PRUDENTIAL

The Prudential Assurance Company Limited

Solvency and Financial Condition Report

31 December 2017

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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.

Summary

Company background

The Prudential Assurance Company Limited ('PAC', 'the Company', 'we') was founded in the United Kingdom ('UK') in 1848, and is 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.

The Company consists of the With-Profits Sub-Fund (WPSF), including the Scottish Amicable Insurance Fund (SAIF), Defined Charge Participating Sub-Fund (DCPSF) and the Shareholder Fund, as shown in the table below.

The Prudential Assurance Company Limited (PAC)			
With-Profits Fund			Shareholder Fund "0:100"
With-Profits Sub-Fund (WPSF) "90:10"	Scottish Amicable Insurance Fund (SAIF) "100:0"	Defined Charge Participating Sub-Fund (DCPSF) "100:0"	

The proportion of divisible profit attributable to with-profits policyholders in the WPSF is defined by the Articles of Association as being at least 90%, with the balance attributable to shareholders. For virtually all business, the policyholders' proportion is currently 90%. Thus the WPSF is a "90:10" sub-fund.

The whole of the profit arising in SAIF, including profits or losses on its non-profit business, will be allocated to with-profits policyholders in SAIF (i.e. SAIF is a "100:0" sub-fund). The profit in the DCPSF arises solely from investment performance and is entirely attributable to DCPSF policyholders (i.e. the DCPSF is a "100:0" sub-fund).

All the profit of the Shareholder Fund is attributable to shareholders (i.e. the Shareholder Fund is a "0:100" sub-fund).

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.

Our products are typically long-term consisting of life insurance, pensions, pension annuities, investment and savings products. In common with other UK long-term insurance companies, our 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 shareholder fund. The Company operates a branch in Poland and owns a life insurance subsidiary in the UK as well as subsidiaries in Ireland and Hong Kong. The legal ownership of the Hong Kong insurance subsidiaries is intended to be transferred from the Company to Prudential Corporation Asia Limited (PCAL). This is expected to complete by the end of 2019, see A.5.3.4 for further details.

Business and performance

The fundamentals underpinning the UK's retirement market are changing. Risk and responsibility for retirement provision continues to transfer away from the state and corporates to individuals. As customers adjust to the reforms introduced by Pensions Freedom in 2015, the new flexible arrangements to control their own pensions have been accompanied by significant complexity which is adding to the burden of personal responsibility to secure an income in retirement. Investment risk, longevity risk and inflation risk are to be mitigated by today's retirement saver.

To support its customers in this changing environment, the Company's product and distribution profile has evolved by increasing the range of product options to mirror the flexibilities of the pensions freedom era. 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.

In particular the Company has launched the Prudential Retirement Account, an online account based plan, that provides customers with the flexibility to save for their retirement, benefit from an income in retirement and facilitate access to their fund as they save. The Retirement Account allows customers to invest in PruFund, the Company's customer proposition managed by Prudential Portfolio Management Group, the Company's award-winning and market leading multi-asset management team. In 2017 Prufund reached £36 billion (2016: £25 billion) in customer assets under management (AUM), up by 46% including the Prudential Retirement Account, which experienced a successful first year accumulating AUM of £7.2 billion.

In August 2017, Prudential plc, the parent of the Company, brought together M&G, the investment management business, with Prudential's UK and European life insurance business, of which the Company forms the major part, to create M&G Prudential. The Company continues to carry out the insurance activities of M&G Prudential.

In March 2018 Prudential plc announced its intention to demerge the newly formed M&G Prudential from Prudential plc, resulting in two separately-listed companies, with different investment characteristics and opportunities.

M&G Prudential as a standalone group will continue to drive its transformation into a more capital-efficient and customer-focused business, targeting growing customer demand for comprehensive financial solutions in the retirement and savings markets. In line with this strategy the Company agreed in March 2018 to the partial sale of its shareholder annuity portfolio, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. In preparation for the demerger process, the legal ownership of the Hong Kong insurance subsidiaries is intended to transfer from the Company to PCAL. The sale of the UK annuity portfolio and the intended transfer of the Company's Hong Kong subsidiaries to Asia are expected to complete by the end of 2019.

The performance of the Company for the year-ended 31 December 2017, 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 of £797 million in 2017 was 57 per cent (£1,069 million) lower than the 2016 operating profit of £1,866 million. The comparative period included the effect of the increase in the Prudential Retirement Income Limited (PRIL) reinsurance quota share arrangement (giving rise to an operating profit of £1,443 million) on 1 January 2016. This was partially offset by annuity profits of £382 million previously reported in PRIL in 2016 now reported in PAC in 2017. Other management actions to improve solvency and changes in longevity assumption basis have increased the operating profit by £449 million (2016: £135 million).

At 31 December 2017 the Company increased the provision for the FCA's thematic review of non-advised annuity sales practices by £225 million from £175 million in 2016 to £400 million excluding any utilisation during the year. This is reported in operating profit.

The Company's total non-operating result has increased by £3,298 million to a profit of £1,795 million in 2017 from a loss of £1,503 million in 2016. Increase in profit in 2017 is driven by an increase in the value of shareholders' subsidiaries from a loss of £1,005 million in 2016 to a profit of £1,667 million in 2017 as well as an increase in short-term fluctuations in investment returns from a loss of £586 million in 2016 to a profit of £40 million in 2017.

The UK GAAP profit before tax has increased by £2,229 million from £363 million in 2016 to £2,592 million in 2017 as a result of these movements in operating and non-operating profits.

System of governance

The Board of The Prudential Assurance Company Limited 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. In 2017 this saw changes made to the internal structure of the Company, as well as the delegation of responsibilities, reporting lines and allocation of functions to meet requirements of the ongoing Merger and Transformation activity though there have been no material changes to the system of governance at the date of this report. 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. 2017 was a year of relative market stability 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 our risk appetite and philosophy towards risk-taking.

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

Further information on the main risks inherent in our business (namely market risk, credit risk, insurance or underwriting risk, liquidity risk, operational risk, business environment risk, strategic risk and technology risk) and how we manage these risks, and maintain an appropriate risk profile is provided in Section C.

Valuation for solvency purposes

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

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

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

The own funds and capital for the Company's non-insurance subsidiary Prudential Lifetime Mortgages Limited which carries out financial activities are included using sectoral rules.

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

Capital management

The Company has been granted approval by the Prudential Regulation Authority to calculate its solvency capital requirement (SCR) based on its internal model. At 31 December 2017, the SCR was £14,397 million (2016: £13,208 million). The minimum capital requirement (MCR) is currently 25% (2016: 25%) of the SCR, £3,599 million at 31 December 2017 (2016: £3,302 million). The

Company's SCR and MCR have been met at all times throughout 2017. At 31 December 2017, the Company's Solvency II surplus at was £6,115 million (2016: £5,098 million).

A summary of the reconciliation of the Company's shareholder Solvency II position published in the Company's 2017 financial statements to the Solvency II position, incorporating the Company's ring-fenced funds, 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 solvency capital requirement is also provided in Section E.

A Business and performance
(Unaudited)

A.1 Business

A.1.1 Overview

Name and legal form

The Prudential Assurance Company Limited ('PAC', 'the Company', 'we') is a company limited by shares incorporated and 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 dual primary listings in London (premium listing) and Hong Kong and has therefore adopted a governance structure based on the UK and Hong Kong Corporate Governance Codes. Prudential plc also maintains secondary listings on the New York Stock Exchange and the Singapore Stock Exchange.

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

Laurence Pountney Hill
London
EC4R 0HH

This Solvency and Financial Condition Report ('SFCR') covers PAC 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, providing credit to consumers, giving investment advice, arranging deals in investments, safeguarding and administration of assets and establishing, operating or winding up a personal or stakeholder pension scheme.

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 2017, Prudential plc, incorporated and registered in England and Wales, is the only holder of qualifying holdings in the Company (being holdings of 10 per cent or more of the capital or voting rights).

A.1.2 Company structure

Material subsidiaries of the Company

The Company's material trading subsidiaries at 31 December 2017 are set out below:

	Main activity	Country of incorporation
Prudential Hong Kong Limited	Insurance	Hong Kong
Prudential Pensions Limited	Insurance	England and Wales
Prudential International Assurance plc	Insurance	Ireland

The Company has 100 per cent of the voting rights of the subsidiaries listed above. The percentage of equity owned is the same as the percentage of the voting rights held. Prudential Hong Kong Limited (PHKL) is the most material of the Company's subsidiaries at 31 December 2017. In preparation for the demerger process, the legal ownership of the Hong Kong insurance subsidiaries is intended to transfer from the Company to PCAL. This is currently expected to occur by the end of 2019. The estimated, pro-forma impact on the Company's shareholder Solvency II surplus position , assuming the transfer had been completed as at 31 December 2017, is a reduction in surplus of £4.4 billion (including a loss of diversification benefits of £1.1 billion). After also allowing for the impact of the UK annuity sale, the resulting 31 December 2017 pro-forma surplus of the Company is £2.8 billion with a shareholder solvency ratio of 150%. See Section A.5.3.5 for further details.

Particulars of the subsidiaries are shown in Section D.1.

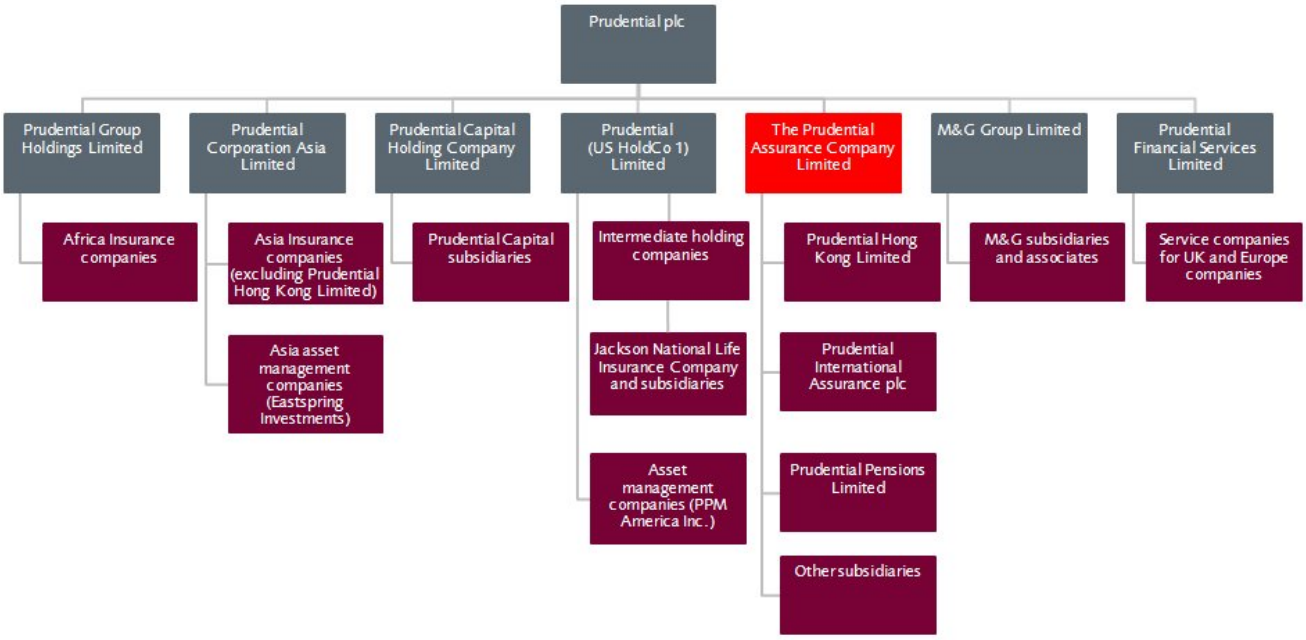
A complete list of the Company's related undertakings is provided in Appendix A.

Legal structure of the Group and related undertakings

As noted above, the Company is part of the Prudential group. Following the combination during the year of the Group's UK insurance business and M&G to form M&G Prudential the Prudential Group is restructured around three main business units: Prudential Corporation Asia (incorporating the asset management business, Eastspring Investments), North America Business Unit and M&G Prudential in UK and Europe. In addition, in recent years, the Group has expanded into Africa. These are supported by central functions which are responsible for Prudential strategy, cash and capital management, leadership development and succession, reputation management and other core group functions. The Company forms the major part of the Group's UK insurance business.

Figure 1 below shows, in a 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 2017. Subsequent to the year-end, Prudential plc announced its intention to demerge its UK & Europe business ('M&G Prudential') from Prudential plc, resulting in two separately-listed companies. See A.5 for further intended changes to the Company structure.

Figure 1: Simplified structure of Prudential plc as at 31 December 2017



A.1.3 Business and performance

Material lines of business and material geographical areas

The Company transacts long-term insurance business in the United Kingdom ('UK'). Throughout 2017 the Company also owned several insurance subsidiary undertakings, including subsidiaries in Hong Kong and Ireland, and a branch in Poland.

The Company's long-term products consist of life insurance, pension products and pension annuities. In common with other UK long-term insurance companies, the Company's products are structured as either with-profits participating products, or non-participating products including annuities in payment and unit-linked products. Depending on the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies.

The Company also has a UK subsidiary, Prudential Pensions Limited, whose business consists of unit-linked products.

The Company's Hong Kong subsidiaries, PHKL and Prudential General Insurance Hong Kong Limited, offer both participating and non-participating term, whole life, endowment and unit-linked policies. They also offer a range of stand-alone health, disablement, critical illness and accident cover to supplement its core life products.

The Company's Irish subsidiary, Prudential International Assurance plc (PIA), is a leading insurer in the offshore bond market while also providing risk insurance for its UK policyholders. PIA sells to both UK and non-UK nationals. Its focus in 2017 has been the sale of multi-asset solutions to UK nationals resident in the UK and selected countries in continental Europe.

The core business of the Company's Polish branch is a life insurance product, Premiopolisa. This is an individual protected product offering guarantees with significant growth potential at maturity. Pure protection products are also offered.

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

In August 2017, Prudential plc, the parent of the Company, brought together M&G, the investment management business, with Prudential's UK and European life insurance business, of which the Company forms the major part, to create M&G Prudential. The Company continues to carry out the insurance activities of M&G Prudential.

A number of management actions were taken in 2017 to improve the Solvency II position of the UK insurance operations and further mitigate market risk, which have generated combined UK GAAP profits of £276 million (2016: £332 million). Of this amount £31 million (2016: £197 million) related to profit from additional longevity reinsurance transactions covering £0.5 billion (2016: £5.4 billion) of UK GAAP annuity liabilities, with the balance of £245 million (2016: £135 million) reflecting the effect of repositioning the fixed income portfolio and other actions. At 31 December 2017, longevity reinsurance covered £14.4 billion (2016: £14.4 billion) of UK GAAP annuity liabilities equivalent to 45 per cent (2016: 42 per cent) of total annuity liabilities.

The Company has agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review will examine whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. The FCA formally released its redress calculation methodology in early 2018 and accordingly Prudential reassessed the provision held to cover the costs of undertaking the review and any potential redress. At 31 December 2017, following this reassessment, the gross provision was increased to £400 million (2016: £175 million), excluding any utilisation during the year. The ultimate amount that will be expended by the Company on the review, which is currently expected to be completed in 2019, remains uncertain. Although the Group's professional indemnity insurance is expected to mitigate the overall financial impact of this review, with potential insurance recoveries of up to £175 million, no such recovery has been factored in the provision, in accordance with the requirements of FRS 102.21 "Provisions and Contingencies".

A.2 Underwriting performance

Operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns, which gives a more relevant measure of the performance of the business. Other items are excluded from operating profit to allow more relevant period on period comparisons of the trading operations of the Company, e.g. the effects of material corporate transactions.

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.

Operating profit broadly equates to premiums less claims (including change in technical provision) and expenses together with assumed longer-term investment returns. Given the linkage between the movement of technical provisions and the movement in investments backing those liabilities (e.g. for unit-linked funds, investment return (where positive or negative) results in a corresponding change in unit-linked technical provisions), the Company has defined operating profit as its underwriting performance as discussed in this section. Similarly, the core discussion of the investment performance of the Company in Section A.3 is by reference to short-term fluctuations in investment returns.

An analysis of premiums, claims, expenses 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 2017 (with 31 December 2016 comparison)

	2017 £m	2016 £m	Change %
Operating profit based on longer-term investment returns	**797**	**1,866**	**(57)**
Short-term fluctuations in investment returns	40	(586)	107
Revaluation of shareholder subsidiaries	1,667	(1,005)	266
Dividends from subsidiaries	88	88	—
Profit before tax attributable to shareholders	**2,592**	**363**	**614**

The Company's total operating profit of £797 million in 2017 was 57 per cent (£1,069 million) lower than the 2016 operating profit of £1,866 million. Most of this is caused by a change in which statutory entity the annuity results are reported in. The majority of the shareholder annuity business on the Company balance sheet was originally underwritten in Prudential Retirement Income Limited ('PRIL', a wholly owned subsidiary of the Company) and was reassured into PAC via a quota share agreement. This quota share reinsurance arrangement from PRIL to PAC was increased from 20% to 100% on

1 January 2016, and was followed by a Part VII transfer of all of the business to the Company on 1 October 2016. The 2016 results of the Company therefore included the result of the former PRIL business only for the three month period from 1 October 2016 to 31 December 2016, in contrast to the 2017 results when all of the annuity results were included in PAC throughout the period. Other management actions to improve solvency and changes in longevity assumption basis have increased the operating profit by £449 million (2016: £135 million).

At 31 December 2017 the Company increased the provision for the FCA's thematic review of non-advised annuity sales practices by £225 million from £175 million in 2016. This is reported in operating profit.

Further detail on short-term fluctuations is set out in a Section A.3.1 and on investments in subsidiaries and dividends in Section A.4.1.

Investments in subsidiaries are carried at fair value through profit and loss.

A.2.2 UK GAAP operating profit analysed by Solvency II lines of business

UK GAAP operating profit, as discussed above, is allocated by material Solvency II lines of business as follows:

Figure 3: Operating profit before tax for the year-ended 31 December 2017 (with 31 December 2016 comparison)

	2017 £m	2016 £m	Change %
Insurance with-profits participation[1]	288	269	7
Other (comprising index-linked and unit-linked insurance, other life insurance and life reinsurance)[2]	509	1,597	(68)
Operating profit before tax	797	1,866	(57)

[1] Insurance with-profits participation comprises the shareholders' transfer from the with-profits funds of the Company.
[2] Other comprises mainly profits relating to the shareholder annuity business.

A.3 Investment performance

A.3.1 Short-term fluctuations

As explained in Section A.2 Underwriting Performance, 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 assumed longer-term returns is reported within short-term fluctuations in investment returns.

Included in non-operating results are gains of £40 million as a result of short-term fluctuations (2016: loss of £586 million). This comprises capital gains on surplus assets of £124 million (2016: loss £146 million) together with favourable credit experience of £87 million (2016: £79 million) and £46 million (2016: loss £36 million) of unrealised gains on certain equity release mortgages partially offset by losses on the partial hedge of the shareholder transfers in respect of future years £124 million (2016: £252 million), losses on surplus assets from credit events £60 million (2016: £39 million) and losses on swaption contracts £33 million (2016: £9 million).

During the year, the assumptions used within the discounted cash flow model used to value equity release mortgage loans were refined to reflect developing market practice, including consideration of the Prudential Regulation Authority's industry wide review in this area and resulting guidance. This refinement contributed £46 million to non-operating profit as detailed above. In 2016 there was a loss of £173 million on the transfer of the lifetime mortgages from the Company to PRIL on 1 January 2016 as part of the annuity business restructure. The Lifetime mortgages were subsequently moved back into the Company as part of the Part VII transfer referred to above.

A.3.2 Investment management expenses

The total investment management expenses incurred by the Company's insurance operations, including those that were paid to the Company's asset management operations totalled £389 million (2016: £372 million).

An analysis of investment return in the income statement by asset class is given in Section A.5.2.4.

A.3.3 Investments in securitisations

Certain of the securities classified as asset-backed securities meet the definition of securitisation under Solvency II for the purpose of the Solvency II capital requirements calculation. Investments in securitisation are subject to specific spread stresses in the calculation in order to ensure that risks arising from securitisation positions are reflected appropriately.

Of the £5,541 million of asset-backed securities at 31 December 2017 (2016: £5,696 million), £4,518 million (2016: £4,054 million) meet the definition of investment of securitisation for the purpose of the Solvency II capital requirement calculation.

A.4 Performance of other activities

A.4.1 Investments in subsidiaries and dividends

The contribution to non-operating profit by the Company's subsidiaries is as shown in the operating profit table in Section A.2.1.

The value of shareholder subsidiaries has increased by £1,667 million in 2017, compared to a loss of £1,005 million in 2016, as shown in figure 2 in Section A.2.1. The current period revaluation gains on subsidiaries are driven by an increase in value of PHKL. The 2016 loss was caused primarily by the reduction in value of PRIL following the Part VII transfer of its business into the Company.

Dividends totalling £88 million (2016: £88 million) were received from shareholder subsidiaries during the year.

A.4.2 Leasing

The Company's operating and finance lease arrangements relate principally to properties.

The Company holds investment properties which are leased out to earn a return. Further information on the Company's leasing arrangements is provided below.

The Company does not hold any individually material leasing arrangements.

A.4.2.1 Operating leases

The Company as a lessor
Investment properties principally relate to the Company's with-profits funds and are carried at fair value. The Company's policy is to let investment properties to tenants through operating leases.

The 2017 income statement includes rental income from investment properties of £496 million (2016: £457 million) and direct operating expenses including repairs and maintenance arising from these properties of £74 million (2016: £62 million).

A.4.2.2 Finance leases

The Company as a lessee
The Company's portfolio of investment properties comprise both freehold and leasehold properties. As at 31 December 2017, investment properties of £4,258 million (2016: £4,193 million) are held under finance leases. These finance leases are arrangements which grant very long leases with a large payment made upfront with minimal ground rent payable on an annual basis.

The 2017 income statement includes £7.1 million in respect of finance lease charges (2016: £9.4 million).

<u>The Company as a lessor</u>
As at 31 December 2017, investment properties of £33 million (2016: £33 million) are held under finance lease assets.

The 2017 income statement includes rental income from investment properties of £2 million (2016: £2 million).

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 2017 is £2,592 million (2016: £363 million), representing operating profit of £797 million (2016: £1,866 million), as set out in Figure 2 and discussed in Section A.2.1, and non-operating profit of £1,795 million (2016: loss of £1,503 million). Analysis of profit before tax is shown in Figure 4 below by nature of revenue and charges.

Figure 4: Total revenue and charges for the year-ended 31 December 2017 (with 31 December 2016 comparison)

	2017 £m	2016 £m
Gross premiums written	13,077	33,093
Outward reinsurance premiums	(1,030)	(635)
Earned premiums, net of reinsurance	**12,047**	**32,458**
Other income	**17**	**29**
Investment income	11,043	8,818
Unrealised gains on investments	2,961	9,166
Investment return	**14,004**	**17,984**
Total revenue, net of reinsurance	**26,068**	**50,471**
Claims paid – gross amount	(12,019)	(10,991)
Claims paid – reinsurers' share	1,085	985
Change in provision for claims - gross amount	(29)	(30)
Change in long-term business provision - gross amount	(9,283)	(37,179)
Change in long-term business provision - reinsurers' share	318	785
Change in technical provision for linked liabilities	(54)	(400)
Claims incurred and changes in other long-term business and technical provisions – Net of reinsurance	**(19,982)**	**(46,830)**
Net operating expenses	(1,011)	(893)
Investment expenses and charges	(408)	(405)
Other charges	(14)	(23)
Tax attributable to the long-term business	(686)	(1,048)
Actuarial and other gains (losses) on pension schemes	94	(75)
Transfer to the fund for future appropriations	(1,649)	(1,180)
Profit before tax (being tax attributable to shareholders' and policyholders' returns)	**2,412**	**17**
Tax credit attributable to the balance on the long-term business technical account	180	346
Profit on ordinary activities before tax	**2,592**	**363**

A.5.2 Premiums, claims and expenses

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

Figure 5: Premiums by Solvency II line of business for the year-ended 31 December 2017 (with 31 December 2016 comparison)

	Health insurance £m	Insurance with-profits participation £m	Index-linked and unit-linked insurance £m	Other life insurance £m	Accepted life insurance £m	Total 2017 £m	Total 2016 £m
Premiums earned - gross	20	11,557	631	424	807	13,439	33,093

Gross premiums for the Company decreased by 59 per cent from £33,093 million in 2016 to £13,439 million in 2017. The prior year comparative included a premium in respect of the increase in the quota share reinsurance with Prudential Retirement Income Limited from 20% to 100%, which took place on 1 January 2016.

The gross earned premiums of £13,077 million in 2017 excludes £362 million of premiums for investment contracts without discretionary participation features (as defined by FRS 103) reflecting the deposit nature of these contracts. The premiums for these investment contracts without discretionary participation features are included in premiums written and earned under Solvency II. The gross premiums amount of £13,439 million, including these investment contracts, is analysed in figure 5.

On-going demand for the Company's PruFund multi-asset funds remains strong as customers continue to be attracted by its performance track record, the benefits of a smoothed return in managing market volatility and its ability to reduce customer investment risk in the current market conditions. The PruFund range of investment funds within an ISA wrapper generated APE sales of £133 million. In total across all products, PruFund APE sales of £1,184 million increased by 36 per cent from 2016, with total AUM having increased 46 per cent since the start of the year to £36 billion.

The Company and its subsidiaries did not write any bulk annuity business in 2017 and have now withdrawn from this market. Sales from new annuity business decreased from £410 million in 2016 to £211 million in 2017. The Company has taken steps to curtail retail sales by establishing an annuity panel arrangement with a number of other firms to provide annuities to its customers. This new service has been phased-in over the course of 2017.

A.5.2.2 Comparison of benefits and claims (including the movement in unallocated surplus of with-profits funds) with the prior period

Figure 6: Benefits and claims by Solvency II line of business for the year-ended 31 December 2017 (with 31 December 2016 comparison)

	Health insurance £m	Insurance with-profits participation £m	Index-linked and unit-linked insurance £m	Other life insurance £m	Accepted life insurance £m	Total 2017 £m	Total 2016 £m
Claims incurred and changes in other long-term business and technical provisions, net of reinsurance	(15)	(15,836)	(1,502)	(1,360)	(1,300)	(20,013)	(46,847)

Claims incurred and changes in other long-term business and technical provisions (net of reinsurance) totalling £19,982 million in 2017 (as noted in Figure 4) includes £19 million (2016: £21 million) of claims handling expenses, £7 million deposit accounting and an adjustment for other charges of £43 million (2016: £38 million).

Claims incurred and changes in other long-term business and technical provisions (net of reinsurance) have decreased by 57 per cent from £46,847 million in 2016 to £20,013 in 2017. The year on year comparison is distorted by the long-term business provision in respect of the increase in the quota share reinsurance with PRIL from 20% to 100%, which took place on 1 January 2016.

A.5.2.3 Acquisition costs and other expenditure

Net operating expenses consist of acquisition costs £218 million (2016: £218 million) and other expenditure £793 million (2016: £675 million). Investment expenses and charges are comprised of investment management expenses £389 million (2016: £372 million), plus interest on bank borrowings of £19 million (2016: £33 million).

Other expenditure has increased by £118 million from £675 million in 2016 to £793 million in 2017. The majority of this increase, £34 million is in relation to an increase in restructuring expenses. In addition the provision for the cost of undertaking a review of past non-advised annuity sales practices and related potential redress was £225 million in 2017, £50 million higher than in 2016.

A.5.2.4 Investment return by asset class

Figure 7: Investment return for the year-ended 31 December 2017 (with 31 December 2016 comparison)

	2017 £m	2016 £m
Income		
Investment properties	496	457
Loans	145	92
Equity securities and portfolio holdings in unit trusts	1,665	1,398
Debt securities	2,851	2,154
Other investments (including deposits)	697	5,648
Total income	**5,854**	**9,749**
Investment appreciation (depreciation) and other investment return		
Investment properties	516	(51)
Loans	(5)	(12)
Equity securities and portfolio holdings in unit trusts	5,393	7,629
Debt securities	(66)	4,058
Other investments	2,312	(3,389)
Total investment appreciation (depreciation) and other investment return	**8,150**	**8,235**
Total investment return	**14,004**	**17,984**

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, including impairment losses.

Total income has decreased by £3,895 million from £9,749 million in 2016 to £5,854 million in 2017. The main reason for this is the decrease (£5,144 million) in investment return received from PRIL as part of the quota share arrangement which ceased on 1 October 2016. As part of this arrangement the underlying investment return was reported in PRIL with a corresponding investment return payable to PAC.

Other investments are carried at fair value through profit and loss and consist mainly of revaluation in subsidiaries and derivative movements. Revaluation of subsidiaries have increased by £1,865 million, which primarily relates to PHKL. Derivatives, which are primarily based on foreign exchange rates have increased by £3,434 million in 2017.

A.5.3 Post balance sheet events

A.5.3.1 Partnership with Tata Consultancy Services (TCS)

On 16 January 2018 the Group announced a new 10-year partnership with Tata Consultancy Services (TCS), to enhance service for its UK savings and retirement customers. The administration of over four million life and pensions contracts will move from Capita, Prudential's business partner for the past 10 years, to Diligenta, the subsidiary of TCS regulated by the Financial Conduct Authority. TCS will also assume responsibility for the operation of some of Prudential's internal IT infrastructure. The 2017 results also include the expected benefits of the new strategic partnership with TCS (£74 million) and associated costs (£31 million).

A.5.3.2 Sale of Prudential Vietnam Finance Company Limited

On 23 January 2018 the Group reached an agreement to sell 100% of its consumer finance business in Vietnam, Prudential Vietnam Finance Company Limited ("PVFC"), for a consideration of US$151m, subject to regulatory approvals. The agreement is with Shinhan Card Co., Ltd. a subsidiary of the Shinhan Financial Group, a Korean financial institution. PVFC is a wholly-owned subsidiary of Prudential Holborn Life Limited which itself is a wholly-owned subsidiary of the Company.

A.5.3.3 Sale of annuity portfolio

In March 2018, M&G Prudential announced the sale of £12 billion of the Company's shareholder annuity portfolio to Rothesay Life. Under the terms of the agreement, the Company has reinsured £12 billion of liabilities (valued as at 31 December 2017) to Rothesay Life, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. The UK GAAP liabilities relating to M&G Prudential's total UK shareholder annuity portfolio as at 31 December 2017 were £33 billion. Based on asset and liability values as at 31 December 2017, the transaction is estimated to give rise to a pre-tax UK GAAP loss of around £500 million in 2018.

A.5.3.4 M&G Prudential Demerger

In March 2018, Prudential plc also announced its intention to demerge its UK & Europe business ('M&G Prudential') from Prudential plc, resulting in two separately-listed companies. The Company forms a major part of M&G Prudential. In preparation for the UK demerger process, the legal ownership of the Hong Kong insurance subsidiaries is intended to transfer from the Company to Prudential Corporation Asia Limited. This is expected to complete by the end of 2019.

A.5.3.5 Financial impacts of post balance sheet events

The estimated pro-forma impact on the Company's shareholder Solvency II capital position, assuming the sale of the annuity portfolio and the transfer of the Hong Kong insurance subsidiaries had both been completed as at 31 December 2017, is a decrease in surplus of £3.3 billion from £6.1 billion to £2.8 billion and a decrease in the shareholder solvency ratio of 28 percentage points from 178% to 150%.

Pro-forma estimated shareholder Solvency II capital position:

	Own Funds	Solvency Capital Requirement	Surplus	Ratio
	£bn	£bn	£bn	%
31 December 2016 as reported	12.0	7.4	4.6	163
31 December 2017 as reported	14.0	7.9	6.1	178
31 December 2017 pro-forma estimate*	8.5	5.7	2.8	150

* The pro-forma estimate assumes that the partial sale of the annuity portfolio and the transfer of the Company's Hong Kong subsidiaries to Asia had both been completed as at 31 December 2017. In relation to the sale of the annuity portfolio, this estimate includes a £1.3 billion reduction in the Solvency Capital Requirement (SCR) and a £0.2 billion decrease in Own Funds, resulting in an increase in capital surplus of £1.1 billion. In relation to the Hong Kong transfer, the impact on the SCR allows for

the release of the Hong Kong business standalone SCR of £2.0 billion, partially offset by the removal of diversification benefits between the UK and Hong Kong of £1.1 billion.

These transactions are not reflected in 31 December 2017 solvency position. For further details on changes in own funds during 2017, see Section E.1.3.

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, the Company is a material subsidiary of Prudential plc within the Prudential Group.

The Group consists of a number of material Business Units ('BU'). These BU's include M&G Prudential which incorporates Prudential UK, which provides the management structure for the Company, along with its subsidiaries and associated entities.

The Prudential UK Chief Executive Officer ('Prudential UK CEO') reports to the Board of Directors of the Company ('the Board') and to the Chief Executive Officer, M&G Prudential ('CEO M&G Prudential'), who in turn reports to the Prudential Group Chief Executive.

The Prudential UK CEO holds the Senior Insurance Manager Function 1 ('SIMF1') role for the Company and has been delegated responsibility for the operational management of the Company and its subsidiaries by the Board. The Prudential UK CEO runs the business through the executive operating structure including an Executive Committee ('EXCOM') and other committees to implement the three lines of defence model in operation across the Company and the whole Prudential Group.

The Board has an independent non-executive Chairman. In addition, two other independent non-executive Board members hold roles of Chair of the Board Risk and Capital Committee ('BRCC') and Board Audit Committee ('BAC'). At least half of the Board of Directors (including the Chairman) are independent non-executive directors. The non-executive directors are responsible for both supporting and overseeing executive management whilst, as members of a unitary Board, sharing in the wider duty to promote the success of the Company and to ensure the Company continues to meet its Threshold Conditions. Whilst forming part of the Prudential Group, the appointment of independent non-executive directors on the Board recognises the need for the Company to maintain local entity integrity distinct from the Group.

The quorum for the Board consists of at least four members, which must include the Chairman (or a non-executive director nominated by the Chairman) and the Prudential UK CEO (or an executive director nominated by the Prudential UK CEO). The membership of the Board as at 31 December 2017 is detailed in Figure 8 below.

Figure 8: Membership of the PAC Board as at 31 December 2017

PAC Board Members	Role
Paul Spencer	Chairman and Independent Non-Executive Director (SIMF 9)
Clive Adamson	Independent Non-Executive Director and Chairman of the BRCC (SIMF 10)
Richard Bennison	Independent Non-Executive Director and Chairman of the BAC (SIMF 11)
Mike Yardley*	Independent Non-Executive Director (Notified NED)
Joanne Dawson	Independent Non-Executive Director (Notified NED)
Clare Bousfield	PAC Director and CEO Prudential UK (SIMF 1)
John Foley	PAC Director and CEO M&G Prudential (SIMF 7)
Mark FitzPatrick	PAC Director and Group CFO (SIMF 7)

*Mike Yardley resigned with effect from 31 December 2017

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 policy set by Prudential plc, including the Prudential Group Governance Manual ('GGM').

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

In August 2017, Prudential plc announced that it would combine its asset manager, M&G, and the Prudential UK business. This was followed in March 2018 with the announcement of the intention to demerge the combined M&G Prudential business from the Prudential Group. At the date of this report there have been no material changes to the Company's system of governance which is considered appropriate for the nature, scale and complexity of the risks inherent in the Company's current business. This will continue to be considered as merger, transformation and demerger activity progresses.

B.1.2 Board Committees and decision making

The Board has established a number of committees comprising independent non-executive directors to provide oversight, challenge and to assist the Board in discharging its responsibilities effectively. The responsibilities of the principal committees are a key component of the governance framework, and a listed below.

The Board is responsible for:

1. **Strategy, Budgets and Business Plans**
   - approving the Company's strategy, long-term objectives, annual budgets and business plan prior to their submission to Prudential plc;
   - monitoring the implementation of the Company's strategy and long-term objectives, annual budgets and business plan as approved by the Prudential plc Board, and oversee any corrective action taken by the Company;

2. **Structure and Capital**
   - approving, subject to the GGM, the following matters;
     - material changes to the Company's corporate structure, including decisions to cease operations in parts of the Company or to extend activities into new business or geographic areas;
     - material changes to the Company's capital structure, including reduction of capital, share issues and the re-organisation or restructuring of capital;
     - the raising of, or committing to, external finance and financing programmes;
     - material transactions and certain other matters.

3. **Financial Reporting and Dividends**
   - approving the Company's Annual Report and Accounts;
   - approving the payment of dividends;
   - ensuring the Company adopts the Group's accounting policies;
   - endorsing the proposed appointment, reappointment or removal of the Group's external auditor;
   - regularly reviewing the overall financial condition of the Company and its subsidiaries, 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 Prudential UK business adheres to the Group Risk Framework ('GRF'), policies and limits;
   - approving the Company's risk appetite and risk framework and policies within the limits;
   - overseeing and approving where applicable, material disclosures to, and regular reporting required by, regulators.

5. **Board and other appointments**
   - taking the following actions, each in accordance with the Group Material Subsidiaries Corporate Governance Manual;
     - implementing changes to the structure, size and composition of the Board and membership, including the chairmanship of its committees and;
     - approving the appointment and removal of Directors;
   - ensuring, in conjunction with the Prudential UK CEO, that there is a succession planning process in place for executive directors and senior management;
   - ensuring an effective process for the ongoing refreshment of non-executive directors.

6. Governance

- ensuring the Company adheres to the Group's governance policies;
- ensuring that an evaluation of the Board's own performance, that of its committees and of all directors is undertaken in accordance with the Material Subsidiaries Corporate Governance Manual and that an appropriate plan of action is adopted to address matters identified in the evaluation;
- authorising any actual or potential conflict of interest situation applying to any director;
- authorising the Company Secretary to arrange for all directors to obtain, at the Company's expense, appropriate external professional advice where necessary;

7. Delegation of Authorities

- delegating authority to a number of standing and ad hoc committees of the Board and regularly reviewing the terms of reference for, and reports from, the committees, in adherence with the Material Subsidiaries Corporate Governance Manual;
- The Prudential UK CEO has responsibility for the operational management of the Company and its subsidiaries and may sub-delegate authority as they determine.

8. With-Profits

- ensuring that the interests of the with-profits policyholders are appropriately considered in relation to matters affecting with-profits policyholders as a whole or as separately identifiable groups of policyholders;
- receiving advice from the With-Profits Committee to ensure compliance with the Company's Principles and Practices of Financial Management ('PPFM').

9. Investment Strategy

- inputting into the development of, and approving, the Prudential UK investment strategy in the context of the Prudential UK business strategy; and
- monitoring the implementation of the Prudential UK investment strategy, and overseeing any corrective action taken by the Company.

Board Committees

The BAC, BRCC, With-Profits Committee, Independent Governance Committee and the Scottish Amicable Board are the principal standing committees of the Board.

The role of each Committee together with details of the current Chairman is summarised in Figure 9 below.

Figure 9: Summary of the role of each Board Committee and Chairman as at 31 December 2017

Board Committees	Role
Board Audit Committee	**Chair : Richard Bennison** The BAC is accountable to the 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 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 the Company. The Committee also oversees compliance with the GRF, related Group Risk Policies and Group Approved Limits.
With-Profits Committee	**Chair: Ronnie Bowie** The With-Profits Committee is an independent committee which acts in an advisory capacity to inform the decision-making of the Company to ensure that the interests of its with-profits policyholders are appropriately considered and to consider issues affecting with-profits policyholders as a whole or as separately identifiable groups of policyholders.
Independent Governance Committee	**Chair: Lawrence Churchill** The role of the Independent Governance Committee is to act solely in the interest of scheme members, to assess, raise concerns and report on the value for money of the Company's contract-based defined contribution workplace pension schemes and to focus on the quality of their schemes and ongoing review of regulatory and legislative requirements.
Scottish Amicable Board	**Chair: Bernard Solomons** The role of the Scottish Amicable Board is to observe and perform the terms of the Scottish Amicable Scheme of Transfer. It has regard solely to the interests and reasonable expectations of the holders of policies allocated to the Scottish Amicable Insurance Fund.

Oversight of the Hong Kong subsidiary is through the Hong Kong Oversight Committee. Increased oversight has been achieved principally through enhancing the seniority and functional mix of attendees at this Committee as well as expanding the financial, risk and operational reporting to it. A report is made after each meeting to the next BRCC, ensuring Non Executive scrutiny of the business. Furthermore, the CEO of PAC is also a member of the PHKL Board.

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

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 Committee and Policy

The M&G Prudential Remuneration Committee is an executive committee with a remit to implement the remuneration policy and structures established by the Group Remuneration Committee. The remit of the committee covers the Company along with other constituents of Prudential UK and M&G.

The Group Remuneration Committee is responsible for ensuring that BUs across the Group (including Prudential UK) comply with the Group Remuneration Policy and with applicable regulations.

The Solvency II requirement for the Company to have an independent remuneration committee is met by the M&G Prudential Remuneration Committee reporting into the Group Remuneration Committee, which provides the independent oversight for the Group Remuneration Policy. Further independence is achieved through membership comprised of non-M&G Prudential personnel and the appointment of an independent NED of the PAC Board to the Committee in December 2017.

Prudential Group's Remuneration Policy and practices ensure that the BUs 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 BU business plans and strategies;
– enables the recruitment and retention of high calibre employees and incentivises them to achieve success for their BU and the Group; and
– is consistent with the organisation's risk framework and appetite.

Remuneration practices within the Company and the other entities within Prudential UK follow the Prudential Group Remuneration Policy and there is no separate remuneration policy at the BU level.

The principles of the Remuneration Policy, implemented within the Company are:

– pay for performance;
– tailored to the relevant market;
– interest in Prudential shares;
– BU and Group focus;
– shareholder value creation;
– fair and transparent system for all;
– designed to minimise regulatory and operational risk; and
– safeguards to avoid conflicts of interest.

Remuneration architecture

Both fixed and variable remuneration is assessed against market data and internal benchmarks on an annual basis and balanced so that the fixed component represents a sufficiently high proportion of the total remuneration. This avoids employees being overly dependent on the variable components and helps 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 BU 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 the Company operates. This allows the Group and BUs to operate a fully flexible bonus policy, including the possibility of not paying an annual bonus based on financial and non-financial criteria.

Any awards made under the Group's LTIPs are based on Group and BU financial metrics and other non-financial metrics, such as the new Sustainability Scorecard which incorporates a conduct measure to be applied to all staff. 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.

Prudential does not operate any supplementary pension or early retirement schemes at Group or UK level. One key function holder for the Company participates in one of the legacy defined benefit schemes. The scheme provides an accrual of 1/60 of final pensionable earnings subject to the earnings cap for each year of pensionable service. 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 risk appetite and business strategy.

B.1.4 Material transactions with directors and shareholders

Transactions with Directors

In addition to remuneration for the role on the Board, 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 accordance with the Companies Act 2006, directors are required to disclose any transactions that may represent a conflict of interest to their roles.

In 2017 and 2016 other transactions with directors were not deemed to be sufficient both by virtue of their size and in the context of the directors' financial position to constitute a conflict of interest. All such 2016 transactions were on terms broadly equivalent to those that prevail in arm's length transactions with other persons.

Transactions with shareholders

A loan of £30 million (2016: £163m) was repaid from Prudential plc to the Company during 2017.

There were no other material transactions with shareholders outside the normal course of business.

B.2 Fit and proper requirements

The Company 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 GGM, which includes the Fit and Proper Policy, and the system of internal control each year end by each BU and the Group Head Office.

The Policy applies to:

– all persons approved as Prudential Regulation Authority ('PRA') SIMFs;
– all persons approved as Financial Conduct Authority ('FCA') Significant Influence Functions ('SIFs');
– 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 initially assessing fitness and propriety

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

– 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; and
– 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

The Company has processes for assessing the ongoing fitness and propriety of persons covered under the Fit and Proper Policy, including:

– sufficient evidence is gathered at least annually, to assess the ongoing Fitness and Propriety of individuals captured by the Senior Insurance Managers Regime, including Key Function holders and notified non-executive directors. This includes;
  - an assessment of whether the individuals are adhering to the relevant PRA/FCA Conduct Standards and Rules;
  - credit and criminality checks
  - self-certification of regulatory Fitness & Propriety questions
  - confirmation that role profile remains up to date and is an accurate reflection of current responsibilities
– for individuals in scope, a specific Approved Persons / Key Function Holder and Performers objective is a requirement of the Performance Management process, against which individuals are appraised on an annual basis. This objective is tailored to the specific FCA and PRA conduct standards for the role being performed.

The activity above is supported by the following processes;

– the Compliance Function are notified where there is a change in the fit and proper status of any Senior Insurance Management Functions, Significant Influence Functions 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; and
– the Compliance Function 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 Own Risk and Solvency Assessment

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 we think there is value to do so, and where it is consistent with 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

Our risk governance comprises the organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies that have been established to make decisions and control activities on risk-related matters. This encompasses individuals, key functions 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) <u>Risk Management Framework</u>

The Company's Risk Management Framework describes the approach to risk management, and the key arrangements and standards for risk management and internal control that support compliance with GGM and regulatory requirements. It provides a disciplined and structured process for the taking and management of risk, that covers the Prudential Group Code of Business Conduct and GRF, plus the statutory and regulatory requirements under Solvency II.

This is achieved through:

- outlining the governance structure and apportionment of accountabilities by which Prudential UK operates;
- providing a reference point when considering risks, by defining the risk management principles, strategy, policies and the risk management cycle;
- provision of a common language and framework for managing all types of risk which is important for consistency and enables understanding the overall risk exposure;
- promoting a responsible risk culture supported through the recruitment and training of the capabilities and behaviours needed to develop and control the business; and
- outlining the key processes for risk management and internal control that support compliance with the statutory and regulatory requirements; including UK Corporate Governance Code compliance, GGM, Solvency II, and the relevant rules of the PRA Rulebook and principles of the FCA Handbook.

(iii) <u>Risk appetite, limits and triggers</u>

The Company's risk appetite and tolerance to take on risk, is specified through risk appetite statements and limits that are aligned to the business model and subject to regular review. Risk appetite defines the amount of each type of risk an organisation is willing to accept in pursuit of its business objectives.

The Board maintains risk appetite statements and limits that inform decision making, reflect the business model and are compatible with Group-wide risk limits which are defined within the GRF and which apply in aggregate for earnings volatility, liquidity and capital requirements. The GRF sets out three types of measure (limits, triggers and indicators) that are used in applying the Group's stated appetite towards individual risk types.

The Company uses the Group Risk Appetite Statements as a basis for developing its own risk appetite statements, triggers and limits for each of the group risk categories. The appetite statements for the Company are approved annually by the ERC and the PAC Board. Regular monitoring of such triggers and indicators facilitates the early identification, escalation and management of potential breaches.

The framework of risk appetite statements, limits and triggers are designed to adequately manage risk within agreed limits and tolerance, rather than eliminate it, although there may exist some risks for which Prudential has no tolerance and which are actively avoided - e.g. Compliance risk and losses from ineffective anti-money laundering and counter-terrorist financing processes and controls.

(iv) <u>Risk policies</u>

Risk policies set out the principles by which we conduct our business in the area covered by the policy, usually by the setting of specific requirements. Policy requirements are typically brief and principles based and seek to address fundamental concepts rather than operational procedures. This allows business users to determine how best to comply with requirements based on their expertise.

There are core risk policies for each of the key risk categories, with supporting policies to help define the internal control framework.

(v) Risk standards

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

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 perspective 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 within the Company is part of the Risk Management Framework and in particular seeks to identify evidence of:

- articulation by the Board and Senior Management, which is visibly supported by the decisions they take, on the need for good risk management as a way to realise long-term value; and
- employee understanding of their role in managing risk including their awareness and open discussion of risk as part of the way they perform their role.

Key aspects of risk culture are reflected in the values and behaviours displayed within the Company, and captured by the Prudential Code of Business Conduct. The Company's performance management and reward structure balances risk with profitability and growth, in the performance evaluation of key individuals, including both senior management and those directly responsible for risk management In addition, every member of staff has a risk management objective to be achieved each year.

The risk management cycle

The Prudential UK risk management cycle consists of the procedures necessary to identify, measure and assess, manage and control, and monitor and report risks on a continuous basis.

(i) Risk identification and Risk Analysis / Measurement

Risk identification and measurement is derived through a number of processes, in particular the annual top-down and bottom-up risk identification processes, quarterly emerging risk process, and an annual exercise of stress and scenario testing in line with regulatory and Group requirements. 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) Risk Evaluation and Risk Treatment

Risks are evaluated against the defined risk appetite limits, triggers and indicators in order to establish whether the business is operating within risk appetite. Where risk appetite is exceeded, or in some cases the limit is close to being exceeded, management are expected to take action in the form of risk treatment.

Risk treatment is the process of selecting and implementing measures to modify the residual risk once evaluated. There are four options available:

- mitigate the risk by improving or adding to the internal controls in place;
- transfer the risk through risk transfer activities (e.g. insurance, reinsurance, hedging);
- avoid the risk through divestment or termination of activities which contravene company policy or the risk strategy (e.g. political risk); and
- accept the risk where the cost to control exceeds the potential impact of the risk.

(iii) Risk monitoring and oversight

Risk monitoring is an ongoing process to track the status of risks and is undertaken throughout the risk management cycle by both the risk owners and through oversight and assurance by the Risk, Compliance and Internal Audit Functions. Risk owners monitor risks against operating limits derived from the risk appetite statements and tolerance limits, monitoring the effectiveness of the controls against policy standards and identifying, responding and learning from incidents and loss events that occur.

(iv) Risk Communication and Reporting

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

- regular management information, prepared by the Prudential UK Risk Function on behalf of the CRCO, which is presented to the ERC and BRCC to enable oversight of risks on an ongoing basis; and
- Own Risk and Solvency Assessment ('ORSA') reporting, further details of which are contained in Section B.3.4.

B.3.2 The Risk Function

Risk management system

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.

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

- coordinating the identification and assessment of key risks to establish the risk profile used as a basis for setting qualitative risk appetite statements and quantitative limits, the management information received by risk committees and the Board;
- the assessment of solvency needs, and the 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;
- 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 Solvency and Financial Condition Report;
- performing the ORSA, undertaking stress and scenario testing including Reverse Stress Testing, and informing the key areas of risk based decision making; and
- 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 liaises with other functions (e.g. Actuarial and Compliance), to provide technical expertise and advice throughout the risk management cycle.

B.3.3 Internal Model

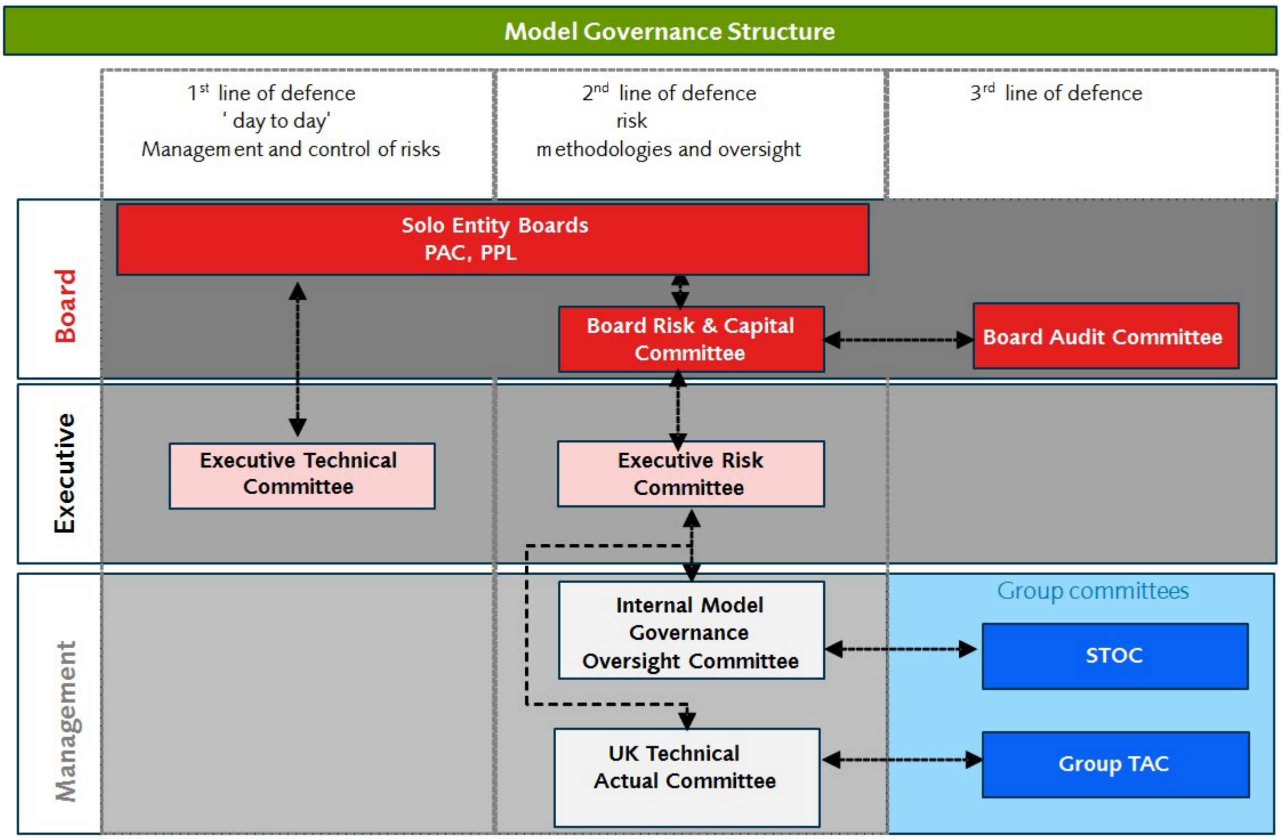
The Solvency II internal model is a key risk management tool and refers to the systems and processes used to identify, monitor and quantify risks for the purpose of calculating the Solvency II capital requirement ('SCR', 'Pillar I') and management's own assessment of economic capital ('ECap', 'Pillar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

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

- model use: to provide 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 UK Internal Model Risk Policy which, in turn, is aligned with the Prudential Group Internal Model Risk Policy and 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 10 below.

Figure 10: 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 use of the Internal Model within the Company and its subsidiaries, 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 Prudential UK ERC, which is chaired by the CRCO. The CRCO reports to the Board(s) as necessary on matters relating to the Internal Model.

As noted above, the model oversight and governance is supported by the implementation of the Prudential UK Internal Model Risk policy which forms part of the Prudential UK Risk Management Framework. The policy defines:

– minimum standards for effective model risk management;
– processes for the Risk Function 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 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 also 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, which should include identification of the Internal Model's 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 or UK TAC, on an annual basis.

Material changes to the Internal Model governance

There were no material changes to Internal Model governance in 2017.

B.3.4 Own Risk and Solvency Assessment

The Company defines the 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 been reviewed by various Committees such as the ERC and BRCC. 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 11 below sets out the key responsibilities of the ORSA stakeholders in the production of the ORSA report.

Figure 11: High level overview of ORSA responsibilities

Stakeholder	Roles
PAC Board	Steer and challenge throughout the ORSA process, approving the ORSA report.
Board Risk and Capital Committee	Review of the ORSA and recommendation to PAC Board for approval.
Executive Risk Committee	Review and comment upon the ORSA prior to submission to BRCC and PAC Board.
Prudential UK Chief Risk and Compliance Officer	Ownership of the ORSA report.
Prudential UK Risk	Preparation of the ORSA report, collaborating with functional areas as needed.
Prudential UK Finance	Preparation of quantitative inputs to ORSA report.

The Company's Risk Management Framework is designed to ensure adequate protection of policyholder and other stakeholder interests. The ORSA is recognised as a valuable component of this, providing to the means to understand the links between strategy, risk and capital. The Company holds capital with the objective of ensuring that the aggregate risk of not being able to meet liabilities as they fall due is kept to an acceptably low level. Embedding of the ORSA within the business drives top-down understanding of risks to the company and ensures the centrality of the Internal Model in business 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 ('GwIA').

B.4.2 Compliance Function

The Compliance Function provides dedicated support for regulatory interactions, including coordinating 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. The Compliance Function reports to the CRCO with its annual plan and required resources agreed by the BAC.

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 BUs 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 GwIA are relevant to the Company's Internal Audit Function.

How the Company's Internal Audit Function is implemented

The work of GwIA 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 Executive Committee, 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.

GwIA activity is not restricted in scope in any way, 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 GwIA in fulfilling its roles and responsibilities.
In executing its responsibilities, GwIA 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'.

- 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.

- 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 Prudential UK Audit Director who is accountable to the BAC with direct access to the Chair of the Committee and reports to the GwIA Director. For administrative purposes (excluding strictly all audit related matters) the Prudential UK Audit Director is a direct report of the Prudential UK CEO.

- The Prudential UK Audit Director reports audit related matters to the BAC and communicates directly with the BAC through attendance at its meetings. In addition, the Prudential UK Audit Director is invited to private session with the BAC members on a regular basis to discuss coverage and any restrictions on GwIA's work as well as engaging in regular dialogue with the BAC Chair outside of the formal Committees to discuss upcoming meetings and the risk and control landscape.

- The Prudential UK Audit Director, in consultation with the Prudential UK CEO, is empowered to attend and observe all or part of EXCOM and Board meetings and any other key management decision making committees and activities as appropriate.
- In accordance with the GwIA Charter, Prudential UK has an internal audit team, led by the Prudential UK Audit Director who reports to the Group-wide Internal Audit Director as functional head, with direct access to the Chair of the BAC. The GwIA Director will consider the independence, objectivity and tenure of the Prudential UK 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 GwIA's own standards and methodology.
- The assessment of the adequacy and effectiveness of the Risk, Compliance and Finance Functions is within the scope of GwIA and as such GwIA is independent of these functions and is neither responsible for, nor part of, them.
- GwIA 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.
- GwIA has a Conflicts of Interest register. Potential conflicts are recorded and monitored by the GwIA 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 the Prudential UK BU, the Actuarial Function is defined as the Chief Actuary, their 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 PRA SIMF and has responsibility for all of the activities of the Actuarial Function. The Prudential UK Chief Actuary and their 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 CRCO as the head of the Risk Function has delegated a number of the Risk Management responsibilities to the Chief Actuary, in particular oversight of the calibration and calculation of the solvency capital requirement 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 Prudential UK 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 constitutes 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, they carry out an annual review of aspects of the policy focussing on different aspects each year, depending on previous reviews, recent business activities and any particular issues that the Chief Actuary wishes to review further. 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, they carry out an annual review of specific aspects of the Reinsurance Policy focussing on different aspects each year, depending on previous reviews, recent business activities and any particular issues that the Chief Actuary wishes to review further. 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 Prudential UK 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 UK Technical Actuarial Committee, 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 announced that, linked to strategic ambitions, the provision of some key services by intra-group outsourcers will move to external providers over the next 12-18 months.

The Company has an Outsourcing and Third Party Supply policy in place, which was refreshed in 2017 and 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 the Company 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 with the Outsourcing and Third Party Supply Policy is completed on an annual basis by the Chief Financial Officer ('CFO') and is overseen by Prudential UK 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 Prudential UK CEO and CFO, Prudential UK report on compliance with the Group's governance policies and the internal control and risk management requirements. The Prudential UK BU 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 GwIA. Issues arising from any external regulatory engagement are also taken into account.

The Company continues to address issues raised following the FCA's thematic reviews of annuity sales and the fair treatment of long-standing customers in the life insurance sector.

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.

The charts below show the undiversified SCR risks in relation to the Company at 31 December 2017 for shareholder-backed and policyholder-backed business. Detailed information on how the SCR allocation has changed during 2017 is set out in Section E.2.

Figure 12: Undiversified SCR for PAC Shareholder business as at 31 December 2017

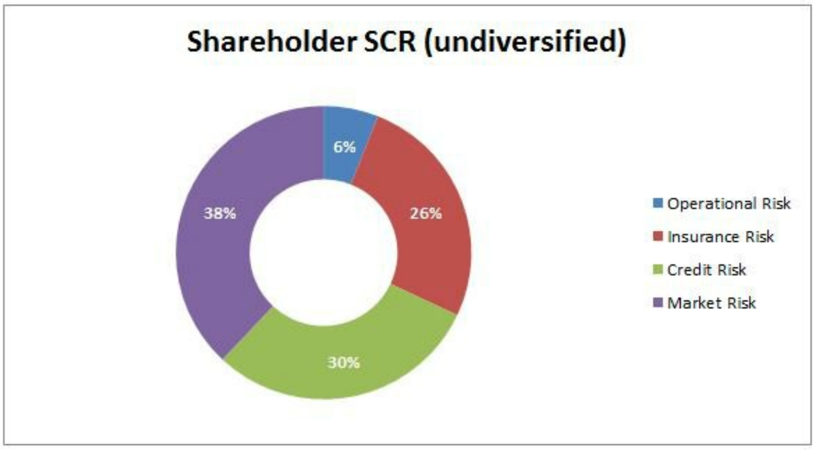
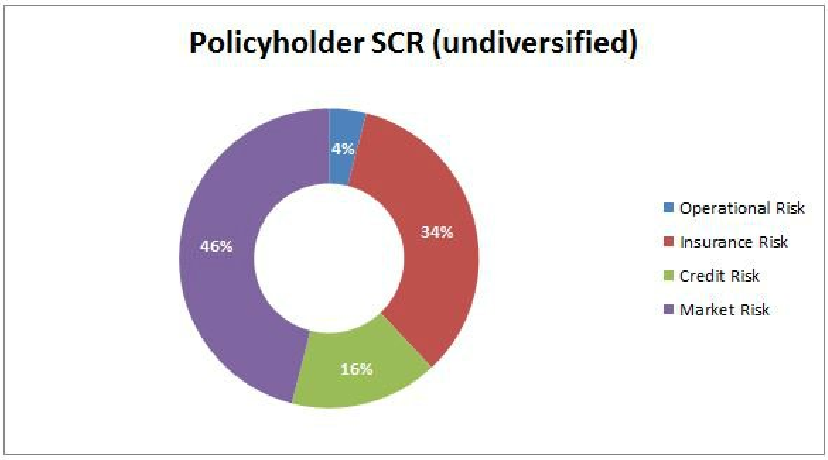


Figure 13: Undiversified SCR for PAC Policyholder business as at 31 December 2017



The key risk exposures are discussed in the following sections:

- Underwriting risk, or insurance risk, which includes persistency, longevity and expense (refer to Section C.1).
- Market risk, which includes equity, interest rate and currency risks (refer to Section C.2).
- Credit risk (refer to Section C.3).
- Liquidity risks (refer to Section C.4).
- Operational risk (refer to Section C.5).
- Other material risks (refer to Section C.6).

There have been no material changes to the measures used to assess the risk exposure or the material risks over the reporting period.

C.1 Underwriting risk

C.1.1 Risk Exposure and mitigation

The Company's shareholder business is exposed to material levels of underwriting risk (or insurance risk) as a result of its insurance business operations. Given the large in-force annuity book, longevity remains the top insurance risk for shareholder business. The policyholder funds' exposure to longevity risk is material and also arises from annuity business.

Longevity risk for both shareholder-backed business and policyholder-backed business has been predominantly managed through:

– annual reviews of best estimate assumptions, supported by detailed assessments of actual mortality experience versus best estimate assumptions;
– longevity research;
– longevity risk transfer transactions, assessed against principles and guidance provided in the Reinsurance Appraisal Framework; and
– monthly monitoring of longevity exposure by the ERC and BRCC.

Other insurance risks, such as persistency risk, expense risk and non-annuitant mortality risk are subject to similar regular reviews, with frequency and intensity proportionate to the materiality of the risk.

C.2 Market risk

C.2.1 Risk exposure and mitigation

Equity and property risk

The Company is materially exposed to risk arising from the mismatch between guarantees embedded in the liabilities and the assets backing them. This is primarily derived from exposure to equity and property prices. The key areas impacted are the present value of expected shareholder transfers from the with-profits business, the lifetime mortgage book.

Interest rate risk

The Company's exposure to interest rate risk primarily arises from the need to match cash payments to meet annuity obligations with cash received from investments. The Company aims to match the duration (a measure of interest rate sensitivity) of assets and liabilities as closely as possible, with regular monitoring and managing of the exposures. The Solvency II regime and its impact on the way the balance sheet is constructed, such as the requirement to include a risk margin in our capital reserves, creates additional interest rate risk for the Company.

The with-profits business of the Company and its subsidiaries is exposed to interest rate risk as a result of underlying guarantees built into certain products. This risk is largely borne by the with-profits fund itself, though shareholder support may be required in extreme circumstances where the fund has insufficient resources to support the risk.

As the solvency position remains sensitive to interest rates, the Company continues to closely monitor and manage its interest rate exposures.

Currency risk

The Company's material currency risk exposure arises from holding the Hong Kong business and investment in non-Sterling assets. The Company has a limited appetite for currency risks and where appropriate, has limits and controls in place to monitor and manage the risk. Where currency risk arises outside risk appetite, currency borrowings, swaps and other derivatives are used to manage the exposure.

Risk Mitigation

The methods used to manage and mitigate 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;
- annual review of the Strategic Asset Allocation;
- use of derivatives including options and futures on equities and interest rates; and
- use of currency hedging.

C.3 Credit risk

C.3.1 Risk exposure and mitigation

The Company is exposed to Credit risk by virtue of fixed income assets, primarily corporate bonds, in the shareholder-backed portfolio. There are also substantial volumes of similar assets held in the with-profits fund, the risk of which is largely borne by the with-profits policyholders, but which can impact the shareholder by reducing the size of the SHIFT assets and, in extremis, resulting in burn-through which requires shareholder support.

The Company operates a robust credit risk framework, comprising risk policies, risk appetite statements, processes and controls, including:

- Credit Risk Policy;
- the credit rating processes operated by the Group's asset management companies used by the Company;
- investment constraints on the asset portfolios, in relation to credit rating, seniority, sector and issuer;
- investment constraints on counterparties in particular for derivatives, reinsurance and cash;
- an average credit quality target for the assets;
- a credit risk limit framework, and associated monitoring for both the shareholder and policyholder businesses;
- activity and oversight from the ERC and BRCC and from the Group Credit Risk Committee (featuring membership from the Company's Risk Function), with a number of forward-looking indicators being monitored to identify potential counterparty risk materialising in the future;
- the invested credit sector reviews; and
- performing deep dive reviews.

C.4 Liquidity risk

C.4.1 Risk exposure and mitigation

The Company's exposure to liquidity risk is considered to be relatively small because of the nature of the operating model. The exposure that does exist primarily arises from:
- higher than expected policyholder withdrawals and collateral requirements;
- surrenders and processing delays;
- unexpected cash outflows; and
- lower than expected market liquidity for assets.

Liquidity risk is not quantified in the Internal Model given this risk is not best managed through holding additional capital. Instead, liquidity risk is managed through a robust Risk Management Framework, which includes:

- a Liquidity Risk policy;
- a Liquidity Contingency Plan; and
- Quarterly monitoring of exposures, under both base and various stressed scenarios, against Liquidity Coverage Ratios triggers / limits.

In 2017, as was the case for 2016, liquidity sources remained sufficient to meet financial obligations as they fell due both under the base and stressed scenarios.

C.4.2 Expected Profit Included in Future Premiums

The Company is required to calculate and report the expected profit included in future premiums (‘EPIFP’) included within its own funds, in accordance with Article 260 of the Delegated Regulation. This calculation requires an assessment of the impact of an increase in insurance liabilities (excluding the risk margin) if future premiums relating to in-force business were not received, regardless of the legal or contractual rights of the policyholder to discontinue the policy. The calculation is carried out at the level of homogeneous risk groups, as defined in Article 35 of the Delegated Regulation.

At the end of 2017 EPIFP had reduced to £nil (2016: £11.4 million) due to the run-off of the business reducing the benefit from charges on future premiums.

C.5 Operational risk

C.5.1 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. Such risks are also relevant in the management of outsourced services and during periods of significant transformation with additional exposure anticipated as the Company enacts its strategic transformation ambitions. Another important element of operational risk relates to non-compliance with the high rate of regulatory change. As well as prudential regulation, we focus on assessing changes in conduct regulation, including regulations related to anti-money laundering, bribery and corruption, and sales practices. Technology Risk, including cyber risk, is also an important and dynamic risk and is expanded on below.

The Company manages and mitigates its operational risk using the following:

- operational risk policies, including outsourcing and third-party supply;
- a cyclical risk management framework, based on the policy standards, that delivers processes and tools to identify, assess, control and monitor the operational risk exposures;
- 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; and
- regular testing of elements of the business continuity and disaster recovery plans.

C.6 Other material risks

C.6.1 Business Environment 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.

- 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.

– Regulatory: Changes in UK government policy, legislation (including tax), regulation or regulatory interpretation applying to insurance companies may adversely affect the Company's product range, distribution channels, capital requirements and, consequently, reported results and financing requirements. Regulators in other jurisdictions in which the Company operates may also introduce changes in the regulatory framework for long-term savings and retirement arrangements and investments, including to selling practices and solvency requirements.

  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.

– Political: Global political risks have been on the rise and look set to remain heightened. Domestically, the withdrawal of the UK from the EU introduces significant uncertainties for both the UK and the EU, affecting consumer and market confidence, and potentially increasing market volatility and the risk of a downturn in economic activity.

The Company's risk management and mitigation of such risks 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.

C.6.2 Strategic risk

Strategic risk is the risk of ineffective, inefficient, or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Company's capabilities.

The key business strategy affecting the Company is the integration of the M&G and Prudential UK & Europe businesses with the aim of delivering capital-light, digitally-enabled, customer-focused solutions. This presents a significant opportunity to leverage scale, financial strength and complementary product and distribution capabilities, but also carries strategic risk, as well as delivery and operational risks associated with the size, complexity and interdependencies of the transformation being undertaken.

C.6.3 Technology risk

The Company has a high dependency on technology to operate effectively and deliver the business plan, with the maintenance, integrity and resilience of the IT infrastructure and applications paramount to meeting business and customer needs. Our current reliance on a large number of legacy systems spread over a complex supply chain and increasing utilisation of outsourcing/Cloud deployments creates an enhanced risk of breaches and IT issues. With the new General Data Protection Regulation requirements on data privacy coming in to force in May 2018, controls around data confidentiality will become even more critical.

C.6.4 Reputation Risk

The Company recognises that, though hard to quantify, reputation is a key asset. The Company continues to develop, along with the wider Prudential Group, an approach to the management and oversight of reputational risk. Reputational risk is primarily a 'second order' risk, in that it results from another risk occurring, rather than in isolation. Reputational risk considerations are an important part of the Company's management of Environmental, Social and Governance (ESG) issues.

C.7 Any other information

C.7.1 Special Purpose Vehicles

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

C.7.2 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.

Stress tests are performed both with and without any allowance for the transitional measures on technical provisions granted by the PRA being recalculated. Stress tests are performed separately for the Company's with-profits funds and shareholder-backed business.

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 summary results from stress testing show that:

- the Company remains exposed to interest rate movements, equity and credit risk. These exposures continue to be subject to ongoing monitoring and management;
- by way of its UK annuity business, the Company retains an exposure to downgrades in the credit portfolio and lighter mortality experience;
- in practice we would expect a number of events to happen simultaneously. The analysis 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;
- the balance sheet is materially exposed to longevity risk. In practice, longevity events are expected to emerge over a number of years, and are therefore less of a concern in the short term than changes in market conditions.

C.7.3 Risk Concentration

The Company's review of significant risk concentration encompasses a review of its exposure to various balance sheet asset classes, individual counterparties, group of interconnected individual counterparties, specific geographical areas and industry sectors.

The Company complies with the Group's Global Counterparty Limits for Prudential UK, which limit significant concentration risks arising from various balance sheet asset classes. These asset classes are assigned a notional weighting that has been derived to reflect the relative riskiness of each asset class.

The Company also has in place a process whereby invested credit and counterparty credit risk outside the scope of the Group Global Counterparty Limits is limited on a single name basis. Under this process, the Group Chief Risk Officer's approval is required for the undertaking of new or additional exposure greater than predefined thresholds. These thresholds are defined for the company and vary by asset class/counterpart exposure and by credit rating. Timebound exemptions from these thresholds may be approved by the Group Chief Risk Officer based on the merits of the individual cases.

As at 31 December 2017, the four largest counterparties the shareholder business had exposure to are:

- United Kingdom of Great Britain and Northern Ireland
- European Investment Bank
- Federal Republic of Germany
- HSBC Holdings plc

As at 31 December 2016, the four largest counterparties the shareholder business had exposure to are:

- United Kingdom of Great Britain and Northern Ireland
- European Investment Bank
- Federal Republic of Germany
- French Republic

As at 31 December 2017, the four largest counterparties the policyholder business had exposure to are:

- United Kingdom of Great Britain and Northern Ireland
- HSBC Holdings plc
- Banco Santander SA
- Deutsche Bank AG

As at 31 December 2016, the four largest counterparties the policyholder business had exposure to are:

- United Kingdom of Great Britain and Northern Ireland
- United States of America
- European Investment Bank
- Bank of America Corporation

There is no other material risk concentration other than counterparty exposure. The Company continues to closely monitor the potential impacts of Brexit and recent banking reforms on the Company's counterparty exposure assessment.

C.7.4 Prudent Person Principle

The Prudent Person Principle requires that the Company only makes investments on behalf of customers that a "prudent person" would make. In order to comply with this Principle, we have to be able to identify, understand, measure and monitor any risks arising from our investment portfolios.

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 intra-group businesses. 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. They are designed to provide general, prudent and principle-based guidance for both shareholder-backed business and policyholder-backed business.
- The GRF covers all aspects of risk management across all BUs and includes minimum standards, controls and requirements for risk management. The GRF is supported by further documents including specific policies that cover credit, market, insurance, liquidity, operational and investment risk as well as lower level Group-wide Operating Standards and Group Approved Limits.

- The Group Investment Policy specifically 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 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.

- The Company oversees its asset managers by means of ensuring compliance with investment management agreements and investment mandates. These are structured in order to ensure compliance with the Prudent Person Principle, and are overseen by the Investment Office. The Investment Office updates and maintains the investment management agreements and investment mandates in line with changes in investment strategy, and carries out monitoring and due diligence of investment managers' compliance with their respective mandates.

D Valuation for solvency purposes

D.1 Valuation of assets

D.1.1 Overview

The 2017 balance sheet valued under both statutory accounts basis (UK GAAP) and Solvency II basis is summarised in Figure 14 below:

Figure 14: Solvency II and UK GAAP balance sheets for the year-ended 31 December 2017

	Statutory accounts - UK GAAP	Presentation differences (note a)	Ring-fenced funds (note b)	Other valuation differences (note c)	2017 Solvency II	2016 Solvency II
	£m	£m	£m	£m	£m	£m
Assets						
Deferred acquisition cost and intangible assets	53		(4)	(49)	—	
Investments (other than participations)	149,616	4,318			153,934	143,113
Participations	13,267	(942)		(1,482)	10,843	8,797
Assets held for index-linked and unit-linked contracts	18,303	(9,281)			9,022	8,968
Loans and mortgages	3,494	7,423	58	42	11,017	11,862
Reinsurance recoverables	7,820		54	(1,032)	6,842	6,585
Cash and cash equivalents	3,365	(1,473)			1,892	1,402
Other[1]	2,613	260	(165)	(6)	2,702	2,817
Total assets	**198,531**	**305**	**(57)**	**(2,527)**	**196,252**	**183,544**
Liabilities						
Technical provisions	172,235		(125,996)	(46,239)	—	—
Best estimate		185	112,901	45,121	158,207	149,407
Risk margin			726	838	1,564	1,100
Other liabilities					—	26
Deferred tax liabilities	1,334		(28)	(133)	1,173	1,018
Debts owed to credit institutions	3,273				3,273	3,306
Financial liabilities other than debts owed to credit institutions	123	(42)			81	112
Other[2]	5,955	162	(202)	316	6,231	6,390
Total liabilities	**182,920**	**305**	**(12,599)**	**(97)**	**170,529**	**161,359**
Excess of assets over liabilities	**15,611**	**—**	**12,542**	**(2,430)**	**25,723**	**22,185**

[1] Other assets include Property, plant and equipment held for own use, Insurance and intermediary receivables, Reinsurance receivables and Receivables (trade, not insurance).
[2] Other liabilities includes Provisions other than technical provisions, Pension benefit obligations, Derivatives liabilities, Deposits from reinsurers, Insurance and intermediaries payable, Reinsurance payables, Payables (trade, not insurance) and Contingent liabilities.

Notes:

(a) *Presentation differences* represent movements between line items with no overall impact on excess of assets over liabilities. The main difference of £9,281 million relates to assets held by the index-linked funds which are presented together in a single line on the UK GAAP statutory accounts balance sheet rather than within each individual asset/liability category. These amounts reported as index-linked funds for the statutory accounts do not meet the Solvency II definition of index-linked and accordingly are reported in the various individual asset and liability categories.

(b) *Ring-fenced funds* represent the impact on the balance sheet of changes in value and presentation of the policyholder assets and liabilities before any restrictions are applied. For UK GAAP purposes, although the individual assets and liabilities are valued, the overall impact of ring-fenced funds on UK GAAP shareholders' funds is not significant. The £12,542 million represents the excess of assets over liabilities on a Solvency II basis before any restrictions are applied and includes the amount attributable to shareholders for the value of future shareholder transfers from the with-profits business.

(c) *Other valuation differences* primarily represent the differences in valuation methods under UK GAAP and on a solvency II basis. The comparison of excess of assets over liabilities on a solvency II basis to UK GAAP is set out within Section E.1.4.

Valuation differences for deferred acquisition cost and intangible assets, participations, loans and mortgages and other assets are explained in Section D.1.2.2. The valuation differences for reinsurance recoverables are explained in Section D.2.8. Valuation differences for technical provisions, best estimate and risk margin are explained in Section D.2.1. Valuation differences for deferred tax liabilities and other liabilities are explained in Section D.3.2.

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:

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

The investments of the Company which are valued using this method include exchange listed equities, 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 so infrequent that the market could not possibly be considered active.

(b) Valuation methods using quoted market prices in active markets for similar assets and liabilities with adjustments to reflect differences or using inputs that are observable in the market
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 these valuation methods are corporate bonds, collateralised securities and other non-national government bonds, together with over-the-counter derivatives such as forward exchange contracts and non-quoted collective investment undertakings.

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. The Company 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 section (c) with 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. The Company 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 majority of the investments of the Company that are valued using alternative valuation methods with significant unobservable inputs are held by the Company's ring-fenced funds.

These investments of the Company's ring-fenced funds principally comprise:

- Investments in properties externally valued by professionally qualified external valuers using the Royal Institution of Chartered Surveyors (RICS) valuation standards. An ‘income capitalisation’ technique is predominantly applied for these properties. This technique calculates the value through the yield and rental value depending on factors such as the lease length, building quality, covenant and location. The variables used are compared to recent transactions with similar features to those of the Company’s investment properties. As the comparisons are not with properties which are virtually identical to Group’s investment properties, adjustments are made by the valuers where appropriate to the variables used. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of the properties.
- Private equity and venture investments which were valued internally based on management information available for these investments. The significant unobservable inputs include the determination of expected future cash flows of the investments being valued and the selection of appropriate discount rates. The valuation is performed in accordance with International Private Equity and Venture Capital Association Valuation guidelines.

These investments are held by the Company’s ring-fenced funds. The ring-fenced funds' contribution towards the Company’s own funds is restricted to the amount required to cover the ring-fenced funds’ solvency capital requirement (as described further in Section E). Therefore any change in the fair value of these investments from assumption changes will only impact the Company’s own funds if the change exceeds the amount of the restriction.

The investments in the shareholder fund that are valued using alternative valuation methods with significant unobservable market inputs at 31 December 2017 include equity release mortgage loans that are valued using discounted cash flow models. The inputs that are significant to the valuation of these loans are primarily the economic assumptions, being the discount rate (risk-free rate plus a liquidity premium) and property values.

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

Deferred acquisition costs and intangibles
The value of deferred acquisition costs and other intangible assets, such as distribution rights and software are nil for Solvency II purposes. For UK GAAP purposes deferred acquisition costs and other intangible assets are recognised at cost less amortisation.

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 2017.

Investments (other than participations)

Investments (other than participations) comprise the following asset classes as included in the Solvency II balance sheet:

Figure 15: Investments (other than participations) for the year-ended 31 December 2017

	2017 £m	2016 £m
Property (other than for own use)	9,058	8,849
Equities	36,791	30,259
Bonds	77,761	76,656
Collateralised securities	5,561	5,723
Collective investment undertakings	21,130	18,112
Derivatives	2,912	2,877
Deposits other than cash equivalents	721	637
Total	**153,934**	**143,113**

All of these categories of investments are valued at fair value within both the Solvency II balance sheet and the Company's UK GAAP financial statements.

Participations

Article 13 of the Solvency II Directive defines a 'participation' as the ownership, direct or by way of control, of 20% or more of the voting rights or capital of an undertaking.

Under Solvency II rules the adjusted equity method is applied to all investments in subsidiary undertakings apart from those classified as financial and credit institutions. The adjusted equity method is based on the excess of assets over liabilities for each subsidiary, with the subsidiaries' individual assets and liabilities valued in accordance with the Solvency II Directive. Where the related undertaking is an insurance undertaking technical provisions are valued in accordance with Articles 76 to 85 of the directive. Financial and credit institutions are valued using sectoral rules.

Included within the value of participations is the impact of transitional measures, volatility adjustments and matching adjustments, as applicable to participations which are insurance undertakings. These items are covered further in Section D.2.4.

The solvency capital requirement ('SCR') related to participations that are insurance undertakings are not included within the participation line in the balance sheet, and are included in the Company's SCR.

Assets held for index-linked and unit-linked contracts

These assets are held to cover linked liabilities where 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 the different definitions of index-linked between the two bases - for Solvency II reporting, business is only classified as index-linked where the policyholder takes the risk and this is not the case for the Company's index-linked business where the shareholder takes the risk. For UK GAAP all index-linked business is classified as index-linked business. There is also a small difference in relation to investment contracts without discretionary participation features, which is treated as reinsurance under Solvency II but as investments under UK GAAP. The individual assets and non-insurance liabilities of the linked business are valued in accordance with the Solvency II principles set out in this section.

Loans and mortgages
Loans and mortgages include the Company's loans to individuals (e.g. policy loans), as well as interests in residential and commercial mortgage portfolios.

Under UK GAAP, these loans are accounted for at amortised cost net of impairment. The exceptions include interest in certain mortgage loans which have been designated at fair value through profit and loss as this loan portfolio is managed and evaluated on a fair value basis.

Within the Solvency II balance sheet, these loans and mortgages are valued on a 'mark-to-model' valuation basis using the discounted cash flows expected to be received. The rate of discount used is the market rate of interest where applicable.

Other assets
Other assets comprise the following asset classes as included in the Solvency II balance sheet:

Figure 16: Other assets for the year-ended 31 December 2017

	2017 £m	2016 £m
Insurance and intermediaries receivables	23	23
Reinsurance receivables	153	6
Receivables (trade, not insurance)	2,388	2,653
Other	138	135
Total	**2,702**	**2,817**

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 third party. If the UK GAAP value is a good proxy for fair value no adjustment is made.

D.1.3 Leasing

The Company's operating and finance lease arrangements relate principally to properties. Further information on the Company's leasing arrangements is provided in Section A.4.2.

D.2 Technical provisions

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

D.2.1 Overview

As a general principle, technical provisions are valued at the amount for which they could theoretically be transferred to a third party in an arm's length transaction. The technical provisions consist of the best estimate liability and the risk margin, reduced by the "transitional measures on technical provisions" ('TMTP') 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 the European Insurance and Occupational Pensions Authority with allowance for a matching adjustment or a volatility adjustment where relevant. The calculation of the best estimate liability is based upon up-to-date and credible information and realistic assumptions (derived from data analysis and expert judgement) and is performed using appropriate actuarial and statistical methods. The cash-flow projections used in the calculation of the best estimate liability takes account of all the cash in- and out-flows required to settle the insurance obligations over their lifetime. The cash-flows included in the best estimate liability calculation are derived after applying Solvency II "contract boundary" rules, which determine whether future cash-flows can be recognised as part of the in-force business. The best estimate liability is calculated before deduction of the amounts recoverable from reinsurance contracts. Those amounts are calculated separately (see Section D. 2.8).

The "contract boundary rules" define:

- When a policy is first included in the cash-flows
- Which premiums should be allowed for in the cash-flows

- When a policy should no longer be included in the cash-flows.

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, with no diversification between the risks in different legal entities. 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 each entity, in line with Article 58 of the Delegated Regulation, rather than a full projection of solvency capital requirements ('SCR'). The SCR for each non-hedgeable risk is assumed to run-off in-line with suitable profiles which differ depending on the types of non-hedgeable risks. The SCR each year is aggregated using a simplified correlation matrix.

The main risks are detailed in Section C.

Transfers to the shareholder fund are not part of the technical provisions, but are included in the calculation to determine restrictions to the surplus on certain ring-fenced funds.

Technical provisions at 31 December 2017

Figure 17: Value of technical provisions 31 December 2017

	Best estimate liability £m	Risk margin £m	Total £m	31-Dec-16 £m
Insurance with-profit participation	93,634	301	93,935	84,591
Index-linked and unit-linked insurance	14,412	37	14,449	14,303
Other life insurance	43,997	1,204	45,201	46,267
Accepted reinsurance - insurance with-profit participation	5,168	—	5,168	4,342
Accepted reinsurance - other life insurance	875	22	897	889
Health insurance	(22)	—	(22)	(34)
Non-life business	143	—	143	149
Total	158,207	1,564	159,771	150,507

The technical provisions shown in Figure 17 above include the impact of the transitional measures for technical provisions (see Section D.2.4.1), which are included within the risk margin column. The transitional measures for technical provisions reduce the Company's technical provisions by £3,954 million as at 31 December 2017.

Reinsurance recoverables at 31 December 2017

The following table shows the reinsurance recoverables with comparisons to the previous year. There have been no significant changes.

Figure 18: Value of reinsurance recoverables 31 December 2017

	2017 £m	2016 £m
Index-linked and unit-linked insurance	5,453	5,088
Other life insurance	1,235	1,334
Accepted reinsurance - other life insurance	11	12
Health insurance	—	2
Non-life business	143	149
Total	6,842	6,585

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

(i) economic assumptions, most of which are published by European Insurance and Occupational Pensions Authority and set by reference 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 dynamic management actions and policyholder behaviour.

D.2.2.1 Economic assumptions

The principle economic assumption is the risk-free interest rate term structure. The risk-free curves at which best estimate liability cash-flows are discounted are specified by the European Insurance and Occupational Pensions Authority. These curves are based on market swap rates, with "credit risk adjustment". The resulting 10-year risk-free spot rates for the material currencies are given below, after the credit risk adjustment.

Figure 19: 10 year risk-free rates at 31 December 2017 (with comparison to 31 December 2016)

Currency	31 December 2017	31 December 2016	Change
British Pound	1.19%	1.08%	0.11 %
United States Dollar	2.32%	2.23%	0.09 %
Hong Kong Dollar	2.21%	2.50%	(0.29)%
Euro	0.80%	0.57%	0.23 %

For most non-profit annuity business, a matching adjustment is applied to the risk-free curve to discount the best estimate liability cash-flows (see Section D.2.4.3). In line with Solvency II requirements, the matching adjustment is not applied when calculating the risk margin. The matching adjustment calibration for UK shareholder annuities at 31 December 2017 allowed for 52 basis points (bps) (2016: 62 bps) per annum of credit provision, including allowances for mismatching.

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. Allowance has also been made for the effect of the contracts signed with TCS within the expense assumptions.

Assumptions are set at realistic, best-estimate levels. If experience varies from the assumptions the result would be the Company holding less or more capital than necessary to meet its obligations.

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

D.2.3.1 Participating business

The best estimate liability for participating business is, in most cases, calculated based on a retrospective calculation of accumulated asset shares, adjusted to reflect any future policy-related liabilities and other outgoings that cannot be charged to asset shares (for example, the excess of projected expenses over any fixed charges). Asset shares broadly reflect the policyholders' share of the participating fund assets attributable to their polices. For some business, a retrospective asset share calculation is not appropriate (for example, business where expected future benefit payments are not based on asset shares) and a prospective valuation approach is used, based on discounting expected future benefit and expense cash-flows.

Asset shares methodology, principles and practices are detailed in the Principles and Practices of Financial Management (PPFM).

The future policy related liabilities include a market-consistent stochastic valuation of the cost of all material guarantees, options and smoothing, less any related charges. The stochastic projections allow for realistic management actions consistent with the operation of the participating funds. Examples of these management actions include:

- *Dynamic adjustments to reversionary and terminal bonus rates.* This includes adjusting reversionary bonuses to target a specified range of terminal bonus cushion at maturity, or to maintain the solvency ratio of the participating fund in stressed conditions. For terminal bonuses, smoothing rules apply limiting the year-on-year change for the same bonus series.
- *Market value reductions.* For some accumulating with-profits policies, market value reductions may apply, subject to certain limits.
- *Dynamic investment strategy.* Switching into lower-risk assets to maintain the solvency of the own fund in stressed conditions.
- *Dynamic new business strategy.* Restricting the volume of new business written to maintain the solvency of the fund in stressed conditions.

D.2.3.2 Non-profit annuity business

The best estimate liability for non-profit annuity business is a discounted value (including a matching adjustment where relevant) of expected future annuity payments and associated expenses. The key assumptions relate to mortality rates, including expectations of future mortality improvements, and the level of credit provisions allowed for within the matching adjustment calibration as prescribed by the European Insurance and Occupational Pensions Authority (see Section D.2.4.3).

Some index-linked non-profit annuity business contains a guarantee that the annuity payment will not reduce during periods of deflation. A simulation method (i.e. stochastic model) was used to determine the embedded guarantee cost.

Mortality assumptions for non-profit annuity business are set in light of recent population and internal experience. The assumptions used are based on standard population mortality tables, with an allowance for expected future mortality improvements. The standard population tables are adjusted to account for the specific socio-economic mix of the portfolio and the effects of selection in the annuity market. Where annuities have been sold on an enhanced basis to impaired lives, assumptions are set to reflect experience, including the appropriate level of impairment.

D.2.3.3 Unit-linked business

The best estimate liability for these contracts reflects both the value of policyholder unit funds and the non-unit liability. The non-unit liability can be negative, and reflects the discounted value of fee income from the unit funds less allowances for expenses. Assumptions are also made for expected mortality and morbidity experience, as relevant, where the products include insurance riders.

Some unit-linked business contains a financial guarantee. A simulation method (i.e. stochastic model) is used to determine the associated guarantee cost.

D.2.3.4 Other business

For 'other business' the best estimate liability is calculated as the present value of expected future benefit payments and associated expenses less the value of expected future premium income. Assumptions are made for expected persistency and mortality/morbidity experience, as relevant.

Included within other business is an immaterial amount of non-life legacy business which is fully reinsured.

D.2.4 Long-term guarantee measures on technical provisions

D.2.4.1 Transitional measures

The Company's technical provisions at 31 December 2017 include transitional measures on technical provisions ('TMTP'), in accordance with Article 308d of Directive 2009/138/EC. The impact of these transitional measure is to increase the Company's Solvency II surplus by £2,321 million (2016: £2,927 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 Prudential Regulation Authority ('PRA') in respect of the transitional measures.

In line with the PRA's Supervisory Statement SS6/16 to allow a recalculation every 24 months, the TMTP was recalculated at 31 December 2017. This is reflected in both the QRTs and the Annual Report & Accounts.

The 31 December 2017 technical provisions and own funds do not include a transitional on the risk-free interest rate term structure.

D.2.4.2 Volatility adjustment

The volatility adjustment referred to in Article 77d of Directive 2009/138/EC has been applied for Hong Kong with-profits business denominated in US dollars. For this business a volatility adjustment (as published by the European Insurance and Occupational Pension Authority) is applied to the risk-free curve to discount the best estimate liability cash-flows, following approval by the PRA in 2016. In line with Solvency II requirements, the volatility adjustment is not applied when calculating the risk margin.

D.2.4.3 Matching adjustment

The matching adjustment referred to in Article 77b of Directive 2009/138/EC has been applied to most of the Company's non-profit annuities.

An adjustment may be applied to the risk-free interest rate term structure if the conditions in Article 77b of the Solvency II Directive are met and approval has been obtained. The risk-free yield curve used to discount most of the Company's non-profit annuity liability cash-flows is increased to include a matching adjustment, as approved by the PRA. The matching adjustment is calculated by reference to the credit spreads on the assigned portfolio of assets, with deductions for the "fundamental spread" (i.e. credit risk allowance) as published by the European Insurance and Occupational Pensions Authority and for cash-flow mismatch allowances.

Previously, separate portfolios were maintained for the Company’s shareholder-backed non-profit annuities and the business subject to the Part VII transfer from Prudential Retirement Income Limited as well as a separate portfolio in respect of an internal quota share reinsurance arrangement. These portfolios were merged on 1 October 2017, after approval from the PRA. A separate portfolio is held for the Company’s policyholder-backed non-profit annuities.

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

The impact of the transitional measures for technical provisions (‘TMTP’) and the long-term guarantees (volatility adjustment (‘VA’) and matching adjustment (MA’)) on the Company’s Solvency II results at 31 December 2017 are shown in the table below:

Figure 20: Impact on Solvency II results of excluding the TMTP, VA and MA at 31 December 2017

	As reported in QRTs	Impact of removing TMTP	Impact of removing VA	Impact of removing MA	Total excluding TMTP, VA and MA
	£m	£m	£m	£m	£m
Technical Provisions	159,771	3,954	—	4,444	168,169
Basic Own Funds	20,512	(1,936)	79	(2,639)	16,016
Own Funds eligible to cover SCR	20,512	(1,936)	79	(2,639)	16,016
Solvency Capital Requirement (SCR)	14,397	385	421	5,032	20,235
Own Funds eligible to cover MCR	20,512	(1,936)	79	(2,639)	16,016
Minimum Capital Requirement (MCR)	3,599	96	105	1,258	5,058

D.2.5 Assumption changes

2017 changes to the assumptions underlying the Company’s calculation of technical provisions include:

– changes to best estimate annuitant longevity assumptions to reflect a more granular modelling approach at an individual level over the lifetime of the policyholder, also taking into account recent experience;

– market-driven changes to economic parameters, including changes to risk-free rates as shown in Section D.2.2.1;

- changes to the matching adjustment allowance in line with changes in the allowances published by the European Insurance and Occupational Pensions Authority and changes to the asset portfolio. The allowances for the fundamental spread within the derivation of the matching adjustment has also been refined.
- changes to persistency assumptions to reflect the results of the most recent experience investigation;
- changes to renewal expense and investment management expense assumptions to reflect recent expense experience. The expense assumptions have also been revised to allow for some of the effects of the contracts signed with TCS, as discussed in Section A.5.3.1; and
- the mortality improvement basis has been updated from a bespoke calibration of Continuous Mortality Investigation 2014 to the core calibration of Continuous Mortality Investigation 2015.

D.2.6 Level of uncertainty

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

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

The best estimate assumptions include assumptions about future economic conditions, for example interest rates and expense inflation levels; and assumptions about future non-economic experience, for example, longevity, mortality and policyholder behaviour. Assumptions are also made about future management actions.

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

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

Figure 21: Comparison of technical provisions between UK GAAP and Solvency II for the year-ended 31 December 2017

	Insurance with-profits participation £m	Index-linked and unit-linked insurance £m	Other life insurance £m	Accepted life reinsurance £m	Health insurance £m	Non-life £m	Total 2017 £m	Total 2016 £m
UK GAAP liabilities (as reported in financial statements)								
	106,169	24,075	36,715	5,299	(23)	143	172,378	161,259
As reported in the template S.02.01.02								
Solvency II technical provisions	**93,935**	**14,449**	**45,201**	**6,064**	**(21)**	**143**	**159,771**	**150,507**

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

(a) Surplus assets in with-profits funds are not included as a liability within the technical provisions for Solvency II but are within the UK GAAP financial statements as "Fund for future appropriations" on the balance sheet.

(b) The UK GAAP liabilities are valued using a basis that includes margins for risk and uncertainty within the non-economic assumptions (mortality, 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.

(c) The UK GAAP liabilities do not include an explicit risk margin as the allowance for risk is included within the non-economic assumptions. The risk margin is explicit under Solvency II. The impact of the transitional measures for 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) The non-life UK GAAP liabilities are included in claims outstanding in the UK GAAP financial statements.

The following table details the differences between UK GAAP and Solvency II liabilities on a monetary basis:

Figure 22: Step-through from UK GAAP liabilities to Solvency II technical provisions for the year-ended 31 December 2017

	£m
UK GAAP liabilities	172,378
Amounts not recognised under Solvency II	(69)
Additional provisions under Solvency II	2,755
Adjustments to measurement basis	(15,293)
Solvency II technical provisions	159,771

Amounts not recognised under Solvency II include the present value of future profits and contract boundaries.

Additional provisions under Solvency II include the risk margin which, as discussed above, does not exist for UK GAAP. This aims to ensure that total technical provisions (the best estimate and the risk margin) are equivalent to the cost of ceding the insurance obligations to a third party. In addition, UK GAAP liabilities do not include other items such as the tax calculated on future shareholder transfers and future enhancements to asset shares in respect of non-profit business.

Adjustments to measurement basis arise largely due to differences between UK GAAP and Solvency II assumptions and methodology as follows:

– the fund for future appropriations is included in UK GAAP but not Solvency II.
– longevity assumptions for non-profit annuity business contain margins under UK GAAP compared to the best estimate assumptions applied under Solvency II.
– UK GAAP liability cash flows for non-profit annuity business are valued using a discount rate derived from the yield on the corresponding assets minus a prudent allowance for defaults of 42 bps at 31 December 2017. Under Solvency II, the discount rate is expressed as a risk free yield curve plus a matching adjustment.

D.2.8 Reinsurance recoverables

The Company primarily uses reinsurance to manage insurance risk exposure, particularly in respect of longevity risk.

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

The valuation methods and assumptions for reinsurance recoverables are consistent with the methods and assumptions for the corresponding technical provisions (see Sections D.2.1 to 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 two sources:

– 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; and
– Reclassification of reinsurers’ share of investment contracts liabilities without discretionary participation features. For the purposes of the financial statements, the Company applies deposit accounting for investment contracts without discretionary participation features (as defined

under UK GAAP) and accordingly presents the reinsurers' share of its liabilities within investments.

The most significant reinsurance treaties are longevity swap treaties with Pacific Life Re, Hannover Re and SCOR.

D.3 Valuation of other liabilities

D.3.1 Valuation of other liabilities

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

D.3.2 Valuation bases under Solvency II compared to UK GAAP

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

Debt liabilities
'Debt liabilities' includes the following line items from the Solvency II balance sheet:

- Debts owed to credit institutions; and
- Financial liabilities other than debts owed to credit institutions.

Debt liabilities in the UK GAAP financial statements are valued at amortised cost and valued at adjusted fair value for the Solvency II balance sheet.

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 102 section 29 are applied to calculate the extent of deferred tax 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. Further information on deferred tax valuation differences is provided in Section D. 1.2.2 above under the heading 'Deferred tax assets'.

The aggregate (£133 million) of the other valuation differences for deferred tax between UK GAAP and Solvency II represents the change in the value of the net deferred tax principally as a result of valuation changes relating to the establishment of the risk margin.

The net deferred tax liability of £1,173 million principally relates to realised gains on investments. Tax on these gains will mainly fall due when the underlying assets are sold.

Other liabilities
Figure 23: Other liabilities for the year-ended 31 December 2017

	2017 £m	2016 £m
Provisions other than technical provisions	409	218
Pension benefit obligations	138	238
Derivatives	1,593	1,730
Insurance and intermediaries payable	730	689
Reinsurance payables	66	35
Payables (trade, not insurance)	1,927	2,062
Other liabilities	1,368	1,418
Total	**6,231**	**6,390**

Insurance and intermediaries payable, reinsurance payables, payables (trade, not insurance) and other liabilities 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.

Provisions other than technical provisions
The majority of provisions other than technical provisions of £409 million relates to the provision for review of past annuity sales. The Company has agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review will examine whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. The FCA formally released its redress calculation methodology in early 2018 and accordingly Prudential reassessed the provision held to cover the costs of undertaking the review and any potential redress. At 31 December 2017, following this reassessment, the gross provision was increased to £400 million (2016: £175 million), excluding any utilisation during the year. The ultimate amount that will be expended by the Company on the review, which is currently expected to be completed in 2019, remains uncertain. Although the Group’s professional indemnity insurance is expected to mitigate the overall financial impact of this review, with potential insurance recoveries of up to £175 million, no such recovery has been factored in the provision, in accordance with the requirements of FRS 102.21 “Provisions and Contingencies”.

Derivative liabilities
Derivative liabilities are valued using quoted prices if exchange listed, quotations from third parties or valued using market consistent valuation techniques.

Pension benefit obligations
The Company does not have any individually material obligations in respect of defined contribution plans, other long-term employee benefits or termination benefits.

The Company has significant obligations in respect of the defined benefit pension schemes.

The majority of staff employed by the Prudential Group in the UK are members of the Prudential Group's pension schemes. The largest scheme is the Prudential Staff Pension Scheme (PSPS). This scheme is primarily a defined benefit scheme but no employees with employment offers after 31 July 2003 are eligible for membership of the defined benefit section of the Scheme. They are instead enrolled in the defined contribution section of the scheme.

At 31 December 2017, the underlying PSPS liabilities account for 82% (2016: 82%) of the aggregate liabilities of the Company's defined benefit schemes. Under FRS 102 a surplus is only recognised to the extent that the Company is able to access the surplus either through an unconditional right of refund to the surplus or through reduced future contributions relating to ongoing service, which have been substantively enacted or contractually agreed. Further, the UK GAAP financial position recorded, reflects the higher of any underlying FRS 102 deficit and any obligation for committed deficit funding where applicable. At 31 December 2017 the Company's share of the surplus of £166 million (2016: £111 million), is recognised in the statutory accounts.

Under the Solvency II basis, the FRS 102 surplus in the PSPS scheme has not been recognised.

There is also a smaller defined benefit scheme, Scottish Amicable Staff Pension Scheme (SASPS) relating to staff formerly employed by the Scottish Amicable Life Assurance Society. The Company's share of the deficit in this scheme is £138 million (2016: £238 million) under the Solvency II basis.

The FRS 102 valuation prescribes market-based assumptions for the valuation of assets and liabilities. Within the market-based framework, the FRS 102 prescribes that the discount rate for liabilities should be based on high quality corporate bonds (interpreted as corporate bonds with a credit rating of AA).

<u>*Methodology and assumptions*</u>
The actuarial assumptions used in determining the benefit obligations and the net periodic benefit costs for the year-ended 31 December 2017 were as follows:

Figure 24: Pension scheme actuarial assumptions

	2017 %	2016 %
Discount rate[1]	**2.5**	2.6
Rate of increase in salaries	**3.1**	3.2
Rate of inflation[2]:		
Retail prices index (RPI)	**3.1**	3.2
Consumer prices index (CPI)	**2.1**	2.2
Rate of increase of pensions in payment for inflation:		
PSPS:		
Guaranteed (maximum 5%)	**2.5**	2.5
Guaranteed (maximum 2.5%)	**2.5**	2.5
Discretionary	**2.5**	2.5
SASPS	**3.1**	3.2

[1] The discount rate has been determined by reference to an 'AA' corporate bond index, adjusted where applicable, to allow for the difference in duration between the index and the pension liabilities.
[2] The rate of inflation reflects the long-term assumption for the UK RPI or CPI depending on the tranche of the schemes.

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality. The specific allowance made is in line with a custom calibration used for 2017 and 2016 to reflect the 2014 mortality model from the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries (CMI). For the PSPS immediate annuities in payment, in 2017 and 2016, a long-term improvement rate of 1.75 per cent per annum and 1.25 per cent per annum were applied for males and females, respectively.

Underlying investments of the schemes
On the ‘economic basis’, after including the underlying assets represented by the investments in Prudential insurance policies as scheme assets, the plans’ assets at 31 December comprise the following investments:

Figure 25: Plan assets

	2017		2016	
	£m	%	£m	%
Equities				
UK	**16**	**0%**	37	0%
Overseas	**363**	**5%**	545	7%
Bonds				
Government	**5,476**	**66%**	5,742	68%
Corporate	**1,659**	**20%**	1,314	16%
Asset-backed securities	**164**	**2%**	145	2%
Derivatives	**182**	**2%**	250	3%
Properties	**200**	**2%**	116	1%
Other assets	**236**	**3%**	279	3%
Total value of assets	**8,296**	**100%**	8,428	100%
Of which relate to PSPS	**7,474**		7,627	
Of which relate to SASPS	**822**		801	

Contingent liabilities
Under UK GAAP, contingent liabilities (as determined in accordance with FRS 102) are disclosed but not recognised. For the Solvency II balance sheet, contingent liabilities (under the same definition as UK GAAP) are required to be recognised where they are material. The material contingent liabilities are recognised on Solvency II balance sheet as the probability-weighted average of future cash-flows

required to settle the contingent liability over the lifetime of that liability, discounted at a relevant risk-free interest rate structure.

A contingent liability of £31 million at 31 December 2017 (2016: £20 million) in relation to a legal case was recognised on the Solvency II balance sheet. The claim relates to a financial restructuring carried out by a borrower in one of the Company's investments. The Court handed down judgement in favour of the Company in November 2017. However the claimant has exercised their right to appeal that decision. The outcome of litigation is always uncertain but the Company believes it has good grounds to defend this claim and the outcome will not have a material adverse effect on the Company's financial condition.

Leases
There are no material liabilities recognised on the Solvency II balance sheet arising as a result of operating and finance leasing arrangements of the Company. Further information on the leasing arrangements of the Company is disclosed in Section A.4.2.

D.4 Alternative methods for valuation

The use of alternative methods for valuation by the Company are discussed in Sections D.1 to D.3 above.

The Group has developed Group-wide Independent Price Verification procedures - which covers all investment asset classes owned by the Business Units of the Group, including the Company, and set minimum requirements for the governance surrounding valuation pricing. These standards require that processes are established to verify the accuracy and independence of model inputs and market prices provided by third parties. Where mark to market valuations are not available from independent price sources, the Independent Price Verification standards set minimum requirements for alternative methodologies including mark to model valuations. The Independent Price Verification standards require the documentation and monitoring of all assumptions, inputs and any mathematical modelling, using market observable standards and inputs where possible.

Valuation uncertainty refers to the variability of the fair value measurement that exists at any given reporting date/time for a financial instrument or portfolio of positions. The Independent Price Verification standards require documentation of the process for assessing valuation uncertainty, including the controls surrounding valuation models and an understanding of the model assumptions and limitations.

In addition, the Group has minimum standards for independent price verification to ensure valuation accuracy is regularly independently verified. Adherence to this policy is monitored across the business units.

D.5 Any other information

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

E Capital management

E.1 Own funds

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

The Company manages its Solvency II own funds as its measure of capital. The Company's own funds at 31 December 2017 in the regulatory template are £20,512 million. A reconciliation from the Solvency II capital position published in the Financial Statements to the Solvency II capital position disclosed in the regulatory template is provided in Section E.1.2 below. The Company's basic, available and eligible own funds to cover the Company's solvency capital requirement and minimum capital requirement at 31 December 2017 are shown in Section E.1.3 below.

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

The Company prepares a 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 Shareholder Solvency II capital position

Reconciliation of Solvency II capital position published in the Annual Report to the QRTs

The Company disclosed the estimated Solvency II capital surplus as at 31 December 2017 in the Company's 2017 Financial Statements of £6,115 million being own funds of £20,512 million less SCR £14,397 million consistent with the disclosures in this document.

E.1.3 Analysis of the components of own funds

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

Figure 26: Analysis of components of own funds for the year-ended 31 December 2017

	Total 2017 £m	Tier 1 unrestricted £m	Total 2016 £m
Ordinary share capital(b)	330	330	330
Surplus funds(c)	10,304	10,304	8,903
Preference shares			1
Reconciliation reserve post ring fenced funds adjustment(d)	9,878	9,878	9,072
Total eligible own funds to meet the SCR(a)	20,512	20,512	18,306
Total eligible own funds to meet the minimum SCR(a)	**20,512**	**20,512**	**18,306**

(a) As at 31 December 2017, the Company has no ancillary own funds and hence the Company's basic own funds are equal to the total available own funds. The eligible own funds are derived by applying Solvency II tiering limits to the tiered available own funds.

(b) <u>Ordinary share capital</u>
The Company's ordinary share capital represents the nominal value of 25p each fully paid equity shares issued.

(c) <u>Surplus funds</u>
Surplus funds arise from the Company's with-profit funds (i.e. surplus funds arise from certain of the Company's ring-fenced funds). The value of surplus funds reported represents the excess of assets over liabilities (excluding the risk margin) of those ring-

fenced funds after deducting the present value of the expected future shareholder transfers (net of any related tax borne by the funds). Having considered the features of Tier 1 own fund instruments set out in Article 71 of the Commission Delegated Regulation (EU) 2015/35 and the guidance in the PRA Supervisory Statement SS13/15 (Solvency II: surplus funds) Prudential has classified surplus funds under Tier 1.

In accordance with the template S.23.01.01 (Own Funds) presentation requirements, the value of surplus funds reported on the template is prior to ring-fencing related restrictions being applied. The related restrictions are included as a deduction in the Reconciliation Reserve under "Restrictions applied to own funds due to ring-fencing". As such, the contribution of surplus funds towards the Company's own funds is lower than what is reported on the face of the Own Funds template.

(d) Reconciliation reserve

The reconciliation reserve represents the residual of excess of asses over liabilities after deducting (i) equity share capital comprising ordinary share capital and (ii) surplus funds and the restriction applied to own funds due to ring fencing.

The following table shows the reasons for the changes in the Own Funds between 31 December 2016 and 31 December 2017.

Figure 27: Analysis of components of own funds for the year-ended 31 December 2017

	£m
Own Funds at 31 December 2016	**18,306**
Underlying operating experience	1,909
Management actions	401
Operating experience	2,310
Non-operating experience (including market movements)	1,086
Other capital movements	
Foreign currency translation impacts	(739)
Dividends paid	(438)
Deferred tax assets/liabilities	(13)
Own Funds at 31 December 2017	**20,512**
Change in own funds	**2,206**

This table shows the movement in consolidated own funds as follows:

- Underlying operating experience has increased own funds by £1,909 million during 2017. This mainly reflects the unwind of in-force business, the contribution from new business and the return on surplus assets.
- The impact of management actions of £401 million mainly due asset optimisations affecting the matching adjustment portfolio and longevity reinsurance.
- Non-operating experience including market movements have increased own funds by £1,086 million predominately reflecting favourable movements in equity and property assets coupled with the reduction in credit spreads.
- The appreciation of Sterling against some overseas currencies has resulted in a decrease in own funds of £739 million.
- Payment of dividends totalling £438 million to Prudential Group.

E.1.4 Reconciliation of UK GAAP shareholder's equity to Solvency II for the year-ended 31 December 2017

The 'excess of assets over liabilities' on the Solvency II balance sheet is not equivalent to own funds as a number of adjustments are made on the own funds template to restrict the valuation. The reconciliation of the Company’s UK GAAP shareholders’ equity to the excess of assets over liabilities on the Solvency II balance sheet to Solvency II eligible own funds value of the Company is in Figure 28 below:

Figure 28: Analysis of components of own funds for the year-ended 31 December 2017

	2017 £m	2016 £m
UK with-profits funds		
Fund for future appropriations	13,581	11,933
Value of shareholder transfers	(2,731)	(2,271)
Impact of risk margin (net of TMTP)	(726)	(620)
Other valuation differences	(546)	(572)
UK GAAP total equity		
Shareholders' equity	15,611	13,623
Impact of risk margin (net of TMTP)	(838)	(480)
Value of shareholder transfers	3,817	3,242
Asset valuation differences	(2,549)	(2,387)
Other valuation differences	(29)	(369)
Increase in value of net deferred tax liabilities (resulting from valuation differences above)	133	86
Restrictions on ring-fenced funds	(5,211)	(3,879)
Eligible own funds at 31 December 2017	**20,512**	**18,306**
Excess of assets over liabilities as recorded in the Solvency II balance sheet[1]	**25,723**	**22,185**

[1]Difference between excess of assets over liabilities as recorded in the Solvency II balance sheet eligible own funds at 31 December 2017 being restriction on ring-fenced funds.

E.1.5 Restrictions

(Unaudited)

Restriction to own funds arising from ring-fenced funds

The Company has considered the specific provisions of national law, insolvency law, contract law and product regulation of the insurance subsidiary's jurisdiction of operations in determining the appropriate treatment of ring-fenced funds.

For ring-fenced funds, own funds are adjusted to reflect that the funds have a reduced capacity to fully absorb losses on a going-concern basis due to their lack of fungibility within the insurance company. The contribution to own funds from a ring-fenced fund is restricted such that the contribution to own funds from the ring-fenced fund is equal to the notional SCR for that ring-fenced fund. The impact of ring-fenced funds on the Company's solvency position in shown in Figure 28 above.

E.2 SCR and MCR

(Unaudited)

E.2.1 Overview

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

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

E.2.2 Components of SCR

At 31 December 2017, the SCR was £14,397 million (2016: £13,208 million).

Figure 29 below shows the undiversified SCR by risk components and the benefit of diversification in relation to the Company at 31 December 2017. A comparison column at 31 December 2016 is included.

Figure 29: SCR for the Company at 31 December 2017

Risk component	2017 £m	2016 £m
Interest rate risk	5,633	4,726
Equity risk	4,464	3,739
Property risk	1,404	1,271
Spread risk	8,161	8,191
Concentration risk	—	32
Currency risk	3,110	2,788
Diversification within market risks	(8,722)	(7,719)
Other counterparty risk	305	314
Mortality risk	177	202
Longevity risk	5,205	4,698
Disability-morbidity risk	122	136
Mass lapse	1,072	1,015
Other lapse risk	736	867
Expense risk	2,414	1,494
Life catastrophe	79	80
Diversification within life underwriting risks	(4,771)	(4,424)
Other non-life underwriting risk	4	4
Operational risk	1,474	1,228
Loss-absorbing capacity of deferred tax	(1,546)	(1,464)
Other adjustments	351	(395)
Total undiversified components	**19,672**	**16,786**
Diversification between market and underwriting risks	**(5,275)**	**(3,577)**
Total diversification SCR	**14,397**	**13,208**

This material movements in the undiversified risk capital shown in the table above are due to the following:

- Favourable market movements, in particular from strong equity and property performance and the narrowing of credit spreads on fixed interest assets, have increased asset values with a corresponding increase in related risk capital.
- Substantial new business written in both UK and Hong Kong during the period primarily affecting the undiversified equity and interest rate risk.
- Modelling refinements mainly increasing the undiversified longevity, expense and operational risk capital.
- Appreciation of Sterling against some overseas currencies have partially offset the impacts mentioned above.

Overall the total undiversified capital requirement has increased markedly as the business continues to grow although this is partially offset by increased diversification between market and underwriting risks.

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 2017, the Company's MCR was £3,599 million. The inputs used to calculate the MCR are detailed in Quantitative Reporting Template S.28.02.01.

The MCR is currently 25% of the SCR (2016: 25%).

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 the 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 solvency capital requirement 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 the standard formula, as part of Solvency II, represents a risk-based measure, it is based on a set of prescribed parameters, calibrated for European insurers and therefore it does not fully reflect the characteristics of the Company and the specific structure and risks the Company is exposed to.

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

E.4.2 Internal model application

The Company applied to use an internal model in late June 2015. In early December 2015 the application was approved by the Prudential Regulation Authority ('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 onwards.

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. Integration techniques are not required.

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 99.5^{th} 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 model SCR and the standard formula SCR include:

- Whereas the standard formula stresses and correlations are prescribed, the internal model risk scenarios reflect the Company's specific risk profile and are derived from a combination of data analysis and expert judgement, subject to the internal model tests and standards required by the Solvency II Directive (see further detail in Figure 30 below).
- Although the same broad risk categories are used to group risk drivers in the internal model, the internal model risk drivers within each category are typically much more granular than the broad risk categories considered under the standard formula. For example, the internal model risk drivers typically vary by country, as well as by other attributes of the risk, whereas many of the standard formula stresses do not vary by country.
- The internal model also covers some risks that are not included in the standard formula (for example, equity implied volatility risk, interest rate implied volatility risk and government bond spread risk).
- The internal model SCR is derived by combining underlying risk drivers together into combined stress scenarios, and then ranking the outcomes of applying these stress scenarios to the Company's balance sheet to derive the 99.5th worst percentile outcome. Conversely, the standard formula SCR is derived by calculating the impact on the balance sheet of each prescribed stress separately and then aggregating these outcomes using prescribed correlation matrices. Therefore, the internal model allows for the impact on the balance sheet of combinations of risks occurring together, whereas the standard formula only considers each risk in isolation.
- The internal model allows for the matching adjustment ring-fence to vary in each risk scenario, reflecting changes in the value of the corresponding liabilities. Therefore, diversification is allowed for between risks inside and risks outside the matching adjustment portfolio. Conversely, because the standard formula does not consider the impacts of combinations of risks occurring together, it requires that no diversification is recognised between risks inside the matching adjustment portfolio and risks outside the matching adjustment portfolio.

Figure 30: Overview of standard formula and internal model differences

Risk category	Standard formula	Internal model
Equity	Stresses vary between "Type 1" (listed EEA and OECD stocks) and "Type 2" (other countries, unlisted equities and alternative equity investments). A symmetric adjustment is applied to the level of stress to smooth out significant movements in markets close to the calculation date.	The model includes more granular stresses with calibrations set for each main equity benchmark index. At least one equity index is calibrated for each relevant global economy. Private equity, infrastructure equity and hedge funds are modelled using specific calibrations. Equity implied volatility is also modelled. No symmetric adjustment is applied.
Credit	For corporate bonds, loans and non-exempt sovereign bonds, credit risk is modelled by stressing credit spreads, with stresses varying by rating and duration bucket. European sovereign bonds are exempt from stress. Stresses on assets with an element of securitisation with no credit rating. The matching adjustment is allowed for by a factor-based reduction of the spread stresses by rating.	Credit spreads, ratings migrations, defaults and fundamental spreads (for the UK matching portfolio) are all explicitly modelled. The spread stresses vary by credit rating, with calibrations differentiated by economy, product and duration bucket where appropriate. Internal credit assessments are used for bonds and loans without an agency rating and to uplift stresses for assets where structuring introduces additional risk. Spread stresses are applied to sovereign bonds, taking into account the credit risk of the issuing government. The matching adjustment is calculated dynamically based on the bond yields and fundamental spread being modelled in each risk scenario.

Yields	Interest rate stresses are defined as bi-directional stresses to the base risk-free curve which vary by term but not by country.	Stresses are calibrated for each relevant global economy, and stresses to the shapes of risk-free yield curves are modelled using an industry-standard 'principle component' methodology. Stressed curves are re-extrapolated beyond the last liquid point for each economy using the methodology specified by EIOPA. Interest rate implied volatility and inflation risk are also modelled.
Property	There is a single property stress applied globally to the value of all assets classified as property.	Property stresses are differentiated by type of property, with separate calibrations for commercial and residential property. The model also separates the risks relating to contractually fixed rental income from that relating to capital growth where this is relevant for the matching adjustment.
Currency	A pair of up and down stresses is applied to the non-GBP net asset value in each business, and then aggregated. This approach also implicitly captures any asset-liability currency mismatch in each country.	A calibration is derived for each currency relative to GBP. Currency outcomes are simulated and used to translate all assets and liabilities into sterling in each risk scenario, thereby including the effect of currency "translation" as well as asset-liability currency mismatches within countries.
Concentration	The capital charge is based on the relative size of individual exposures as a proportion of the overall asset portfolio. Some non-EEA sovereigns are included, depending on their credit rating.	A similar approach is used as for the standard formula, with a more risk-based approach adopted for Asia sovereigns.
Counterparty default risk	Counterparty default risk is calculated taking into account the loss-given-default and probability of default, using fixed factors. Separate parameters and different aggregation approaches are applied for Type 1 exposures (e.g. derivatives, reinsurance, deposits) compared to Type 2 exposures (e.g. receivables from intermediaries).	A stochastic portfolio model (calibrated by credit rating) is used to capture counterparty risk, allowing for stochastic default and recovery rates. The model allows for counterparty exposures to increase under stressed conditions arising from other market and insurance risks.
Lapse	Policyholder lapse rates are stressed in both directions and a mass lapse stress is also applied. The capital charge is based on the largest of these impacts. The stresses are fixed for all countries and products (except for "group policies" which have a higher capital charge).	The lapse calibration is more granular and includes stresses to lapse assumptions and mass lapses. The stresses vary by product type as appropriate.
Longevity	A downward stress to mortality rates is applied to all relevant business.	The longevity calibration is more granular and includes stresses to base mortality rates and longevity trend assumptions separately. Calibrations are differentiated by gender and by different blocks of business, as appropriate.
Mortality & Life catastrophe	An increase in best estimate mortality rates and an instantaneous catastrophe risk stress are applied to all relevant business.	The mortality calibration allows for stresses to both best estimate mortality rates and catastrophe risks.
Morbidity	An increase in long-term morbidity rates is applied, including a reduction in morbidity recovery rates. The same stresses apply for all relevant business.	An increase to the best estimate morbidity rats for all future years.
Expense	Both the level of expenses and level of expense inflation are stressed under the standard formula. The same stresses apply to all business	Expense level and expense inflation risks are modelled, with stresses calibrated by product type where appropriate.

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

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

The Company's SCR and MCR have been met during 2017.

E.6 Any other information

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

Appendix A - List of subsidiaries and related undertakings

The following is a list of subsidiaries and related undertakings of the Company at 31 December 2017.

(i) Direct subsidiary undertakings

Investment

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Cardinal Distribution Park Management Limited	Ordinary Shares	66%	United Kingdom	1st Floor, Cavendish House, 39 Waterloo Street, Birmingham, B2 5PP, UK
Carraway Guildford General Partner Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Cribbs Mall Nominee (1) Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Edger Investments Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Edinburgh Park (Management) Limited	Private company limited by guarantee	100%	Scotland	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL, UK
The Greenpark (Reading) Limited Partnership	Limited Partnership Interest	50%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Manchester Nominee (1) Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Minster Court Estate Management Limited	Ordinary Shares	56%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
NAPI REIT, Inc	Ordinary Shares	99%	USA	7 St. Paul Street, Suite 820, Baltimore MD 21202, USA
Optimus Point Management Company Limited	Ordinary Shares	58.1%	United Kingdom	Barrat House Cartwright Way, Forest Business Park, Bardon Hill, Coalville, Leicestershire, LE67 1UF, UK
Pacus (UK) Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
PPMC First Nominees Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential Investment (Luxembourg) 2 S.à r.l.	Ordinary shares	100%	Luxembourg	34-38, Avenue de la Liberté, L-1930, Luxembourg
Prudential Properties Trusty Pty Limited	Unclassified Shares	100%	Australia	Darling Park Tower 2, 201 Sussex Street, Sydney, NSW 2000, Australia
Prudential Property Investments Limited	Ordinary Shares & Preference Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential Real Estate Investments 1 Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential Real Estate Investments 2 Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential Real Estate Investments 3 Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prutec Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK

PVM Partnerships Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Sealand (No 1) Limited	Ordinary Shares	100%	Jersey	Lime Grove House, Green Street, St Helier, Jersey, JE1 2ST
Sealand (No 2) Limited	Ordinary Shares	100%	Jersey	Lime Grove House, Green Street, St Helier, Jersey, JE1 2ST
Smithfield Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Three Snowhill Birmingham SARL	Ordinary Shares	100%	Luxembourg	5, rue Guillaume Kroll, L-1882, Luxembourg
Two Snowhill Birmingham SARL	Ordinary shares	100%	Luxembourg	5, rue Guillaume Kroll, L-1882, Luxembourg
Wessex Gate Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK

Insurance

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Prudential General Insurance Hong Kong Limited	Ordinary Shares	100%	Hong Kong	59th Floor, One Island East, 18 Westlands Road, Quarry Bay, Hong Kong
Prudential Hong Kong Limited	Ordinary Shares	100%	Hong Kong	59th Floor, One Island East, 18 Westlands Road, Quarry Bay, Hong Kong
Prudential International Assurance plc	Ordinary Shares	100%	Ireland	Montague House, Adelaide Road, Dublin 2, D02 K39, Ireland
Prudential Pensions Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK

Pension

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Prudential Corporate Pensions Trustee Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK

Holding company

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Prudential Holborn Life Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK

Mortgage lending

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Prudential Lifetime Mortgages Limited	Ordinary & Preference Shares	100%	United Kingdom	Craigforth, Stirling, FK9 4UE, UK

Financing

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Scottish Amicable Finance plc	Ordinary Shares	100%	United Kingdom	Craigforth, Stirling, FK9 4UE, UK

Service

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Prudential International Management Services Limited	Ordinary Shares	100%	Ireland	Montague House, Adelaide Road, Dublin 2, D02 K39, Ireland

In liquidation

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Central Square Leeds Limited (in liquidation)	Ordinary Shares	100%	United Kingdom	Mazars LLP, 45 Church Street, Birmingham, B3 2RT
Empire Holding SARL (in liquidation)	Ordinary Shares	100%	Luxembourg	5, rue Guillaume Kroll, L-1882, Luxembourg
Euro Salas Properties Limited (in liquidation)	Ordinary Shares	100%	United Kingdom	Mazars LLP, 90 St. Vincent Street, Glasgow, G2 5UB, UK
LIPP SARL (in liquidation)	Ordinary Shares	100%	Luxembourg	5, rue Guillaume Kroll, L-1882, Luxembourg
MM&S (2375) Limited (In liquidation)	Ordinary Shares	100%	United Kingdom	Mazars LLP, 90 St. Vincent Street, Glasgow, G2 5UB, UK
Prudential Dublin Investment Limited (in liquidation)	Ordinary Shares	100%	Ireland	IFSC, North Wall Quay, Dublin 1, D01 H104, Ireland
Prudential Retirement Income Limited (in liquidation)	Ordinary Shares & Preference Shares	100%	United Kingdom	Mazars LLP, 90 St. Vincent Street, Glasgow, G2 5UB, UK
The Hub (Witton) Management Company Limited (in liquidation)	Ordinary Shares	100%	United Kingdom	Mazars LLP, 45 Church Street, Birmingham, B3 2RT
Warren Farm Office Village Limited (in liquidation)	Limited by Guarantee	100%	United Kingdom	Mazars LLP, 45 Church Street, Birmingham, B3 2RT
The Hub (Witton) Management Company Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK

Dormant

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Scottish Amicable Life Assurance Society	No Share Capital	100%	United Kingdom	Craigforth, Stirling, Scotland, FK9 4UE

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(ii) Other subsidiaries, associated undertakings, joint ventures and significant holdings

Investment

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
ANRP II (AIV VI FC), L.P.	Limited Partnership Interest	37%	Cayman Islands	Walkers Corporate Limited, Cayman Corporate Centre, 27 Hospital Road, George Town KY 9008, Cayman Islands
BOCHK Aggressive Growth Fund	Ordinary shares	60%	Hong Kong	27th Floor, Bank of China Tower, 1 Garden Road, Central and Western District, Hong Kong
BOCHK Balanced Growth Fund	Ordinary shares	48%	Hong Kong	12th Floor and 25th Floor, Citicorp Centre, 18 Whitfield Road, Causeway Bay, Hong Kong
BOCHK China Equity Fund	Ordinary shares	66%	Hong Kong	12th Floor and 25th Floor, Citicorp Centre, 18 Whitfield Road, Causeway Bay, Hong Kong
BOCHK Conservative Growth Fund	Ordinary shares	56%	Hong Kong	12th Floor and 25th Floor, Citicorp Centre, 18 Whitfield Road, Causeway Bay, Hong Kong
BWAT Retail Nominee (1) Limited	Ordinary Shares	50%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
BWAT Retail Nominee (2) Limited	Ordinary Shares	50%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Carraway Guildford (Nominee A) Limited	Ordinary Shares	100%	Jersey	13 Castle Street, St Helier, Jersey, JE4 5UT
Carraway Guildford (Nominee B) Limited	Ordinary Shares	100%	Jersey	13 Castle Street, St Helier, Jersey, JE4 5UT
Carraway Guildford Investments Unit Trust	Ordinary Shares	100%	Jersey	13 Castle Street, St Helier, Jersey, JE4 5UT
Carraway Guildford Limited Partnership	Limited partnership interest	50%	United Kingdom	Lloyds Chambers, 1 Portsoken Street, London, E1 8HZ
Centaurus Retail LLP	Limited Partnership Interest	50%	United Kingdom	40 Broadway, London, SW1H 0BU, UK
Centre Capital Non-Qualified Investors IV AIV Orion, L.P.	Limited partnership interest	46%	USA	2711 Centreville Road, Suite 400, Wilmington, DE, 19808, USA
Centre Capital Non-Qualified Investors IV AIV-ELS, L.P.	Limited partnership interest	46%	USA	2711 Centreville Road, Suite 400, Wilmington, DE, 19808, USA
Centre Capital Non-Qualified Investors IV, L.P.	Limited partnership interest	45%	USA	2711 Centreville Road, Suite 400, Wilmington, DE, 19808, USA
Centre Capital Non-Qualified Investors V AIV-ELS LP	Limited partnership interest	37%	USA	2711 Centreville Road, Suite 400, Wilmington, DE, 19808, USA
Centre Capital Non-Qualified Investors V LP	Limited partnership interest	34%	USA	2711 Centreville Road, Suite 400, Wilmington, DE, 19808, USA

CF Prudential European QIS Fund	Ordinary Shares	88%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
CF Prudential Japanese QIS Fund	Ordinary Shares	84%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
CF Prudential North American QIS Fund	Ordinary Shares	91%	United Kingdom	135 Bishopsgate, London EC2M 3UR, UK
CF Prudential Pacific Markets Trust Fund	Ordinary Shares	72%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
CF UK Growth Qualified Investor Scheme	Ordinary Shares	94%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Cribbs Causeway JV Limited	Ordinary Shares	50%	United Kingdom	40 Broadway, London SW1H 0BU, UK
Cribbs Causeway Merchants Association Ltd	Limited by Guarantee	Membership is fluid, therefore there is no fixed percentage interest	United Kingdom	Management Offices, The Mall at Cribbs Causeway, Bristol BS34 5DG
Eastspring Investments - Asia Pacific Equity Fund	Ordinary Shares	97%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Asian Bond Fund	Ordinary Shares	30%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Asian Dynamic Fund	Ordinary shares	90%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Asian Equity Fund	Ordinary shares	52%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Asian High Yield Bond Fund	Ordinary shares	21%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Asian Low Volatility Equity Fund	Ordinary shares	92%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments China Equity Fund	Ordinary shares	50%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Emerging Europe, Middle East and Africa Dynamic Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Global Emerging Markets Bond Fund	Ordinary shares	48%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Global Market Navigator Fund	Ordinary shares	88%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Global Multi Asset Income Plus Growth Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Greater China Equity Fund	Ordinary shares	72%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Hong Kong Equity Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments India Equity Fund	Ordinary shares	81%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Japan Fundamental Value Fund	Ordinary shares	66%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments Latin American Equity Fund	Ordinary shares	89%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg

Eastspring Investments North America Value Fund	Ordinary shares	74%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments SICAV-FIS - Alternative Investments Fund	Ordinary shares	52%	Luxembourg	2-4 rue Eugene Ruppert Luxembourg 2453
Eastspring Investments SICAV-FIS - Asia Pacific Loan Fund	Ordinary shares	49%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments SICAV-FIS Universal USD Bond Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments US Corporate Bond Fund	Ordinary shares	62%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments World Value Equity Fund	Ordinary shares	86%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Asian Local Bond Fund	Ordinary shares	97%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Asian Smaller Companies Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Asian Total Return Bond Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Developed and Emerging Asia Equity Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Global Emerging Markets Dynamic Fund	Ordinary shares	93%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - US Equity Income Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Japan Equity Fund	Ordinary shares	85%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Developed and Emerging Asia Equity Fund	Ordinary shares	100%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Investments - Asian Bond Fund	Ordinary shares	56%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Eastspring Infrastructure Debt Fund L.P.	Partnership Interest	45%	Cayman Islands	PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands
European Specialist Investment Funds - M&G Total Return Credit Investment Fund	Ordinary shares	100%	Luxembourg	80, route d'Esch, L-1470, Luxembourg
Foudry Properties Limited	Ordinary Shares	50%	United Kingdom	Clearwater Court, Vastern Road, Reading RG1 8DB
Global Low Volatility Equity fund D Acc	Ordinary shares	84%	Luxembourg	26, Boulevard Royal, L-2449, Luxembourg
Infracapital Partners LP	Limited partnership interest	23%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Infracapital Partners II LP	Limited partnership interest	26%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
JNL Strategic Income Fund LLC	LLC Interests	100%	USA	1209 Orange Street, Wilmington, DE 19801, USA

Lion Credit Opportunity Fund Public Limited Company - Credit Opportunity Fund XV	Ordinary Shares	100%	Luxembourg	53 Merrion Square South, Dublin 2, D02 PR63, Ireland
MCF S.r.l.	Ordinary shares	45%	Italy	Via Romagnosi 18/a, 00196 Roma, Italy
M&G Asia Property Fund	A Class Shares	54%	Luxembourg	34-38 Avenue de la Liberté, L-1930, Luxembourg
M&G Corporate Bond Fund	Ordinary shares	25%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
M&G Dividend Fund	Ordinary shares	53%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
M&G Episode Defensive Fund	Ordinary Shares	90%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
M&G European Credit Investments Fund	Ordinary Shares	100%	Luxembourg	80, route d'Esch, L-1470, Luxembourg
M&G European High Yield Credit Investments Fund	Ordinary Shares	100%	Luxembourg	80, route d'Esch, L-1470, Luxembourg
M&G European Property Fund SICAV-FIS	Ordinary Shares	52%	Luxembourg	34-38 Avenue de la Liberté, L-1930, Luxembourg
M&G European Secured Property Income Fund	Units	23%	Luxembourg	34-38 Avenue de la Liberté, L-1930, Luxembourg
M&G European Select Fund	Ordinary Shares	40%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
M&G Gilt & Fixed Interest Income Fund	Ordinary shares	21%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
M&G Global Corporate Bond Fund	Ordinary Shares	30%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
M&G Global Credit Investments Fund	Ordinary Shares	67%	Luxembourg	80, route d'Esch, L-1470, Luxembourg
M&G Managed Growth Fund	Ordinary Shares	21%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
M&G Real Estate Debt Fund LP	Limited partnership interest	29%	Guernsey	PO Box 313, Lefebvre House Lefebvre Street St, Peter Port, GUERNSEY, GY1 3TF
M&G UK Companies Financing Fund II LP	Limited partnership interest	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Manchester JV Limited	Ordinary Shares	50%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
M&G RED SLP LP	Limited Partnership Interest	29%	Scotland	50 Lothian Road, Festival Square, Edinburgh, EH3 9WJ
Old Kingsway, LP	Limited Partnership Interest	100%	USA	251 Little Falls Drive, Wilmington, DE 19808, USA
PPM America Private Equity Fund LP	Limited Partnership Interest	45%	USA	874 Walker Road, Suite C, Dover, DE 19904, USA
PPM America Private Equity Fund II LP	Limited Partnership Interest	50%	USA	874 Walker Road, Suite C, Dover, DE 19904, USA
PPM America Private Equity Fund III LP	Limited Partnership Interest	50%	USA	874 Walker Road, Suite C, Dover, DE 19904, USA
PPM America Private Equity Fund IV LP	Limited Partnership Interest	50%	USA	874 Walker Road, Suite C, Dover, DE 19904, USA

PPM America Private Equity Fund V LP	Limited Partnership Interest	50%	USA	874 Walker Road, Suite C, Dover, DE 19904, USA
PPM America Private Equity Fund VI LP	Limited Partnership Interest	45%	USA	874 Walker Road, Suite C, Dover, DE 19904, USA
Prenetics Limited	Class C Preference Shares	15%	Hong Kong	7th floor, Prosperity Millennia Plaza, 663 King's Road, North Point, Hong Kong
Property Partners (Two Rivers) Limited	Ordinary Shares	50%	United Kingdom	Bow Bells House, 1 Bread Street, London, EC4H 9HH, UK
Prudential Credit Opportunity SCSp	Ordinary shares	100%	Luxembourg	1, rue Hildegard von Bingen, L - 1282, Luxembourg
Prudential Dynamic 10-40 Portfolio	Ordinary Shares	24%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic 20 - 55 Portfolio	Ordinary Shares	30%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic 40-80 Portfolio	Ordinary Shares	31%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic 0-30 Portfolio	Ordinary Shares	21%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic 60-100 Portfolio	Ordinary Shares	28%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic Focused 0-30 Portfolio	Ordinary Shares	57%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic Focused 10-40 Portfolio	Ordinary Shares	19%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic Focused 20 - 55 Portfolio	Ordinary Shares	38%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic Focused 40-80 Portfolio	Ordinary Shares	23%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Dynamic Focused 60-100 Portfolio	Ordinary Shares	31%	United Kingdom	17 Rochester Row, London SW1P 1QT, UK
Prudential Equity Release Mortgages Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential Greenfield LP	Limited partnership interest	80%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential Loan Investments SCSp	Limited partnership interest	100%	Luxembourg	1, Rue Hildegard von Bingen, L-1282 Luxembourg
Prudential M&G UK Companies Financing Fund LP	Limited partnership interest	34%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential UK Real Estate Limited Partnership	Limited Partnership Interest	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential UK Real Estate Nominee 1 Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential UK Real Estate Nominee 2 Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential UK Real Estate Investments 1 Limited	Ordinary Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential Loan Investments 1 S.à.r.l.	Ordinary Shares	100%	Luxembourg	1, Rue Hildegard von Bingen, L-1282 Luxembourg

Randolph Street LP	Limited Partnership Interest	100%	USA	2711 Centreville Road, Suite 400, Wilmington, DE 19808, USA
Sectordate Limited	Ordinary Shares	33%	United Kingdom	1st Floor Cavendish House 39 Waterloo Street Birmingham, B2 5PP
SMLLC L.L.C.	Limited Partnership Interest	100%	USA	251 Little Falls Drive, Wilmington, DE 19808, USA
St Edward Homes Limited	Ordinary Shares	50%	United Kingdom	Berkeley House, 19 Portsmouth Road, Cobham, Surrey KT11 1JG, UK
Silverfleet Capital 2011/12 LP	Limited Partnership Interest	100%	Guernsey	1 Royal Plaza, St Peters Port, Guernsey, GY1 2HL
Silverfleet Capital II WPLF	Limited Partnership Interest	100%	Guernsey	1 Royal Plaza, St Peters Port, Guernsey, GY1 2HL
The Car Auction Unit Trust	Ordinary shares	50%	Guernsey	Dorey Court, Admiral Park St Peter Port GY1 3BG, Guernsey
The Heights Management Company Limited	Limited by Guarantee	50%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
The St Edward Homes Partnership	Limited Partnership Interest	50%	United Kingdom	Berkeley House, 19 Portsmouth Road, Cobham, Surrey KT11 1JG
The Strand Property Unit Trust	Limited Partnership Interest	50%	Jersey	Liberte house, 19-23 La Motte Street, St Helier, Jersey, JE2 4SY
The Two Rivers Trust	Ordinary shares	50%	Jersey	Liberte house, 19-23 La Motte Street, St Helier, Jersey, JE2 4SY
US Strategic Income Bond Fund D USD Acc	Ordinary shares	96%	Luxembourg	26, Boulevard Royal Luxembourg L-2449
US Total Return Bond Fund D USD Acc	Ordinary shares	100%	Luxembourg	26, Boulevard Royal Luxembourg L-2449
Wynnefield Private Equity Partners II, LP	Limited Partnership Interest	99%	USA	1209 Orange Street, Wilmington, DE 19801, USA

In liquidation

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Fashion Square ECO LP (in liquidation)	Limited Partnership Interest	50%	USA	1209 Orange Street, Wilmington, DE 19801, USA
Prudential Development Management Limited (in liquidation)	Ordinary Shares & Preference Shares	100%	United Kingdom	Laurence Pountney Hill, London, EC4R 0HH, UK
Prudential Europe Assurance Holdings Limited (In liquidation)	Ordinary Shares	100%	United Kingdom	Mazars LLP, 90 St. Vincent Street, Glasgow, G2 5UB

Financing

Name	Classes of Shares held	Proportion held	Country of Incorporation	Address
Prudential Vietnam Finance Company Limited	Ownership Interest	100%	Vietnam	23rd Floor, Saigon Trade Centre, 37 Ton Duc Thang Street, District 1, Ho Chi Minh City, Vietnam

QIS Waiver

The Financial Conduct Authority, on the application of The Prudential Assurance Company Limited (the firm), made a direction in January 2018 under section 138A of the Financial Services and Markets Act 2000. The effect of the direction is to enable the firm to contract to pay benefits under linked long term contracts relating to;

(i) Ex-Prudential Holborn Life Limited (PHL) funds in Prudential Assurance Company Limited (PAC) (Prudential International, Prudential Managed, Prudential Strategic Growth, Prudential Japanese, Prudential North American and Prudential Equity (Life only);

(ii) Ex-Scottish Amicable Life (SAL) funds in PAC (Prudential European, Prudential International, Prudential Managed, Prudential Japanese, Prudential North American and Prudential Equity (Life only);

(iii) Ex-Scottish Amicable Life (SAL) funds in PAC (Prudential European, Prudential International, Prudential Managed, Prudential Japanese, Prudential North American and Prudential Equity (Pension only);

(iv) Ex-M&G funds in PAC (Pru Equity Pension fund (ex M&G), Pru Equity Life fund (ex M&G), Pru Managed life fund (ex M&G) Pru Managed pension fund (ex M&G) and Pru Personal Pension fund (ex M&G) (Life & Pension); and

(v) PAC fund (Prufund Managed Fund) which are themselves determined, either wholly or partly, by reference to units in the CF Prudential European QIS Fund, CF Prudential Japanese QIS Fund, CF Prudential North American QIS Fund, and CF Prudential UK Growth QIS Fund provided that each of these funds comply with the requirements of provisions implementing the Directive 2009/65/EC or would do if they were subject to those provisions and with certain other conditions.

Statement of directors' responsibilities

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

The directors are satisfied that:

(a) throughout the financial year to 31 December 2017, the Company has complied in all material respects with the requirements of the PRA rules and the Solvency II Regulations as applicable at the level of the Company; and

(b) it is reasonable to believe that in respect of the period from 31 December 2017 to the date of the publication of the SFCR, the Company has continued so to comply and will continue so to comply for the remainder of the financial year to 31 December 2018.

Signed on behalf of the Board of Directors

C Bousfield
Director
2 May 2018

Independent Auditor's Report

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

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

Opinion

Except as stated below, we have audited the following documents prepared by Prudential Assurance Company Limited as at 31 December 2017:

– The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of Prudential Assurance Company Limited as at 31 December 2017, ('**the Narrative Disclosures subject to audit**'); and

– Company templates S02.01.02, S12.01.02, S17.01.02, S22.01.21, S23.01.01 and S28.02.01 ('**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;

– Company templates S05.01.02, S19.01.21, S.25.02.21;

– the technical provisions used to calculate the transitional measures, and therefore information relating to the transitional measures 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').

In our opinion, the information subject to audit in the Relevant Elements of the Solvency and Financial Condition Report of Prudential Assurance Company Limited as at 31 December 2017 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.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Relevant Elements of the Solvency and Financial Condition Report* section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the Solvency and Financial Condition Report in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter - Basis of Accounting

We draw attention to the ‘Valuation for solvency purposes’ and other relevant disclosures 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.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you if:

- the directors’ use of the going concern basis of accounting in the preparation of the SFCR is not appropriate; or
- the directors have not disclosed in the SFCR any identified material uncertainties that may cast significant doubt about the company’s ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the SFCR is authorised for issue.

Other Information

The directors are responsible for the Other Information.

Our opinion on the Relevant Elements of the Solvency and Financial Condition Report does not cover the Other Information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the Solvency and Financial Condition Report, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the Relevant Elements of the Solvency and Financial Condition Report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the Relevant Elements of the Solvency and Financial Condition Report or a material misstatement of the Other Information. 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.

Responsibilities of directors for the Solvency and Financial Condition Report

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.

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; assessing the company’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor’s Responsibilities for the Audit of the Relevant Elements of the Solvency and Financial Condition Report

It is our responsibility to form an independent opinion as to whether the Relevant Elements of the Solvency and Financial Condition Report are prepared, in all material respects, with financial reporting provisions of the PRA Rules and Solvency II regulations on which it they based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Our objectives are to obtain reasonable assurance about whether the Relevant Elements of the Solvency and Financial Condition Report are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but it is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decision making or the judgement of the users taken on the basis of the Relevant Elements of the Solvency and Financial Condition Report.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities.

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.

Report on Other Legal and Regulatory Requirements

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook we are also required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of Prudential Assurance Company Limited 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.

Daniel Cazeaux
for and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
Canary Wharf
London
E14 5GL

2 May 2018

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.

PRUDENTIAL

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 R0090: Amount of transitional measure on technical provisions in relation to the technical provisions of Prudential Hong Kong Limited (PHKL)
- 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.17.01.02
- Row R0280: Technical provisions calculated as a sum of BE and RM - Risk margin
- Rows R0290 to R0310 - 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 R0020 - Adjustment for restricted own fund items in respect of ring fenced funds of the Company and the ring fenced funds of Prudential Hong Kong Limited (PHKL)
- 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.28.02.01
- Row R0310: SCR

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

PRUDENTIAL

Quantitative Reporting Templates (QRTs)
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	138,108
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	164,777,398
R0080	Property (other than for own use)	9,058,097
R0090	Holdings in related undertakings, including participations	10,843,437
R0100	Equities	36,790,722
R0110	Equities - listed	36,739,264
R0120	Equities - unlisted	51,458
R0130	Bonds	83,321,567
R0140	Government Bonds	20,976,278
R0150	Corporate Bonds	56,784,742
R0160	Structured notes	—
R0170	Collateralised securities	5,560,547
R0180	Collective Investments Undertakings	21,130,472
R0190	Derivatives	2,912,348
R0200	Deposits other than cash equivalents	720,755
R0210	Other investments	—
R0220	Assets held for index-linked and unit-linked contracts	9,021,912
R0230	Loans and mortgages	11,017,352
R0240	Loans on policies	4,329
R0250	Loans and mortgages to individuals	1,620,459
R0260	Other loans and mortgages	9,392,564
R0270	Reinsurance recoverables from:	6,842,463
R0280	Non-life and health similar to non-life	143,294
R0290	Non-life excluding health	143,294
R0300	Health similar to non-life	—
R0310	Life and health similar to life, excluding index-linked and unit-linked	1,246,228
R0320	Health similar to life	198
R0330	Life excluding health and index-linked and unit-linked	1,246,030
R0340	Life index-linked and unit-linked	5,452,940
R0350	Deposits to cedants	—
R0360	Insurance and intermediaries receivables	22,559
R0370	Reinsurance receivables	9,528
R0380	Receivables (trade, not insurance)	2,531,260
R0390	Own shares (held directly)	—
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	—
R0410	Cash and cash equivalents	1,891,668
R0420	Any other assets, not elsewhere shown	—
R0500	**Total assets**	196,252,247

S.02.01.02 Balance Sheet

		Solvency II value
	Liabilities	C0010
R0510	Technical provisions - non-life	143,343
R0520	Technical provisions - non-life (excluding health)	143,343
R0530	TP calculated as a whole	—
R0540	Best Estimate	143,343
R0550	Risk margin	—
R0560	Technical provisions - health (similar to non-life)	—
R0570	TP calculated as a whole	—
R0580	Best Estimate	—
R0590	Risk margin	—
R0600	Technical provisions - life (excluding index-linked and unit-linked)	145,178,336
R0610	Technical provisions - health (similar to life)	(21,459)
R0620	TP calculated as a whole	—
R0630	Best Estimate	(21,528)
R0640	Risk margin	70
R0650	Technical provisions - life (excluding health and index-linked and unit-linked)	145,199,794
R0660	TP calculated as a whole	—
R0670	Best Estimate	143,673,435
R0680	Risk margin	1,526,359
R0690	Technical provisions - index-linked and unit-linked	14,448,933
R0700	TP calculated as a whole	—
R0710	Best Estimate	14,411,715
R0720	Risk margin	37,218
R0740	Contingent liabilities	31,000
R0750	Provisions other than technical provisions	408,701
R0760	Pension benefit obligations	137,633
R0770	Deposits from reinsurers	1,480,807
R0780	Deferred tax liabilities	1,173,406
R0790	Derivatives	1,593,487
R0800	Debts owed to credit institutions	3,272,722
R0810	Financial liabilities other than debts owed to credit institutions	80,710
R0820	Insurance & intermediaries payables	586,729
R0830	Reinsurance payables	66,285
R0840	Payables (trade, not insurance)	1,927,293
R0850	Subordinated liabilities	—
R0860	Subordinated liabilities not in BOF	—
R0870	Subordinated liabilities in BOF	—
R0880	Any other liabilities, not elsewhere shown	—
R0900	**Total liabilities**	170,529,385
R1000	**Excess of assets over liabilities**	25,722,862

S.05.01.02 Premiums claims and expenses by line of business

Unaudited

All amounts are in £'000

	Non-life	Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)						Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)						Line of business for: accepted non-proportional reinsurance				Total
		Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Misc. financial loss	Health	Casualty	Marine, aviation and transport	Property	
		C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0200
	Premiums written																	
R0110	*Gross - Direct Business*																	—
R0120	*Gross - Proportional reinsurance accepted*																	—
R0130	*Gross - Non-proportional reinsurance accepted*																	—
R0140	*Reinsurers' share*																	—
R0200	*Net*	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
	Premiums earned																	
R0210	*Gross - Direct Business*																	—
R0220	*Gross - Proportional reinsurance accepted*																	—
R0230	*Gross - Non-proportional reinsurance accepted*																	—
R0240	*Reinsurers' share*																	—
R0300	*Net*	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
	Claims incurred																	
R0310	*Gross - Direct Business*				2,748				738									3,486
R0320	*Gross - Proportional reinsurance accepted*																	—
R0330	*Gross - Non-proportional reinsurance accepted*																	—
R0340	*Reinsurers' share*				2,748				738									3,486
R0400	*Net*	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
	Changes in other technical provisions																	
R0410	*Gross - Direct Business*																	—
R0420	*Gross - Proportional reinsurance accepted*																	—
R0430	*Gross - Non-proportional reinsurance accepted*																	—
R0440	*Reinsurers' share*																	—
R0500	*Net*	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
R0550	**Expenses incurred**																	—
R1200	**Other expenses**																	
R1300	**Total expenses**																	—

S.05.01.02 Premiums claims and expenses by line of business

	Life	Line of Business for: life insurance obligations						Life reinsurance obligations		Total
		Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Health reinsurance	Life reinsurance	
		C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
	Premiums written									
R1410	*Gross*	19,854	11,557,392	631,214	423,581			—	807,069	13,439,108
R1420	*Reinsurers' share*	1,641	1,103	368,578	1,014,218			—	—	1,385,539
R1500	*Net*	18,213	11,556,289	262,636	(590,637)			—	807,069	12,053,569
	Premiums earned									
R1510	*Gross*	19,854	11,557,392	631,214	423,581			—	807,069	13,439,108
R1520	*Reinsurers' share*	1,641	1,103	368,578	1,014,218			—	—	1,385,539
R1600	*Net*	18,213	11,556,289	262,636	(590,637)			—	807,069	12,053,569
	Claims incurred									
R1610	*Gross*	7,646	7,276,009	1,901,441	2,984,860			—	376,784	12,546,740
R1620	*Reinsurers' share*	4,341	2,477	556,984	1,049,845			—	953	1,614,600
R1700	*Net*	3,304	7,273,532	1,344,457	1,935,015			—	375,831	10,932,140
	Changes in other technical provisions									
R1710	*Gross*	(7,941)	(8,545,746)	(535,250)	614,282			—	(924,340)	(9,398,995)
R1720	*Reinsurers' share*	4,080	15,679	(377,357)	39,481			—	—	(318,117)
R1800	*Net*	(12,021)	(8,561,424)	(157,893)	574,801			—	(924,340)	(9,080,878)
R1900	**Expenses incurred**	(644)	718,025	174,859	459,436			—	(74)	1,351,603
R2500	**Other expenses**									38,466
R2600	**Total expenses**									1,390,069

S.12.01.02 Life and Health SLT Technical Provisions

All amounts are in £'000

		Insurance with profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, including Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
				Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees					Contracts without options and guarantees	Contracts with options or guarantees			
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0150	C0160	C0170	C0180	C0190	C0200	C0210
R0010	Technical provisions calculated as a whole	—	—			—			—	—	—	—			—	—	—
R0020	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated	—	—			—			—	—	—	—			—	—	—
	Technical provisions calculated as a sum of BE and RM																
	Best estimate																
R0030	Gross Best Estimate	93,634,312		13,663,187	748,528		30,187,722	13,808,953	—	6,042,449	158,085,150		(7,937)	(13,591)	—	—	(21,528)
R0080	Total Recoverables from reinsurance/SPV and Finite	(380)		5,452,940	—		803,826	431,337	—	11,247	6,698,971		1,511	(1,313)	—	—	198
R0090	Best estimate minus recoverables from	93,634,691		8,210,246	748,528		29,383,896	13,377,616	—	6,031,202	151,386,180		(9,448)	(12,279)	—	—	(21,727)
R0100	Risk margin	1,099,618	139,962			4,196,977			—	81,333	5,517,889	70			—	—	70
	Amount of the transitional on Technical Provisions																
R0110	Technical Provisions calculated as a whole	—	—			—			—	—	—	—			—	—	—
R0120	Best estimate	—		—	—		—	—	—	—	—		—	—	—	—	—
R0130	Risk margin	(799,198)	(102,743)			(2,992,933)			—	(59,438)	(3,954,312)	—			—	—	—
R0200	Technical provisions - total	93,934,732	14,448,933			45,200,718			—	6,064,344	159,648,727	(21,459)			—	—	(21,459)

S.17.01.02 Non-Life Technical Provisions

All amounts are in £'000

		Direct business and accepted proportional reinsurance				Direct business and accepted proportional reinsurance				Direct business and accepted proportional reinsurance				Accepted non-proportional reinsurance				
		Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Non-proportional health reinsurance	Non-proportional casualty reinsurance	Non-proportional marine, aviation and transport reinsurance	Non-proportional property reinsurance	Total Non-Life obligation
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0170	C0180
R0010	**Technical provisions calculated as a whole**																	—
R0050	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default																	—
	Technical provisions calculated as a sum of BE and RM																	
	Best estimate																	
	Premium provisions																	
R0060	Gross																	—
R0140	Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default																	—
R0150	**Net Best Estimate of Premium Provisions**																	—
	Claims provisions																	
R0160	Gross				20,810				122,533									143,343
R0240	Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default				20,801				122,494									143,294
R0250	**Net Best Estimate of Claims Provisions**				9				39									48
R0260	**Total best estimate - gross**				20,810				122,533									143,343
R0270	**Total best estimate - net**				9				39									48
R0280	**Risk margin**				—				—									—
	Amount of the transitional on Technical Provisions																	
R0290	Technical Provisions calculated as a whole																	—
R0300	Best estimate																	—
R0310	Risk margin																	—
R0320	**Technical provisions - total**				20,810				122,533									143,343
R0330	**Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total**				20,801				122,494									143,294
R0340	**Technical provisions minus recoverables from reinsurance/ SPV and Finite Re - total**				9				39									48

S.19.01.21 Non-Life insurance claims
Unaudited
All amounts are in £'000

Total Non-life business

Z0010 **Accident year / underwriting year** —

Gross Claims Paid (non-cumulative)
(absolute amount)

		C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0170	C0180
	Year	—	1	2	3	4	5	6	7	8	9	10 & +	In Current year	Sum of years (cumulative)
R0100	Prior											2,530	2,530	2,530
R0160	N-9													
R0170	N-8													
R0180	N-7													
R0190	N-6													
R0200	N-5													
R0210	N-4													
R0220	N-3													
R0230	N-2													
R0240	N-1													
R0250	N													
R0260	Total													

Gross undiscounted Best Estimate Claims Provisions
(absolute amount)

		C0200	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0290	C0300	C0360
	Year	—	1	2	3	4	5	6	7	8	9	10 & +	Year end (discounted data)
R0100	Prior											143,343	102,403
R0160	N-9												
R0170	N-8												
R0180	N-7												
R0190	N-6												
R0200	N-5												
R0210	N-4												
R0220	N-3												
R0230	N-2												
R0240	N-1												
R0250	N												
R0260	Total												

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**	159,770,612	3,954,312	—	—	4,444,127
R0020	**Basic own funds**	20,512,257	(1,935,943)	—	79,390	(2,639,208)
R0050	**Eligible own funds to meet Solvency Capital Requirement**	20,512,257	(1,935,943)	—	79,390	(2,639,208)
R0090	**Solvency Capital Requirement**	14,397,147	385,172	—	420,869	5,031,575
R0100	**Eligible own funds to meet Minimum Capital Requirement**	20,512,257	(1,935,943)	—	79,390	(2,639,208)
R0110	**Minimum Capital Requirement**	3,599,287	96,293	—	105,217	1,257,894

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

	Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35	**Total**	**Tier 1 unrestricted**	**Tier 1 restricted**	**Tier 2**	**Tier 3**
		C0010	C0020	C0030	C0040	C0050
R0010	Ordinary share capital (gross of own shares)	329,517	329,517		—	
R0030	Share premium account related to ordinary share capital	—	—		—	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type	—	—		—	
R0050	Subordinated mutual member accounts	—		—	—	—
R0070	Surplus funds	10,304,040	10,304,040			
R0090	Preference shares	—		—	—	—
R0110	Share premium account related to preference shares	—		—	—	—
R0130	Reconciliation reserve	9,878,700	9,878,700			
R0140	Subordinated liabilities	—		—	—	—
R0160	An amount equal to the value of net deferred tax assets	—				—
R0180	Other own fund items approved by the supervisory authority as basic own funds not specified above	—	—	—	—	—
	Own funds from the financial statements that should not be represented by the reconciliation reserve					
R0220	Own funds from the financial statements that should not be represented by the reconciliation reserve and do	—				
	Deductions					
R0230	Deductions for participations in financial and credit institutions	—	—	—	—	
R0290	Total basic own funds after deductions	20,512,257	20,512,257	—	—	—
	Ancillary own funds					
R0300	Unpaid and uncalled ordinary share capital callable on demand	—			—	
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual	—			—	
R0320	Unpaid and uncalled preference shares callable on demand	—			—	—
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	—			—	—
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	—			—	
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	—			—	—
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	—			—	
R0370	Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/	—			—	—
R0390	Other ancillary own funds	—			—	—
R0400	**Total ancillary own funds**	—			—	—
	Available and eligible own funds					
R0500	Total available own funds to meet the SCR	20,512,257	20,512,257	—	—	—
R0510	Total available own funds to meet the MCR	20,512,257	20,512,257	—	—	
R0540	Total eligible own funds to meet the SCR	20,512,257	20,512,257	—	—	—
R0550	Total eligible own funds to meet the MCR	20,512,257	20,512,257	—	—	
R0580	**SCR**	14,397,147				
R0600	**MCR**	3,599,287				
R0620	**Ratio of Eligible own funds to SCR**	1.4247				
R0640	**Ratio of Eligible own funds to MCR**	5.6990				

	Reconciliation reserve	C0060
R0700	Excess of assets over liabilities	25,722,862
R0710	Own shares (held directly and indirectly)	—
R0720	Foreseeable dividends, distributions and charges	—
R0730	Other basic own fund items	10,633,557
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	5,210,605
R0760	**Reconciliation reserve**	9,878,700
	Expected profits	
R0770	Expected profits included in future premiums (EPIFP) - Life business	—
R0780	Expected profits included in future premiums (EPIFP) - Non- life business	—
R0790	**Total Expected profits included in future premiums (EPIFP)**	—

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	5,632,742	5,632,742		
2	104	Equity risk	4,463,624	4,463,624		
3	106	Property risk	1,404,214	1,404,214		
4	107	Spread risk	8,161,338	8,161,338		
5	108	Concentration risk	—	—		
6	109	Currency risk	3,110,300	3,110,300		
7	110	Other market risk	—	—		
8	199	Diversification within market risk	(8,722,433)	(8,722,433)		
9	203	Other counterparty risk	305,226	305,226		
10	301	Mortality risk	176,849	176,849		
11	302	Longevity risk	5,204,958	5,204,958		
12	303	Disability-morbidity risk	121,651	121,651		
13	304	Mass lapse	1,071,697	1,071,697		
14	305	Other lapse risk	736,156	736,156		
15	306	Expense risk	2,413,990	2,413,990		
16	308	Life catastrophe risk	79,345	79,345		
17	309	Other life underwriting risk	—	—		
18	399	Diversification within life underwriting risk	(4,771,447)	(4,771,447)		
19	505	Other non-life underwriting risk	4,499	4,499		
20	701	Operational risk	1,474,236	1,474,236		
21	801	Other risks	—	—		
22	802	Loss-absorbing capacity of technical provisions	—	—		
23	803	Loss-absorbing capacity of deferred taxes	(1,546,018)	(1,546,018)		
24	804	Other adjustments	351,000	351,000		

S.25.02.21 Solvency Capital Requirement
– for undertakings using the standard formula and partial internal model
Unaudited
All amounts are in £'000

	Calculation of Solvency Capital Requirement	C0100
R0110	Total undiversified components	19,671,926
R0060	Diversification	(5,274,779)
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	—
R0200	**Solvency capital requirement excluding capital add-on**	14,397,147
R0210	Capital add-ons already set	—
R0220	**Solvency capital requirement**	14,397,147

	Other information on SCR	
R0300	Amount/estimate of the overall loss-absorbing capacity of technical provisions	(13,285,027)
R0310	Amount/estimate of the overall loss-absorbing capacity ot deferred taxes	(1,546,018)
R0400	Capital requirement for duration-based equity risk sub-module	—
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	2,171,080
R0420	Total amount of Notional Solvency Capital Requirement for ring fenced funds	4,211,914
R0430	Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	8,014,153
R0440	Diversification effects due to RFF nSCR aggregation for article 304	—

S.28.02.01 Minimum Capital Requirement – Both life and non-life insurance activity

All amounts are in £'000

		Non-life activities	Life activities
		$MCR_{(NL,NL)}$ Result	$MCR_{(NL,L)}$ Result
		C0010	C0020
R0010	**Linear formula component for non-life insurance and reinsurance obligations**	5	—

		Non-life activities: Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Non-life activities: Net (of reinsurance) written premiums in the last 12 months	Life activities: Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Life activities: Net (of reinsurance) written premiums in the last 12 months
		C0030	C0040	C0050	C0060
R0020	Medical expense insurance and proportional reinsurance	—	—	—	—
R0030	Income protection insurance and proportional reinsurance	—	—	—	—
R0040	Workers' compensation insurance and proportional reinsurance	—	—	—	—
R0050	Motor vehicle liability insurance and proportional reinsurance	9	—	—	—
R0060	Other motor insurance and proportional reinsurance	—	—	—	—
R0070	Marine, aviation and transport insurance and proportional reinsurance	—	—	—	—
R0080	Fire and other damage to property insurance and proportional reinsurance	—	—	—	—
R0090	General liability insurance and proportional reinsurance	39	—	—	—
R0100	Credit and suretyship insurance and proportional reinsurance	—	—	—	—
R0110	Legal expenses insurance and proportional reinsurance	—	—	—	—
R0120	Assistance and proportional reinsurance	—	—	—	—
R0130	Miscellaneous financial loss insurance and proportional reinsurance	—	—	—	—
R0140	Non-proportional health reinsurance	—	—	—	—
R0150	Non-proportional casualty reinsurance	—	—	—	—
R0160	Non-proportional marine, aviation and transport reinsurance	—	—	—	—
R0170	Non-proportional property reinsurance	—	—	—	—

		$MCR_{(L,NL)}$ Result	$MCR_{(L,L)}$ Result
		C0070	C0080
R0200	**Linear formula component for life insurance and reinsurance obligations**	—	(1,510,180)

		Non-life activities: Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Non-life activities: Net (of reinsurance/SPV) total capital at risk	Life activities: Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Life activities: Net (of reinsurance/SPV) total capital at risk
		C0090	C0100	C0110	C0120
R0210	Obligations with profit participation - guaranteed benefits	—		29,615,975	
R0220	Obligations with profit participation - future discretionary benefits	—		69,186,441	
R0230	Index-linked and unit-linked insurance obligations	—		8,958,774	
R0240	Other life (re)insurance and health (re)insurance obligations	—		43,603,263	
R0250	Total capital at risk for all life (re)insurance obligations		—		19,062,098

	Overall MCR calculation	C0130
R0300	Linear MCR	(1,510,176)
R0310	SCR	14,397,147
R0320	MCR cap	6,478,716
R0330	MCR floor	3,599,287
R0340	Combined MCR	3,599,287
R0350	Absolute floor of the MCR	3,251
R0400	**Minimum Capital Requirement**	3,599,287

	Notional non-life and life MCR calculation	C0140	C0150
R0500	Notional linear MCR	5	(1,510,180)
R0510	Notional SCR excluding add-on (annual or latest calculation)	(46)	14,397,193
R0520	Notional MCR cap	(21)	6,478,737
R0530	Notional MCR floor	(11)	3,599,298
R0540	Notional combined MCR	(21)	3,599,298
R0550	Absolute floor of the notional MCR	3,251	3,251
R0560	**Notional MCR**	3,251	3,599,298