Prudential Multi-Asset Funds
Governance Report

This is just for UK advisers – it’s not for use with clients.
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1. Size and Strength – M&G plc

On 14 March 2018, the Prudential Group announced that M&G and Prudential UK & Europe would combine to form a new entity, M&G plc, which will be demerged and floated as an independent company on the London Stock Exchange. As an independent company, business decision making will move closer to our clients and we’ll have more flexibility about how we deploy our capital, people and resources to serve you. We’ve started the work of becoming an independent listed company and will be keeping the markets updated on our progress.

M&G plc is a fully formed legal entity. Please note however, that both M&G’s and Prudential UK’s legal structures remain in order to manage legal and regulatory requirements, as well as day-to-day operations.
1. Size and Strength – M&G plc continued

**M&G Treasury and Investment Office (T&IO)**

T&IO are a well-established team who are entrusted with the day to day asset allocation decisions for £175 billion of policyholders’ money as at end June 2019.

T&IO is a large team that includes experienced investment professionals with specialist expertise in capital markets research, manager research, investment strategy design, liability management and portfolio management.

**T&IO**

<table>
<thead>
<tr>
<th>Key Personnel/Teams</th>
<th>High Level Objectives</th>
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</thead>
<tbody>
<tr>
<td><strong>CEO</strong></td>
<td>David King</td>
</tr>
</tbody>
</table>
| **Long Term Investment Strategy** | Parit Jakhria  
Director of Long Term Investment Strategy |
|  | • Recommend the strategic asset allocation (SAA), asset liability matching (ALM) and hedging strategies  
• Provide asset modelling services and advice on setting benchmarks and mandates  
• Responsible for Capital Markets and economic research, including qualitative and quantitative scenarios  
• Responsible for generating medium and long term economic and capital markets assumptions which are inputs for the SAA and ALM and used by various parts of the M&G plc Group |
| **Portfolio Management** | Charles Griffith  
Head of Multi Asset Portfolio Management |
|  | • Manage the portfolios in line with the product design to achieve the performance objectives  
• Manage portfolios within given limits, and monitor and review performance to ensure it stays in line with the desired strategy  
• Support relevant UK&E teams to grow their business |
<table>
<thead>
<tr>
<th>T&amp;IO Team</th>
<th>Key Personnel/Teams</th>
<th>High Level Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manager Oversight</td>
<td>Ciaran Mulligan</td>
<td>• Ensure rigorous discipline around the oversight of internal and external (non alternatives) managers</td>
</tr>
<tr>
<td></td>
<td>Head of Manager Oversight</td>
<td>• Organise due diligence and quarterly manager meetings</td>
</tr>
<tr>
<td>Business</td>
<td>Mark Riggall</td>
<td>• Fund marketing and distribution support</td>
</tr>
<tr>
<td>Development</td>
<td>Head of Business Development</td>
<td>• New business support</td>
</tr>
</tbody>
</table>
1. Size and Strength – M&G plc continued

T&IO, M&G plc fund managers and external managers

- Each of our insured Multi-Asset funds has a portfolio manager who is responsible for implementing asset allocation views.
- T&IO ensure that both the M&G plc fund managers and the external fund managers, who manage day to day stock selection/management, have a clear mandate that they adopt to deliver performance within the relevant asset classes.

Examples of M&G plc & external fund managers that T&IO work with:
2. How T&IO manage PruFunds

The following section aims to provide the answers to questions you may have regarding how T&IO manage money. The answers reflect the views and opinions of T&IO, as at 31 December 2018 (unless otherwise stated) and shouldn’t be taken as advice. More specific information on some of the Multi-Asset funds we offer is covered in Section 3.

Philosophy

<table>
<thead>
<tr>
<th>We believe in...</th>
<th>Sources of Value Add</th>
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<tbody>
<tr>
<td>A long-term approach</td>
<td>Strategic asset allocation</td>
</tr>
<tr>
<td>Diversification, both by asset category and geography</td>
<td>Mandate design</td>
</tr>
<tr>
<td>Active management</td>
<td>Tactical asset allocation</td>
</tr>
<tr>
<td>The importance of valuation</td>
<td>Underlying manager alpha</td>
</tr>
<tr>
<td>Liquidity and credit premiums</td>
<td>Efficient implementation</td>
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</table>

Our portfolios have some common intended characteristics

- Equity portfolios have a value bias
- Fixed income portfolios have a credit bias
- Property have a bias towards high quality assets in core locations
- Private assets represent a sizeable proportion of our portfolios
- Evolving asset mix as we embrace new asset classes and opportunities
The process for determining the Strategic Asset Allocation (SAA) is holistic, taking into account capital markets and economic views (which itself takes into account historic market returns analysis, bespoke ex-ante research and modelling and internal and external market insights and a number of quantitative and qualitative scenarios. This is combined with portfolio construction techniques (to optimise along the risk/return space for a given client risk appetite). Ultimately this leads to a return optimised portfolio, diversified across asset classes and geographies. In addition, hedging strategies are designed where required, including current hedging programs including FX, Interest Rates and Cost of Guarantees.

In your opinion are there factors that differentiate the process and philosophy?

In the context of the UK adviser market, there are several differentiators:

- **Resource applied to asset allocation**: core specialism is asset allocation. Stock selection decisions are outsourced to experienced fund managers in particular asset classes or markets.

- **Long-term**: being part of an insurance group allows a longer investment horizon and provides the opportunity to exploit the risk premiums offered through holding illiquid assets and access to a wide range of asset classes.

- **Governance framework**: our approach of setting and policing clear mandates, where possible – over and above what would naturally happen as part of a local management structure – provides an additional quality control layer between the investment managers and the adviser.

The above taken together are bound up with the existence of T&IO – set up specifically to manage the asset allocation, safeguard the investment philosophy, and "manage the managers", on behalf of policyholders.

### Decision Making

**How much consideration is given to peer group when constructing the portfolios? How valid is comparison to the peer group for your Multi-Asset funds?**

Peer group positioning doesn’t feature heavily in the day to day running of the insured Multi-Asset funds (see Section 3).

Strong performance relative to the benchmark asset mix and country indices over the medium-term will lead to favourable performance relative to peers. T&IO believe that becoming too fixated on trying to match peer groups over the short-term will lead to some chasing of the tail which isn’t in the interests of policyholders. Ultimately it’s absolute risk and return that’s the most significant thing for investors, not short-term relative performance.

**Investment management agreements (IMAs) govern how a strategy/mandate should be implemented by the fund managers. Managers will be given different mandates across asset classes and benchmarks and the degree of flexibility may vary.**

**In general, how is the quality of investment decisions evaluated?**

Peer group review operates at all stages of the investment process. Review within the analyst teams, Fund Manager review of the analysts, and peer group review at the asset allocation level.

Localised, formal, risk & portfolio monitoring, and performance attribution: there are regular processes in place at each specialist management company (including T&IO in terms of asset allocation decisions) by risk monitoring experts to analyse and feed back to the specialists and their desk heads the risks taken in underlying funds, and their effectiveness.

Individual appraisal – individual performance is reviewed annually as part of the appraisal process carried out by line managers.
How is exposure to assets in the Multi-Asset funds achieved?

Exposure is largely gained by buying stocks and shares directly via segregated mandates for the large Multi-Asset funds, and for others by buying units into pre-existing internal and/or 3rd party collective investment scheme (CIS) funds.

The number of different funds will depend on the geographic scope of the Multi-Asset fund in question. Within each fund (and asset class) we strongly believe in having well diversified portfolios.

Portfolio Monitoring

How do you measure and analyse each fund’s/portfolio’s risk?

T&IO carry out a full and thorough analysis of portfolios using BlackRock Solutions Aladdin Platform in conjunction with their portfolio management tools.

The table below lists some of the key tests, but this list isn’t exhaustive:

<table>
<thead>
<tr>
<th>Equities</th>
<th>Stock bet, sector bet, economic group bet, country bet (where appropriate), liquidity, turnover, statistical risk (Tracking Error), valuation metrics (e.g. P/E relative, beta), common money.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td>Duration bet, credit bet, credit issuer diversification, curve positioning, average credit, minimum credit, industry bet, turnover.</td>
</tr>
<tr>
<td>Property</td>
<td>Liquidity, geographic bet, sector bet, geographic-sector bet, asset diversification, tenant diversification, void rates, rental yield.</td>
</tr>
<tr>
<td>Asset allocation</td>
<td>Asset bet, country bet.</td>
</tr>
<tr>
<td>Total fund</td>
<td>Total statistical risk (tracking error), tracking error risk decomposition, performance, regulatory breaches, deviations from IMA guidelines (total fund and individual disciplines).</td>
</tr>
</tbody>
</table>

Risk Management

What internal controls exist to safeguard the funds/portfolios from taking on undue risk?

All regulatory limits are monitored by Prudential compliance and regulatory reporting functions, and breaches are notified to T&IO, the Actuarial Function Holder, and the risk management committee of the relevant investment management company.

In addition to the regulatory limits, each investment discipline applied to any fund has a distinct mandate that operates at the subfund level, as well as such guidelines at the asset allocation level. These, as well as standard “best practice” limits are monitored and any exceptions that are identified by this process are logged, investigated with the individual managers concerned, and if necessary escalated for resolution. It’s important to note that these are guidelines, and deviations from the guidelines are a common occurrence in running the funds normally (for example, cash balances will be higher in the midst of an asset allocation move).

This process works very well in heading off potential issues in advance, and keeping managers, funds and the mandates that govern them in line with one another.

What is the policy on stock diversification in quantity and quality terms for the underlying asset class funds/portfolios?

T&IO believe strongly in the benefit of diversification. Asset class portfolios are therefore characterised by being large (in terms of number of stocks) and well diversified. Within equity portfolios we stipulate a target range for number of stocks, and in bond portfolios we specify maximum exposures to a single issuer, with lower limits applying to weaker credits.
Do you use derivatives? If so, how are any underlying derivative exposures taken into account and please outline the strategies pursued, the costs/benefits and the monitoring system used to maintain control. Are they marked to market?

Our strategy, when using currency hedges, generally is to manage (down) the risks associated with overseas currency exposure in funds.

Futures are also used to gain desired exposures to certain equity and bond markers efficiently.

Derivatives are to be used consistent with a Derivatives Usage Form process and the usage restrictions described in the applicable laws and regulations.

Outline the process for assessing underlying fund managers?

The Manager Oversight team regularly monitor internal and external managers against their benchmarks and mandate and will report any material issues.

IMA’s govern how a strategy/mandate should be implemented by the fund managers. Managers will be given different mandates across asset classes and the degree of flexibility may vary.

The Manager Oversight team are responsible for the investment due diligence and ongoing monitoring of internal and external managers. This entails very close interaction through:

- Best practice monitoring (monthly) – T&IO reviews the underlying managers’ key exposures and holdings on a monthly basis.

- Strategy and performance review (quarterly) – T&IO has quarterly meetings with the managers, either in person for those based in London and by video conference for the managers located overseas. Each manager submits a Data Request Book prior to the quarterly meeting, which provides performance data, risk metrics and attribution for the quarter. The Data Request Book forms the basis of the meeting, enabling T&IO to pinpoint areas that require further discussion.

- Investment due diligence (annually) – annual site visits are conducted to assess each fund manager on their suitability and alignment with T&IO strategy. Investment due diligence covers both quantitative and qualitative factors. Quantitative factors include measures of performance and holdings analysis. Qualitative analysis incorporates People, Process, Philosophy and Infrastructure.

- IMA review (at least annually) – Manager IMA’s are reviewed as part of the annual investment due diligence to ensure the mandate and guidelines remain fit for purpose.

How does your firm address the issue of “Key Person Risk” within your asset management operation?

T&IO adopt a team-run, process-based style of management. Each named Portfolio Manager or Fund Manager has a designated alternate to assume their responsibilities when needed. So, while it’s important that we have good calibre people in each role, we believe the risks associated with “key personnel” are low.
Consistency of Investment Process and Investment Results

Who is responsible for the performance review of funds/portfolios?

Whilst a number of committees can see and challenge performance the ultimate responsibility rests with the PAC board, which has created an investment subcommittee to formally discharge this duty. This Investment Committee is supported in this by T&IO, who produce investment reporting for the funds, and will draw to the attention of the board any matters of immediate concern. Performance of funds relative to peer group is highly visible, and there is a high degree of scrutiny applied to performance data in many areas of the business throughout the year.

How do you assess performance?

The primary concern is that managers perform to mandate or fund objective – which may from time to time lead to positive or negative relative return when compared to either peer group or benchmarks. This is a highly complex area, and the extensive governance and control framework described previously helps achieve this.

How do you ensure that a fund/portfolio possesses the appropriate structure to achieve your explicit performance objectives (target active return, target relative yield, target tracking error, etc.)?

By having in place a process of clearly articulating a segregated mandate ex-ante, and measuring performance relative to that mandate ex-post, we ensure that the funds/portfolios remain fit for purpose and possess the appropriate structure to achieve the objectives.

Clearly the mandate is key, and these are formally reviewed and re-agreed with the investment subcommittee of the PAC board on an annual basis.

Remuneration

What is your remuneration policy as it directly relates to your portfolio managers and research analysts?

M&G plc has many investment professionals globally – and each one has different terms and conditions associated with their employment, dependent on location, role, etc. Bonuses are generally linked to performance measurement metrics dependent again on local market convention, role, individual history, etc.

Please describe the extent of integration/automation in the operational processing chain from the time the trade is placed to the time it’s integrated in the portfolio accounts (e.g. order book – manager holdings tools – connections front office to back office)?

Please note that the following is a broad overview. There are certain asset classes and funds for which the processes are different to those stated.

For PruFunds, there are essentially three types of deal:

1) Cash inflow or outflow from the fund
Notification of inflows/outflows is sent by email to both the Portfolio Manager and the relevant investment operations team, and also loaded on to the Aladdin system. The Portfolio Manager makes purchase and sale decisions based on the notification which then flows through Aladdin to be executed.

2) Portfolio Manager allocates between underlying Fund Managers
Where the allocation is to Fund Managers running directly held portfolios, notification to the underlying Fund Manager is given by email, and the movement in cash is keyed into the system. All tranches/physical allocations are processed through Aladdin for full automation.
2. How T&IO manage PruFunds continued

3) Underlying Fund Managers deal
The Fund Manager gets notification either by email from the Portfolio Manager, or via the underlying collective investment scheme (CIS) injections/withdrawals process (which operates in the same way as 1 above). The Fund Manager uses their localised decision support system to decide on the specific deals required, and then completes a dealing request on an electronic dealing system – which then interfaces with the straight-through processing (STP) back office processes.

Day-to-day management

Please describe the nature and frequency of cross-checking cash and portfolio holdings?

There are three key areas involved as far as stock and cash holdings are concerned: the Custodian, the Fund Administrator and the Portfolio/Fund Manager.

Cash is inevitably affected by all transactions that occur in the fund, so discrepancies in cash will arise whenever there are discrepancies in cash items and stock transactions.

Cash positions are reconciled daily between the Fund Administrator and the Custodian.

Cash positions are also reconciled daily between the Fund Manager and the Custodian.

Stock positions are reconciled monthly between the Fund Administrator and the Custodian. Stock positions are also reconciled daily between the Fund Manager and the Custodian.

As an additional check stock positions are reconciled fortnightly between the Fund Manager and the Fund Administrator, and the total fund size is reconciled between these two monthly.
3. PruFund Options

The following funds are available through a number of different product options. For information on this, plus fact sheets, daily prices, performance figures, fund guides and T&I/O PruFund market commentary, please visit pruadviser.co.uk/funds

PruFund

| **Diversification** | • Invests globally in a range of assets including equities, property and fixed interest.  
| | • Pools together the money of large numbers of investors to offer excellent diversification.  
| | • Invests predominantly using a range of M&G plc and external fund managers.  |

| **Governance** | T&I/O monitor and manage the M&G plc and external fund managers responsible for the majority of underlying funds that these PruFunds invest in.  |

| **Special Features** | • Smoothing.  
| | • Financial strength.  
| | • Backed by the assets of the largest With-Profits funds in the UK (end December 2018).  |
3. PruFund Fund Options continued

Risk Managed PruFund

These funds provide a choice of five options each offering different levels of risk and potential return.

<table>
<thead>
<tr>
<th>Asset Allocation</th>
<th>PruFund Risk Managed 1 Fund</th>
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<tbody>
<tr>
<td></td>
<td>PruFund Risk Managed 2 Fund</td>
</tr>
<tr>
<td></td>
<td>PruFund Risk Managed 3 Fund</td>
</tr>
<tr>
<td></td>
<td>PruFund Risk Managed 4 Fund</td>
</tr>
<tr>
<td></td>
<td>PruFund Risk Managed 5 Fund</td>
</tr>
</tbody>
</table>

A choice of five Risk Managed PruFund funds.

The Risk Managed PruFund funds use T&IO asset allocation models to decide the high level asset allocation positions of each of the funds.

The high level asset allocation positions for the Risk Managed PruFund funds are updated quarterly. Within each high level asset type (for example international equities or fixed interest) the amount held in different types of that asset is driven by the proportion held in the main With-Profits fund.

Visit pruadviser.co.uk/risk-managed-smoothed for more information.

Optional Protection PruFund

These funds can offer a range, where available, of optional guarantee terms which may, at an additional cost, provide some added security for clients. We also provide versions of the same funds without the optional guarantees.

<table>
<thead>
<tr>
<th>Asset Allocation</th>
<th>PruFund Protected Growth*/PruFund Growth</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Maintaining the financial security of the fund is the overriding priority – within that T&amp;IO manage the asset allocation to help meet the funds’ aim of maximising growth within an acceptable risk budget over the medium to long-term.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Asset Allocation</th>
<th>PruFund Protected Cautious*/PruFund Cautious</th>
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<tbody>
<tr>
<td></td>
<td>These funds offer alternative asset splits to the PruFund Growth funds by offering a different allocation of real (equities, property and alternative assets) versus nominal (fixed interest and cash) assets. This is to help the funds’ meet their aims for providing growth over the medium to long-term through a cautious approach to investing while maintaining an acceptable level of risk to the funds.</td>
</tr>
<tr>
<td></td>
<td>T&amp;IO asset allocation changes in the PruFund funds will be reflected within the real and nominal assets held.</td>
</tr>
<tr>
<td></td>
<td>The onshore PruFunds invest in the main life fund. The international PruFund funds are backed by assets in the life fund through a reinsurance agreement.</td>
</tr>
</tbody>
</table>

Visit pruadviser.co.uk/prufund for more information.

* Currently closed to new investments.
With-Profits

Including: With-Profits (referred to as Optimum Return With-Profits fund and Optimum Bonus With-Profits fund for our Onshore Bond products).

| Diversification      | • Invests globally in a range of assets including equities, property, fixed interest and alternative assets.  
|                      | • Pools together the money of large numbers of investors to offer excellent diversification.  
|                      | • Invests predominantly using a range of M&G plc and external fund managers.  |
| Asset allocation     | **With-Profits (referred to as Optimum Return for our Onshore Bond products)**  
|                      | • T&IO select a wide range of assets to hold in the With-Profits fund, in line with the fund’s objective. The aim is to maximise long-term investment returns while maintaining the financial security of the fund.  
|                      | • The international With-Profits funds are backed by assets in the life fund through a reinsurance agreement.  |
|                      | **Onshore Bonds only – Optimum Bonus**  
|                      | • The fund invests in the With-Profits fund, but offers an alternative split of real (equities, property and alternative assets) versus nominal (fixed interest and cash) assets, to help meet the fund’s aim of providing medium to long-term growth and to generate income.  
|                      | • T&IO asset allocation changes in the With-Profits fund will be reflected within the real and nominal assets held.  |
| Governance           | T&IO monitor and manage the M&G plc and external fund managers responsible for the majority of underlying funds that these Multi-Asset funds invest in.  |
| Special features     | • Smoothing.  
|                      | • Guarantees.  
|                      | • Financial strength.  
|                      | • Asset liability management.  |

Visit [pruadviser.co.uk/funds/with-profits/](http://pruadviser.co.uk/funds/with-profits/) for more information.

The information in this document is correct as at 21 October 2019 unless otherwise stated.

Further fund information, including fact sheets and performance information is available on our website [pruadviser.co.uk/funds](http://pruadviser.co.uk/funds)
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