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Group Chief Risk and Compliance Officer's report on the risks facing our business and how these are managed

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Our Group Risk Framework and risk appetite have allowed us to control our risk exposure throughout 2020. Our governance, processes and controls enable us to deal with uncertainty effectively, which is critical to the achievement of our strategy of capturing long-term structural opportunities and helping our customers achieve their long-term financial goals.

This section explains the main risks inherent in our business and how we manage those risks, with the aim of ensuring an appropriate risk profile is maintained. Although Jackson is preparing to be a fully independent business, until the proposed demerger is effected Jackson's risks (as with those of the Group's other businesses) will continue to be managed within the Group Risk Framework and this report reflects this position.

1. Introduction

The Group

2020 was a truly eventful year. The Covid-19 pandemic swept across the world and has resulted in significant humanitarian suffering and material and prolonged disruption to social and economic activity. The business had to consider and navigate the risks arising from the Covid-19 on multiple fronts. These included capital and liquidity risks arising from abrupt market dislocation as well as risks associated with the disruption to the Group's operations across Asia, Africa, the US and UK. Concurrently, the business has maintained uninterrupted delivery of services for its policyholders, and has been committed to doing the right thing for both its customers and employees throughout the crisis. The Risk, Compliance and Security function has successfully transitioned into, and maintained, new ways of working across multiple time zones to provide strong stewardship and enhanced monitoring of these risks during the most acute phases of the pandemic's impact.

Through these extraordinary circumstances, the function has also provided risk opinions, guidance and assurance on critical activity, including Athene's reinsurance of $27.6 billion of Jackson's fixed and fixed index annuity portfolio and $500 million equity investment into Prudential's US business, the proposed demerger of Jackson from the Group and the revision to its hedge modelling for US statutory standards for calculating reserves and capital. At the same time, the function retained its focus on managing the risks of the ongoing business, performing its defined role in providing risk management support and oversight, as well as objective challenge to ensure the Group remained within its risk appetite.

The Group continues to engage constructively with the Hong Kong Insurance Authority (IA) as its Group-wide supervisor and is transitioning to a new supervisory framework. The Group's mature and well-embedded risk framework will enable decisions to be taken with confidence as the business seeks to capture the opportunities in the growth markets in which it is now focused while continuing to operate prudently with discipline.

The world economy

At the start of 2020 the prospects for global growth appeared to be improving. This positive momentum was abruptly reversed by the Covid-19 pandemic, leading to the shutdown of much of the world's economy and a sharp recession. In response to this unprecedented shock, governments and central banks deployed massive fiscal and monetary stimulus measures to mitigate the impact on the labour force and restore confidence in financial markets. Driven largely by the strong macro policy response, global economies have started to recover although this remains far from complete. In Asia, China has been leading the economic rehabilitation, benefiting other Asian economies to an extent, although the regional recovery to date has been highly uneven. The economic environment in Asia is expected to remain challenging given the limited headroom for additional conventional monetary easing, increasing inflation risks from weaker foreign exchange rates, supply chain disruptions, and increasing fiscal pressures. Viewed more broadly, the pandemic has increased the debt burden of many economies and may result in sovereign debt sustainability issues, increasing the dependence on low interest rates by governments.

Financial markets
2020 began with risk assets performing well until concerns over the economic impact of the Covid-19 outbreak dented investor confidence, eventually leading to a global sell-off that unfolded at extraordinary speed. The S&P 500 index plunged by 35 per cent from an all-time high on 19 February 2020 to its low point on 23 March 2020. Interest rates in major markets declined significantly, falling to historical lows as investors fretted over the risks to the economic outlook. Credit spreads widened significantly, in line with the plunge in equity markets.

The stress on financial markets was broadly eased by the central banks maintaining accommodative monetary policies and implementing various support programmes. Since their trough in March 2020, financial markets have rallied strongly, initially driven by broad reductions in infection rates in some countries, optimism with respect to the restart of the global economy, and, in the US, a small group of large-cap stocks that has buoyed the cap-weighted index. Risk assets in particular continued to rally strongly in the second half of 2020.

Risk asset valuations appear elevated and display some disconnect with economic fundamentals, and may therefore be subject to the risk of a correction given the renewed lockdowns implemented across the world towards the end of 2020 and into 2021, the logistical challenges to the roll out of Covid-19 vaccination programmes (which may be more prolonged than initially anticipated) and the development of new strains of the coronavirus. On interest rates, the consensus outlook is of an environment in which they will remain low-for-longer. The US Federal Reserve's forward guidance has constrained expectations of higher short-term yields in the foreseeable future, while economic fundamentals and globally accommodative conditions are likely to keep downward pressure on long-term yields. For credit assets, risks of a further round of widespread pressure on corporate liquidity – as experienced during 2020 – remain, given the stretched credit fundamentals of corporate borrowers, although the magnitude of the pre-funding and liquidity-raising that has been accomplished in 2020 is expected to mitigate this to an extent.

(Geo)political landscape
During the first half of 2020, the civil unrest increasingly seen in many places across the world was partially curtailed by the Covid-19 restrictions put in place by governments. The second half of the year, saw an increase in popular protests against long-standing social issues and inequalities and were in some cases triggered by national elections in the US, Africa and Asia. An observable trend in recent protest movements, aided by social media, is the speed and frequency at which they can gather momentum and their evolving forms of leadership. The stability of governments is likely to be tested in different ways and potentially on a more frequent basis as a result, as will the resilience of businesses. As a global organisation, the Group has well-established local and global plans to mitigate the business risks from disruption. These have operated well when deployed across the Group during the Covid-19 crisis and also locally during the outbreaks of unrest seen during 2020 and continued into 2021 in markets where the Group operates. Operational resilience will continue to be critically evaluated and enhanced as the longer-term lessons from the pandemic response in particular, become clearer. Governmental responses to the pandemic have involved a necessary balancing of the impacts to people's health and lives, their individual rights and liberties, and economic growth. These considerations, and the dynamics between and within them, have become increasingly politicised and another source of polarisation and popular discontent which, in some places, have also provided impetus to protest movements.

Many governments continue to face the challenge of reconciling the inter-connectedness of the global economy with pressure to prioritise national self-interests. The experience of the pandemic may provide a further impetus to the regionalisation or fragmentation of global trade, investment and standards, and risks undermining efforts in international cooperation and coordination. Into 2021, accessibility to Covid-19 vaccine supplies, which may become a prolonged challenge, has the potential to contribute to an increase in geopolitical tensions. A key source of geopolitical risk during 2020 was the US-China relationship and its wider impact on international relations, and this looks likely to continue during President Biden's term in office. Hong Kong's perceived level of autonomy will remain influential in geopolitical tensions, with potential global trade and economic consequences. Responses by the US, UK and other governments to the enactment and application of the national security law in Hong Kong and other constitutional or legislative changes in the territory, which continue to develop, may impact Hong Kong's economy.

Being a key market for the Group which also hosts regional and head office functions, this could potentially impact Prudential's sales, operations and product distribution. For internationally active groups which operate across impacted jurisdictions such as Prudential, these government responses and measures add to the complexity of legal and regulatory compliance. Compliance with Prudential's legal or regulatory obligations 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 for the Group.

Regulations
Prudential operates in highly regulated markets, and the nature and focus of regulation and laws remain fluid. A number of national and international regulatory developments are in progress, with a continuing focus on solvency and capital standards, conduct of business, systemic risk regulation, corporate governance and senior management accountability, and macroprudential policy. Some of these changes will have a significant impact on the way that the Group operates, conducts business and manages its risks. With geopolitical tensions elevated, the complexity of sanctions compliance is increasing and continues to represent a challenge for international businesses. These regulatory developments will continue to be monitored at a national and global level and form part of Prudential's engagement with government policy teams and regulators. The immediate regulatory and supervisory responses to Covid-19 have been broad and have included increased scrutiny of the operational resilience, liquidity and capital strength (including the impact of making dividend payments) of financial services companies as well as changes that have helped the Group to continue to support its customers through non-face-to-face contact. The financial burden in addressing the pandemic is likely to influence changes in governmental fiscal policies, laws or regulations aimed at increasing financial stability, and this may include measures on businesses or specific industries to contribute to, lessen or otherwise support, the financial cost to governments of treating patients and meeting the logistical challenges of providing vaccines. It is possible that requirements are imposed on private insurance companies and healthcare providers to cover costs associated with the treatment and prevention of Covid-19 beyond contractual or policy terms.

Against this evolving regulatory backdrop, constructive engagement continues with Prudential's Group-wide supervisor, the Hong Kong IA, on the Group-wide Supervision (GWS) Framework. The GWS Framework is expected to be effective for Prudential upon designation by the Hong Kong IA in the second quarter of 2021, subject to transitional arrangements. The primary legislation was enacted in July 2020 and will come into operation on 29 March 2021. The framework adopts a principle-based and outcome-focused approach, and allows the Hong Kong IA to exercise direct regulatory powers over the holding companies of multinational insurance groups, reinforcing Hong Kong's position as a preferred base for large insurance groups in Asia Pacific and a global insurance hub. During 2020, the Hong Kong IA engaged with the Group and other relevant stakeholders in the development of the GWS Framework, which will be anchored on the requirements for three pillars: capital, risk and governance, and disclosure.

Societal developments

The experience of the pandemic has underlined the ability of evolving demographic, geographical and environmental factors to change the nature, likelihood and impact of extreme events. These factors can also drive public health trends such as increasing obesity, with consequential potential impacts to Prudential's underwriting assumptions and product design. While insights can be gleaned from the current pandemic, the unique set of variables associated with extreme events means that their impact on the functioning of society, and the disruption to business operations, staff, customers and sales, cannot be predicted or fully mitigated. The Group has been actively managing the impact of the crisis as it has developed over 2020 and into 2021, including assisting affected policyholders and staff in meeting their resulting needs.

In support of increased ease of access and social inclusion, and to meet evolving customer needs, the Group is increasing its use of digital services, technologies and distribution methods for the products and services that it offers. The Covid-19 pandemic has accelerated these developments, with the Group's businesses having implemented virtual face-to-face sales of select ranges of products in many of its markets, and adoption of Prudential's Pulse application has continued to increase. The digital health platform is now available in 15 markets in 11 languages, with total downloads having reached 20 million as of February 2021. Changes to the Group's use of technology and distribution models have broad implications, touching on Prudential's conduct of business, increasing the risks of technology and data being compromised or misused and potentially leading to new and unforeseen regulatory issues.

A strong sense of purpose for an enterprise is a driver of long-term profitability, and this is making companies evaluate their place in, and contribution to, society. The 'why and how' a business acts has become arguably at least as important as what it produces or the services that it provides. Understanding and managing the environmental, social and governance (ESG) impact and requirements of its business is fundamental to Prudential's brand, reputation and ultimately its long-term success. Ensuring high levels of transparency and responsiveness to stakeholders is a key aspect of this. Recent events have highlighted the structural inequalities in our societies and are prompting organisations to question where they stand on these important issues. Prudential's ESG Strategic Framework is designed to deliver on its purpose of 'helping people get the most out of life'. It includes a focus on inclusivity: inclusivity of access to quality healthcare, protection and savings for our customers; inclusivity of the working environment for our people; and inclusivity in the Group's support of the transition to low-carbon in the economies, markets and communities in which it operates.

2. Key internal, regulatory, economic and (geo)political events over the past 12 months

Q1 2020

In January 2020, the virus responsible for what initially appeared to be viral pneumonia is identified as a novel coronavirus. The resulting disease is subsequently named Covid-19, and over 2020 the coronavirus begins its spread across the globe. Across its markets the Group rolls out initiatives to support customers and staff.

In January, Prudential Vietnam announces an exclusive bancassurance partnership with Southeast Asia Commercial Joint Stock Bank (SeABank), a fast-growing bank in Vietnam with around 1.2 million customers and almost 170 branches, for a 20-year term.

On 20 March, the Hong Kong IA published the Insurance (Amendment) (No. 2) Bill as part of its submission to the Hong Kong LegCo, a key step towards GWS implementation.

In Singapore, a revised risk-based capital framework (RBC2) for insurers comes into force as at 31 March 2020.

The California Consumer Protection Act (CCPA) comes into force on 1 January 2020, creating data privacy rights to California consumers. Jackson ensures compliance with the Act in December 2019. The National Association of Insurance Commissioners (NAIC) implements changes to the US statutory reserve and capital framework for variable annuities, effective from 1 January 2020. Jackson chooses to early adopt the changes as at 31 December 2019 for US statutory reporting.

The Covid-19 pandemic shuts down much of the world's economy and triggers a sharp recession. Equity markets sell off at an extraordinary speed, volatility spikes, credit spreads widen sharply and interest rates in major markets decrease to new historical lows. Central banks maintain accommodative monetary policies and implement various asset purchase and support programmes to restore confidence in financial markets. Governments deploy massive fiscal stimulus to mitigate the economic fallout and the unprecedented shock on the labour force.

Q2 2020

On 18 June 2020 the Group announces the reinsurance of $27.6 billion of Jackson's fixed and fixed index annuity portfolio by Athene, and a $500 million equity investment into Prudential's US business in return for an 11.1 per cent economic interest.

Shriti Vadera joins the Board as a Non-executive Director and member of the Nomination & Governance Committee on 1 May 2020, and succeeds Paul Manduca as Chair of the Board and of the Nomination & Governance Committee on 1 January 2021.

IAIS releases the requirements for a Covid-19 tailored Data Collection exercise for 2020. The original Data Collection exercise, released in March for the purpose of monitoring the build-up of systemic risk for insurers, is paused for 2020. In April 2020, the IAIS also releases the requirements for the 2020 ICS and Aggregation Method Data Collection exercises.

The Network for Greening the Financial System publishes its Guide for Supervisors in May 2020 which outlines recommendations for integrating climate-related and environmental risks into prudential supervision.

Markets rally sharply during Q2 on the back of asset purchases, direct intervention by the US Federal Reserve in credit markets, stimulus programmes, the gradual rebound in economic activity enabled by the progressive easing of lockdown measures and a broad reduction in virus infection rates.

A broad easing of Covid-19 restrictions begins to take place across many countries in the latter half of Q2 and into Q3, including in some countries with high infection rates, with many countries taking steps to mitigate a second wave of infections. Other countries, such as the US and those in Central and South America and South Asia continue to see high daily case numbers.

Key

- Prudential
- Regulatory
- (Geo)political
- Markets/economies

Q3 2020

In August, and building on its earlier announcement in May, the Group announces its intention to fully separate Jackson from the Group. This is followed by a further announcement in January 2021 confirming that the separation will be facilitated by way of demerger, which is proposed to complete in Q2 2021.

The Insurance (Amendment) (No. 2) Ordinance, being the enabling primary legislation providing for the GWS Framework was enacted on 24 July 2020 and will come into operation on 29 March 2021. The relevant subsidiary legislation, including the Insurance (Group Capital) Rules, was tabled before the Legislative Council on 6 January 2021 and will also come into operation on 29 March 2021. The GWS Framework is expected to be effective for Prudential upon designation by the Hong Kong IA in the second quarter of 2021, subject to transitional arrangements.

The US Federal Reserve adopts a new flexible average inflation targeting strategy and introduces new forward guidance on interest rates that delays future increases until the economy reaches maximum employment and inflation rises to 2 per cent and is on track to moderately exceed this level for some time.

US GDP increases by $1.6 trillion over Q3, partially offsetting the decrease of $2.0 trillion in Q2, as consumer spending rebounds strongly. Meanwhile, China's GDP growth improves from 3.2 per cent year-on-year in Q2 to 4.9 per cent in Q3. Growth in all major investment activities return to positive levels, with real growth rising from -1.1 per cent year-on-year in August to 2.4 per cent in September.

Volatility in the financial markets remain elevated. Equity markets briefly fall in September, accompanied by a sell-off in US treasuries, although this is short-lived and avoids a collapse of similar levels as seen in March. As credit market conditions stabilise, central banks, including the US Federal Reserve and European Central Bank (ECB), lower the pace of their asset purchases.

A new national security law for Hong Kong is implemented on 30 June 2020. The US response includes enactment of the Hong Kong Autonomy Act which introduces potential sanctions on financial institutions doing significant business with Chinese officials materially contributing to the alleged erosion of Hong Kong's autonomy. Over Q3 and Q4 the US introduces sanctions on a range of individuals and entities in connection to a number of issues.

On 31 July 2020, Carrie Lam postpones the September LegCo elections for one year, citing coronavirus concerns.

Q4 2020

Covid-19 cases surge in Q4 across the US and Europe. Towards the end of 2020, major European economies start to reintroduce restrictions on movement and business to various degrees. Amid this increase in infection rates, vaccine approvals and roll-outs begin to take place in the UK and other countries.

Against the backdrop of the US election and positive Covid-19 vaccine news, equity markets continue to rally in November and volatility reaches new post-March lows. Central banks of major economies keep interest rate levels on hold. In Europe, the Pandemic Emergency Purchase Programme resolves to continue bond purchases until June 2021. In the US, a second stimulus package worth $900 billion passed in December.

The US elections take place amid a surge in coronavirus case numbers across the country. After legal challenges from President Trump are denied by the courts and the storming of the US Capitol buildings by protestors, Joe Biden is inaugurated as the 46th US president on 20 January 2021, taking control of both houses of Congress.

On 15 November, at the annual Association of Southeast Asian Nations (ASEAN) Leaders Summit, 15 countries formally sign the Regional Comprehensive Economic Partnership (RCEP) trade deal, making it the world's largest trading bloc. Signatories aim to work through ratification of the deal in 2021. The RCEP comprises all ten ASEAN economies, plus China, Japan, South Korea, Australia and New Zealand.

Moves to ban an opposition party in 2019 trigger anti-establishment protests in Thailand in early 2020. Protest activity peaks in mid-October and spikes again mid-November, with protest leaders threatening to resume demonstrations with increased intensity in early 2021.

In the run-up to the Uganda presidential elections on 14 January 2021, violence breaks out in Kampala with dozens killed in the first few weeks of electoral campaigning.

In early October, Nigeria is rocked by the outbreak of nationwide demonstrations against police brutality that leaves a reported 56 people dead.

On 23 October, China's Central Bank, the People's Bank of China, publishes a draft banking law recognising, and providing a regulatory framework for, its planned central bank digital currency, the digital yuan.

On 11 November 2020, China's National People's Congress Standing Committee determines that Hong Kong LegCo members can be disqualified on various grounds including endangering national security, with four members being immediately disqualified. In protest, the remaining 15 member pro-democracy bloc resign en masse.

On 30 December 2020, the EU and China reach an agreement in principle on the Comprehensive Agreement on Investment, which covers market access. Both sides commit to finalising detailed negotiations on the investment protections covered by the Agreement, which will require ratification, within two years.

A B C O

3. Managing the risks in implementing our strategy

This section provides an overview of the Group's strategy, the significant risks arising from the delivery of this strategy and current risk management focus. The risks outlined below, which are not exhaustive, are discussed in more detail in section 5.

Our strategy	Significant risks arising from the delivery of the strategy	Risk management focus
Group-wide Our strategy is to capture the long-term structural opportunities for our markets and geographies, while operating with discipline and seeking to enhance our capabilities through innovation to deliver high-quality resilient outcomes for our customers.	Transformation risks around key change programmes, including those related to the Group's digital strategy	— Continuing development of the transformation risk framework, including risk appetite, and focus on, and ensuring consistency in, transformation risk management across the Group's business units. — Provision of independent risk assurance, challenge and advice on first line programme risk identification and assessments. — Focus on the financial and non-financial stability of Jackson as a standalone business.
	Group-wide regulatory risks	— Ongoing compliance with in-force regulations and management of new regulatory developments. — Engagement with national governments, regulators and industry groups on macroprudential and systemic risk-related regulatory initiatives, international capital standards, and other initiatives with Group-wide impacts. — Implementation of the Group-wide Supervision Framework, which is expected to be effective for Prudential upon designation by the Hong Kong IA in the second quarter of 2021, subject to transitional arrangements.
	Information security and data privacy risks	— Operationalisation of the Group-wide governance model and strategy for cyber security management focusing on automation, business enablement, efficiency, and continuous improvement. — Continued focus on compliance with applicable privacy laws across the Group and the appropriate and ethical use of customer data.
	Business disruption and third-party risks	— Continued application of the Group's global business continuity management framework, with an enhanced focus on operational resilience as it relates to business disruption tolerance levels and customer impacts. Embedding of insights from the Covid-19 pandemic. — Applying the distinct oversight and risk management required over the Group's third parties, including its strategic partnerships for product distribution, non-traditional services and processing activities.
	Conduct risk	— Implementing and embedding the Group-wide customer conduct risk management framework and policy, with particular focus on sales practices and the Group's digital ecosystem. — Enhancement of conduct risk oversight using data analytics.
	Model and data risks	— Focus on requirements for data and AI and complex tooling ethics principles and framework. — Ongoing risk assessment of tools used.
	People and culture	— Focus on Group Culture as a key mechanism to support sound risk management behaviours, practices and awareness. — Embedding responses and insights from Group-wide employee engagement surveys through enhancements to the Group Risk Framework.
	ESG – commitments and disclosure	— Assessing the potential financial impacts from climate-related transition risk in the asset book and integration of climate risk into the Group Risk Framework. — Supporting the Group ESG Committee in its responsibility to deliver the Group's ESG Strategic Framework and develop its disclosures.

Our strategy	Significant risks arising from the delivery of the strategy	Risk management focus
Asia Serving the protection and investment needs of the growing middle class in Asia.	Financial risks	— Maintaining, and enhancing where necessary, risk limits and implementing business initiatives to manage financial risks, including asset allocation, bonus revisions, product repricing and reinsurance where required.
	Persistency risk	— Implementation of business initiatives to manage persistency risk, including additional payment methods, enhancing customer experience, revisions to product design and incentive structures. Ongoing experience monitoring.
	Morbidity risk	— Implementation of business initiatives to manage morbidity risk, including product repricing where required. Ongoing experience monitoring.
Africa Providing savings, health and protection solutions to customers in Africa.	As its presence in Africa expands and grows in materiality, the Group will continue to increase its focus on Prudential Africa's most significant risks. A number of significant Group-wide risks detailed above are considered material in the region, and these include: — Financial crime and security risks, where the focus is on implementation of Group policies and standards; — Transformation risks, where the focus is on overseeing and managing parallel initiatives while developing local capabilities to meet the demands of a fast-paced transformation agenda; and — Regulatory risks, where the focus is on active monitoring of the local regulatory landscape and adoption of Group processes in order to meet international regulatory standards.	
United States Providing asset accumulation and retirement income products to US retirees.	Financial risks	— Maintaining, and enhancing where necessary, risk limits, hedging strategies (including mitigating measures against basis risk), modelling tools and risk oversight appropriate to Jackson's product mix with a view to demerger from the Prudential Group.
	Policyholder behaviour risk	— Continued monitoring of policyholder behaviour experience and review of assumptions.

B C I O

4. Risk governance

a System of governance

Prudential has in place a system of governance that promotes and embeds a clear ownership of risk, processes that link risk management to business objectives and a proactive Board and senior management providing oversight of risks. Mechanisms and methodologies to review, discuss and communicate risks are in place together with risk policies and standards to enable risks to the Group to be identified, measured and assessed, managed and controlled, monitored and reported.

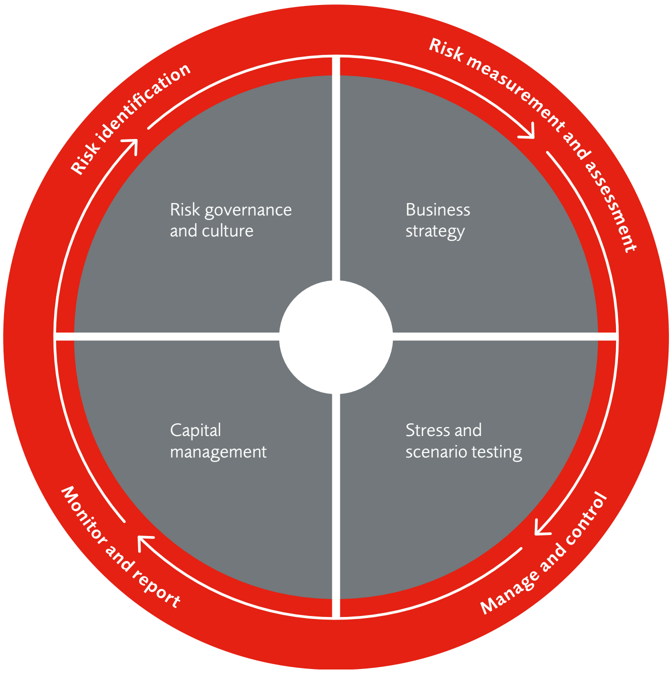
Material risks are retained selectively when it is considered that there is value in doing so, and where it is consistent with the Group's risk appetite and philosophy towards risk-taking. The Group Risk Framework, which is owned by the Board, details Prudential's risk governance, risk management processes and risk appetite. The Group's risk governance arrangements are based on the 'three lines of defence' model, comprising risk taking and management, risk control and oversight, and independent assurance.

The aggregate Group exposure to its key risk drivers is monitored and managed by the Risk, Compliance and Security function, which is responsible for reviewing, assessing, providing oversight and reporting on the Group's risk exposure and solvency position from the Group economic, regulatory and ratings perspectives.

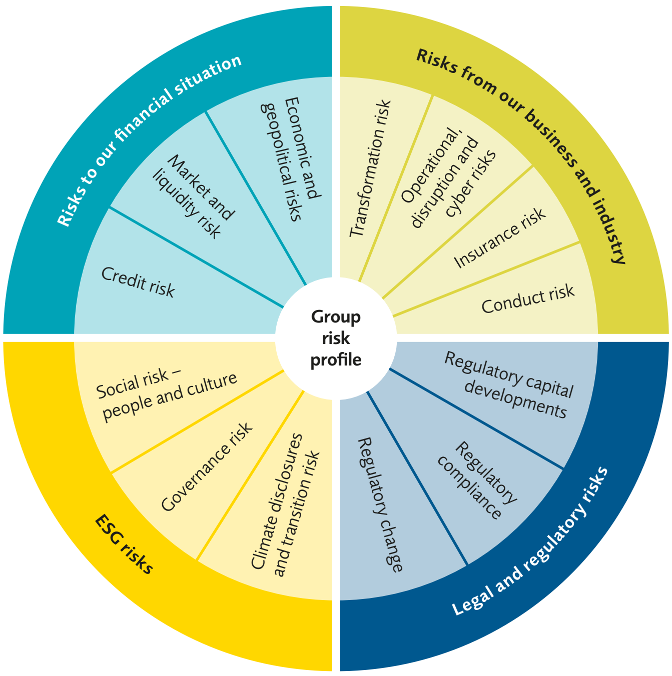
During 2020, the Group has continued to review and update its policies and processes for alignment with the requirements of its Group-wide supervisor. The Group has also focused on development of its Group-wide customer conduct risk framework and policy; its AI ethics principles; and enhancements to its operational resilience.

The following section provides more detail on our risk governance, risk culture and risk management process.

Risk management



Identified major risk categories



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 reviews and approves changes made to the Group Risk Framework and to relevant policies. It also reviews and approves new risk policies and recommends to the Board any material policies which require Board approval. A number of core risk policies and standards support the Framework to enable risks to the Group to be identified, measured and assessed, managed and controlled, monitored and reported.

The risk governance arrangements for the Group's major businesses were delayered and strengthened in 2020 with the implementation of direct lines of communication, reporting and oversight of the risk committees of these businesses by the Committee. To support the enactment of these arrangements, the terms of reference for the major business risk committees were aligned and approved locally, and include a standing invitation for the Group Chief Risk and Compliance Officer (CRCO) and the requirement for risk escalations to the Committee.

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. Components of the framework include 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 guide ESG activities. The culture framework components are intended to be supportive of 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. The framework is supported through inclusion of risk 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 include a series of guiding principles that govern the day-to-day conduct of all its people and any organisations acting on its behalf. This is supported by specific risk-related policies which require that the Group act in a responsible manner. These include, but are not limited to, policies related to financial crime covering anti-money laundering and sanctions and anti-bribery and corruption. The Group's third-party supply policy requires that human rights and modern slavery considerations are embedded across all of its supplier and supply chain arrangements. Embedded procedures to allow individuals to speak out safely and anonymously against unethical behaviour and conduct are also in place.

ESG is overseen by the Board, which is responsible for determining strategy and prioritisation of key focus areas. In order to provide greater senior executive involvement and holistic oversight of ESG matters material to the Group, in 2020, a Group ESG Committee was established. The Committee, chaired by the Group Chief Financial Officer and Chief Operating Officer in his role as ESG sponsor, was supported by senior functional leaders and representatives from the Group's business units, including the chief investment officers of the Group's asset managers. The Group ESG Committee reported to the Board in 2020 through the Group Nomination & Governance Committee, comprising the Group's Chair, the Senior Independent Director, and the chairs of the Audit, Remuneration and Risk committees and was regularly attended by the Group Chief Executive. The policies and procedures to support how the Group operates in relation to certain ESG topics are included in the Group Governance Manual, which establishes standards for managing ESG issues across the Group and sets out the policies and procedures to support how Prudential operates. Further details on the Group's ESG governance arrangements, including the establishment in early 2021 of a Board Responsibility & Sustainability Working Group, are included in the ESG Report on pages 74 to 76.

ii. The risk management cycle

Risk identification

In accordance with provision 28 of the UK Corporate Governance Code, a process is in place to support Group-wide identification of the Company's emerging and principal risks and this combines both top-down and bottom-up views of risks at the level of the Group and its business units. The Board performs a robust assessment and analysis of these principal and emerging risks facing the Company 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 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 is given enhanced management and reporting focus.

Risk measurement and assessment

All identified risks are assessed based on an appropriate methodology for that risk. All quantifiable risks, which are material and mitigated by holding capital, are modelled in the Group's internal model, which is used to determine economic capital requirements 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. Risk management and control requirements are set out in the Group's risk policies and define the Group's risk appetite in respect of material risks and the framework under which the Group's exposure to those risks is limited. The processes to enable Group senior management to effect the measurement and management of the Group material risk profile in a consistent and coherent way, which include the flows of management information required, are also set out in the Group's risk policies. The methods and risk management tools that the Group employs to mitigate each of its major categories of risks are detailed in section 5 below.

Risk monitoring and reporting

The identification of the Group's principal risks informs the management information received by the Group Risk Committee and the Board. Risk reporting of key exposures against appetite is also included, as well as ongoing developments in the Group's principal and emerging risks.

iii. Risk appetite, limits and triggers

The Group recognises that interests of its customers and shareholders, and a managed acceptance of risk in pursuit of its strategy, lies at the heart of its business, and that effective risk management capabilities represent a key source of competitive advantage. Qualitative and quantitative expressions of risk appetite are defined and operationalised through risk limits, triggers and indicators. The Risk, Compliance and Security function reviews the scope and operation of 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 shareholders, 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 is responsible for reviewing the risks inherent in the Group's business plan and for providing the Board with input on the risk/reward trade-offs implicit therein. This review is supported by the Risk and Compliance function, which uses submissions from local business units to calculate the Group's aggregated position relative to Group risk appetite and limits.

- **Capital requirements.** Limits on capital requirements aim to ensure that the Group maintains sufficient capital in excess of internal economic capital requirements in business-as-usual and stressed conditions, achieves its desired target rating to meet its business objectives, and supervisory intervention is avoided. The two measures currently in use at the Group level are the regulatory local capital summation method (LCSM) capital requirements (both minimum and prescribed levels) and internal economic capital requirements (ECap), which under the GWS Framework will be determined by the Group Internal Economic Capital Assessment (GIECA). In addition, capital requirements are monitored on local statutory bases.

- **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 (LCR) which considers the sources of liquidity against liquidity requirements under stress scenarios.

Non-financial risks. The Group is exposed to non-financial risks, including environmental, social and governance risks, 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 other external stakeholders, and to avoid material adverse impact on its reputation.

Risk management

Risk identification

Risk identification covers Group-wide:

- Top-down risk identification
- Bottom-up risk identification
- 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

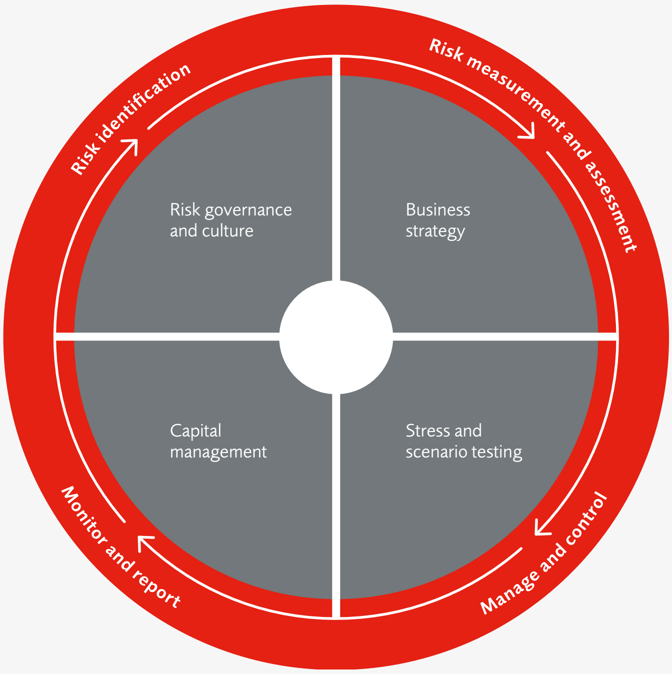
Risk appetite and limits allow for the controlled growth of our business, in line with business strategy and plan.

Processes that support the oversight and control of risks include:

- The Risk and Control Assessment process.
- The Own Risk and Solvency Assessment (ORSA).
- Group approved limits and early warning triggers.
- Large risk approval process.
- Global counterparty limit framework.
- Financial incidents procedures.
- 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.

C O

5. The Group's principal risks

Broadly, the risks assumed across the Group can be categorised as those relating to its financial situation; its business and industry; regulatory and legal compliance; and those relating to ESG. Principal risks, whether materialising within the Group or at third parties on which the Group relies, may have a financial impact and could also impact the performance of products or services provided to customers and distributors and the ability to fulfil commitments to customers, giving rise to potential risks to its brand and reputation. These risks, which are not exhaustive, are detailed below. The materiality of these risks, whether material at the level of the Group or its business units, is also indicated. The Group's disclosures covering risk factors are aligned to the same categories and can be found at the end of this document.

In reading the sections below, it is useful to understand that there are some risks that Prudential's policyholders assume by virtue of the nature of their products, and some risks that the Group and its shareholders assume. Examples of the latter include those risks arising from assets held directly by and for the Group or the risk that policyholder funds are exhausted. This report is focused mainly on risks to the shareholder but will include those which arise indirectly through policyholder exposures.

Covid-19 risks and responses

The Group has responded in a number of ways to the risks arising from the coronavirus pandemic; some responses were part of existing risk management processes and procedures, while others have been initiated specifically in response to the pandemic, in particular during the acute phases experienced in Q1 and Q2.

The Group Critical Incident Procedure (GCIP) defines specific governance to be invoked in the event of a critical incident, such as a 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 any activity during a critical incident. In response to the economic and financial market shocks triggered by the Covid-19 pandemic the Group CRCO invoked the GCIP and convened a series of CIG meetings to provide high-cadence monitoring and management of potential threats to the capital or liquidity position of the Group. Local Incident Management teams were also activated to monitor and manage the tailored response required to support the operations, customers and employees of the Group's businesses.

These risks arising from Covid-19, and the Group's responses to them, are summarised below, with further information provided, where relevant, within the descriptions of the Group's principal risks.

Risk areas	Responses
Staff safety and wellbeing	Proactive move to working from home arrangements across jurisdictions, with Local Incident Management teams monitoring country-specific developments, undertaking risk assessments and providing regular staff communications and support.
Customer outcomes are not met, increasing conduct risk	Initiatives and campaigns rolled out across markets, including customer cash benefits, goodwill payments, and extended grace periods for premium payments.
Disruption to the operations of the Group, and its key partners	Application of the Group and local business continuity plans. Local Incident Management teams activated to monitor, manage and lead a tailored response to ensure continuity of service to existing customers.
Financial market and liquidity impacts, including to Group and business unit solvency	Invocation of the GCIP and convening of a CIG to monitor and manage threats to the Group's solvency or liquidity position.
Heightened risk of phishing and social engineering tactics	Group-wide phishing and targeted awareness campaigns. Heightened threat monitoring and review of cyber hygiene controls. Active management of connections to the Group network.
Sales impacts	Roll-out of virtual face-to-face sales processes in most of the Group's markets with appropriate regulatory engagement, digital product offerings, oversight of incremental conduct and operational risks and ongoing monitoring of the commercial impact to existing sales channels.
Insurance risks, in particular increased lapses and surrenders resulting from the broader economic effects as well as increased and/or delayed morbidity impacts	Close monitoring by the Group's businesses and targeted management actions where necessary. Covid-19-related claims have not been material to date, but are being closely monitored.

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

Changes in global economic conditions can impact Prudential directly; for example, by leading to reduced investment returns and fund performance and liquidity, and increasing the cost of promises (guarantees) that have been made to the Group's customers. Changes in economic conditions, such as the abrupt and uncertain longer-term impacts resulting from the Covid-19 crisis, can also have an indirect impact on the Group; for example, leading to a decrease in the propensity for people to save and buy Prudential's products, as well as changing prevailing political attitudes towards regulation.

The geopolitical environment can also impact the Group in a wide range of ways, both directly and indirectly. Financial markets and economic sentiment have been highly susceptible to geopolitical developments in recent years, with implications for the Group's financial situation. We have seen in recent times that geopolitical tensions can result in the imposition of protectionist or restrictive regulatory and trading requirements by governments and regimes. The Covid-19 pandemic has further prompted governments to rethink the current globalised nature of supply chains, while accessibility to vaccine supplies has the potential to contribute to an increase in geopolitical tensions. These factors may have geopolitical and trading implications, the full extent of which may not be clear for a while. Various governments have effected, or may effect, the postponement of elections and other constitutional or legislative processes in response to the pandemic, and the longer-term impact from this increase in constitutional and political uncertainty remains to be seen. The pandemic has had a negative impact on all economies, with increased fiscal burdens, higher levels of borrowing and reduced revenues. These pressures will impact on the business operating environments, for example, through changes to taxation, and are likely to contribute to political pressures for governments.

Responses by the US, UK and other governments to the enactment and application of the national security law in Hong Kong and other constitutional or legislative changes in the territory, which continue to develop, may impact Hong Kong's economy. Being a key market for the Group which also hosts regional and head office functions, this could potentially impact Prudential's sales, operations and product distribution. For internationally active groups which operate across impacted jurisdictions such as Prudential, these government measures and responses add to the complexity of legal and regulatory compliance. Compliance with Prudential's legal or regulatory obligations 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 for the Group. All these factors can increase the operational, business disruption, regulatory and financial market risks to the Group and can directly impact its sales and distribution networks. Developments in Hong Kong and the continuing impacts of the pandemic are being closely monitored by the Group and plans have been enacted to manage the disruption to the business, its employees and its customers within existing business resilience processes. Further information on the Group's business disruption risks are included below.

Macroeconomic and geopolitical risks are considered material at the level of the Group.

Market risks to our investments
(Audited)

This is the potential for reduced value of Prudential's investments resulting from the volatility of asset prices, driven by fluctuations in equity prices, interest rates, foreign exchange rates and property prices. Interest rates in the Group's key markets decreased to historically low levels in Q1 2020, with the stance of central banks making it likely they will remain extremely low for a while. A persistently low interest rate environment poses challenges to both the capital position of life insurers as well as to new business profitability and this is a scenario that the Group is planning for.

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;
- The Group Asset Liability Committee – a first-line risk management advisory committee to the Group Chief Executive Officer which supports the identification, assessment and management of key financial risks significant to the achievement of the Group's business objectives;
- Risk appetite statements, limits and triggers;
- Asset and liability management programmes which include management actions such as asset allocation, bonus revisions, repricing and the use of reinsurance where appropriate;
- Hedging derivatives, including equity options and futures, interest rate swaps and swaptions and currency forwards;
- The monitoring and oversight of market risks through the regular reporting of management information; and
- Regular deep dive assessments.

As noted above, in response to the economic and financial market shocks triggered by the Covid-19 pandemic, the Group CRCO invoked the GCIP and convened a series of CIG meetings to provide high-cadence monitoring and management of any potential threats to the capital or liquidity position of the Group.

Market risks to our investments continued
(Audited)

Equity and property investment risk. In Asia, the shareholder exposure to equity price movements results from unit-linked products, where fee income is linked to the market value of the funds under management. Further exposure arises from with-profits businesses where bonuses declared are based broadly on historical and current rates of return from the Asia business's investment portfolios, which include equities.

In Jackson, investment risk arises from the assets backing customer policies. Equity risk is driven by the variable annuity business, where the assets are invested in both equities and bonds and the main risk to the shareholder comes from providing the guaranteed benefits offered. The exposure to this is primarily controlled by using a derivative hedging programme, as well as through the use of reinsurance to pass on the risk to third-party reinsurers.

Basis risk is the inherent risk associated with imperfect hedging and is caused by variables or characteristics that drive differences between the value of an underlying position and the hedge instruments used to offset changes in its value. Within Jackson's variable annuity business, basis risk can arise from differences between the performance of the Separate Account funds in which policyholders choose to invest and that of the instruments used to replicate these funds for hedging and liability modelling purposes, which are primarily linked to the S&P 500 index. This risk exposure is proportionate to the magnitude of liability risk/hedge position which fluctuates with equity and interest rate levels. While the market sell-off in Q1 2020 increased this liability risk/hedge exposure, the subsequent rally in equity markets over 2020 has had a corresponding opposite and positive impact. Jackson continues to actively evaluate the costs and benefits of ways to further mitigate basis risk.

Interest rate risk. This is driven by the valuation of Prudential's assets (particularly the bonds that it invests in) and liabilities, which are dependent on market interest rates and expose the Group to the risk of those moving in a way that is detrimental. Some products that Prudential offers are sensitive to movements in interest rates. As part of the ongoing management of this risk, a number of mitigating actions to the in-force business have been taken, as well as repricing and restructuring new business offerings in response to recent relatively low interest rates. Nevertheless, some sensitivity to interest rate movements is still retained. The impact of lower interest rates may also manifest through reduced solvency levels in some of the Group's businesses, impairing their ability to make remittances, as well as reduced new business profitability.

The Group's appetite for interest rate risk is limited to where assets and liabilities can be tightly matched and where liquid assets or derivatives exist to cover interest rate exposures.

In Asia, our exposure to interest rate risk arises from the guarantees of some non-unit-linked products with a savings component, including the Hong Kong with-profits and non-profit business. This exposure exists because of the potential for an asset and liability mismatch, where long-dated liabilities and guarantees are backed by short-dated assets, which cannot be eliminated but is monitored and managed through local risk and asset liability management committees against risk appetite aligned with the Group's limit framework.

Interest rate risk results from the cost of guarantees in the variable annuity and fixed index annuity business, which may increase when interest rates fall. The level of sales of variable annuity products with guaranteed living benefits is actively monitored, and the risk limits we have in place help to ensure we are comfortable with the level of interest rate and market risks incurred as a result. Derivatives are also used to provide some protection. Jackson is also affected by interest rate movements to its fixed annuity book where the assets are primarily invested in bonds and shareholder exposure comes from the mismatch between these assets and the guaranteed rates that are offered to policyholders. As at 1 June 2020, this risk has been substantially transferred as part of the reinsurance transaction with Athene, leaving only a limited exposure from residual policies including those from the blocks acquired externally (ie from the REALIC and John Hancock businesses).

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 that 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 financial statements when results are reported in US dollars. This risk is accepted within our 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 it is believed to be economically favourable to do so. 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.

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

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, and the Group considers this under both normal 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, which are sufficient to meet all of our 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 2025. Access to further liquidity is available through the debt capital markets and an extensive commercial paper programme is in place, and 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 this 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 LCRs 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 gap analysis of liquidity risks and the adequacy of available liquidity resources under normal and stressed conditions;
— Regular stress testing;
— Our contingency plans and identified sources of liquidity;
— The Group's ability to access the money and debt capital markets;
— Regular deep dive assessments; and
— The Group's access to external committed credit facilities.

Credit risk
(Audited)

Credit risk is the potential for a reduction in the value of investments which results from the perceived level of risk of an investment issuer being unable to meet its obligations (defaulting). Counterparty risk is a type of credit risk and relates to the risk of the counterparty to any contract we enter into being unable to meet their obligations causing the Group to suffer a loss.

Prudential invests in bonds that provide a regular, fixed amount of interest income (fixed income assets) in order to match the payments needed to policyholders. It also enters into reinsurance and derivative contracts with third parties to mitigate various types of risk, as well as holding cash deposits at certain banks. As a result, it is exposed to credit risk and counterparty risk across its business. The assets backing the Jackson general account portfolio and the Asia shareholder business means credit risk is considered a material risk for the Group's business units.

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.

A number of risk management tools are used to manage and mitigate this 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; and
— Close monitoring or restrictions on investments that may be of concern.

The total debt securities[4] at 31 December 2020 were $125.8 billion (31 December 2019: $134.6 billion). Credit risk arises from the debt portfolio in the Asia business comprising the shareholder, with-profit and unit-linked funds, the value of which was $89.6 billion at 31 December 2020. The majority (69 per cent) of the portfolio is in unit-linked and with-profits funds. The remaining 31 per cent of the debt portfolio is held to back the shareholder business.

Credit risk continued
(Audited)

In the general account of the Group's US business, $36.0 billion of debt securities are held to support shareholder liabilities. The shareholder-backed debt portfolio of the Group's other operations was $0.2 billion as at 31 December 2020. Further details of the composition and quality of our debt portfolio, and exposure to loans, can be found in the IFRS financial statements.

Group sovereign debt. Prudential invests in bonds issued by national governments. This sovereign debt holding represented 28 per cent or $18.0 billion[1] of the shareholder debt portfolio of the Group as at 31 December 2020 (31 December 2019: 22 per cent or $18.8 billion of the shareholder debt portfolio). The particular risks associated with holding sovereign debt are detailed further in our disclosures on risk factors.

The exposures held by the shareholder-backed business and with-profits funds in sovereign debt securities at 31 December 2020 are given in note C1 of the Group's IFRS financial statements.

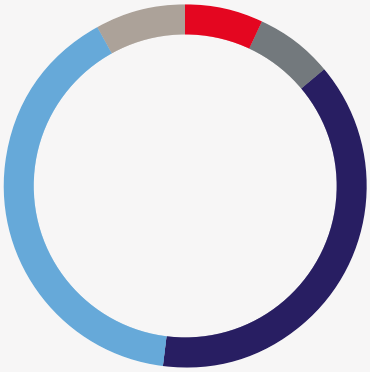
Corporate debt portfolio. In the Asia shareholder business, corporate debt exposures totalled $13.9 billion of which $12.4 billion or 89 per cent were investment grade rated. In the US general account, corporate debt exposures amounted to $26.6 billion following the Athene transaction, and the portfolio remains of high credit quality with 97 per cent[5] remaining investment grade rated.

Bank debt exposure and counterparty credit risk. Prudential's exposure to banks is a key part of its core investment business, as well as being important for the hedging and other activities undertaken to manage its various financial risks. Given the importance of its relationship with its banks, exposure to the sector is considered a material risk for the Group. The exposure to derivative counterparty and reinsurance counterparty credit risk, which includes the recently announced reinsurance agreement with Athene Life Re, is managed using an array of risk management tools, including a comprehensive system of limits. Where appropriate, Prudential reduces its exposure, buys credit protection or uses additional collateral arrangements to manage its levels of counterparty credit risk.

At 31 December 2020:

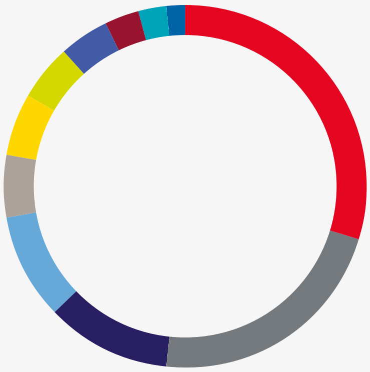
- 92 per cent of the Group's shareholder portfolio (excluding all government and government-related debt) is investment grade rated[2]. In particular, 52 per cent of the portfolio is rated[2] A- and above (or equivalent); and
- The Group's shareholder portfolio is well diversified: no individual sector[3] makes up more than 15 per cent of the total portfolio (excluding the financial and sovereign sectors). The exposures held by the shareholder-backed business and with-profits funds in bank debt securities at 31 December 2020 are given in note C1 of the Group's IFRS financial statements.

Shareholder exposure by rating



AAA	7%
AA+ to AA-	7%
A+ to A-	38%
BBB+ to BBB-	40%
Below BBB- and unrated	8%

Shareholder exposure by sector



Government	29.89%
Financial	22.05%
Utilities	11.06%
Consumer, non-cyclical	9.37%
Industrial	5.59%
Energy	5.56%
Consumer, cyclical	4.92%
Communications	4.45%
Technology	3.09%
Basic materials	2.50%
Other	1.52%

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
Prudential has a number of significant change programmes under way to deliver the Group's strategy for growth, improve customer experiences, strengthen its operational resilience and control environment, and meet regulatory and industry requirements. If the Group does not deliver these programmes to defined timelines, scope and cost, this may negatively impact on its operational capability; control environment; reputation; and ability to deliver its strategy and maintain market competitiveness.

Transformation risk remains a material risk for Prudential. The Group's transformation and change programmes inherently give rise to design and execution risks, and may introduce new, or increase existing, business risks and dependencies. Implementing further strategic transformation initiatives may amplify these risks. In order to manage these risks, the Group's Transformation Risk Framework 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, and regular risk monitoring and reporting to risk committees is delivered.

Prudential's current portfolio of transformation and significant change programmes include the proposed demerger of Jackson from the Group; the expansion of the Group's digital capabilities and use of technology, platforms and analytics; and improvement of business efficiencies through operating model changes (covering data, systems and people). Programmes related to regulatory/industry change such as the transition to the Hong Kong IA's 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. See below for further detail on these regulatory changes. The Group is cognisant that the speed of technological change in the business could outpace its ability to anticipate all the unintended consequences that may arise. While the adoption of innovative technologies such as artificial intelligence has opened up new product opportunities and channels, it also exposes Prudential to potential information security, operational, ethical and conduct risks which, if not managed effectively, could result in customer detriment and reputational damage. The Transformation Risk Framework therefore operates alongside the Group's existing risk policies and frameworks in these areas to ensure appropriate controls and governance are in place to mitigate these risks.

Non-financial risks
In the course of doing business, the Group is exposed to non-financial risks. A combination of the complexity of the Group, its activities and the extent of transformation in progress creates a challenging operating environment. The Group's main non-financial risks are detailed below. These risks are considered to be material at the level of the Group.

Operational risk. Prudential defines operational risk as the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel or systems, or from external events. This may arise from employee error, model error, system failures, fraud or other events which disrupt business processes or has a detrimental impact to customers. Activities across the scope of our business, including operational activity, regulatory compliance, and those supporting ESG activities more broadly can expose us to operational risks. A large volume of complex transactions is processed by the Group across a number of diverse products and are subject to a high number of varying legal, regulatory and tax regimes. Prudential has no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement or monitor appropriate controls to manage operational risks.

The Group's outsourcing and third-party relationships require distinct oversight and risk management processes. A number of important third-party relationships exist which provide the distribution and processing of Prudential's products, both as market counterparties and as outsourcing partners, including new IT and technology partners. In Asia, the Group continues to expand its strategic partnerships and renew bancassurance arrangements, and in Africa Prudential is continuing its expansion through acquisitions. These third-party arrangements support Prudential in providing a high level and cost-effective service to our customers, but they also make us reliant on the operational resilience and performance of our outsourcing partners.

The Group's requirements for the management of material outsourcing arrangements, which are in accordance with relevant applicable regulations, are included through its well-established Group-wide third-party supply policy. Third-party management is also included and embedded in the Group-wide framework and risk management for operational risk (see below).

The performance of the Group's core business activities places reliance on the IT infrastructure, provided by our external IT and technology partners, that supports day-to-day transaction processing and administration. This IT environment must also be secure, and an increasing cyber risk threat needs to be addressed as the Group's digital footprint increases and the sophistication of cyber threats continue to evolve – see separate information security risk sub-section below. Exposure to operational and other external events could impact operational resilience by significantly disrupting systems, operations and services to customers, which may result in financial loss, customer impacts and reputational damage. Operational challenges also exist in keeping pace with regulatory changes. This requires implementing processes to ensure we are, and remain, compliant on an ongoing basis, including regular monitoring and reporting.

Non-financial risks continued

Group-wide framework and risk management for operational risk
The risks detailed above form key elements of the Group's operational 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:

- Application of a risk and control self-assessment (RCSA) process, where operational risk exposures are identified and assessed as part of a periodical cycle. The RCSA process considers a range of internal and external factors, including an assessment of the control environment, to determine the business's most significant risk exposures on a prospective basis;
- An internal incident management process, which identifies, quantifies and monitors remediation conducted through root cause analysis and application of action plans for risk events that have occurred across the business;
- A scenario analysis process for the quantification of extreme, yet plausible manifestations of key operational risks across the business on a forward-looking basis. This is carried out at least annually and supports external and internal capital requirements as well as informing risk oversight activity across the business; and
- An operational risk appetite framework that articulates the level of operational risk exposure the business is willing to tolerate, covering all operational risk categories, and sets out escalation processes for breaches of appetite.

Outputs from these processes and activities performed by individual business units are monitored by the Risk function, which provides an aggregated view of the risk profile across the business to the Group Risk Committee and Board.

These core framework components are embedded across the Group via the Group Operational Risk Policy and Standards documents, which set out the key principles and minimum standards for the management of operational risk across the Group. The Group Operational Risk Policy, standards and operational risk appetite framework sit alongside other risk policies and standards that individually engage with key 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, including:

- A transformation risk framework that assesses, manages and reports on the end-to-end transformation life cycle, project prioritisation and the risks, interdependencies and possible conflicts arising from a large portfolio of transformation activities;
- Internal and external review of cyber security capability and defences;
- Regular updating and testing of elements of disaster-recovery plans and the Critical Incident Procedure process;
- Group and business unit-level compliance oversight and testing in respect of adherence with in-force regulations;
- Regulatory change teams in place to assist the business in proactively adapting and complying with regulatory developments;
- On financial crime risks (see below), screening and transaction monitoring systems are in place and a programme of compliance control monitoring reviews is undertaken, as well as regular risk assessments;
- A framework is in place for emerging risk identification and analysis in order to capture, monitor and allow us to prepare for operational risks that may crystallise beyond the short-term horizon;
- Corporate insurance programmes to limit the financial impact of operational risks; and
- Reviews of key operational risks and challenges within Group and business unit business plans.

These activities are fundamental in maintaining an effective system of internal control, and as such outputs from these also inform core RCSA, incident management and scenario analysis processes and reporting on operational risk. Furthermore, they also 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.

Business disruption risk. Events in 2020 have shown how material business disruption risk is to effective business operations and delivery of business services to policyholders, and the potential impact to our customers and the market more broadly. The Group continuously seeks to develop greater business resilience through planning, preparation, testing and adaption. Business continuity management (BCM) is one of a number of activities undertaken by the Group Security function that helps the Group to protect its key stakeholders and its systems, and business resilience is at the core of the Group's embedded BCM programme. The BCM programme and framework are appropriately linked to all business activities, and includes business impact analyses, risk assessments, incident management plans, disaster recovery plans, and the exercising and execution of these plans. Based on industry standards, the BCM programme is designed to provide business continuity that matches the Group's evolving business needs and is appropriate to the size, complexity and nature of the Group's operations. Prudential is also taking a broader, multi-functional approach to building greater business resilience, working with our external third-party providers and our service delivery teams to improve our ability to withstand, absorb and recover from disruption to our business services, while minimising the impact on our customers. The Group continuously reviews and develops its contingency plans and its ability to respond effectively when disruptive incidents occur, such as those resulting from the Covid-19 pandemic and, prior to this, the Hong Kong protests in 2019. Business disruption risks are closely monitored by the Group Security function, with key operational effectiveness metrics and updates on specific activities being reported to the Group Risk Committee and discussed by cross-functional working groups.

Risks from the nature of our business and our industry continued

Non-financial risks continued

Information security risk and data privacy. Information security and data privacy risks remain significant considerations for Prudential. This includes the risk of malicious attack on its systems, network disruption and risks relating to data security, integrity, privacy and misuse. The cyber security threat and criminal capability in this area continues to evolve globally in sophistication and potential significance with an increased level of understanding of complex financial transactions which increases the risks to the financial services industry. The systemic risk of sophisticated but untargeted attacks remains elevated, particularly during times of heightened geopolitical tensions and during the current disruption caused by the Covid-19 pandemic. The scale of the Group's IT infrastructure and network (and the services required to monitor and manage it), stakeholder expectations and high-profile cyber security and data misuse incidents across industries mean that these risks are considered material at the level of the Group.

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

Developments in data protection requirements, such as the California Consumer Protection Act which came into force on 1 January 2020, continue to evolve worldwide. This increases financial and reputational implications for Prudential in the event of a breach of its (or third-party suppliers') IT systems. As well as protecting data, stakeholders expect companies and organisations to use personal information transparently and appropriately. New and currently unforeseeable regulatory issues may also arise from the increased use of emerging technology, data and digital services. This includes the international transfer of data which, as a global organisation, increases regulatory risks for Prudential. Given this, both information security and data privacy are key risks for the Group. As well as having preventative risk management 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.

During 2020, work to operationalise the revised organisational structure and governance model for cyber security management has continued. This change has resulted in a centralised Group-wide Information Security and Privacy function, leveraging skills, tools and resources across the business under a 'centre of excellence' model. This global function is led by the Group Chief Information Security Officer and falls within the scope of the responsibilities of the Group Chief Digital Officer, working closely with the Group Risk and Compliance Function and Group CRCO to ensure appropriate second line oversight. Cyber risk management is also conducted 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 understand the latest regulatory expectations and the threats facing the Group and that they have the means to enable appropriate oversight in this area.

An updated Group-wide information security policy has been introduced that aligns to over 20 international standards such as ISO 27001/2, MAS, and NIST Cyber Security Framework to ensure full coverage and adoption of best practices. Local policies are also aligned to relevant local regulation or law. Our Group-wide privacy 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 laws and regulations. This approach ensures that all our stakeholders have confidence in our approach to information security and risk management.

These developments have allowed the Group to progress on its cyber security strategy, which for 2020 has four key objectives:

- Automation of key processes to provide near real-time information on cyber security risks, allowing for increased response times scalability of defences to threat vectors across all security disciplines. This also enables improved, and more rapid, decision-making;
- Using technology for the rapid enablement of the Group's businesses, which supports the Group Digital Transformation strategy while meeting the security requirements and expectations;
- Optimisations for efficiency in cyber security and data privacy management. This includes the delivery of centralised services across the Group in areas such as vulnerability management; and
- Continuous identification and implementation of improvements to the people, processes or technology deployed on cyber security and privacy management.

Risks from the nature of our business and our industry continued

Non-financial risks continued

Model, user developed application (UDA) and robotics process automation (RPA) risk. There is a risk of adverse consequences arising from erroneous or misinterpreted tools used in core business activities, decision making and reporting. 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 applications. Many of these tools are an integral part of the information and decision-making framework of Prudential and errors or limitations in these tools, or inappropriate usage, may lead to regulatory breaches, inappropriate decision-making, financial loss, or reputational damage.

The Group has no appetite for model, UDA and RPA risk arising as a result of failing to develop, implement and monitor appropriate risk mitigation measures.

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

- The Group's Model, UDA and RPA 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 Risk-function to support the measurement and management of the risk.

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 claims or transactions, or procurement of services, are made against or through the business); sanctions compliance (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 there is a higher concentration of exposure to politically-exposed persons, or which otherwise have higher geopolitical risk exposure.

The Group-wide policies we have 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, while a programme of compliance control monitoring reviews is being undertaken. 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 staff and other stakeholders can report concerns relating to potential misconduct. The process and results of this are overseen by the Group Audit Committee.

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) 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 of policies), and increases in the costs of claims, including the level of medical expenses increases over and above price inflation (claim inflation).

The principal drivers of the Group's insurance risk vary across its business units. Across Asia, where a significant volume of health and protection business is written, the most significant insurance risks are persistency risk, morbidity risk and medical inflation risk. In Jackson, policyholder behaviour risk is particularly material, especially in the take up of options and guarantees on variable annuity business which impacts profitability and is influenced by market performance and the value of policy guarantees.

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 remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

The impact of Covid-19 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 choose to defer or stop paying insurance premiums or reduce deposits into retirement plans. In particular extended restrictions on movement could affect product persistency in the Group's Asia business. 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. While these impacts to the business have not been material to date, they are being closely monitored by the Group's businesses with targeted management actions being implemented where necessary, which includes additional Incurred But Not Reported (IBNR) claims reserves in some markets where deferrals in non-acute medical treatments due to movement restrictions have been observed.

Risks from the nature of our business and our industry continued

Insurance risks continued
(Audited)

The Group's persistency assumptions reflect similarly a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumptions. Persistency risk is managed by appropriate training and sales processes (including active customer engagement and service quality) and managed locally post-sale through regular experience monitoring and the identification of common characteristics of business with high lapse rates. Where appropriate, allowance is made for the relationship (either assumed or observed historically) between persistency and investment returns and any additional risk is accounted for. Modelling this dynamic policyholder behaviour is particularly important when assessing the likely take-up rate of options embedded within certain products. The effect of persistency on the Group's financial results can vary but depends mostly on product design and market conditions.

In Asia, Prudential writes significant volumes of health and protection business and so a key assumption is the rate of medical inflation, which is often in excess of general price inflation. There is a risk that the expenses of medical treatment increase more than expected, so the medical claim cost passed on to Prudential is higher than anticipated. Medical expense inflation risk is best mitigated by retaining the right to reprice our products each year and by having suitable overall claims limits within our policies, either limits per type of claim or in total across a policy, annually and/or over the policy lifetime. Prudential's morbidity risk is mitigated by appropriate underwriting when policies are issued and claims are received. Our morbidity assumptions reflect our recent experience and expectation of future trends for each relevant line of business.

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

- The Group's insurance, product and underwriting risk policies;
- 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;
- Using product repricing and other claims management initiatives in order to mitigate medical expense inflation risk; and
- Regular deep dive assessments.

Conduct risk
Prudential's conduct of business, especially the design and distribution of its products, is crucial in ensuring that the Group's commitment to meeting customers' needs and expectations are met. The Group's conduct risk framework, owned by the Group Chief Executive, was further developed in 2020 and 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, to its diverse distribution channels, including 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 the Pulse by Prudential app, there is increased focused on making insurance more inclusive to underserved segments of society, through bite-size low cost digital products and services. Through this transition, Prudential must continue to ensure the quality of its ongoing servicing of all its customers. Prudential mitigates conduct risk with robust controls, which are identified and assessed through the Group's conduct risk assessment framework, regularly tested 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 and underwriting risk policies and other related policies;
- Ensuring the quality of sales and marketing material via robust review and sign off procedures;
- Ensuring sales practices meet commitments to customers and regulators via the use of well-designed monitoring programmes relevant to the type of business (insurance or asset management), distribution channel (agency, bancassurance, or digital) and ecosystem;
- Ensuring sales processes are designed to meet commitments to customers and regulators and that they are operating effectively via robust assurance programmes both pre and post implementation;
- Maintaining the quality of sales processes and training, and using other initiatives such as special requirements for vulnerable customers, to improve customer outcomes;
- Proper claims management and complaint handling practices;
- Regular deep dive assessments on, and monitoring of, conduct risks; and
- 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 with in the conduct of its business.

Prudential operates under the ever-evolving requirements set out by diverse regulatory, legal and tax regimes which may impact Prudential's business or the way in which 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. In addition to the risks arising from regulatory change, the breadth of local and Group-wide regulatory arrangements presents the risk that regulatory requirements are not fully met, resulting in specific regulator interventions or actions including retrospective interpretation of standards by regulators which may result in regulatory censure or significant additional costs to the business. Furthermore, 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 the regulatory developments and standards emerging around 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 that are having, and will continue to have, an impact on the way Prudential is supervised. Decisions taken by regulators, including those related to solvency requirements, corporate or governance structures, capital allocation, financial reporting and risk management may have an impact on our business.

The focus of some governments toward more protectionist or restrictive economic and trade policies could impact on the degree and nature of regulatory changes and Prudential's competitive position in some geographic markets. This could take effect, for example, through increased friction in cross-border trade, capital controls or measures favouring local enterprises such as changes to the maximum level of non-domestic ownership by foreign companies. 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 and regulators.

Further information on specific areas of regulatory and supervisory requirements and changes are included below.

Group-wide supervision. From 21 October 2019, Prudential's Group-wide supervisor changed to the Hong Kong IA. As a result, the Group currently applies the local capital summation method (LCSM) to determine Group regulatory capital requirements (both minimum and prescribed levels). The primary legislation was enacted in July 2020 and will come into operation on 29 March 2021. The relevant subsidiary legislation, including the Insurance (Group Capital) Rules, was tabled before the Legislative Council on 6 January 2021 and will also come into operation on 29 March 2021. This will be supported by further guidance material to be released by the Hong Kong IA. Prior to the GWS Framework becoming effective for the Group, which is expected in the second quarter of 2021 upon designation by the Hong Kong IA, Prudential remains subject to the Regulatory Letter signed with the Hong Kong IA. The letter outlines the interim supervision arrangements from October 2019 when it became the group-wide supervisor of the Group.

Global regulatory developments and systemic risk regulation. Efforts to curb systemic risk and promote financial stability are also under way. At the international level, the Financial Stability Board (FSB) continues to develop recommendations for the asset management and insurance sectors, including ongoing assessment of systemic risk measures. The International Association of Insurance Supervisors (IAIS) has continued its focus on the following key developments.

In November 2019 the IAIS adopted the Common Framework (ComFrame) which establishes supervisory standards and guidance focusing on the effective group-wide supervision of Internationally Active Insurance Groups (IAIGs). Prudential was included in the first register of IAIGs released by the IAIS on 1 July 2020 and was designated an IAIG by the Hong Kong IA following an assessment against the established criteria in ComFrame.

The IAIS has also been developing the ICS (Insurance Capital Standard) as part of ComFrame. The implementation of ICS will be conducted in two phases: a five-year monitoring phase followed by an implementation phase. The Aggregation Method is one of the alternatives being considered to the default approach undertaken for the ICS during the monitoring period and the related proposals are being led by the National Association of Insurance Commissioners (NAIC). Alongside the current ICS developments, the NAIC is also developing its Group Capital Calculation (GCC) for the supervision of insurance groups in the US. The GCC is intended to be a risk-based capital (RBC) aggregation methodology. In developing the GCC, the NAIC will also consider Group capital developments by the US Federal Reserve Board, which will inform the US regulatory association in its construction of a US group capital calculation.

In November 2019 the FSB endorsed a new Holistic Framework (HF), intended for the assessment and mitigation of systemic risk in the insurance sector, for implementation by the IAIS in 2020 and has suspended G-SII designations until completion of a review to be undertaken in 2022. Many of the previous G-SII measures have already been adopted into the Insurance Core Principles (ICPs) and ComFrame. As an IAIG, Prudential is expected to be subject to these measures. The HF also includes a monitoring element for the identification of a build-up of systemic risk and to enable supervisors to take action where appropriate. As a result of the Covid-19 pandemic, this monitoring requirement was replaced with a Covid-19-focused exercise for 2020, with annual monitoring expected to recommence in 2021. In November 2020 the IAIS launched a public consultation on phase 1 of a proposed liquidity metric to be used as an ancillary indicator in the monitoring of the build-up of systemic risk. This followed a more general consultation on liquidity metrics earlier in 2020. Consultations on a phase 2 liquidity metric, as well as on macroeconomic elements of the HF, are expected to follow. The FSB published its 2020 Resolution Report in November 2020, highlighting intra-group connectedness and funding in resolution as key areas of attention for its work on resolution planning. Resolution regimes will continue to be a near-term focus in the FSB's financial stability work, potentially being a key tool in informing decisions around the reformed G-SII designation in 2022.

Risks related to regulatory and legal compliance continued

In the US, various initiatives are under way to introduce fiduciary obligations for distributors of investment products, which may reshape the distribution of retirement products. Jackson has introduced fee-based variable annuity products in response to the potential introduction of such rules, and we anticipate that the business's strong relationships with distributors, history of product innovation and efficient operations should further mitigate any impacts.

In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. New local capital rules and requirements could be introduced in these and other regulatory regimes that challenge legal or ownership structures, or current sales practices, or could be applied to sales made prior to their introduction retrospectively, which have a negative impact on Prudential's business and reported results.

IFRS 17. In May 2017, the International Accounting Standards Board (IASB) published its replacement standard on insurance accounting IFRS 17, 'Insurance Contracts'. Some targeted amendments to this standard, including to the effective date, were issued in June 2020. IFRS 17, 'Insurance Contracts', as amended, will introduce fundamental changes to the IFRS-based reporting of insurance entities that prepare accounts according to IFRS from 2023. IFRS 17 is expected to, among other things, include altering the timing of IFRS profit recognition, and the implementation of the standard is likely to require changes to the Group's IT, actuarial and finance systems. The Group is reviewing the complex requirements of this standard and considering its potential impact.

Inter-bank offered rate reforms. In July 2014, the Financial Stability Board (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 Sterling Overnight Index Average (SONIA) benchmark in the UK and the Secured Overnight Financing Rate (SOFR) in the US 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.

Risk management and mitigation of regulatory risk at Prudential includes the following:

- Risk assessment of the Business Plan which includes consideration of current strategies;
- Close monitoring and assessment of our business environment and strategic risks;
- The 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.

D

The Group's ESG-related risks

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

The purpose of a business and the way in which it operates in achieving its objectives, including in relation to ESG-related matters, are an increasingly material consideration for key stakeholders in achieving their own objectives and aims. ESG-related risks may directly or indirectly impact Prudential's business and the achievement of its strategy and consequently those of its key stakeholders, which range from customers, institutional investors, employees and suppliers, to policymakers, regulators, industry organisations and local communities, all of whom have expectations, concerns and aims which may differ. Material risks associated with key ESG themes may adversely impact the reputation and brand of the Group, its ability to attract and retain customers and staff, its ability to deliver on its long-term strategy and therefore the results of its operations and long-term financial success.

The Prudential ESG Strategic Framework, developed in 2020, focuses on giving people greater 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. Prudential seeks to ESG-related risks to its strategy and their negative implications to stakeholder through a transparent and consistent implementation of this strategy in its key markets and across operational, underwriting and investment activities. The strategy is enabled by strong internal governance, sound business practices and a responsible investment approach, both as an asset owner and asset manager.

(a) Environmental risks

Prudential's strategic ESG focus on stewarding the human impacts of climate change recognises that environmental concerns, notably those associated with climate change, may pose significant risks to Prudential, 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, physical and litigation risks. 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.

The Group's ESG-related risks continued

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. This climate-related transition risk may adversely impact the valuation of investments held by the Group, and the potential broader economic impact may affect customer demand for the Group's products. Prudential's stakeholders increasingly expect and/or rely on the Group to support an orderly transition based on an understanding of relevant country and company-level plans and which takes into consideration the impact on the economies, businesses and customers in the markets in which it operates and invests. Understanding and appropriately reacting to transition risk 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, will increasingly influence the longevity, mortality and morbidity risk assessments for the Group's life 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 impact the Group's operational resilience and its customers. More information about the activities the Group is undertaking to increase its understanding and risk management of these climate-related risks can be found in the Prudential plc ESG Report 2020, see pages 87 to 92.

(b) Social risks

Social risks that could impact Prudential may arise from a failure to consider the rights, diversity, wellbeing, and interests of people and 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. As an employer, the Group aims to attract, retain and develop highly-skilled staff, which relies on having in place responsible working practices and recognising the benefits of diversity and promoting a culture of inclusion. The Group's reputation extends to its supply chains, which may be exposed to factors such as poor labour standards and abuses of human rights by third parties. Emerging population risks associated with public health trends (such as an increase in obesity) and demographic changes (such as population urbanisation and ageing) may affect customer lifestyles and therefore may impact claims against the Group's insurance product offerings. As a provider of insurance and investment services the Group is committed to playing a greater role in preventing and postponing illness in order to protect its customers as well as making health and financial security accessible through an increased focused on digital innovation, technologies and distribution methods for a broadening range of products and services. As a result, Prudential has access to 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. These risks are explained above. The increasing digitalisation of products, services and processes may also result in new and unforeseen regulatory requirements and stakeholder expectations which Prudential monitors for, as well as ensuring support for its customers through this transformation.

(c) Governance risks

Maintaining high standards of corporate governance is crucial for the Group and its customers, staff 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 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.

Risk management and mitigation of ESG risks at Prudential include the following:

- The Group's ESG Strategic Framework focused on strategic differentiators and enablers;
- The Group Code of Business Conduct and Group Governance Manual including ESG linked policies;
- ESG risk identification including through emerging risk processes;
- Deep dives into ESG themes including climate-related risks; and
- Integrating ESG considerations into investment processes

Further information on the Group's ESG governance is included in section 4 above, and further detail on the Group's ESG Strategic Framework and the management of material risks associated with ESG themes are included in the ESG Report 2020, see pages 70 to 117.

Notes

1 Excluding assets held to cover linked liabilities and those of the consolidated investment funds.
2 Based on middle rating from Standard & Poor's, Moody's and Fitch. If unavailable, NAIC and other external ratings and then internal ratings have been used.
3 Source of segmentation: Bloomberg Sector, Bloomberg Group and Merrill Lynch. Anything that cannot be identified from the three sources noted is classified as other.
4 From half year 2020, to align more closely with the internal risk management analysis, the Group altered the compilation of its credit ratings analysis to use the middle of the Standard & Poor's, Moody's and Fitch ratings, where available. Where ratings are not available from these rating agencies, NAIC ratings (for the US), local external rating agencies' ratings and lastly internal ratings have been used. Securities with none of the ratings listed above are classified as unrated and included under the 'below BBB- and unrated' category. The total securities (excluding sovereign debt) that were unrated at 31 December 2020 were $780 million (31 December 2019: $648 million). Previously, Standard & Poor's ratings were used where available and if not, Moody's and then Fitch were used as alternatives.
5 Excluding assets in consolidated funds financed largely by external third-party (non-recourse) borrowings, for which the Group's exposure is limited to the investment held by Jackson. Including these assets, the US corporate debt portfolio is 93 per cent investment grade.

A

Viability statement prepared in accordance with Provision 31 of the UK Corporate Governance Code

The Group's longer-term prospects

Prudential aims to make healthcare affordable and accessible, protect people's wealth and empower customers to save for their goals, which can often be over a time frame of many years. As such, Prudential considers that its purpose aligns closely with important societal needs, including making health and financial security more accessible, improving financial inclusion and education and transitioning to a low carbon economy. Prudential is focused on addressing these increasing needs, reflecting population demographics in our chosen markets. The drivers for this structural growth, such as the low penetration rates across the Asian region, are discussed on pages 19 to 25 alongside the activities we undertook during 2020 to expand our Asian and African footprint and enhance our capabilities, particularly through increased digitalisation. To enable the Group to focus exclusively on its high-growth Asia and Africa businesses, the Group intends to pursue the demerger of its US business allowing Jackson to focus on the distinct opportunities within the US retirement market. Further information on the progress of this demerger is set out on pages 06 to 07. In undertaking these activities, we aim to both meet the evolving needs of our customers and provide sustainable growth for our shareholders, which will ultimately lead to the viability of our business over the longer term.

In 2020, the Covid-19 pandemic has impacted the global economy and the related restrictions have applied to the Group's individual markets to varying degrees and at different periods. Our focus during this time has been on supporting our communities, customers and staff through the challenges created. The business has seen a short-term impact on sales but we believe the Covid-19 disruptions have also acted to intensify the structural opportunities in Asia and Africa over the longer term with a clear and increasing need for the broad-based products we deliver. During the pandemic, the Group has continued to innovate, as demonstrated by the continued rollout of Pulse by Prudential, to ensure we can capture these opportunities post Covid-19. The long-term macro-economic impacts of the pandemic remain uncertain but all of the Group's activities are underpinned by ongoing risk management, implemented via the Group Risk Framework and risk appetite limits described on pages 51 to 54.

The Group as a whole and each of its life assurance operations are subject to extensive regulation and supervision, which are designed primarily to reinforce the Group's management of its long-term solvency, liquidity and viability to ensure that it can continue to meet obligations to policyholders. Further details on the current capital strength of the Group are provided on pages 31 to 32.

The Group's management of wider environmental, social and governance issues that could pose a risk in the future to the Group is set out in the Environmental, Social and Governance report on pages 70 to 117.

This risk and regulatory focus supports the sustainability of our business over the longer term.

Period of viability assessment

The Directors have assessed the viability of the Group for a period longer than the 12 months required by the going concern statement.

The Directors performed the assessment by reference to the three-year plan period to 31 December 2023. Three years is considered an appropriate period as it represents the period covered by the detailed business plan that is prepared annually on a rolling three-year basis. In approving the business plan, the Directors reviewed the Group's projected performance with regards to profitability, cash generation and capital position, together with the parent company's liquidity over this three-year period. This projection involves setting a number of economic and other assumptions that are inherently volatile over a much longer reporting period. Such assumptions include foreign exchange rates, interest rates, economic growth rates, the impact on the business environment arising from the impact of Covid-19, geopolitical events and continued level of changes in regulation and supervision. The Directors are satisfied that this period is sufficient to enable a reasonable assessment of viability to be made.

The intended demerger of Jackson from the Group is expected to occur within the period covered by the viability statement. The Directors have therefore considered the ability of the Group to continue in its current form (ie the scenario in which the demerger does not proceed) for the three-year period ending 31 December 2023 as well as the viability of the Group in the more likely scenario that the demerger proceeds.

Assessment of principal risks over the period

The Group's business plan implements the Group's strategic objectives through the business model and activities discussed on pages 14 to 15. Matters considered as part of that planning process included the effect of current Covid-19 restrictions on people movement and face-to-face business activity and the continued rollout of Pulse by Prudential. Assessment of the risks to achieving the projected performance remains an integral part of the planning process. The Group's approach to risk management and a summary of the key risks facing the Group are set out on pages 45 to 69.

For the purposes of assessing the Group's viability, the Directors considered those risks where the impact of possible adverse external developments could be of such speed and severity to present a shock to the Group's financial position. The risks considered, from those detailed on pages 55 to 67 are: market risk, credit risk, liquidity risk and regulatory risk. The Directors considered the macroeconomic environment and geopolitical risks in the markets which the Group operates.

Stress and scenario testing
As noted above, underpinning the projections in the business plan are a number of economic and other assumptions. To evaluate the Group's resilience to significant deteriorations in market and credit conditions and other shock events, these risks are grouped together into scenarios which are then applied to the assumptions underlying the business plans considered. Scenarios considered include those reflecting the possible impacts of Covid-19 on new business, including the uncertainty as to the duration of restrictions in individual markets and the length of time for sales to recover to previous levels and different timings of expected regulatory changes. Separately stresses have been applied to the economic and non-economic assumptions underlying the base case business plan. These stresses assess the potential impact of up or down interest rate movements combined with corporate credit spread widening, a rating level downgrade on part of the credit asset portfolio, falling equity values and insurance stresses (such as changes in policyholder behaviour, including lapses, and increased morbidity in Asia). In addition, the adequacy of liquid resources of the Group's parent company across the plan period has been assessed by considering a stress scenario assuming the closure of short-term debt markets, as well as additional calls on central liquidity by the business units. In this liquidity stress scenario, the Group would have access to sufficient resources to meet the funding requirements of the business, after taking into account the Group's undrawn committed liquidity facilities of $2.6 billion, on top of central cash and short-term investment balances, which as at 31 December 2020 were $1.5 billion.

The scenarios tested showed that the Group would be able to maintain viability over the three-year period under assessment, after taking account of the actions available to management to mitigate the impacts on capital and liquidity in such scenarios. In addition, the Group conducts an annual reverse stress test which gives the Directors an understanding of the maximum resilience of the Group to extremely severe adverse scenarios. The projections in the business plan, and in the scenarios considered, do not assume that the Group accesses or relies upon the proceeds from any potential equity raise in the three-year period under assessment. This analysis assists in identifying management actions that could be implemented to restore the Group's capital and liquidity resources from extreme positions. This analysis also informs the Group's recovery plan and liquidity risk management plan.

The impact on the business of known areas of regulatory change whose financial implications can be reasonably quantified is also considered as part of the plan, for example the introduction of the Hong Kong Insurance Authority's Group-wide Supervision regime and the implementation of RBC regimes in Hong Kong and other markets. As well as known areas of regulatory change, the Group is exposed to the risk of sudden and unexpected changes in regulatory requirements at the Group and local levels. While unexpected changes cannot be fully anticipated and hence modelled, the risk of regulatory change is mitigated by capital held by the Group and its subsidiaries in excess of Group and local regulatory requirements, the Group and its subsidiaries' ability to generate significant capital annually through operational delivery and the availability of compensating actions designed to restore key capital metrics.

Conclusion on viability
Based on this assessment, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year plan period to December 2023.