

Prudential International Assurance Plc.

Solvency and Financial Condition Report
Year Ended 31 December 2019

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Summary

Company background

Prudential International Assurance plc (“PIA” or “The Company”) is an Irish domiciled insurance company that is authorised and regulated by the Central Bank of Ireland (“Central Bank”) and whose principal activity is the transaction of life assurance business. PIA is a leading insurer in the UK offshore bond market while also providing risk insurance for its UK and Polish policyholders. Its focus in 2019 has been on the sale of multi-asset solutions in the UK, the Crown Dependencies, Poland and selected countries in continental Europe.

As a result of the decision of the UK government to trigger Article 50 of the Lisbon Treaty and leave the European Union (“Brexit”), our parent Prudential Assurance Company (“PAC”) Limited transferred its long-term non-UK European business to PIA. The business includes an open book based in Poland and several closed books of business written by PAC France, PAC Malta, and by branches of the Equitable Life Assurance Society Germany and Ireland. This was done via a Part VII transfer as sanctioned by the UK High Court of England and Wales effective 1 January 2019.

To facilitate the transfer, PIA set up a branch in Poland on a freedom of establishment basis. The branch has written new with profits savings and protection business in Poland from 1 January 2019 and accepted the Part VII transfer of PAC’s existing Polish business.

Business and performance

Profit for the year amounted to £8.85 million (2018: profit £5.97 million). Overall profit is higher than prior year mainly due to the contributed revenue and profit of the transferred businesses of £42.6m and £4.6m respectively. Further information on business performance is provided in section A, including an assessment of the impact of the recent COVID-19 outbreak.

System of governance

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

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

Risk profile

Our Risk Management System 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.

For our shareholders, we generate value by selectively taking exposure to risks that are adequately rewarded and that can be appropriately quantified and managed. We retain risks within a clearly defined risk appetite,

where we believe doing so contributes to value creation and the Company is able to withstand the impact of an adverse stressed outcome.

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

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

Further information on the main risks inherent in our business (namely market risk, credit risk, insurance or underwriting risk, liquidity risk, operational risk, business environment risk and strategic 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.
- (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.

Further information on the valuation of assets, technical provisions and other liabilities of the Company for solvency purposes is provided in section D.

Capital management

The Company has been granted approval by the Central Bank to calculate its solvency capital requirement based on its internal model. The Prudential Regulation Authority (‘PRA’), in consultation with the CBI, approved a Major Model Change on 14 November 2019 to reduce the scope of Prudential group’s internal model so that it applied only to the M&G plc group post-demergers. Following the reduction in scope the approved internal model is classified as a full internal model.

The Company’s solvency capital requirement has been met during 2019. The Company’s Solvency II position at 31 December 2019 is shown in the table below.

	2019 £m
Own funds	270
Solvency Capital Requirement (‘SCR’)	174
Surplus	96
Solvency ratio	155%
Minimum Capital Requirement (‘MCR’)	44

Additional information on the components of the Company's own funds and SCR is provided in section E.

Business and Performance

A.1 Business

A.1.1 Name and legal form

Prudential International Assurance plc (“The Company” or “PIA”) is an Irish domiciled insurance company that is authorised and regulated by the Central Bank and whose principal activity is the transaction of life assurance business.

PIA’s immediate parent company is The Prudential Assurance Company Ltd (“PAC”), with the ultimate parent entity being M&G plc. Each immediate parent company has a 100% interest in the equity capital of its subsidiary.

PIA is subject to the relevant regulatory requirements and guidelines of the Central Bank, who are based at New Wapping Street, North Wall Quay, Dublin 1, Ireland.

PIA also has a UK branch and a Poland branch. The UK branch, Prudential International Assurance UK Branch (PIA UK Branch), is authorised and regulated by the PRA and the Financial Conduct Authority (“FCA”). The Poland branch, Prudential International Assurance PLC SA Oddział w Polsce Branch, is regulated by the Polish Financial Supervision Authority (“KNF”).

PIA’s parent company M&G plc., is a holding company, some of whose subsidiaries are authorised and regulated, as applicable, by the PRA and the FCA. The PRA offices are based at Bank of England, Threadneedle Street, London, EC2R 8AH, United Kingdom.

The independent external auditor is KPMG. Their offices are based at 1 Harbourmaster Place, IFSC, Dublin 1.

Simplified structure of Prudential International Assurance plc as at 31 December 2019



Key	
	Ultimate parent undertaking
	Other regulated entity
	Relevant regulated entity
P	Parent undertaking (above the relevant regulated entity level)
C	Controller (above the relevant regulated entity level)

A.1.2 Business operations

PIA is a leading insurer in the UK offshore bond market. Its focus in 2019 has been on the sale of multi-asset solutions to UK nationals resident in the UK, the Crown Dependencies and selected countries in continental Europe.

As a result of the decision of the UK government to trigger Article 50 of the Lisbon Treaty and leave the European Union (“Brexit”), PAC transferred its long-term non-UK European business to PIA. The business includes an open book based in Poland and several closed books of business written by PAC France, PAC Malta, and by branches of the Equitable Life Assurance Society (‘ELAS’) in Germany and Ireland. This was done via a Part VII transfer as sanctioned by the UK High Court of England and Wales effective 1 January 2019. The with-profits business transferred has been reinsured to PAC.

PIA current markets outside of the UK include Poland (via the Poland Branch), France, Spain, Malta, Cyprus, Gibraltar and the Crown Dependencies (Isle of Man, Jersey and Guernsey). The Company also receives top up premiums for existing policies in other countries where it previously had operations (including for example Belgium, Germany, Austria and South America).

PIA UK Branch sells investment bonds to UK customers. The onshore product is an open architecture bond allowing customers to have access to a number of funds offered by external fund managers.

PIA Poland Branch mainly sells with-profit endowment products and non-profit protection term life products with a range of optional riders attached to its products. They also offer affinity protection products and other short term protection products to the Polish market.

PIA has three lines of business: *unit-linked insurance*, *insurance with profit participation*, and *other life insurance*.

Insurance with profit participation business comprises all single premium investment products that are invested in the PAC with-profits funds via a reinsurance arrangement and the with-profit endowment products written by PIA Poland branch, which are also reinsured to PAC.

PIA unit-linked business ranges from proprietary to open architecture products and also includes products that offer mortality and morbidity benefits. Proprietary products are products where the policyholder can only invest in funds offered by PIA, whereas open architecture products allow policyholders to invest in a wide range of external funds and other assets.

The *Other life insurance* line of business relates to non-profit insurance products written by the PIA Poland Branch.

A.1.3 Significant events during the period

As noted above, there was a Part VII Transfer of the long-term non-UK European business of PAC to PIA on 1 January 2019. The Part VII Transfer has been accounted for as a business combination under common control, with nil impact on profit and loss. The following liabilities were transferred to PIA on 1 January 2019:

- Equitable Life – annuity business written by ELAS in both Ireland and Germany. The total liability transferred was £20m.
- PAC Poland – with-profits and non-profit business written by PAC Poland. The total liability transferred was negative (£9.5m).

- PAC Malta – mostly with-profit business written by PAC Malta with a very small number of non-profit policyholders. The total liability transferred was £4m.
- PAC France – with-profits and unit linked business written by PAC France. The total liability transferred was £38m.

Neither the terms and conditions of these policies nor their servicing were materially impacted by the transfer.

The Company did not propose or pay dividend during the year (2018: nil) on the ordinary shares.

In October 2019, Prudential Group demerged its UK & Europe business, M&G, from the remainder of its worldwide business. M&G plc is an independent, capital-efficient business, headquartered and premium-listed in London. Prudential plc combines the Asian, US and African business of the Group and remains headquartered and premium-listed in London. PIA forms part of M&G Group. The demerger had no direct impact on PIA and its operations.

The Company continues to assess and take advantage where appropriate of tactical and strategic opportunities as they arise and is exploring a number of developments which could be material for the business going forward.

Following the UK formally leaving the EU on 31 January 2020, a key risk to the Company is the possible loss of access to the Financial Services Compensation Scheme (“FSCS”) for new policyholders which would be a competitive disadvantage to PIA. Contingency plans are being put in place to mitigate this risk.

The company continues to monitor the effects of the coronavirus (COVID-19) outbreak which was declared as a pandemic by the World Health Organization on 11 March 2020. The outbreak has not only prompted widespread health concerns, but has caused a significant deterioration in global market conditions. PIA’s solvency position is not expected to be materially impacted by the outbreak as a large part of PIA’s risk exposure arises from the value of future profits included in Own Funds. Although adverse market conditions lead to a reduction in expected future profitability and consequently a reduction in Own Funds, there is a corresponding reduction in the SCR due to the reduced risk exposure. Furthermore, PIA’s mortality and morbidity exposures are limited due to the nature of the reinsurance arrangements in place, with at least 75% of the risk being reinsured to a highly rated external counterparty. PIA’s overall solvency and liquidity positions are therefore resilient to the stress scenarios most likely to arise as a result of the pandemic.

A.2 Underwriting performance

The company’s financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (“FRS 101”).

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (“IFRS”) as adopted by the EU (“Adopted IFRSs”), but makes amendments where necessary in order to comply with the Companies Act 2014, and the European Union (Insurance Undertakings: financial statements) Regulations 2015.

IFRS profit broadly equates to premiums less claims (including change in technical provision) and expenses together with investment returns. Given the linkage between the movement of technical provisions and movement in investments (e.g. for unit-linked funds, investment return (whether positive or negative) results

in a corresponding change in unit-linked technical provisions), PIA has defined IFRS profit as its underwriting performance as discussed in this section.

A detailed breakdown of the principle components of the IFRS profit is contained in Section A.5.

A.2.1 Overview of IFRS profits

Overview of IFRS profits	2019 £m	2018 £m	Change %
Gross IFRS Profits	12.4	4.2	195%
Tax credit / (charge) attributable to shareholders' returns	-3.6	1.8	-300%
Profit for the year attributable to shareholders	8.8	6.0	47%

The profit for the year amounted to £8.85 million which related to continuing activities (2018: profit £5.97 million). Overall profit is higher than prior year mainly due to contributed profit of £4.6m from the Part VII transferred businesses and higher fee income due to higher Assets Under Management ("AuM"). The contributed profit from the transferred businesses is driven by one off reserve changes for PAC France and a one off transfer from the PAC With-Profits Sub-Fund to PIA in respect of historic charges on the PAC France Unitised With-Profits ('UWP') business.

A.2.2 IFRS profit analysed by Solvency II lines of business

The gross IFRS profit is allocated by material Solvency II lines of business as follows:

Gross IFRS Profits	2019 £m	2018 £m	Change %
Insurance with profit participation	9.1	3.2	184%
Unit-linked Insurance	3.2	1.0	220%
Other life insurance	0.1	N/A	N/A
Total	12.4	4.2	195%

A.2.3 IFRS profit analysed by material geographical territory

The operating profit, as discussed above is allocated by material territory as follows:

Gross IFRS Profits	2019 £m	2018 £m	Change %
UK & Crown Dependencies	7.2	3.8	89%
Other	5.2	0.3	1,633%
Total	12.4	4.2	195%

A significant increase in “Other” gross profit relates to Part VII transferred businesses as explained in the section A2.1 above.

A.3 Investment performance

A.3.1 Investment analysis

The following investments are held in respect of shareholder and policyholder linked assets.

	2019 £m	2018 £m	Change %
Fixed Income Securities	28	36	-22%
Collective Investment Schemes	1,766	1,592	11%
Equities	7	8	-13%
Cash and Deposits	242	218	11%
Other	1	2	-50%
Total Assets	2,044	1,856	10%

A.3.2 Investment return

	2019 £m	2018 £m
Income		
Fixed Income Securities	2.2	2.1
Collective Investment Schemes	17.0	16.7
Cash and Deposits	0.4	0.2
Total income	19.6	19.0
Total realised gains	75.0	40.9
Total unrealised (losses) / gains	120.8	(152.2)
Total investment return	215.4	(92)

Investment income comprises interest, dividends and realised investment gains and losses on investments at fair value through profit or loss. Unrealised investment gains and losses on investments at fair value through profit or loss are separately disclosed in unrealised (losses)/gains on investments. Dividends are recognised on an ex-dividend basis. Interest is accounted for on an effective interest rate basis.

Investment in Collective Investment Schemes accounted for 86% of the total asset portfolio in 2019 and 86% in 2018. Shareholder investment in Fixed Income Securities accounted for 1% of the total asset portfolio in 2019 and for 2% in 2018, comprising 1 UK (2 in 2018) and 1 French Government Bond (1 in 2018). The remaining asset portfolio comprised cash and deposits and other sundry receivables.

Investment income increased in 2019 due to higher dividends on collective investment schemes and higher interest on other assets.

The increase in investment return from (£92m) in 2018 to £215m in 2019 principally reflects the increase in realised gains and the movement from a position of unrealised losses to unrealised gains on Collective Investment Funds due to market movements over the period.

A.3.3 Investment management expenses

The Company incurred £21 million (2018: £20.4 million) investment management expenses over the period. Investment management expenses have increased in 2019 by 3% primarily due to increase in AuM, partially offset by a reduction in investment management fee rates.

A.4 Performance of other activities

There are no material activities carried out by the Company other than those described above.

A.5 Any other information

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

The following table shows the Company's total revenue and total charges for the years presented:

	2019 £m	2018 £m
Gross premiums written	1,061	920
Outward reinsurance premiums	(1,074)	(881)
Earned premiums, net of reinsurance	(12)	39
Investment income	95	60
Other income	71	60
Unrealised (losses) gains on investments	121	(152)
Total revenue, net of reinsurance	274	6
Claims paid - Gross amount	(462)	(413)
Claims paid - Reinsurers' share	420	362
Change in provision for claims - gross amount	(10)	(6)
Change in provision for claims - reinsurers' share	3	1
Change in life assurance provision - gross amount	(1047)	(432)
Change in life assurance provision - reinsurers' share	1093	431
Change in technical provision for linked liabilities	(57)	83
Change in financial liabilities – investment contracts	(113)	38
Net operating expenses	(64)	(46)
Investment expenses and charges	(21)	(20)
Foreign exchange gains/(losses)	(2)	(1)
Profit on ordinary activities before tax	12	4

Total IFRS profit before tax attributable to shareholders for the year ended 2019 is £12.41 million (2018: £4.2 million). Analysis of profit before tax is shown below by nature of revenue and charges.

A.5.2 Premiums, claims and expenses

A.5.2.1 Comparison of earned premiums with the prior period

Premiums earned (IFRS)	Insurance with profit participation £m	Index-linked and unit-linked insurance £m	Other life insurance £m	2019 Total £m	2018 Total £m
Gross	1,004	45	13	1,061	920
Reinsurer's share	1,051	21	2	1,074	881
Net	(47)	24	11	12	39

The table above is made up of premiums earned on an IFRS basis from insurance contracts split by lines of business.

Total gross insurance premiums have increased compared to the prior year. The reinsurer's share of premiums earned exceeds the gross amount of premium earned as a result of the reinsurance premium paid to PAC in respect of the with-profits business transferred to PIA on 1 January 2019.

IFRS requires contracts written by insurers to be classified as either 'insurance contracts' or 'investment contracts'. For investment contracts, premiums are not included in the income statement. They are reflected as deposits on the balance sheet within technical provisions.

The table below represents total premiums earned from both insurance and investment contracts as reported in QRT S.05.01.

Premiums earned (SII)	Insurance with profit participation £m	Index-linked and unit-linked insurance £m	Other life insurance £m	Pia 2019 Total £m	2018 Total £m
Gross	1,004	136	13	1,152	1,021
Reinsurer's share	1,051	21	2	1,074	881
Net	(47)	115	11	78	140

A.5.2.2 Comparison of claims with the prior period

Claims incurred (IFRS)	Insurance with profit participation £m	Index-linked and unit-linked insurance £m	Other life insurance £m	2019 Total £m	2018 Total £m
Gross	402	68	3	473	418
Reinsurer's share	400	20	2	422	363
Net	2	48	1	51	55

The table above is made up of claims incurred on an IFRS basis from insurance contracts split by line of business.

The increase in claims is primarily driven by an increase in the value of surrenders during the period. The number of policies in-force has increased in comparison to prior period.

IFRS requires contracts written by insurers to be classified as either ‘insurance contracts’ or ‘investment contracts’. For investment contracts, claims are reflected as withdrawals on the balance sheet within technical provisions.

The table below represents total claims incurred from both insurance and investment contracts as reported in QRT S.05.01.

Claims incurred (SII)	Insurance with profit participation £m	Index-linked and unit-linked insurance £m	Other life insurance £m	2019 Total £m	2018 Total £m
Gross	402	145	3	550	497
Reinsurer's share	400	20	2	422	363
Net	2	125	1	128	134

A.5.2.3 Comparison of expenses with the prior period

Net operating expenses have increased by c.40% over the period. The main driver of this increase is the inclusion of operating expenses related to the non-profit business of PIA Poland (expenses related to the with-profits business are fully reinsured to PAC). However, there has also been an increase in PIA's other operating expenses which is primarily due to increased development expenditure.

B. System of Governance

B.1 General information on the system of governance

The PIA Risk Governance System provides a disciplined and structured process for the taking and management of risk that includes the M&G plc Group Governance Framework. PIA as an Irish regulated entity is subject to the relevant requirements and guidelines of the Central Bank, the PRA and FCA in the UK (UK branch only) and the Polish Financial Supervision Authority ('KNF') (Poland branch only), the European Insurance and Occupational Pension Authority ("EIOPA") and European Union (Insurance and Reinsurance) Regulations 2015 ("Solvency II"). PIA is also required to comply with the General Good Requirements of the jurisdictions into which it sells on a Freedom of Service ("FoS") basis including the UK, Poland, France, Spain, Gibraltar, Malta and Cyprus. PIA is also permitted to sell into Jersey, Guernsey and the Isle of Man.

B.1.1 Structure of the system of governance

The PIA Risk Governance System includes the PIA Risk Governance Framework detailing the Principles, the PIA Board, Board Committees, and Management Committee structures, the apportionment and Delegation of Authorities and the Fitness and Probity Regime. The terms of references for all Board and Management Committees sets out the decision making authorities, responsibilities and reporting lines of each Committee.

The risk management function, led by the Chief Risk and Compliance Officer ("CRCO"), has responsibility for maintaining the PIA Risk Governance System and supporting risk management and governance policies on behalf of the Board. The Risk Management function carries out oversight activity to ensure that the system operates effectively and is adhered to by the business. Any exceptions identified are highlighted within the regular risk reporting from the CRCO and escalated internally to the PIA Risk Committee, as appropriate.

PIA's approach to risk management is consistent with the 'three lines of defence' model, ensuring appropriate segregation of duties with oversight and challenge on decision making.

The Board maintains a risk appetite statement with limits that inform decision making, reflect the entity's business model and are compatible with the M&G risk appetite and limits. The risk management function is involved at an appropriate early stage in all material decisions.

The CRCO presents an update on risk to the Risk Committee each quarter and attends the Board meetings.

The Head of the Actuarial Function ("HoAF") attends the quarterly Board meetings and Risk Committee meetings.

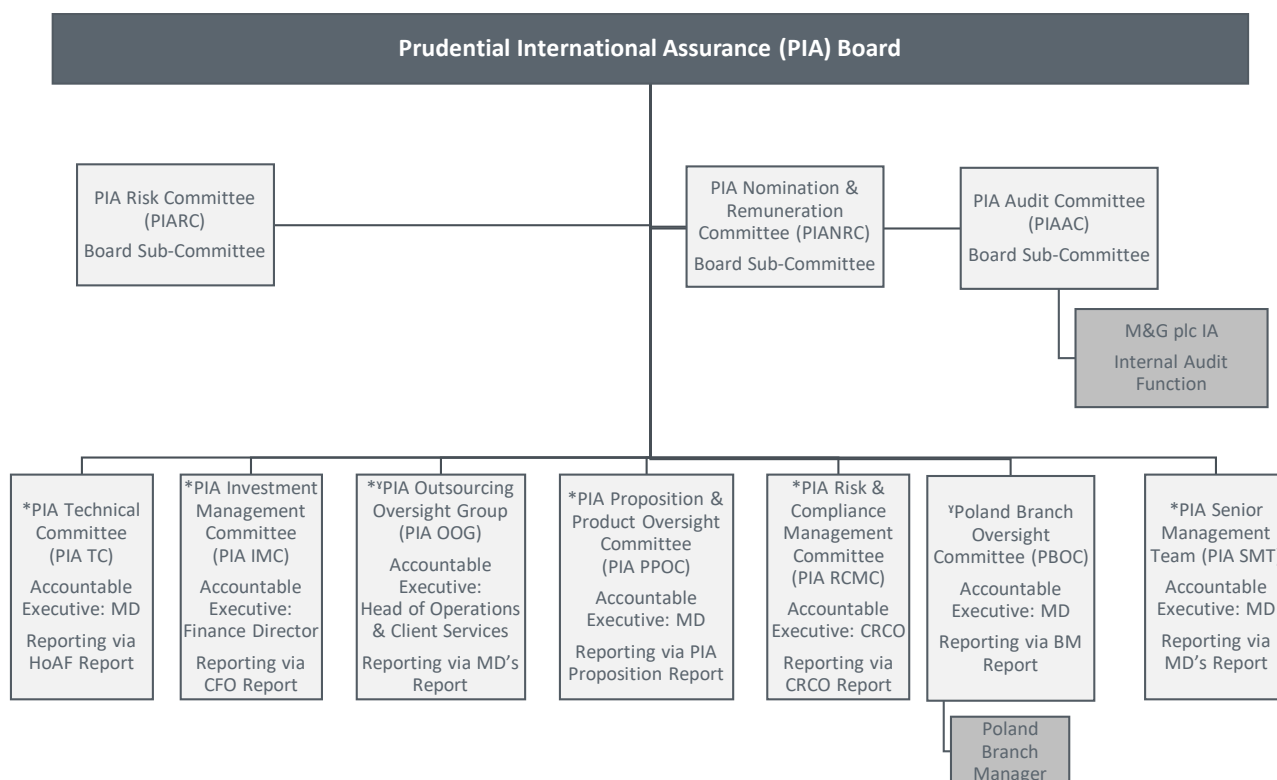
The Head of Compliance and MLRO presents an update on compliance and financial crime matters to the Risk Committee on a quarterly basis.

The CRCO and HoAF are members of the Technical Committee ("PIATC"). The purpose of the PIATC is to assist the Managing Director ("MD") of PIA in providing leadership, direction and oversight of the technical bases and practices of the PIA business for regulatory and statutory reporting purposes, in addition to all other technical, financial and risk aspects of running the business.

Organisational structure

The PIA Board, the various committees, and the key functional areas involved in governance, risk management and oversight are set out below. The delegation of authority to committees and individuals is a Board responsibility. Each committee may refer agenda items to other relevant committees as required. For example, fund closures from the Investment Management Committee may be referred to the Proposition & Product Oversight Committee; compliance and/or customer matters from any of the committees may be referred to the Risk and Compliance Management Committee.

PIA committee structure: statutory committees as at 31 December 2019



* Includes oversight of PIA, UK Branch and Poland Branch

† New Oversight Group and Committee effective 1st January 2019, membership comprise:

MD, Managing Director

CFO, Chief Financial Officer

HoAF, Head of Actuarial Function

HOC, Head of Compliance and MLRO

BM, Branch Manager

The Board has delegated functions of the Board to the following statutory committees:

- PIA Audit Committee (PIAAC)
- PIA Risk Committee (PIARC)
- PIA Nomination and Remuneration Committee (PIANRC)

The Board has delegated authority to the Managing Director of the Company to exercise all the powers of the Directors of the Company subject to the limits imposed and approvals required by the PIA governance framework and the M&G plc Group Governance Framework; and matters reserved to the Board.

To assist the Managing Director and the Board in the operations of the business the following advisory committees were established:

- PIA Technical Committee (PIATC)
- PIA Investment Management Committee (PIA IMC)
- PIA Outsourcing Oversight Group ('PIA OOG')
- PIA Proposition & Product Oversight Committee (PIA PPOC)
- PIA Risk and Compliance Management Committee (PIARCMC)
- Poland Branch Oversight Committee (PBOC)
- PIA Senior Management Team (PIA SMT)

For the PPOC, TC, IMC and RCMC, a quarterly report on decisions made and issues to be escalated is provided to the PIA Board or Risk Committee for information and the right to amend any decisions.

Functions

As at 31 December 2019 PIA is organised on a functional basis, as detailed below:

- Managing Director
- Finance
- Actuarial
- Risk and Compliance
- Operations
- Commercial and Marketing
- Product Management, Proposition Development and Delivery
- Change and Transformation
- Poland branch
- UK branch

Heads of Functions together form the PIA Senior Management team (PIA SMT), with a reporting line into the PIA Managing Director, who in turn reports to the Board of PIA. The role, responsibilities and reporting lines of each member of the PIA SMT are documented in the relevant PIA SMT job role profile descriptions.

Roles & Responsibilities

PIA Board of Directors

The PIA Board is responsible for the long-term success of the Company and for providing leadership within the management framework. The control environment assists the Board in identifying significant risks to the business and applies appropriate measures to manage and mitigate them. The Board is responsible for approving the Company strategy and for ensuring the Company is suitably resourced to achieve it.

The Board is assisted in the discharge of its duties by a number of Committees, to which it has delegated certain responsibilities.

Audit Committee

The PIA Audit Committee is a sub-committee of the Board and its purpose is to assist the Board in meeting its responsibilities with respect to the integrity of the Company's financial statements, the effectiveness of

the Company's internal control framework, and in monitoring the effectiveness and objectivity of the internal and external auditors.

The Audit Committee objectives also include reviewing, discussing and making any recommendations, as appropriate, on internal and external reporting, policies and procedures as established by management; and in providing a monitoring and oversight function for work carried out by management.

The membership of the Audit Committee consists of at least three members all of which are non-executive Directors. The majority are independent, one of which takes the Chair.

Key responsibilities:

- Assist the Board in meeting its responsibilities with respect to the integrity of the Company's financial statements, the effectiveness of the Company's internal control and risk management systems, and in monitoring the effectiveness and objectivity of the internal and external auditors.
- Monitor the effectiveness of the Company's systems of internal control and approving the statements to be included in financial reports.
- Consider the effectiveness of the compliance arrangements, and approve annual compliance and risk assurance and audit plans.
- Review the procedures for managing allegations from whistle-blowers and arrangements for employees to raise concerns about possible financial reporting improprieties.

Risk Committee

The PIA Risk Committee ("PIARC") is a sub-committee of the Board with the purpose of oversight and governance of PIA's risk management framework, risk appetite and risk management systems, system of governance, Solvency II requirements and internal capital and own funds. The PIARC is also responsible for reviewing the Company's material risk exposures against the risk methodologies and management actions to monitor and control such exposures.

The membership of the Risk Committee consists of at least three members all of which are non-executive Directors, at least one of whom is independent.

Key responsibilities:

- To assist the Board by providing oversight and governance of the Company's risk management framework, risk appetite and risk management systems, systems of governance, Solvency II requirements and internal capital and own funds.
- Reviewing the Company's material risk exposures against the risk methodologies and management's actions to monitor and control such exposures.
- Assess the effectiveness of the risk management system throughout the Company.
- Advise the Board on the risks inherent in strategic decisions and the business plan.
- Review the effectiveness of the internal model used for the purposes of Solvency II reporting with recommendations for changes as required to the model.

Nomination and Remuneration Committee

The PIA Nomination and Remuneration Committee is a sub-committee of the Board and assists the Board in meeting its responsibilities with respect to the remuneration and nomination practices of PIA.

Key responsibilities:

- To assist the Board in meeting its responsibilities with respect to ensuring that the nomination practices of the Company are compliant with various regulations and codes, including Solvency II, and that remuneration practices and framework are in line with the risk strategies of the Company and do not promote excessive risk taking.
- Monitoring, evaluating and reporting the Company's systems of governance in respect to nominations and remuneration.

The membership of the Committee consists of at least three members with the majority being independent non-executive directors.

B.1.2 Adequacy of systems of governance

The PIA governance system is in place to ensure:

- that the governance structures are and continue to remain appropriate to the scale and nature of the Company's business
- that all policies and procedures are in place and adequately documented
- that the appropriate segregation of duties and responsibilities are clearly defined
- that there is an effective operation of the M&G Group's system of internal controls
- and that reporting and disclosure requirements to satisfy regulatory and corporate governance requirements are in place.

B.1.3 Changes to the system of governance

As a result of PAC's Brexit planning, on 1 January 2019 it transferred business to PIA under a Part VII transfer. The Part VII transfer includes policies written by PAC Poland, PAC France, PAC Malta, and those by Equitable Life Assurance Society branches in Germany and Ireland. On 5th December 2018, the PIA Board approved changes to the governance committee structure effective from 1 January 2019 to allow for the management of this business. This involved the set-up of a PIA Outsourcing Oversight Committee (PIA OOG) and a Poland Branch Oversight Committee (BPOC). Other existing committees now have appropriate representation from PIA Poland as appropriate.

In October 2019 the demerger of M&G plc from Prudential plc was completed, with M&G plc being PIA's ultimate parent entity. See section A.1.1 for the new company structure.

B.1.4 Remuneration policy & practices

PIA remuneration practices are set by M&G plc in line with the M&G plc Remuneration policy.

The M&G plc Remuneration Policy in place that:

- Promotes the long-term success of the Company;
- Attracts, motivates and retains the best talent to help ensure continued growth and success of M&G plc as a separated listed company;
- Supports the Company's diversity and inclusion objectives to provide equality of opportunity for all who apply for and perform work for the Group;
- Aligns the interests of the Executive Directors, Senior Managers and employees with the interests of current and future Shareholders and other stakeholders;

- Strikes an appropriate balance between short-term and long-term performance with strong linkage to Group performance, effective risk management, management of conflicts of interest, customer outcomes, the culture and values of the Group and long-term shareholder value creation;
- Is simple and transparent, both externally and to colleagues; and
- Is compliant with relevant local remuneration regulation requirements e.g., Solvency II for PIA.

The remuneration structures are designed to support the achievement of the Group's short and long-term business objectives, underpinned by the principles listed above. The remuneration policy is consistent with and promotes sound and effective risk management.

Governance processes across the Group apply to PIA and deliver robust oversight of reward, effective management of conflicts of interest and reflect the need to link remuneration decisions with risk culture. The PIA Remuneration Committee is responsible for local implementation of group remuneration policy and structures for all employees of the relevant business to ensure alignment with the Company's business strategy, objectives, values, risk appetite and long-term interests. PIA's Nomination and Remuneration Committee is a sub-committee of PIA Board dedicated to implementing the remuneration policy and structures established by the Group Remuneration Committee and providing oversight of remuneration of Business Unit executives.

Remuneration structure

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

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

Annual short-term incentive arrangements operate to support the alignment of colleagues to the Group's financial and strategic objectives, customer outcomes, culture, values, risk management policies and pay-for-performance principles. Currently, annual bonus awards are based on Business Unit and individual performance, and market practice. This allows PIA to operate a fully flexible bonus policy, including the possibility of not paying annual bonus based on financial and non-financial criteria.

M&G plc operate a LTIP over M&G plc's shares with performance conditions aligned with its long-term financial/strategic objectives and shareholder value creation. Participation in the LTIP is reserved for senior colleagues who have significant accountability and ability to influence the delivery of M&G plc's long-term business objectives. Awards are granted annually and at the complete discretion of the M&G plc Remuneration Committee. PIA does not operate an LTIP except in circumstances where there is a compelling commercial/strategic rationale and both the PIA Nomination and Remuneration Committee and the M&G plc Remuneration Committee are satisfied that such an arrangement is appropriate.

B.1.5 Transactions with the shareholders

The sole direct shareholder for PIA is its parent company The Prudential Assurance Company Limited ("PAC"). An additional 35,701,971 ordinary shares of €1.27 each which were issued by PIA in consideration for the non-UK European business of PAC transferred to PIA on 1 January 2019.

B.2 Fit and proper requirements

The Company operates in line with the Central Bank's Fitness and Probity regime as laid out in the Fitness and Probity Standards ("F&P Standards"). F&P Standards apply to all employees and officers of PIA holding either a Controlled Function ("CF") or Pre-Approval Controlled Function ("PCF") role, as defined by the F&P Standards.

B.2.1 Fit and Proper requirement

Each employee or officer of PIA in scope of the F&P Standards must demonstrate their fitness and probity to perform the CF or PCF role.

Fitness relates to the qualifications, experience, knowledge and other relevant factors that will make an individual fit for the performance of a CF or PCF role within PIA. In order for assess an individual's fitness to perform a CF or PCF role, PIA must assess an individual's competency and capability in the context of these factors.

Probity is a matter of character illuminated by an individual's past behaviour. In order for assess an individual's probity to perform a CF or PCF role, PIA must assess an individual's honesty, diligence, independence of mind, ethics and integrity, as well as their ability to act without conflict of interest and being financially sound.

B.2.2 Fit and Proper process

B.2.2.1 Procedures for New Control Function (CF) Appointments

The PIA process conducted by PIA Compliance includes executing appropriate due diligence in the context of the CF or PCF role, including evidence of:

- Compliance with the Minimum Competency Code (MCC), where relevant, including Continuous Professional Development (CPD) requirements.
- Professional qualification(s).
- CPD records.
- Record of interview and application (if applicable).
- References.
- Record of previous experience.
- Concurrent responsibilities.

The Company has processes for assessing the fitness and probity of individuals in scope of the F&P Standards, including a number of direct questions and independent checks. These processes are summarised below:

- During the recruitment process and before any regulatory application is made, an assessment of the individual's fitness is conducted including:
 - The individual's professional and formal qualifications;
 - Relevant experience within the insurance sector, other financial sectors or other businesses; and
 - Where relevant, the insurance, financial, accounting, actuarial and management skills of the individual.
- During the recruitment process and before any regulatory application is made, an assessment of the individual's probity is conducted including integrity, honesty, and financial soundness, based on evidence regarding their character, personal behaviour and business conduct, including any financial and supervisory checks.

Independent verification checks which are also conducted include:

- The Individual is not a Disqualified or Restricted Director using the registers;
- No disciplinary action has been taken by any regulatory body;
- The Individual does not appear on an Economic Sanctions list or Watch list; and
- No Judgments have been issued against the individual and that the individual has not been declared Bankrupt.

There are also annual refresh reviews to assess the on-going Fitness and Probity of the in-scope individuals, which includes annual attestations by the in-scope individuals to PIA, confirming their ongoing compliance with the F&P Standards.

Annually, a return is submitted by PIA in respect of its PCFs and their on-going compliance with the F&P Standards.

B.2.2.2 Procedures for New Pre-Approval Controlled Function (PCF) Appointments **Central Bank Approval process for PCFs**

Before a regulated financial service provider can appoint a person to a PCF, the Central Bank must have approved the appointment in writing. The Central Bank expects a regulated financial service provider to have conducted its own due diligence before proposing a person for appointment to a PCF.

The approval process requires the submission of a individual questionnaire (“IQ”) to the Central Bank. The Central Bank expects that the approval process will be based on the IQ, reference checks, and in some cases requests for further information. Where the Central Bank considers it necessary, it may conduct an interview with proposed holders of PCFs before deciding on whether or not to approve an application.

Where a person wishes to apply for several PCFs they must submit an application for each PCF. Due diligence for the vacant role must still be conducted even if the individual is already a CF or PCF holder for another function within PIA.

In addition, the PIA process for PCF also includes those tasks as outlined under B2.2.1 ‘Procedures for New Control Function (CF) Appointments’.

PIA has a succession plan in place which covers key PCF roles. The plan is approved annually by the PIA Nomination and Remuneration Committee.

B.3 Risk management system including the own risk and solvency assessment

B.3.1 Risk management strategy

PIA recognises that the managed acceptance of risk lies at the heart of the business. As a result, effective risk management capabilities represent a key source of competitive advantage for PIA. By the managed acceptance of risk, PIA seeks to generate shareholder value by selectively taking exposure to risks for which it is well compensated. PIA will, additionally, accept exposure to risks, where appropriate to do so for which it is not directly compensated where these are an inevitable by-product of its business activities, with these risks reduced to the extent it is cost-effective to do so. In general, therefore, PIA’s control procedures and systems are designed to manage risk, rather than eliminate the risks.

However, at certain times, there may be other risks for which PIA has no tolerance and which are actively avoided. Where risks are formally accepted by the business, these will be reviewed periodically to ensure this remains appropriate.

The PIA Risk Governance Framework provides an overview of the risk management system at PIA and forms part of the overall system of governance. The framework describes the approach, arrangements and standards for risk management that support compliance with statutory and regulatory requirements. It outlines the principles for the taking and management of risk, and addresses requirements arising under the M&G Group Governance Framework and Risk Management Framework as well as statutory and regulatory requirements under Solvency II and the Central Bank's regulatory regime.

This is achieved through:

- outlining the governance structure and apportionment of accountabilities by which PIA operates;
- defining risk management principles, strategy, policies and risk management cycle to identify, measure, monitor, manage and report current and future risks;
- providing a common language and framework for managing all types of risk which is important for consistency and enables understanding of the overall risk exposure; and
- promoting a responsible risk culture supported through the recruitment and training of capabilities and behaviours needed to develop and control the business.

The risks to which PIA is exposed as a result of its business strategy are understood and managed through the existing PIA risk management framework, which is approved annually by the PIA Board.

The operational principles defining the risk and control governance within PIA are as follows:

- **Organisational structure** – PIA maintains an appropriate and transparent organisational structure with clear allocation of responsibilities and delegated authorities;
- **Three Lines of Defence Model** – PIA's approach to risk management is consistent with the "Three lines of defence" model, ensuring that there are appropriate segregation of duties, oversight and challenge occurs on decision making;
- **Risk Appetite Statement and Limits** – The Board maintains and approves risk appetite statements and limits that inform decision making, reflect the business model and are compatible with our Group-wide risk limits, with materiality taken into consideration;
- **Risk Management Cycle** – PIA operates an effective risk management cycle to identify, measure, evaluate, manage, monitor and report on risks on an on-going basis;
- **Policies and Procedures** – PIA maintains policies and procedures which set out the control framework and operating standards required to meet internal, legal and regulatory requirements; and
- **Skills and Resources** – PIA maintain systems and policies to ensure that a proper risk management system is in place. The resources required to manage the business appropriately with succession planning and appropriate funding is controlled through the Nomination and Remuneration Committee.

The risk governance framework in PIA Poland is integrated into the PIA Risk Governance Framework and aligns to M&G plc standards whilst reflecting local statutory and regulatory requirements.

Three lines of defence model

PIA's risk governance is based on the principle of the 'three lines of defence' model of: managing risk, risk oversight and independent assurance. This model distinguishes between responsibility for taking risk, managing risk and ensuring there is appropriate oversight of risk. This structure aims to ensure that there is an integrated approach to risk management with appropriate segregation of duties, authorisation and avoidance of gaps or overlaps in activities.

The model of the Three Lines of Defence is positioned on the following:

- That primary responsibility for risk identification, assessment/measurement, monitoring and management lies with the business;
- That risk assessment includes categorisation, scoring, and quantification of risks where feasible;
- That identification of controls and cost effective mitigating actions are derived and implemented for each risk; and
- That risks across all classes are managed within appetite and risks that are above the risk appetite are reported to and challenged or approved by the Risk Committee and the Board as appropriate.

Business operations (1st Line of Defence)

The Company's first line of defence is line management. The Managing Director and the PIA Senior Management Team, together with business line management and employees, are responsible for identifying and managing the risks inherent in PIA's products, activities, processes and systems. This includes responsibility for implementing sufficient and appropriate controls to manage risk across the Company.

The PIA PPOC, PIATC, PIAIMC, the PIA SMT, the Poland Branch Oversight Committee ('PBOC') and the PIA Outsourcing Oversight Group ('PIA OOG') form part of the first line of defence. The PIA/Capita Joint Management Committee (JMC) and the Poland Executive Committee are also key governance forums supporting PIA's first line committees. The PIA Risk & Capital Management Committee is responsible for second line oversight across PIA and its branches. PIA's governance framework will be reviewed in 2020.

PIA line management are in charge of internal control policies, standards, procedures, governance and operating limits that manage core processes and risks across the business.

Management information and formal reporting lines are used to enforce, monitor and review the effectiveness of controls throughout the Company and its key outsourced service providers. Areas of deficiency and improvement will be identified on an on-going basis to redesign the control activities, making them more effective and efficient in mitigating against identified risks.

Risk assessments and control assessments, including the Annual Statement of Compliance (systems and controls assertion) is performed by the business. The risk assessment and systems and controls review evaluates current risks and existing controls and determines whether additional controls are required. Risk and control self-assessments are undertaken quarterly where there is a significant change to the risk profile of the business.

First line risk and compliance support to the business is provided by the PIA Risk & Compliance Function.

Risk and compliance function (2nd Line of Defence)

The Company's second line of defence comprises the Chief Risk and Compliance Officer (CRCO) and the Risk & Compliance Function, and the PIA Risk Committee. The Risk & Compliance Function incorporates the PIA Risk Management function, the PIA Compliance function and the PIA Poland Risk & Compliance Function. The second line of defence has oversight over all the activities of the business, support and control units, including outsourced activities.

The Risk Management function, which is under the direct responsibility of the CRCO, is charged with oversight, review and supervision of the identification, measurement, management, reporting and monitoring of risk to which PIA is exposed, including ensuring appropriate risk management processes exist so that all key risks are identified, assessed and appropriately managed by the PIA SMT.

The Risk & Compliance Function is established at senior management level, has adequate authority and responsibility to fulfil its functions, has a direct reporting line to the Risk Committee and is independent of the first line business. The PIA Risk Committee approves and monitors the annual risk and compliance assurance plan for PIA, which includes its UK and Poland branches, as undertaken by the PIA Risk Management and Compliance Function.

Risk control and oversight:

- The Risk Management function assists the Board to formulate and then implement the risk appetite statement, risk framework, risk management plans, risk policies, risk reporting and risk identification processes.
- The Risk Management function reviews and assesses the risk-taking activities of the first line of defence, where appropriate.
- The Risk Management function and the Compliance function both conduct risk and compliance assurance reviews in accordance with the approved annual risk and compliance assurance plan. These assurance plan is considered on an annual basis by the PIA Risk Committee and the PIA Audit Committee, as relevant, with updates provided on progress throughout the year.

The PIA Risk and Compliance Management Committee (RCMC); PIA Outsourcing Oversight Committee (PIA OOG), Poland Branch Oversight Committee (BPOC) and ultimately the Board Risk Committee form part of the second line of defence.

Internal audit arrangements (3rd Line of Defence)

The Company's third line of defence is Internal Audit, as provided by Internal Audit, and provides independent assurance on the design, effectiveness and implementation of the overall system of internal control, including risk management and compliance. The third line of defence provides independent assurance of the first and second lines of defence to the Audit Committee and the Board.

The annual internal audit plan is approved and monitored by PIA's Audit Committee. Internal Audit reports are presented on a quarterly basis to PIA's Audit Committee.

B.3.2 Risk policies and standards

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.

PIA 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.

In addition to the normal management information produced and reviewed by line management and the functional business areas, monitoring of PIA's risk position against risk appetite is performed by the Risk Management function, with reporting to the Risk Committee quarterly. This monitoring is based on relevant management and risk information provided by the business functional areas, Capita, M&G plc and also sourced independently by the Risk Management function as required. In addition to Risk management function monitoring of PIA's risk appetite, the members of the PIA SMT have functional area responsibility for monitoring relevant risks against the stated risk appetite for their functional areas.

Risk appetite and limits

PIA sets its risk appetite in order to assist the business in implementing the strategy and achieving business plan objectives, whilst operating within the realms of the tolerances and limits defined by Board and the risk strategy. Risk Appetite is the amount and type of risk an organisation is willing to accept in pursuit of its business objectives. The high level components of the risk appetite statement for PIA are indicated below.

Category	Risk appetite
Solvency Levels	To hold a capital buffer sufficient to ensure that PIA's capital position is resilient to the most onerous stresses that are relevant to the business (after allowance for management action).
Capital and earnings management	Target returns on capital in line with pricing frameworks. PIA generates appropriate earnings and cash flows to support required capital and solvency levels and planned dividends and withstand unexpected shocks. Volatility of earnings is consistent with the expectations of the shareholder and in accordance with the annual PIA business plan.
Liquidity	PIA generates sufficient cash flows to meet financial obligations (outgoing cashflows) including policyholder liabilities as they fall due, in both a business as usual and appropriate agreed stressed scenarios.
Market Risk	PIA has appetite where it is value creating and within its target capital and solvency position; where it arises from profit-generating insurance activities to the extent that it remains part of a balanced portfolio of sources of income for shareholders; and is compatible with a robust solvency position.
Insurance Risk	PIA has appetite, within defined limits, where it is deemed more value creating than transferring the risk and within its target capital and solvency position, and when strong controls covering policyholder servicing, claims management, experience monitoring, stress testing and validation of assumptions are in place.

Category	Risk appetite
Operational Risk	PIA has no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement and monitor appropriate controls to manage operational risks. PIA does not actively seek to take operational risk to generate returns. Instead, it accepts a level of risk that means the controls in place should prevent material losses, but should also not excessively restrict business activities.
Conduct Risk	PIA has no appetite for unfair customer outcomes arising from systemic failures in its culture or any element of the customer lifecycle.

Risk Culture

Risk culture is a subset of the broader organisational culture at PIA and is reflected in the values and behaviours the Company displays when managing risk.

A responsible risk culture is promoted in three main ways:

- through the leadership and behaviours demonstrated by management;
- by building skills and capabilities to support risk management; and
- by including risk management in the performance evaluation of individual employees.

B.3.3 Risk management processes

Risk identification

PIA operates a risk management cycle which involves a process for evaluating risks (assessing), responding to risks (managing) and monitoring the impact of risks through reporting. The risk identification exercise is performed as an annual review; however, as business initiatives or actions can occur over the year, it is continuously reviewed.

The three key steps to identifying risks are:

- a top-down risk review;
- a bottom-up risk process;
- identify any emerging risks to the business.

These risks are assessed over the short to medium-term horizon consistent with the own risk and solvency assessment processes. The risk identification process is designed to identify and assess risk from a different perspective to form an overall understanding of the business' risk profile and its evolution.

Risk control and mitigation

Risk control is the process of selecting and implementing measures to modify the residual risk once evaluated. These include improving or adding to the internal controls in place, transferring the risk through risk transfer activities (e.g. reinsurance), avoiding risks which contravene company policy or the risk strategy (e.g. political risk), and accepting risks where the cost to control exceeds the potential impact of the risk.

B.3.4 Risk monitoring

Own risk and solvency assessment

The Own Risk and Solvency Assessment (ORSA) is a continuous process. An ORSA report is produced at least annually. It pulls together the analysis performed by a number of risk and capital management processes, and provides quantitative and qualitative assessments of PIA's risk profile, risk management and solvency needs on a forward-looking basis. The scope of the ORSA covers the full known risk universe of PIA including both modelled and non-modelled risks. The ORSA annual report documents the key risks for PIA, stress and scenario test results as well as the risks arising from the current strategy. The ORSA projections cover a three year period to examine the business horizons and requirements for capital in the future.

The PIA ORSA policy and annual report are produced by the PIA CRCO with input from the Actuarial Function. The PIA Board plays a central role in the ORSA process and ultimately approve the final ORSA.

B.3.5 Internal Model

The Solvency II internal model is a key risk management tool and is used to calculate the Solvency II and internal economic capital requirements.

Internal model governance and controls

To ensure that the Internal Model is, and continues to be, suitable to support the Company's assessment of risk and capital, the Company has implemented a governance and control framework in relation to:

- **Model Use:** to provide assurance 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 implemented 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 Internal Model Risk Policy which is aligned with the 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. Reports are approved by the Risk & Compliance Management Committee, Risk Committee or Board as appropriate.

Validation process

Internal model validation (IMV) is a key aspect of the system of governance for the internal model. The Risk & Compliance Management Committee and the Technical Committee have responsibility for ensuring that the Internal Model is, and continues to be, suitable for PIA to support the assessment of risk and capital and that it complies with all regulatory requirements. The RCMC is responsible for the independent validation of the PIA aspects of the model. PIATC is responsible for reviewing and approving the PIA aspects of the

methodology and assumptions for the Internal Model, including any changes to the model. The RCMC and PIATC report to the Risk Committee.

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

- Minimum standards for effective 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 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 of the Internal Model.

Material Changes to the Internal Model Governance

There were a number of material changes to the Internal Model governance in 2019. The internal model governance of the business transferred from PAC on 1 January 2019 moved from the UK equivalent committees to the PIATC and the RCMC. Ahead of the demerger, ownership of the model was transferred from Prudential plc to M&G plc. The Internal Model was also reclassified from a partial internal model to a full internal model.

All changes went through the proper governance process for Major Model Changes, being approved by the PIA Board before submission of a formal application to the Prudential Regulation Authority with the Central Bank as a co-signatory due to PIA being a "solo entity" using the Internal Model within the EU but outside the UK where the model is authorised.

B.4 Internal control system

PIA adheres to policies approved at a Group level and to the six principles of internal control as detailed below:

- Management Delegated Authority – PIA is managed in accordance with the authority delegated by the PIA Board, with due consideration of the position of the M&G plc Group.
- Lines of responsibility – Each Business Unit has clearly defined lines of responsibility and delegated authority.
- Appropriate recording – Transactions are appropriately recorded to permit the preparation of reliable financial statements.
- Financial reporting control procedures and systems – The internal control system over financial reporting includes control procedures and systems which are regularly reviewed.
- Financial crime (fraud and money laundering) – Financial crime is detected and prevented where possible.
- Risk Management – The risks to which PIA and the Group are exposed to are identified and managed.

PIA is required to attest annually to the application of the policies that collectively represent the Group Governance Framework, including internal control policies.

B.4.1 Compliance function

The PIA Compliance function represents the “second line of defence” within the three lines of defence model applied by PIA, and is responsible for identifying, assessing, monitoring and reporting on PIA’s compliance risk. PIA Compliance promotes ethical conduct and compliance with rules, regulations and standard processes that govern how PIA must conduct its business.

PIA Compliance is under the responsibility of the Head of Compliance and MLRO (HoC) who reports directly to the CRCO.

The key roles and responsibilities of PIA Compliance are summarised below.

- **Promote a compliance culture**

A culture of Compliance is an integral part of PIA’s ethics and it is the role of PIA Compliance to promote behaviors that deliver a compliance culture within PIA. Examples of how this is executed include provision of training, Compliance policies and guidance.

- **Compliance risk assessment**

PIA Compliance conducts a risk assessment to facilitate appropriate monitoring of PIA’s compliance risks. PIA Compliance applies a risk-based Compliance Monitoring Programme (CMP) on the basis of its compliance risk assessment to determine its priorities and the focus of its monitoring, advisory and assistance activities. The PIA Board and Risk Committee approves the annual CMP and receives related reports and progress updates against the CMP, typically on a quarterly basis.

- **Monitoring**

The Compliance function is authorised by PIA’s Board to review all areas of PIA as necessary and to have full and unrestricted access to activities, documentation, employees and assets to assist in their work as well as the authority to investigate potential compliance breaches.

PIA Compliance monitoring activities aim to evaluate whether PIA’s business is conducted in compliance with the relevant rules, regulations and standard processes that govern how PIA must conduct its business.

Monitoring activities performed by PIA Compliance take into account:

- a) the business area’s obligation to comply with regulatory requirements;
- b) the first level of controls in PIA’s business areas (i.e. controls by the operative units, as opposed to second level controls performed by compliance); and
- c) reviews by the risk management function, internal audit function or other control functions.

The risk-based approach to compliance monitoring forms the basis for determining the appropriate tools and methodologies used by PIA Compliance in executing its CMP and the frequency of the monitoring activities performed.

- **Reporting**

The PIA HoC has a direct reporting line into the PIA Board and Risk Committee. PIA Compliance are responsible for providing written reports to PIA's Board and Risk Committee, detailing compliance matters that must be brought to their attention covering the breadth of PIA's business activities.

PIA Compliance is also responsible for managing PIA's relationships with its regulators and providing them with timely and accurate notifications and reports on PIA's behalf, and as circumstances require. Similarly, communications received by PIA from its regulators are distributed internally by PIA Compliance to the relevant stakeholders, with management of any required follow up.

- **Advisory**

PIA fulfils its advisory responsibilities by, amongst other activities, providing support for staff training, providing day-to-day assistance to staff and participating in the establishment of policies and procedures within PIA. In addition, it is PIA Compliance's responsibility to not only be up to date with all regulatory issues relevant to PIA, but to identify potential threats of non-compliance and take measures and make recommendations to alleviate them.

The Compliance function monitors PIA's internal control system and its compliance with the Group Governance Framework annually, which is reported to the Risk Committee and Board by the CRCO.

The Compliance function manages PIA's Compliance policies, which captures local regulatory requirements as well as those arising from Group in respect of all business conducted by PIA. The requirements arising from these Compliance policies are mandatory for all PIA employees and officers, where applicable.

PIA Compliance function is independent of other functions within PIA and this is reinforced by the HoC having a direct reporting line into the PIA Board and Risk Committee.

B.5 Internal Audit function

How the undertaking's internal audit function is implemented:

As a subsidiary of the Prudential Assurance Company Ltd ("PAC"), PIA source its internal audit activities through the M&G plc Internal Audit function. The Internal Audit function operates as a 3rd Line of defence in the 3LoD model, providing independent assurance to the PIA Senior Management Team and Board Audit and Risk Committees on the adequacy of the design and effectiveness of the organisation's systems of internal control, including risk management, governance and operational processes, thereby helping them protect the assets, reputation and future sustainability of the organisation.

Audit work in respect of the PIA business is reported to the PIA Audit Committee ("PIAAC"), with the Head of Audit (PCF13) for PIA reporting directly to the M&G plc Chief Audit Officer (CAO), and the PIAAC Chair, with an administrative reporting line to the PIA Managing Director for PIA related matters.

Internal Audit is not restricted in scope in any way and is empowered by the PIAAC to audit all parts of PIA, with full access to any of the organisation's records, physical properties and personnel. In executing its responsibilities Internal Audit adheres to:

- the Institute of Internal Auditors requirements as set out in the Institute of Internal Audit's 'Code of Ethics' and 'International Standards for the Professional Practice of Internal Auditing';
- the Chartered Institute of Internal Auditor's revised guidance, 'Effective Internal Audit in the Financial Services Sector' ('CIIA Code');

- the International Association of Insurance Supervisors ('IAIS') Core Principles and the European Confederation of Institutes of Internal Audit ('ECIIA'), effective in 2019, prescribing the principal requirements for Internal Audit functions in Insurance Companies under the Solvency II framework;
- 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; and
- the requirements of the Central Bank's Fitness and Probity Standards and the Group's Fit and Proper Policy.

How the undertaking's internal audit function maintains its independence and objectivity from the activities it reviews

By way of the structure explained above, Internal Audit maintains its independence and objectivity in the discharge of its responsibilities and has appropriate reporting lines in place to support this goal.

- The Head of Audit for PIA reports to the M&G plc CAO as functional head, reports all audit related matters to the PIAAC (with direct access to the Chair of the PIAAC) and communicates directly with the PIAAC through attendance at its meetings. The M&G plc CAO will consider the independence, objectivity and tenure of the Head of Audit for PIA when performing their appraisals;
- The Head of Audit for PIA is empowered to attend and observe all or part of the PIA Board meetings and any other key management decision making committees and activities as appropriate;
- The Head of Audit submits an annual audit plan of coverage to the PIAAC for review and approval; this forms part of the M&G plc audit plan approved by the M&G plc Board Audit Committee ("BAC"). The audit plan is based on prioritisation of Internal Audit's identified 'audit universe' using an 'audit needs' risk-based methodology, incorporating input from business stakeholders and consideration of external factors such as emerging industry themes. The plan is continuously reviewed and updated as required to reflect evolving assurance requirements and business priorities;
- The assessment of the adequacy and effectiveness of the Risk, Compliance and Finance functions is within the scope of Internal Audit. As such, Internal Audit is independent of these functions and is neither responsible for, nor part of, them. In addition, Internal Audit have no direct operational responsibility or authority over any business activity or personnel outside of the function;
- The Internal Audit Chief Operations Officer (COO), who is independent of the audit delivery team reporting directly to the M&G plc CAO, monitors and evaluates the function's adherence with all relevant Internal Audit standards of practice and audit methodology. The results of these assessments are presented quarterly to the M&G plc and PIA Audit Committees. An independent external assessment of the Internal Audit function is performed every 5 years in line with Internal Audit standards; and
- Internal Audit personnel are expected to exhibit the highest level of professional objectivity in carrying out their duties, make a balanced assessment of all relevant circumstances, remain impartial and seek to avoid any professional or personal conflict of interest. Potential conflicts are recorded in the Internal Audit conflict of interest register and monitored by the Internal Audit COO, including a quarterly review of reported conflicts to assess appropriate management oversight.

B.6 Actuarial function

Within PIA, the Actuarial Function is defined as the Head of Actuarial Function (HoAF) and individuals within the actuarial team who are responsible for carrying out the tasks of the Actuarial Function. The role of the HoAF is a Central Bank PCF role and has responsibility for all of the activities of the Actuarial Function.

Valuation of Technical Provisions

The Actuarial Function proposes the valuation methodology and assumptions and calculates the technical provisions. The HoAF reviews the valuation methodology and assumptions, the models and data used in the calculation of the technical provisions and advises the PIA Board accordingly. The reports to the Board constitute component reports of the overall Actuarial Function Report.

Underwriting policy

The HoAF reviews and advises on all aspects of the underwriting policy on an ongoing basis. In addition, the HoAF carries out an annual review of specific aspects of the policy. The HoAF 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 HoAF reviews and advises on all aspects of the reinsurance arrangements on an ongoing basis. In addition, the HoAF carries out an annual review of specific aspects of the reinsurance policy. The HoAF 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 Actuarial Function proposes the valuation methodology and assumptions, and calculates the SCR. The HoAF reviews the valuation methodology and assumptions and the SCR and advises the Board accordingly. The HoAF works closely with the CRO and the Board to agree the ORSA scenarios and produce the projections and associated commentary for the ORSA. The HoAF provides an opinion to the Board in respect of the ORSA process.

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

PIA uses outsourcing and third party solution providers to allow focus on its core business strengths, reduce costs and manage its delivery risks. PIA recognises that the use of outsourcing and third party solution providers can impact its risk profile, for example, the service may fail, resulting 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.

PIA 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 Ireland and the UK. The intra-group outsourcers provide various support services including sales and marketing services, infrastructure services and associated security / operational monitoring services and portfolio management services located in the UK.

PIA has a Third Party Supply Policy in place which forms part of the overall Risk Management Framework and is aligned with the three lines of defence governance model. The policy sets out the requirements for the management of all outsourcing and third party supply arrangements across the Company and is aligned to

relevant policies, which address specific outsourcing topics, e.g. data security, information risk, and business continuity. The policy is compliant with regulatory requirements for outsourcing, covering the full lifecycle of managing outsourcers and third parties, from procurement to management and oversight, relationship management and contract termination. The 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 Third Party Supply Policy is completed on an annual basis by the Head of Operations and is overseen by the Risk Function.

B.8 Any other information

The risk management framework and internal control system are critical components of the ORSA, and it is important that the system is working effectively to allow the Company to identify, understand and manage risks which could impact the capital and liquidity position.

The PIA Governance System is in place to ensure:

- that the governance structures are appropriate to the scale and nature of the Company's business;
- that all policies and procedures are in place and adequately documented;
- that the appropriate segregation of duties and responsibilities are clearly defined;
- that there is an effective operation of the system of internal controls;
- that reporting and disclosure requirements to satisfy regulatory and corporate governance requirements are in place.

The overall system of governance is an adequate structure to support the Company's business and is appropriately reported to the PIA Board.

C. Risk Profile

PIA's strategy seeks to ensure financial performance is achieved in accordance with the business plan, whilst ensuring the efficient use and allocation of capital, growing shareholder value through bringing new propositions to market, and meeting customer, regulatory and shareholder expectations and requirements.

PIA sets its risk appetite in order to assist the business in implementing the strategy and achieving business plan objectives, whilst operating within the realms of the tolerances and limits defined by Board and the risk strategy. PIA's risk appetite statement is subject to annual review by the Board with ad-hoc reviews required upon a strategy change, and updated in line with PIA's evolving risk profile as well as emerging experience and requirements. The high-level components of the risk appetite statement for PIA are capital, solvency levels, earnings, liquidity and operational risk.

PIA Poland currently has a standalone risk appetite statement though the two statements are broadly similar and use the same limits, where relevant. PIA's risk appetite statement is due to be reviewed and refreshed in 2020, with work underway to consolidate this into one comprehensive risk appetite statement covering PIA and all its branches and to incorporate continuous improvements across the organisation in relation to risk culture.

The following section provides an overview of PIA's risk profile along with details of its Solvency Capital Requirement (SCR) by risk category.

Sections C.1 to C.6 give more detailed information on PIA's risk exposures, along with management and mitigation techniques. Section C.7 outlines risk sensitivities, PIA's compliance with the prudent person principle, future management actions and other financial mitigation techniques.

Overview

M&G plc defines and categorises the key risks to the Group and its subsidiaries, including PIA, in its Risk Management Framework. It also defines risk appetite ranges and limits for each key risk at both the parent and local entity level. PIA defines risk policies that include risk appetite and limits that are compatible with those set by the Group. These policies also support the control and management of risks at a risk category level, i.e. underwriting, market, credit, liquidity, operational and other. The approach to each risk category is discussed in sections C.1 to C.6. PIA's risk policies support the Risk Management Framework setting out the principles by which we conduct our business in the area covered by the policy to adhere to internal, legal and regulatory requirements. As such, they are a key risk management tool for each risk category discussed in section C.1 to C.6. PIA's risk policies include the roles and responsibilities of the first line and second line in implementing sound risk management throughout the organisation, including identification, monitoring and reporting of risks. PIA's suite of policies include:

- Insurance Risk
- Market Risk
- Savings and Investment Risk
- Credit Risk
- Liquidity Risk
- Operational Risk
- Technology Risk
- Security Risk
- Reputational Risk

- Third Party Risk Management
- Strategic Risk
- Internal Model Risk
- Model & User Developed Applications Risk

Risk Profile

PIA assesses its risk profile using its Solvency II capital requirement, an approach that is widely used in industry. The Solvency Capital Requirement (SCR) determines the amount of capital needed to withstand a 1-in-200 year risk event over a one year time horizon. The SCR is shown after allowing for risk mitigation actions, for example reinsurance. Risks not modelled under Solvency II are also fully assessed and captured in PIA's ORSA.

PIA's year-end SCR by risk category is shown in the table below for both 2018 and 2019. It was calculated using the Company's Internal Model. This is in line with industry practice where insurance entities have developed an internal model. PIA's material risks are market, expense, lapse and operational, which is reflective of PIA's main lines of business: insurance with-profits participation and unit-linked insurance.

Risk Category Undiversified	2019 £m	2018 £m
Market Risk	195	146
Equity	107	83
Property	13	13
Interest Rate	10	8
Credit incl. Counterparty	23	23
Currency	42	19
Underwriting Risk	267	201
Expense	87	64
Lapse (all)	162	125
Mortality & Morbidity	18	12
Operational Risk	35	29
Loss absorbing capacity of deferred tax	-27	-18
Interaction Effects	-46	-36
Sum of SCR by Risk	424	322
Diversification	-250	-185
SCR (diversified across all risks)	174	137

The capital required for each risk type reflects the amount required for each risk when the impact of a 1-in-200 year event for that risk is quantified in isolation. If a number of risk events occur simultaneously, the impact would be different. This is reflected in the line item "Interaction Effects" (referred to within Quarterly Reporting Templates as "Other Adjustments").

As stress events result in the loss of value (future profits) to the Company, there is a reduction in the associated deferred tax liability. The item "Loss absorbing capacity of deferred tax" reflects the extent of this for PIA.

The “SCR (Diversified across all Risks)” reflects a 1-in-200 year event for the Company. “Diversification” reflects the extent to which 1-in-200 year events would not be expected to occur for all risks simultaneously.

The increase in capital requirements since 2018 is driven by business transferred from PAC to PIA on 1 January 2019, as well as the impacts of new business written and positive market experience, partly offset by the release of capital on in-force business.

PIA is exposed to other material risks that are not covered as part of its internal capital model. These risks include those associated with liquidity, the business environment, the conduct of business, being part of a larger Group and the strategy that the company is pursuing, and are covered in section C.6. Significant sections of the Own Risk and Solvency Assessment cover the qualitative assessment of these non-modelled risk types.

C.1 Underwriting Risk

C.1.1 Context

PIA is exposed to underwriting risk (or insurance risk) as a result of its insurance business operations, and is currently PIA’s largest risk exposure in terms of capital required. PIA defines this risk as: “the risk of loss to PIA, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of a number of insurance risk drivers. These include adverse mortality, morbidity, persistency and expense experience.”

Lapse risk, also known as persistency risk, is the risk that actual lapse rates differ from their expected level as allowed for when calculating the best estimate liabilities. This risk may result in a cost for the Company, for example, a reduction in fund charges arising from the business.

Expense risk is one of PIA’s more significant risks and arises when actual expenses differ to the assumed level of the expenses. As PIA sells mostly unit-linked products, one of its key challenges is to ensure that the cost of administering the business does not increase to such an extent that it affects the profitability and solvency of the Company. Expense risk also covers the risk of expenses increasing with inflation.

The other underwriting risks faced by PIA are mortality and morbidity. PIA does not have a large exposure to these risks due to the use of reinsurance.

C.1.2 Risk strategy and objectives

PIA has appetite for underwriting risk and for retaining such risk, within defined limits, where it is deemed more value creating for the Company than transferring the risk, the risk is within its target capital and solvency positions, and strong controls covering policyholder servicing claims management, experience monitoring, stress testing and validation of assumptions are in place.

PIA accepts some exposure to lapse risk. To help mitigate this risk, strong controls related to policyholder servicing, experience and behaviour monitoring are in place. PIA also monitors the risk exposure and conducts stress testing and validation of its lapse assumptions.

PIA accepts expense risk as an unavoidable risk associated with running its business. The expense strategy is to set budgets which are consistent with the Company's target levels of solvency and profitability, while ensuring that the company has sufficient resources to run its business and achieve its business objectives. Expense budgets are approved by the PIA Board as part of the Company's Business Plan. Expenses are managed to ensure that actual expenses incurred are in line with approved budgets.

PIA accepts limited morbidity and mortality risks acknowledging that controls are in place to cover claims management, experience monitoring, stress testing, and validation of assumptions.

C.1.3 Risk management

PIA measures and assesses its exposure to underwriting risks using metrics agreed by the Board which are compatible with the Company's risk appetite, for example actual lapse rates compared to plan assumptions. The Company considers various items to determine its insurance risk mitigation and management strategy; these include correlation with other risks, cost effectiveness, and credit standing of relevant counterparties (if applicable).

PIA sets assumptions for underwriting risk based on its own experience and its understanding of each risk. The Company performs experience studies, where actual experience is analysed and compared with expected experience. Appropriate actions are taken in the event of deviations in experience from pricing or reserving assumptions.

PIA monitors lapse experience on an ongoing basis and, when necessary, makes changes to product design and/or undertakes policy retention initiatives. Lapse experience studies are conducted regularly and are split by homogeneous risk groups for analysis.

PIA monitors its expenses on an ongoing basis and takes appropriate and timely action where incurred expenses are higher than the approved budget. Expense assumptions are set based on historical and projected future expenses.

PIA also monitors its expense inflation risk and its policy count. Expense inflation is set relative to expected Eurozone inflation.

Additionally, as part of its business planning (which includes the ORSA), the Company stress tests items such as the expected level of expenses to ensure that it has sufficient capital to meet costs, even under stressed scenarios.

Reinsurance is used to manage underwriting risks when it is desirable or cost effective to reduce exposure to a particular risk. PIA has a reinsurance limit framework to limit the exposure to a single external reinsurer.

C.2 Market risk

C.2.1 Context

Market risk is defined as the risk of adverse changes in PIA's financial position resulting from changes in the market value of policyholder and shareholder assets. Market risk drivers include equity, property, interest rates and currency.

Due to the nature of PIA's business it is exposed to market risk through two sources:

- (i) *Indirect exposure through fees earned*: The management fees earned by PIA depend on the value of policyholder assets under management. Therefore a lengthy decline in fund returns would lead to a reduction in future fee income to PIA as most charges are a percentage of funds under management.
- (ii) *Direct exposure through shareholder's investments*: PIA faces the risk of adverse movements in the value of the assets in which PIA's shareholder funds are invested. These funds, which are used to meet capital requirements and provide the Company with working capital, are invested in accordance with the Investment Policy.

The key market risk faced by PIA is equity risk, which relates to adverse movements in the management fees earned on its business, as outlined in point (i) above. Property risk arises in a similar way but is much less significant for PIA than equity risk given the smaller holdings in property.

Currency risk is the risk of loss resulting from changes in exchange rates. PIA's currency exposure arises due to a currency mismatch between mainly euro denominated expenses and mainly sterling denominated charges taken as a percentage of funds. In setting up a Polish Branch, PIA has increased its exposure to currency translation risk. This risk arises because PIA's financial reporting currency is sterling and hence a shift in exchange rates (sterling: zloty) could have a negative impact on our solvency position, all else being equal.

Interest rate risk relates to the risk that changes in market interest rates will adversely impact asset values and values of future cashflows.

C.2.2. Risk strategy and objectives

PIA's appetite for market risk (including equity, interest, currency and property) is to retain market risk only to the extent that it is value creating and within the Company's target capital and solvency positions, arises from profit-generating insurance activities and remains part of a balanced portfolio of sources of income for shareholders.

C.2.3 Risk management

Market risk policies, risk appetite statements, risk limits and triggers, processes and controls are in place to support effective market risk management, and PIA closely monitors and manages its exposures to key market risks.

PIA accepts the risk of reduced management fee income on policyholder assets as a result of adverse movements in policyholder funds under management, which is exposure (i) outlined above. PIA's view is that it is more value-creating to retain this risk than to mitigate the risk through financial techniques such as hedging.

For market risk associated with shareholder funds, item (ii) above, PIA does not intend to take any undue risk in the investment of its shareholder assets. Shareholder assets will be held in short dated cash, near cash instruments or government bonds. Where a manager is appointed to run any cash portfolios, the PIA Investment Management Committee ('IMC') will ensure there is a clear mandate for the handling of such monies, which ensures that cash is placed with good quality counterparties and that there is a suitable spread of such counterparties. The IMC will investigate any deviations from the approved mandate.

Currency risk can be broadly mitigated as PIA has the right to increase fixed monetary product charges in line with foreign exchange movements in addition to inflation movements, whilst the PIA Poland branch business income and expenses are both in zloty. However, PIA remains exposed to translation risk when consolidating the PIA Poland Branch from a financial reporting point of view. Linked liabilities are suitably matched for PIA's existing business.

C.3 Credit risk

C.3.1 Context

PIA defines credit risk as the risk of loss or adverse change in the financial situation of the insurer resulting from fluctuations in the credit standing of securities issuers, counterparties and any debtors. This risk category includes counterparty default risk, downgrade risk, spread widening or other changes to the portfolio such as changes in the rating or in market risk concentrations that could have a financial impact to which PIA is exposed.

Credit risk in PIA is split into two categories:

- **Investment credit risk** – The risk of adverse deviations in the market value of risky assets (such as corporate bonds), as a result of default; downgrade and/or spread widening.
- **Counterparty risk** – The risk of loss arising from any other credit exposure such as reinsurance contracts, derivative transactions and cash management.

In terms of counterparty risk, PIA places reliance on a number of internal and external reinsurance contracts. PIA's most significant reinsurance contracts include intra-group reinsurance with its parent company PAC (A+, Aa3 and AA- ratings for financial strength from S&P, Moodys and Fitch respectively¹) to access PruFund and external reinsurance with institutions with very strong credit ratings to cover mortality and morbidity risk.

PIA has an indirect exposure to credit risk in that, for example, changes in credit spreads on fixed interest assets will adversely impact asset values and values of future cashflows and thus impact on the value of future fees earned.

C.3.2 Risk strategy and objectives

PIA has appetite for credit risk (including credit counterparty, credit concentration and sovereign credit risk) within defined limits. PIA's appetite is to take credit risk to the extent that it remains part of a balanced portfolio of sources of income for shareholders, and that it is compatible with a robust solvency position. PIA will accept counterparty risk, within limits, where this arises as a by-product of reinsurance or derivative transactions used to mitigate other exposures and in the operational management of cash.

C.3.3. Risk management

PIA's risk appetite statement sets out a number of Key Risk Indicators (KRIs) for credit risk which are monitored regularly. Credit risk is managed by applying these Board approved exposure limits and triggers to individual counterparties and applying minimum credit quality and asset concentration limits. There are no limits for internal group counterparties but there are for external ones. Within PIA, management information on credit risk exposures is reported to the PIA Risk & Compliance Management Committee.

¹ Correct as of March 2020.

The sections below outline specific management and mitigation techniques used by PIA on the key areas of credit risk it is currently exposed to.

- Investment credit risk

PIA employs various risk management techniques for investment of shareholder funds and policyholder funds where PIA manages the assets directly.

Credit risk on shareholder funds arises from bank failure or government insolvency and/or default. It is managed through appropriate diversification and monitoring of credit rating updates and other market information. Investments are made according to the PIA Investment Policy, which is set in line with the risk appetite set out for credit risk exposure and is reviewed annually. Deposits are placed in various banks with higher proportions permitted in higher rated banks. PIA monitors its relevant exposures and their ratings on an ongoing basis, and produces reports outlining changes required if necessary.

PIA has limited appetite for credit risk for direct management of policyholder assets in the offerings of PIA deposit funds. PIA monitors credit risk exposure on these funds, for example ratings of bank counterparties and their financial conditions, and also produces quarterly reports on the exposures.

- Counterparty risk

The Company sets minimum approved credit ratings for reinsurers from whom it can purchase reinsurance; these ratings are assessed when reinsurance contracts are signed or renewed and are monitored on an ongoing basis. The company also sets maximum counterparty exposure to any third party external reinsurer it is involved with.

PIA monitors and reports on its relevant exposures and their ratings on a monthly basis. If a reinsurer's rating falls below the approved credit rating limit, a report is prepared for the PIA Propositions & Product Oversight Committee and the Risk Committee. This report will outline the reason behind the fall, the steps to manage any required change in the strategic role of the reinsurer and the credit rating outlook. The senior management team and Risk Committee will then decide on a course of action (if required).

C.4 Liquidity risk

C.4.1 Context

Liquidity risk is the risk that the Company, although solvent, either does not have enough available resources to enable it to meet its cash payment obligations as they fall due or can secure them only at excessive cost. The sub-components of liquidity risks are:

1. **Cash flow mismatch** – this risk would materialise if forecast cash flows significantly underestimate actual net cash flows and result in a larger than expected outflow of money.
2. **Asset risk** – the availability of liquid assets within the profile of the existing asset portfolio for each fund to meet any un-forecasted liabilities as they arise. This would not include the counterparty aspects of asset risk which are considered part of credit risk.

PIA's liquidity risk is considered to be relatively low because of the nature of the operating model.

C.4.2 Risk strategy and objectives

PIA has very limited appetite for liquidity cash flow mismatch risk and no appetite for a breach in the liquidity coverage ratio. To ensure the Company remains within appetite, liquidity risk relating to cash flow mismatch and asset risk, is measured and monitored by the liquidity coverage ratio where applicable. The Company seeks to ensure clients' claims and other liabilities can be covered at all times.

When formulating its liquidity risk appetite, PIA also considers the following items:

- Scope of business activities;
- Intra-group arrangements;
- Correlation between liquidity risk and other risk classes;
- Financial management and control procedures between liquidity and cash flows;
- Monitoring of liquidity risk.

C.4.3 Risk management

Liquidity risk is not quantified in the Solvency II Internal Model as this risk is not best managed through holding additional capital. Instead, liquidity is monitored against the liquidity metric set out in the Risk Appetite Statement, to hold a minimum balance of £20m in cash and/or money market instruments.

The management of liquidity risk includes the production of management information and includes a number of processes such as:

- daily cashflow forecasts;
- permitted cash and/or money market instruments must be sufficiently liquid which is defined as redeemable within a 24 hour period or equal to the duration of matched liabilities.
- daily cashflow management with daily monitoring of cash balances and cash movements;
- quarterly analysis of actual cashflows

As part of the business planning process, PIA produces liquidity projections and reviews these against the risk appetite under the base and stressed scenarios as part of the ORSA.

C.5 Operational risk

C.5.1 Context

Operational risk is defined as 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, systems failures, fraud, the risk of a cyber-attack or some other event which disrupts business processes. The definition also includes operational elements inherent across other risk categories. Operational risk may result in financial losses, unavailability of services, information deficiencies or losses, regulatory fines and damage to brand, image and reputation.

As discussed in Section B.7, PIA has material external and intra-group outsource providers to support its business operations. As such, material outsourcing and supplier dependency risk is a key component of PIA's operational risk. This risk could lead to an outsourcer or supplier materially failing to meet the required service requirements, poor service delivery or delays in MI, reporting or timely delivery of customer service.

C.5.2 Risk strategy and objectives

PIA does not actively seek to take on operational risk to generate returns. Rather, PIA accepts that operational risk arises as a consequence of its business operations and accepts a level of risk such that the controls in place should prevent material losses, whilst not excessively restricting business activities. Accordingly, PIA has no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement and monitor appropriate controls to manage operational risk.

PIA's approach is outlined in the M&G plc Operational Risk Policy, a document reviewed regularly by the Risk Committee and the Board.

C.5.3 Risk management

As a key element of PIA's overall risk and governance system, PIA performs risk identification, assessment, monitoring and reporting to ensure that the overall management of operational risk is within appetite and is consistent with PIA's strategic objectives. Its approach includes a Risk and Control Self-Assessment (RCSA) process which incorporates the use of a risk register, scenario analysis for quantification purposes, key risk indicators and control indicators. With the exception of scenario analysis, this process is performed on a quarterly basis. The approach is designed to capture the operational risks associated with its entire operational activities and internal processes together with the IT systems supporting its activities.

Further operational risk management and mitigating actions include:

- Operational risk policies including Third Party Supply;
- Service level agreements for any outsourcing arrangements with a third party, and regular governance meetings;
- Regular testing of elements of the business continuity and disaster recovery plans;
- Succession plans for key roles;
- Monitoring of legislative, regulatory and fiscal rule changes on an ongoing basis; and
- Oversight activities including oversight committees and assurance work.

C.6 Other material risks

PIA faces other risks that are described below, but not specifically modelled in the Company's Internal Model. These other non-quantitative risks are assessed as part of the ORSA process.

Business environment risk is the risk that can arise as a result of changing external factors in the business environment in which PIA operates. These are considered under three sub categories: economic, social and technology; market forces; and political, statutory, legal and regulatory. Capital is not specifically held to account for business environment risk although the impacts are considered when modelling forward looking capital requirements for the main risk types. This risk is assessed as part of the operational risk and business planning process and allowed for in the Own Risk and Solvency Assessment.

Conduct risk is the risk that acts or omissions of the Company, or individuals within the Company, deliver poor or unfair outcomes for customers, other stakeholders (including employees) or affect market integrity. PIA is also exposed to conduct risks arising from the activities and advice practices of distribution channels through which PIA's products are sold, for example intermediaries and appointed representatives. Conduct risk is managed by PIA through a variety of measures covering qualitative and quantitative aspects that holistically provide the Board and Senior Management with visibility on PIA's conduct risk and how it is being

appropriately managed within PIA's risk appetite, thereby supporting i) the delivery of fair customer outcomes; ii) PIA's employees and iii) market integrity.

Examples of PIA's measures include, but are not limited to:

- HR initiatives that monitor and reward good conduct;
- Training to raise awareness and understanding of the importance of good conduct;
- Putting customer needs at the heart of product delivery and thereafter steering the product lifecycle;
- Setting clear responsibilities for the Board and Senior Management to champion and promote good conduct and ultimately be held accountable for poor conduct;
- Protectively identifying and managing conflicts of interest;
- Second and third line assurance reviews that incorporate assessing conduct measures and their outcomes;
- Incorporation of conduct metrics within management information that is reported to management and governance committees and the Board;
- Positive promotion of speaking out against poor conduct.

Group risk is the risk associated with being part of a group, particularly as a result of contagion. Operational and counterparty default risks arising from group interactions are considered and reflected in the model when they are material. Capital is not held for reputational damage that can arise from other group activities. Reputational damage is considered as an indirect impact in the operational risk process. As PIA's main exposure to group risk was its exposure with its direct parent, Prudential Assurance Company ('PAC'), the exposure is relatively unchanged as a result of the Prudential plc demerger.

Strategic risk is the risk that can arise as a result of ineffective or inadequate business strategy decisions in relation to competitors, consumers and the market. These risks are inherent in the chosen strategy and the environment in which it operates. It primarily impacts future earning potential and capital is not specifically held for this risk as it is not deemed material. The risks are identified through the business planning process.

Reputation, though hard to quantify, is a key asset. PIA continues to develop, along with the wider M&G plc 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.

Cyber security

The performance of core activities places reliance on the IT infrastructure that supports day-to-day transaction processing. Our IT environment must also be secure and we must address an increasing cyber risk threat as our digital footprint increases. The risk that our IT infrastructure does not meet these requirements is a key area of focus. Our current threat assessment is that, while we are not individually viewed as a compelling target for a direct cyber-attack, we are at risk of suffering attacks as a member of the M&G Group and financial services industry, with potentially significant impact on business continuity, our customer relationship and our brand reputation. Protecting our customers remains core to our business. The cyber security risks are managed through oversight of our material outsourced arrangements and regular Penetration Testing. Cyber risk is also quantified within operational risk capital.

C.7 Other information

Risk sensitivities

Stress and scenario testing is embedded in the risk management framework and is an effective tool in forward-looking risk analysis. It is performed in order to:

- Assess the Company's ability to withstand significant deterioration in financial and non-financial conditions;
- Provide feedback on 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
- Assist in the monitoring of adherence to the Company's and the Group's risk appetite.

To evaluate the Company's resilience to significant deteriorations in market and credit conditions and other shock events, the risks facing the Company as described in the sections above are grouped together into severe but plausible scenarios. In addition, the Company assesses an annual reverse stress test which gives the directors an understanding of the maximum resilience to extremely severe adverse scenarios. The Company also maintains a risk appetite framework which assesses the Company's ability to withstand a specified level of shock and still cover its solvency capital requirements.

The scenarios tested showed that the Company would be able to maintain viability over the three year period assessed.

Prudent person principle

The 'prudent person principle' sets standards for prudent investment. These include standards in relation to portfolio diversification, the use of financial derivatives, exposure to non-regulated markets and risk concentration, asset-liability matching and the security, quality and profitability of the whole investment portfolio. In particular, it emphasises the need for firms to exercise prudence in relation to the acquisition and holding of assets and to ensure that assets are appropriate to the nature and duration of the liability.

PIA's risk appetite is set in relation to overall solvency, liquidity and other business needs, with risk limits and targets used to make sure that the business is managed within Risk Appetite and be compliant with the Prudent Person Principle.

The Company's product offering includes internally and externally managed unit-linked funds. The Company outsources internal unit-linked investment management to Prudential Portfolio Management Group ('PPMG').

The Investment Policy sets out the system for management and oversight of investment performance and investment related risk including externally managed funds. The Company mitigates material risk by matching policyholder liabilities with the relevant assets.

Management Actions and other Financial Mitigation Techniques Included in the SCR

PIA does not assume or model any management actions or other financial mitigation techniques in the SCR.

D. Valuation for Solvency Purposes

D.1 Valuation of assets

D.1.1 Introduction

The 2019 balance sheet under both statutory accounts value (FRS 101) and Solvency II value bases is summarised in the table below:

	Statutory accounts	Presentation differences (note a)	Other (note b)	Solvency II
	£m	£m	£m	£m
Assets				
Deferred acquisition costs	61		(61)	0
Intangible assets	5		(5)	0
Investments-other than participations	118	(0.1)		118
Assets held for index-linked and unit-linked contracts	1,923	(12)		1,911
Reinsurance recoverable	6,074		147	6,221
Cash and cash equivalents	53			53
Other ⁽¹⁾	22	8.1		30
Total assets	8,256	(4)	81	8,333
Liabilities				
Technical provisions				
Best estimate liability	8,013	(6)	(145)	7,862
Risk margin	-		63	63
Other liabilities				
Deferred tax liabilities	2		22	24
Other ⁽²⁾	112	2		114
Total liabilities	8,127	(4)	(60)	8,063
Excess of assets over liabilities	129	-	141	270

¹ Other assets includes Insurance and intermediary receivables, Reinsurance receivables, Receivables (trade, not insurance), Tangible assets and Other assets.

- ² Other liabilities includes Provisions other than technical provisions, Insurance and intermediaries payable, Reinsurance payables and Payables (trade, not insurance).

Notes:

- (a) Presentation differences represent movements between line items with no overall impact on excess of assets over liabilities. The main item relates to assets held by the unit-linked funds which are presented together in a single line on the statutory accounts balance sheet rather than within each individual asset/liability category.
- (b) Other valuation differences represent the key changes to excess of assets over liabilities between statutory reporting (IFRS) and Solvency II. These are analysed within the reconciliation set out within Section E.1.5.

D.1.2 Valuation of assets

D.1.2.1 Determination of fair value

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

When valuing assets and liabilities in accordance with Solvency II, the fair valuation hierarchy set out below is followed, which is consistent with the fair value measurement hierarchy as applied by the Company for statutory reporting (IFRS) purposes:

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

A significant proportion of the Company's assets in this category are Collective Investment Schemes where most recent market data is unavailable at the reporting date. 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 and are subject to a number of monitoring controls, such as stale price reviews and variance analysis on prices. 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 fund managers.

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 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 with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date.

(c) Alternative valuation techniques

Assets valued using this method typically include suspended funds and certain investments deemed to be exposed to potential bespoke risks taking into account current market data.

Investments valued using alternative valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions (e.g. market illiquidity). The valuation techniques used may include comparison to recent arm's length transactions, reference to other instruments that are substantially the same and discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used priority is given to publicly available prices from independent sources when available, but overall the source of pricing is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date. The fair value estimates are made at a specific point in time, based upon available market information and judgements about the financial instruments.

D.1.2.2 Valuation bases under Solvency II compared with Irish GAAP (FRS101)

Goodwill

The value of goodwill is nil for IFRS and Solvency II purposes.

Deferred acquisition costs and intangibles

The value of deferred acquisition costs and other intangible assets, such as distribution rights and software are nil for the solvency II purposes. For IFRS purposes, deferred acquisition costs and other intangible assets are recognised at cost less amortisation.

Deferred tax assets

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 IFRS 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 2019. The value of deferred tax liability as at 31 December 2019 under Solvency II was £24 million (2018: £14 million).

Investments

Investments (other than assets held for index-linked and unit-linked contracts) comprise the following asset types as included in the Solvency II balance sheet.

Investments for the year-ended 31 December 2019

	£m
Bonds	28
Collective investment undertakings	2
Deposits other than cash equivalents	88
Total	118

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

Assets held for index-linked and unit-linked contracts

These assets relate to insurance products where the policyholder bears the investment risk, namely unit-linked products, and are presented as a single line 'Assets held for index-linked and unit-linked funds' within the Solvency II balance sheet. The individual assets are valued using the same approaches as if held outside such funds, and as described above.

Reinsurance Recoverable

Technical provisions are calculated on a gross-of-reinsurance basis, and a corresponding Reinsurance Asset ("Reinsurance Recoverable") exists on the balance sheet, as described in Section D.2.8 and D.2.9.4.

Cash and Cash Equivalents

Cash and cash equivalent are valued at fair value, an amount not less than the amount payable on demand.

Other assets

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

Other assets for the year-ended 31 December 2019

	£m
Insurance and intermediaries receivables	2
Reinsurance receivables	13
Receivables (trade, not insurance)	14
Tangible assets (Property, plant and equipment)	1
Total	30

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

Assets are derecognised when it is deemed that substantially all the risks and rewards of ownership have been transferred.

D.2 Technical provisions

D.2.1 Introduction

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 are the sum of two elements: the best estimate liabilities (BEL) and the risk margin.

This section gives an overview of PIA's technical provisions. It outlines the methods and main assumptions used in calculating the technical provisions for each of PIA's material lines of business: *unit-linked insurance*, *insurance with profit participation* ("with profit" business) and *other life insurance*.

PIA does not apply any of the following measures, which are permitted under the Solvency II requirements (subject to approval):

- Matching adjustment, as referred to in Article 77b of the Directive;
- Volatility adjustment, as referred to in Article 77d of the Directive;
- Transitional risk-free interest rate-term structure, as referred to in Article 308c of the Directive;
- Transitional deduction, as referred to in Article 308d of the Directive.

D.2.2 General principles

D.2.2.1 Methods

Solvency II requires that the "liabilities shall be valued at the amount for which they can be settled between knowledgeable and willing parties in an arm's length transaction".

The BEL 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 EIOPA. The calculation of the BEL is based upon up-to-date and credible information and realistic assumptions (derived from data analysis and expert judgement) and is performed using appropriate actuarial and statistical methods. The cash-flow projection used in the calculation of the BEL takes account of all the cash in-flows and out-flows required to settle the insurance obligations over their lifetime. The BEL is calculated before deduction of the amounts recoverable from reinsurance contracts. Those amounts are calculated separately (see sections D.2.8 & D.2.9).

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 transferring the insurance obligations to a third party. The calculation assumes a 6 per cent per annum cost of capital and applies to non-hedgeable risks only. This calculation applies simplified methods in line with Article 58 of the Delegated Regulation rather than a full projection of the Solvency Capital Requirement (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. For less material lines of business other simplifications apply (e.g. assumed to run-off in line with the BEL).

D.2.2.2 Assumptions

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

- (i) economic assumptions, most of which are published by EIOPA and set by reference to market data at the valuation date;

- (ii) non-economic assumptions, used to derive non-market related best estimate liability cash flows (for example future claims and expenses);

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

10 year risk-free rates at 31 December 2019 (with comparison to 31 December 2018):

Currency	31 December 2019	31 December 2018	Change
British Pound	0.91%	1.34%	-0.43%
Euro	0.11%	0.73%	-0.61%
Polish Zloty	2.03%	N/A	N/A
United States Dollar	1.78%	2.55%	-0.77%

Non-market assumptions (e.g. persistency, mortality, morbidity and expense assumptions) are derived from analysis of recent historic experience data, and also reflect expected future experience. These assumptions are based on PIA's own experience where there is sufficient reliable data to be analysed. If not, then industry data may be used. Expert judgement is applied where necessary and justification for it is documented.

D.2.3 Quantitative results

The values of the technical provisions for PIA as at 31 December 2019 are set out in the table below.

Gross of reinsurance	2019 £m
Insurance with profit participation	6,102
Unit-Linked Insurance	1,808
Other life insurance	-48
Total Best Estimate Liabilities ("BEL")	7,862
Risk Margin	63
Total technical provisions	7,925

Technical provisions are gross of reinsurance.

The with-profits benefits attached to the insurance with profit participation line of business are reinsured to the PAC. Section D.2.8 and D.2.9 provide further information on Reinsurance Recoverables.

D.2.4 Details on methodology and assumptions by lines of business

This section explains how the BEL is calculated for each material line of business.

The BEL has two components, the unit-liability component and the non-unit-liability component. The calculation is slightly different for each of PIA's three lines of business (insurance with profit participation business, unit-linked insurance business and other life insurance business). The methods chosen for each line of business are proportionate to the nature, scale and complexity of the underlying risks.

The non-unit BEL is generally calculated by discounting projected future cash flows from the contracts. This calculation incorporates PIA's best estimate assumptions for the factors that determine the future projected cash flows.

Further details are contained in sections D.2.4.1 and D.2.4.2 below

D.2.4.1 Insurance with profit participation business

D.2.4.1.1 Background

This category comprises all single premium unit-linked investment products and regular premium savings products that provide with profits benefits to policyholders. With profits benefits are provided by PAC With-Profits Fund via a reinsurance treaty between PIA and PAC. The With-Profits Fund contains asset funds that are denominated in EUR, GBP, USD and PLN.

PIA's existing with-profit products (i.e. excluding business transferred to PIA on 1 January 2019) offer a death benefit of either 101% or 100.1% of the cash-in value of the bond, depending on the age of the life assured when the investment was taken out. No benefit is paid on disability and there is no maturity benefit as the product is written on a whole-of-life basis. Surrender is permitted; however, a surrender charge may apply in the first few years.

Of the business transferred to PIA on 1 January 2019 only the Polish business is open to new business. This business is a fixed term conventional with-profits endowment which receives discretionary increases in benefits by way of regular renewal bonuses and a terminal bonus at the point of payout. Certain plans offer guarantees on surrender and maturity. Regular premium and limited pay (i.e. premium payment terms of 2-5 years) apply. Non-profit protection rider benefits are also offered with the endowment; however, only the with-profits benefits are reinsured with PAC.

The with-profits benefits for the other business transferred (also reinsured with PAC) to PIA on 1 January 2019 are:

- The business transferred from PAC France business comprises single premium bonds invested in a mix of unitised with profit and unit linked funds; only the with-profits benefits are reinsured with PAC. No additional benefits are offered on death or maturity. While it is closed to new business it remains open to top-ups on existing business.
- The Equitable Life Assurance Society (ELAS) business transferred comprises with-profit annuity contracts written in Germany and Ireland.
- The business transferred from PAC Malta business comprises conventional with-profits whole of life policies.

A general explanation of how Prudential manages its with-profits business can be found in the With-Profits Operating Principles ("WPOP") documents. These are publicly available documents which set out the principles that PIA and PAC, our parent company, use to manage policies which are invested in the Defined Charge Participating Sub-Fund ("DCPSF") and With-Profits Sub-Fund ("WPSF") and are available at the following links: www.prudential-international.com/financial-report and www.prudential.pl/mam-polise-konsultant-owu. The DCPSF and WPSF are owned and managed by PAC and the way these funds are managed is described in more detail in the PAC Principles and Practices of Financial Management ("PPFM") document. This is also a publicly available document published on Prudential's website, www.pru.co.uk.

D.2.4.1.2 Options and guarantees

The financial guarantees which are provided for within the with-profits fund include:

1. With profits fund guarantees, which include future discretionary benefits and profit sharing; in particular, regular (reversionary) bonuses may be declared annually, and, if declared, are added to policies; the declaration of a regular bonus is not guaranteed each year, but when added, it acts to increase the guaranteed minimum pay-out where it applies.
2. Return of premium guarantees on the Polish business and also on a small closed block of Austrian business;
3. Surrender guarantees;

These financial guarantees are 100% reinsured to PAC.

D.2.4.1.3 Reinsurance

PIA reinsures 100% of the with-profits benefits to PAC. PIA's reinsurance asset is equal to the value of these with profits benefits, as described in section D2.4.1.4 below. PIA assumes a zero probability of default for this reinsurance asset because the PAC with profits fund is assumed to be managed to an AAA standard.

D.2.4.1.4 Valuation Methodology

The BEL is calculated as the sum of the unit BEL and the non-unit BEL.

The Unit BEL reflects the value of the with profit benefits reinsured to PAC, and includes both:

- the in-force asset share at the valuation date; and
- the value of future differences between reinsurance payments to PIA from PAC and asset shares, arising from options, guarantees and smoothing. These differences are referred to as the Net Cost of Options and Guarantees.

The Asset Share represents the retrospective accumulation of premiums, investment return, claims payments for regular withdrawals and part surrenders, and the charges payable by the policyholder as specified by the policy terms and conditions.

The Net Cost of Options and Guarantees on both the unitised and conventional with profit business is calculated on a pro-rata basis using the net cost of options and guarantees on similar PAC products. This value is determined using a stochastic modelling approach which allows for realistic management actions that are consistent with the operation of the with profits funds. The PAC management actions include the following:

- 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. Terminal bonuses may be subject to a surrender penalty in certain market conditions.
- Market Value Reductions. For some accumulating with profits policies, market value reductions may apply, subject to certain limits.

- Suspension of smoothing. The usual smoothing rules can be suspended to maintain the solvency ratio of the participating fund in stressed conditions.
- Dynamic investment strategy. This can include switching into lower-risk assets to maintain the solvency of the fund in stressed conditions.

The use of similar PAC products to calculate PIA's net cost is deemed reasonable as these products have highly similar product features or, in the case of PIA Poland, the net cost is not currently expected to be material. Furthermore, as mentioned above, this benefit is 100% reinsured to PAC. The Net Cost of Options and Guarantees has no impact on the liabilities on a net of reinsurance basis.

PIA holds a non-unit BEL for unitised with profit business that is calculated using a deterministic approach by discounting projected future cash flows from the contracts. The non-unit BEL also includes an amount in respect of expected development spend over the 12 months after the valuation date. A non-unit BEL for the Polish with profit business is also calculated but is 100% reinsured to PAC.

D.2.4.1.5 Assumptions

The most significant assumptions used in the calculation of the non-unit BEL for this business are lapse assumptions and expense assumptions. These are best estimate assumptions.

The lapse assumptions used vary by product and by the duration of the policies, based on the results of annual experience studies. Expense assumptions reflect current and expected future expense levels and business volumes. Expert judgment is also used where deemed necessary. There is significant uncertainty around the long term per policy expense assumption due to the tactical and strategic opportunities currently being explored by the Company. Further detail is set out in Section D.2.6.

D.2.4.2 Unit-Linked insurance

D.2.4.2.1 Background

PIA sells a small number of unit-linked products. These products include proprietary and open architecture products. Proprietary products are products where the policyholder can only invest in funds offered by PIA, whereas open architecture products allow policyholders to invest in funds offered by a wide variety of providers. Some products include significant mortality and morbidity benefits, however these products are not open to new business although top-ups are accepted. This business also includes unit-linked funds relating to PAC France business transferred to PIA on 1 January 2019.

D.2.4.2.2 Options and Guarantees

PIA's unit-linked business does not contain any material financial guarantees or options. A small number of products included in this line of business offer a capital redemption option that offers a maturity benefit. As this guarantee is insignificant in size it does not require stochastic modelling.

D.2.4.2.3 Reinsurance

PIA reinsures the risk benefits (e.g. mortality, critical illness and long-term-care) on these products to external reinsurers. Reinsurance is on a quota-share and surplus basis. PIA reinsures at least 75% of these risks.

D.2.4.2.4 Valuation Methodology

The BEL is calculated as the sum of unit liability plus non-unit liability. The unit liability is calculated as the fair value of units deemed allocated at the valuation date discounted as appropriate for future management charges due to the Company. The non-unit liabilities comprise:

- the present value of all non-unit cash flows allowing for persistency, mortality, morbidity, the rate at which the unit reserves are expected to grow, expenses, expense inflation, charges for benefits, charges for expenses. This can be negative, and reflects the discounted value of fee income from the unit funds less allowances for expenses.
- any additional reserves required – including long term care, unapplied single premium, Incurred but Not Reported (IBNR) on life and critical illness business, and expected development spend over the 12 months after the valuation date.

The non-unit liability is modelled on a deterministic basis.

D.2.4.2.5 Assumptions

The most significant assumptions for this business are lapse rates and mortality and morbidity rates. The assumptions used vary by product and reflect recent experience where available. Where there is insufficient experience to perform a credible analysis of experience, reinsurers' rates are used.

Expense assumptions are also significant. Expense assumptions reflect current and expected future expense levels and business volumes. Expert judgment is applied where necessary.

Market-related assumptions are discussed in section D.2.2.2.

D.2.4.3 Other life insurance

D.2.4.3.1 Background

Non-profit business written through the PIA Poland branch includes a standalone non-profit protection product and rider benefits associated with the with-profits endowment assurance product. An immaterial amount of non-profit whole of life policies in respect of PAC Malta were also transferred to PIA on 1 January 2019.

D.2.4.3.2 Options and Guarantees

Financial guarantees do not apply on these lines of business.

D.2.4.3.3 Reinsurance

In relation to the PIA Poland non-profit business including the rider products, 75% of all mortality and morbidity risks are reinsured with an external reinsurer.

D.2.4.3.4 Valuation Methodology

The BEL comprises the present value of future benefits and expenses less the present value of future premiums allowing for persistency, mortality, morbidity, commissions, expenses and expense inflation.

The BEL is modelled on a deterministic basis.

D.2.4.2.5 Assumptions

The most significant assumptions for this business are lapse rates and mortality and morbidity rates. The assumptions used vary by product and reflect recent experience where available. As there is insufficient experience to perform a credible analysis of experience, reinsurers' rates are used.

Expense assumptions are also significant. Expense assumptions reflect current and expected future expense levels and business volumes. Expert judgment is also used where deemed necessary.

D.2.5 Simplifications

There are a number of simplified methods used to calculate less material technical provisions. These include the following areas:

- As noted earlier, the Net Cost of Options and Guarantees on both the unitised and conventional with profit business is calculated on a pro-rata basis using the net cost of options and guarantees on similar PAC products.
- For the less material lines of business transferred to PIA on 1 January 2019 (i.e. other than PIA Poland branch business) the technical provisions use simplified approaches.
- For other less material business (e.g. long term care products which have claims in payment) the technical provisions are set to be those calculated for statutory reporting purposes.
- Some product features with minimal financial significance are not modelled on the grounds of materiality.

D.2.6 Changes in assumptions

In 2019, the significant changes to the assumptions underlying the Company's calculation of technical provisions were as follows:

- Market-driven changes to economic parameters, including changes to risk-free rates as shown in section D.2.2.2.
- Expense assumptions reflect the long-term best estimate level of expenses based on the current operating model for the business and are updated annually to reflect the most recent expense forecast for the business.
- Persistency and mortality assumptions are derived from analysis of recent historic experience data.
- Following the Part VII transfer of PAC's European business to PIA on 1 January 2019, best estimate assumptions are required in respect of the transferred business. The material assumptions relate to mortality, morbidity, persistency and expense assumptions in relation to the PIA Poland business.

As noted earlier, an allowance is made for the expected development spend over the 12 months after the valuation date.

D.2.7 Sensitivities & uncertainty

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

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

D.2.8 Reinsurance recoverables

In the Solvency II balance sheet, the Company includes the full expected cost of claims within the technical provisions, and treats the expected corresponding reinsurance recoverables 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.2.2 & D2.4). The value of the recoverable asset is the best estimate of future reinsurance cash flows, allowing for the probability of default by the reinsurer.

PIA's primary reinsurance is in respect of its insurance with profit participation business where it reinsures 100% of the unit BEL (and non-unit BEL in the case of the PIA Poland with-profits business) and the net cost of options and guarantees on such business to its parent company, PAC. The reinsurance arrangement transfers all financial risk to PAC. For with-profits business transferred to PIA from PAC on 1 January 2019, non-financial risks are also reinsured to PAC. As a result, PIA has a policyholder liability for insurance with profit participation which is backed by the PAC reinsurance asset.

With respect to its unit-linked insurance and other life insurance lines of business, where such business has significant death and/or disability benefits, PIA has reinsurance arrangements in place with an external reinsurer where at least 75% of the mortality and morbidity risk on such products are reinsured. This reinsurance asset is currently negative as the expected value of future premiums payable to the reinsurer exceeds the expected value of future claims. Similarly, the remaining 25% exposure gives rise to a negative liability on PIA's balance sheet. For the majority of the book the retained sum at risk is less £50k.

PIA does not include an allowance for counterparty risk within its reinsurance recoverables calculation in relation to the insurance with profit participation business. This business is reinsured into the PAC with-profits fund, a fund which is managed to a high credit rating level and which would give rise to a negligible default risk after allowing for expected recoveries. Allowance is made for default of the mortality and morbidity reinsurance on the unit-linked insurance business. However, the impact is immaterial.

D.2.9 Comparing Solvency II with the financial statements

D.2.9.1 Overview

A number of different approaches and methodologies are used to calculate the technical provisions for financial statement reporting purposes and for Solvency II reporting purposes. As a result, there are differences in the technical provisions reported under each basis.

The following table shows the reconciliation in respect of the technical provisions reported in the financial statements and those reported under Solvency II. The sections beneath explain the key differences in methodology and assumptions.

Reconciliation of technical provisions	Solvency II £m	Financial Statements £m	Difference £m
Technical Provisions	7,925	8,013	-88
Best Estimate	7,862	8,013	-151
Insurance with profit participation business	6,102	6,088	14
Unit-linked business	1,808	1,924	-116
Other life insurance	-48	1	-49
Risk Margin	63	-	63
Insurance with profit participation business	44	-	44
Unit-linked business	12	-	12
Other life insurance	7	-	7

D.2.9.2 Main Methodology Differences

The main methodology differences between the two bases are:

- The financial statements are based on a prudent assessment of non-unit liabilities that does not recognise the value of future fee income in excess of that required to meet the projected cash outflows on the business. The Solvency II liabilities recognise these fully on a best estimate basis.
- Different approaches are used to calculate the best estimate liabilities on insurance with profit participation business; the Solvency II value reflects the full asset share, net cost of options and guarantees, and the present value of future profits associated with the business. The financial statements value can be lower because it is based on the minimum of the surrender value and the asset share for certain products, and currently the asset share exceeds the surrender value.
- The financial statements include a “Deferred Income Reserve” on unit-linked insurance business. This is removed under Solvency II.
- Inclusion of a risk margin for Solvency II reporting requirements.

D.2.9.3 Main Assumption Differences

The assumptions used within the calculation of the technical provisions for the financial statements include a margin for prudence. However, for Solvency II reporting purposes, these margins have been removed and the technical provisions are calculated using best estimate assumptions. The impact of these assumption changes is captured in the non-unit liability.

The technical provisions for Solvency II purposes also include additional expenses above those included in the financial statements. These expenses are short term in nature and relate to commitments that have been made and are not allocated to maintenance or acquisition expenses.

D.2.9.4 Reinsurance Recoverable

A reconciliation of the reinsurance asset reported in the financial statements and under Solvency II is set out in the table below.

Reconciliation of Reinsurance Recoverable	Solvency II £m	Financial statements £m	Difference £m
Total Reinsurance Recoverable	6,221	6,074	147
Internal Reinsurance	6,265	6,061	204
Insurance with profit participation business	6,265	6,061	204
External Reinsurance	-44	13	-55

The main differences are:

- Similar to technical provisions, different approaches are used to calculate the reinsurance asset on insurance with profit participation business.
- The reinsurance asset corresponds with the reinsurers share of the liability on mortality and morbidity business. Under Solvency II the asset is negative as the full future cost of the reinsurance on a best estimate basis is reflected on the balance sheet.

D.3 Valuation of other liabilities

D.3.1 Introduction

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

D.3.2 Valuation bases under Solvency II compared to IFRS

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

Deferred tax liabilities

Deferred taxes are calculated based upon the differences (“temporary differences”) between the values given to assets and liabilities in the Solvency II balance sheet and their values for tax and statutory reporting purposes. The principles of IAS 12 “Income Taxes” are applied to calculate the extent of deferred taxes applicable on those value differences. The deferred tax on the Solvency II balance sheet is mainly driven by differences in the value of Technical Provisions (Net of Reinsurance) between an IFRS and Solvency II basis. The capitalised value of the future profits is one of these adjustments, and this results in a corresponding increase in the deferred tax liability.

Other liabilities

Other liabilities for the year-ended 31 December 2019	£m
Provisions other than technical provisions	3
Insurance & intermediaries payables	72
Reinsurance payables	5
Payables (trade, not insurance)	33
Lease liability	1
Total	114

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

Provisions other than Technical Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of such an obligation. Provisions are discounted when the effect of the time value of money is considered material. There is one provision which relates to PIA's estimated liability in respect of payments due to policyholders as a result of fees which have been applied incorrectly in the past. The provision is based on the best estimate of the potential amount payable.

There are no changes made to the recognition and valuation bases used or on estimations during the reporting period.

D.4 Alternative methods for valuation

The use of alternative methods for valuation by the Company are discussed in section D.1.2.1. £27 million (2018: £16 million) of assets are valued using alternative valuation methods (as per section D1.2.1). These relate to assets held in index-linked and unit-linked funds, which are materially offset by unit-linked liabilities. Therefore, any valuation changes in this category would not have a material effect on the valuation Solvency II own funds.

The M&G Group has Group-wide Independent Price Verification procedures in place which cover all investment asset classes owned by the business units of the Group, including the Company, and set minimum requirements for the governance surrounding valuation process. 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 mark valuations are not available from independent price sources, the Independent Price Verification standards set minimum requirements for 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 limitation.

D.5 Any Other Information

There is no other material information regarding the valuation of assets and liabilities for solvency purposes which has not been disclosed above.

E. Capital Management

E.1 Own funds

E.1.1 Overview

The Own Funds have been prepared using the controls set out in the PIA's Own Funds Policy, approved by the Technical Committee in December 2019.

E.1.2 Objectives, policies and processes for managing own funds

The Company manages its Solvency II own funds as its measure of capital. 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 to the objectives, policies or processes for managing the Company's own funds during the year.

The assets and liabilities underpinning the Solvency II basic own funds are valued separately using valuation methods that are consistent with the valuation approach set out in the Solvency II directives. These methods are described in Section D of this document.

E.1.3 Analysis of the components of own funds

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

	Total £m	Tier 1 - unrestricted £m	Tier 1 - restricted £m	Tier 2 £m	Tier 3 £m
Ordinary share capital (note b)	65	65	-	-	-
Reconciliation reserve (note c)	183	183	-	-	-
Other items approved by supervisory authority as basic own funds (note d)	23	23	-	-	-
Total own funds (note a)	270	270	-	-	-

Notes:

(a) PIA's basic own funds principally comprises equity share capital, retained earnings attributable to equity shareholders calculated in the reconciliation reserve, and a capital contribution approved by CBI. PIA has no ancillary own funds.

(b) Equity Share Capital

PIA's ordinary share capital represents 137,083,243 ordinary shares of €1.27 each. This comprises 101,381,272 ordinary shares where the partly paid amount equals 25% of each nominal share value, being €0.3175, and an additional 35,701,971 ordinary shares of €1.27 each, which were issued in 2019 as a result of the business transferred from PAC. There is only one class of share capital. The ordinary shares have call rights to dividends, are entitled to a surplus on a winding up and have full voting rights.

(c) Reconciliation reserve

The reconciliation reserve represents the residual of excess of assets over liabilities after deducting (i) equity share capital comprising ordinary share capital and share premium and (ii) capital contribution. The key elements of this are IFRS retained earnings and the non-unit-liability element of technical provisions, net of the corresponding Deferred Tax Liability.

(d) Other items approved by supervisory authority as basic own funds

This represents the £23 million capital contribution from PAC which was approved by the Central Bank in December 2015.

E.1.4 Comparison with financial statements

This section explains the differences between equity in the financial statements and the Solvency II own funds, i.e. the excess of assets over liabilities for solvency purposes.

Reconciliation of equity and Solvency II surplus	£m
Shareholder's equity in Financial Statements at 31 December 2019	129
Removal of deferred acquisition costs and intangibles ⁽¹⁾	(66)
Change in valuation of technical provisions, net of reinsurance ⁽²⁾	292
Change in Risk Margin ⁽³⁾	(63)
Change in value of deferred tax principally as a result of valuation changes ⁽⁴⁾	(22)
Excess of assets over liabilities as recorded in the Solvency II Balance Sheet	270

Notes to Table

The movement between equity in the financial statements and excess of assets over liabilities under Solvency II is discussed below. The numbering corresponds to the superscripts in the table above.

1. Deferred acquisition costs and other intangibles such as computer software and deferred income reserve contributing to equity in the financial statements are revalued to nil for Solvency II purposes.
2. Under Solvency II, technical provisions are calculated on a best estimate basis. This best estimate includes recognition of expected future premiums (net of related costs/claims) for contracts already written by PIA at the balance sheet date, subject to regulatory restrictions. This adjustment therefore accounts for any differences in the valuation assumptions for solvency compared with those for the financial statements.
3. The technical provisions for Solvency II reporting include the Risk Margin. The Risk Margin does not exist in the financial statements.
4. The material differences that impact deferred tax are set out in section D.3.2.

E.2 Solvency Capital Requirements and Minimum Capital Requirement

E.2.1 Overview

For the purpose of Solvency II regulatory reporting and disclosures, risk management, and calculation of any free surplus generation, M&G Group has approval to use an internal model for calculating the SCR. PIA is using this internal model to calculate its SCR.

The MCR is a formulaic calculation, which is subject to a cap and a floor that are both expressed relative to the SCR.

E.2.2 Results

E.2.2.1 Summary

The following table shows the company's diversified SCR and MCR at 31 December 2019.

	2019 £m
SCR – internal model	174
MCR	43

E.2.2.2 SCR by Risk Category

The main risks covered by the SCR are quantified in the table below:

Risk Category	2019 £m
Market Risk	195
Life underwriting risk	18
Lapse	162
Expense	87
Operational risk	35
Diversification	-250
Loss-absorbing capacity of deferred tax	27
Other adjustments (Interaction effects)	-46
Total	174

E.2.2.3 MCR

Minimum capital requirement at 31 December 2019 in the table below:

MCR	2019 £m
Linear formula component for non-life insurance and reinsurance obligations	0
Linear formula component for life insurance and reinsurance obligations	14
Linear MCR	14
SCR	174
MCR cap	78
MCR floor	43
Combined MCR	43
Absolute floor of the MCR	3
MCR	43

The inputs used to calculate the MCR are detailed in Quantitative Reporting Template S.28.01.01.
The MCR is currently 25% of the SCR.

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

PIA 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 such as Prudential.

E.4 Differences between the standard formula and the internal model

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 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 PIA 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.

As required in Article 101 of Directive 2009/138/EC, the SCR 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.

E.4.2 Structure of the model and aggregation methodologies

The standard formula and internal model adopt the same model structure, however there are key methodology differences as described in E4.5.

E.4.3 Probability Distribution Function

The Probability Distribution Function (PDF) required is for the basic own funds in one year's time. When deriving the realistic probability distribution for the basic own funds in one year's time, profits and losses which are expected to arise over that year (but are not included in the BEL) are included. The internal model selects appropriate risk drivers that represent the risks to which the company is exposed. The risk drivers are modelled to produce up to 100,000 risk scenarios, required to represent an appropriate probability distribution for each risk driver in isolation, and also an appropriate dependency between the risk drivers. Unlike in the standard formula SCR, movements in each of the internal model risk drivers apply simultaneously in each risk scenario, so the combined impact and interactions between the risks are more accurately reflected in the internal model SCR. These 100,000 risk scenarios are used to produce the probability distribution for the own funds.

E.4.4 Risks covered by standard formula and internal model

The same risks are covered by both the standard formula and the internal model. PIA currently models the following risk categories in its internal model:

- **Market risks:** equity, yield curve level, corporate credit, counterparty credit, property and currency;
- **Non-market risks:** expense & expense inflation, lapse, mortality, morbidity and life catastrophe;
- **Other risks:** operational and concentration.

Risks are reviewed on an annual basis as part of the risk identification process to ensure the internal model accurately reflects the risks to which the company is exposed. Further details on the differences in methodologies by risk are provided in the following section.

There are other risks that PIA's internal model does not cover and these are outlined in section C.6 "Other Material risks".

E.4.5 Main Differences in methodology and assumptions

The standard formula and internal model adopt the same model structure, however there are key methodology differences in the calculation of the SCR, as set out below:

- The standard formula SCR is derived by calculating the impact of each stress individually and then aggregating the results using prescribed correlation matrices. The standard formula does not allow for any interaction effects between risks which are allowed for in the internal model calculations.
- Standard formula stresses and correlations differ to the internal model stresses for most risk categories. Whereas the standard formula stresses are prescribed, the internal model stresses are set to reflect PIA's specific risk profile and are derived from a combination of data analysis and expert judgement. Internal model stresses are subject to the internal model tests and standards required by the Solvency II Directive, in particular Articles 120-126 covering: use test, statistical quality standards, calibration standards, profit and loss attribution validation standards, documentation standards and external models and data.

- Internal model stresses are applied over a 1 year period, whereas standard formula stresses apply at the valuation date;
- The internal model includes capital in relation to 1 year of future new business and recognises the corresponding contribution to Own Funds. The standard formula SCR does not include 1 year of future new business.

E.4.6 Nature and appropriateness of data

Data is defined as "items of dynamic information used in the model to which agreed (static) methodology is applied in order to generate results".

The data used in the internal model includes the following:

- Liability data
- Asset data
- Accounts data
- Operational risk data
- Economic data
- Other data

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.5 Non-compliance with Minimum Capital Requirement and Solvency Capital Requirement

PIA currently complies with the Minimum Capital Requirement and the Solvency Capital Requirement.

E.6 Any other information

There is no other information to note.

Appendix

QRTs Reference	QRTs Name
S.02.01.02	Balance Sheet
S.05.01.02	Premiums Claims and Expenses by LOB
S.05.02.01	Premiums Claims Expenses by country
S.12.01.02	Technical Provisions
S.23.01.01	Own Funds
S.25.03.21	Solvency Capital Requirement - for undertakings using the standard formula and full internal model
S.28.01.01	MCR - Non Composite

S.02.01.02 Balance Sheet (Balances in '000 units)

		Solvency II value
		C0010
Assets		
R0030	Intangible assets	0
R0040	Deferred tax assets	0
R0050	Pension benefit surplus	0
R0060	Property, plant & equipment held for own use	1,138
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	118,088
R0080	<i>Property (other than for own use)</i>	0
R0090	<i>Holdings in related undertakings, including participations</i>	0
R0100	<i>Equities</i>	0
R0110	<i>Equities - listed</i>	0
R0120	<i>Equities - unlisted</i>	0
R0130	<i>Bonds</i>	28,101
R0140	<i>Government Bonds</i>	28,101
R0150	<i>Corporate Bonds</i>	0
R0160	<i>Structured notes</i>	0
R0170	<i>Collateralised securities</i>	0
R0180	<i>Collective Investments Undertakings</i>	1,791
R0190	<i>Derivatives</i>	0
R0200	<i>Deposits other than cash equivalents</i>	88,196
R0210	<i>Other investments</i>	0
R0220	Assets held for index-linked and unit-linked contracts	1,911,278
R0230	Loans and mortgages	0
R0240	<i>Loans on policies</i>	0
R0250	<i>Loans and mortgages to individuals</i>	0
R0260	<i>Other loans and mortgages</i>	0
R0270	Reinsurance recoverables from:	6,220,657
R0280	<i>Non-life and health similar to non-life</i>	0
R0290	<i>Non-life excluding health</i>	0
R0300	<i>Health similar to non-life</i>	0
R0310	<i>Life and health similar to life, excluding index-linked and unit-linked</i>	6,264,711
R0320	<i>Health similar to life</i>	0
R0330	<i>Life excluding health and index-linked and unit-linked</i>	6,264,711
R0340	<i>Life index-linked and unit-linked</i>	-44,054
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	2,089
R0370	Reinsurance receivables	12,721
R0380	Receivables (trade, not insurance)	14,073
R0390	Own shares (held directly)	0
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
R0410	Cash and cash equivalents	52,934
R0420	Any other assets, not elsewhere shown	0
R0500	Total assets	8,332,979

S.02.01.02 Balance Sheet Continued (Balances in '000 units)

		Solvency II value
Liabilities		C0010
R0510	Technical provisions - non-life	0
R0520	<i>Technical provisions - non-life (excluding health)</i>	0
R0530	<i>TP calculated as a whole</i>	0
R0540	<i>Best Estimate</i>	0
R0550	<i>Risk margin</i>	0
R0560	<i>Technical provisions - health (similar to non-life)</i>	0
R0570	<i>TP calculated as a whole</i>	0
R0580	<i>Best Estimate</i>	0
R0590	<i>Risk margin</i>	0
R0600	Technical provisions - life (excluding index-linked and unit-linked)	6,104,551
R0610	<i>Technical provisions - health (similar to life)</i>	0
R0620	<i>TP calculated as a whole</i>	0
R0630	<i>Best Estimate</i>	0
R0640	<i>Risk margin</i>	0
R0650	<i>Technical provisions - life (excluding health and index-linked and unit-linked)</i>	6,104,551
R0660	<i>TP calculated as a whole</i>	0
R0670	<i>Best Estimate</i>	6,053,832
R0680	<i>Risk margin</i>	50,719
R0690	Technical provisions - index-linked and unit-linked	1,820,550
R0700	<i>TP calculated as a whole</i>	0
R0710	<i>Best Estimate</i>	1,808,537
R0720	<i>Risk margin</i>	12,013
R0740	Contingent liabilities	0
R0750	Provisions other than technical provisions	2,985
R0760	Pension benefit obligations	0
R0770	Deposits from reinsurers	0
R0780	Deferred tax liabilities	23,894
R0790	Derivatives	0
R0800	Debts owed to credit institutions	0
R0810	Financial liabilities other than debts owed to credit institutions	947
R0820	Insurance & intermediaries payables	71,875
R0830	Reinsurance payables	4,611
R0840	Payables (trade, not insurance)	33,442
R0850	Subordinated liabilities	0
R0860	<i>Subordinated liabilities not in BOF</i>	0
R0870	<i>Subordinated liabilities in BOF</i>	0
R0880	Any other liabilities, not elsewhere shown	0
R0900	Total liabilities	8,062,854
R1000	Excess of assets over liabilities	270,125

S.05.01.02 Premiums Claims and Expenses by LOB (Balances in '000 units)

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	Health reinsurance	Life reinsurance	
C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
Premiums written								
R1410 Gross	1,003,999	135,626	12,660					1,152,286
R1420 Reinsurers' share	1,050,752	20,646	2,281					1,073,679
R1500 Net	-46,753	114,980	10,380					78,607
Premiums earned								
R1510 Gross	1,003,999	135,626	12,660					1,152,286
R1520 Reinsurers' share	1,050,752	20,646	2,281					1,073,679
R1600 Net	-46,753	114,980	10,380					78,607
Claims incurred								
R1610 Gross	401,663	145,051	2,821					549,535
R1620 Reinsurers' share	400,169	20,150	2,138					422,457
R1700 Net	1,494	124,901	683					127,079
Changes in other technical provisions								
R1710 Gross	-1,047,164	-170,373	-306					-1,217,843
R1720 Reinsurers' share	-1,093,280	168	0					-1,093,111
R1800 Net	46,116	-170,541	-306					-124,731
R1900 Expenses incurred	57,270	19,043	8,406					84,720
R2500 Other expenses								
R2600 Total expenses								84,720

S.05.02.01 Premiums claims expenses by country (Balances in '000 units)

	C0150	C0160	C0170	C0180	C0190	C0200	C0210
	Home Country	Top 5 countries (by amount of gross premiums written) - life obligations			Top 5 countries (by amount of gross premiums written) - life obligations		Total Top 5 and home country
		GB	JE	IM	ES	MT	
	C0220	C0230	C0240	C0250	C0260	C0270	C0280
Premiums written							
R1410 Gross	0	708,247	165,004	57,970	57,898	43,872	1,032,990
R1420 Reinsurers' share	0	597,586	165,074	57,125	57,932	47,006	924,723
R1500 Net	0	110,661	-71	846	-35	-3,134	108,267
Premiums earned							
R1510 Gross	0	708,247	165,004	57,970	57,898	43,872	1,032,990
R1520 Reinsurers' share	0	597,586	165,074	57,125	57,932	47,006	924,723
R1600 Net	0	110,661	-71	846	-35	-3,134	108,267
Claims incurred							
R1610 Gross	0	367,226	59,355	22,393	10,760	9,008	468,742
R1620 Reinsurers' share	0	257,433	56,948	20,058	10,162	6,849	351,451
R1700 Net	0	109,793	2,407	2,335	597	2,159	117,291
Changes in other technical provisions							
R1710 Gross	0	-787,163	-185,781	-66,458	-58,923	-52,316	-1,150,641
R1720 Reinsurers' share	0	-629,719	-184,889	-65,616	-58,623	-53,020	-991,867
R1800 Net	0	-157,444	-893	-841	-300	705	-158,774
R1900 Expenses incurred	0	41,145	5,098	3,578	2,688	4,518	57,027
R2500 Other expenses							0
R2600 Total expenses							57,027

S.12.01.02 Life and Health SLT Technical provisions (Balances in '000 units)

	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	Accepted reinsurance	Total (Life other than health insurance, including Unit-Linked)
			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
R0010 Technical provisions calculated as a whole	0	0			0					0
R0020 Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	0	0			0					0

Technical provisions calculated as a sum of BE and RM**Best estimate**

R0030 Gross Best Estimate	6,101,730		1,808,537	0		-47,898	0			7,862,368
R0080 Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	6,265,977		-44,054	0		-1,267	0			6,220,657
R0090 Best estimate minus recoverables from reinsurance/SPV and Finite Re	-164,248		1,852,591	0		-46,632	0			1,641,712
R0100 Risk margin	43,987	12,013			6,732					62,732
Amount of the transitional on Technical Provisions										
R0110 Technical Provisions calculated as a whole	0	0			0					0
R0120 Best estimate	0		0	0		0	0			0
R0130 Risk margin	0	0			0					0
R0200 Technical provisions - total	6,145,717	1,820,550			-41,167					7,925,100

S.23.01.01 Own Funds (Balances in '000 units)

Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35

R0010	Ordinary share capital (gross of own shares)
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 undertakings
R0050	Subordinated mutual member accounts
R0070	Surplus funds
R0090	Preference shares
R0110	Share premium account related to preference shares
R0130	Reconciliation reserve
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
R0220	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds
R0230	Deductions for participations in financial and credit institutions
R0290	Total basic own funds after deductions

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 and mutual - type undertakings, callable on demand
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/EC
R0390	Other ancillary own funds
R0400	Total ancillary own funds

Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
C0010	C0020	C0030	C0040	C0050
64,738	64,738		0	
0	0		0	
0	0		0	
0		0	0	0
0	0			
0		0	0	0
0		0	0	0
182,776	182,776			
0		0	0	0
0				0
22,612	22,612	0	0	0
0				
0				
270,125	270,125	0	0	0
0				
0				
0				
0				
0				
0				
0				
0			0	0

S.23.01.01 Own Funds Continued (Balances in '000 units)

Available and eligible own funds

R0500 Total available own funds to meet the SCR

R0510 Total available own funds to meet the MCR

R0540 Total eligible own funds to meet the SCR

R0550 Total eligible own funds to meet the MCR

R0580 SCR

R0600 MCR

R0620 Ratio of Eligible own funds to SCR

R0640 Ratio of Eligible own funds to MCR

Reconciliation reserve

R0700 Excess of assets over liabilities

R0710 Own shares (held directly and indirectly)

R0720 Foreseeable dividends, distributions and charges

R0730 Other basic own fund items

R0740 Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

R0760 Reconciliation reserve

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)

270,125	270,125	0	0	0
270,125	270,125	0	0	
270,125	270,125	0	0	0
270,125	270,125	0	0	

173,920
43,480
155.32%
621.26%

C0060

270,125
0
87,350
0
182,776

63,142
63,142

S.25.03.21 Solvency Capital Requirement – for undertakings using the standard formula and full internal model (Balances in '000 units)

	Unique number of component	Component description	Calculation of the Solvency Capital Requirement
Row	C0010	C0020	C0030
1	103-00-I	Other interest rate risk - insurance	10,150
2	103-00-P	Other interest rate risk - pension scheme	0
3	104-00-I	Equity Risk - insurance	106,598
4	104-00-P	Equity Risk - pension scheme	0
5	106-00-I	Property Risk - insurance	12,665
6	107-00-I	Spread Risk - insurance	23,363
7	107-00-P	Spread Risk - pension scheme	0
8	108-00-I	Concentration Risk - insurance	0
9	109-00-I	Currency Risk - insurance	41,964
10	109-00-P	Currency Risk - pension scheme	0
11	301-00-I	Mortality Risk - insurance	15,413
12	302-00-I	Longevity Risk - insurance	0
13	302-00-P	Longevity Risk - pension scheme	0
14	303-00-I	Disability-morbidity risk - insurance	2,503
15	305-00-I	Other lapse risk - insurance	162,374
16	306-00-I	Expense risk - insurance	86,751
17	505-00-I	Other non-life underwriting risk - insurance	0
18	701-00-I	Operational risk - insurance	34,604
19	802-00-I	Loss-absorbancy capacity of technical provisions - insurance	0
20	803-00-I	Loss-absorbancy capacity of deferred tax - insurance	-26,837
21	804-00-I	Other adjustments - insurance	-45,610

S.25.03.21 Solvency Capital Requirement – for undertakings using the standard formula and full internal model (Balances in '000 units) (continued

Calculation of Solvency Capital Requirement

C0100

R0110	Total undiversified components
R0060	Diversification
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC
R0200	Solvency capital requirement excluding capital add-on
R0210	Capital add-ons already set
R0220	Solvency capital requirement

423,939
-250,019
0
173,920
0
173,920

Other information on SCR

R0300	Amount/estimate of the overall loss-absorbing capacity of technical provisions
R0310	Amount/estimate of the overall loss-absorbing capacity of deferred taxes
R0410	Total amount of Notional Solvency Capital Requirements for remaining part
R0420	Total amount of Notional Solvency Capital Requirement for ring fenced funds
R0430	Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios
R0440	Diversification effects due to RFF nSCR aggregation for article 304

0
-26,837
173,920
0
0
0

Approach to tax rate

C0109

R0590	Approach based on average tax rate
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Calculation of loss absorbing capacity of deferred taxes

LAC DT

C0130

R0640	Amount/estimate of LAC DT
R0650	Amount/estimate of LAC DT justified by reversion of deferred tax liabilities
R0660	Amount/estimate of LAC DT justified by reference to probable future taxable economic profit
R0670	Amount/estimate of AC DT justified by carry back, current year
R0680	Amount/estimate of LAC DT justified by carry back, future years
R0690	Amount/estimate of Maximum LAC DT

0

S.28.01.01 Minimum Capital Requirement (Balances in '000 units)

Linear formula component for non-life insurance and reinsurance obligations

C0010

R0010 MCR_{NL} Result

0

Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
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C0020

C0030

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
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
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

S.28.01.01 Minimum Capital Requirement (Balances in '000 units) (continued)**Linear formula component for life insurance and reinsurance obligations**R0200 MCR_L Result

C0040

13,854

Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
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C0050

C0060

R0210 Obligations with profit participation - guaranteed benefits
 R0220 Obligations with profit participation - future discretionary benefits
 R0230 Index-linked and unit-linked insurance obligations
 R0240 Other life (re)insurance and health (re)insurance obligations
 R0250 Total capital at risk for all life (re)insurance obligations

0	
0	
1,852,591	
0	
	1,265,980

Overall MCR calculation

C0070

R0300 Linear MCR
 R0310 SCR
 R0320 MCR cap
 R0330 MCR floor
 R0340 Combined MCR
 R0350 Absolute floor of the MCR
 R0400 **Minimum Capital Requirement**

13,854
173,920
78,264
43,480
43,480
3,187
43,480