Enabling decisions to be taken with confidence

Prudential's Group Risk Framework and risk appetite have allowed the business to control its risk exposure throughout 2021. Its governance, processes and controls enable the Group to deal with uncertainty effectively, which is critical to the achievement of its strategy of capturing long-term structural opportunities and helping customers achieve their long-term financial goals.

This section explains the main risks inherent in the business and how Prudential manages those risks, with the aim of ensuring an appropriate risk profile is maintained.

1. Introduction

The Group

2021 was a year in which the pace of transformative change continued, both for the Prudential Group and the operating environments in which it operates. In May, the Group-wide Supervision (GWS) Framework became effective for the Group following designation by the Hong Kong Insurance Authority (IA), subject to agreed transitional arrangements. The demerger of the Jackson business completed in September, reshaping the Group into an Asia and Africa-focused business. The subsequent equity raise in October enhanced Prudential's financial flexibility in light of the breadth of opportunities to invest for growth. The Group Risk, Compliance and Security (RCS) function provided risk opinions, guidance and assurance on these critical activities to enable strategic decisions to be taken with confidence, while retaining its focus on overseeing the risks of ongoing business, providing risk management and compliance advice, together with objective challenge on the execution of the strategic objectives. The core objective of the RCS function continued to be that the Group remained within its risk appetite. During the year, the RCS function continued to take steps to consolidate its position as a group-wide function, effectively leveraging the Group's risk management and compliance experience in more mature markets and applying it in a nimble way to its emerging markets, appropriate to their unique risks, opportunities, customer needs and customs.

With supply chain issues likely to continue to impact the world economy, the risks of persistent higher inflation remain firmly on the agenda. Strategic competition between the US and China is driving further decoupling of areas of their economies as both look to protect national interests. These objectives are increasingly being implemented through new laws and regulations protecting domestic data, technology and financial services. This dynamic increases the strategic, operational, regulatory and reputational risks for businesses operating within and across their spheres of influence. In China, the government's application of its domestic policy aims has continued against the backdrop of a weakening real estate sector. The cycle of peaks and troughs of Covid-19 infection levels and associated restrictions experienced by the Group's markets will undoubtedly take a toll on its customers and its people. Prudential continues to focus on delivering accessible and socially inclusive propositions, the fair treatment of its policyholders and all its customers, and the wellbeing of its employees in a sustainable way. The RCS function will continue to apply the holistic and coordinated approach to support the Group in managing these increasingly dynamic, multi-faceted and often inter-connected risks facing its business.

The world economy

The world economy remains in recovery following the significant loss of output in 2020. Global growth in 2022 is anticipated to remain above average historical trends although this is expected to slow and remains subject to developments in the pandemic. The pattern of recovery has not been the same across economies. Developed economies have received significant support from unprecedented fiscal stimulus and accommodative monetary policy aimed at maintaining consumption levels, while in emerging economies this support has been more muted and the focus has been on maintaining production levels. As fiscal stimulus is withdrawn and many economies transition to a strategy of treating Covid-19 as endemic, domestic demand is expected to shift from goods towards services in developed economies, reducing pressure on supply chains and inflation on imports. Monetary policy is also expected to become less accommodative, in particular in the US where the Federal Reserve has started to reduce asset purchases and is expected to raise its federal funds rate to address inflation concerns, which are no longer considered transitory. Developments in the labour market are expected to influence the pace and magnitude of monetary policy tightening.

In Asia, economic reopening has lagged the West, with prolonged restrictions on movement and relatively slow vaccine rollouts, although growth has also rebounded as a consequence of steady manufacturing activity in the region. A resumption of tourism activities and the consumption of other services would support growth, but the emergence of new Covid-19 variants are a continuing challenge. Another key risk for the region is a property-led slowdown in China, which has the potential to be a drag on economic activity more broadly in the country and the region. The outlook remains highly dependent on the nature of the government response to stabilise demand in the sector. Inflationary pressures in most Asian economies have largely been contained and an abrupt tightening in monetary policy is considered unlikely. However, tightening US monetary policy, combined with any resulting further strengthening of the US dollar, may lead to adverse external financing conditions for emerging economies within the region. In Africa, while countries with more diversified economies and stronger pre-pandemic fundamentals such as Kenya, Ghana and Côte d'Ivoire are expected to perform better, the region as a whole faces significant headwinds. With low vaccination rates, Africa remains highly vulnerable to the health and economic impacts of new Covid-19 infection waves and emerging and new variants. Inflation levels in the region are expected to ease slightly in 2022 but are likely to remain elevated, leaving central banks facing difficult monetary policy choices and governments with limited fiscal space in which to manoeuvre.

Financial markets

Against a backdrop of the current, emerging and future Covid-19 variants, financial markets in 2021 reflected economic trends. Equity assets continued their rally although with short episodes of volatility, and developed markets closed the year at near all-time highs. Market movements were influenced by a number of factors during the course of the year, including the broad reflation following vaccine rollouts, fiscal stimulus, supply chain issues, increases in global inflation rates, fears of stagflation and the US Federal Reserve's tapering timeline. Comparatively, emerging markets underperformed, particularly in Q3 due to growth and regulatory concerns in China, which significantly impacted the property sector and resulted in tightened credit conditions. Interest rates were dominated by market expectations for central bank policy responses, while credit spreads in investment grade markets remained relatively muted and continued to tighten, supported by the reopening of economies over the course of the year. The Russia-Ukraine conflict, which was preceded by a period of rising tensions over Q4 2021, has contributed to large market movements and increases in energy prices in Q1 2022, the full extent of which remains uncertain.

Increasing inflationary pressure in the US, the expected tightening in financial conditions driven by reduced asset purchases and the anticipated increase in federal fund rates may drive funding costs higher, with implications for global markets. This will increase risks for highly leveraged companies and countries, including those in Asia. Interest rate hikes are expected to support the US dollar while introducing currency depreciation risk for emerging markets. Emerging markets also remain susceptible to a reversal in capital flows, although they may be more resilient to this than in the past, given healthy current account balances, the fact that currencies remain relatively cheap by historical standards and that central banks in the region have pursued relatively conservative monetary policy compared to developed markets in 2021.

Geopolitical landscape

Governmental strategies in managing Covid-19 have reflected how they have balanced the impacts to people's health and lives with their individual rights and liberties and the need for economic growth. The way this balance tilts remains a potential source of division both within and between nations, with governments mindful of the risk of falling behind global levels of economic recovery. The experience of the pandemic and the civil unrest seen in recent times has shown that the stability of governments and the resilience of businesses will continue to be tested. The Group has well-established local and global plans to mitigate the business risks from disruption. These have operated well during the pandemic and local outbreaks of unrest in certain markets, and the Group's operational resilience will continue to be critically evaluated and enhanced.

The relationship between the US and China continues to be a key driver of the level of global geopolitical tension, exerting pressure on national policymakers in other countries, including the South-east Asia markets in which the Group operates. As 2021 progressed, with the US and China turning their attention to more domestic matters, diplomatic escalations between the two countries eased albeit against a backdrop of increasing strategic competition. Over Q4 2021 and into 2022, tensions between western powers and Russia have escalated into conflict in Ukraine, following years of hostilities along the Ukraine-Russia border. The conflict is likely to have broad implications for geopolitical relations which remain to be seen, and may drive the bifurcation of global trade, financial systems and standards.

Domestically, the China government has continued to pursue its policy aims with regulatory tightening and actions that have been multi-faceted and ranging across industries including technology, real estate, education and entertainment, and have extended to data usage and the provision of online medical and insurance services and products. Where these actions have implications for interactions with the global environment there may be geopolitical effects which require assessment. The broader long-term impact on business sentiment, and linked economies such as Hong Kong, remains to be seen. Legislative or regulatory changes that adversely impact Hong Kong's economy or its international trading and economic relationships, as a key market which also hosts Group head office functions, could have an adverse impact on sales and distribution and the operations of the Prudential Group. Meanwhile, the emergence of the Omicron coronavirus variant and the China and Hong Kong governments' continued application of a 'zero-Covid-19' policy has increased uncertainty on the timing of border relaxation between the two territories.

Regulations

Prudential operates in highly regulated markets, and as the nature and focus of regulation and laws evolve, the complexity of regulatory (including sanctions) compliance continues to increase and represents a challenge for international businesses. Key regulatory compliance risks for the financial services industry include those related to customer-facing conduct, financial crime and sanctions compliance, information security and data privacy and residency, and those associated with third-party management. Prudential's portfolio of transformation programmes, which include the expansion of the Group's digital capabilities and improvement of business efficiencies through operating model changes, have the potential to introduce new, or increase existing, regulatory risks and supervisory interest, while increasing the complexity of ensuring concurrent regulatory compliance across markets driven by increasing intra-Group connectivity and dependencies. National and international regulatory developments continue to progress, with a continuing focus on solvency and capital standards, sustainability, technology and data, conduct of business, systemic risk regulation, corporate governance and senior management accountability, and macro prudential policy. Some of these changes will have a significant impact on the way that the Group operates, conducts business and manages its risks. Regulatory developments are monitored at a national and global level and form part of Prudential's engagement with government policy teams and regulators.

The increase in global strategic competition may provide an impetus to the fragmentation or increased regionalisation of trade, investment and standards, increasing the strategic and regulatory risks for businesses, in particular with laws and regulations with extra-territorial application. For internationally active groups such as Prudential, operating across multiple jurisdictions increases the complexity of legal and regulatory compliance. Compliance with the Group's legal or regulatory obligations (including in respect of international sanctions), in one jurisdiction may conflict with the law or policy objectives of another jurisdiction, or may be seen as supporting the law or policy objectives of that jurisdiction over another, creating additional legal, regulatory compliance and reputational risks. These risks may be increased where the scope of regulatory requirements and obligations are uncertain, and where specific cases applicable to the Prudential Group are complex. The Group has in place risk tolerance frameworks to deal with complex and conflicting risk trade-offs to guide executive decisions. In China, the swiftness with which some of the recent regulatory changes and interventions have been applied has the potential to increase uncertainty and the strategic and regulatory risks for businesses operating in China or those which deal with Chinese companies.

The Hong Kong IA's GWS Framework became effective for Prudential following designation by the Hong Kong IA on 14 May 2021. The Group remains compliant with the Framework, subject to agreed transitional arrangements, and will continue to engage constructively with the Hong Kong IA as its Group-wide supervisor as it ensures ongoing sustainable compliance.

Societal developments

Societal changes, including those driven by the Covid-19 pandemic and anticipated as part of the transition to a lower carbon economy, can have broad, complex and long-term effects, with the potential to exacerbate structural inequalities within and across countries. Such transitions can compel organisations to re-evaluate how best to serve their customers and the societies in which they operate. A key development of the pandemic has been the acceleration of digitalisation across businesses and their supply chains, with an accompanying increase in the importance of maintaining resilience against cyber incidents and security threats, such as ransomware attacks. The Covid-19 pandemic also provided a prompt for businesses and employees to re-evaluate traditional working practices and has accelerated certain thematic trends around increased flexibility, inclusivity and psychological safety in the workplace to enable employees to openly contribute and challenge.

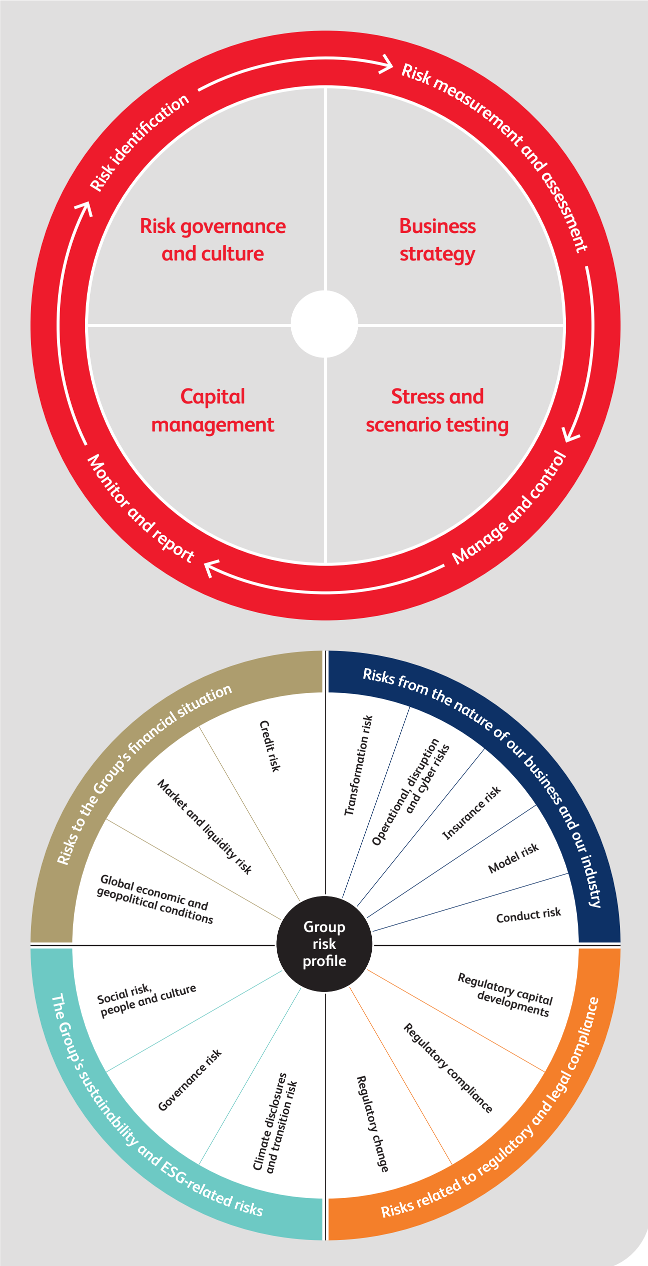
Prudential's increasing use of digital services, technologies and distribution methods, increased adoption of its Pulse platform and the implementation of virtual face-to-face sales of select ranges of products in many of its markets during the pandemic have broad implications for Prudential and its conduct of business. These developments support the delivery of the Group's aim to increase the accessibility and inclusiveness of its products and services, but also increase technology, data security or misuse and regulatory risks. Prudential, as a responsible employer, is increasing opportunities for employees to voice their views and responding to feedback with initiatives centred on flexible and new ways of working and on how it incentivises and upskills its workforce. The Group continues to monitor emerging social trends, including those linked to environmental change, and their potential impact on its wide range of stakeholders and how its products and services meet the needs of affected societies. Its risk management framework continues to evolve in order to manage the changing nature of these wide-ranging risks including activities to promote a transparent culture, actively encouraging open discussion and learning from mistakes.

2. Risk governance

a System of governance

Prudential has in place a system of governance that embeds a clear ownership of risk, together with risk policies and standards to enable risks to be identified, measured and assessed, managed and controlled, monitored and reported. The Group Risk Framework, owned by the Board, details Prudential's risk governance, risk management processes and risk appetite. The Group's risk governance arrangements are based on the 'three lines' model. The 'first line' is responsible for taking and managing risk, while the 'second line' provides additional challenge, expertise, oversight, and scrutiny. The role of the 'third line', assumed by the independent Group-wide Internal Audit function, is to provide objective assurance on the design, effectiveness and implementation of the overall system of internal control. The Group-wide Risk, Compliance and Security (RCS) function reviews, assesses, oversees and reports on the Group's aggregate risk exposure and solvency position from an economic, regulatory and ratings perspectives.

During 2021, the Group continued to review and update its policies and processes for alignment with the requirements of the Hong Kong IA's GWS Framework, which became effective for the Group on 14 May 2021. The Group has also focused on embedding climate-change as a cross-cutting risk within the Group Risk Framework and development and embedding of its Group-wide customer conduct risk framework and policy; its third-party and outsourcing policy; its data policy and enhancements to its operational resilience.



b Group Risk Framework

i. Risk governance and culture

Prudential's risk governance comprises the Board organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies that have been established to make decisions and control activities on risk-related matters. The risk governance structure is led by the Group Risk Committee, supported by independent Non-executive Directors on risk committees of the Group's main subsidiaries. The Group Risk Committee approves changes to the Group Risk Framework and the core risk policies that support it. The Group Risk Committee has direct lines of communication, reporting and oversight of the risk committees of the Group's major businesses. As its adoption across Asia and Africa increases, the application of the Group's governance framework and policies to the Pulse business has been increased. The Pulse Audit & Risk Committee for Pulse Ecosystems Limited, the holding company for Pulse, was formed and met for the first time in H1 2021.

Risk culture is a strategic priority of the Board, which recognises its importance in the way that the Group does business. A Group-wide culture framework is currently being implemented to unify the Group towards its shared purpose of helping people get the most out of life. At the start of the year, the Board established the Responsibility & Sustainability Working Group to support its responsibilities in relation to implementation of the culture framework, as well as embedding the Group's ESG strategic framework, and progress on diversity and inclusion initiatives. The culture framework includes principles and values that define how the Group expects business to be conducted in order to achieve its strategic objectives, inform expectations of leadership and support the resilience and sustainability of the Group. The components of the culture framework support sound risk management practices by requiring a focus on longer-term goals and sustainability, the avoidance of excessive risk taking and highlighting acceptable and unacceptable behaviours. This is supported through inclusion of risk and sustainability considerations in performance management for key individuals; the building of appropriate skills and capabilities in risk management; and by ensuring that employees understand and care about their role in managing risk through open discussions. The Group Risk Committee has a key role in providing advice to the Remuneration Committee on risk management considerations to be applied in respect of executive remuneration.

Prudential's Group Code of Business Conduct and Group Governance Manual, supported by risk-related policies, include guiding principles on the day-to-day conduct of all its people and any organisations acting on its behalf. Supporting policies include those related to financial crime, covering anti-money laundering, sanctions, anti-bribery and corruption and conduct. The Group's third-party and outsourcing policy requires that human rights and modern slavery considerations are embedded across all of its supplier and supply chain arrangements. Procedures to allow individuals to speak out safely and anonymously against unethical behaviour and conduct are also in place.

Further details on the Group's ESG governance arrangements and strategic framework are included in the Group's ESG Report, see pages 66 to 136.

ii. The risk management cycle

Risk identification

In accordance with provision 28 of the UK Corporate Governance Code and the GWS guidelines issued by the Hong Kong IA, a top-down and bottom-up process is in place to support Group-wide identification of principal risks. An emerging risk identification framework exists to support the Group's preparations in managing financial and non-financial risks expected to crystallise beyond the short-term horizon. The Board performs a robust assessment and analysis of these principal and emerging risk themes through the risk identification process, the Group Own Risk and Solvency Assessment (ORSA) report and the risk assessments undertaken as part of the business planning review, including how they are managed and mitigated, which supports decision-making.

The ORSA is the ongoing process of identifying, measuring and assessing, managing and controlling, monitoring and reporting the risks to which the business is exposed. It includes an assessment of capital adequacy to ensure that the Group's solvency needs are met at all times. Stress and scenario testing, which includes reverse stress testing requiring the Group to ascertain the point of business model failure, is another tool that helps to identify the key risks and scenarios that may have a material impact on the Group. The risk profile assessment is a key output from the risk identification and risk measurement processes and is used as a basis for setting Group-wide limits, management information, assessment of solvency needs, and determining appropriate stress and scenario testing. The Group's annual set of principal risks are given enhanced management and reporting focus.

Risk measurement and assessment

All identified risks are assessed based on an appropriate methodology for that risk. Quantifiable risks, which are material and mitigated by holding capital, are modelled in the Group's internal model, which is used to determine the Group Internal Economic Capital Assessment (GIECA) and is subject to independent validation and processes and controls around model changes and limitations.

Risk management and control

The Group's control procedures and systems focus on aligning the levels of risk-taking with the Group's strategy and can only provide reasonable, and not absolute, assurance against material misstatement or loss. The Group's risk policies define the Group's appetite to material risks and set out the risk management and control requirements to limit exposure to these risks, see below. These policies also set out the processes to enable the measurement and management of these risks in a consistent and coherent way, including the flows of management information required. The methods and risk management tools employed to mitigate each of its major categories of risks are detailed in section 4 below.

Risk monitoring and reporting

The Group's principal risks inform the management information received by the Group Risk Committee and the Board, which also includes key exposures against appetite and developments in the Group's principal and emerging risks.

iii. Risk appetite, limits and triggers

The Group recognises the interests of its broad spectrum of stakeholders (including customers, investors, employees, communities and key business partners) and that a managed acceptance of risk lies at the heart of the business. The Group seeks to generate stakeholder value by selectively taking exposure to risks, reduced to the extent it is cost-effective to do so, where these are an outcome of its chosen business activities and strategy. Those risks for which the Group has no tolerance are actively avoided. The Group's systems, procedures and controls are designed to manage risk appropriately, and its approach to resilience and recovery aims to maintain the Group's ability and flexibility to respond in times of stress.

Qualitative and quantitative expressions of risk appetite are defined and operationalised through risk limits, triggers and indicators. The RCS function reviews these measures at least annually. The Board approves changes to the Group's aggregate risk appetite and the Group Risk Committee has delegated authority to approve changes to the system of limits, triggers and indicators.

Group risk appetite is defined and monitored in aggregate by the setting of objectives for its liquidity, capital requirements and non-financial risk exposure, covering risks to stakeholders, including those from participating and third-party business. Group limits operate within these expressions of risk appetite to constrain material risks, while triggers and indicators provide additional defined points for escalation. The Group Risk Committee, supported by the RCS function, is responsible for reviewing the risks inherent in the Group's business plan and for providing the Board with a view on the risk/reward trade-offs and the resulting impact to the Group's aggregated position relative to Group risk appetite and limits, including non-financial risk considerations.

a. **Capital requirements.** Limits on capital requirements aim to ensure that in business-as-usual and stressed conditions the Group maintains sufficient capital in excess of internal economic capital requirements, achieves its desired target rating to meet its business objectives, and supervisory intervention is avoided. The two measures in use at the Group level are the GWS group capital requirements and internal economic capital requirements, determined by the Group Internal Economic Capital Assessment (GIECA).

b. **Liquidity.** The objective of the Group's liquidity risk appetite is to ensure that sufficient cash resources are available to meet financial obligations as they fall due in business-as-usual and stressed scenarios. This is measured using a liquidity coverage ratio which considers the sources of liquidity against liquidity requirements under stress scenarios.

Non-financial risks. At the end of 2021 the Group approved a more streamlined and simplified Non-Financial Risk Appetite approach, framed around the perspectives of its varied stakeholders, to be embedded in 2022. The Group accepts a degree of non-financial risk exposure as an outcome of its chosen business activities and strategy. It aims to manage these risks effectively to maintain its operational resilience and its commitments to customers and all stakeholders and avoid material adverse financial loss or impact to its reputation.

Risk management

Risk identification
Risk identification covers Group-wide:

1 Top-down risk identification.

2 Bottom-up risk identification.

3 Emerging risk identification.

Risk measurement and assessment
Risks are assessed in terms of materiality. Material risks which are modelled are included in appropriately validated capital models.

Manage and control
Risk appetite and limits allow for the controlled growth of the Group's business, in line with business strategy and plan. Processes that support the oversight and control of risks include:

1 The Risk and Control Assessment process.

2 The Own Risk and Solvency Assessment (ORSA).

3 Group-approved limits and early warning triggers.

4 Large risk approval process.

5 Global counterparty limit framework.

6 Financial and critical incidents procedures.

7 Stress and scenario testing, including reverse stress testing.

Monitor and report
Escalation requirements in the event of a breach are clearly defined. Risk reporting provides regular updates to the Group's Board and risk committees on exposures against Board-approved appetite statements and limits. Reporting also covers the Group's key risks.

Risk governance and culture
Risk governance comprises the Board, organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies. The Group-wide culture framework includes principles and values that define how business is conducted in order to achieve its strategic objectives, inform expectations of leadership and guide ESG activities.

Business strategy
Business strategy and the business plan provide direction on future growth and inform the level of limits on solvency, liquidity and earnings and for our key risks. The Risk, Compliance and Security function provides input and opinion on key aspects of business strategy.

Capital management
Capital adequacy is monitored to ensure that internal and regulatory capital requirements are met, and that solvency buffers are appropriate, over the business planning horizon and under stress.

Stress and scenario testing
Stress and scenario testing is performed to assess the robustness of capital adequacy and liquidity, and the appropriateness of risk limits. Recovery planning assesses the effectiveness of the Group's recovery measures and the appropriateness of activation points.

3. The Group's principal risks

The delivery of the Group's strategy in building long-term value for its shareholders and other stakeholders, focusing on high-growth business in Asia and Africa, exposes Prudential to risks. The materialisation of these risks within the Group or at its joint ventures or key third party partners may have a financial impact and may affect the performance of products or services or the fulfilment of commitments to customers and other stakeholders with an adverse impact on Prudential's brand and reputation. This report is focused mainly on risks to the shareholder but includes those which arise indirectly through policyholder exposures and third-party business. The Group's principal risks, which are not exhaustive, are detailed below. The Group's Risk Factor disclosures can be found at the end of this document.

Covid-19 – longer-term risks and forward-looking areas of focus

As the pandemic and the associated global response have evolved, it has become clear that Covid-19 and its impacts will persist far longer than many would have predicted at the onset of the global outbreak in 2020. The pandemic continues to present risks for the Group, particularly given the on-going uncertainty arising from current, emerging and future variants of the virus, and has also resulted in transformative changes to the business environment and Prudential's business model, which are likely to persist even after Covid-19 is considered endemic. These longer-term risks and forward-looking areas for the Group are summarised below and, where relevant, further information is provided within the descriptions of the Group's principal risks.

- **People risks:** Prudential continues to actively support and enable its employees to work remotely and flexibly and in line with government policy and guidance in the markets in which it operates. It has provided its fullest support to those directly impacted by the coronavirus and their families. The Group is exploring new ways of working, acknowledging that the pandemic may accelerate demand for a permanent shift in the pre-pandemic norms in working arrangements. The duration of the pandemic and related restrictions in some of the Group's markets has heightened the risks to the physical and mental health of its employees. This is a key area of focus across Prudential, with a coordinated suite of initiatives being progressed designed to measure and support the wellbeing and potential uncertainty of employees due to the Covid-19 pandemic or changes in the Group as it reshapes into an Asia and Africa focussed business.
- **Customer conduct, product and distribution risks:** As the initial pandemic-related initiatives and campaigns rolled out across markets to support customers expire (including customer cash benefits, goodwill payments, and extended grace periods for premium payments), the Group is monitoring the impact to customers to ensure they are treated fairly and with due care. The Group's customer conduct risk framework enshrines its focus on customer outcomes, under which risk monitoring is performed, irrespective of the pandemic. Prudential rolled out, with appropriate regulatory engagement, virtual face-to-face sales processes and digital product offerings in most its markets during the pandemic. Where these are expected to remain, the Group will ensure these processes are in line with evolving regulations and regulatory expectations, and monitor such developing processes for customer conduct, operational and commercial risks. Regardless of the pandemic, Prudential regularly assesses the suitability and affordability of its products, aiming to reduce their perceived complexity and increase the transparency of their costs and benefits. These aims, as well as the Group's increasing focus on the sustainable digital distribution of its health and wealth products via its Pulse platform, help to expand the financial inclusion of Prudential's products in its markets.
- **Financial market and economic risks:** Throughout 2021, pandemic developments, both positive and negative (such as the emergence of new Covid-19 variants), have contributed to financial market volatility. The Group continues close monitoring of equity, interest rate and credit risks and inflation expectations, as well as the broader macroeconomic impacts of the pandemic, including the effects of an uneven recovery across markets. Risk limits and the appropriateness of the Group's counter-cyclical capital buffer are regularly reviewed and adjusted where required.
- **Information security risks:** Office-based working may not return to pre-pandemic levels which, along with the pandemic-accelerated growth in digital operations, products and services, increases organisational exposure to long-term heightened information security risks, increasing the opportunities for cyber-crime and ransomware attacks. The Group continues to strengthen its robust information security management framework and progress its programme to enhance and maintain levels of cyber hygiene, combined with ongoing training and phishing campaigns, aligned with threat intelligence feeds, and simulation exercises to support data privacy and operational resilience.
- **Insurance risks:** In the short term, the Group has seen an increase in Covid-19-related mortality claims in select markets. A combination of the economic impact of the pandemic and extended restrictions on movement has also increased persistency risk at some of the Group's businesses. The potential longer-term impacts of the pandemic include lapses, surrenders and premium affordability from the broader economic effects; increased and/or delayed morbidity claims resulting from the deferral of medical treatment by policyholders during the pandemic; latent morbidity impacts from the deferral of medical treatment by policyholders; and the implications from other factors such as long-term post-Covid-19 symptoms (although there is currently no consensus on the longer-term impact on morbidity).

Risks to the Group's financial situation

(including those from the external macroeconomic and geopolitical environment)

The global economic and geopolitical environment may impact on the Group directly by affecting trends in financial markets and asset values, as well as driving short-term volatility.

Risks in this category include the market risks to our investments and the credit quality of our investment portfolio as well as liquidity risk.

Global economic and geopolitical conditions

Macroeconomic and geopolitical developments are considered material to the Group and can increase the operational, business disruption, regulatory and financial market risks to the Group and can directly impact its sales and distribution networks. Changes in global economic conditions can impact Prudential directly; for example, by reducing investment returns and fund performance and liquidity, and increasing the cost of product guarantees. Indirect impacts include higher inflation, which can reduce disposable income and decrease propensity for people to save and buy Prudential's products, as well as changes in political attitudes towards regulation. As some countries begin to adopt strategies to manage Covid-19 as an endemic disease, variations in the speed of economic recovery from the pandemic between markets, and the subsequent impact on their respective interest rates, inflation expectations and the relative strength of their currencies (and the associated impact on their foreign currency debt obligations), may drive broader long-term economic and financial uncertainty which may disproportionately impact emerging economies. Financial markets, economic sentiment and regulatory compliance risks can be highly susceptible to geopolitical developments. These have been outlined in Section 1.

Market risks to our investments

(Audited)

This is the potential for reductions in the value of Prudential's investments driven by fluctuations in equity prices, interest rates, foreign exchange rates and property prices. While interest rates have been rising steadily and may rise further in response to increasing inflationary pressures, a return to a low interest rate environment poses challenges to the capital position of life insurers and new business profitability. The Group has appetite for market risk where it arises from profit-generating insurance activities to the extent that it remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

The Group's market risks are managed and mitigated by the following:

- The Group market risk policy;
- Risk appetite statements, limits and triggers;
- The Group's asset liability committees (ALCOs);
- Asset and liability management activities, which include management actions such as changes in asset allocation, bonus revisions, repricing and the use of reinsurance where appropriate;
- Hedging using derivatives, including currency forwards, interest rate futures and swaps, and equity futures;
- The monitoring and oversight of market risks through the regular reporting of management information; and
- Regular deep dive assessments.

The Group Critical Incident Procedure (GCIP) defines specific governance to be invoked in the event of a critical incident, such as significant market, liquidity or credit-related event. This includes, where necessary, the convening of a Critical Incident Group (CIG) to oversee, coordinate, and where appropriate, direct activities during a critical incident.

Interest rate risk, including asset liability management (ALM). Interest rate risk is driven by the valuation of Prudential's assets (particularly government and corporate bonds) and liabilities, which are dependent on market interest rates. Sustained inflationary pressures which may drive higher interest rates may impact the valuation of fixed income investments and reduce fee income. Some of the Group's products are sensitive to movements in interest rates. Prudential's appetite for interest rate risk requires that assets and liabilities should be tightly matched for exposures where assets or derivatives exist that can cover these exposures. Interest rate risk is accepted where this cannot be hedged, provided that this arises from profitable products and to the extent that interest rate risk exposure remains part of a balanced exposure to risks and is compatible with a robust solvency position.

The Group's exposure to interest rate risk arises from the guarantees of some non-unit-linked products with a savings component, including the Hong Kong and Singapore with-profits and non-profit businesses. This exposure arises from the potential for an asset and liability mismatch, where long-dated liabilities and guarantees are backed by short-dated assets. When this mismatch is not eliminated, it is monitored and managed through local risk and asset liability management committees and Group risk limits consistent with the Group's appetite for interest rate risk. Unit-linked based businesses, such as Indonesia and Malaysia, are also exposed to interest rate risk resulting from the impact to the present value of future fees from such products.

The Group-level ALCOs are risk management advisory committees supporting the identification, assessment and management of key financial risks to the achievement of the Group's business objectives. They also oversee ALM and solvency risks of the local businesses as well as the declaration and management of non-guaranteed benefits for participating and universal life lines of business. Local business units are responsible for the management of their own asset and liability positions.

Market risks to our investments
continued

The objective of the local business unit ALM process is to meet policyholder liabilities with the returns generated from the investment assets held, while maintaining the financial strength of capital and solvency positions. The ALM strategy adopted by the local business units considers the liability profile and related assumptions of in-force business and new products to appropriately manage investment risk within ALM risk appetite, under different scenarios in accordance with policyholders' reasonable expectations, and economic and local regulatory requirements. Factors such as the availability of matching assets, diversification, currency and duration are considered as appropriate. The assumptions and methodology used in the measurement of assets and liabilities for ALM purposes conform with local solvency regulations. Assessments are carried out on an economic basis which conforms to the Group's internal economic capital methodology.

Equity and property investment risk. The shareholder exposure to equity price movements arises from various sources, including from unit-linked products where fee income is linked to the market value of the funds under management. Exposure also arises from with-profits businesses through potential fluctuations in the value of future shareholders' profits and where bonuses declared are based broadly on historical and current rates of return from the Asia business's investment portfolios, which include equities. The Group has limited acceptance for exposures to equity risk but accepts the equity exposure that arises on future fees (including shareholder transfers from the with-profits business).

The material exposures to equity risk in the Group's businesses include the following: The China joint venture business is exposed to equity risk through its investments in equity assets for most of its products, including participating and non-participating savings products and protection and investment-linked products. The Hong Kong business and, to a lesser extent, the Singapore business contribute to the Group's equity risk exposure due to the equity assets backing participating products. The Indonesia and Malaysia businesses are exposed to equity risk through their unit-linked products.

Foreign exchange risk. The geographical diversity of Prudential's businesses means that it has some exposure to the risk of foreign exchange rate fluctuations. Some entities within the Group write policies, invest in assets or enter into other transactions in local currencies or currencies not linked to the US dollar. Although this limits the effect of exchange rate movements on local operating results, it can lead to fluctuations in the Group's US dollar-reported financial statements. This risk is accepted within the Group's appetite for foreign exchange risk. In cases where a non-US dollar denominated surplus arises in an operation which is to be used to support Group capital, or where a significant cash payment is due from a subsidiary to the Group, this currency exposure may be hedged where considered economically favourable. Further, the Group generally does not have appetite for significant direct shareholder exposure to foreign exchange risks in currencies outside the countries in which it operates, but it does have some appetite for this on fee income and on equity investments within the with-profits fund. Where foreign exchange risk arises outside appetite, currency swaps and other derivatives are used to manage the exposure.

Liquidity risk
(Audited)

Prudential's liquidity risk arises from the need to have sufficient liquid assets to meet policyholder and third-party payments as they fall due, considered under both business-as-usual and stressed conditions. It includes the risk arising from funds composed of illiquid assets and results from a mismatch between the liquidity profile of assets and liabilities. Liquidity risk may impact on market conditions and valuation of assets in a more uncertain way than for other risks like interest rate or credit risk. It may arise, for example, where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or where redemption requests are made against Prudential's external funds. Liquidity risk is considered material at the level of the Group. Prudential has no appetite for any business to have insufficient resources to cover its outgoing cash flows, or for the Group as a whole to not meet cash flow requirements from its debt obligations under any plausible scenario.

The Group has significant internal sources of liquidity sufficient to meet its expected cash requirements for at least 12 months from the date the financial statements are approved, without having to resort to external sources of funding. The Group has a total of $2.6 billion of undrawn committed facilities that can be made use of, expiring in 2026. Access to further liquidity is available through the debt capital markets and the Group's extensive commercial paper programme. Prudential has maintained a consistent presence as an issuer in the market for the past decade.

A number of risk management tools are used to manage and mitigate liquidity risk, including the following:

- The Group's liquidity risk policy;
- Risk appetite statements, limits and triggers;
- Regular assessment by the Group and business units of Liquidity Coverage Ratios which are calculated under both base case and stressed scenarios and are reported to committees and the Board;
- The Group's Liquidity Risk Management Plan, which includes details of the Group Liquidity Risk Framework as well as analysis of Group and business units liquidity risks and the adequacy of available liquidity resources under business-as-usual and stressed conditions;
- Its contingency plans and identified sources of liquidity;
- The Group's ability to access the money and debt capital markets; and
- The Group's access to external committed credit facilities.

Risks to the Group's financial situation (including those from the external macroeconomic and geopolitical environment) continued

Credit risk
(Audited)

Credit risk is the potential for loss resulting from a borrower's failure to meet its contractual debt obligation(s). Counterparty risk, a type of credit risk, is the probability that a counterparty to a transaction defaults on its contractual obligation(s) causing the other counterparty to suffer a loss. These risks arise from the Group's investments in bonds, reinsurance arrangements, derivative contracts with third parties, as well as its cash deposits with banks. Credit risk is considered a material risk for the Group's business units.

The Group's holdings across its life portfolios are mostly in local currency and with a largely domestic investor base, which provides support to these positions. The Group's portfolios are generally positioned towards high quality names, including those with either government or considerable parent company balance sheet support. Areas which the Group are actively monitoring include the developments in the China property sector and the degree of government support for state-owned entities in Asia, given recent defaults observed in the market by such entities in China and Thailand. The Group's portfolio is generally well diversified in relation to individual counterparties, although counterparty concentration is monitored, in particular in local markets where depth (and therefore the liquidity of such investments) may be low. Prudential actively reviews its investment portfolio to improve the robustness and resilience of the solvency position. The Group has some appetite to take credit risk to the extent that it remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position. Further detail on the Group's debt portfolio is provided below.

A number of risk management tools are used to manage and mitigate credit risk, including the following:

- A credit risk policy and dealing and controls policy;
- Risk appetite statements and portfolio-level limits that have been defined on issuers, and counterparties;
- Collateral arrangements for derivative, secured lending reverse repurchase and reinsurance transactions which aim to provide a high level of credit protection;
- The Group Credit Risk Committee's oversight of credit and counterparty credit risk and sector and/or name-specific reviews;
- Regular assessments of individual and sector exposures subject to elevated credit risks; and
- Close monitoring or restrictions on investments that may be of concern.

The total debt securities at 31 December 2021 for the Group's continuing operations were $99.1 billion (31 December 2020: $89.8 billion). The majority (70 per cent) of the portfolio is in unit-linked and with-profits funds. The remaining 30 per cent of the debt portfolio is held to back the shareholder business.

Group sovereign debt. Prudential invests in bonds issued by national governments. This sovereign debt holding of the Group's operations represented 47 per cent or $14.2 billion[1] of the shareholder debt portfolio of the Group's operations as at 31 December 2021 (31 December 2020: 45 per cent or $12.8 billion of the shareholder debt portfolio for the Group's continuing operations). The particular risks associated with holding sovereign debt are detailed further in the disclosures on Risk Factors.

The exposures held by the shareholder-backed business and with-profits funds in sovereign debt securities at 31 December 2021 are given in note C1 of the Group's IFRS financial statements.

Corporate debt portfolio. In the shareholder-backed business, corporate debt exposures totalled $14.5 billion of which $12.7 billion or 87 per cent were investment grade rated.

Bank debt exposure and counterparty credit risk. The banking sector represents a material concentration in the Group's corporate debt portfolio which largely reflects the composition of the fixed income markets across the regions in which Prudential is invested. As such, exposure to banks is a key part of its core investments, as well as being important for the hedging and other activities undertaken to manage its various financial risks. Exposure to the sector is considered a material risk for the Group. Derivative and reinsurance counterparty credit risk exposure is managed using an array of risk management tools, including a comprehensive system of limits. Prudential manages the level of its counterparty credit risk by reducing its exposure, buying credit protection or using additional collateral arrangements where appropriate.

At 31 December 2021:

- 87 per cent of the Group's shareholder portfolio (excluding all government and government-related debt) is investment grade rated[2]. In particular, 52 per cent of the portfolio is rated[2] A- and above (or equivalent); and
- The Group's shareholder portfolio is well diversified: no individual sector[3] makes up more than 15 per cent of the total portfolio (excluding the financial and sovereign sectors).

The Group's Sustainability and ESG-related risks

These include sustainability risks associated with environmental considerations such as climate change (including physical and transition risks), social risks arising from diverse stakeholder commitments and expectations and governance-related risks.

Material risks associated with key ESG themes may undermine the sustainability of a business by adversely impacting its reputation and brand, ability to attract and retain customers and employees, and therefore the results of its operations and delivery of its strategy and long-term financial success. Prudential seeks to manage sustainability risks and their potential negative impact on its business and stakeholders through a focus on the Group's purpose to 'help people get the most out of life', and transparent and consistent implementation of its strategy in its key markets and across operational, underwriting and investment activities. The Group's strategy includes providing greater and more inclusive access to good health and financial security, responsible stewardship in managing the human impact of climate change and building human and social capital with its broad range of stakeholders. It is enabled by strong internal governance, sound business practices and a responsible investment approach, with ESG considerations integrated into investment decisions and the performance of fiduciary and stewardship duties, including voting and active engagement decisions with respect to investee companies, as both an asset owner and an asset manager.

i. Environmental issues

Prudential's strategic focus on stewarding the human impacts of climate change and decarbonising its operations and investment activities recognises that environmental concerns, such as water pollution, biodiversity degradation and notably those associated with climate change, and their social and economic impacts present long-term risks to the sustainability of Prudential, and may impact its customers and other stakeholders.

Prudential's investment horizons are long term and it is therefore exposed to the potential long-term impact of climate change risks, which include the financial and non-financial impact of transition to a lower carbon economy and physical and litigation risks. The global transition to a lower carbon economy may have an adverse impact on investment valuations as the financial assets of carbon-intensive companies re-price, and this could result in some asset sectors facing significantly higher costs and a reduction in demand for their products and services. The speed of this transition, and the extent to which it is orderly and managed, will be influenced by factors such as public policy, technology and changes in market or investor sentiment. The potential impact of these factors on the valuation of investments may also have a broader economic and social impact that may affect customers and their demand for the Group's products and services.

The transition to a lower carbon economy has the potential to disproportionately impact the Asia and Africa markets in which Prudential operates and invests, and the Group's stakeholders increasingly expect and/or rely on the Group to support an orderly, inclusive and sustainable transition based on an understanding of relevant country and company-level plans, taking into consideration the impact on the economies, businesses, communities and customers in these markets.

The pace and volume of new climate-related regulation and reporting standards emerging across the markets in which the Group operates, the need to deliver on existing and new voluntary exclusions on investments in certain sectors, engagement and reporting commitments and externally assured reporting may give rise to compliance, operational and disclosure risks which may be increased by the multi-jurisdictional coordination required in adopting a consistent risk management approach. Understanding and appropriately reacting to transition risk and implementing carbon reduction commitments requires sufficient and reliable data on carbon exposure and transition plans for the assets in which the Group invests.

The direct physical impacts of climate change, driven by both specific short-term climate-related events such as natural disasters and longer-term changes to climate and the natural environment, are likely to become increasingly significant factors in the mortality and morbidity risk assessments for the Group's insurance product underwriting and offerings and their associated claims profiles. Climate-driven events in countries in which Prudential or its key third parties operate could adversely impact the Group's operational resilience and its customers, which may potentially occur through migration or displacement both within and across borders.

A failure to understand, manage and provide greater transparency of its exposure to these climate-related risks may have increasing adverse implications for Prudential and its stakeholders.

ii. Social issues

Social risks that could impact Prudential may arise from a failure to consider the rights, diversity, wellbeing, needs and interests of its customers and employees and the communities in which the Group or its third parties operate. These risks are increased as Prudential operates in multiple jurisdictions with distinct local cultures and considerations. Perceived inequalities and income disparities, intensified by the pandemic, have the potential to further erode social cohesion across the Group's markets, emphasising the importance of an inclusive and sustainable global economic recovery.

The Group's Sustainability and ESG-related risks
continued

Evolving social norms and emerging population risks associated with public health trends (such as an increase in obesity and mental health deterioration) and demographic changes (such as population urbanisation and ageing) may affect customer lifestyles and therefore may impact the level of claims against the Group's insurance product offerings. As a provider of insurance and investment services the Group is committed to playing a role in preventing and postponing illness in order to protect its customers, as well as making health and financial security more inclusive and accessible through enhancements to its products and services and an increased focus on digital innovation, technologies and distribution methods. As a result, Prudential has access to sensitive customer personal data, including data related to personal health, and an increasing ability to analyse and interpret this data through the use of complex tools, machine learning and artificial intelligence technologies. The Group therefore actively manages the regulatory, ethical and reputational risks associated with actual or perceived customer data misuse or security breaches and its operational resilience to support its customers. These risks are outlined below. The increasing digitalisation of products, services and processes may also result in new and unforeseen regulatory requirements and stakeholder expectations for which Prudential monitors, as well as ensuring support for its customers through this transformation.

As an employer, the Group aims to attract, retain and develop a diverse group of highly-skilled employees to meet the changing needs of a transformative organisation. This requires the implementation of responsible working practices and recognising the benefits of diversity, ensure psychological safety for employees to contribute and challenge, and promoting a culture of inclusion and sense of belonging.

The Group's reputation extends to its supply chains and its investee companies, which may be exposed to factors such as poor labour standards and abuses of human rights by third parties.

iii. Governance

Maintaining high standards of corporate governance is crucial for the Group and its customers and employees, reducing the risk of poor decision-making and a lack of oversight of its key risks. Poor governance may arise where key governance committees have insufficient independence, a lack of diversity, skills or experience in their members, or unclear (or insufficient) oversight responsibilities and mandates. Inadequate oversight over remuneration also increases the risk of poor senior management behaviours. Prudential operates across multiple jurisdictions and has a Group and subsidiary governance structure which may add further complexity to these considerations. Participation in joint ventures or partnerships where Prudential does not have direct overall control and the use of third-party suppliers increases the potential for reputational risks arising from poor governance.

Prudential is an active contributor to industry fora on sustainability and the Group was a key contributor to the CRO Forum's November 2021 guidance paper ('Mind the Sustainability Gap – Integrating sustainability into insurance risk management'), that seeks to define a set of industry best practice guidelines to manage the integration of sustainability into insurers' risk management frameworks. Risk management and mitigation of ESG sustainability risks at Prudential include the following:

- The Group's strategic focus on providing greater and more inclusive access to good health and financial security, responsible stewardship in managing the human impact of climate change and building human and social capital with its broad range of stakeholders;
- The Group Code of Business Conduct and Group Governance Manual including ESG-linked policies;
- Activities to embed ESG and sustainability and risk within the Group Risk Framework including:
  - Environmental and social risk identification including through emerging risk processes; and
  - Deep dives into ESG themes, including climate-related risks;
- Integrating ESG considerations into investment processes and responsible supply chain management; and
- Participation in networks to further develop understanding and support collaborative action in relation to ESG sustainability risks such as climate change.

Further information on the Group's ESG governance is included in section 3 above, and further detail on the Group's ESG strategic framework and the management of material ESG themes are included in the Group's ESG Report 2021 on pages 66 to 137.

Risks from the nature of our business and our industry

These include the Group's non-financial risks (including operational and financial crime risk), transformation risks from significant change activity and the insurance risks assumed by the Group in providing its products.

Transformation risk

Transformation risk remains a material risk for Prudential, with a number of significant change programmes under way, which if not delivered to defined timelines, scope and cost may negatively impact its operational capability; control environment; reputation; and ability to deliver its strategy and maintain market competitiveness.

The Group's transformation and change programmes inherently give rise to design and execution risks, and may introduce new, or increase existing, business risks (including increasing uncertainty for the Group's employees) and increase intra-Group connectivity and dependencies. While the adoption of technologies related to digital distribution and artificial intelligence has opened up new product distribution and value-added service opportunities, it also exposes Prudential to additional regulatory, information security, data privacy, operational, ethical and conduct risks which, if not managed effectively, could result in customer detriment and reputational damage. The speed of technological change and adoption in the business also increase the risk that all unintended consequences are not anticipated. The Group therefore aims to ensure that, for both transformation and strategic initiatives, strong programme governance is in place with embedded risk expertise to achieve ongoing and nimble risk oversight, with regular risk monitoring and reporting to risk committees. Transformation risk oversight operates alongside the Group's existing risk policies and frameworks to ensure appropriate governance and controls are in place to mitigate these risks.

Prudential's current portfolio of transformation and significant change programmes include the expansion of the Group's digital capabilities and use of technology, platforms and analytics, and improvement of business efficiencies through operating model changes. Programmes related to regulatory/industry change such as the development and embedding of the Group Internal Economic Capital Assessment (GIECA) model under the GWS Framework, changes required to effect the discontinuation of inter-bank offered rates (IBORs) in their current form and the implementation of IFRS 17 are also ongoing.

Risks associated with the Group's joint venture and jointly owned businesses

Prudential operates, and in certain markets is required by local regulation to operate, through joint ventures and other joint ownership or third-party arrangements. A material proportion of the Group's business comes from its joint ventures in China and India. For such operations the level of control exercisable by the Group depends on the terms of the contractual agreements between participants. As such the level of oversight, control and access to management information the Group is able to exercise over the extent of the exposure to material risks at these operations may be lower compared to the Group's wholly owned businesses. Further information on the risks to the Group associated with joint ventures and jointly owned businesses are included in the disclosures on Risk Factors.

Risks from the nature of our business and our industry
continued

Non-financial risks

The complexity of Prudential, its activities and the extent of transformation in progress creates a challenging operating environment and exposure to non-financial risks. The Group's appetite framework for non-financial risks considers risks across a broad range of categories which are outlined below. These risks are considered to be material at the level of the Group.

Operational risk. This is the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel or systems and external events, and may arise from employee error, model error, system failures, fraud or other events which disrupt business processes or which have a detrimental impact to customers. Prudential accepts a degree of non-financial risk exposure as an outcome of its chosen business activities and strategy. It aims to manage these risks effectively to maintain its operational resilience and its commitments to customers and all stakeholders and avoid material adverse financial loss or impact on its reputation.

Outsourcing and third-party risks. The Group's outsourcing and third-party relationships require distinct oversight and risk management processes. The Group has a number of important third-party relationships, both with market counterparties and outsourcing partners, including distribution, technology and ecosystem providers. In Asia, the Group continues to expand its strategic partnerships and renew bancassurance arrangements. These arrangements support the delivery of high level and cost-effective services to customers, but also create a reliance on the operational resilience and performance of outsourcing and business partners. The Group's requirements for the management of material outsourcing arrangements have been aligned to the requirements of the Hong Kong IA's GWS Framework and are included in its Group third party supply and outsourcing policy. Third-party management is also included and embedded in the Group-wide operational risk framework (see below).

Information security and data privacy risk. This includes risks related to malicious attack on systems, network disruption and the infringement of data security, integrity or privacy. The frequency and sophistication of intrusion activities and criminal capability in this area, including in ransomware (malicious software designed to block access to a computer system until a sum of money is paid), continues to increase globally. The technology landscape of Prudential is transforming at a rapid pace and the underlying technology infrastructure (and support services) has grown in scope and complexity in recent years. This, combined with stakeholder expectations and the potential for reputational and conduct risk from cyber security breaches and data misuse, which can be highly-publicised, mean that these risks are considered material at the level of the Group. As well as having preventative risk management processes in place, it is fundamental that the Group has robust critical recovery systems in place in the event of a successful attack on its infrastructure, a breach of its information security or a failure of its systems in order to retain its customer relationships and trusted reputation.

Prudential and the insurance industry are making increasing use of emerging technological tools and digital services, or partnering with third parties that provide these capabilities. While these provide new opportunities, opening up markets, improving insights and increasing scalability, it also comes with additional risks, including operational and data misuse risks, which are managed within the Group's existing governance and risk management processes. Automated digital distribution channels increase the criticality of system and process resilience in order to deliver uninterrupted service to customers.

Globally, ransomware attacks have increased markedly with the shift to remote working practices driven by the Covid-19 pandemic. Prudential has a number of defences in place to protect its systems from this type of attack, including but not limited to: AI-based endpoint security software, continuous security monitoring, network-based intrusion detection, and employee training and awareness campaigns to raise understanding of attacks utilising email phishing techniques. Cyber insurance coverage is in place to provide some protection against potential financial losses and the Group conducts simulation exercises for ransomware attacks to assess and develop the effectiveness of incident responses across its businesses.

Data protection requirements continue to evolve, and include developments in China outlined in the overview of the Group's regulatory risks below. As well as protecting data, stakeholders expect companies and organisations to use personal information transparently and appropriately. Control of data through national data security regimes has become an increasing priority for governments amid the increase in global strategic competition. This adds further complexity to regulatory compliance in this area, in particular in the cross-border transfer or use of data, for global organisations in addition to the existing regulatory, financial and reputational risks of a breach of Prudential's (or third-party suppliers') IT systems or loss or misuse of data. In 2021 a new Group Data Policy was approved, establishing the principles and requirements for effective and scalable data management in light of the increase in volume and variety of data expected to be held, as well as the speed at which it is collected, as part of the Group's digital aspirations.

Non-financial risks

continued

The Group's Information Security and Data Privacy strategy has four key objectives: business enablement; continuous improvement of cyber defences; automation and optimisation; and governance and assurance to ascertain ongoing robustness of cyber security and privacy measures. In 2021 a focus of Prudential has been ensuring consistent global coverage of security controls, following the operationalisation of a revised organisational structure and governance model for cyber security management. This included the establishment of a centralised Technology Risk Management team, leveraging skills, tools and resources across different technology domains to provide advisory, assurance and operations support for holistic technology risk management including information security and privacy. A Group Technology Risk Committee has been established, providing group-wide oversight of technology risks, including information security and privacy. Risk management is also performed locally within business units, with input from business information security officers and with oversight from local risk committees. The Prudential plc Board is briefed at least twice annually on cyber security by the Group CISO and executive training is provided to ensure that members have the means to enable appropriate oversight and understand the latest threats and regulatory expectations. The Group-wide information security policy was developed in collaboration with industry experts to support a pragmatic approach to the evolving regulatory environment globally and ensure compliance with all applicable privacy laws and regulations and the appropriate and ethical use of customer data. The policy was also developed with reference to international standards, including ISO 27001/2, the NIST Cyber Security Framework and supervisory guidelines. Local standards are aligned to local regulations and laws.

Model and user developed application (UDA) risk. Erroneous or misinterpreted tools used in core business activities, decision-making and reporting may have adverse consequences for Prudential. The Group utilises various tools to perform a range of operational functions including the calculation of regulatory or internal capital requirements, the valuation of assets and liabilities, determining hedging requirements, and in acquiring new business using artificial intelligence and digital platforms. Many of these tools are an integral part of the information and decision-making frameworks used at Prudential and errors or limitations in these tools, or inappropriate usage, may lead to regulatory breaches, inappropriate decision-making, financial loss, customer detriment, inaccurate external reporting or reputational damage.

The Group has no appetite for model and UDA risk arising as a result of failing to develop, implement and monitor appropriate risk mitigation measures. Prudential's model and UDA risk framework and policy applies a risk-based approach in order to ensure appropriate and proportionate risk management is applied to all models and UDAs used across the business, depending on the materiality and nature of the data used in these tools, as well as their complexity.

Prudential's model and UDA risk is managed and mitigated using the following:

- The Group's Model and UDA Risk Policy and relevant Guidelines;
- Annual risk assessment of all tools used for core business activities, decision-making and reporting;
- Maintenance of appropriate documentation for tools used;
- Implementation of controls to ensure tools are accurate and appropriately used;
- Tools are subject to rigorous and independent model validation; and
- Regular reporting to the RCS function and risk committees to support the measurement and management of the risk.

In 2021 the Group updated its Group's Model and User Developed Applications Policy which included a broadening of the considerations when assessing model criticality to include a wider group of stakeholders including policyholders (in addition to shareholders) and associated reputational risk impacts and increased oversight of models in development, including the model being developed for RBC at the Hong Kong business.

Technological developments, in particular in the field of AI, pose new questions on risk oversight provided under the Group Risk Framework. An oversight forum for the use of AI was established during 2021 and key ethical principles, which were approved by the Group Risk Committee in 2020, have been adopted to apply to the use of AI by the Group.

Business disruption risk. The Group continually seeks to increase business resilience through adaptation, planning, preparation and testing of contingency plans and its ability to respond effectively to disruptive incidents. Business resilience is at the core of the Group's embedded Business continuity management (BCM) programme and framework that help to protect the Group's systems and its key stakeholders. The BCM programme and framework covers business impact analyses, risk assessments, and the maintenance and exercising of business continuity, incident management and disaster recovery plans. The programme is designed to provide business continuity aligned to the Group's evolving business needs and the size, complexity and nature of its operations. Business disruption risks are monitored by the Group Security function, with key operational effectiveness metrics and updates on specific activities being reported to the Group Risk Committee.

Risks from the nature of our business and our industry
continued

Non-financial risks
continued

Financial crime risk. As with all financial services firms, Prudential is exposed to risks relating to money laundering (the risk that the products or services of the Group are used by customers or other third parties to transfer or conceal the proceeds of crime); fraud (the risk that fraudulent insurance claims, transactions, or procurement of services, are made against or through the business); sanctions compliance breaches (the risk that the Group undertakes business with individuals and entities on the lists of the main sanctions regimes); and bribery and corruption (the risk that employees or associated persons seek to influence the behaviour of others to obtain an unfair advantage or receive benefits from others for the same purpose).

Prudential operates in some high-risk countries where, for example, the acceptance of cash premiums from customers may be common practice, large-scale agency networks may be in operation where sales are incentivised by commission and fees, where is a higher concentration of exposure to politically-exposed persons, or which otherwise have higher geopolitical risk exposure.

The Group-wide policies in place on anti-money laundering, fraud, sanctions and anti-bribery and corruption reflect the values, behaviours and standards that are expected across the business. Screening and transaction monitoring systems are in place and a series of improvements and upgrades are being implemented, and a programme of compliance control monitoring reviews is in place across the Group. Proactive fraud capabilities are in development and being rolled across local businesses. Work is also underway to enhance detective fraud, conflicts and anti-bribery and corruption controls relating to third-party risk management in procurement. Risk assessments are performed annually at higher risk locations. Due diligence reviews and assessments against Prudential's financial crime policies are performed as part of the Group's business acquisition process. The Group continues to undertake strategic activity to monitor and evaluate the evolving fraud risk landscape, mitigate the likelihood of fraud occurring and increase the rate of detection.

The Group has in place a mature confidential reporting system through which employees and other stakeholders can report concerns relating to potential misconduct. The process and results of this are overseen by the Group Audit Committee.

Group-wide framework and risk management for operational and other non-financial risks

The risks detailed above form key elements of the Group's non-financial risk profile. A Group-wide operational risk framework is in place to identify, measure and assess, manage and control, monitor and report effectively on all material operational risks across the business. The key components of the framework are listed below. Outputs from these processes and activities performed by individual business units are monitored by the RCS function, which provides an aggregated view of the risk profile across the business to the Group Risk Committee and Board.

- Application of a risk and control self-assessment (RCSA) process, where risk exposures are identified and assessed as part of a periodical cycle;
- An internal incident management process, which identifies, quantifies and monitors remediation conducted through root cause analysis and application of action plans for risk events;
- An annual scenario analysis process for the quantification of extreme, yet plausible manifestations of key operational risks across the business on a forward-looking basis; and
- A risk appetite framework for non-financial risks that articulates the level of risk exposure the business is willing to tolerate and defines escalation processes for breaches of appetite.

These core framework components are embedded across the Group via the Group Operational Risk Policy and accompanying standards, which set out the key principles and minimum standards for the management of operational risk within risk appetite. These sit alongside other risk policies and standards that individually engage with specific operational risks, including outsourcing and third-party supply, business continuity, financial crime, technology and data, operations processes and extent of transformation. These policies and standards include subject matter expert-led processes that are designed to identify, assess, manage and control operational risks, detailed below. These activities are fundamental in maintaining an effective system of internal control, and ensure that operational risk considerations are embedded in key business decision-making, including material business approvals and in setting and challenging the Group's strategy.

- Reviews of key operational risks and challenges within Group and business unit business plans during the annual planning cycle, to support business decisions;
- Corporate insurance programmes to limit the financial impact of operational risks;
- Oversight of risk management during the transformation life cycle, project prioritisation and the risks, interdependencies and possible conflicts arising from a large portfolio of transformation activities;
- Regulatory change teams to assist in proactively adapting and complying with regulatory developments;
- Group and business unit-level compliance oversight and risk-based testing in respect of adherence with regulations;
- Screening and transaction monitoring systems for financial crime and a programme of compliance control monitoring reviews and regular risk assessments;
- Internal and external review of cyber security capability and defences; and
- Regular updating and risk-based testing of disaster-recovery plans and the Critical Incident Procedure process.

Insurance risks

(Audited)

Insurance risk makes up a significant proportion of Prudential's overall risk exposure. The profitability of its businesses depends on a mix of factors, including levels of, and trends in, mortality (policyholders dying), morbidity (policyholders becoming ill or suffering an accident) and policyholder behaviour (variability in how customers interact with their policies, including utilisation of withdrawals, take-up of options and guarantees and persistency, ie lapsing/surrendering of policies), and increases in the costs of claims over time (claim inflation). The Group has appetite for retaining insurance risks in the areas where it believes it has expertise and operational controls to manage the risk and where it judges it to be more value-creating to do so rather than transferring the risk, and only to the extent that these risks remain part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

The impact of the Covid-19 pandemic to economic activity and employment levels across the Group's markets has the potential to elevate the incidence of claims, lapses, or surrenders of policies, and some policyholders may defer or stop paying insurance premiums or reduce deposits into retirement plans. In particular extended restrictions on movement could affect product persistency. The pandemic may also result in elevated claims and policy lapses or surrenders in a less direct way, and with some delay in time before being felt by the Group, due to factors such as policyholders deferring medical treatment during the pandemic, or policyholders lapsing or surrendering their policies on the expiry of grace periods for premium payments provided by the Group's businesses. Inflationary pressures driving higher interest rates may lead to increased lapses for some guaranteed savings products where higher levels of guarantees are offered by products of the Group's competitors, reflecting consumer demand for returns at the level of, or exceeding, inflation. The Group's assessment to date is that elevated mortality claims in some markets can be attributed to Covid-19. These impacts to the business are being closely monitored with targeted management actions being implemented where necessary, which includes additional Incurred But Not Reported (IBNR) claims reserves in some markets, including where deferrals in non-acute medical treatments due to movement restrictions have been observed.

The principal drivers of the Group's insurance risk vary across its business units. In Hong Kong, Singapore, Indonesia and Malaysia a significant volume of health and protection business is written and the most significant insurance risks are persistency risk, morbidity risk and medical claims inflation risk.

Medical claims inflation risk: A key assumption in these markets is the rate of medical claims inflation, which is often in excess of general price inflation, while the cost of medical treatment increasing more than expected, resulting in higher than anticipated medical claims cost passed on to Prudential, is a key risk. This risk is best mitigated by retaining the right to reprice products and appropriate overall claims limits within policies, either per type of medical treatment or in total across a policy, annually and/or over the policy lifetime.

Morbidity risk: Prudential's morbidity risk is managed through prudent product design, underwriting and claims management, and for certain products, the right to reprice where appropriate. Prudential's morbidity assumptions reflect its recent experience and expectation of future trends for each relevant line of business.

Persistency risk: The Group's persistency assumptions reflect recent experience and expert judgement, especially where a lack of experience data exists, as well as any expected change in future persistency. Persistency risk is managed by appropriate controls across the product life cycle. This includes review and revisions to product design and incentive structures where required, ensuring appropriate training and sales processes, including those ensuring active customer engagement and high service quality, appropriate customer disclosures and product collaterals, use of customer retention initiatives as well as post-sale management through regular experience monitoring. Strong risk management and mitigation of conduct risk and the identification of common characteristics of business with high lapse rates is also crucial. Where appropriate, allowance is made for the relationship (either assumed or observed historically) between persistency and investment returns. Modelling this dynamic policyholder behaviour is particularly important when assessing the likely take-up rate of options embedded within certain products.

Prudential's insurance risks are managed and mitigated using the following:

- The Group's insurance policy, which sets out the Group's insurance risk appetite; required standards for effective insurance risk management by head office and local businesses, including processes to enable the measurement of the Group's insurance risk profile; management information flows; and escalation mechanisms;
- The Group's product and underwriting risk policy, which sets out the required standards for effective product and underwriting risk management and approvals for new, or changes to existing, products (including the role of Group); and the processes to enable the measurement of underwriting risk. The policy also describes how the Group's Customer Conduct Risk Policy is met in relation to new product approvals and current and legacy products;
- In product design and appropriate processes related to the management of policyholder reasonable expectations;
- The risk appetite statements, limits and triggers;
- Using persistency, morbidity and longevity assumptions that reflect recent experience and expectation of future trends, and industry data and expert judgement where appropriate;
- Using reinsurance to mitigate mortality and morbidity risks;
- Ensuring appropriate medical underwriting when policies are issued and appropriate claims management practices when claims are received in order to mitigate morbidity risk;
- Maintaining the quality of sales processes, training and using initiatives to increase customer retention in order to mitigate persistency risk;
- The use of mystery shopping to identify opportunities for improvement in sales processes and training;
- Using product repricing and other claims management initiatives in order to mitigate morbidity and medical expense inflation risk; and
- Regular deep dive assessments.

Risks from the nature of our business and our industry
continued

Customer conduct risk

Prudential's conduct of business, especially in the design and distribution of its products and the servicing of customers, is crucial in ensuring that the Group's commitment to meeting its customers' needs and expectations is met. The Group's customer conduct risk framework, owned by the Group Chief Executive, reflects management's focus on customer outcomes.

Factors that may increase conduct risks can be found throughout the product life cycle, from the complexity of the Group's products and services to its diverse distribution channels, which include its agency workforce, virtual face-to-face sales and sales via online digital platforms. In alignment with the Group's purpose of helping people get the most out of life, Prudential strives towards making health and protection coverage affordable and accessible to all. Through Prudential's Pulse platform, there is increased focus on making insurance more inclusive to underserved segments of society through bite-size low-cost digital products and services. Prudential has developed a Group Customer Conduct Risk Policy which sets out five customer conduct standards that the business is expected to meet, being:

1. Treat customers fairly, honestly and with integrity;
2. Provide and promote products and services that meet customer needs, are clearly explained and that deliver real value;
3. Manage customer information appropriately, and maintain the confidentiality of customer information;
4. Provide and promote high standards of customer service; and
5. Act fairly and timely to address customer complaints and any errors found.

Prudential manages conduct risk via a range of controls that are assessed through the Group's conduct risk assessment framework, reviewed within its monitoring programmes, and overseen within reporting to its Boards and Committees.

Management of Prudential's conduct risk is key to the Group's strategy. Prudential's conduct risks are managed and mitigated using the following:

- The Group's code of business conduct and conduct standards, product underwriting and other related risk policies, and supporting controls including the Group's fraud risk control programme;
- A culture that supports the fair treatment of the customer, incentivises the right behaviour through proper remuneration structures, and provides a safe environment to report conduct risk related issues via the Group's internal processes and Speak Out;
- Distribution controls, including monitoring programmes relevant to the type of business (insurance or asset management), distribution channel (agency, bancassurance, or digital) and ecosystem, to ensure sales are conducted in a manner that considers the fair treatment of customers within digital environments;
- Quality of sales processes and training, and using other initiatives such as special requirements for vulnerable customers, to improve customer outcomes;
- Appropriate claims management and complaint handling practices; and
- Regular deep dive assessments on, and monitoring of, conduct risks and periodic conduct risk assessments.

Risks related to regulatory and legal compliance

These include risks associated with prospective regulatory and legal changes and compliance with existing regulations and laws – including their retrospective application – with which the Group must comply in the conduct of its business.

Prudential operates under the ever-evolving requirements and expectations of diverse regulatory, legal and tax regimes which may impact its business or the way it is conducted. This covers a broad range of risks including changes in government policy and legislation, capital control measures, and new regulations at either national or international level. The breadth of local and Group-wide regulatory arrangements presents the risk that requirements are not fully met, resulting in specific regulator interventions or actions including retrospective interpretation of standards by regulators. As the industry's use of emerging technological tools and digital services increases, this is likely to lead to new and unforeseen regulatory issues and the Group is monitoring emerging regulatory developments and standards on the governance and ethical use of technology and data.

In certain jurisdictions in which Prudential operates there are also a number of ongoing policy initiatives and regulatory developments which will impact the way Prudential is supervised. These developments continue to be monitored by the Group at a national and global level and these considerations form part of the Group's ongoing engagement with government policy teams, industry groups and regulators. Further information on specific areas of regulatory and supervisory requirements and changes are included below and in the disclosures on Risk Factors.

Risks related to regulatory and legal compliance
continued

Risk management and mitigation of regulatory risk at Prudential includes:

- Risk assessment of the Business Plan which includes consideration of the Group's current strategies;
- Close monitoring and assessment of our business environment and strategic risks;
- The explicit consideration of risk themes in strategic decisions;
- Ongoing engagement with national regulators, government policy teams and international standard setters; and
- Compliance oversight to ensure adherence with in-force regulations and management of new regulatory developments.

Group-wide supervision. The GWS Framework became effective for the Group on 14 May 2021 following designation by the Hong Kong IA, subject to transitional arrangements allowed in legislation which have been agreed with the Hong Kong IA. Under the GWS Framework, all debt instruments, both senior and subordinated, issued by Prudential at the date of designation meet the transitional conditions set by the Hong Kong IA and are included as eligible Group capital resources.

Global regulatory developments: In the Group's key markets, regulatory changes and reforms are in progress, with some uncertainty on the full impact to Prudential.

- In China, regulatory tightening across a number of industries in 2021 will likely continue across other industries. Regulatory developments in China which may have more direct implications to the Group include the following:
  - Development of a holistic data governance regime in China, which have recently included the Data Security Law, the Personal Information Protection Law, and the revised Measures for Cybersecurity Review.
  - The CBIRC recently released new regulations on internet life insurance sales in China which include restrictions on the selling of certain long-term products online, effective 31 December 2021.
  - On 26 October 2021, the National Health Commission released for public comment draft rules on the internet healthcare services, usage of which has increased rapidly in China which include restrictions on online AI-driven diagnosis and treatments and requirements on meeting financial and operational criteria.
- Regulators in Hong Kong and Malaysia are progressing with plans for their respective risk-based capital (RBC) regimes. The Hong Kong IA is permitting applications for early adoption of its framework. Meanwhile in China, on 30 December 2021, the CBIRC released the official regulation for its China Risk Oriented Solvency System (C-ROSS) II, to be effective for Q1 2022 solvency reporting.
- In Indonesia, regulatory and supervisory focus on the insurance industry remains high, with a recent focus being on insurers' governance and IT risk management and the requirements of 2014 Insurance Law relating to the separation of conventional and Sharia business.
- The protection of customers is an increasing regulatory theme, with changes to the regulation of investment-linked products (ILP) progressing in Indonesia as well as Malaysia.
- The pace and volume of climate-related regulatory changes both internationally and locally across Asia markets is also increasing. The IAIS published an application paper on the supervision of climate-related risks in the insurance sector in May 2021, while regulators, including the Hong Kong Monetary Authority, the Monetary Authority of Singapore, BNM in Malaysia and the Financial Supervisory Commission in Taiwan, are in the process of developing supervisory and disclosure requirements.

The Group is actively monitoring and engaging with supervisory authorities on these changes, among others. These changes may give rise to compliance, operational and disclosure risks requiring Prudential to coordinate across multiple jurisdictions in order to apply a consistent risk management approach.

Systemic risk regulation. Efforts to curb systemic risk and promote financial stability are also under way. These include developments by the Financial Stability Board (FSB) and International Association of Insurance Supervisors (IAIS) in the areas of the Common Framework (ComFrame), which establishes supervisory standards and guidance focusing on the effective group-wide supervision of Internationally Active Insurance Groups (IAIGs) such as Prudential, and the Insurance Capital Standard (ICS). Further detail on these developments are included in the disclosures on Risk Factors.

Inter-bank offered rate reforms. In July 2014, the FSB announced widespread reforms to address the integrity and reliability of IBORs. The discontinuation of IBORs in their current form and their replacement with alternative risk-free reference rates such as the Secured Overnight Financing Rate (SOFR) in the US and the Singapore Swap Offer Rate (SOR) could, among other things, impact the Group through an adverse effect on the value of Prudential's assets and liabilities which are linked to, or which reference IBORs, a reduction in market liquidity during any period of transition and increased legal and conduct risks to the Group arising from changes required to documentation and its related obligations to its stakeholders.