

Risk and capital management

As a provider of financial services, including insurance, we recognise that the managed acceptance of risk lies at the heart of our business. As a result, effective risk management capabilities represent a key source of competitive advantage for our Group.

The Group's risk appetite framework sets out our tolerance to risk exposures as well as our approach to risk management and return optimisation. Under this approach, we monitor our risk profile continuously against agreed limits. Our main strategies for managing and mitigating risk include asset liability management, using derivatives to hedge relevant market risks, and implementing reinsurance and corporate insurance programmes.

Risk oversight

Group risk appetite

We define and monitor aggregate risk limits for our earnings volatility and our capital requirements based on financial and non-financial stresses:

- a **Earnings volatility:** the objectives of the limits are to ensure that (a) the volatility of our earnings is consistent with our stakeholders' expectations, (b) the Group has adequate earnings (and cash flows) to service debt, expected dividends and to withstand unexpected shocks, and (c) earnings (and cash flows) are managed properly across geographies and are consistent with our funding strategies. The two measures we apply to monitor the volatility of our earnings are European Embedded Value (EEV) operating profit and International Financial Reporting Standards (IFRS) operating profit, although EEV and IFRS total profits are also considered.
- b **Capital requirements:** the limits aim to ensure that (a) the Group meets its internal economic capital requirements, (b) the Group achieves its desired target rating to meet its business objectives, and (c) supervisory intervention is avoided. The two measures we apply are the EU Insurance Groups Directive (IGD) capital requirements and internal economic capital requirements. In addition, we also monitor capital requirements on a local statutory basis.

Our risk appetite framework forms an integral part of our annual business planning cycle. Our Group Risk function monitors the Group's risk profile against the agreed limits. Using submissions from business units, Group Risk calculates the Group's aggregated position (allowing for diversification effects between business units) relative to the limits implied by the risk appetite statements.

Local limits are agreed with each of the business units to ensure that the aggregate risk exposure remains within the defined Group-level risk appetite. Each business unit determines its own individual risk position by calculating the impacts (on earnings and capital measures) of a shock to its market, credit, insurance and operational risk exposures and agrees them with Group Risk and the Group Executive Risk Committee (GERC).

We use a two-tier approach to apply the limits at business unit level. Firstly, we calculate business unit risk limits. These ensure that, provided each business unit keeps within its limits, the Group risk position will remain within the Group limits. Secondly, the impact on the risk position is considered as part of Group Risk's scrutiny of large transactions or departures from plans proposed by individual business units.

In the event that any of the business unit plans imply risk limits will be exceeded, this will necessitate a dialogue between GERC and the relevant business unit or units. Exceeding Group limits may be avoided if, for example, limits in other business units are not fully utilised, or if the diversification effect at Group level of a particular risk with other business units means the Group limit is not breached.

Market risk is managed such that as conditions evolve the risk profile is maintained within risk appetite. In addition to business unit operational limits on credit risk, we set counterparty risk limits at Group level. The limits on our total Group-wide exposures to a single counterparty are specified within different credit rating 'categories'. Group Risk and the GERC monitor our actual exposures against these limits on a monthly basis.

Risk exposures

The Group Risk Framework deploys a common risk language, allowing meaningful comparisons to be made between different business units. Risks are broadly categorised as shown opposite.

1 Financial risks

a Market risk

i Equity risk

In the UK business, most of our equity exposure is incurred in the with-profits fund which includes a large inherited estate estimated at £6.4 billion as at 31 December 2009 (2008: £5.4 billion), which can absorb market fluctuations and protect the fund's solvency. The inherited estate itself is partially protected against falls in equity markets through an active hedging policy. In the course of 2009 we have reduced the with-profit fund's exposure to UK equities whilst increasing the proportion of fixed income assets.

In Asia, a high proportion of our in-force book is made up of unit-linked products with limited shareholder exposure to equities. We have minimal direct shareholder exposure to Asian equity markets outside our unit-linked holdings.

In the US, where we are a leading provider of variable annuities, there are well-understood risks associated with the guarantees embedded in our products. We provide guarantees for minimum death benefits (GMDB) on all policies in this class, minimum withdrawal benefits (GMWB) on 47 per cent of the book, and minimum income benefits (GMIB) on only eight per cent. To protect the shareholders against the volatility induced by these embedded options, we use both a comprehensive hedging programme and reinsurance. Due to the inability to economically reinsure or hedge the GMIB, Jackson ceased offering this benefit in 2009.

In our variable annuity sales activities, we focus on meeting the needs of conservative and risk averse customers who are seeking reliable income in retirement, and who display little tendency to arbitrage their guarantees. These customers select conservative investment options and, importantly, buy fewer guarantee products compared to the industry as a whole. We are able to meet the needs of these customers because our unique and market leading operational platform allows us to tailor more than 1,400 product combinations.

Category	Risk type	Definition
1 Financial risks	a) Market risk	The risk that arises from adverse changes in the value of, or income from, assets and changes in interest rates or exchange rates.
	b) Credit risk	The risk of loss if another party fails to meet its obligations, or fails to do so in a timely fashion.
	c) Insurance risk	The inherent uncertainty as to the occurrence, amount and timing of insurance cash flows. This includes the impact of adverse mortality, morbidity and persistency experience.
	d) Liquidity risk	The risk that a business, though solvent on a balance sheet basis, either does not have the financial resources to meet its obligations as they fall due or can secure them only at excessive cost.
2 Non-financial risks	Operational risk	The risk of direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events. This includes legal and regulatory compliance risk.
	Business environment risk	Exposure to forces in the external environment that could significantly change the fundamentals that drive the business's overall objectives and strategy.
	Strategic risk	Ineffective, inefficient or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Group's capabilities.

It is our philosophy not to compete on price. Our individual guarantees tend to be more expensive than the market average, because we seek to sell at a price capable of funding the cost we incur to hedge or reinsure our risks.

We use a macro approach to hedging that covers the entire equity risk in the US business, including all exposure to GMDB and GMWB guarantees. Within this macro approach we make use of the natural offsets that exist between the variable annuity guarantees and the fixed index annuity book, and then use a combination of OTC options and futures to hedge the residual risk, allowing for significant market shocks and limiting the amount of capital we are putting at risk. The hedging programme also covers the fees on variable annuity guarantees.

Jackson hedges the economics of its products rather than the accounting result. Accordingly, while its hedges are effective on an economics basis, due to different accounting treatment for the hedges and some of the underlying hedged items, the reported income effect is more volatile. For Jackson's variable annuities guaranteed benefits and related hedges, while there has been some volatility of results in 2008 and 2009, there has been a small cumulative net operating loss of £7 million over the 24 month period, reflecting the overall effectiveness of the hedging programme.

ii Interest rate risk

Interest rate risk arises primarily from Prudential's investments in long-term debt and fixed income securities. Interest rate risk also exists in policies that carry investment guarantees on early surrender or at maturity, where claim values can become higher than the value of backing assets as a result of rises or falls in interest rates.

Interest rates primarily impact our Asia, US and UK with-profits businesses. Following the sale of the agency-based business in Taiwan, the exposure to interest rate risk in Asia has significantly reduced. The remaining risk in the region relates mostly to guarantees on traditional shareholder-backed life products and asset-liability mismatches, driven by limited availability of long-term assets in some territories. This exposure is monitored and managed carefully on an ongoing basis, for example by setting clear limits on duration risk set in the investment guidelines. We have a range of risk mitigation options available that would help to reduce the exposure to interest rate movements.

In the US there is interest rate risk across the portfolio. We manage fixed annuity interest rate exposure through a combination of interest rate swaps and interest rate options, to protect capital against rates rising quickly, and through the contractual ability to reset crediting rates annually.

In the UK the investment policy for the shareholder-backed annuity business is to match the cash flow from investments with the annuity payments. As a result, assets and liabilities are closely matched by duration. The impact of any residual cash flow mismatching can be adversely affected by changes in interest rates, therefore the mismatching position is regularly monitored.

iii Foreign exchange risk

Prudential principally operates in the UK, the US, and in 13 countries in Asia. The geographical diversity of our businesses means that we are inevitably subject to the risk of exchange rate fluctuations. Prudential's international operations in the US and Asia, which represent a significant proportion of our operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in our consolidated financial statements when results are expressed in pounds sterling.

We do not generally seek to hedge foreign currency revenues, as these are substantially retained locally to support the growth of the Group's business and meet local regulatory and market requirements. However, in cases where a surplus arising in an overseas operation supports Group capital or shareholders' interest, this exposure is hedged if it is economically optimal to do so. Currency borrowings, swaps and other derivatives are used to manage exposures.

b Credit risk

Debt portfolio

Our debt portfolio on an IFRS basis was £101.8 billion at 31 December 2009. £45.6 billion of these assets backed shareholder business, of which 93 per cent were investment grade, compared to 96 per cent at 31 December 2008. This change was a result of downgrades, largely occurring in March and April, with the pace of downgrade significantly slowing thereafter. Sovereign debt backing shareholder business represented 11 per cent of the portfolio, or £4.9 billion at 31 December 2009, 67 per cent of this was AAA and 91 per cent investment grade. Eurozone sovereign exposures backing shareholder business were £3.1 billion at 31 December 2009, 98 per cent of these were AAA rated. Of the remaining 2 per cent, the highest exposure was in respect of Italy (£55 million) and Spain (£1 million) whilst there was no exposure to Greece, Portugal or Ireland.

Asia

Asia's debt portfolio totalled £10.0 billion at 31 December. Of this, approximately 75 per cent was invested in unit-linked and with-profits funds with minimal shareholders' risk. The remaining 25 per cent is shareholder exposure and is invested predominantly (79 per cent) in investment grade bonds. For Asia, the portfolio has performed very well, and did not experience any default losses in 2009.

UK

The UK's debt portfolio on an IFRS basis is £67.8 billion as at 31 December 2009, including £42.3 billion within the UK with-profits fund. Shareholders' risk exposure to the with-profits fund is limited as the solvency is protected by the large inherited estate. Outside the with-profits fund there is £6.4 billion in unit linked funds where the shareholders' risk is limited, with the remaining £19.0 billion backing the shareholders' annuity business and other non-linked business (of which 78 per cent is rated AAA to A, 19 per cent BBB and three per cent non-investment grade).

On a statutory (Pillar 1) basis we have held prudent credit reserves within the UK shareholder annuity funds of £1.6 billion to allow for future credit risk. For Prudential Retirement Income Limited (PRIL) this allowance is set at 71bps at 31 December 2009 (2008: 80bps). This now represents 41 per cent of the portfolio spread over swaps compared to 31 per cent as at 30 June 2009 and 25 per cent as at 31 December 2008. A low level of new defaults (£11 million) were reported on the debt portfolio held by the UK shareholder backed annuity business in 2009.

During the second half of 2009 we materially reduced our holdings in subordinated financial debt backing our annuity business, which has improved the overall credit quality of our bond portfolios. This has resulted in gross losses of £254 million on shareholder-backed business and £80 million on policyholder backed business. On a Pillar I basis these losses have been fully offset by a reduction in long-term default reserves of £180 million shareholder/£31 million policyholder that arose as a result of the improvement in the quality of our remaining bond portfolios and a further £74 million shareholder/£49 million policyholder release of short-term default reserves which were allocated to the assets sold. On an IFRS basis, the gross costs less the reduction in long-term and short-term default reserves resulted in an overall pre-tax operating loss of £51 million shareholder/£32 million policyholder.

US

The most significant area of exposure to credit risk for the shareholders is Jackson in the US. At 31 December 2009 Jackson's fixed income portfolio totalling £22.8 billion, comprised £16.5 billion Corporate Debt, £2.1 billion of Commercial Mortgage Backed Securities (CMBS), £3.3 billion of Residential Mortgage Backed Securities (RMBS) and £0.9 billion of other instruments.

The US Corporate Debt portfolio of £16.5 billion is 94 per cent investment grade. Concentration risk is low, with the top ten holdings accounting for less than seven per cent of the portfolio. The non-investment grade portfolio is also well diversified with an average holding of £8 million. Our largest sector exposures in the investment grade portfolio are Utilities and Energy both at 15 per cent. We actively manage the portfolio and will sell exposures as events dictate.

Within the RMBS portfolio of £3.3 billion, the agency guaranteed portion is 60 per cent. Another 21 per cent of the portfolio is non-agency prime and Alt-A investments with pre-2006/2007 vintages, where experience has been much more positive than later vintages. Our exposure to the 2006/2007 vintages totals £466 million of which £373 million is invested in the senior part of the capital structure, thereby significantly reducing the risk of defaults and the magnitude of loss if a shortfall does occur. The actual exposure to non-senior 2006/2007 Prime and Alt-A RMBS is only £93 million. The total RMBS portfolio has an average fair value price of 78 cents in the dollar.

The CMBS £2.1 billion portfolio is performing strongly, with 46 per cent of the portfolio rated AAA and less than 1 per cent rated below investment grade. The entire portfolio has an average credit enhancement level of 30 per cent. This level provides significant protection, since it means the bond has to incur a 30 per cent loss, net of recoveries, before we are at risk.

In Jackson total amounts charged to profits relating to debt securities was £631 million (2008: £624 million). This is net of recoveries/reversals recognised in the year of £5 million (2008: £3 million).

In 2009, Jackson's total defaults were less than £1 million (2008: £78 million). In addition, as part of our active management of the book, we incurred net losses of £6 million (2008: £130 million) on the sale of impaired bonds.

IFRS write-downs excluding defaults for the year were £630 million compared to £419 million in 2008. Of this amount £509 million (2008: £167 million) was in respect of RMBS securities.

The impairment process reflects a rigorous review of every single bond and security in our portfolio. The accounting requires us to book full mark-to-market losses on impaired securities through our income statement. However we would expect only a proportion of these losses eventually to turn into defaults, and some of the impaired securities to recover in price over time.

In considering potential future losses for Jackson, it is essential to examine the key components of the debt portfolio. As at 31 December 2009, 93 per cent of Jackson's total debt portfolio of £22.8 billion consisted of investment grade securities and seven per cent were non-investment grade.

Asset management

The debt portfolio of the Group's asset management operations of £1.2 billion principally comprises £1.1 billion related to Prudential Capital operations. Of this amount, debt securities of £1.1 billion were rated AAA to A- by S&P or Aaa by Moody's.

Loans

Of the total Group loans of £8.8 billion at 31 December 2009, £6.9 billion are held by shareholder-backed operations comprising of £4.5 billion commercial mortgage loans and £2.4 billion of other loans.

Of this total held by shareholder-backed operations, the Asian insurance operations held £0.4 billion of other loans, the majority of which are commercial loans held by the Malaysian operation that are investment graded by two local rating agencies. The US insurance operations held £4.3 billion of loans, comprising £3.8 billion of commercial mortgage loans, all of which are collateralised by properties, and £0.5 billion of policy loans. The US commercial mortgage loan portfolio does not include any single-family residential mortgage loans and therefore is not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The UK insurance operations held £0.8 billion of loans, the majority of which are mortgage loans collateralised by properties.

The balance of the total shareholder loans amounts to £1.4 billion and relates to bridging loan finance managed by Prudential Capital. The bridging loan assets generally have no external credit ratings available, with internal ratings prepared by the Group's asset management operations as part of the risk management process, with the majority being rated BBB+ to BBB-.

Unrealised credit losses in the US

Jackson's net unrealised position moved from a loss of £2,897 million at 31 December 2008 to a net gain of £4 million at 31 December 2009 as the markets rebounded from the historically wide spreads at the end of 2008. The gross unrealised loss position moved from £3,178 million at 31 December 2008 to £966 million at 31 December 2009. Gross unrealised losses on securities priced at less than 80 per cent of face value totalled £594 million at 31 December 2009 compared to £1.9 billion at 31 December 2008.

c Insurance risk

The processes of determining the price of our products and reporting the results of our long-term business operations require us to make a number of assumptions. In common with other industry players, the profitability of our businesses depends on a mix of factors including mortality and morbidity trends, persistency, investment performance, unit cost of administration and new business acquisition expenses. We continue to conduct rigorous research into longevity risk using data from our substantial annuitant portfolio. Prudential's persistency assumptions reflect recent experience for each relevant line of business, and any expectations of future persistency. Where appropriate, allowance is also made for the relationship – either assumed or historically observed – between persistency and investment returns, and for the resulting additional risk.

d Liquidity risk

The holding company has significant internal sources of liquidity which are sufficient to meet all of our expected requirements for the foreseeable future without having to make use of external funding. In aggregate the Group has £2.1 billion of undrawn committed facilities, of which, in February 2009, we renewed £1.4 billion of the undrawn syndicated committed banking facility for a further three years. We also have two £100 million undrawn bilateral committed banking facilities expiring in 2011 and 2012, with the balance being an annually renewable £500 million committed securities lending facility. In addition the Group has access to liquidity via the debt capital markets, which was demonstrated most recently through the two hybrid instruments, £400 million of Lower Tier 2 debt issued in May, US\$750 million (approximately £455 million) of Innovative Tier 1 debt issued in July and a £250 million senior 3-year MTN issued in January 2010. Liquidity is also assessed at business unit level under base case and stressed assumptions. The liquidity resources available have been assessed to be sufficient under both sets of assumptions.

2 Non-financial risk

Prudential is exposed to operational, business environment and strategic risk in the course of running its businesses. We process a large number of complex transactions across numerous and diverse products, and are subject to a number of different legal and regulatory, including tax, regimes. We also have a significant number of third-party relationships that are important to the distribution and processing of our products, both as market counterparties and as business partners.

We use the qualitative and quantitative analysis of operational risk exposures material to the Group to support business decisions, to inform overall levels of capital held and to assess the adequacy of the corporate insurance programme.

Capital management**Regulatory capital (IGD)**

Prudential is subject to the capital adequacy requirements of the European Union (EU) Insurance Groups Directive (IGD) as implemented by the Financial Services Authority (FSA) in the UK. The IGD capital adequacy requirements involves aggregating surplus capital held in our regulated subsidiaries, from which Group borrowings, except those subordinated debt issues that qualify as capital, are deducted. No credit for the benefit of diversification is permitted under this approach.

Our capital position has been further strengthened during 2009, driven by our prudent but proactive risk management. Our IGD capital surplus is estimated at £3.4 billion at 31 December 2009 (before allowing for the 2009 final dividend) giving an estimated solvency ratio of 270 per cent. This compares to a surplus at 31 December 2008 (before allowing for the 2008 final dividend) of £1.5 billion and a solvency ratio of 152 per cent. The positive movement of £1.9 billion during 2009 mainly comprises:

- Net capital generation mainly through operating earnings (in-force releases less investment in new business) of £1.1 billion
- The impact of the sale of our agency distribution business in Taiwan of £0.8 billion
- Hybrid debt issues in May and July 2009, totalling £0.9 billion
- Additional recognition of £0.4 billion of surplus in respect of part of the shareholders' interest in the future transfers from the PAC with-profit fund, recognition of £0.2 billion of future profits in the UK and Hong Kong and other intra-group capital efficiencies of £0.3 billion.

Offset by:

- Final 2008 dividends, net of scrip, of £0.2 billion and interim 2009 dividends, net of scrip, of £0.1 billion
- External financing costs and other central costs of £0.6 billion
- Credit related impairments and default losses in the US of £0.4 billion
- Impacts arising from regulatory changes of £0.2 billion
- Foreign exchange movements of £0.3 billion.

We have strengthened our IGD capital position in challenging markets. We continue to have further options available to us to manage available and required capital. These could take the form of either increasing available capital (for example, through financial reinsurance or debt issuance) or reducing required capital (for example, through the level and the mix of new business, notably by maintaining pricing discipline and through the use of other risk mitigation strategies such as hedging and reinsurance).

In addition to this strong capital position, the total credit reserve for the UK shareholder annuity funds, which protects our capital position in excess of the IGD surplus, has been strengthened to £1.6 billion (from £1.5 billion at 30 September 2009). This reserve is equivalent to 71 bps per annum over the lifetime of the assets.

During the severe equity market conditions experienced in the first quarter of 2009 the Group entered into exceptional overlay short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operational hedging programmes. The hedge contracts have expired and have not been renewed.

Stress testing

As at 31 December 2009, the impact of an instantaneous 20 per cent fall in equity markets levels (which is equivalent to the worst historic daily fall in the S&P index), would reduce IGD surplus by £150 million. Were equity markets to fall by more than 20 per cent, we believe that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which we would be able to put into place mitigating management actions. For example, we have estimated that the impact (net of mitigating management actions) of an additional 20 per cent fall in equity markets over a four week period following an instantaneous 20 per cent fall would be an estimated reduction in the IGD surplus of a further £350 million.

In summary, the findings of our stress testing and sensitivity analysis, which are part of the continual process of assessing the resilience of the Group's IGD capital position to withstand significant further deterioration in market conditions include:

- An instantaneous 20 per cent fall in equity markets from 31 December 2009 levels would reduce IGD surplus by £150 million.
- A 40 per cent fall in equity markets (comprising an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four week period) would reduce the IGD surplus by £500 million.
- A 150bps reduction (subject to a floor of zero) in interest rates from 31 December 2009 would reduce the IGD surplus by £400 million.
- Credit defaults of ten times the expected level would have an impact of £550 million in excess of the annual reserve release.

We believe that the results of these stress tests, together with our Group's strong underlying earnings capacity, our established hedging programmes and our additional areas of financial flexibility, demonstrate that we are in a position to withstand possible significant further deterioration in market conditions.

We also use an economic capital assessment to monitor our capital requirements across the Group, allowing for realistic diversification benefits and continue to maintain a strong position. This assessment provides valuable insights into our risk profile.

Solvency II

The European Union (EU) is developing a new solvency framework for insurance companies, referred to as 'Solvency II'. The Solvency II Directive, which sets out the new solvency framework for insurers in the European Union, was formally approved by the Economic and Financial Affairs Council in November 2009. The new approach is based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements.

Specifically, Pillar 1 covers the quantitative requirements around own funds, valuation rules for assets and liabilities and capital requirements. Pillar 2 provides the qualitative requirements for risk management, governance and controls, including the requirement for insurers to submit an Own Risk and Solvency Assessment (ORSA) which will be used by the Regulator as part of the supervisory review process. Pillar 3 deals with the enhanced requirements for supervisory reporting and public disclosure.

A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies. Companies may be allowed to make use of internal economic capital models if approved by the local regulator.

The European Commission has already initiated the process of developing the detailed rules that complement the high-level principles in the Directive, referred to as 'implementing measures'. These are subject to a consultation process that is not expected to be finalised until late 2011.

In particular, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) published a number of consultation papers in 2009 covering advice to the European Commission on the implementing measures but there remains significant uncertainty regarding the outcome from this process. Prudential is actively participating in shaping the outcome through our involvement in industry bodies and trade associations, including the Chief Risk Officer and Chief Financial Officer Fora, together with the Association of British Insurers (ABI) and the Comité Européen des Assurances (CEA).

Many of the issues being actively debated have received considerable focus both within the industry and from national bodies. However, the application of Solvency II to international groups is still unclear and there remains a risk of inconsistent application, which may place Prudential at a competitive disadvantage to other European and non-European financial services groups. There is also a risk that the effect of the measures finally adopted could be adverse for the Group including potentially a significant increase in the capital required to support the UK annuity business.

Having assessed the high-level requirements of Solvency II, an implementation programme was initiated with dedicated teams to manage the required work across the Group. The activity of the local Solvency II teams is being coordinated by Group Head Office to achieve consistency in the understanding and application of the requirements.

Over the coming months we will be progressing our implementation plans further and remaining in regular contact with the FSA as we prepare for the initial stage of the approval process for the internal model.

Capital allocation

Prudential's approach to capital allocation takes into account a range of factors, especially risk adjusted returns on capital, the impact of alternative capital measurement bases (accounting, regulatory, economic and ratings agency assessments), tax efficiency, and wider strategic objectives.

We optimise capital allocation across the Group by using a consistent set of capital performance metrics across all business units to ensure meaningful comparison. Capital utilisation, return on capital and new business value creation are measured at a product level. The use of these capital performance metrics is embedded into our decision-making processes for product design and product pricing.

Our capital performance metrics are based on economic capital, which provides a view of our capital requirements across the Group, allowing for realistic diversification benefits. Economic capital also provides valuable insights into our risk profile and is used both for risk measurement and capital management.

Risk mitigation and hedging

We manage our actual risk profile against our tolerance of risk. To do this, we maintain risk registers that include details of the risks we have identified and of the controls and mitigating actions we employ in managing them. Any mitigation strategies involving large transactions – such as a material derivative transaction – are subject to review at Group level before implementation.

We use a range of risk management and mitigation strategies. The most important of these include: adjusting asset portfolios to reduce investment risks (such as duration mismatches or overweight counterparty exposures); using derivatives to hedge market risks; implementing reinsurance programmes to limit insurance risk; implementing corporate insurance programmes to limit the impact of operational risks; and revising business plans where appropriate.