. Under Solvency II, the discount rate is expressed as a risk free yield.

(c) The UK GAAP liabilities do not include an explicit risk margin as the allowance for risk is included within the non-economic assumptions. The risk margin (£28.7 million) is explicit under Solvency II, but is partially mitigated by allowance for transitional measures (i.e. TMTP £(10.6) million) which smooths the impact from the previous Solvency I regime. The risk margin net of TMTP is £18.1 million at 31 December 2020. The TMTP is run-off in a straight line over 16 years, but can be recalculated if there has been a significant change in the risk profile of the business since the previous calculation.

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

D.2.1.4 Reinsurance Recoverables

The Company primarily uses reinsurance to manage insurance risk exposure.

In the Solvency II balance sheet, the full expected cost of claims is included within the technical provisions and the corresponding reinsurance recoverables are shown as an asset.

The valuation methods and assumptions for reinsurance recoverables are consistent with the methods and assumptions for the corresponding technical provisions (see Sections D.2.1.3). The value of the reinsurance recoverable asset is the Company's best estimate of future reinsurance cash flows, where this figure allows for the probability of partial or total default by the reinsurer. In accordance with Solvency II regulations, a simplified approach to calculating the counterparty default adjustment has been adopted. In certain cases, for example longevity swaps, the value of the reinsurance recoverable can be negative.

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

Figure 18: Value of reinsurance recoverables at 31 December 2020

All figures in £m	**31 December 2020**	31 December 2019
Other life insurance	**50.5**	52.6
Accepted life reinsurance	**1,953.4**	1,967.5
Total	**2,003.9**	2,020.1

D.2.2 Solvency II Technical Provisions methodology and assumptions

Further details of the methodology and assumptions used for each material line of business are discussed below. The methods chosen for each line of business are proportionate to the nature, scale and complexity of the underlying risks.

The key assumptions required in the valuation of technical provisions are:

(i) economic assumptions, most of which are published by the PRA (prior to 31 December 2020 the technical information was obtained from the European Insurance and Occupational Pensions Authority) and set by reference to market data at the valuation date;

(ii) non-economic assumptions, used to derive non-market related best estimate liability cash flows (for example future claims and expenses); and

(iii) assumptions in respect of policyholder behaviour.

D.2.2.1 Economic assumptions

The principal economic assumption is the risk-free interest rate term structure. The risk-free curves at which best estimate liability cash flows are discounted are specified by the PRA. These curves are based on market swap rates, with an adjustment for "credit risk". The resulting 10-year risk-free spot rate is given below, after the credit risk adjustment.

Figure 19: 10 year risk-free rates at 31 December 2020

Currency	31 December 2020	31 December 2019	Change
British Pound	**0.29 %**	0.91 %	(0.62)%

D.2.2.2 Non-economic assumptions

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

Assumptions are set at realistic, best-estimate levels. If experience varies from the assumptions the result would impact the available capital the Company holds to meet its obligations.

D.2.3 Details on methodology and assumptions by lines of business

D.2.3.1 Unit-linked business

The best estimate liability for these contracts reflects both the value of the policyholder unit funds and the non-unit liability. The non-unit liability can be negative, and reflects the discounted value of fee income from the unit funds less allowances for expenses and the cost of insurance benefits.

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

D.2.3.2 Non-profit annuity business

The best estimate liability for non-profit annuity business is a discounted value of expected future annuity payments and associated expenses. The key assumptions relate to mortality rates, including expectations of future mortality improvements and the discount rate.

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

In setting the 2020 longevity basis, the best estimate assumption has been updated for 2020 to include additional England and Wales population data, and the allowance for future improvement rates is updated from CMI 2017 to CMI 2018 with a stronger smoothing assumption for both males and females. The long term rates remains unchanged at 1.75% for males and 1.50% for females. Additionally a proportion of allowances relating to areas of uncertainty within the basis have been released following planned data investigations and a review of key judgements within the longevity model. Given the uncertainty around the coronavirus pandemic for 2020 experience and beyond, no changes due to COVID-19 were proposed.

D.2.4 Long-term guarantee measures on technical provisions

D.2.4.1 Transitional measures

The Company's technical provisions at 31 December 2020 include TMTP', in accordance with Solvency II regulations. The TMTP is unaudited. The impact of these transitional measures is to increase the Company's Solvency II surplus by £10.6 million (2019: £8.5 million).

The transitional measures are considered high-quality capital, and are a core part of the Solvency II reporting regime. The Company has received the necessary approvals from the PRA in respect of the transitional measures.

The TMTP was recalculated as at 31 March 2020. The PRA granted written permission for this recalculation of the TMTP in June 2020.

The 31 December 2020 technical provisions do not include a transitional measure on the risk-free interest rate term structure.

D.2.4.2 Volatility Adjustment

The Company has not applied a Volatility Adjustment as at 31 December 2020.

D.2.4.3 Matching Adjustment

The Company has not applied a Matching Adjustment as at 31 December 2020.

D.2.4.4 Impact of transitional measures and long-term guarantees

The impact of the TMTP on the Company's Solvency II results at 31 December 2020 is shown in the table below:

Figure 20: Impact on Solvency II metrics of TMTP at 31 December 2020

All figures in £m	As reported in QRTs	Impact of removing TMTP	Total excluding TMTP
Technical provisions	11,217.6	10.6	11,228.3
Basic own funds	85.1	(8.6)	76.4
Own funds eligible to cover SCR	**85.1**	**(8.6)**	**76.4**
Solvency capital required	49.8	2.0	51.8
Minimum capital required	22.4	0.9	23.3
Solvency Ratio	**171 %**	**(23)%**	**147 %**

D.2.5 Assumption changes

Changes to the assumptions used at 31 December 2020 in the Company's calculation of technical provisions include:

- changes to renewal expense assumptions to reflect forecast expense experience;
- changes to investment expense assumptions to reflect changes in strategic asset allocation;
- changes to persistency assumptions to reflect the results of the most recent experience investigation;
- changes to best estimate annuitant longevity assumptions to reflect emerging data and a partial release of allowances relating to areas of uncertainty within the basis; and
- market-driven changes to economic parameters, including changes to risk-free rates as shown in Section D.2.2.1.

D.2.6 Level of uncertainty

The valuation of technical provisions relies upon the Company's best estimate of future liability cash flows, including the projection of the future level of the solvency capital requirement in the calculation of the risk margin. These cash flows are derived using best estimate assumptions, which are set using a combination of experience data, market data and expert judgement.

Uncertainty exists in the technical provisions as to whether the actual future cash flows will match those expected under the Company's best estimate assumptions. Over time, experience may differ from the best estimate assumptions or the Company's forward-looking expectations may evolve, such that assumptions will be updated with a consequent change in the value of future technical provisions.

The best estimate assumptions include assumptions about future economic conditions, for example interest rates and expense inflation levels; and assumptions about future non-economic experience, for example, longevity, and mortality.

Each assumption is set at the Company's best estimate of future experience and approved by the Board Audit Committee. However, each assumption is by its very nature assumed and so the actual future experience is not certain.

D.3 Valuation of other liabilities

Other liabilities for solvency purposes are valued separately using valuation methods that are consistent with the valuation approach set out in the Solvency II directives. Unless otherwise stated, valuation of other liabilities is carried out in conformity with international accounting standards, where this is consistent with the objectives of Solvency II.

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

D.3.1 Deferred tax liabilities

The Company reported deferred tax liabilities of £2.7 million under Solvency II (£0.8 million under UK GAAP) at 31 December 2020. Deferred tax liabilities are calculated based upon the differences between the values given to liabilities in the Solvency II balance sheet and their values for tax purposes. The principles of FRS 101 are applied to calculate the extent of deferred taxes applicable to those value differences. Changes in the valuation of underlying liabilities between UK GAAP and Solvency II give rise to deferred tax value differences.

D.3.2 Other liabilities

Other liabilities include reinsurance payables, payables (trade, not insurance), and other liabilities not shown elsewhere. There are no material valuation differences between the 2020 Solvency II position and the 2020 financial statements in respect of other liabilities.

D.4 Alternative methods for valuation

The company currently does not use alternative methods for valuation.

D.5 Any other information

There is no other material information regarding the Company's valuation of assets and liabilities for solvency purposes other than those disclosed in the sections above.

E Capital management

E.1 Own funds

E.1.1 Objectives, policies and processes for managing own funds

The Company manages its Solvency II own funds as its measure of capital. The Company's own funds at 31 December 2020 in the regulatory template are £85.1 million (2019: £87.0 million). The Company's basic, available and eligible own funds to cover the Company's solvency capital requirement and minimum capital requirement at 31 December 2020 are shown in Section E.1.3 below.

The Company manages its Solvency II capital to ensure that sufficient own funds are available on an ongoing basis to meet regulatory capital requirements.

The Company prepares a medium term capital plan as part of its business planning process. The business plan is prepared annually on a rolling basis and covers a four-year period. There were no material changes in the objectives, policies or processes for managing the Company's own funds during the year.

E.1.2 Solvency II Capital position

The table below shows the PPL Solvency II surplus, calculated on a regulatory TMTP basis, at 31 December 2020 and 31 December 2019 as disclosed in the Company's 2020 Statutory Accounts.

Figure 21: PPL surplus at 31 December 2020

All figures in £m	**2020**	2019
Own Funds	**85.1**	87.0
SCR	**49.8**	47.8
Surplus	**35.2**	39.2
SCR Coverage %	**171 %**	182 %

The Company's Solvency II surplus has decreased by £4.0 million between 31 December 2019 and 31 December 2020. The 31 December 2020 figures above are consistent with the information submitted within the Solvency II Pillar III templates Own Funds (S.23.01.01) and SCR (S.25.03.21).

E.1.3 Analysis of the components of own funds

The following components make up the Company's basic, available and eligible own funds amounts. The Company has no ancillary own funds.

Figure 22: Analysis of components of own funds for the year-ended 31 December 2020

	2020		2019
All figures in £m	**Total**	**Tier 1 unrestricted**	Total
Ordinary share capital (b)	**6.0**	**6.0**	6.0
Reconciliation reserve (c)	**79.1**	**79.1**	81.0
Total eligible own funds to meet the SCR and MCR (a)	**85.1**	**85.1**	87.0

(a) As at 31 December 2020, the Company has no ancillary own funds and hence the Company's basic own funds are equal to the total available own funds. The eligible own funds are derived by applying Solvency II tiering limits to the tiered available own funds. The Company's tier 1 restricted available own funds have not exceeded the tiering limits and hence the Company's total available own funds are equal to the total eligible own funds. The Company's own funds before adjustments principally comprises equity share capital and retained earnings attributable to equity shareholders calculated in the reconciliation reserves.

(b) Ordinary share capital. The Company's ordinary share capital comprises of 6,000,000 ordinary shares of £1 each fully paid.

(c) Reconciliation reserve. The reconciliation reserve represents the residual of excess of assets over liabilities after deducting ordinary share capital. The reconciliation reserve can be volatile as it captures all changes in the Shareholder Fund.

Figure 23: Analysis of components of the reconciliation reserve at 31 December 2020

Figures in £m	**2020**	2019
Excess of assets over liabilities	**85.1**	87.0
Own shares (held directly and indirectly)	**(6.0)**	(6.0)
Reconciliation reserve	**79.1**	81.0

The following table shows the reasons for the changes in the Own Funds between 31 December 2019 and 31 December 2020.

Figure 24: Analysis of changes in the own funds for the year-ended 31 December 2020

All figures in £m	PPL
Own Funds as at 31 December 2019	**87**
Total underlying own funds generation	14
Other operating own funds generation	(13)
Total operating own funds generation	**1**
Market movements	(3)
Tax	(2)
Total Own Funds Generation	**(3)**
Total Movement in Own Funds	**(3)**
Impact of moving to regulatory transitional measure	1
Own funds as at 31 December 2020	**85**

The key drivers of the change in Own Funds are:

- £14 million from underlying own funds movements, comprised of expected surplus from in-force business and the contribution from new business.
- Other operating movements of £(13) million. This includes the impact of longevity and expense assumption changes.
- £(3) million from market movements.
- Tax changes of £(2) million.

E.1.4 Reconciliation of UK GAAP shareholder's equity to Solvency II for the year ended 31 December 2020

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

Figure 25: Differences between UK GAAP shareholder's equity and SII own funds for the year ended 31 December 2020

All figures in £m	2020	2019
Shareholder's equity in financial statements at 31 December	**76.6**	74.4
Valuation differences	**28.5**	32.6
Impact of risk margin (net of TMTP)	**(18.1)**	(17.4)
Change in value of deferred tax asset (resulting from valuation differences above)	**(1.9)**	(2.6)
Excess of assets over liabilities as recorded in the Solvency II Balance Sheet	**85.1**	87.0

E.2 Solvency Capital Requirement ("SCR") and Minimum Capital Requirement ("MCR")

E.2.1 Overview

The SCR is the amount of capital Solvency II regulations require the Company to hold. It is calculated based on ensuring that the Company has enough capital to meet its obligations in the event of a 1-in-200 year risk scenario occurring.

For the purpose of Solvency II regulatory reporting and disclosures, risk management, and calculation of any free surplus generation, the Company has approval to use an internal model for calculating the SCR. The assets and liabilities are valued on a Solvency II basis.

E.2.2 Components of SCR

At 31 December 2020, the SCR was £49.8 million (2019: £47.8 million). The PRA has the power to impose a capital add-on to the SCR where they feel the SCR may be insufficient. They have not done so for PPL. The risks and approach used to calculate the capital requirements may differ from those used by other companies and therefore may not be comparable.

Figure 26 below shows the undiversified SCR by risk components and the benefit of diversification in relation to the Company at 31 December 2020. A comparison column as at 31 December 2019 is also included.

Figure 26: SCR for the Company at 31 December 2020

Risk component	31 December 2020	31 December 2019
Interest rate risk	**3**	4
Equity risk	**19**	17
Property risk	**2**	2
Spread risk	**16**	15
Concentration risk	**—**	
Currency risk (incl. FX translation)	**7**	6
Diversification between market risks	**(13)**	(14)
Counterparty	**—**	—
Mortality risk	**—**	
Longevity risk	**—**	
Disability-morbidity risk	**—**	
Mass lapse	**5**	7
Other lapse risk	**21**	7
Expense risk	**62**	55
Life catastrophe	**—**	
Diversification between insurance risks	**(50)**	(38)
Non-life underwriting risk	**—**	
Operational risk	**14**	11
Loss-absorbing capacity of deferred tax	**(6)**	(8)
Other adjustments	**—**	
Total undiversified components	**81**	65
Diversification between market and underwriting risks	**(32)**	(17)
Total SCR	**50**	48
MCR	**22**	22

The MCR is a formulaic calculation, which is subject to a cap and a floor that are both expressed relative to the SCR. At 31 December 2020, the Company's MCR was £22.4 million. The inputs used to calculate the MCR are detailed in Quantitative Reporting Template S.28.01.01.

The MCR is currently 45% of the SCR (2019: 45%).

The following table shows the reasons for the changes in the SCR between 31 December 2019 and 31 December 2020.

Figure 27: Movements in the SCR for the Company between 31 December 2019 and 31 December 2020

All figures in £m	PPL
SCR as at 31 December 2019	**(48)**
Total Underlying SCR movements	**5**
Other operating SCR movements	(3)
Total operating SCR movements	**2**
Market movements	**(3)**
Restructuring	**—**
Tax	(2)
Total SCR generation	**(2)**
Dividends & capital movements	—
Total Movement in SCR	**(2)**
Impact of moving to regulatory transitional measure	—
SCR as at 31 December 2020	**(50)**

Note that in the above table, the SCR is presented as negative, therefore a positive value above represents a fall in the SCR and therefore an increase in surplus.

The £(2) million surplus impact from increase in SCR over the period is driven by a combination of:

- An Underlying SCR movement of £5 million due to partially offsetting impacts from the reduction in capital as the business runs off and the increase in capital as new business is written.
- £(3) million reduction in surplus from other operating SCR movements, mainly due to an update to expected renewal expenses.
- Market movements reducing surplus of £(3) million.
- £(2) million reduction in the benefit provided by Loss Absorbency of Deferred Tax (LADT).

E.2.2.1 Loss-absorbing capacity of deferred tax

The SCR involves the calculation of the amount of capital required to ensure the company can withstand a 1-in-200 adverse event in the year following the valuation date. Such an event would inevitably lead to taxable losses, but these taxable losses could in part be mitigated by offset against profits as permitted by tax law or establishing deferred tax assets. Solvency II requirements permit the basic SCR to be adjusted for the loss-absorbing capacity of deferred tax ("LADT").

In the Solvency II Pillar 1 valuation for the Company as at 31 December 2020, the SCR has been reduced by an adjustment for LADT of £6 million (2019: £8 million).

In calculating the adjustment for LADT, the recoverability of deferred tax assets under the stress scenario has been demonstrated by offsetting against:

- Unutilised deferred tax liabilities (to the extent there are any).
- Carry back relief against prior year profits.
- Unutilised taxable profits of the year of shock.
- Unutilised post-stress taxable future profits.
- Expected profits from future premiums excluded under Solvency II contract boundary rules.

E.3 Use of the duration-based equity risk sub-module in the calculation of the SCR

The Company has not used the duration-based equity risk sub-module in the calculation of its SCR as it is a standard formula approach and not applicable to an internal model firm.

E.4 Differences between the standard formula and the internal model

E.4.1 Overview

The Company's internal model, which is consistent with the requirements of the Solvency II Directive, is a key risk management tool and refers to the collection of systems and processes used to identify, monitor and quantify risks for the purpose of calculating the Solvency II SCR and economic capital requirements. This is a risk-based measure and, compared to the standard formula (as described below), has the advantage of better reflecting the specifics of the Company's business and risks.

The standard formula capital refers to the capital that is calculated in line with the standard formula rules provided by the Solvency II Directive. Even though standard formula, as part of Solvency II, represents a risk-based measure, it is based on a set of prescribed parameters, calibrated for European insurers and therefore it does not fully reflect the characteristics of the Company and the specific structure and risks the Company is exposed to.

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

E.4.2 Internal model application

As part of the demerger process, a Major Model Change application was made to the PRA to amend the existing internal model to apply at the level of M&G plc, rather than at the level of Prudential plc group. This focused on changes to the governance and risk management frameworks around the model at the point of demerger in October 2019. Approval was given to use a full Internal Model under Article 231 of the Directive (and Commission Delegated Regulation (EU) 2015/35 Article 347) to calculate the consolidated M&G plc Group SCR and solo entity SCR for each applicable EEA based insurance entity, namely, PAC, PPL and PIA.

As required in Solvency II regulations , the solvency capital requirement from the approved internal model is calculated as the value-at-risk of the basic own funds of an (re)insurance undertaking at a confidence level of 99.5 per cent over a one year period. The main risk categories allowed for in the internal model are shown in Section E.2.2. Within these categories, underlying "risk drivers" are specified as the result of an annual risk identification process. A model is defined and calibrated for each underlying risk driver and these are combined with an appropriate dependency structure and simulated to generate multiple thousands of combined risk scenarios. These risk scenarios are applied to all the assets and liabilities of the Company (for each entity within the scope of the internal model) to generate a wide range of possible outcomes. For simplicity, and to avoid circularity, the risk margin is held constant in all these risk scenarios. The resulting probability distribution is used to calculate the internal model solvency capital requirement, by subtracting the 99.5th worst percentile outcome from the unstressed balance sheet.

The data used in the internal model covers the following:

- liability data;
- asset data;
- finance data;
- operational risk data;
- policyholder data;
- data used in setting assumptions, including demographic, economic and other; and
- other relevant data required by the internal model and technical provisions.

The quality of the data is subject to the internal model data quality framework to ensure the accuracy, completeness, appropriateness and timeliness of the data.

E.4.3 Internal model vs standard formula

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

- Whereas the standard formula stresses and correlations are prescribed, the internal model risk scenarios reflect the Company's specific risk profile and are derived from a combination of data analysis and expert judgement, subject to the internal model tests and standards required by the Solvency II Directive (see further detail in Figure 28 below).
- Although the same broad risk categories are used to group risk drivers in the internal model, the internal model risk drivers within each category are typically much more granular than the broad risk categories considered under the standard formula. For example, the internal model risk drivers typically vary by country, as well as by other attributes of the risk, whereas many of the standard formula stresses do not vary by country.

- The internal model also covers some risks that are not included in the standard formula (for example, government bond spread risk).

The internal model SCR is derived by combining underlying risk drivers together into combined stress scenarios, and then ranking the outcomes of applying these stress scenarios to the Company's balance sheet to derive the 99.5th worst percentile outcome. Conversely, the standard formula SCR is derived by calculating the impact on the balance sheet of each prescribed stress separately and then aggregating these outcomes using prescribed correlation matrices. Therefore, the internal model allows for the impact on the balance sheet of combinations of risks occurring together, whereas the standard formula does not allow for interaction effects when risks occur simultaneously.

Figure 28: Overview of standard formula and internal model differences

Risk category	Standard Formula	Internal Model
Equity	Stresses vary between "Type 1" (listed EEA and OECD stocks) and "Type 2" (other countries, unlisted equities and alternative equity investments). A symmetric adjustment is applied to the level of stress to smooth out significant movements in markets close to the calculation date.	The model includes more granular stresses with calibrations set for each main equity benchmark index. At least one equity index is calibrated for each relevant global economy. Private equity, infrastructure equity and hedge funds are modelled using specific calibrations. Equity implied volatility is also modelled. No symmetric adjustment is applied.
Credit	For corporate bonds, loans and non-exempt sovereign bonds, credit risk is modelled by stressing credit spreads, with stresses varying by rating and duration bucket. European sovereign bonds are exempt from stress.	Credit spreads, ratings migrations, and defaults are all explicitly modelled. The spread stresses vary by credit rating, with calibrations differentiated by economy, product and duration bucket where appropriate. Internal credit assessments are used for bonds and loans without an agency rating and to uplift stresses for assets where structuring introduces additional risk. Spread stresses are applied to sovereign bonds, taking into account the credit risk of the issuing government.
Yields	Interest rate stresses are defined as bi-directional stresses to the base risk-free curve which vary by term but not by country.	Stresses are calibrated for each relevant global economy, and stresses to the shapes of risk-free yield curves are modelled using an industry standard 'principle component' methodology. Stressed curves are re-extrapolated beyond the last liquid point for each economy using the methodology specified by the PRA. Interest rate implied volatility and inflation risk are also modelled.
Property	There is a single property stress applied globally to the value of all assets classified as property.	Property stresses are differentiated by type of property, with separate calibrations for commercial and residential property.
Currency	A pair of up and down stresses is applied to the non-GBP net asset value in each business, and then aggregated. This approach also implicitly captures any asset-liability currency mismatch in each country.	A calibration is derived for each currency relative to GBP. Currency outcomes are simulated and used to translate all assets and liabilities into sterling in each risk scenario, thereby including the effect of currency "translation" as well as asset- liability currency mismatches within countries.
Counterparty default risk	Counterparty default risk is calculated taking into account the loss-given-default and probability of default, using fixed factors. Separate parameters and different aggregation approaches are applied for Type 1 exposures (e.g. derivatives, reinsurance, deposits) compared to Type 2 exposures (e.g. receivables from intermediaries).	A stochastic portfolio model (calibrated by credit rating) is used to capture counterparty risk, allowing for stochastic default and recovery rates. The model allows for counterparty exposures to increase under stressed conditions arising from other market and insurance risks.
Lapse	Policyholder lapse rates are stressed in both directions and a mass lapse stress is also applied. The capital charge is based on the largest of these impacts. The stresses are fixed for all countries and products (except for "group policies" which have a higher capital charge).	The lapse calibration is more granular and includes stresses to lapse assumptions and mass lapses. The stresses vary by product type as appropriate.
Mortality & Life catastrophe	An increase in best estimate mortality rates and an instantaneous catastrophe risk stress are applied to all relevant business.	The mortality calibration allows for stresses to both best estimate mortality rates and catastrophe risks.
Expense	Both the level of expenses and level of expense inflation are stressed under the standard formula. The same stresses apply to all business.	Expense level and expense inflation risks are modelled, with stresses calibrated by product type where appropriate.

Risk category	Standard Formula	Internal Model
Operational	Operational risk is calculated using a factor based approach applied to premiums, technical provisions and unit linked expenses.	Individual operational risks are assessed bottom-up, and modelled using a frequency-severity model. These are combined with correlation assumptions to produce aggregate probability distributions of potential operational losses.

E.4.4 Probability Distribution used in Internal Model

The internal model calibrations are primarily based on historical data, with expert judgements applied where required.

E.5 Non-compliance with the MCR and with the SCR

The Company's SCR and MCR have been met during 2020.

E.6 Any other information

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

Statement of directors' responsibilities

The directors of Prudential Pensions Limited acknowledge their responsibility for preparing the Solo SFCR in all material respects in accordance with the PRA rules and Solvency II Regulations.

The directors are satisfied that:

a. throughout the financial year to December 2020, the Company has complied in all material respects with the requirements of the PRA rules and the Solvency II Regulations as applicable at the level of the Company; and

b. it is reasonable to believe that in respect of the period from 31 December 2020 to the date of the publication of the SFCR, the Company has continued so to comply and will continue so to comply for the remainder of the financial year to 31 December 2021.

Signed on behalf of the Board of Directors

P Cooper

Director

6 April 2021

Templates provided in the SFCR implementing Technical Standard

S.02.01.02 Balance Sheet

All amounts are in £'000

		Solvency II value
	Assets	C0010
R0030	Intangible assets	—
R0040	Deferred tax assets	—
R0050	Pension benefit surplus	—
R0060	Property, plant & equipment held for own use	—
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	26,062
R0080	*Property (other than for own use)*	—
R0090	*Holdings in related undertakings, including participations*	—
R0100	*Equities*	—
R0110	*Equities - listed*	—
R0120	*Equities - unlisted*	—
R0130	*Bonds*	26,062
R0140	*Government Bonds*	26,062
R0150	*Corporate Bonds*	—
R0160	*Structured notes*	—
R0170	*Collateralised securities*	—
R0180	*Collective Investments Undertakings*	—
R0190	*Derivatives*	—
R0200	*Deposits other than cash equivalents*	—
R0210	*Other investments*	—
R0220	Assets held for index-linked and unit-linked contracts	9,224,275
R0230	Loans and mortgages	81,600
R0240	*Loans on policies*	—
R0250	*Loans and mortgages to individuals*	—
R0260	*Other loans and mortgages*	81,600
R0270	Reinsurance recoverables from:	2,003,911
R0280	*Non-life and health similar to non-life*	—
R0290	*Non-life excluding health*	—
R0300	*Health similar to non-life*	—
R0310	*Life and health similar to life, excluding index-linked and unit-linked*	50,517
R0320	*Health similar to life*	—
R0330	*Life excluding health and index-linked and unit-linked*	50,517
R0340	*Life index-linked and unit-linked*	1,953,394
R0350	Deposits to cedants	—
R0360	Insurance and intermediaries receivables	—
R0370	Reinsurance receivables	6,243
R0380	Receivables (trade, not insurance)	9,010
R0390	Own shares (held directly)	—
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	—
R0410	Cash and cash equivalents	7,205
R0420	Any other assets, not elsewhere shown	—
R0500	**Total assets**	**11,358,306**

S.02.01.02 Balance Sheet

		Solvency II value
	Liabilities	C0010
R0510	Technical provisions - non-life	—
R0520	*Technical provisions - non-life (excluding health)*	—
R0530	*TP calculated as a whole*	—
R0540	*Best Estimate*	—
R0550	*Risk margin*	—
R0560	*Technical provisions - health (similar to non-life)*	—
R0570	*TP calculated as a whole*	—
R0580	*Best Estimate*	—
R0590	*Risk margin*	—
R0600	Technical provisions - life (excluding index-linked and unit-linked)	50,782
R0610	*Technical provisions - health (similar to life)*	—
R0620	*TP calculated as a whole*	—
R0630	*Best Estimate*	—
R0640	*Risk margin*	—
R0650	*Technical provisions - life (excluding health and index-linked and unit-linked)*	50,782
R0660	*TP calculated as a whole*	—
R0670	*Best Estimate*	50,782
R0680	*Risk margin*	1
R0690	Technical provisions - index-linked and unit-linked	11,166,834
R0700	*TP calculated as a whole*	—
R0710	*Best Estimate*	11,148,728
R0720	*Risk margin*	18,105
R0740	Contingent liabilities	—
R0750	Provisions other than technical provisions	—
R0760	Pension benefit obligations	—
R0770	Deposits from reinsurers	—
R0780	Deferred tax liabilities	2,731
R0790	Derivatives	—
R0800	Debts owed to credit institutions	—
R0810	Financial liabilities other than debts owed to credit institutions	—
R0820	Insurance & intermediaries payables	—
R0830	Reinsurance payables	142
R0840	Payables (trade, not insurance)	52,752
R0850	Subordinated liabilities	—
R0860	*Subordinated liabilities not in BOF*	—
R0870	*Subordinated liabilities in BOF*	—
R0880	Any other liabilities, not elsewhere shown	—
R0900	**Total liabilities**	**11,273,241**
R1000	**Excess of assets over liabilities**	**85,065**

S.05.01.02 Premiums claims and expenses by line of business

All amounts are in £'000

S.05.01.02

Premiums, claims and expenses by line of business

	Life	Line of Business for: life insurance obligations						Life reinsurance obligations		Total
		Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Health reinsurance	Life reinsurance	
		C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
	Premiums written									
R1410	*Gross*	0	0	1,085,426	0			0	292,487	1,377,913
R1420	*Reinsurers' share*	0	0	0	0			0	0	0
R1500	*Net*	0	0	1,085,426	0			0	292,487	1,377,913
	Premiums earned									
R1510	*Gross*	0	0	1,085,426	0			0	292,487	1,377,913
R1520	*Reinsurers' share*	0	0	0	0			0	0	0
R1600	*Net*	0	0	1,085,426	0			0	292,487	1,377,913
	Claims incurred									
R1610	*Gross*	0	0	1,556,213	4,476			0	477,104	2,037,793
R1620	*Reinsurers' share*	0	0	0	4,476			0	0	4,476
R1700	*Net*	0	0	1,556,213	0			0	477,104	2,033,317
	Changes in other technical provisions									
R1710	*Gross*	0	0	43,986	1,221			0	-156,966	-111,759
R1720	*Reinsurers' share*	0	0	0	1,221			0	0	1,221
R1800	*Net*	0	0	43,986	0			0	-156,966	-112,980
R1900	**Expenses incurred**	0	0	24,907	0			0	0	24,907
R2500	**Other expenses**									0
R2600	**Total expenses**									24,907

S.12.01.02 Life and Health SLT Technical Provisions

All amounts are in £'000

		Insurance with profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, including Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
				Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees					Contracts without options and guarantees	Contracts with options or guarantees			
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0150	C0160	C0170	C0180	C0190	C0200	C0210
R0010	Technical provisions calculated as a whole	–	–			–			–	–	–	–			–	–	–
R0020	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	–	–			–			–	–	–	–			–	–	–
	Technical provisions calculated as a sum of BE and RM																
	Best estimate																
R0030	Gross Best Estimate	–		5,475,049	508		22,851	27,931	–	5,673,171	11,199,510		–	–	–	–	–
R0080	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	–		–	–		22,676	27,841	–	1,953,394	2,003,911		–	–	–	–	–
R0090	Best estimate minus recoverables from reinsurance/SPV and Finite Re	–		5,475,049	508		175	90	–	3,719,777	9,195,599		–	–	–	–	–
R0100	Risk margin	–	17,119			1			–	11,630	28,749	–			–	–	–
	Amount of the transitional on Technical Provisions																
R0110	Technical Provisions calculated as a whole	–	–			–			–	–	–	–			–	–	–
R0120	Best estimate	–		–	–		–	–	–	–	–		–	–	–	–	–
R0130	Risk margin	–	(6,338)			–			–	(4,305)	(10,643)	–			–	–	–
R0200	Technical provisions - total	–	5,486,338			50,782			–	5,680,495	11,217,616	–			–	–	–

S.22.01.21 Impact of long term guarantees measures and transitionals

All amounts are in £'000

		Amount with Long Term Guarantee measures and transitionals	Impact of transitional on technical provisions	Impact of transitional on interest rate	Impact of volatility adjustment set to zero	Impact of matching adjustment set to zero
		C0010	C0030	C0050	C0070	C0090
R0010	Technical provisions	11,217,616	10,643	—	—	—
R0020	Basic own funds	85,065	(8,621)	—	—	—
R0050	Eligible own funds to meet Solvency Capital Requirement	85,065	(8,621)	—	—	—
R0090	Solvency Capital Requirement	49,823	2,022	—	—	—
R0100	Eligible own funds to meet Minimum Capital Requirement	85,065	(8,621)	—	—	—
R0110	Minimum Capital Requirement	22,420	910	—	—	—

S.23.01.01 Own Funds - All amounts are in £'000

	Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35	Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
R0010	Ordinary share capital (gross of own shares)	6,000	6,000		—	
R0030	Share premium account related to ordinary share capital	—	—		—	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	—	—		—	
R0050	Subordinated mutual member accounts	—		—	—	—
R0070	Surplus funds	—	—			
R0090	Preference shares	—		—	—	—
R0110	Share premium account related to preference shares	—		—	—	—
R0130	Reconciliation reserve	79,065	79,065			
R0140	Subordinated liabilities	—		—	—	—
R0160	An amount equal to the value of net deferred tax assets	—				—
R0180	Other own fund items approved by the supervisory authority as basic own funds not specified above	—	—	—	—	—
	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds					
R0220	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	0				
	Deductions					
R0230	Deductions for participations in financial and credit institutions	0	0	0	0	0
R0290	Total basic own funds after deductions	85,065	85,065	0	0	0
	Ancillary own funds					
R0300	Unpaid and uncalled ordinary share capital callable on demand	—			—	
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	—			—	
R0320	Unpaid and uncalled preference shares callable on demand	—			—	—
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	—			—	0
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	—			—	
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	—			—	0
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	—			—	
R0370	Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	—			—	—
R0390	Other ancillary own funds	—			—	—
R0400	Total ancillary own funds	0			0	0
	Available and eligible own funds					
R0500	Total available own funds to meet the SCR	85,065	85,065	—	—	0
R0510	Total available own funds to meet the MCR	85,065	85,065	—	—	
R0540	Total eligible own funds to meet the SCR	85,065	85,065	—	—	0
R0550	Total eligible own funds to meet the MCR	85,065	85,065	0	0	
R0580	SCR	49,823				
R0600	MCR	22,420				
R0620	Ratio of Eligible own funds to SCR	171 %				
R0640	Ratio of Eligible own funds to MCR	379 %				

	Reconcilliation reserve	C0060
R0700	Excess of assets over liabilities	85,065
R0710	Own shares (held directly and indirectly)	—
R0720	Foreseeable dividends, distributions and charges	—
R0730	Other basic own fund items	6,000
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	—
R0760	Reconciliation reserve	79,065
	Expected profits	
R0770	Expected profits included in future premiums (EPIFP) - Life business	—
R0780	Expected profits included in future premiums (EPIFP) - Non- life business	—
R0790	Total Expected profits included in future premiums (EPIFP)	0

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

Row	Unique number of component	Component description	Calculation of the Solvency Capital Requirement
	C0010	C0020	C0030
1	103	Interest rate risk	3,476
2	104	Equity risk	19,006
3	106	Property risk	2,087
4	107	Spread risk	15,901
5	108	Concentration risk	—
6	109	Currency risk	7,393
7	110	Other market risk	—
8	199	Diversification within market risk	(12,677)
9	203	Other counterparty risk	245
10	301	Mortality risk	—
11	302	Longevity risk	—
12	303	Disability-morbidity risk	—
13	304	Mass lapse	4,831
14	305	Other lapse risk	20,825
15	306	Expense risk	62,186
16	308	Life catastrophe risk	53
17	309	Other life underwriting risk	—
18	399	Diversification within life underwriting risk	(49,596)
19	505	Other non-life underwriting risk	—
20	701	Operational risk	13,974
21	801	Other risks	—
22	802	Loss-absorbing capacity of technical provisions	—
23	803	Loss-absorbing capacity of deferred taxes	(6,354)
24	804	Other adjustments	—

S.25.03.21

Solvency Capital Requirement - for undertakings on Full Internal Models

	Calculation of Solvency Capital Requirement	C0100
R0110	Total undiversified components	81,349
R0060	Diversification	(31,526)
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	—
R0200	**Solvency capital requirement excluding capital add-on**	49,823
R0210	Capital add-ons already set	—
R0220	**Solvency capital requirement**	49,823
	Other information on SCR	
R0300	Amount/estimate of the overall loss-absorbing capacity of technical provisions	—
R0310	Amount/estimate of the overall loss-absorbing capacity ot deferred taxes	(6,354)
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	49,823
R0420	Total amount of Notional Solvency Capital Requirement for ring fenced funds	—
R0430	Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	—
R0440	Diversification effects due to RFF nSCR aggregation for article 304	—

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

	Calculation of loss absorbing capacity of deferred taxes	**LAC DT** C0130
R0640	Amount/estimate of LAC DT	(6,354)
R0650	Amount/estimate of LAC DT justified by reversion of deferred tax liabilities	(3,674)
R0660	Amount/estimate of LAC DT justified by reference to probable future taxable economic profit	(1,594)
R0670	Amount/estimate of AC DT justified by carry back, current year	(1,086)
R0680	Amount/estimate of LAC DT justified by carry back, future years	—
R0690	Amount/estimate of Maximum LAC DT	(10,834)

S.28.01.01 Minimum Capital Requirement

– Only life or non-life insurance or reinsurance activity

– All amounts are in £'000

		MCR(NL) Result
		C0020
R0010	Linear formula component for non-life insurance and reinsurance obligations	0

		Net (of reinsurance/ SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
		C0050	C0060
R0020	Medical expense insurance and proportional reinsurance	0	0
R0030	Income protection insurance and proportional reinsurance	0	0
R0040	Workers' compensation insurance and proportional reinsurance	0	0
R0050	Motor vehicle liability insurance and proportional reinsurance	0	0
R0060	Other motor insurance and proportional reinsurance	0	0
R0070	Marine, aviation and transport insurance and proportional reinsurance	0	0
R0080	Fire and other damage to property insurance and proportional reinsurance	0	0
R0090	General liability insurance and proportional reinsurance	0	0
R0100	Credit and suretyship insurance and proportional reinsurance	0	0
R0110	Legal expenses insurance and proportional reinsurance	0	0
R0120	Assistance and proportional reinsurance	0	0
R0130	Miscellaneous financial loss insurance and proportional reinsurance	0	0
R0140	Non-proportional health reinsurance	0	0
R0150	Non-proportional casualty reinsurance	0	0
R0160	Non-proportional marine, aviation and transport reinsurance	0	0
R0170	Non-proportional property reinsurance	0	0

		Result
		C0080
R0200	Linear formula component for life insurance and reinsurance obligations	64,399

		Net (of reinsurance/ SPV) best estimate and TP calculated as a whole	Net (of reinsurance/ SPV) total capital at risk
		C0110	C0120
R0210	Obligations with profit participation - guaranteed benefits	0	
R0220	Obligations with profit participation - future discretionary benefits	0	
R0230	Index-linked and unit-linked insurance obligations	9,195,334	
R0240	Other life (re)insurance and health (re)insurance obligations	265	
R0250	Total capital at risk for all life (re)insurance obligations		37,598

	Overall MCR calculation	C0130
R0300	Linear MCR	64,399
R0310	SCR	49,823
R0320	MCR cap	22,420
R0330	MCR floor	12,456
R0340	Combined MCR	22,420
R0350	Absolute floor of the MCR	3,338
R0400	Minimum Capital Requirement	22,420

	Notional non-life and life MCR calculation	C0150
R0500	Notional linear MCR	64,399
R0510	Notional SCR excluding add-on (annual or latest calculation)	49,823
R0520	Notional MCR cap	22,420
R0530	Notional MCR floor	12,456
R0540	Notional combined MCR	22,420
R0550	Absolute floor of the notional MCR	3,338
R0560	Notional MCR	22,420