Prudential Pensions Limited

Solvency and Financial Condition Report

31 December 2016

Contents

This report has been prepared in compliance with the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009|138|EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (‘Delegated Regulation’). The structure of this report follows the structure set out in Annex XX and discloses the information referred to in Articles 292 to 298 of the Delegated Regulation. The report also contains narrative information in quantitative and qualitative form supplemented, where appropriate, with quantitative templates. Where a comparison of the information on a Solvency II basis with that reported on the previous reporting period is required, this report does not report comparative information by availing the transitional arrangements on comparative information available under Article 303 of the Delegated Regulation (EU).

Summary

(Unaudited)

Group background

We were founded in the United Kingdom ('UK') in 1848, and are a leading provider of savings and retirement income products. Our biggest strength comes from providing investments that help our customers meet their long-term goals, whilst also protecting them against short-term market fluctuations.

Our core strengths in with-profits and financial products for retirement are underpinned by our expertise in areas such as understanding life expectancy, handling investment risk and managing a range of investment assets. We are also financially strong which means we are able to withstand major market volatility and ensure we meet our commitments.

The Group's products are typically long-term consisting of life insurance, pensions and pension annuities. In common with other UK long-term insurance companies, the Group's products are structured as either with-profits (or participating) products written in the with-profits funds, or non-participating products including annuities in payment and unit-linked products written in the non-profit fund.

Company background

Prudential established Prudential Pensions Limited ('PPL', 'the Company' 'we') in 1971, as a subsidiary to The Prudential Assurance Company Limited ('PAC'). The original purpose of the company was to maintain the unit-linked funds for corporate pension customers of the PAC. Following the acquisition in 1999 of M&G Investments, PPL started to write business directly with trustees with the support of the M&G division of the Prudential group.

Business and performance

The UK's retirement market is changing. The risk and responsibility for planning for retirement continues to transfer away from the State and employers to individual savers. The reforms introduced by Pension Freedoms in 2015 give our customers new flexibility in how they take their pension income. However, investment, increasing life expectancy and inflation risks have made things more complicated and guidance or advice is becoming increasingly important.

The Company's long-term products mainly consist of unit-linked pensions and some pension annuities.

The Company and the group in which it sits are well placed in this evolving marketplace due to our ability to offer differentiated products to meet customer needs. This is evident in the new business profile of the group relative to a few years ago. There has been a shift away from a reliance on annuity business to a focus on more flexible bond, ISA, pension and income drawdown products across a range of tax efficient solutions

The Company continues to benefit from the group's Corporate Pension sales. The group continues to focus on securing new members and incremental business from its current portfolio of customers and on additional voluntary contribution plans within the public sector, where it is the market leader providing schemes for 73 of the 101 public sector authorities in the UK. For any members who invest into unit-linked funds, the Company will be the likely recipient of that investment.

The performance of the Company for the year-ended 31 December 2016, as provided in section A, is described using the Company's results as presented in its UK GAAP financial statements.

The Company's total operating profit was 10 per cent lower, at £8.5 million, than 2015. This decrease is primarily due to additional regulatory costs for the Company due to Solvency II.

The Company's total non-operating result has increased by £3.0 million to a profit of £2.1 million in 2016. This profit in 2016 is driven by an increase in the value of the Company's non-linked investments. The Company holds some non-linked UK gilts, which have increased in value over the year.

System of governance

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

We keep our governance structures under constant review to ensure they suit the needs of our business and stakeholders. Further information on the Company's system of governance including information on the composition of its Board, key functions, risk management and internal control system is provided in section B.

Risk profile

Our Risk Management Framework is designed to ensure the business remains strong through stress events so we can continue to deliver on our long term commitments to our customers and shareholders. 2016 was a year of extraordinary uncertainty and the financial strength of the Company remained robust throughout.

For our shareholders, we generate value by selectively taking exposure to risks that are adequately rewarded and that can be appropriately quantified and managed. We retain risks within a clearly defined risk appetite, where we believe doing so contributes to value creation and the Company is able to withstand the impact of an adverse stressed outcome.

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

For our retained risks, we ensure that we have the necessary capabilities, expertise, processes and controls to manage appropriately the exposure.

Further information on the main risks inherent in our business (namely market risk, underwriting risk, liquidity risk, operational risk, business environment risk and strategic risk) and how we manage these evolving risks, with the aim of ensuring we maintain an appropriate risk profile is provided in section C.

Valuation for solvency purposes

With effect from 1 January 2016, the Company is required to adopt Solvency II as its capital regime. This was developed by the EU in order to harmonise the various regimes previously applied across EU member states.

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

(i) As a general principle, technical provisions are valued at the amount for which they could theoretically be transferred immediately to a third party in arm's length transaction. The technical provisions consist of the best estimate liability and a risk margin plus a transitional deduction.

(ii) The assets and liabilities of the Company are valued at the amount for which they could be exchanged between knowledgeable and willing parties in arm's length transaction. The assets are valued separately using methods that are consistent with the valuation approach set out in the Solvency II directives.

Further information on the valuation of assets, technical provisions and other liabilities of the Company for solvency purposes is provided in section D, including a discussion of the differences to the UK GAAP financial statements basis.

Capital management

The Company's solvency capital requirement ('SCR') has been met during 2016. At 31 December 2016, the Company's Solvency II surplus at 31 December 2016 was £12.5 million.

A summary of the reconciliation of the Company's shareholder Solvency II position published in the Company's 2016 Annual Report to the Solvency II position, included in the quantitative reporting templates attached to this document, is provided in section E. Additional information on the components of the Company's own funds and SCR is also provided in section E.

A. Business and performance

(Unaudited)

A.1 Business

A.1.1 Overview

Name and legal form

PPL ('the Company', 'we') is a company limited by shares incorporated and registered in England and Wales.

PPL is a wholly owned subsidiary of PAC registered in England and Wales. PAC is a wholly owned subsidiary of Prudential plc. Prudential plc is a public limited company, limited by shares, incorporated and registered in England and Wales. Prudential plc is the parent company of the Prudential group (the 'Prudential Group' or 'the Group'). The Group is an international financial services group, with significant operations in Asia, the United States and the United Kingdom. Prudential plc has primary listing on the London and Hong Kong stock exchanges and secondary listings on Singapore and New York stock exchanges.

The address of the registered office of PPL, PAC and Prudential plc is:

Laurence Pountney Hill
London
EC4R 0HH

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

Supervisory authority and Group supervisory authority

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

Prudential Regulation Authority
Bank of England
Threadneedle Street
London
EC2R 8AH
United Kingdom

The Company is authorised by the PRA to provide regulated products and services, including: carrying out contracts of insurance, accepting deposits, arranging deals in investments and safeguarding and administration of assets .

External auditor

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

KPMG LLP
15 Canada Square
London
E14 5GL
United Kingdom

Holders of qualifying holdings

As at 31 December 2016, PAC is the only holder of qualifying holdings in PPL (being holdings of 10 per cent or more of the voting power).

A.1.2 Group structure

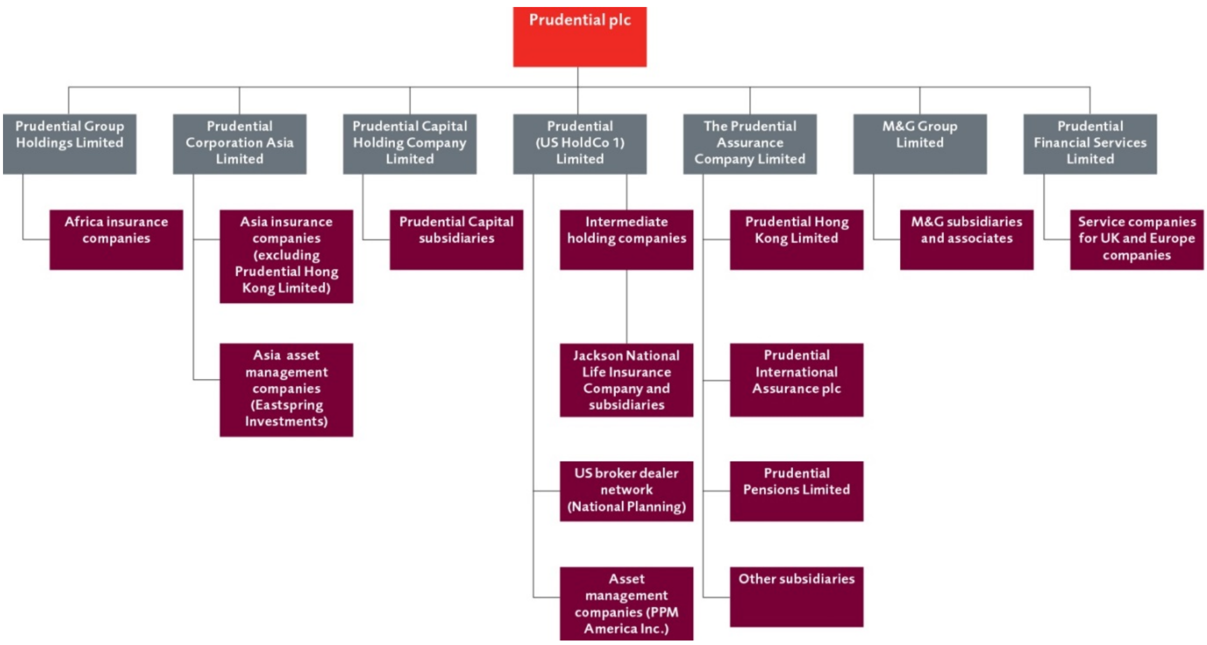
Material subsidiaries

The only material subsidiary of the company is a Fond commun de placement collective investment fund called M&G UK Property Fund FCP-FIS, which is 99.79 per cent owned by the company.

Legal structure of the Group and related undertakings

Prudential plc is the ultimate parent holding company of the Group. Figure 1 below shows, in simplified form, the direct subsidiary undertakings of the parent company, Prudential plc (shares held directly or via nominees) and Prudential's significant subsidiaries as at 31 December 2016.

Figure 1: Simplified structure of Prudential plc as at 31 December 2016



A.1.3 Business and performance

Material lines of business and material geographical areas

All of the Company's long-term insurance business is transacted in the UK. This is mainly into its unit-linked funds, either as directly from pension trusts or reassured from PAC.

PPL offers a range of retail financial products and services, all of which are long-term insurance products.

Most of the Company's unit-linked assets is due to business written directly with defined benefit trustees. However, approximately a third of the Company's linked assets are due to a reassurance of defined contribution corporate pension customers from PAC. Nearly all of the unit-linked corporate pension business written by PAC is reassured to the Company.

PPL has a small amount of non-profit annuity business, the best estimate liability for which is £67.9m (gross of reinsurance) (0.6 per cent of the Company's technical provisions). These annuities are fully reassured to PAC and are closed to new business.

The Company's long-term products consist of pension products and pension annuities. All of the products offered by the company are non-participating products.

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

There have been no significant changes to the company in 2016.

A.2 Underwriting performance

IFRS operating profit is management's primary measure of profitability.

IFRS is used to report the results of the Company to Prudential plc. The Company uses UK GAAP to prepare its solo entity statutory financial statements, and IFRS to report the results of the Company to Prudential plc for inclusion in the Group results. The accounting policies between UK GAAP and IFRS are aligned where possible and as such there are no material differences in operating profit between these two bases. The performance results set out in section A are on a UK GAAP basis, consistent with the Company's solo entity statutory financial statements.

IFRS operating profit is equal to the operating profit on ordinary activities before tax as shown in the statutory accounts less any realised or unrealised gain on the company's non-linked UK gilt investment. This means that the IFRS operating profit equates to premiums less claims (including change in technical provision) plus investment returns. Given the linkage between the movement of technical provisions and movement in investments for unit-linked technical provisions, the Group has defined IFRS operating profit as its underwriting performance as discussed in this section. Similarly, the core discussion of the investment performance of the Group in section A.3 is by reference to short-term fluctuations in investment returns.

An analysis of premiums, claims and investment return is given in section A.5.2 below.

A.2.1 Operating profit overview

Figure 2: Shareholder profit for the year-ended 31 December 2016 (with 31 December 2015 comparison)

	2016 £m	2015 £m	Change %
Operating profit	8.5	9.4	(10)
Non-operating profit	2.1	(0.9)	333

The operating profit is attributable to the Company's unit-linked insurance business. Although the company has written some other life insurance products these are fully reassured to PAC and therefore do not contribute towards the operating profit.

The non-operating profit reflects the unrealised gains and losses achieved on the Company's non-linked UK gilt investment.

A.3 Investment performance

A.3.1 Investment return

In section A.2, the Company describes its UK GAAP performance by reference to operating profit and non-operating profit, the key component of which is UK GAAP short-term fluctuations in investment returns (as described below).

UK GAAP operating profit is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and the assumed longer-term returns is reported within short-term fluctuations in investment returns.

For the Company this short-term fluctuation equates to its return on its non-linked UL gilt investment.

A.3.2 Investment management expenses

The total investment management expenses incurred by the Company's operations, including those that were paid to the Company's asset management operations totalled £20.3 million (2015: £21.6 million).

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

A.4 Performance of other activities

A.4.1 Investments in subsidiaries

As stated in section A1.2 the Company's only subsidiary is a Fond commun de placement collective investment fund. This investment is held within the Company's unit-linked investments, and therefore is subject to changes in investment as policyholders move in and out of the fund.

A.4.2 Leasing

Operating leases

The Company does not act as a lessor or lessee.

Finance leases

The Company does not act as a lessor or lessee.

A.5 Any other information

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

Total profit before tax attributable to shareholders for the year-ended 2016 is £10.6 million (2015: £8.4 million), representing operating profit of £8.5 million (2015: £9.4 million), as set out in Figure 2 and discussed in section A.2.1, and non-operating profit of £2.1 million (2015: loss of £0.9 million). Analysis of profit before tax is shown in Figure 3 below by nature of revenue and charges.

Figure 3: Total revenue and charges for the year-ended 31 December 2016 (with 31 December 2015 comparison)

	2016	2015
	£'000	£'000
Investment income	923,157	895,712
Unrealised gains / (losses) on investments	682,681	(668,212)
Other technical income	17,823	20,994
Total revenue, net of reinsurance	**1,623,661**	**248,494**
Change in provision for claims - gross amount	(8,123)	7,118
Change in provision for claims - reinsurers' share	8,066	(7,118)
Change in technical provision for linked liabilities	(1,718,707)	(241,473)
Net operating expenses	(4,592)	(4,931)
Investment expenses and charges	(5,255)	(6,567)
Foreign exchange gains / (losses)	117,522	14,894
Interest payable	(2)	(58)
Foreign taxation	(1,999)	(1,910)
Profit before tax	**10,571**	**8,449**

A.5.2 Premiums, claims and investment return

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

All of the Company's unit-linked insurance products are deemed to be investment only products. This means that they do not have any features that could describe them as being insurance. Investment only products do not record a premium or a claim, and therefore gross premiums and claims for the Company for these products were £nil in both 2016 and 2015.

The statutory accounts disclose in the policyholder liabilities movement that the deposits received in 2016 were £767.7 million (2015: £757.7 million) and made payments to policyholders of investment contracts of £2,360 million (2015: £2,679 million).

The Company's other life insurance business consists of an annuity product. No premiums were written in 2016 and 2015. Claims of £5.6m were paid to policyholders, but this was fully recovered from PAC as part of a reassurance agreement.

New business sales for the year were £767.7m of single premiums, (2015: £757.7m). The Company's biggest source of premiums continues to be the reassured premiums it receives from PAC.

A.5.2.2 Investment return by asset class

Figure 4: Investment return for the year-ended 31 December 2016 (with 31 December 2015 comparison)

	2016	2015
	£m	£m
Income		
Equity	114.3	119.7
Debt	210.4	247.3
Other	17.7	22.6
Total income	**342.4**	**389.6**
Realised gains/(losses)		
Equity	334.8	202.6
Debt	347.8	301.9
Other	(101.9)	1.4
Total realised gains/(losses)	580.7	505.9
Unrealised gains/(losses)		
Equity	375.9	(113.4)
Debt	310.6	(565.5)
Other	(3.8)	10.7
Total unrealised gains/(losses)	682.7	(668.2)
Exchange gains / (losses)	117.5	14.9
Total investment income	**1,723.3**	**242.2**

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

The changes in investment income is mainly due to the change in individual assets held, as policyholders have moved between the various possible available funds.

The significant switch from unrealised losses to unrealised gains in the year is due to the market movements observed during 2016.

The 'other' assets are mainly derivatives where the company has hedges in place to negate unwanted foreign exchange movement.

B. System of governance

(Unaudited)

B.1 General information on the system of governance

B.1.1 Board governance

As noted in section A.1.1, PPL is a wholly owned subsidiary of PAC which is a material subsidiary of Prudential plc within the Prudential Group.

The Group consists of a number of material Business Units who have management responsibility for the legal entities within the Group. Prudential UK & Europe ('UK&E') includes a number of sub-Business Units including Prudential UK&E Insurance ('UK&EI').

The Chief Executive Officer, UK&EI ('ICEO') reports to the Chief Executive UK&E ('CEO UK&E'), who reports to the Prudential Group Chief Executive.

The ICEO holds the Senior Insurance Manager Function 1 ('SIMF1') role for the Company and has been delegated specific responsibilities by the Board. The ICEO is responsible for the day to day operational management of the Company and runs the business unit through the executive operating structure including an Executive Committee ('EXCOM') and other committees which reflect the three lines of defence model in operation across UK&E.

The PPL Board has an independent non-executive Chairman and two executive directors . The quorum for the Board consists of at least two members, which must include the Chairman.

The current membership of the PPL Board is detailed in Figure 5 below.

Figure 5: Current membership of the PPL Board as at 31 December 2016

PPL Board members	Role
Paul Spencer	Chairman and Independent Non-Executive Director (SIMF 9)
Jeremy Deeks	PPL Director and Insurance CFO (SIMF 2)
Michael Hawes	PPL Director (CF1)

The Board is authorised to exercise all the powers of the Company within any applicable legislation and the provisions of the Articles of Association subject to the limits imposed, approvals required and policies set by UK&EI and the Prudential Group., including the Prudential Group Governance Manual. The Company's risk appetite is part of its parent company's risk appetite framework and is consistent with the Prudential Group Risk Appetite.

The terms of reference for the Board are reviewed on an annual basis and an annual effectiveness review of the Board is also undertaken.

Material changes to the system of governance

During 2016, the constitution of the PPL Board was changed to have an independent non-executive director as Chairman.

B.1.2 Board Committees and decision making

PAC (the immediate parent of PPL) has established a number of committees comprising non-executive directors and independent members to provide independent oversight, challenge and assist the Board in operating effectively. The responsibilities of the principal committees are a key component of the governance framework.

The PPL Board is responsible for:

1. Strategy and Business Plan
- approving the Prudential UK&EI strategy, long term objectives, annual budgets and business plan and approving any company specific subsidiary business plan;
- monitoring the implementation of the Company's strategy and long-term objectives;
- annual budgets and business plan, and oversee any corrective action taken by the Company;

2. Structure and Capital
- approving, subject to the UK&EI Business Unit Governance Manual the following matters:
  - material changes to the Company's corporate structure, including decisions to cease operations in parts of the Company or to extend activities into new business or geographic areas;
  - material changes to the Company's capital structure, including reduction of capital, share issues and the reorganisation or restructuring of capital;
  - the raising of or committing to external finance and financing programmes;
  - material transactions and other matters that require referral to PAC under UK&EI Business Unit Governance Manual;

3. Financial Reporting and Dividends
- approving the Company's Annual Report and Accounts;
- approving payment of dividends;
- monitoring the operation of the long term funds to ensure the fair treatment of policyholders;
- approving any significant changes to the Company's investment strategy, including any significant changes to Investment Management Agreements;
- approving liquidity and funding requirements;
- reviewing the overall financial condition of the Company, and any relevant credit ratings and regulatory capital requirements;

4. Internal Control and Risk Management
- ensuring an effective system of internal control and risk management is in place, maintained and reviewed annually;
- ensuring the overall risk appetite and tolerance of the Company adheres to the Business Unit risk framework, policies and limits;
- adopting the UK&EI risk appetite and risk framework and policies and approving any company specific subsidiary risk appetite, risk framework and policies;
- reviewing and approving where applicable, material disclosures to, and regular reporting required by, regulators;
- adopting Prudential UK&EI internal model governance and major model changes and approving any company specific major model changes;

5. Others
- approving changes to the Board's composition, subject to the approval of the Chief Executive Officer, Insurance UK & Europe (ICEO);
- approving the establishment of, and terms of reference for, committees of the Board, except where that authority is delegated to the PAC Board to approve changes to the Business Unit Board Committees.

Board Committees

The Committees relevant for PPL include the Board Audit Committee ('BAC') and the Board Risk and Capital Committee ('BRCC'), which cover PPL, and have a wider remit over UK&EI activity.

Each Board Committee has written terms of reference, which are reviewed during the course of the year to ensure that these remain in line with best practice and that each committee continues to have suitable delegated authority to fulfil their responsibilities without creating duplication of activities.

The role of the Board Committees together with the current Chairman is summarised in Figure 6 below.

Figure 6: Summary of the role of the PAC Board Committees relevant for PPL as at 31 December 2016

Board/Committe	Role
Board Audit Committee	**Chair : Richard Bennison** The BAC is accountable to the PAC Board and assists the Board in meeting its responsibility for the integrity of the Company's financial statements, for the effectiveness of the Company's internal control and risk management systems and for monitoring the effectiveness and objectivity of the internal and external auditors.
Board Risk and Capital Committee	**Chair : Clive Adamson** The BRCC is accountable to the PAC Board and assists the Board in meeting its responsibility for overseeing the effectiveness of risk and capital management frameworks for all financial and non-financial risks faced by UK&EI. The Committee also oversees compliance with the Group Risk Framework, related Group Risk Policies and Group Approved Limits.

The key functional control areas of Risk, Internal Audit, Compliance and Actuarial report to the respective Board Committees in accordance with each Committee's terms of reference. It is the responsibility of the BAC to review the resources of Internal Audit and Compliance through review of annual plans.

Further information of the key functions, e.g. Risk, Compliance, Group-wide Internal Audit and Actuarial is given in sections B.3.2, B.4.2, B.5 and B.6, respectively.

B.1.3 Remuneration Policy

Prudential's Remuneration Policy and practices ensure that the Business Units and the Group Head Office have an effective approach in place to reward our employees in an appropriate way that:

- aligns incentives to business objectives in order to support the delivery of Group and Business Unit business plans and strategies;
- enables the recruitment and retention of high calibre employees and incentivises them to achieve success for their Business Unit and the Group; and
- is consistent with the organisation's risk appetite.

Remuneration practices within the UK&EI and the statutory entities within it follow Prudential Group Remuneration Policy and there is no separate remuneration policy at the Business Unit level.

The principles of the Remuneration Policy, implemented within the Company and UK&EI are:

- Pay for Performance
- Tailored to the relevant market
- Interest in Prudential shares
- Business Unit and Group focus
- Shareholder value creation
- Fair and transparent system for all
- Designed to minimise regulatory and operational risk
- Safeguards to avoid conflicts of interest

Remuneration architecture

Both fixed and variable remuneration is assessed against market data and internal relativities on an annual basis and balanced so that the fixed component represents a sufficiently high proportion of the total remuneration to avoid employees being overly dependent on the variable components and to mitigate unintended consequences and inappropriate behaviours to the detriment of customer outcome.

Variable remuneration available to employees includes short term-incentives (i.e. annual bonus, quarterly sales incentives for sales staff) and long-term incentive plan ('LTIP') awards.

Annual bonus measures include various combinations of UK&EI financial and / or strategic targets, Group financial targets, functional targets and individual performance reflecting the level, nature and scope of the role and the practice in the market in which UK&E operates. Currently, annual bonus awards are based on Business Unit business and individual performance and potential, and market practice. This allows the Group and Business Units to operate a fully flexible bonus policy, including the possibility of not paying annual bonus based on financial and non-financial criteria.

Awards made under the Group's LTIP plans include Group and Business Unit financial metrics. The LTIP awards to senior executives are made under the Prudential LTIP and include a Group target to ensure their remuneration includes a link to the overall results of the Group. Senior leadership beyond UK&E and UK&EI EXCOM receive LTIP awards based on Business Unit targets only.

Prudential does not operate supplementary pension or early retirement schemes at Group or Business Unit level. Two of the members of the UK&EI EXCOM and one key function holder participate in one of the legacy defined benefits schemes. The scheme provides an accrual of 1/60 of final pensionable earnings for each year of pensionable service or the earnings cap. The defined benefit schemes are closed to new members.

Governance processes deliver robust oversight of reward, effective management of conflicts of interest and reflect the need to link remuneration decisions with Prudential's risk appetite.

The Group Chief Risk Officer is actively involved in ensuring that remuneration across the business reflects the extent to which decisions were made within the organisation's risk appetite. The Group Chief Risk Officer reports to the Remuneration Committee, in writing, at least once a year providing:

- input to the Committee's decision on risk adjustment of bonus awards; and
- information on the performance of the Group against risk appetite.

Similarly, the UK & Europe Chief Risk and Compliance Officer provides written reports to UK & Europe Remuneration Committee on an annual basis, covering behaviours and adherence to risk appetite and providing input on variable remuneration outcomes for those employees within the remit of the Committee.

B.1.4 Material transactions with directors and shareholders

Transactions with Directors

Executive officers and directors of the Company may, from time to time, purchase insurance, asset management or annuity products marketed by the Group's companies in the ordinary course of business on substantially the same terms as those prevailing at the time for comparable transactions with other persons.

In 2016 and 2015, other transactions with directors were not deemed to be significant both by virtue of their size and in the context of the directors' financial positions. All these transactions are on terms broadly equivalent to those that prevail in arm's-length transactions.

Transactions with shareholders

There were no transactions with the shareholders in 2016.

B.2 Fit and proper requirements

UK&EI ensures that senior managers are fit and proper through the implementation of a Fit and Proper Policy.

There is an annual certification programme to demonstrate compliance with the Group Governance Manual, which includes the Fit and Proper Policy, and the system of internal control each year-end by each Business Unit and the Group Head Office.

The Policy applies to:

- all persons approved as PRA Senior Insurance Management Functions;
- all persons approved as Financial Conduct Authority ('FCA') Significant Influence Functions;
- all persons defined as Key Function holders and notified to the regulator; and
- all persons defined as notified non-executive directors and notified to the regulator.

B.2.1 Fit and proper criteria

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

- honesty, integrity and reputation, i.e. that they will be open and honest in their dealings and able to comply with the requirements imposed on them;
- competence and capability, i.e. that they have the necessary skills to carry on the function they are to perform; and
- financial soundness.

B.2.2 Processes for assessments

Processes for assessing fitness and propriety

The Company has processes for assessing the fitness and propriety of persons covered under the Fit and Proper Policy. These processes are described below.

- Develop and maintain appropriate processes for assessing the fitness and propriety of persons covered under the Fit and Proper Policy, including Key Function Performers; this may involve a number of direct questions and independent checks.
- During the recruitment process and before any regulatory application is made, an assessment of the person's fitness is conducted including:
    - The person's professional and formal qualifications.
    - Knowledge and relevant experience within the insurance sector, other financial sectors or other businesses.
    - Where relevant, the insurance, financial, accounting, actuarial and management skills of the person.
- During the recruitment process and before any regulatory application is made, an assessment of the person's propriety is conducted including integrity, honesty, and financial soundness, based on evidence regarding their character, personal behaviour and business conduct, including any criminal, financial and supervisory checks.
- In relation to outsourced key functions, an individual who is responsible for assessing the fitness and propriety of the service provider is identified.

Ongoing assessment fitness and propriety

- Sufficient evidence is gathered at least annually, to assess the ongoing Fitness and Propriety of individuals captured by SIMR, including key function performers and notified non-executive directors. This includes an assessment of whether the individuals are adhering to the relevant PRA/FCA Conduct Standards and Rules.
- The Compliance Function are notified where there is a change in the fit and proper status of any SIF, SIMF or Key Function Holder.
- The PRA and FCA are notified of any change to the fit and proper status of SIMFs, SIFs or Key Function Holders, including instances of where these individuals have been replaced because they are no longer fit and proper.
- The PRA and FCA is notified as soon as reasonably practicable when a breach has occurred in the Conduct Standards and Rules that has a material impact on the assessment of an individual's fitness and propriety.
- Compliance is notified as soon as reasonably practicable in the event of a breach of the Fit and Proper Policy requirements.

B.3 Risk management system including the ORSA

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

The Company defines 'risk' as the uncertainty that we face in successfully implementing our strategies and objectives. This includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the company. As such, material risks will be retained selectively, where there we think there is value to do so, and where it is consistent with the Group's and the Company's Risk Appetite and philosophy towards risk-taking.

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

Risk governance

Risk governance comprises the organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies that are established to make decisions and control their activities on risk-related matters form the foundation of the Group's and PPL's risk governance. This encompasses individuals, Group-wide functions (such as Group-wide Internal Audit), and committees involved in the management of risk.

(i) Risk committees and governance structure

The Company's risk governance structure is led by the BRCC, the members of which are independent non-executive directors. The BRCC assists the Board in providing leadership and oversight of the Company's overall risk appetite in addition to guidance on risk tolerance and strategy. The Committee oversees and advises the Board on the current and potential future risk exposures of the Company, reviewing and approving the Company's Risk Management Framework, monitoring its effectiveness and adherence to the various risk policies. The BRCC also supports the Board and management in embedding and maintaining a supportive culture in relation to the management of risk.

In addition, there are various executive risk forums to ensure risk issues are considered and escalated appropriately. These are led by the Executive Risk Committee ('ERC') which is supported by a number of technical sub-committees that have members with the specialist skills required.

(ii) Risk Management Framework

The Company's Risk Management Framework has been developed to monitor and manage the risk of the business at all levels and is owned by the Board. The aggregate exposure to the key risk drivers is monitored and managed by the Risk Function whose responsibility it is to review, assess and report on the Company's risk exposure and solvency position.

The Risk Management Framework requires the establishment of processes for identifying, evaluating and managing the key risks faced by the company - the 'Risk Management Cycle' and is based on the concept of the 'three lines of defence', comprising risk taking and management, risk control and oversight, and independent assurance.

A major part of the Risk Management Cycle is the annual assessment of the Company's risks which are considered key. These key risks range from risks associated with the economic, market, political and regulatory environment; those that we assume when writing our insurance products and by virtue of the investments we hold; and those that are inherent in our business model and its operation. This is used to inform risk reporting to the risk committees and the Board.

(iii) Risk appetite, limits and triggers

The extent to which we are willing to take risk in the pursuit of our objective to create shareholder value is defined by a number of risk appetite statements, operationalised through measures such as limits, triggers and indicators. The Company's risk appetite is approved by the Board and is set with reference to economic and regulatory capital, liquidity and earnings volatility. The Company's risk appetite is aimed at ensuring that we take an appropriate level of aggregate risk and covers all risks to shareholders. We have no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement and monitor appropriate controls to manage operational risks. Limits operate within the risk appetite to constrain the material risks, while triggers and indicators provide further constraint and ensure escalation. The Chief Risk & Compliance Officer determines the action to be taken upon any breaches.

The Risk Function is responsible for reviewing the scope and operation of these measures at least annually, to determine that they remain relevant. The Board approves all changes made to the Shareholder and Policyholder Risk Appetite Framework.

The Company sets its risk appetite in order to assist the business in implementing the strategy and achieving business plan objectives, whilst operating within relevant tolerances and limits defined by the Board and the risk strategy. As part of this, the Company's risk appetite and limits are cascaded from the Group Approved Limits Framework but aligned with the actual risk profile and risk management objectives of the Company, with specific controls introduced as needed.

Key elements of the risk appetite framework are as follows:

- articulation of the aggregate level and types of risk the Company is willing to take in the pursuit of its business objectives. These risk appetites are further defined for the most significant financial and non-financial risk exposures arising from the shareholder and policyholder business;
- specific UK quantitative risk limits and granular risk triggers and controls are set to operationalise the qualitative risk appetites and facilitate risk monitoring against those; and
- monitoring against risk appetite is done through monthly risk management information presented to Board and ERC or ad-hoc papers on material issues. Any changes to the risk appetite framework require Board approval.

(iv) Risk policies

Risk policies set out the specific requirements which cover the fundamental principles for risk management within the Risk Management Framework. Policies are designed to give some flexibility so that business users can determine how best to comply with policies based on their expertise.

There are core risk policies for credit, market, insurance, liquidity, conduct and operational risks, and a number of internal control policies covering internal model risk, underwriting, dealing controls and tax risk management.

(v) Risk standards

The Company adopts and complies with the Group-wide Operating Standards which provide supporting detail to the higher level risk policies. In many cases they define the minimum requirements for compliance with Solvency II regulations which in some areas are highly prescriptive. The standards are more detailed than policies.

Our risk culture

Culture is a strategic priority of the Board who recognise the importance of good culture in the way that we do business. Risk culture is a subset of broader organisational culture, which shapes the organisation-wide values that we use to prioritise risk management behaviours and practices.

An evaluation of risk culture is part of the Risk Management Framework and in particular seeks to identify evidence that:

(i) senior management articulate the need for good risk management as a way to realise long-term value and continuously support this through their actions.
(ii) employees understand and care about their role in managing risk - they are aware of and openly discuss risk as part of the way they perform their role; and
(iii) employees invite open discussion on the approach to the management of risk.

Key aspects of risk culture are also communicated through the Code of Conduct and the policy set, including the commitments to the fair treatment of our customers and staff. The approach to the management of risk is also a key part of the evaluation of the remuneration of executives. Risk culture is an evolving topic across the financial services industry and we will be continuing work to evaluate and embed a strong risk culture through 2017.

The risk management cycle

The risk management cycle comprises processes to identify, measure and assess, manage and control, and monitor and report on our risks.

(i) Risk identification

Risk identification is derived through a number of processes, in particular the top risk, bottom-up risk, emerging risk, short- to medium-term horizon scanning, and own risk and solvency assessment processes. Each of these is designed to identify and assess risk from a different perspective to form an overall understanding of the business' risk profile and its evolution.

(ii) Own Risk and Solvency Assessment

The Own Risk and Solvency Assessment Report pulls together the analysis performed by a number of risk and capital management processes, and provides quantitative and qualitative assessments of the Company's risk profile, risk management and solvency needs on a forward looking basis. The scope of the Own and Risk Solvency Assessment Report covers the full known risk universe of the Company.

(iii) Risk measurement, assessment, monitoring and reporting

Metrics used to measure risks include market values, best estimate liabilities, Solvency II regulatory capital requirements ('Pillar I') and economic capital requirements ('Pillar II') and impact on earnings. Point-in-time measures are supplemented by quarterly sensitivities and stress and scenario testing.

Operational risk is less easily quantifiable, however, a risk incident process is in place to ensure that incidents and risk events are identified and appropriately managed in a timely manner in line with the Operational Risk Framework.

Risk exposures are evaluated in terms of their relative position against the Company's risk appetite to assess materiality in order to determine the appropriate response. In addition, an ongoing system of risk monitoring and reporting is in place to communicate insight, enable risk-based decision-making, and drive action as needed.

B.3.2 The Risk Function

The Company's risk governance arrangements, which support the Board, the BRCC and the BAC, are based on the principles of the 'Three Lines of Defence' model: risk taking and management, risk control and oversight, and independent assurance.

Within the Three Lines of Defence model, the Risk Function is structurally independent of the 1st Line of Defence ('1st Line') and is responsible for risk control and oversight. While the 1st Line has responsibility for risk-taking, which is constrained within clear parameters, the Risk Function assists the Board to formulate, and then implement, the approved Risk Appetite and Limit Framework, risk management plans, risk policies, risk reporting and risk identification processes. The Risk Function also reviews and assesses the risk taking activities of the 1st Line, where appropriate challenging the actions being taken to manage and control risks and approving any significant changes to the controls.

Broadly, the Risk Function has the following main responsibilities but is not limited to:

- Co-ordinating identification and assessment of key risks to establish the risk profile used as a basis for setting quantitative risk appetite statements and limits, management information received by the BRCC and the Board, assessment of solvency needs and determining appropriate stress and scenario testing.

- Providing an overall coordination and control of the effectiveness and efficiency of risk management processes and systems.

- Supporting the Board and management in embedding and maintaining a supportive culture in relation to the risk management.

- Through oversight and the internal model validation process, ensuring that the development of the internal model is within the framework of model governance and remains fit for purpose.

- Reporting on material exposures against risk appetite which also includes ongoing developments in the Company's top and emerging risks.

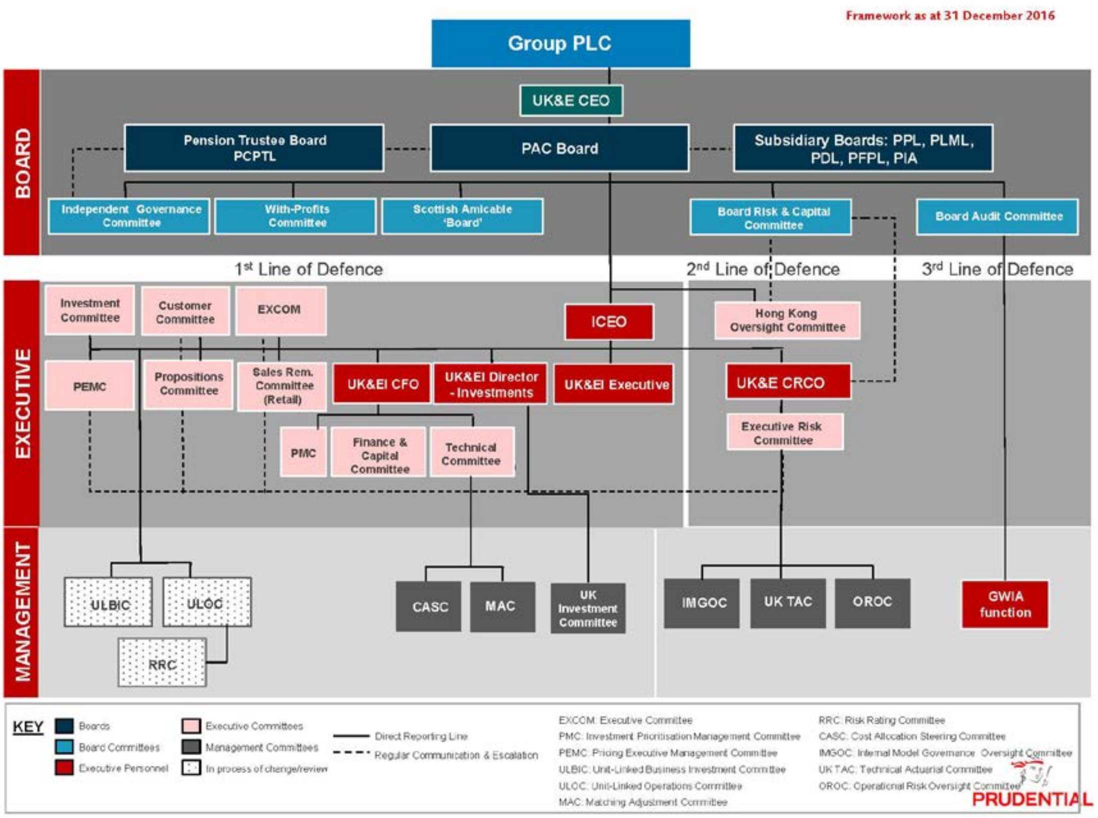
- Providing input and review of public and regulatory disclosures, such as the annual SFCR.

- Performing Own Risk and Solvency Assessment, undertaking stress and scenario testing including Reverse Stress Testing and informing the key areas of risk based decision making.

- Considering material findings from regulatory reviews and interactions with regulators which impact on risk governance or risk management processes.

In order to fulfil these responsibilities, the Risk Function often liaises with other functions (e.g. Actuarial and Compliance), to provide technical expertise and advise throughout the risk management cycle.

Figure 7: UK & Europe Insurance Governance Structure as at 31 December 2016



B.3.3 Internal model

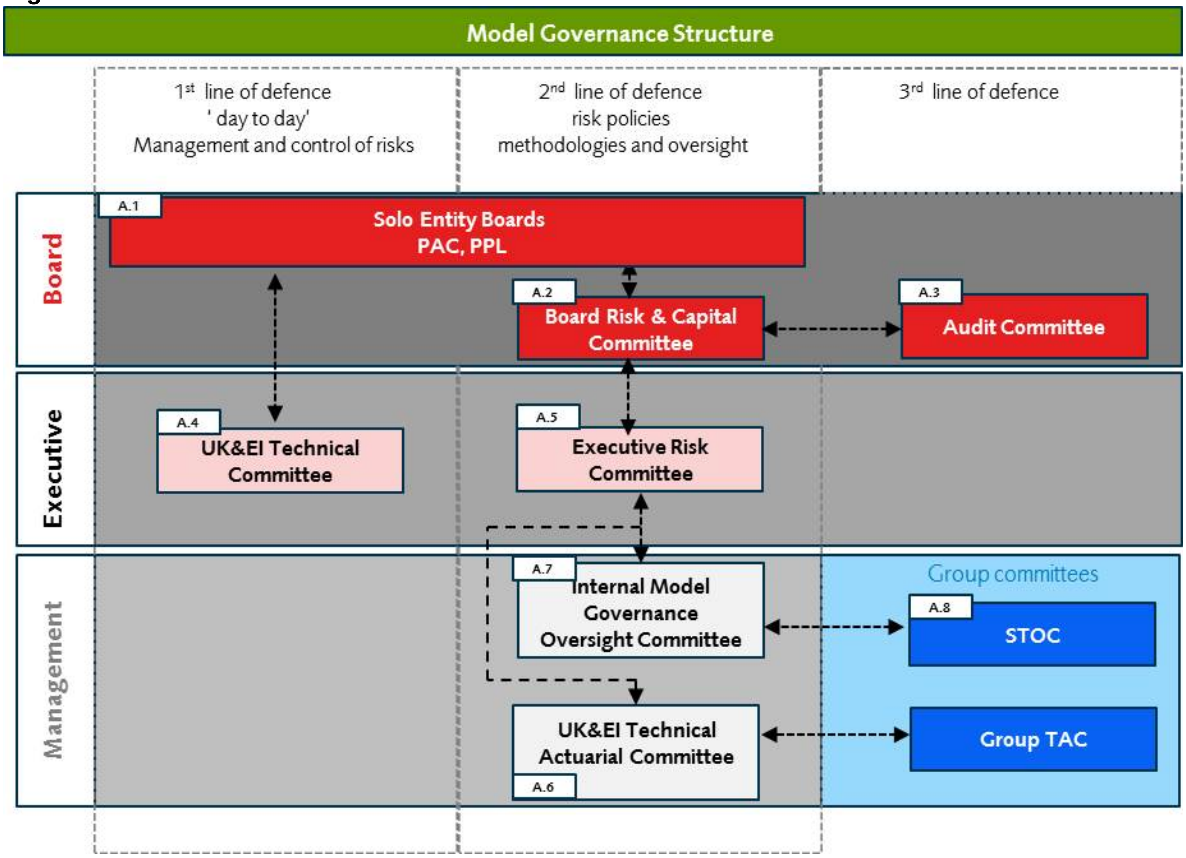
The Solvency II internal model is a key risk management tool and refers to the systems and processes used to identify, monitor and quantify risks for the purpose of calculating the Solvency II capital requirement ('SCR', 'Pillar I') and management's own assessment of economic capital ('ECap', 'Pillar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

To ensure that the internal model is, and continues to be, suitable to support this assessment of risk and capital, UK & Europe Insurance has implemented a governance and control framework in relation to:

- model use: to provide that the model is widely used in the business, playing an important role in the system of governance and decision-making processes;
- model change: where changes to the internal model are required (e.g. adjustments, enhancements), these are enacted in a consistent and controlled manner with consideration of any potential implications;
- model limitations, assumptions and judgements: to note the circumstances under which the internal model does not work effectively, including where assumptions and judgements are made, making sure these are reasonable and understood by those who may rely upon any model output; and
- model validation: to confirm that the capital requirements resulting from the internal model remain appropriate through an annual schedule of rigorous and independent testing.

This model governance framework is implemented in accordance with the Prudential Group Internal Model Risk Policy which, in turn, is aligned with relevant requirements of the Solvency II Directive. Further Policies and Operational Standards support the application of the Internal Model Risk Policy, with a committee structure in place to manage and oversee the framework as set out in Figure 8 below.

Figure 8: Committee Structure to oversee the Internal Model Governance



Validation process

The Internal Model Governance Oversight Committee ('IMGOC') and the UK Technical Actuarial Committee ('UK TAC') have responsibility for ensuring that the Internal Model is, and continues to be, suitable to support the assessment of risk and capital and that it complies with all regulatory requirements. The IMGOC is responsible for overseeing the Internal Model, including independent validation of the model. The UK TAC is responsible for reviewing and approving the methodology, and assumptions for the Internal Model, including any changes to the model. The IMGOC and UK TAC report to the UK&EI ERC, chaired by the UK&E Chief Risk and Compliance Officer (CRCO). The CRCO reports to the Board(s) as necessary on matters relating to the Internal Model.

The model oversight and governance is supported by the implementation of the Internal Model Risk policy which forms part of UK&EI's risk management framework. The policy defines:

- minimum standards for effective model risk management by Business Units including Group Head Office;
- processes for UK&EI Risk functions and relevant management bodies to monitor and manage model risk and ensure the Internal Model is fit for purpose ("model governance"); and
- flows of management information (MI) required to manage model risk and to meet the needs of external stakeholders and in doing so, fulfil the relevant legislation and supervisory requirements and rating agency requests.

The policy is in line with the Prudential Group Internal Model Risk policy and the relevant requirements of the Solvency II regulations for Internal Models. The policy gives rise to the following key requirements with respect to governance of the Internal Model:

- establish controls for the Internal Model;
- ensure appropriate documentation of the model, methodology, assumptions and inputs. This should include identification of the models' limitations and weaknesses;
- ensure the users of the model have an adequate understanding of the Internal Model;
- establish and maintain a system for making and managing changes to the Internal Model; and
- establish and maintain a system for validation for the Internal Model.

Compliance with the policy is attested to, and overseen by the IMGOC, on an annual basis.

Material changes to the internal model governance

During 2016, the UK&EI Technical Actuarial Committee was established.

B.3.4 Own risk and solvency assessment

The Company defines the Own Risk and Solvency Assessment ('ORSA') as the ongoing process of identifying, assessing, controlling, monitoring and reporting the risks to which the business is exposed, and of assessing the own funds necessary to ensure that the Company's solvency needs are met at all times. Risk appetite and limits are the key controls that apply on the current and future risk profile, as a result of the Company's strategy and business plan, and ensure that the company complies with its solvency requirements on a continuous basis under a reasonable range of scenarios. This process is documented and evidenced through an ORSA report. The ORSA is performed at least annually, and more frequently if there is a significant change in the Company's risk profile following any internal actions or a change in the external environment.

The ORSA report combines the analysis performed by and the outcomes of the ongoing risk and capital management processes that are embedded and which have usually been reviewed by various Committees such as the ERC and Board Risk and Compliance Committee . It provides a quantitative and qualitative assessment of the Company's risk profile and solvency needs on a forward looking basis incorporating the Company's strategy and business plan.

The scope of the ORSA report covers all the known risks of the Company.

Figure 9 below sets out the key responsibilities of the ORSA stakeholders in the production of the ORSA report.

Figure 9: High level overview of ORSA responsibilities

Stakeholder	Roles
PPL Board	Steer and challenge throughout the ORSA process, approving the ORSA report.
UK&EI Chief Risk and Compliance Officer	Ownership of the ORSA report.
UK&EI Risk	Preparation of the ORSA report, collaborating with functional areas as needed.
UK&EI Finance	Preparation of quantitative inputs to ORSA report.

The ORSA is recognised as a valuable component of the Company's business, providing an integral framework to understand the interplays between strategy, risk and capital. In embedding the ORSA within the business, the centrality of the internal model within business decision-making is considered a key attribute. Other important attributes include the integration of the ORSA with other key business processes, top-down understanding, steering and challenge of the process, and the use of ORSA related findings and conclusions in decision-making.

B.4 Internal control system

B.4.1 Overview

The internal control system for the Company consists of the policies, processes, structures and other arrangements that are used – across the Three Lines of Defence – to give effect to the agreed approach to risk management. The internal control framework is a central part of the risk management system with a key role in the management of risks that are significant to the fulfilment of business objectives, and maintaining positions within agreed risk appetite and tolerance.

The purpose of the internal control system is to set the parameters and procedures that ensure the effectiveness and efficiency of operations, the reliability of reporting (both internal and external) and compliance with regulatory and other requirements.

The Board has delegated authority to the BAC to review the framework and effectiveness of the systems of internal control. The BAC is supported in this responsibility by the assurance work carried out by Group-wide Internal Audit.

B.4.2 Compliance Function

The purpose of the Compliance Function, which is part of the 2nd Line of Defence, is to advise on compliance with the laws, regulations and administrative provisions in respect of the Solvency II Directive by ensuring that the UK&EI internal control system remains effective and by reporting to the Board in respect of compliance with the Group Governance Manual.

The Compliance Function provides dedicated support for regulatory interactions, including co-ordinating regulatory activity across the business, and provision of support and advice to the business on regulatory matters as well as future policy developments. The Compliance Function also provides guidance, advice and feedback on regulation, as well as setting, and advising on, compliance standards. Routine monitoring and deep dive activities are carried out, to assess compliance with regulatory rules and legislation. In addition, the Compliance Function undertakes other activities which support the business and the wider governance framework, such as business education and training.

The Group Compliance Policy sets out the principles and minimum requirement by which the Company conducts its business and controls the scope covered by the policy. The policy includes requirements to:

- treat customers fairly openly and honestly;
- provide and promote a range of products and services that meet customer needs, are easy to understand and that deliver real value;
- maintain honest, constructive and open relationships with governments and regulators to ensure mutual trust, respect and understanding;
- comply with all Group Policies, as well as applicable laws, rules and regulations in every country in which we operate;
- accept responsibility in all its activities for compliance with the spirit as well as the letter of all applicable laws, rules and regulations;
- act with due skill, care and diligence;

- ensure that an effective compliance culture thrives and operates at all levels of the business; and
- maintain appropriate means of identifying, assessing, managing and reporting regulatory compliance risks within Business Units and on an aggregated basis across the Group.

B.5 Internal Audit Function

Internal Audit is implemented through a Group-wide Function, therefore, references to Group-wide Internal Audit ('GwIA') are relevant to the Company's Internal Audit Function.

How the Company's Internal Audit Function is implemented

The work of Group-wide Internal Audit is part of the overall Internal Control Framework of the Prudential Group in that it operates as a 3rd Line of Defence in providing independent and objective internal control assurance.

GwIA's primary objective is to assist the Board, Group EXCOM, Group Audit Committee and Group Risk Committee in protecting the assets, reputation and sustainability of the organisation through the assessment and reporting of the overall effectiveness of risk management, control and governance processes across the Group; and by appropriately challenging Executive Management to improve the effectiveness of those processes.

The audit department is led by the UK&EI Audit Director whose primary reporting line is to the Group-wide Internal Audit Director, with a secondary administrative reporting line to the UK&EI Chief Executive Officer and with direct access to the Chair of the BAC, as required. The global Group-wide Internal Audit function also has a Quality Assurance Director, whose primary role is to monitor and evaluate adherence to industry practice guidelines and Group-wide Internal Audit's own standards and methodology. Internal audit resources, plans, budgets and its work are overseen by both the Prudential Group Audit Committee and the BAC.

Group-wide Internal Audit activity is not restricted in scope in any way and is empowered by the Prudential Group Audit Committee to audit all parts of the Prudential Group and has full access to any of the organisation's records, physical properties and personnel. All employees are required to assist Group-wide Internal Audit in fulfilling its roles and responsibilities.

The UK&EI Audit Director submits an annual audit plan to the BAC for review and approval. The audit plan is also agreed with the Group Audit Committee. The annual audit plan is based on prioritisation of the identified 'audit universe' using an 'audit needs' risk-based methodology, incorporating input from Group and Business Unit stakeholders and is subject to ongoing review.

Group-wide Internal Audit adheres to the Institute of Internal Auditors requirements as set out in the Institute of Internal Audit's 'Code of Ethics' and 'International Standards for the Professional Practice of Internal Auditing', and the Chartered Institute of Internal Auditor's revised guidance, 'Effective Internal Audit in the Financial Services Sector'.

Group-wide Internal Audit adheres to the requirements for internal audit functions set out in the Solvency II Directive 2009/138/EC (Level 1 text) Article 47 and Delegated Regulation (EU) 2015/35 (Level 2 text) Article 271

Group-wide Internal Audit adheres to the requirements of the Senior Insurance Managers Regime and the Group's Fit and Proper Policy.

How the Company's Internal Audit Function maintains its independence and objectivity from the activities it reviews

GwIA maintains its independence and objectivity in the discharge of its responsibilities and appropriate reporting lines are in place to support this goal.

- The audit department is led by the UK&EI Audit Director who is accountable to the BAC with direct access to the Chair of the Committee and reports to the Group-wide Internal Audit Director. For administrative purposes (excluding strictly all audit related matters) the UK&EI Audit Director is a direct report of the UK&EI Chief Executive Officer.
- The UK&EI Audit Director reports audit related matters to the BAC and communicates directly with the BAC through attendance at its meetings.
- The UK&EI Audit Director, in consultation with the UK&EI Chief Executive Officer, is empowered to attend and observe all or part of Board meetings and any other key management decision making committees and activities as appropriate.
- In accordance with the Group-wide Internal Audit Charter, UK&EI has an internal audit team, led by the UK&EI Audit Director who reports to the Group-wide Internal Audit Director as functional head, with direct access to the Chair of the BAC. The Group-wide Internal Audit Director will consider the independence, objectivity and tenure of the UK&EI Audit Director when performing their appraisals.
- The function also has an autonomous Quality Assurance Director, whose primary role is to monitor and evaluate adherence to industry practice guidelines and Group-wide Internal Audit's own standards and methodology.
- The assessment of the adequacy and effectiveness of the Risk, Compliance and Finance Functions is within the scope of Group-wide Internal Audit and as such Group-wide Internal Audit is independent of these functions and is neither responsible for, nor part of, them.
- Group-wide Internal Audit staff are expected to exhibit the highest level of professional objectivity in carrying out their duties; must make a balanced assessment of all relevant circumstances; remain impartial; and seek to avoid any professional or personal conflict of interest.
- Group-wide Internal Audit has a Conflicts of Interest Policy. Potential conflicts are recorded and monitored by the Group-wide Internal Audit Quality Assurance Director, including a quarterly review of reported conflicts to assess appropriate management oversight. Where deemed necessary, the Quality Assurance team will review audits where a potential conflict has been identified to ensure conformance with Group-wide Internal Audit Policy.

B.6 Actuarial Function

Within UK&EI, the Actuarial Function is defined as the Chief Actuary, his team within the Risk department, and specified individuals within the Finance Function who are responsible for carrying out the tasks of the Actuarial Function. The role of the Chief Actuary is a Prudential Regulation Authority Senior Insurance Management Function and has responsibility for all of the activities of the Actuarial Function. The UK&EI Chief Actuary and his team form part of Prudential Group's Actuarial Function.

The need for, and the scope of, the Actuarial Function is defined in Article 48 of the Solvency II Directive. This sets out the tasks that the Actuarial Function is responsible for. In addition to the tasks defined in Article 48 of the Solvency II Directive, the Chief Risk and Compliance Officer as the head of the Risk Management Function has delegated a number of the Risk Management responsibilities to the Chief Actuary, in particular oversight of the calibration and calculation of the SCR. This ensures that the Actuarial Function is embedded in the key stages of the risk management system in relation to the calculation of the capital requirements.

The key activities undertaken by the Actuarial Function to meet its responsibilities are summarised below:

Valuation of technical provisions

The UK&EI Finance Function propose the valuation methodology, assumptions and calculate the technical provisions. The Chief Actuary reviews the valuation methodology and assumptions, the models and data used in the calculation of the technical provisions and the technical provisions and advises the Board accordingly. The report to the Board constitute a component report of the overall Actuarial Function Report.

Underwriting Policy

The Chief Actuary reviews and advises on all aspects of the Underwriting Policy on an ongoing basis. In addition, he carries out an annual review of specific aspects of the policy. The Chief Actuary provides an annual report to the Board expressing an opinion on the Underwriting Policy, identifying any deficiencies and providing recommendations. This constitutes a component report of the overall Actuarial Function Report.

Reinsurance arrangements

The Chief Actuary reviews and advises on all aspects of the reinsurance arrangements on an ongoing basis. In addition, he carries out an annual review of specific aspects of the Reinsurance Policy. The Chief Actuary provides an annual report to the Board expressing an opinion on the adequacy of the reinsurance arrangements, identifying any deficiencies and providing recommendations. This constitutes a component report of the overall Actuarial Function Report.

Capital requirements

The UK&EI Finance Function propose the valuation methodology and assumptions, and calculate the SCR. The Chief Actuary reviews the valuation methodology and assumptions and the SCR and advises the Board accordingly. The Chief Actuary also chairs the internal management committee with responsibility for internal capital model methodology and assumptions.

Actuarial Function Report

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

B.7 Outsourcing

The Company uses outsource and third party supply providers to allow focus on its core business strengths, reduce costs and manage its delivery risks. The Company recognises that the use of outsourcers (whether intra-group or external third parties) can impact its risk profile. There is a risk with outsourcing and third party supply arrangements that the outsourcer / supplier could fail, which could result in significant business interruptions, liability for losses and costs, reputational damage and regulatory breaches. The Company retains ultimate responsibility for any activity that is supplied or outsourced.

The Company has material external and intra-group outsource providers. The external providers supply customer servicing, policy administration, new business processing, claims activity and related IT support services located in the UK and India, and back office administration for pension schemes and annuities located in the UK. The intra-group outsourcers provide IT infrastructure support services and investment strategy and portfolio management services located in the UK.

The Company has an Outsourcing and Third Party Supply policy in place, which forms part of the overall Risk Management Framework and is aligned with the three lines of defence governance model. This policy sets out the requirements for the management of all outsourcing and third party supply arrangements across UK&EI and is aligned with relevant policies, which address specific outsourcing topics, e.g. data security, information risk, and business continuity. It is compliant with regulatory requirements for outsourcing and covers the full lifecycle of managing outsourcers and third parties, from procurement to managing and monitoring and relationship, and exiting a contract. The Outsourcing and Third Party Supply Policy provides definitions of types of outsourcer (e.g. external, intra-group) and criticality of arrangements, along with minimum requirements to manage them. Attestation of compliance to the Outsourcing and Third Party Supply Policy is completed on an annual basis by the Chief Financial Officer and is overseen by UK&EI Risk.

B.8 Any other information

The effectiveness of the system of internal control and risk management is reviewed regularly and the outcomes are considered by the Board and its sub-committees. As part of the evaluation, the Chief Executive and Chief Financial Officer report on compliance with the Group's governance policies and the internal control and risk management requirements. The UK&EI Risk Function facilitates a review of the matters identified by this certification process. This includes the assessment of any risk and control issues reported during the year, and the findings from the reviews undertaken by Group-wide Internal Audit, which carries out risk-based audit plans across the Group. Issues arising from any external regulatory engagement are also taken into account.

Prudential is conducting a Past Business review of T non-advised annuity sales made by the Company, and PRIL in respect of the Part VII transferred business, from 1 July 2008. This follows the Financial Conduct Authority's thematic review of non-advised annuity sales practices, which identified that Prudential's sales process and in particular its telephone interactions with customers, may not have provided adequate information about the customers' potential eligibility for an enhanced annuity and the benefits of shopping around for an enhanced annuity. A review of the treatment of legacy business is underway following the FCA's thematic review of long-standing customers in the life insurance sector. This will address certain customer communications, the management of products and the customer outcomes demonstrated.

C. Risk profile

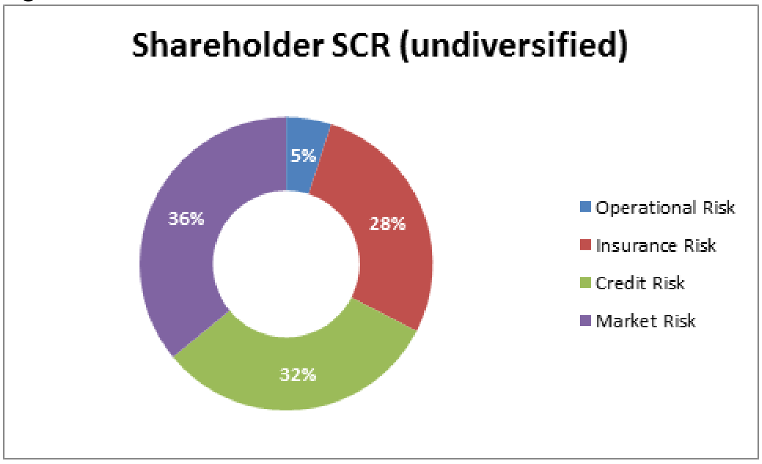
(Unaudited)

Under the Solvency II regime, companies are required to manage their solvency position in line with the Solvency II regulatory SCR. Companies are also required to form their own views of the capital needed to ensure that they can meet liabilities as they fall due, allowing for the risks that they retain (Solvency II Pillar II or Economic Capital requirements). For the Company, the regulatory basis is the focus for the purpose of the capital assessments.

Due to the nature of PPL's unit-linked business whereby policyholder liabilities are essentially the same as the net asset values backing those liabilities, its exposure to financial risk is limited. Nevertheless, the business does have some exposure to insurance (i.e. persistency and expense) risk and market (i.e. investment return) risk. PPL has limited exposure to credit risk due to the close matching of policyholder liabilities to attaching asset value movements.

The charts below show the undiversified SCR risks in relation to PPL at 31 December 2016.

Figure 10: Undiversified SCR for PPL as at 31 December 2016



The key risk exposures are discussed in the following sections:

- Underwriting risk or insurance risk, which includes persistency and expense (refer to section C.1).
- Market risk (refer to section C.2)
- Credit risk (refer to section C.3)
- Operational risk (refer to section C.4)
- Other risks (refer to section C.5)

C.1 Underwriting risk

C.1.1 Risk exposure and mitigation

The Company is exposed to material levels of underwriting risk (or insurance risk) as a result of its insurance business operations. Given the nature of the PPL business, persistency and expense risks remain the top insurance risks.

PPL operates under the same risk management framework as its parent company, the Prudential Assurance Company Limited (see section B.3 for more details). Broadly the Company's Insurance Risk policy covers risk identification, measurement, monitoring and reporting of insurance risks such as expense risk and persistency risk.

Expense Risk

PPL's business is materially exposed to expense risk, making up 36% of the undiversified SCR. PPL defines expense risk as the risk of loss or of adverse change in the profitability or financial situation of the business resulting from changes in the level of expenses incurred. Specifically, the business makes assumptions about future expected levels of expenses for each line of business and uses these in pricing and the calculation of reserves. If the actual expenses realised exceed these assumptions, this will adversely impact profitability for the company.

Persistency Risk

PPL defines persistency risk as the risk that actual persistency, or customer retention, levels differ from the company's expectations i.e. the risk that policyholder rates of exit are higher or lower than those assumed in pricing and reserving. PPL's persistency assumptions are based on past experience and also include expected trends in future persistency rates. Experience is actively monitored and assumptions are periodically reviewed. If the actual levels of future persistency are significantly lower than assumed then the firm's financial results could be negatively impacted due to a reduction in expected income from management charges.

For in-force business, management actions to reduce persistency exposures are limited, although the company has enacted a customer retention strategy.

C.2 Market risk

C.2.1 Risk exposure and mitigation

Market risk is the risk of loss, or adverse change, in the financial condition of the business resulting directly or indirectly from fluctuations in the level and/ or volatility of market prices of assets and liabilities, and changes in interest rates and exchange rates.

The risk to PPL arises whereby a potential fall in investment returns and / or adverse movements in foreign currency exchange rates results in a reduction to the market value of assets under management. This is because a significant part of the firm's income is earned through fund management charges that are expressed as a percentage of funds under management. As such, a fall in market value of funds under management as a result of market risk would therefore adversely affect PPL's profitability.

The methods that we use to manage and mitigate our market risks include the following:

- Market Risk Policy;
- risk appetite statements, limits and triggers that we have in place;
- the monitoring and oversight of market risks through the regular reporting of management information;
- asset and liability management programmes that are in place.

C.3 Credit risk

C.3.1 Risk exposure and mitigation

Credit risk is the risk that a counterparty or an issuer of securities, which the Company holds in its asset portfolio, defaults or another party fails to perform according to the terms of the contract.

Due to the matching of policyholder liabilities to attaching asset value movements the UK unit-linked business is not directly affected by credit risk. The Company is also exposed to credit-related losses in the event of non-performance by counterparties.

C.4 Operational risk

C.4.1 Risk exposure and mitigation

Operational risk is the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel and systems, or from external events. This includes employee error, model error, system failures, fraud or some other event which disrupts business processes.

We manage and mitigate our operational risk using the following:

- operational risk and outsourcing and third-party supply policies;
- corporate insurance programmes to limit the impact of operational risks;
- scenario analysis for operational risk capital requirements, which focus on extreme, yet plausible, events;
- internal and external review of cyber security capability; and
- regular testing of elements of the disaster-recovery plan.

The performance of core activities places reliance on the IT infrastructure that supports day-to-day transaction processing. Our IT environment must also be secure and we must address an increasing cyber risk threat as our digital footprint increases – see separate Cyber risk section below. The risk that our IT infrastructure does not meet these requirements is a key area of focus, particularly the risk that legacy IT infrastructure supporting core activities/processes affects business continuity or impacts on business growth.

The calculation of the overall capital requirement for operational risk is based on scenarios that focus on extreme, yet plausible events.

C.5 Liquidity risk

C.5.1 Risk exposure and mitigation

Liquidity risk is the risk that the Company although solvent on a balance sheet basis is not able to liquidate assets in a timely manner to meet its cash obligations as they fall due or can access liquidity only at excessive cost.

Liquidity risk is carefully managed in particular in relation to: bank balances, cash-flow forecasting and requirement to maintain minimum “liquidity coverage ratios”. This improves the chances that even under adverse conditions, the Company can access liquidity necessary to cover its outflows. To manage liquidity risk in property funds which are inherently more illiquid, the Company has deferral clauses in place, which can allow the Company to defer cash payments to withdrawing customers in extreme adverse liquidity scenarios. Liquidity risk however cannot be completely eliminated for unit-linked funds, in particular over the short term, where market volatility can result in mass withdrawals over a short period of time.

C.6 Other material risks

C.6.1 'Macro' risks

Some of the risks that the Company is exposed to are necessarily broad given the external influences which may impact on the company. These risks include:

- Global economic conditions. Changes in global economic conditions can impact us directly; for example by leading to poor returns on our investments and increasing the cost of promises we have made to our customers. They can also have an indirect impact; for example economic pressures could lead to decreased savings, reducing the propensity for people to buy our products. Global economic conditions may also impact on regulatory risk for the company by changing prevailing political attitudes towards regulation.

- Geopolitical risk. The geopolitical environment is increasingly uncertain with political upheaval in the UK, the US and the Eurozone.

- Digital disruption. The emergence of advance technologies is providing an impetus for companies to rethink their existing operating models and how they interact with their customers. The company is embracing the opportunities presented by digitalisation and is closely monitoring any risks which arise.

C.6.2 Global Regulatory and Political Risk

The Company's risk management and mitigation of regulatory and political risk includes the following:

- a Risk and Capital Plan that includes considerations of current strategies;
- close monitoring and assessment of our business environment and strategic risks; and
- Board strategy sessions that consider risk themes.

In June 2016, the UK voted to leave the EU. The potential outcome of the negotiations on UK withdrawal and any subsequent negotiations on trade and access to major trading markets, including the single EU market, is currently highly uncertain.

The ongoing uncertainty and likelihood of a lengthy negotiation period may increase volatility in the markets where we operate, creating the potential for a general downturn in economic activity and for further or prolonged falls in interest rates in some jurisdictions due to easing of monetary policy and investor sentiment. The Company may be impacted by a UK withdrawal from the EU.

The EU's Solvency II Directive came into effect on 1 January 2016; however, the UK's vote to leave the EU has the potential to result in changes to future applicability of the regime in the UK. In September 2016, following the Brexit vote, the UK Treasury published terms of reference of its consultation into Solvency II to consider the options for British insurers and to assess the impact of the regime on the competitiveness of the UK insurance industry, the needs of UK consumers and the wider UK business economy. The outcome is likely to be dependent on the overall Brexit agreement reached between the UK and EU. Separately, the European Commission has commenced a review of some elements of the application of the Solvency II legislation with a particular focus on the SCR calculated using the standard formula.

There are a number of ongoing policy initiatives and regulatory developments that are having, and will continue to have, an impact on the way the Company is supervised. These include addressing Financial Conduct Authority reviews, ongoing engagement with the Prudential Regulation Authority, and the work of the Financial Stability Board and standard-setting institutions such as the International Association of Insurance Supervisors. Decisions taken by regulators, including those related to solvency requirements and capital allocation may have an impact on our business.

C.6.3 Cyber security

Cyber risk is an area of increased security for global regulators after a number of recent high profile attacks and data losses. The growing maturity and industrialisation of cyber-criminal capability, together with an increasing level of understanding of complex financial transaction by criminal groups are two reasons why risks to the financial services industry are increasing.

Given this, cyber security is seen as a key risk for the Company. Our current threat assessment is that, while we are not individually viewed as a compelling target for a direct cyber-attack, we are at risk of suffering attacks as a member of the financial services industry, with potentially significant impact on business continuity, our customer relationship and our brand reputation.

The Board, BRCC and ERC receive periodic updates on cyber risk management. The current Group-wide Cyber Risk Management Strategy and the associated Group-wide Coordinated Cyber Defence Plan was approved by the PPL Board in 2016.

Protecting our customers remains core to our business and the successful delivery of the Cyber Defence Plan will reinforce our capabilities to continue doing so in cyberspace as we transition to a digital business.

C.7 Any other information

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

C.7.1 Risk sensitivity

Stress and scenario testing is embedded in the Company's risk management framework. It is performed in order to:

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

To evaluate the Company's resilience to significant deteriorations in market and credit conditions and other shock events, the risks facing the company as described in the sections above are grouped together into severe but plausible scenarios. In addition, the Company conducts an annual reverse stress test which gives the directors an understanding of the maximum resilience to extremely severe adverse scenarios.

In considering these scenarios the impacts of mitigating management actions designed to maintain or restore key capital, liquidity and solvency metrics to the Company's approved risk appetite are considered. In the scenarios tested, sufficient actions were available to management to maintain the viability of the Company over the three-year period under assessment.

Core economic stress scenarios

The Company has a set of core stress scenarios that are based on external economic stresses outside the control of the Company. These scenarios are simplistic stresses that have been applied consistently over time, allowing year-on-year comparisons of results for individual risk exposures.

The stress testing has shown that it would take a strong event to reduce the capital coverage ratio below 100%. At 100% capital coverage, the Company would have sufficient capital to withstand a 1 in 200 year event.

C.7.2 Risk concentration

The Company has limited exposure to credit risk due to the close matching of policyholder liabilities to attaching asset value movements and therefore does not have significant risk concentrations.

C.7.3 Prudent person principle

The Company has an investment risk oversight framework which ensures that the Company's investment risks are managed effectively and efficiently. The framework focuses on the integrity and effectiveness of the investment processes, governance and controls, as well as appropriateness of resourcing and compliance of processes with applicable regulatory requirements (e.g. prudent person principles set out in the Solvency II Directive).

The investment risk oversight framework comprises a risk appetite statement, standards, processes and controls, which ensures investment risk is managed appropriately in regards to the Company's risk appetite.

The Company outsources investment management to an intra-group business. That business is governed by a common Group-wide Governance framework. The following information provides details on the Group-wide approach to the prudent person principles an insurance entity should apply when making investment decisions.

Prudential Group's policies provide a common framework for the oversight of financing and investment activities across the Group. It is designed to provide general, prudent and principle-based guidance for both shareholder-backed business and policyholder-backed business.

The Group Risk Framework covers all aspects of risk management across the Group and includes minimum standards, controls and requirements for risk management across all Business Units. The Group Risk Framework is supported by further documents including specific policies that cover credit, market, insurance, liquidity, operational and investment risk. Accompanying these are a number of Group-wide Operating Standards and other documents including the Group Approved Limits that specify limits on individual credit and counterparty exposures, average credit quality and amount of market risk taken across the Group.

The Group Investment Policy sets out the framework for management and oversight of investment performance and investment related risk across the Group. It focuses on ensuring that all of the Group's Business Units have appropriate policies and procedures in place to manage, monitor and report on the investment risk that they have taken on.

The Independent Price Verification Group-wide Operating Standards sets out the minimum operating standards for Business Units within the Group to develop processes to verify the accuracy and independence of market prices or model inputs, incorporating local legislations/regulations/best practices as applicable. Documenting the effectiveness of risk transfer using derivatives (non-routine hedging) is covered by the Risk Transfer Group-wide Operating Standard, The Group Dealing Controls Policy provides detail of the controls and monitoring in place in relation to all trading operations, including the operational controls around derivative collateral management. The policy also sets out uniform controls across all asset classes (including non-listed and securitised investments) and clarifies the responsibility of Business Units to ensure full compliance with all local regulations and requirements.

D. Valuation for solvency purposes

D.1 Assets

D.1.1 Overview

The 2016 balance sheet valued under both the statutory accounts basis (UK GAAP) and the Solvency II basis is summarised in Figure 11 below:

Figure 11: Solvency II and UK GAAP balance sheets for the year-ended 31 December 2016

	Solvency II £m	Financial Statements £m	Difference £m £m
Assets			
Investments (other than participations)	81.7	81.7	-
Assets held in index-linked and unit-linked funds	9,670.2	11,411.5	(1,741.3)
Reinsurance recoverable	1,812.8	67.9	1.744.9
Cash and cash equivalents	2.3	2.3	-
Other assets	7.8	6.7	1.1
Total assets	**11,574.8**	**11,570.1**	**4.7**
Liabilities			
Technical provisions *(unaudited)*	11,481.8	11,479.4	2.4
Deferred taxation *(unaudited)*	2.5	2.2	0.3
Other liabilities	20.3	19.3	1.0
Total liabilities	11,504.6	11,500.9	3.7
Excesses of assets over liabilities	**70.2**	**69.2**	**1.0**

The large movement from assets in unit-linked funds into reinsurance recoverable is due to external reassurance being treated as an investment contract on a statutory basis and as reassurance on a Solvency II basis.

Investments (other than participations)

These assets are mainly a non-linked UK gilt that the company owns or the cash on deposit the company has placed over the reporting date.

Assets held in index-linked and unit-linked funds

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

Reinsurance recoverable

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

Cash and cash equivalents

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

Other assets

Increase in other assets of £1.1m relates to reclassification of assets under Solvency II.

D.1.2 Valuation of assets

D.1.2.1 Determination of fair value

Within the Solvency II balance sheet, assets are valued using valuation methods that are consistent with the valuation approach set out in the Solvency II Directive. The overall principle when valuing assets and liabilities under Solvency II is to use a fair value, as set out in Article 75 of the Directive. There have been no changes to the recognition and / or valuation basis of assets and other non-insurance liabilities in the Solvency II balance sheet during the year.

When valuing assets and liabilities in accordance with Solvency II, the fair valuation hierarchy set out below is followed, which is consistent with the fair value measurement hierarchy as applied under UK GAAP:

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

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

The investments of the Company that are valued using this method include exchange listed equities, collective investment undertakings with quoted prices, exchange traded derivatives such as futures and options, and national government bonds unless there is evidence that trading in a given instrument is infrequent that the market could not possibly be considered active.

(b) Quoted market prices in active markets for similar assets and liabilities with adjustments to reflect differences

Where quoted market prices in active markets for the same assets or liabilities are not available, the Company applies either of the following two valuation methods on a case by case basis:

- using quoted market prices in active markets for similar assets and liabilities with adjustments to reflect factors specific to the asset or liability such as condition or volume or level of activity in the markets; or
- using an alternative valuation method with the significant inputs that are observable for the asset directly (i.e. as prices) or indirectly (i.e. derived from prices).

The majority of the assets of the Company that are valued using alternative valuation methods with significant observable inputs are corporate bonds, collateralised securities and other non-national government bonds, together with over-the-counter derivatives such as forward exchange contracts.

These assets, in line with market practice, are generally valued using independent pricing services or third-party broker quotes. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

Pricing services, where available, are used to obtain the third-party broker quotes. Where pricing services providers are used, a single valuation is obtained and applied.

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

Generally, no adjustment is made to the prices obtained from independent third parties. Adjustment is made in only limited circumstances, where it is determined that the third-party valuations obtained do not reflect fair value (e.g. either because the value is stale and/or the values are extremely diverse in range). These are usually securities which are distressed or that could be subject to a debt restructure or where reliable market prices are no longer available due to an inactive market or market dislocation. In these instances, prices are derived using internal valuation techniques including those as described below in this note with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date. The techniques used require a number of assumptions relating to variables such as credit risk and interest rates. Examples of such variables include an average credit spread based on the corporate bond universe and the relevant duration of the asset being valued. Prudential determines the input assumptions based on the best available information at the measurement dates. Securities valued in such manner are classified as being based on alternative valuation methods. Alternative valuation methods use observable market data where available; where unavailable, unobservable inputs may be used (as further described below).

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

The Company has had less than £0.1m of these alternative valuation method assets at the end of 2016.

There are no material differences between the bases, methods and assumptions used for the valuation of the Company's assets for solvency purposes compared to UK GAAP.

The valuation basis for each material class of assets are described below:

D.1.2.2 Valuation bases under Solvency II compared with UK GAAP

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

Assets held for unit-linked contracts

These assets are held to cover linked liabilities and whereby the policyholders bear the investment risk of the assets. Under both UK GAAP and Solvency II these assets are recorded in aggregate as a single line entry on the balance sheet. The difference between UK GAAP and Solvency II relates to reinsurance in relation to investment contracts without discretionary participation features, which is treated as reinsurance under Solvency II but as investments under UK GAAP.

Deferred tax asset

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

There is no deferred tax asset on the Solvency II balance sheet as at 31 December 2016.

Other assets

Other assets in the Solvency II balance sheet are measured at fair value determined using alternate valuation methods that are market consistent and represents the realisable value of individual assets on transfer to a third party. If the UK GAAP value is a good proxy for fair value no adjustment is made.

Investments (other than participations)

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

D.2 Technical provisions

D.2.1 Overview

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

The best estimate liability corresponds to the probability-weighted average of future cash-flows, taking account of the time value of money (i.e. the expected present value of future cash-flows), using the risk-free interest rate term structure published by European Insurance and Occupation Pension Authority. The calculation of the best estimate liability is based upon up-to-date and credible information and realistic assumptions (derived from data analysis and expert judgement) and is performed using appropriate actuarial and statistical methods. The cash-flow projection used in the calculation of the best estimate liability takes account of all the cash in- and out-flows required to settle the insurance obligations over their lifetime. The cash-flows included in the best estimate liability calculation are derived after applying Solvency II "contract boundary" rules, which determine whether future cash-flows can be recognised as part of the in-force business. The best estimate liability is calculated before deduction of the amounts recoverable from reinsurance contracts. Those amounts are calculated separately (see section D.2.8).

The risk margin is calculated in line with Solvency II requirements, and aims to ensure that the total technical provisions are equivalent to the cost of ceding the insurance obligations to a third party. The calculation assumes a 6 per cent per annum cost of capital and applies to non-hedgeable risks only. This calculation includes simplified methods and requires assumptions as to the run-off profile of non-hedgeable capital requirements for each line of business, in line with Article 58 of the Delegated Regulation, rather than a full projection of SCR. The SCR for each non-hedgeable risk is assumed to run-off in-line with a suitable profile. The SCR each year is aggregated using a simplified correlation matrix.

Technical provisions at 31 December 2016

Figure 12: Value of technical provisions (net of transitional measures on technical provisions) at 31 December 2016

	Best estimate liability £m	Risk margin £m	Total £m
Non-profit annuity business	71.6	—	71.6
Unit-linked business	6,571.2	15.6	6,586.8
Reinsurance Accepted	4,816.1	7.3	4,823.4
Total	**11,459.0**	**22.9**	**11,481.8**

The technical provisions shown in Figure 12 above include the impact of the transitional measures on technical provisions (see section D.2.4.1) which are included within the risk margin column. The transitional measures on technical provisions reduce the Company's technical provisions by £3.1 million as at 31 December 2016.

D.2.2 Methodology and assumptions

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

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

(i) economic assumptions, most of which are published by EIOPA and set by reference to market data at the valuation date;
(ii) non-economic assumptions, used to derive non-market related best estimate liability cash-flows (for example future claims and expenses); and
(iii) assumptions in respect of policyholder behaviour.

D.2.2.1 Economic assumptions

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

Figure 13: 10 year risk-free rates at 31 December 2016 (with comparison to 31 December 2015)

Currency	31 December 2016	31 December 2015	Change
British Pound	1.08%	1.92%	(0.84%)

D.2.2.2 Non-economic assumptions

Persistency, mortality and expense assumptions are derived from analysis of recent historic experience data, and also reflect expected future experience. Where relevant and material, allowance is also made for how policyholder behaviour is expected to vary in line with economic conditions.

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

D.2.3.1 Unit-linked business

The best estimate liability for these contracts reflects both the value of the policyholder funds and the non-unit liability. The non-unit liability reflects the discounted value of fee income from the unit funds less associated expenses.

Some unit-linked business contains a financial guarantee that the price of the cash funds will not fall. This is only 0.01 per cent of the total unit-linked Gross BEL, therefore has low materiality.

D.2.3.2 Non-profit annuity business

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

Mortality assumptions for non-profit annuity business are set in light of recent population and internal experience. The assumptions used are base assumptions expressed as percentages of standard actuarial mortality tables, with an allowance for expected future mortality improvements. Where annuities have been sold on an enhanced basis to impaired lives assumptions are set to reflect experience, including the appropriate level of impairment.

Since 2009, new mortality improvement projection models have been released regularly by the Continuous Mortality Investigation (CMI). The mortality improvement assumptions in the 31 December 2016 technical provisions have been derived from the CMI 2014 model, calibrated to reflect the Company’s view of future mortality improvements, including a 0.25 per cent per annum uplift to initial rates of mortality improvement.

D.2.4 Long-term guarantee measures on technical provisions

D.2.4.1 Transitional measures

The Company's technical provisions at 31 December 2016 include transitional measures on technical provisions, in accordance with Article 308d, in respect of business written before 1 January 2016. The impact of these transitional measures is to increase the Company's Solvency II surplus by £2.5 million.

The transitional measures are considered high-quality capital, and are a core part of the Solvency II reporting regime. The Company has received the necessary approvals from the PRA in respect of the transitional measures. However, if the transitional measures on technical provisions were excluded, the impact would be as follows.

Figure 14: Impact on Solvency II metrics of TMTP at 31 December 2016

	With TMTP £m	Without TMTP £m	Impact £m
Technical Provisions	11,481.8	11,485.0	(3.1)
Basic Own Funds	70.2	67.6	2.6
Own Funds eligible to cover SCR	70.2	67.6	2.6
Minimum Capital Required	26.0	25.7	0.3
Solvency Capital Required	57.7	57.1	0.7

The 31 December 2016 technical provisions and own funds do not include a transitional on the risk-free interest rate term structure.

D.2.5 Assumption changes

In 2016, the changes to the assumptions underlying the Company's calculation of technical provisions include:

- changes to the expense assumptions to reflect recent experience;
- market-driven changes to economic parameters, including changes to risk-free rates as shown in section D.2.2.1; and
- changes to the mortality assumptions used for valuing non-profit annuities to reflect recent mortality experience.

D.2.6 Level of uncertainty

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

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

D.2.7 Reconciling Solvency II technical provisions to the financial statements

Figure 15: Comparison of technical provisions between UK GAAP and Solvency II for the year-ended 31 December 2016

	Index-linked and unit-linked insurance £m	Other life insurance £m	Total 2016 £m
UK GAAP liabilities (as reported in financial statements)	11,411.5	68.0	11,479.5
As reported in the template S.02.01.02	11,411.5	68.0	11,479.5
Solvency II technical provisions	11,410.2	71.6	11,481.8

The movement in technical provisions between the UK GAAP financial statements and Solvency II is discussed below:

(a) The UK GAAP 'other life insurance' liabilities relate to the reassured annuities in the Company. These are valued using a basis that includes margins for risk and uncertainty within the non-economic assumptions (mortality, morbidity, persistency and expenses) as well as different economic assumptions to the Solvency II technical provisions. The method of calculation can also differ between the bases.

The most significant differences between UK GAAP and Solvency II assumptions and methodology for these annuities are described below:

- UK GAAP liability cash-flows for annuity business are valued using a discount rate derived from the yield on the corresponding assets minus a prudent allowance for defaults of 36.5 bps at 31 December 2016.
- Longevity assumptions for annuity business contain margins under UK GAAP compared to the best estimate assumptions applied under Solvency II.

(b) The UK GAAP liabilities do not include an explicit risk margin as the allowance for risk is included within the non-economic assumptions within the annuity liabilities only. The risk margin is explicit under Solvency II so is added in here along with a similar deduction for the present value of future profits. The impact of the transitional measures on technical provisions to restore the surplus of the Company to broadly equivalent levels as those established under the previous Solvency I regime has been offset against this explicit risk margin.

D.2.8 Reinsurance recoverables

The Company primarily uses reinsurance to manage insurance risk exposure.

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

The valuation methods and assumptions for reinsurance recoverables are consistent with the methods and assumptions for the corresponding technical provisions (see sections D2.2 and D2.3). The value of the reinsurance recoverable asset is the Company's best estimate of future reinsurance cash-flows, where this figure allows for the probability of partial or total default by the reinsurer. In accordance with Article 61 of the Delegation Regulations, a simplified approach to calculating the counterparty default adjustment has been adopted.

The difference in the value of reinsurance recoverables between Solvency II and the UK GAAP financial statements stems from Reinsurers' share of value of technical provisions. This is calculated on a basis consistent with the underlying technical provisions and, for Solvency II, includes an allowance for the probability of reinsurer default.

D.3 Valuation of other liabilities

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

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

Deferred tax liabilities

Deferred tax liabilities are calculated based upon the differences between the values given to liabilities in the Solvency II balance sheet and their values for tax purposes. The principles of FRS 101 are applied to calculate the extent of deferred taxes applicable to those value differences. Changes in the valuation of underlying liabilities between UK GAAP and Solvency II give rise to deferred tax value differences.

Other liabilities

Other liabilities in the Solvency II balance sheet are measured at fair value determined using alternative valuation methods that are market consistent and represent the value to settle the liabilities with the third party. Where the UK GAAP valuation is a good proxy for fair value no adjustment is made.

Other liabilities includes, reinsurance payables, payables (trade, not insurance), and other liabilities not shown elsewhere.

There are no material valuation differences between Solvency II and the financial statements beyond a minor restatement between other assets and other liabilities of £1.0 million.

D.4 Alternative methods for valuation

The company currently does not use alternative methods of valuation.

D.5 Any other information

There is no other information.

E. Capital management

E.1 Own funds

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

(Unaudited)

The Company manages its Solvency II own funds as its measure of capital.

At 31 December 2016, the PPL Solvency II own funds were £70.2 million.

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

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

E.1.2 Solvency II capital position

(Unaudited)

The table below shows the PPL Solvency II surplus at 31 December 2015 and 31 December 2016 as disclosed in the Company's 2016 Annual Report and Financial Statements;

Figure 16: PPL surplus at 31 December 2016

£m	YE16	YE15
Own Funds	70.2	78.0
SCR	57.7	50.8
Surplus	12.5	27.2
SCR Coverage %	122%	154%

The Company's Solvency II surplus position has decreased by £14.8m between 31 December 2015 and 31 December 2016. The 31 December 2016 figures above coincide with the information submitted within the Solvency II Pillar III templates Own Funds (S.23.01.01) and SCR (S.25.02.21).

PPL is managed with a relatively low level of surplus which is reflective of the low risk to which the company is exposed. The reduction in surplus at year-end 2016 is largely due to a strengthening of the operational risk capital calibration.

E1.3 Analysis of the components of own funds

The following components make up the Company's own funds amount:

Figure 17: Analysis of components of own funds for the year-ended 31 December 2016

	Total £m	Tier 1 unrestricted £m	Tier 1 restricted £m	Tier 2 £m	Tier 3 £m
Ordinary share capital (b)	6	6	0	0	0
Preference shares (b)	0	0	0	0	0
Reconciliation reserve (c)	64.2	64.2	0	0	0
Surplus funds (d)	0	0	0	0	0
Total own funds (a)	70.2	70.2	0	0	0

(a) The Company's own funds before adjustments principally comprises equity share capital and retained earnings attributable to equity shareholders calculated in the reconciliation reserves.

(b) Equity share capital
The Company's issued share capital is £6 million, which comprised of 6,000,000 ordinary shares of £1 each fully paid.

(c) Reconciliation reserve
The reconciliation reserve represents the residual of excess of assets over liabilities.

E1.4 Reconciliation of shareholder's equity to own funds

The following table shows the differences between IFRS shareholder's equity and own funds.

Figure 18: Analysis of Surplus for PPL

	2016 (£m)	2015 (£m)
Shareholder's equity in financial statements at 31 December	69.2	60.7
Change in valuation of technical provisions, net of reinsurance[1]	24.1	38.4
Change in Risk Margin[2] *(unaudited)*	-22.9	-17.3
Change in value of deferred tax principally as a result of valuation changes[3]	-0.2	-3.8
Excess of assets over liabilities as recorded in the Solvency II Balance Sheet	**70.2**	**78.0**

The movement between equity in the financial statements and excess of assets over liabilities under Solvency II is discussed below.

1. Under Solvency II, technical provisions are calculated on a best estimate basis and a risk margin is added. This best estimate includes recognition of expected future premiums (net of related costs/claims) for contracts already written by PPL at the balance sheet date, subject to regulatory restrictions. This adjustment therefore accounts for any differences in the valuation assumptions for solvency compared with those for the financial statements.

2. The technical provisions for Solvency reporting include the Risk Margin. The Risk Margin does not exist in the financial statements and the "change in Risk Margin" accounts for this difference.
3. The material differences that impact deferred tax are those noted above.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

E.2.1 Overview

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

E.2.2 Components of SCR

(Unaudited)

At 31 December 2016, the SCR was £57.7m.

Figure 19 below shows the undiversified SCR by risk components and the benefit of diversification in relation to the Company at 31 December 2016.

Figure 19: Undiversified SCR for PPL at 31 December 2016

Risk component	2016 (£m)
Equity risk	22.2
Property risk	3.1
Interest rate risk	5.5
Credit risk	6.4
Counterparty risk	2.7
Currency risk	7.1
Expense risk	54.2
Lapse risk	15.3
Operational risk	32.4
Other adjustments	(11.1)
Loss-absorbing capacity of deferred tax	(5.2)
Total (pre-diversification)	**132.6**
Diversification benefit	(74.9)
Total diversified SCR	**57.7**

The minimum capital requirement ('MCR') is a formulaic calculation, which is subject to a cap and a floor that are both expressed relative to the SCR. At 31 December 2016, the Company's MCR was £26.0 million. The inputs used to calculate the MCR are detailed in Quantitative Reporting Template S.28.01.01.

Figure 20: MCR for PPL at 31 December 2016

MCR	**2016 (£m)**
Linear formula component for non-life insurance and reinsurance obligations	—
Linear formula component for life insurance and reinsurance obligations	67.5
Linear MCR	67.5
SCR	57.7
MCR cap	26.0
MCR floor	14.4
Combined MCR	26.0
Absolute floor of the MCR	3.3
MCR	**26.0**

The MCR is currently 45 per cent of the SCR.

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

(Unaudited)

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

E.4 Differences between the standard formula and internal model

(Unaudited)

E.4.1 Overview

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

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

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

E.4.2 Internal model application

The Company applied to use an internal model in late June 2015. In early December 2015 the application was approved by the PRA. This was followed by an application to the PRA for a “major model change” to the internal model in 2016, which was approved by the PRA to be effective for full year 2016 reporting.

The Company’s internal model is described as “partial” because the Group’s US insurance companies are aggregated into the Group SCR using method 2: deduction and aggregation. For PPL, a full Internal Model is used.

As required in Article 101 of Directive 2009/138/EC, the solvency capital requirement from the approved internal model is calculated as the value-at-risk of the basic own funds of an (re)insurance undertaking at a confidence level of 99.5 per cent over a one-year period. The main risk categories allowed for in the internal model are shown in section E.2.2. Within these categories, underlying “risk drivers” are specified as the result of an annual risk identification process. A model is defined and calibrated for each underlying risk driver and these are combined with an appropriate dependency structure and simulated to generate multiple thousands of combined risk scenarios. These risk scenarios are applied to all the assets and liabilities of the Company (for each entity within the scope of the internal model) to generate a wide range of possible outcomes. For simplicity, and to avoid circularity, the risk margin is held constant in all these risk scenarios. The resulting probability distribution is used to calculate the internal model solvency capital requirement, by subtracting the 99.5th worst percentile outcome from the unstressed balance sheet.

The data used in the internal model covers the following:

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

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

E.4.3 Internal model vs standard formula

Key differences between the calculation of the internal formula SCR and the standard formula SCR include:

- Whereas the standard formula stresses and correlations are prescribed, the internal model risk scenarios reflect the Company’s specific risk profile and are derived from a combination of data analysis and expert judgement, subject to the internal model tests and standards required by the Solvency II Directive (see further detail in the table below).

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

  The internal model SCR is derived by combining underlying risk drivers together into combined stress scenarios, and then ranking the outcomes of applying these stress scenarios to the Company’s balance sheet to derive the worst 0.5th percentile outcome. Conversely, the standard formula SCR is derived by calculating the impact on the balance sheet of each prescribed stress separately and then aggregating these outcomes using prescribed correlation matrices. Therefore, the internal model allows for the impact on the balance sheet of combinations of risks occurring together, whereas the standard formula only considers each risk in isolation.

Figure 21: Overview of standard formula and internal model differences

Risk component	Standard Formula	Internal Model
Equity	Stresses vary between European (Type 1), global stocks (Type 2) and strategic equity investments in related undertakings. A symmetric adjustment is applied to the level of stress to smooth out significant movements in markets close to the calculation date.	The internal model includes more granular stresses with calibrations and correlation assumptions set for each main equity benchmark index. At least one equity index is calibrated for each relevant global economy.
Credit	Corporate bond credit spread stresses vary by rating and duration with different stresses on structured credit and credit derivatives. Where bonds have no official rating different stresses apply dependent upon collateralisation.	A single corporate bond is modelled for all unit-linked business with the relevant credit spread and yield stress applying. Sovereign credit risk is also modelled, including the government bond spread risk.
Yields	Interest rate stresses are defined as multiplicative stresses to the yield curve which vary by term.	The model stresses one point on the yield curve term structure and a parallel shift in yields is assumed.
Property	There is a single property stress applied to all immovable property exposure globally.	No difference in methodology to standard formula
Currency	The value of overseas assets is stressed according to the calibrated currency risks. The same stresses are used for all economies.	The internal model includes more granular stresses, with calibrations and correlation assumptions set for each main currency exposure.
Counterparty default risk	Counterparty default risk captures the credit risk which has not be captured in the spread risk module and is included in the standard formula on a loss given default and probability of default basis. Separate set of modelling assumption and resulting stresses are applied to tier 1 and tier 2 counterparties.	Similar to the standard formula, counterparty default risk captures aspects of credit risk which have not been captured in the spread risk module and uses separate modelling of loss given default and probability of defaults. Similar to the standard formula, different modelling approaches are used for assessing the risk associated with material (type 1) and other (type 2) counterparties.
Lapse	Bi-directional stresses applied to base lapse rates along with a mass lapse stress. The worst outcome of each stress is held as lapse risk.	The internal model applies a much more granular approach to modelling with tailored stresses for a base lapse rates and mass lapse.
Mortality & Life catastrophe	An increase in best estimate mortality rates for mortality risk and an instantaneous mortality event for life catastrophe risk.	No difference in methodology to standard formula.
Expense	Both the level of expenses and level of expense inflation are stresses under the standard formula	No difference in methodology to standard formula.
Operational	Operational risk is calculated using a factor based approach applied to premiums, technical provisions and	In comparison with the standard formula, the internal model follows a much more sophisticated and granular

Risk component	Standard Formula	Internal Model
	unit linked expenses.	modelling approach by modelling the risk at individual operational risk scenario level and then using appropriate correlations between these individual scenarios to derive an aggregate operation risk capital assumption. The use of this sophisticated modelling approach enables much better alignment with the internal risk management processes.

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

The Company's SCR and minimum capital requirements have been met during 2016.

E.6 Any other information

There is no other information.

Statement of directors' responsibilities

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

The directors are satisfied that:

(a) throughout the financial year in question, the Company has complied in all material respects with the requirements of the PRA rules and the Solvency II Regulations as applicable at the level of the Company; and
(b) it is reasonable to believe that the Company has continued so to comply subsequently and will continue so to comply in future.

Signed on behalf of the Board of Directors

Mr J Deeks
Chief Financial Officer
17 May 2017

Independent Auditor's Report

Report of the external independent auditor to the directors of Prudential Pensions Limited ('the Company') pursuant to Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook applicable to Solvency II firms

Except as stated below, we have audited the following documents prepared by Prudential Pensions Limited as at 31 December 2016:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of Prudential Pensions Limited as at 31 December 2016, ('the Narrative Disclosures subject to audit'); and
- Company templates S02.01.02, S12.01.02, S22.01.21, S23.01.01, and S28.01.01 ('the Templates subject to audit').

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the '**Relevant Elements of the Solvency and Financial Condition Report'**.

We are not required to audit, nor have we audited, and as a consequence do not express an opinion on the Other Information which comprises:

- information contained within the Relevant Elements of the Solvency and Financial Condition Report set out about above which are, or derive from, the Solvency Capital Requirement, as identified in the Appendix to this report;
- The 'Business and performance', 'System of governance' and 'Risk profile' sections of the Solvency and Financial Condition Report;
- information relating to 31 December 2015 voluntarily disclosed by the Company in the 'Valuation for solvency purposes' and 'Capital management' sections of the Solvency and Financial Condition Report section of the Solvency and Financial Condition Report;
- Company templates S05.01.02, S.25.02.21;
- information calculated in accordance with the previous regime used in the calculation of the transitional measure on technical provisions, and as a consequence all information relating to the transitional measures on technical provisions as set out in the Appendix to this report where disclosed;
- the written acknowledgement by the directors of their responsibilities, including for the preparation of the solvency and financial condition report ('the Responsibility Statement').

To the extent the information subject to audit in the Relevant Elements of the Solvency and Financial Condition Report includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

Respective responsibilities of directors and auditor

As explained more fully in the Responsibility Statement, the directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been supplemented by the approvals and determinations made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based.

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of a Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error.

Our responsibility is to audit, and express an opinion on, the Relevant Elements of the Solvency and Financial Condition Report in accordance with applicable law and International Standards on Auditing (UK and Ireland) together with ISA (UK) 800 and ISA (UK) 805. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Relevant Elements of the Solvency and Financial Condition Report

A description of the scope of an audit is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on the Relevant Elements of the Solvency and Financial Condition Report

In our opinion, the information subject to audit in the Relevant Elements of the Solvency and Financial Condition Report of Prudential Pensions Limited as at 31 December 2016 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Emphasis of Matter - Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' and other relevant disclosure sections of the Solvency and Financial Condition Report, which describe the basis of accounting. The Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority. As a result, the Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Other Matter

The Company has authority to calculate its Solvency Capital Requirement using an internal model ('the Model') approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to audit the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.

Matters on which we are required to report by exception

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook for Solvency II firms we are also required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of Prudential Pensions Limited's statutory financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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

This report of the external auditor is made solely to the company's directors, as its governing body, in accordance with the requirement in Rule 4.1(2) of the External Audit Part of the PRA Rulebook and the terms of our engagement. We acknowledge that the directors are required to submit the report to the PRA, to enable the PRA to verify that an auditor's report has been commissioned by the company's directors and issued in accordance with the requirement set out in Rule 4.1(2) of the External Audit Part of the PRA Rulebook and to facilitate the discharge by the PRA of its regulatory functions in respect of the company, conferred on the PRA by or under the Financial Services and Markets Act 2000.

Our audit has been undertaken so that we might state to the company's directors those matters we are required to state to them in an auditor's report issued pursuant to Rule 4.1(2) and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company through its governing body, for our audit, for this report, or for the opinions we have formed.

KPMG LLP

KPMG LLP
Chartered Accountants
15 Canada Square
Canary Wharf
London
E14 5GL

17 May 2017

The maintenance and integrity of Prudential plc's website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Solvency and Financial Condition Report since it was initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of Solvency and Financial Condition Reports may differ from legislation in other jurisdictions.

Appendix – relevant elements of the Solvency and Financial Condition Report that are not subject to audit

Solo internal model

The relevant elements of the Solvency and Financial Condition Report that are not subject to audit comprise:

The following elements of template S.02.01.02:
- Row R0550: Technical provisions - non-life (excluding health) - risk margin
- Row R0590: Technical provisions - health (similar to non-life) - risk margin
- Row R0640: Technical provisions - health (similar to life) - risk margin
- Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
- Row R0720: Technical provisions - Index-linked and unit-linked - risk margin

The following elements of template S.12.01.02
- Row R0100: Technical provisions calculated as a sum of BE and RM - Risk margin
- Rows R0110 to R0130 – Amount of transitional measure on technical provisions

The following elements of template S.22.01.21
- Column C0030 – Impact of transitional measure on technical provisions
- Row R0010 – Technical provisions
- Row R0090 – Solvency Capital Requirement

The following elements of template S.23.01.01
- Row R0580: SCR
- Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

The following elements of template S.28.01.01
- Row R0310: SCR

Elements of the Narrative Disclosures subject to audit identified as ‘unaudited’.

Templates provided in the SFCR implementing Technical Standard

S.02.01.02 Balance sheet

All amounts are in £'000

		Solvency II value
	Assets	C0010
R0030	Intangible assets	
R0040	Deferred tax assets	
R0050	Pension benefit surplus	
R0060	Property, plant & equipment held for own use	0
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	24,943
R0080	*Property (other than for own use)*	0
R0090	*Holdings in related undertakings, including participations*	0
R0100	*Equities*	0
R0110	*Equities - listed*	0
R0120	*Equities - unlisted*	0
R0130	*Bonds*	24,697
R0140	*Government Bonds*	24,697
R0150	*Corporate Bonds*	0
R0160	*Structured notes*	0
R0170	*Collateralised securities*	0
R0180	*Collective Investments Undertakings*	246
R0190	*Derivatives*	0
R0200	*Deposits other than cash equivalents*	0
R0210	*Other investments*	-
R0220	Assets held for index-linked and unit-linked contracts	9,670,197
R0230	Loans and mortgages	55,500
R0240	*Loans on policies*	0
R0250	*Loans and mortgages to individuals*	0
R0260	*Other loans and mortgages*	55,500
R0270	Reinsurance recoverables from:	1,812,801
R0280	*Non-life and health similar to non-life*	0
R0290	*Non-life excluding health*	0
R0300	*Health similar to non-life*	0
R0310	*Life and health similar to life, excluding index-linked and unit-linked*	71,641
R0320	*Health similar to life*	0
R0330	*Life excluding health and index-linked and unit-linked*	71,641
R0340	*Life index-linked and unit-linked*	1,741,160
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	0
R0370	Reinsurance receivables	7,167
R0380	Receivables (trade, not insurance)	1,887
R0390	Own shares (held directly)	0
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
R0410	Cash and cash equivalents	2,338
R0420	Any other assets, not elsewhere shown	0
R0500	**Total assets**	11,574,835

S.02.01.02 Balance sheet
All amounts are in £'000

		Solvency II value
	Liabilities	C0010
R0510	Technical provisions - non-life	0
R0520	*Technical provisions - non-life (excluding health)*	0
R0530	*TP calculated as a whole*	0
R0540	*Best Estimate*	0
R0550	*Risk margin*	0
R0560	*Technical provisions - health (similar to non-life)*	0
R0570	*TP calculated as a whole*	0
R0580	*Best Estimate*	0
R0590	*Risk margin*	0
R0600	Technical provisions - life (excluding index-linked and unit-linked)	71,641
R0610	*Technical provisions - health (similar to life)*	0
R0620	*TP calculated as a whole*	0
R0630	*Best Estimate*	0
R0640	*Risk margin*	0
R0650	*Technical provisions - life (excluding health and index-linked and unit-linked)*	71,641
R0660	*TP calculated as a whole*	0
R0670	*Best Estimate*	71,641
R0680	*Risk margin*	0
R0690	Technical provisions - index-linked and unit-linked	11,410,206
R0700	*TP calculated as a whole*	0
R0710	*Best Estimate*	11,387,330
R0720	*Risk margin*	22,877
R0740	Contingent liabilities	0
R0750	Provisions other than technical provisions	0
R0760	Pension benefit obligations	0
R0770	Deposits from reinsurers	0
R0780	Deferred tax liabilities	2,451
R0790	Derivatives	0
R0800	Debts owed to credit institutions	0
R0810	Financial liabilities other than debts owed to credit institutions	0
R0820	Insurance & intermediaries payables	0
R0830	Reinsurance payables	0
R0840	Payables (trade, not insurance)	20,315
R0850	Subordinated liabilities	0
R0860	*Subordinated liabilities not in BOF*	0
R0870	*Subordinated liabilities in BOF*	0
R0880	Any other liabilities, not elsewhere shown	0
R0900	**Total liabilities**	11,504,615
R1000	**Excess of assets over liabilities**	70,220

S.05.01.02 Premium, claims and expenses by line of business

(Unaudited)

All amounts are in £'000

Life	Line of Business for: life insurance obligations						Life reinsurance obligations		Total
	Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Health reinsurance	Life reinsurance	
	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
Premiums written									
Gross	0	0	0	0			0	0	0
Reinsurers' share	0	0	0	0			0	0	0
Net	0	0	0	0			0	0	0
Premiums earned									
Gross	0	0	0	0			0	0	0
Reinsurers' share	0	0	0	0			0	0	0
Net	0	0	0	0			0	0	0
Claims incurred									
Gross	0	0	0	5,625			0	0	5,625
Reinsurers' share	0	0	0	5,625			0	0	5,625
Net	0	0	0	0			0	0	0
Changes in other technical provisions									
Gross	0	0	1,189,205	8,066			0	529,559	1,726,830
Reinsurers' share	0	0	0	8,066			0	0	8,066
Net	0	0	1,189,205	0			0	529,559	1,718,764
Expenses incurred	0	0	9,806	0			0	0	9,806
Other expenses									0
Total expenses									9,806

S.12.01.02 Life and Health SLT Technical Provisions

All amounts are in £'000

Life and Health SLT Technical Provisions

		Insurance with profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, including Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
				Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees					Contracts without options and guarantees	Contracts with options or guarantees			
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0150	C0160	C0170	C0180	C0190	C0200	C0210
R0010	**Technical provisions calculated as a whole**	0	0			0			0	0	0	0			0	0	0
R0020	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	0	0			0			0	0	0	0			0	0	0
	Technical provisions calculated as a sum of BE and RM																
	Best estimate																
R0030	**Gross Best Estimate**	0		6,570,628	616		34,298	37,343	0	4,816,086	11,458,971		0	0	0	0	0
R0080	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	0		0	0		34,298	37,343	0	1,741,160	1,812,801		0	0	0	0	0
R0090	Best estimate minus recoverables from reinsurance/SPV and Finite Re	0		6,570,628	616		0	0	0	3,074,926	9,646,170		0	0	0	0	0
R0100	**Risk margin**	0	17,723			0			0	8,293	26,016	0			0	0	0
	Amount of the transitional on Technical Provisions																
R0110	Technical Provisions calculated as a whole	0	0			0			0	0	0	0			0	0	0
R0120	Best estimate	0		0	0		0	0	0	0	0		0	0	0	0	0
R0130	Risk margin	0	-2,139			0			0	-1,001	-3,140	0			0	0	0
R0200	**Technical provisions - total**	0	6,586,828			71,641			0	4,823,378	11,481,848	0			0	0	0

S.22.01.21 Impact of long term guarantees measures and transitionals

All amounts are in £'000

		Amount with Long Term Guarantee measures and transitionals	Impact of transitional on technical provisions	Impact of transitional on interest rate	Impact of volatility adjustment set to zero	Impact of matching adjustment set to zero
		C0010	C0030	C0050	C0070	C0090
R0010	**Technical provisions**	11,481,848	3,140	0	0	0
R0020	**Basic own funds**	70,220	-2,592	0	0	0
R0050	**Eligible own funds to meet Solvency Capital Requirement**	70,220	-2,592	0	0	0
R0090	**Solvency Capital Requirement**	57,743	-678	0	0	0
R0100	**Eligible own funds to meet Minimum Capital Requirement**	70,220	-2,592	0	0	0
R0110	**Minimum Capital Requirement**	25,985	-305	0	0	0

S.23.01.01 Own Funds

	Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35 All amounts are in £'000	Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
R0010	Ordinary share capital (gross of own shares)	6,000	6,000		0	
R0030	Share premium account related to ordinary share capital	0	0		0	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	0	0		0	
R0050	Subordinated mutual member accounts	0		0	0	0
R0070	Surplus funds	0	0			
R0090	Preference shares	0		0	0	0
R0110	Share premium account related to preference shares	0		0	0	0
R0130	Reconciliation reserve	64,220	64,220			
R0140	Subordinated liabilities	0		0	0	0
R0160	An amount equal to the value of net deferred tax assets	0				0
R0180	Other own fund items approved by the supervisory authority as basic own funds not specified above	0	0	0	0	0
	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds					
R0220	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	0				
	Deductions					
R0230	Deductions for participations in financial and credit institutions	0	0	0	0	
R0290	**Total basic own funds after deductions**	70,220	70,220	0	0	0
	Ancillary own funds					
R0300	Unpaid and uncalled ordinary share capital callable on demand	0			0	
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	0			0	
R0320	Unpaid and uncalled preference shares callable on demand	0			0	0
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0			0	0
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0			0	
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0			0	0
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0			0	
R0370	Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0			0	0
R0390	Other ancillary own funds	0			0	0
R0400	**Total ancillary own funds**	0			0	0
	Available and eligible own funds					
R0500	Total available own funds to meet the SCR	70,220	70,220	0	0	0
R0510	Total available own funds to meet the MCR	70,220	70,220	0	0	
R0540	Total eligible own funds to meet the SCR	70,220	70,220	0	0	0
R0550	Total eligible own funds to meet the MCR	70,220	70,220	0	0	
R0580	**SCR**	57,743				
R0600	**MCR**	25,985				
R0620	**Ratio of Eligible own funds to SCR**	1.2161				
R0640	**Ratio of Eligible own funds to MCR**	2.7024				

	Reconcilliation reserve	C0060
R0700	Excess of assets over liabilities	70,220
R0710	Own shares (held directly and indirectly)	0
R0720	Foreseeable dividends, distributions and charges	0
R0730	Other basic own fund items	6,000
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0
R0760	**Reconciliation reserve**	64,220
	Expected profits	
R0770	Expected profits included in future premiums (EPIFP) - Life business	0
R0780	Expected profits included in future premiums (EPIFP) - Non- life business	0
R0790	**Total Expected profits included in future premiums (EPIFP)**	0

S.25.02.21 Solvency Capital Requirement - for undertakings using the standard formula and partial internal model

(Unaudited)

All amounts are in £'000

	Unique number of component	Component description	Calculation of the Solvency Capital Requirement	Amount modelled	USP	Simplifications
Row	C0010	C0020	C0030	C0070	C0080	C0090
1	103	Interest rate risk	5,495	5,495		
2	104	Equity risk	20,099	20,099		
3	106	Property risk	3,099	3,099		
4	107	Spread risk	6,408	6,408		
5	108	Concentration risk	0	0		
6	109	Currency risk	7,144	7,144		
7	110	Other market risk	0	0		
8	199	Diversification within market risk	-17,041	-17,041		
9	203	Other counterparty risk	2,701	2,701		
10	301	Mortality risk	0	0		
11	302	Longevity risk	0	0		
12	303	Disability-morbidity risk	0	0		
13	304	Mass lapse	6,066	6,066		
14	305	Other lapse risk	9,243	9,243		
15	306	Expense risk	54,139	54,139		
16	308	Life catastrophe risk	0	0		
17	309	Other life underwriting risk	0	0		
18	399	Diversification within life underwriting risk	-47,547	-47,547		
19	505	Other non-life underwriting risk	0	0		
20	701	Operational risk	32,368	32,368		
21	801	Other risks	0	0		
22	802	Loss-absorbing capacity of technical provisions	0	0		
23	803	Loss-absorbing capacity of deferred taxes	-5,182	-5,182		
24	804	Other adjustments	-11,131	-11,131		

PRUDENTIAL

S.25.02.21 Solvency Capital Requirement - for undertakings using the standard formula and partial internal model

(Unaudited)
All amounts are in £'000

		C0100
	Calculation of Solvency Capital Requirement	
R0110	Total undiversified components	65,858
R0060	Diversification	-8,115
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	0
R0200	**Solvency capital requirement excluding capital add-on**	57,743
R0210	Capital add-ons already set	0
R0220	**Solvency capital requirement**	57,743
	Other information on SCR	
R0300	Amount/estimate of the overall loss-absorbing capacity of technical provisions	0
R0310	Amount/estimate of the overall loss-absorbing capacity ot deferred taxes	-5,182
R0400	Capital requirement for duration-based equity risk sub-module	0
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	57,743
R0420	Total amount of Notional Solvency Capital Requirement for ring fenced funds	0
R0430	Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	0
R0440	Diversification effects due to RFF nSCR aggregation for article 304	0

S.28.01.01 Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

All amounts are in £'000

	Linear formula component for non-life insurance and reinsurance obligations	C0010
R0010	MCR_{NL} Result	0

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
		C0020	C0030
R0020	Medical expense insurance and proportional reinsurance	0	0
R0030	Income protection insurance and proportional reinsurance	0	0
R0040	Workers' compensation insurance and proportional reinsurance	0	0
R0050	Motor vehicle liability insurance and proportional reinsurance	0	0
R0060	Other motor insurance and proportional reinsurance	0	0
R0070	Marine, aviation and transport insurance and proportional reinsurance	0	0
R0080	Fire and other damage to property insurance and proportional reinsurance	0	0
R0090	General liability insurance and proportional reinsurance	0	0
R0100	Credit and suretyship insurance and proportional reinsurance	0	0
R0110	Legal expenses insurance and proportional reinsurance	0	0
R0120	Assistance and proportional reinsurance	0	0
R0130	Miscellaneous financial loss insurance and proportional reinsurance	0	0
R0140	Non-proportional health reinsurance	0	0
R0150	Non-proportional casualty reinsurance	0	0
R0160	Non-proportional marine, aviation and transport reinsurance	0	0
R0170	Non-proportional property reinsurance	0	0

	Linear formula component for life insurance and reinsurance obligations	C0040
R0200	MCR_L Result	67,523

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
		C0050	C0060
R0210	Obligations with profit participation - guaranteed benefits	0	
R0220	Obligations with profit participation - future discretionary benefits	0	
R0230	Index-linked and unit-linked insurance obligations	9,646,170	
R0240	Other life (re)insurance and health (re)insurance obligations	0	
R0250	Total capital at risk for all life (re)insurance obligations		0

	Overall MCR calculation	C0070
R0300	Linear MCR	67,523
R0310	SCR	57,743
R0320	MCR cap	25,985
R0330	MCR floor	14,436
R0340	Combined MCR	25,985
R0350	Absolute floor of the MCR	3,332
R0400	**Minimum Capital Requirement**	25,985