PENSION INSURANCE CORPORATION

PENSION RISKS SECURED

PENSION INSURANCE CORPORATION GROUP LIMITED
SOLVENCY AND FINANCIAL CONDITION REPORT 2017

Pension Insurance Corporation plc (PIC) is a market-leading, specialist UK insurer of defined benefit pension funds.

PIC'S PURPOSE

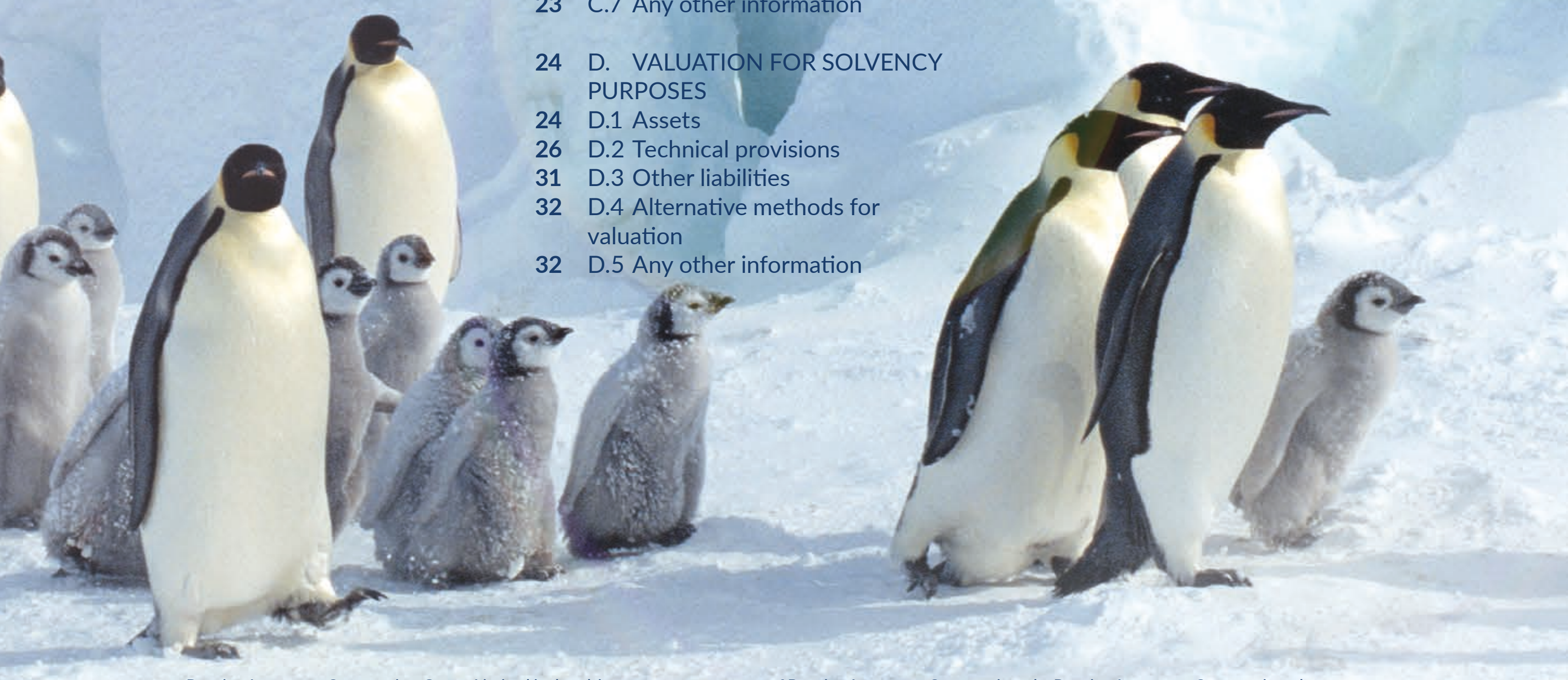
Our purpose is to pay the pensions of our policyholders.

WHO WE ARE

We are recognised as a leader in the bulk annuity sector.

We provide secure and stable retirement incomes for our policyholders through leading customer service, comprehensive risk management and excellence in asset and liability management.

Contents



Pension Insurance Corporation Group Limited is the ultimate parent company of Pension Insurance Corporation plc. Pension Insurance Corporation plc is registered in England and Wales under company number 05706720. It is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority (FRN 454345). Its registered office is at 14 Cornhill, London EC3V 3ND.

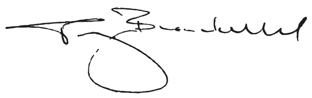
DIRECTORS' RESPONSIBILITY STATEMENT

We acknowledge our responsibility for preparing the insurer and Group Solvency and Financial Condition Report ("SFCR") in all material respects in accordance with the PRA Rules and the Solvency II Regulations.

We are satisfied that:

a) throughout the financial year in question, the insurer and Group have complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations as applicable at the level of the insurer and Group; and

b) it is reasonable to believe that the insurer and Group have continued so to comply subsequently and will continue so to comply in future.



Signed on behalf of the Board of Directors

7 June 2018

REPORT OF THE INDEPENDENT EXTERNAL AUDITOR

Report of the external independent auditor to the Directors of Pension Insurance Corporation Group Limited ("the Group") pursuant to Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook applicable to Solvency II firms

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

Opinion

Except as stated below, we have audited the following documents prepared by the Group and the Company as at 31 December 2017:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Group and the Company as at 31 December 2017 ('the Narrative Disclosures subject to audit'); and
- Group templates S.02.01.02, S.22.01.22, S.23.01.22, S.32.01.22 and Company templates S.02.01.02, S.12.01.02, S.22.01.21, S.23.01.01, S.28.01.01 ('the Templates subject to audit').

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

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

- information contained within the Relevant Elements of the Group Solvency and Financial Condition Report set out above which are, or derive from the Solvency Capital Requirement, as identified in the Appendix to this report;
- The 'Business and performance', 'System of governance' and 'Risk profile' elements of the Group Solvency and Financial Condition Report;
- Group templates S.05.01.02, S.05.02.01, S.25.02.22, S.25.03.22;
- Company templates S.05.01.02, S.05.02.01, S.19.01.21, S.25.02.21, S.25.03.21;
- the technical provisions as at 31 December 2015 used to calculate the transitional measures, and therefore information relating to the transitional measures set out in the Appendix to this report where disclosed;
- the written acknowledgement by management of their responsibilities, including for the preparation of the Group Solvency and Financial Condition Report ('the Responsibility Statement');
- information which pertains to an undertaking that is not a Solvency II undertaking and has been prepared in accordance with PRA rules other than those implementing the Solvency II Directive or in accordance with an EU instrument other than the Solvency II regulations ('the sectoral information').

In our opinion, the information subject to audit in the Relevant Elements of the Group Solvency and Financial Condition Report of Pension Insurance Corporation Group Limited as at 31 December 2017 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)), including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Relevant Elements of the Group Solvency and Financial Condition Report section of our report. We are independent of the Group and the Company in accordance with the ethical requirements that are relevant to our audit of the Group Solvency and Financial Condition Report in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter – special purpose basis of accounting

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

Conclusions relating to going concern

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

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

Other Information

The Directors are responsible for the Other Information.

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

In connection with our audit of the Group Solvency and Financial Condition Report, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the Relevant Elements of the Group Solvency and Financial Condition Report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the Relevant Elements of the Group Solvency and Financial Condition Report or a material misstatement of the Other Information. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors for the Solvency and Financial Condition Report

The Directors are responsible for the preparation of the Group Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations which have been modified by the approvals and modifications granted by the PRA under the Solvency II Regulations 2015 and section 138A of FSMA respectively.

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of a Group Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

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

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

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

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

Other Matter

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

Report on other legal and regulatory requirements

Sectoral information

In our opinion, in accordance with rule 4.2 of the External Audit Chapter of the PRA Rulebook, the sectoral information has been properly compiled in accordance with the PRA Rules and EU instruments relating to that undertaking from information provided by members of the Group and the relevant insurance group undertaking.

Other Information

In accordance with Rule 4.1(3) of the External Audit Chapter of the PRA Rulebook, we are required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of the Pension Insurance Corporation Group Limited statutory financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

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

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

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

For and on behalf of KPMG LLP

Philip Smart

Philip Smart (Senior Statutory Auditor)
15 Canada Square
London
E14 5GL

7 June 2018

REPORT OF THE INDEPENDENT EXTERNAL AUDITOR

CONTINUED

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

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

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

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

Group:

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

- The following elements of Group template S.22.01.22:
  - Column C0030: – Impact of transitional measures on technical provisions
  - Row R0010: – Technical provisions
  - Row R0090: – Solvency Capital Requirement

- The following elements of Group template S.23.01.22:
  - Row R0020: Non-available called but not paid in ordinary share capital at Group level
  - Row R0060: Non-available subordinated mutual member accounts at Group level
  - Row R0080: Non-available surplus at Group level
  - Row R0100: Non-available preference shares at Group level
  - Row R0120: Non-available share premium account related to preference shares at Group level
  - Row R0150: Non-available subordinated liabilities at Group level
  - Row R0170: The amount equal to the value of net deferred tax assets not available at the Group level
  - Row R0190: Non-available Own Funds related to other Own Funds items approved by supervisory authority
  - Row R0210: Non-available minority interests at Group level
  - Row R0380: Non-available ancillary Own Funds at Group level
  - Rows R0410 to R0440: Own Funds of other financial sectors
  - Row R0680: Group SCR
  - Row R0740: Adjustment for restricted own Fund items in respect of matching adjustment portfolios and ring-fenced funds
  - Row R0750: Other non-available Own Funds

- Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.

Solo:

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

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

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

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

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

- Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.

SUMMARY

The Solvency and Financial Condition Report ("SFCR") is an annual report that is required to be produced under the European Union ("EU") and UK law, as part of the Solvency II regime.

The Group is required to produce a single SFCR, covering both Pension Insurance Corporation plc ("PIC", or "the Company") and Pension Insurance Corporation Group Limited ("PICG", or "the Group"). This requirement is set out in a direction made by the Prudential Regulatory Authority ("PRA") on 19 December 2016. This direction is in force until 19 December 2019.

The SFCR is a public document, and is required to be published on the Company's website. It also must be provided to the Company's prudential regulator, the PRA.

The content of the SFCR is prescribed by EU regulation, and must contain the following sections:

Section	Description of content
Business and Performance	Provides the basic information on the Group and Company, and gives a summary of the business performance during the year in question.
System of Governance	Provides governance information on the Group and Company, including Board and Committee structure, responsibilities, and details of the principal process.
Risk Profile	Provides qualitative and quantitative information regarding the risks that face the Group and Company, and how they are managed.
Valuation for Solvency Purposes	Provides values for the Group and Company's assets and liabilities in accordance with IFRS and Solvency II rules, gives details on the assumptions used in the valuations, and provides an explanation on valuation differences between IFRS and Solvency II.
Capital Management	Provides detail on the regulatory capital (Own Funds) which the Group and Company must hold in line with Solvency II rules, and the composition of such Own Funds.

A summary of the content of each of these sections is provided below:

Business and performance

The Group and Company continued to trade profitably during 2017. The Group made an IFRS profit before tax of £383 million (2016: £266 million). This was primarily made up of profits before tax from PIC of £391 million (2016: £276 million), together with losses from other companies (primarily Group costs borne at top company level) of £8 million (2016: £10 million).

Statement of comprehensive income highlights

	2017 £m	2016 £m
Gross premiums written	3,704	2,598
Net premiums revenue earned	3,663	2,574
Investment return (including commissions earned)	1,093	3,220
Total revenue	**4,756**	**5,794**
Claims paid	(909)	(768)
Change in insurance liabilities	(3,324)	(4,656)
Operating expenses	(91)	(72)
Finance costs	(41)	(22)
Total claims and expenses	**(4,365)**	**(5,518)**
Profit before tax	**391**	**276**

Premiums

Gross premiums written have increased significantly from £2,598 million in 2016 to £3,704 million in 2017 as a result of 20 new business transactions during the year.

Net premiums earned represent the gross premiums written less the premiums ceded to reinsurers. Net premiums written has increased at a lower rate than gross premiums due to seven new reinsurance transactions concluded in 2017.

Investment return

Investment return comprises interest received on fixed income securities, the realised and unrealised gains or losses on financial investments.

Interest received increased from £561 million in 2016 to £631 million in 2017, reflecting the growth in the investment portfolio.

The net movement in the fair value of assets, including realised gains, was a gain of £526 million compared to a gain of £2,613 million in 2016. This comprises realised gains of £310 million (2016: £374 million) and unrealised gains of £216 million (2016: £2,239 million). The significant reduction in the unrealised gains was due to the increase in interest rates during the year.

Claims paid

Claims paid represents the total payments made to policyholders during the year and was £1.0 billion in 2017.

Net claims paid are gross claims paid less the amounts recovered from reinsurers. Net claims paid increased from £768 million in 2016 to £909 million in 2017, reflecting the increase in the insurance book during the year.

Change in insurance liabilities

Change in insurance liabilities represents the change in the gross insurance liabilities less the reinsurance assets.

The increase in liabilities was due to the new business written in 2017, claims paid and the impact of market fluctuations.

Operating expenses

The increase in operating expenses from £72 million in 2016 to £92 million in 2017 was in line with the growth of the business.

Finance costs

Finance costs represent the interest payable on borrowings. The £41 million expense in 2017 includes the full year interest payable on the two subordinated debt securities issued by the Company.

Balance sheet review

Balance sheet extract	2017 £m	2016 £m
Reinsurance assets	2,450	2,522
Financial investments	25,671	22,594
Derivative assets	8,775	9,320
Gross insurance liabilities	(24,993)	(21,741)
Derivative liabilities	(9,663)	(10,654)

By the end of 2017, PIC had total financial investments of £25.7 billion, compared with £22.6 billion at the end of 2016. The increase of £3.1 billion over 2017 was principally due to the effect of the new business premiums received, offset by the impact of market movements, reinsurance contracts during the year and claim payments made to policyholders.

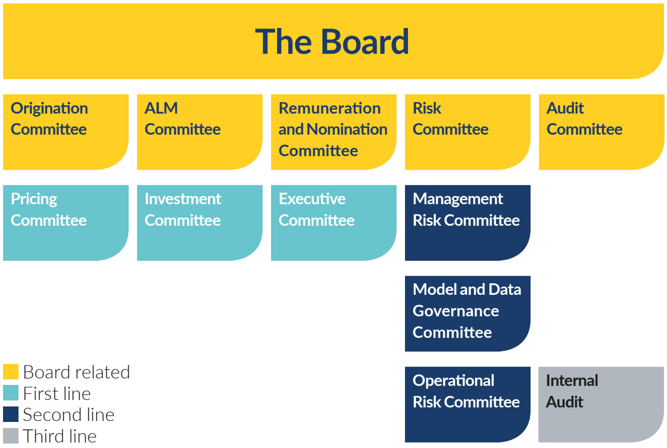
The increase in insurance liabilities since December 2016 reflects the addition of new business written during 2017, less claims paid and changes in actuarial assumptions, as well as the impact of movements in macroeconomic factors such as interest rates and inflation during the year.

Gross derivative assets and derivative liabilities have both reduced since 31 December 2016, as the Company sought to close out certain swap contracts during the year.

IFRS NAV increased from £1,760 million in 2016 to £2,076 million in 2017, reflecting the profits generated during the year.

System of Governance

PIC's governance structure supports the "three lines of defence" model which is operated by the Group. This structure is summarised below (and is unchanged from last year):



First line
- **Operational line management responsible for delivering actual performance aligned with the plan**
- **Responsible for day-to-day management of risk**
- **Must comply with all Group strategies, policies and risk appetite**

Second line
- **Independent of first line**
- **Includes Risk function, Actuarial function and Compliance function**
- **Responsible for providing the framework within which the strategy is delivered**
- **Provides information, oversight support and challenge to decision making**
- **Advises Board on forward-looking assessment of threats and opportunities**

Third line
- **Provides independent assurance on the overall systems of internal control**

Risk Profile

The Group and Company's risk profile is best measured by its Internal Model, which was approved for use by the PRA in December 2015. A Major Model Change was approved by the PRA in December 2017 to the Internal Model related to the treatment of longevity and inflation risk.

The following table shows the component risks which make up the Group's total Solvency Capital Requirement ("SCR"), which represents the amount of capital the firm must hold to protect it from extreme risk events and comply with EU regulation.

SCR	2017 £m	% of SCR	2016 £m	% of SCR
Market risk	**1,853**	56%	1,524	49%
Counterparty risk	**73**	2%	64	2%
Insurance risk	**994**	30%	1,227	40%
Expense risk	**211**	6%	115	4%
Operational risk	**202**	6%	171	5%
Total before diversification	**3,333**	100%	3,101	100%
Diversification	**(1,027)**		(959)	
Total after diversification	**2,306**		2,142	
Loss absorbing capacity of deferred tax ("LACDT")	**(224)**		(230)	
Total SCR after LACDT	**2,082**		1,912	

Valuation for Solvency Purposes

The table below summarises the Company and Group's assets and liabilities valued in accordance with its statutory accounting basis (IFRS), and the Solvency II regulatory basis at 31 December:

2017 £m	Group Solvency	Group IFRS	Company Solvency	Company IFRS
Total Assets	**36,671**	**37,406**	**36,640**	**37,387**
Total Liabilities	**33,338**	**35,323**	**33,312**	**35,311**
Own Funds/Equity	**3,333**	**2,083**	**3,328**	**2,076**

2016 £m	Group Solvency	Group IFRS	Company Solvency	Company IFRS
Total Assets	35,302	34,821	35,268	34,789
Total Liabilities	32,148	33,042	32,134	33,029
Own Funds/Equity	3,154	1,779	3,134	1,760

Differences in the valuation of assets and liabilities between the two bases are driven by the following:

- Subordinated debt issued by PIC, which is treated as a liability for IFRS purposes and Own Funds for Solvency purposes;
- Adjustments relating to differences between the IFRS and Solvency results related to liability, reinsurance and deferred tax positions, relating to items such as the Solvency II Risk Margin (less transitionals) and prudent margins under IFRS; and
- Minor valuation differences between IFRS and Solvency results (such as valuation differences relating to fixed assets and intangible assets at a Group level).

Capital Management

The table below summarises the Group and Company's capital and solvency position as at 31 December 2017.

2017	Group	Company
Own Funds £m	**3,333**	**3,328**
SCR £m	**2,082**	**2,082**
SCR coverage ratio %	**160%**	**160%**

2016	Group	Company
Own Funds £m	3,154	3,134
SCR £m	1,912	1,912
SCR coverage ratio %	165%	164%

The Group and Company have been granted permission by the PRA to use an Internal Model for the purposes of calculating the Solvency Capital Requirement.

A. BUSINESS AND PERFORMANCE (UNAUDITED)

A.1 Business

The full legal name of the undertaking is Pension Insurance Corporation plc ('PIC', or 'the Company'). It is a public limited company, registered in England and Wales with the company registration number 05706720.

The Company is a wholly owned subsidiary of PIC Holdings Limited. PIC Holdings Limited is a wholly owned subsidiary of Pension Insurance Corporation Group Limited ('PICG', or 'the Group'), a company registered in England and Wales and the European registered company in the Group. Pension Insurance Corporation Group Limited is regarded as the ultimate parent company of Pension Insurance Corporation plc.

Pension Services Corporation Limited ('PSC') is a subsidiary company of PIC Holdings Limited, and provides employees and other services to companies within the PICG Group.

The External Auditor to the Group is KPMG LLP, 15 Canada Square, London E14 5GL.

PIC is authorised by the Prudential Regulation Authority, 20 Moorgate, London EC2R 6DA and regulated by the Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS and the Prudential Regulation Authority (FRN 454345).

The principal activity of PIC is providing insurance annuity products to UK defined benefit occupational pension funds and their members (commonly referred to as "pension insurance" or "bulk annuities"). Pension insurance products are used by pension funds to transfer to an insurance company the risks and liabilities arising from the benefit promises made to pension fund members. Insurance is also used as a means by which the ultimate responsibility to pay the benefits promised is transferred to the insurance company through the issuance of an individual annuity insurance policy to the pension fund member.

The Group and Company prepare their financial statements in accordance with International Financial Reporting Standards ("IFRS") and those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

Summary of the IFRS Statement of Comprehensive Income for the year ended 31 December 2017

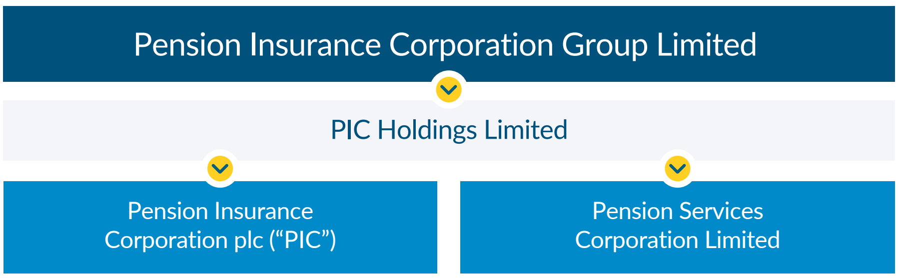
	Group		Company	
£m	**2017**	2016	**2017**	2016
Net premium revenue earned	**3,663**	2,574	**3,663**	2,574
Investment income	**567**	607	**567**	607
Net realised gains	**310**	374	**310**	374
Net unrealised gains	**216**	2,239	**216**	2,239
Net-claims	**(909)**	(768)	**(909)**	(768)
Movement in net long-term business provision	**(3,324)**	(4,656)	**(3,324)**	(4,656)
Administrative expenses	**(140)**	(104)	**(132)**	(94)
Profit before taxation	**383**	266	**391**	276

The Company made an IFRS profit before tax of £391 million in 2017 (2016: £276 million), and the Group made an IFRS profit before tax of £383 million in 2017 (2016: £266 million).

During 2017, the Company continued its strategy of providing pension insurance products to defined benefit schemes and their trustees.

Group

A Group structure chart, and a description of the Group as at 31 December 2017 is set out below:



Group undertakings	Country of incorporation	Principal activity	2017 % equity holding	2016 % equity holding
Pension Insurance Corporation Group Limited	England	Holding company		
PIC Holdings Limited	England	Holding company	100%	100%
Pension Insurance Corporation plc	England	Bulk annuity insurance	100%	100%
Pension Services Corporation Limited	England	Service company	100%	100%

Material lines of business, and geographical areas

The principal activity of PICG is to act as the holding company for the other companies within the PICG Group. It has no employees, and incurs administrative expenses. It also holds any share incentive plans which are in existence for the Group.

PIC Holdings Limited is an intermediate holding company, and has no material assets or liabilities in the context of the Group.

The principal activity of PIC is providing insurance annuity products to UK defined benefit occupational pension funds and their members.

PSC is the service company of the Group, and employs all the staff which are responsible for the performance of the Group's activities. It also enters into material contracts (with the exception of pension insurance contracts) on behalf of the Group.

During 2017, PSC had income of £77,720k (2016: £66,450k) from other Group companies (primarily PIC) for the performance of its service contracts.

The tables in sections A.2 to A.4 below present extracts from the Group's and Company's IFRS Statements of Comprehensive Income, splitting the IFRS income and expense items between underwriting activity (section A.2), investment activity (section A.3) and other activity (section A.4). Comparative information has been presented where available.

A.2 Performance of underwriting activity

	Group		Company	
£m	**2017**	2016	**2017**	2016
Gross premiums written	**3,704**	2,598	**3,704**	2,598
Outward reinsurance premiums	**(41)**	(24)	**(41)**	(24)
Net premium revenue earned	**3,663**	2,574	**3,663**	2,574
Claims paid – gross	**(1,003)**	(797)	**(1,003)**	(797)
Reinsurers' share of claims paid	**94**	29	**94**	29
Net claims	**(909)**	(768)	**(909)**	(768)
Gross increase in insurance liabilities	**(3,252)**	(5,261)	**(3,252)**	(5,261)
Increase/(decrease) in reinsurers' share of insurance liabilities	**(72)**	605	**(72)**	605
Movement in net long-term business provision	**(3,324)**	(4,656)	**(3,324)**	(4,656)
Acquisition and other operating expenses	**(124)**	(95)	**(116)**	(85)
Underwriting result	**(694)**	(2,945)	**(686)**	(2,935)

The table above sets out a sub-section of the Group and Company's results for the year. The overall profit for the year is set out in the table in section A.1.

The Underwriting result, as presented in the table above, is only a reflection of premiums written, claims paid, changes in insurance liabilities (whether arising from new business, or from changes in economic or non-economic assumptions) and expenses. It does not reflect any investment activity, or income and gains from the investment portfolio owned by the Group, which is presented in section A.3.

During the year, PIC completed a further 20 (2016: 17) new transactions with pension schemes, with a total premium amount of £3.7 billion (2016: £2.6 billion).

PIC concluded seven (2016: two) longevity swap reinsurance transactions during the year which covered longevity risk on £4.0 billion (2016: £1.4 billion) of insurance liabilities.

The Company is now responsible for the pension payments of 151,600 individuals (2016: 134,900). Payment of annuities grew by 21% in 2017 to £725 million (2016: £600 million) mainly through new business written during the year. Total claim amounts paid were £1,003 million (2016: £797 million), an increase of 26%, as the growth in annuity payments was supplemented by a growth in lump sum payments and transfers out compared with the prior year.

At the end of 2017, PIC had 84,300 current individual policies in issue, in respect of 90 pension schemes (2016: 80,900 individual policies in respect of 74 schemes). The number of individual policies in issue increased by 3,400 due to new business during the year, offset by commutations and deaths.

At 31 December 2017, 73% of PIC's total longevity exposure on a regulatory solvency basis was reinsured to third party, investment grade reinsurer counterparties (2016: 68%).

Group-level expenses of £8 million (2016: £10 million) have been included within "Acquisition and other operating expenses" above.

A. BUSINESS AND PERFORMANCE (UNAUDITED)

A.3 Performance of investment activity

IFRS £m	Group 2017	Group 2016	Company 2017	Company 2016
Interest income	**632**	562	**632**	562
Other investment income	**(65)**	45	**(65)**	45
Realised gains	**331**	416	**331**	416
Realised losses	**(21)**	(42)	**(21)**	(42)
Unrealised gains	**900**	3,012	**900**	3,012
Unrealised losses	**(684)**	(773)	**(684)**	(773)
Investment management expenses	**(16)**	(9)	**(16)**	(9)
Total	**1,077**	3,211	**1,077**	3,211

The table above sets out a sub-section of the Group and Company's results. The overall profit is set out in the table in section A.1 above.

The investment performance, as presented in the table above, is only a reflection of income, gains, losses and expenses arising from the investment portfolio owned by the Group. It does not reflect any insurance activity, which is presented in section A.2.

Investment income: by Solvency II Asset Class £m	Group and Company 2017	Group and Company 2016
Government bonds	**253**	1,506
Corporate bonds	**439**	2,178
Collective investment undertakings	**(33)**	73
Cash and deposits	**(3)**	(8)
Collateralised securities	**9**	17
Mortgages and loans	**63**	94
Property	**7**	6
Derivative-based instruments	**358**	(646)
Total	**1,093**	3,220

Derivative instruments are held by the Group for the purposes of risk management and hedging, and accordingly the losses reflected above are more than offset by, and should be viewed in the context of, gains recognised on other classes of assets.

Solvency asset class information is collated from the 2017 Annual Group QRT return.

A.4 Performance of other activities

Pension Insurance Corporation plc

The Company incurred tax charges of £75 million for the year ended 31 December 2017 (2016: £55 million).

Pension Insurance Corporation Group Limited

Group tax charges, including those incurred by PIC, were £73 million during the year (2016: £54 million).

A.5 Any other information

None.

B. SYSTEM OF GOVERNANCE (UNAUDITED)

B.1 Governance function

Board of Directors

Pension Insurance Corporation Group Limited

PICG is governed by its Board of Directors (the "Board") consisting of 13 Directors, 12 of whom are non-executive.

Of the non-executive Board members, two are appointed by Reinet PC Investments (Jersey) Limited which indirectly holds a 43.452% interest in PIC, one is appointed by PIC Holdings (Cayman) Limited, a JC Flowers entity, which indirectly holds a 21.398% interest in PIC, and one is appointed by Blue Grass Holdings Limited, a CVC entity, which indirectly holds a 12.921% interest in PIC.

The Board maintains overall responsibility for PICG and an oversight responsibility for the Pension Insurance Corporation group ("the Group") in the best interests of its policyholders, shareholders, employees and other stakeholders and to set the Group's long-term objectives and commercial strategy.

The main activities of the Group are conducted through its principal operating subsidiary, PIC.

The Board has delegated the day-to-day management and administration of the Company to the Chief Executive Officer ("CEO") who established the Executive Committee at the operating entity level, PIC, to assist the CEO in the day-to-day running of PIC.

PICG Board

Director	Approved function
Jon Aisbitt	SIMF 7 Group Entity Senior Insurance Manager Function, SIMF 9 Chairman
Tracy Blackwell	SIMF 1 Chief Executive Function, SIMF 7 Group Entity Senior Insurance Manager Function
Mike Eves	Non-Executive Director
Ed Giera	Non-Executive Director
Tim Hanford	SIMF 7 Group Entity Senior Insurance Manager Function
Arno Kitts	Non-Executive Director
Jing Li	SIMF 7 Group Entity Senior Insurance Manager Function
Nick Lyons	SIMF 12 – Chair of the Remuneration Committee, SIMF 14 – Senior Independent Director
Josua Malherbe	SIMF7 Group Entity Senior Insurance Manager Function
Roger Marshall	Non-Executive Director
Peter Rutland	SIMF 7 Group Entity Senior Insurance Manager Function
Mark Stephen	Non-Executive Director
Wilhelm Van Zyl	SIMF 7 Group Entity Senior Insurance Manager Function

Pension Insurance Corporation plc

PIC is governed by its Board of Directors (the "Board") consisting of 13 Directors, 11 of whom are non-executive. A majority of PIC's Directors are independent.

Of the non-executive Board members, two are appointed by Reinet PC Investments (Jersey) Limited which indirectly holds a 43.452% interest in PIC, one is appointed by PIC Holdings (Cayman) Limited, a JC Flowers entity, which indirectly holds a 21.398% interest in PIC, and one is appointed by Blue Grass Holdings Limited, a CVC entity, which indirectly holds a 12.921% interest in PIC.

The Board has overall responsibility for the operations of PIC and oversees the management of the Company in the best interests of its policyholders, shareholders, employees and other stakeholders and to set the Company's long-term objectives and commercial strategy.

The Board has delegated responsibility for a number of functions to Board Committees as set out below. The Committees all have Terms of Reference setting out in more detail their responsibilities.

The Board has delegated the day-to-day management and administration of the Company to the Chief Executive Officer ("CEO") who has established the Executive Committee to assist the CEO with the day-to-day running of PIC.

PIC Board

Director	Approved function
Jon Aisbitt	SIMF 7 Group Entity Senior Insurance Manager Function, SIMF 9 Chairman
Tracy Blackwell	SIMF 1 Chief Executive Function, SIMF 7 Group Entity Senior Insurance Manager Function
Amanda Bowe	Non-Executive Director
Timothy Hanford	SIMF 7 Group Entity Senior Insurance Manager Function
Arno Kitts	Non-Executive Director
Nick Lyons	SIMF 12 – Chair of the Remuneration Committee, SIMF 14 – Senior Independent Director
Roger Marshall	SIMF 11 Chair of the Audit Committee
Eloy Michotte	SIMF 7 Group Entity Senior Insurance Manager Function
Peter Rutland	SIMF 7 Group Entity Senior Insurance Manager Function
Steve Sarjant	SIMF 10 Chair of the Risk Committee
Rob Sewell	SIMF 2 Chief Finance Function
Mark Stephen	Non-Executive Director
Wilhelm Van Zyl	SIMF 7 Group Entity Senior Insurance Manager Function

Audit Committee

The Audit Committee's key role is to assist the Board with the discharge of its responsibilities with regard to oversight of the financial reporting process, the system of internal controls, internal and external audits, and system of governance and compliance.

The Audit Committee comprises four Non-Executive Directors. The Board is satisfied that members of the Audit Committee have relevant accounting and financial reporting experience.

Financial reporting

The Audit Committee oversees the financial reporting process, monitors the integrity of the financial statements, which includes the annual financial statements of the Company, half yearly results, regulatory returns and any significant estimates and judgements made, as well as a review as to whether the Company has followed appropriate accounting standards.

Internal controls

The Audit Committee oversees and, where necessary, challenges the framework, effectiveness and adequacy of the Company's systems of internal control. The Committee reviews findings and recommendations of the Internal Audit and External Auditors and receives an Integrated Assurance Report which forms the basis to the statements included in the Annual Report and Financial Statements with regard to the effectiveness of the internal controls system.

B. SYSTEM OF GOVERNANCE (UNAUDITED)

Financial Crime and Whistleblowing

The Audit Committee reviews the adequacy and security of the Company's arrangements for its employees and contractors to raise concerns about possible wrongdoing in financial reporting and other matters. It also reviews the Company's arrangements for detection of fraud, and systems and controls for the prevention of bribery and anti-money laundering.

Internal audit

The Audit Committee reviews the effectiveness of the Company's and Internal Audit function in the context of the Company's overall risk management system and its performance against agreed objectives, approves and removes the Head of Internal Audit. The Committee receives, reviews and approves the annual internal audit plan, which forms part of the annual Integrated Assurance programme, and monitors management's responsiveness to the Internal Audit's findings.

External Audit

The Audit Committee considers and makes recommendations to the Board in relation to the appointment, re-appointment and removal of the Company's External Auditor, its terms of engagement and fees. The Audit Committee also reviews the non-audit services fees and monitors that these are in accordance with the Company's non-audit services policy and assesses the External Auditor's independence and objectivity. The Audit Committee reviews and approves the annual audit plan and reviews the External Auditor's findings with the auditor and with the Company.

Risk Committee

The Risk Committee has primary responsibility to the Board for the Risk Management Framework which includes the Company's current and likely risk exposures, risk tolerances and appetite, risk measurement, risk management performance, and its risk policies and procedures, as well as recommending the risk policies to the Board.

Risk Strategy, Appetite and Policy

The Risk Committee advises the Board on the Company's overall risk exposures, and the current and future risk strategy. The Committee reviews and recommends to the Board the design and implementation of Risk Management Frameworks and measurement strategies for the Company. It further reviews and recommends to the Board for approval the risk appetite and tolerances.

Risk Oversight and Monitoring

The Risk Committee keeps under review the Company's overall risk identification, assessment and management process that inform the Board's decision making. The Committee is responsible for oversight of the Internal Model and for reporting to the Board on any areas needing improvement, and updating the Board on the status of efforts to improve previously identified weaknesses.

The Committee advises the Board on the risks to the business plan and capital implications, making sure that these are adequately identified and assessed as part of the business planning process through stress testing and scenario analysis. The Committee also works with the Nomination and Remuneration Committee to ensure that risk management is taken into consideration in objective setting and the design of overall remuneration. It further provides the advice, oversight and challenge necessary to embed and maintain a supportive risk culture throughout the Company.

The Risk Committee also reviews reports on any material breaches of risk and compliance limits and material incidents, and monitors the adequacy of proposed actions and management's responsiveness to remedial actions proposed by the Chief Risk Officer.

Risk Function and the Chief Risk Officer

The Risk Committee considers and approves the Risk Function mandate and reviews and assesses the performance of the Chief Risk Officer. It works with the Nomination and Remuneration Committee on making recommendations to the Board with regard to the appointment/removal of the Chief Risk Officer.

Asset Liability Management Committee

The Asset Liability Management Committee oversees the management of all aspects of investment policy and strategy for PIC and provides oversight of the operation of PIC's investment portfolios within established strategy and risks frameworks. The Committee plays a key role in PIC's governance of pricing by providing oversight of portfolio pricing for large deals.

Origination Committee

The Origination Committee's role is to oversee all aspects of PIC's new business and reinsurance origination within established strategy, business plan and risk frameworks including conduct risk. The Committee also oversees all aspects of interaction with policyholders including administration, tracing and complaints and recommends to the Board any actions needed to ensure policyholders are treated fairly.

The Committee approves at least annually the pricing assumptions used by the Pricing Committee and approves the pricing authority for the Pricing Committee. The Committee also provides additional oversight of the outsourced administration of policies.

Nomination and Remuneration Committee

The Nomination and Remuneration Committee's role is to regularly review the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board and make recommendations to the Board with regard to any changes and determine and agree with the Board the framework or broad policy for the remuneration of all employees and the specific compensation in respect of the Company's Chairman, Non-Executive Directors, Chief Executive, the Executive Directors and such other members of the executive management as it is designated to consider.

Executive Committee

The Executive Committee consists of the CEO and senior management of the Company. Its role is to propose strategy to the Board and, once approved, implement it together with operational plans, policies, procedures and budgets. The Committee's purpose is also to shape, embed and maintain a culture which safeguards PIC's values by promoting attitudes and behaviours of high ethical standards and integrity in everyday conduct of PIC's business. The Committee further ensures that appropriate systems and controls are in place, monitors operating and financial performance, and assesses and controls risks. The Committee also reviews resources and prioritises their use and allocation.

Executive Committee
Chief Executive Officer ("CEO")
Chief Financial Officer ("CFO")
Chief Risk Officer ("CRO")
Chief Operating Officer ("COO")
General Counsel ("GC")
Head of Strategic Development ("HSD")
Chief Origination Officer ("COrigO")
Chief Administration Officer ("CAO")
Chief Investment Officer ("CIO")
Head of Internal Audit ("HIA")
Chief Actuary
Chief Technology Officer

Material changes to the governance structure over the reporting period

Pension Insurance Corporation Group Limited

The Board of Directors of PICG all served from 1 January 2017 to the date of this report, with the exception of the following appointments or resignations:

- Roger Marshall was appointed on 1 April 2017;
- Eloy Michotte resigned on 11 October 2017;
- Peter Rutland was appointed on 5 May 2017; and
- Wilhelm Van Zyl was appointed on 12 October 2017.

On 21 March 2017, the Board of PICG resolved to disband its Audit and Risk Committee and delegate its risk and audit responsibilities to the PIC Risk Committee and PIC Audit Committee respectively. The decision was taken in order to streamline the governance structure of the PICG Group and reduce governance overlap.

Pension Insurance Corporation plc

The Board of Directors of PIC all served from 1 January 2017 to the date of this report, with the exception of the following appointments or resignations:

- Amanda Bowe was appointed on 1 January 2017;
- Peter Rutland was appointed on 5 May 2017; and
- John Coomber resigned on 22 May 2017.

Remuneration Policies and Practices

Governance of remuneration

The PIC Nominations and Remuneration Committee ("RemCo"), which is a sub-committee of the Board, has responsibility for setting the remuneration policy of the Company and for its implementation. Reports on Committee activity are provided to the Board as appropriate.

The RemCo consists fully of Non-Executive Directors and is chaired by an independent Non-Executive Director. The RemCo is governed by its Terms of Reference, which sets out its duties, which are reviewed regularly.

The RemCo is responsible for the determination, regular review and implementation of the remuneration policy. The RemCo is also responsible for individual remuneration arrangements and outcomes for the Company's Chairman, Chief Executive, Executive Directors, material risk takers and such other members of the executive management as it is designated to consider (all Solvency II Identified Staff). To minimise the risk of any conflicts of interest, no individual is involved in decisions regarding their own remuneration.

In its oversight of the remuneration structures, the RemCo takes full account of strategic objectives and stakeholder views, as well as the interests of the customer/policyholder. The alignment of risk and reward is a prominent consideration, and the RemCo seeks input from the Chief Risk Officer ("CRO"), Chair of the Board Risk Committee ("BRC"), and the Chair of the Audit Committee in the design of remuneration policies and in determining collective and individual reward outcomes.

The RemCo also has responsibility for compliance with all relevant legal and regulatory requirements on remuneration, including Solvency II, which came into force on 1 January 2016. The RemCo ensures that its remuneration policies and practices are suitably aligned with the requirements of Solvency II, and is responsible for the oversight of individual remuneration arrangements and outcomes in respect of all Solvency II Identified Staff. The remuneration for the CEO and CFO is also approved by the Board.

B. SYSTEM OF GOVERNANCE (UNAUDITED)

Remuneration policy

The Company's remuneration policy is designed to enable the Company to recruit, retain and motivate employees of the appropriate calibre to deliver its strategy over the long term. The policy is intended to be consistent with and promote sound and effective risk management and to ensure that it does not encourage risk taking that exceeds the tolerated risk appetite of the Company.

A description of the different remuneration elements for 2017 is set out below.

Base salary	Salaries are reviewed annually and are set to be market competitive taking into account the individual's skills, the size and scope of their role, and that of the Company. Salaries are set at such a level that employees are not overly dependent on variable pay and to allow the Company to operate a fully flexible bonus policy.
Benefits	The following benefits are offered to all permanent employees: Private health cover; annual travel insurance; interest free loans (up to £10,000) for season tickets; death in service life assurance; and participation in the Save As You Earn Plan.
Pension	All employees who meet the minimum criteria are automatically enrolled in the Stakeholder Pension scheme. Employees who have reached their lifetime or annual allowance limit for pensions for tax purposes may receive a cash alternative in lieu of the Company's contribution that otherwise would have been made under the Stakeholder Pension arrangement.
Annual bonus	The annual bonus plan provides participants with an opportunity to receive a cash amount, subject to performance measured in respect of the relevant financial year. All employees may be invited to participate in the plan. Awards are based on the achievement of annual objectives. At all levels within the Company, individual performance metrics include compliance with standards relating to risk and compliance set by the Board. Other performance metrics assess alignment with the Company's core values, and good conduct both within the firm and in dealings with customers. For Solvency II Identified Staff, individual bonus payments will be determined by the Remuneration Committee based on a review of both Company financial and strategic measures and assessment of individual performance over the year, including a review of individual performance by the CRO. Performance may be assessed against both financial and non-financial criteria. Financial performance will be reviewed against a basket of financial metrics agreed at the beginning of the year which could include measures such as new business premium, IFRS operating profit (before and after tax), embedded value, management expenses and Solvency II ratios. Non-financial criteria could consider metrics such as compliance with risk appetite, compliance breaches, customer service measures and conduct, and findings of risk, compliance and internal audit reviews. The CRO, with input from the Chair of the BRC and the Chair of the Audit Committee, assesses the financial performance of the year against the firm's risk appetite and behaviours and attitude to risk and compliance. If the performance has been achieved by exceeding the risk appetite of the firm, as stated and approved by the Board and the Board Risk Committee, the bonus pool and/or individual outcomes may be adjusted downwards, potentially to zero. Performance against all of the above measures is assessed by the Committee in the round. For staff in assurance functions, at least 75% of the annual bonus award is based on the achievement of objectives related to the individual's assurance function. The remaining 25% will relate to the performance of the Company. Awards for this population are subject to a prevailing affordability underpin, and no bonuses will be paid if overall financial performance is not sufficient to fund awards. The bonus opportunity will be expressed as a percentage of salary, and will depend on an individual's role and responsibilities. The maximum annual bonus available is 300% of base salary, but may be amended at the determination of the RemCo. The annual bonus comprises a cash element and an award of nil-cost options. While the cash element of the bonus will be paid upfront, for Solvency II Identified Staff at least 40% of annual bonuses will be in the form of nil-cost options which are subject to deferral over a three-year period using the Deferred Bonus Share Plan ("DBSP").

Deferred Bonus Share Plan	The Deferred Bonus Share Plan ("DBSP"), effective from the performance year 2017, seeks to align the long-term interests of the Company for all senior management and other key individuals through bonus deferral. Under the DBSP, bonuses comprise of a cash element paid upfront and are awarded annually at the end of the financial year. The deferred element is awarded in the form of nil cost options which vest after three years and is subject to a further holding period of up to two years, with one-third of shares released at vesting, 12 months post vesting and 24 months post vesting. For Solvency II Identified Staff a minimum of 40% of any bonus award is deferred. 55 employees were awarded a bonus, of which part was deferred, under the DBSP for the performance year 2017. Prior to vesting, the Remuneration Committee can make adjustments to awards under the malus and clawback provisions. The Committee has the ability to reduce or extinguish the level of any award, or require amounts to be reclaimed from individuals. This may be the case in the event of: • significant financial losses or material misstatement of the accounts for the Company or any Group company; or • material failure of risk management for any period that the Committee reasonably considers is relevant; • discovery of a material error in relation to the assessment of annual performance on which an award was based; and/or • reasonable evidence of any act or omission by the participant which, in the opinion of the Committee: – has contributed to material losses or serious reputational damage to the Company or any business area; or – has amounted to serious misconduct, fraud or misstatement (whether by exaggeration of financial performance or mismarking the valuation of any asset or otherwise).
2017 Growth Share Plan	Growth Share awards were granted in 2017 to certain senior employees and Directors. No further grants will be made under this plan. Grant levels were determined based on an assessment of individual performance and future potential as determined at the time. These Growth Share awards are due to vest in January 2021 based on growth in value of the Company over the four year performance period from 1 January 2017. Participants receive a portion of the growth in the Company's value above a hurdle. The level of reward at vesting is dependent on the growth achieved and can be zero if the growth in Company value is less than the hurdle rate. The proportion of growth above the hurdle allocated to participants reduces once the growth rate exceeds the upper end of expected performance. Prior to vesting, the Remuneration Committee can make adjustments to awards under the malus provisions, and clawback provisions also apply following vesting.
Legacy Performance Share Plan ("PSP")	The DBSP replaced PSPs for the 2017 performance year. Under this legacy plan selected senior individuals were invited, at the discretion of the RemCo, to receive share awards since performance year 2012. The last award under this plan was granted in respect of the 2016 performance year. The awards, granted based on annual performance, vest over a three year period and have a further post-vesting retention period of up to three years. Awards vest at the end of the three year period if the Embedded Value of the Company is not less than it was at the beginning, to ensure maintained growth. This plan is designed to align variable remuneration for senior management with the long-term interests of the Company, and meet the Solvency II requirements for at least 40% of variable pay for Solvency II Identified Staff to be deferred over three years.
Legacy 2012 Growth Share Plan	During 2012, certain senior employees and Directors participated in legacy growth share arrangements put in place in 2012. These awards were based on growth in the value of PICG above a minimum level. These awards vested in October 2016. Senior management who are not included in the 2017 Growth Plan are required to retain at least 50% of their 2012 Growth Plan shares, while those who are not are able to sell up to one-third a year.

Link between pay and risk management

The Company's Remuneration Policy includes the following elements which are intended to align employees' reward to the Company's risk management:

- Maintaining an appropriate ratio between fixed and variable pay.
- Performance measures – Variable remuneration is subject to an assessment of financial and non-financial performance. Financial targets are set at a level consistent with the Company's risk appetite. For all employees, there is consideration of performance against risk and compliance criteria, thereby ensuring that there is risk adjustment at an individual level.
- Long-term incentives – Alignment with the long-term interests of the Company for senior management is achieved by the award of variable remuneration in shares for a three year vesting period, followed by a post-vesting holding period of up to three years.
- Risk adjustment process – The RemCo, in formulating its recommendation on aggregate variable pay to the Board for approval, will review progress against strategic goals and financial targets, and seek input from the CRO and Chair of the BRC and Chair of the Audit Committee for an assessment of risk and compliance within established risk appetite limits as stated and approved by the Board and the Risk Committee. If the performance has been achieved out of line with risk appetite, the variable incentive pool may be adjusted downwards, including to zero.
- Malus and clawback provisions apply to all share-based variable remuneration paid to employees whereby awards may be reduced, withheld or reclaimed in certain circumstances, as outlined in the table above.
- For staff engaged in assurance functions, variable remuneration is mainly determined by reference to performance against functional/ individual performance. The RemCo signs off on all remuneration for senior assurance staff, ensuring independent review of achievements.

Material transactions during the reporting period

Transactions with Directors and key management personnel

During 2017, certain share-based payment schemes operated by PICG in respect of employees of PSC have vested.

In addition, the Group settled tax liabilities on behalf of certain employees, including Directors and key management personnel, who exercised their options upon vesting of the Performance Share Plan. The settlement was made on the condition that the employees would repay this amount to the Group within 90 days after the end of the relevant tax year. The Group recognised a loan asset of £1,209k (2016: £1,112k) due from the Directors and key management personnel at 31 December 2017. The loans do not bear any interest and, except for the repayment period, do not have any other condition attached to them.

Transactions with shareholders

The following share capital transactions took place during 2017:

Pension Insurance Corporation plc

There were no transactions with shareholders during 2017.

Pension Insurance Corporation Group Limited

The Company issued 688,166 £0.00161678179673884 ordinary shares on 4 July 2017 to satisfy the vesting of awards of certain share-based payment schemes operated by the Company. The share issue was fully paid and wholly subscribed for cash consideration. The issue of shares resulted in new share capital of £1,113.

On 29 June 2017, the Company issued 2,000 C shares with a nominal value of £0.00161678179673884. The share issue was fully paid and wholly subscribed for cash consideration. The issue of shares resulted in new share capital of £3.23 and a share premium of £1,629,997.

B.2 Fit and proper requirements

PIC has in place procedures to ensure its staff are:

(a) Fit – Their professional qualifications, knowledge and experience are adequate to enable sound and prudent management; and
(b) Proper – They are of good repute and integrity.

In respect of each role, PIC compiles a detailed job description including the role's competencies and required qualifications. Potential recruits are interviewed by people experienced in these areas and confirmation is obtained from external agencies that they have the qualifications claimed. References from previous employers are taken up if available.

PIC carries out CRB checks and also credit checks on all staff who are involved in finance, investments or administration or who are senior.

PIC also monitors staff throughout the year and reviews their performance by way of an appraisal. Staff are expected to keep up to date with relevant changes in applicable technical competencies and their CPD hours are recorded.

A list of the approved persons of the Company is held on the Financial Services Register website, maintained by the Financial Conduct Authority, and is available from the following link:

http://www.fsa.gov.uk/register/firmIndivSearch.do?pageNumber=1&sid=173742&searchType=1&surname

B.3 Risk management system including the Own Risk and Solvency Assessment

PIC adopts a holistic enterprise-wide perspective on risk facilitated through a strong risk culture. The Company's ambition is to protect its obligations to policyholders and treat them fairly, whilst growing shareholder value through making better risk-return based business decisions resulting from a balanced awareness of the opportunities and threats, only taking risks that the Company has the capability to understand and manage.

PIC achieves this through linking its business strategy objectives and its approach to risk management through the key business processes operated, including setting the business plans, seeking new business opportunities, selecting investments and implementing risk mitigation techniques such as hedges and reinsurance.

The Company's Board and committee structure, and the "three lines of defence" model by which its internal control system operates, are more fully described in the "Governance function" section earlier.

The Board controls and monitors risk through the application of a risk governance framework, and through setting risk appetites and risk limits for the principal risk types to which the Company is exposed.

The Risk Appetite Framework ("RAF") considers the material risks to the business in the context of the achievement of its strategic objectives. As such, the RAF covers:

- Capital and liquidity requirements;
- The Company's reputation with customers, advisers and investors;
- Internal capacity and the capability to deliver on promises and plans;
- The corporate delivery of risk-adjusted growth in the value of the business; and
- The impact of changes in regulation and legislation.

PIC's risk management framework outlines how risks are identified, assessed, controlled and managed; and is organised as follows:

TRANSPARENT, FOCUSED, RELEVANT

- Write it down: make it **clear and transparent**
- **Focused and relevant** risk analysis

ROLE OF EVERYONE TO MANAGE RISK

- **Role of everyone to identify risk** and role of management to decide how to manage
- **Everyone in business** is responsible for risks in their domain

ACTIVE RISK MANAGEMENT

SYSTEMATIC, COMPLETE, DOCUMENTED

- Be **systematic** and **complete** in our assessment and management of risks
- Ensure we **evidence** our controls

COVERS RISK TO KEY OBJECTIVES

- **Encompass** all our risks to all **key business objectives**
- **Manage possibilities**, not predict the future

CONSCIOUS RISK TAKING

- Know **which risks** we choose to take and why
- Have our **eyes wide open** to both the biggest risks and everyday risks
- Ensure adequate return for risk

All employees relating to PIC have a responsibility to identify risks in their area, engage to ensure they are appropriately assessed and controls are put in place to manage the risks within the Company's risk appetite. The risks identified are documented, and a log is maintained, known as the Risk Register.

The Risk Register contains all material risks to PIC's business. The Management Risk Committee reviews any changes in the status of existing risks, and any new and emerging risks added to the Register.

Risks in the Risk Register are assessed by the CRO, with all material and quantifiable risks to which PIC is exposed over the coming year for which capital is an appropriate risk mitigating technique incorporated within PIC's Internal Model.

The regular Board Risk Committee meetings receive details of key risks, as well as new and emerging risks that have been identified.

Those quantifiable and material risks for which capital is not held as part of their risk mitigation treatment or are expected to occur at a future date over the planning horizon, in excess of the 12-month horizon of the Solvency Capital Requirement ("SCR") calculation, are not included within PIC's Internal Model, and are instead measured by considering their impact as part of the stress and scenario testing programme; and also discussed in Risk and Solvency reports, such as the own risk and solvency assessment ("ORSA").

Non-quantifiable and material risks are also considered by measuring their impact as part of the stress and scenario testing programme; and also discussed in Risk and Solvency reports, such as the ORSA.

B. SYSTEM OF GOVERNANCE (UNAUDITED)

Of note, Conduct Risk is the risk that actions will have a detrimental effect on the Company's customers or will impact one of the FCA's other objectives relating to financial crime or competition. These risks often also fall across multiple risk categories.

The dimensions not best addressed through holding additional capital on the balance sheet, but through other risk management techniques, are outlined below.

B.3.1 Liquidity risk

PIC does not hold capital for liquidity risk but instead prefers to set a risk appetite limit for the amount of liquid assets that it needs to hold as PIC believes this to be a more appropriate approach to the management of this risk. PIC also uses a monthly liquidity stress test to check that the level of liquid assets can withstand a reasonable adverse scenario.

B.3.2 Regulatory and legislative risk

PIC does not hold capital against regulatory and legislative risk as management prefer to monitor this activity and do not see this as a risk that can be readily quantified. In the event that such a risk is likely to crystallise, the Board would meet to discuss the best way forward.

B.3.3 Brand and reputation risk

PIC does not explicitly hold capital for reputational and brand risks as the Company prefers to manage this with an appropriate governance structure. Reputational damage is most likely to reduce the quantum of future new business flows, which would have a beneficial effect on solvency, because new business generally consumes capital, whereas managing the in-force policies only over their lifetime generally releases capital.

B.3.4 The annual ORSA process

The annual ORSA process runs alongside the existing business strategy and business planning process. If there is a key decision or change which results in a business plan refresh being required, the ORSA process is re-run. Management has established triggers for when the business plan refresh may be required, which take account of PIC's risk profile and the volatility of its overall solvency needs relative to its capital position.

Within the annual ORSA process, the Board:

- Requests the commencement of the Strategy, Business Planning and ORSA process;
- Challenges the strategy proposed by management;
- Establishes its preferences for taking various types of risks;
- Establishes the risk appetite and limit framework within which it wishes the strategy to be managed;
- Reviews and challenges the stress and scenario testing programme (including reverse stress tests) developed to support the ORSA; and
- Challenges the business plan and the associated ORSA report.

B.3.5 Capital buffer

In addition to managing the profile of its assets to meet the Company's objectives to ensure it can meet its obligations to policyholders and providers of capital in a timely manner, the Board determines its own view of the amount of capital it believes the business needs to hold.

The Board's assessment of the capital buffer held over the regulatory capital requirement serves to:

- provide an extra layer of security to policyholder benefits;
- provide an extra layer of security to debt investors;
- safeguard the franchise value for equity investors;
- act as a buffer against quantitative risks and absorb short-term balance sheet volatility, such as from credit spreads, interest inflation or exchange rate movements;
- act as a buffer against qualitative risks that do not readily lend themselves to statistical quantification but for which capital is an appropriate risk mitigant; and
- ensure financial flexibility by maintaining strong liquidity and access to a range of capital markets.

This assessment is based on an economic view of the business requirements, with the final assessment including consideration of other constraints such as regulatory requirements, external analyst perceptions, competitor positioning and pricing. Presently, this amount of capital is expressed as a buffer over the regulatory capital requirement which serves to define the overall capital needs. The Board reviews the capital buffer on an annual basis as a part of the review of the Risk Appetite.

The ranking and categorisation of risks for internal economic capital assessment and regulatory reporting through the use of an Internal Model is undertaken in a consistent manner.

B.4 Internal control system

The Board takes responsibility for the implementation of a comprehensive framework of controls across the Company supported by a continuous monitoring process to ensure that key policy objectives are met. Each committee reviews and oversees processes and procedures established by management to provide an appropriate control environment that supports the key processes for which the committee is responsible for oversight.

These processes and procedures encapsulate specific principles of the Internal Control Framework which are exercised in the operation of the Company's day-to-day activities, in particular in the following areas:

- Staff recruitment, appraisal and training;
- Segregation of duties: The authorisation, custody, execution and record keeping for transactions is segregated between personnel;
- Authorisation of transactions;
- Retention of records;
- Physical safeguards;
- Performance reviews;
- Information Security;
- Safeguarding and maintenance of data;
- Fraud detection;
- Reporting; and
- Re-performance.

PIC's internal control framework is designed to provide reasonable assurance that the Company's activities are focused on ensuring the Company's objectives are achieved in an effective and efficient manner and with due regard to managing Conduct Risk. The daily control activities include approvals, reconciliations, management reviews, appropriate measurements applicable to each business area, physical access controls, compliance with agreed limits, and compliance with operating principles/instructions and procedures. The control activities should be proportionate to the risks stemming from the controlled activities and processes. They consist of a number of control activities which are deemed appropriate to the business and examples of their application are shown on the next page.

Control activity	Examples of application
Existence: Only valid or authorised transactions are processed and appropriate assets and liabilities recorded.	Reconciliation of records for assets held by external custodian to statements provided by independent third party investment managers to ensure assets held in custody match the expected holdings.
Occurrence: Transactions are correctly processed and recorded in the period to which they relate on a timely basis.	Controls over outsourcing arrangements to ensure pensions are paid and recorded in the correct month. Premiums and liabilities recorded when the Company goes on risk for a specific scheme.
Completeness: All valid transactions are processed without omissions.	Checks to ensure all pensioners are paid each month. Outsourced pension administration function with agreed service standards. Monitored by management on a monthly basis and subject to regular review by Internal Audit. Records for assets maintained by outsourced custodian are checked to ensure completeness and accuracy.
Valuation: The value of each transaction and balance in the Company's accounts is calculated using an appropriate methodology and is computationally accurate.	Investment valuation policy agreed with External Auditors. Consistently applied by third party custodians and reviewed by management. The Head of the Actuarial Function and the External Auditors review liability model and assumptions as set out in the Valuation Basis Paper for appropriateness. Quotations for new business are priced appropriately and the effect on the Company's solvency and value are considered and approved before commitment.
Security: The Company's assets and data are held in a secure environment with adequate safeguards over misuse and misappropriation.	Fixed asset register maintained. Checks over physical existence performed. Reconciliation of investments in custody accounts at the custodian to third party confirmations from investment managers. An Information Security Committee ("ISC") has been established with a mandate to ensure the security of all information held within the Company and specifically data that relates to our policyholders. The ISC reports to the CEO and Audit Committee on all information security matters and is the ultimate owner of the Information Security Policy. Further details are contained within the Company's Data policy.
Rights and obligations: Assets and liabilities are properly recorded and valued. Assets represent the rights of the Company, and liabilities its obligations, as at a given date.	See above re custody of investments, fixed assets and calculation of insurance liabilities.
Presentation and disclosure: Components of financial statements (or other reporting) shall be properly classified (by type or account) and described appropriately.	Approval of financial statements, embedded value reports and PRA returns by External Auditors. Audit trail from financial statements to internal management reports.
Competence: Staff employed by the Company have the skills appropriate to their role and responsibilities and are supported by a suitable training programme to augment their skills as necessary.	Established staff job descriptions for all roles. Monitoring and support of staff to participate in Continuing Professional Development programmes. Annual performance reviews. Annual independent assessment of "fit and proper" person for all SIFs and critical finance functions as detailed in the Company's Fit and Proper Persons policy.
Regulation: The Company's affairs are conducted at all times in compliance with the rules of the regulatory bodies of which it is a member.	Established Compliance function supported by staff training and regular monitoring of key parameters by which compliance is measured (e.g. treating customers fairly, breach reporting).
Risk: The Company identifies and considers the operational and financial risks it runs in the course of managing its business and identifies and implements appropriate mitigating procedures.	The Board set a Risk Framework for the Company which includes Risk Appetite and tolerance limits. Board Risk, Risk Management and Operational Risk Committees meet on a regular basis. Meetings are minuted and action points followed up by Chief Risk Officer and Operational Risk Manager. Hedging of assets and liabilities to minimise risk of mismatch of liquidity and exposures to inflation and interest rate movements. Risk of pensioners living longer than assumed when pricing schemes is mitigated by the use of longevity reinsurance swap and quota share arrangements on appropriate tranches of liabilities.
Continuity: Business continuity plans are produced, maintained and regularly tested.	Latest disaster recovery test in February 2017, updated by quarterly departmental testing.

B. SYSTEM OF GOVERNANCE (UNAUDITED)

B.4.1 Compliance

The operation of the Company's internal control framework is supported by the Company's Compliance function. The Compliance function sits with the General Counsel of the Company, who reports to the CEO. The role of the Compliance function includes advisory services to the business to support it in discharging regulatory obligations and managing conduct risk, to run processes to manage personal conflicts of interests including personal dealing, gifts and entertainment and outside business activities. The function also coordinates and delivers compliance training to PIC staff, management and the Board and is responsible for tracking regulatory developments and their impact on PIC. Furthermore, the function carries out a number of monitoring reviews across the business each year, liaising with the Risk function, Internal Audit and the Head of the Actuarial Function to ensure each area is properly monitored, reporting findings to the Audit Committee. Compliance Monitoring programme forms part of the annual Integrated Assurance programme.

B.5 Internal Audit function

The Head of Internal Audit is responsible for providing internal audit services supported by co-sourced specialist expertise as required. The purpose of Internal Audit is to provide independent and objective assurance that the governance processes, management of risk and systems of internal control are adequate and effective to mitigate the most significant risks, both current and emerging, that threaten the achievement of the organisation's objectives, and in doing so help improve the control culture of the Company. In addition, Internal Audit helps the Board and Executive Management to protect the assets, reputation and sustainability of the organisation.

The scope of Internal Audit activities encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organisation's governance, risk management and internal control processes in relation to the organisation's defined goals and objectives. The scope includes:

- Independent assessment of risk and the design and operational effectiveness of controls implemented to mitigate the risks identified, including that the risk appetite has been established and reviewed through the active involvement of the Board and executive management. Internal Audit assesses whether risk appetite is embedded within the activities, limits and reporting of the organisation.
- An assessment of whether the information presented to the Board and executive management for strategic and operational decision making fairly represents the benefits, risks and assumptions associated with the strategy and corresponding business model.
- An assessment of the management of the organisation's capital and liquidity risks.
- An assessment of the adequacy and effectiveness of the Risk Management, Compliance and Finance functions.
- Effectiveness and efficiency of operations and employment of resources.
- Compliance with significant policies, plans, procedures, laws and regulations.
- Reliability and integrity of management and financial information processes, including the means to identify, measure, classify, and report such information.
- Safeguarding of assets.
- Assisting in the investigation of significant suspected fraudulent activities within the organisation and notifying management and the Audit Committee of the results.
- Key corporate events such as the introduction of new products and services, outsourcing decisions and acquisitions/divestments to determine whether key risks are being adequately addressed and reported.
- The risk and control culture of the organisation.
- An evaluation as to whether the design and control of products, services and supporting processes deliver appropriate customer outcomes.
- An evaluation of the design and operating effectiveness of the organisation's internal governance, policies and processes, and that they are in line with the objectives, risk appetite and values of the organisation.
- Making objective and appropriate recommendations to improve the organisation's control environment and assist the business achieve their strategies.
- Focusing on not just the design and operation of business processes operated by management but also on the outcomes produced by the operation of such business processes.
- Reporting significant matters arising to Audit Committee and the Board.
- Providing assurance that issues raised are addressed and resolved to mitigate the risks reported on a timely basis.

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

To provide for independence, Internal Audit reports functionally to the Chair of the Audit Committee and administratively to the Chief Executive Officer. Financial independence, essential to the effectiveness of internal auditing, is provided by the Audit Committee approving a budget to allow Internal Audit to meet the requirements of this policy.

Internal Audit is functionally independent and objective from the activities audited and the day-to-day internal control processes of the organisation, and shall be able to conduct an assignment on its own initiative, with free and unfettered access to people and information, in respect of any relevant department, establishment or function of the organisation, including the actions of outsourced activities.

Internal Audit is represented on, or has full access to, minutes and presentations to all of the major committees, so as to keep abreast of the Company's strategic direction, developments and risk/control breakdowns.

In addition to internal audit reports of activity and regular updates to committees and the Board, Internal Audit provides an annual written assessment of the adequacy and effectiveness of PIC's risk management, internal control and governance processes and systems.

Internal Audit co-ordinates activity with other assurance functions as part of an "Integrated Assurance Approach": this includes agreeing a co-ordinated assurance plan, aligning audit and assurance work where relevant and completing integrated assurance reporting of thematic issues to committees and the Board.

B.6 Actuarial function

The Company manages its actuarial function through a combination of internal and external resources. The role of Head of the Actuarial Function ("AFH") is currently outsourced to Mr Paul Whitlock, a senior qualified actuary employed by Willis Towers Watson. Mr Whitlock is supported by other Willis Towers Watson actuaries. The AFH reports to the Company's Chief Executive, and has direct access to the Board. The AFH attends the PIC Audit Committee and PIC Board Risk Committee.

The AFH has no day-to-day management responsibilities within the Company, including in relation to the production of technical provisions or direct involvement in decisions relating to underwriting or reinsurance. The work of the AFH in these areas is supported by the in-house actuarial teams employed by PSC on behalf of the Company and working in the areas of regular financial reporting, longevity risk management and reinsurance, asset/liability management and actuarial aspects of new business development. These teams are responsible for the development of the underlying models, methodologies and assumptions, and operation of these on a day-to-day basis to produce technical provisions, capital requirements, new business pricing and associated management information. The AFH maintains regular close oversight of these activities through scheduled monthly meetings with the in-house actuarial team under the Company's internal Chief Actuary, at which each month end's valuation results and profit/loss attribution are discussed along with the projected short-term financial position of the Company, and by receiving regular information from other areas of the business including the Risk Function and other assurance functions.

In this way, the AFH is able to discharge the Actuarial function's responsibilities under Article 48 of the Solvency II Directive and Article 272 of the Solvency II delegated acts relating to the co-ordination of the calculation of technical provisions, providing an opinion on underwriting policy and adequacy of reinsurance arrangements, and contributing to the effective implementation of the risk management systems.

B.7 Outsourcing

PIC has a number of outsource providers, noting always that it maintains responsibility for the services they provide. The material functions which are outsourced are administration of policies, investment management, custodian services, and certain IT related services.

When choosing a material outsource provider, PIC's policy requires it to ensure the following issues are considered and documented in the legal arrangements between it and its chosen outsourcer:

- Ability, capacity and authorisation
- Financial resources
- Staff
- Change management and future proofing
- Control framework
- Conflicts
- Rights and obligations
- Sub outsourcers
- Data protection
- Operational risks
- Authorisation
- Contingency plans
- Exit plans
- Cost

PIC also maintains sufficiently qualified staff to monitor the provision of these services and to carry out checks against the above areas and provide reports on their performance to the relevant Board Committee.

Depending on the function outsourced, the relevant Board Committee must approve the outsourcing or any material change to the outsourcing, of critical, important, or material functions or activities.

All proposals for outsourcing, or material changes to the outsourcing, of critical, important or material functions or activities are reviewed by the Board Risk Committee who will recommend approval or otherwise to the Board.

PIC's Compliance, Risk and Internal Audit functions also carry out reviews throughout the year both of the outsource providers and also of the internal department that monitors the providers.

The Group's service company, PSC, provides all staff and certain services to PIC under the terms of a services agreement. The provision of these services is overseen by the Board. PSC charges to PIC during 2017 totalled £76 million (2016: £63 million).

The following key functions and activities have been outsourced:

- Policyholder payroll and administration services to Mercer.
- Head of Actuarial Function to Willis Towers Watson.
- Tax compliance to PwC.
- Payroll and some HR services to CBHC.
- Custodian and investment accounting to JP Morgan.
- Custodian and Trade Management to Northern Trust.
- Asset management to Henderson Global Investors, JP Morgan and Schroders.
- IT support to Endava.

All of the outsourcers utilised are located within the European Union.

B.8 Any other information

Adequacy of systems of governance

The Board continues to believe that the systems of governance operated by the Group and Company remain appropriate given the nature, scale and complexity of the risks inherent in the business.

C. RISK PROFILE (UNAUDITED)

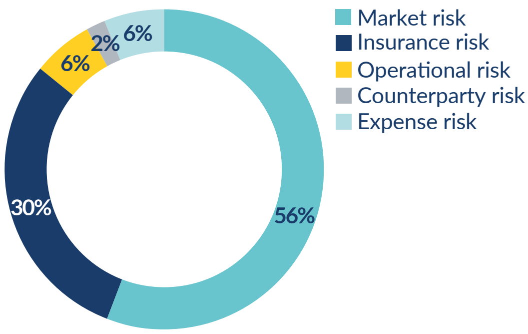
The Solvency Capital Requirement for both PICG and PIC was £2.082 billion as at 31 December 2017 (31 December 2016: £1.912 billion), as measured by the Group's Internal Model.

In order of relative size of contribution to the Solvency Capital Requirement, the most important risks to the Company are:

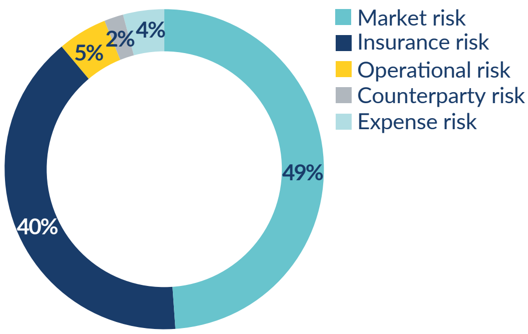
- Market risk (see C.2)
- Insurance risk (see C.1)
- Expense risk (see C.6)
- Operational risk (see C.5)
- Counterparty default risk (see C.3)

This can be expressed graphically, as shown below.

2017



2016



The various components of the Risk profile are discussed in further detail below.

C.1 Underwriting risk

Underwriting risk, classified internally as insurance risk, is the risk that mortality experience of the Company's policyholders is lighter than assumed, thus requiring pensions to be paid for a longer period than anticipated, resulting in a higher than expected cost to the Company.

In order to help minimise this risk and also uncertainty arising through future longevity experience, PIC adopts an active approach to reinsuring these risks where it is economic to do so. This reinsurance can be classified into two broad categories:

Longevity only reinsurance

This provides longevity cover in respect of certain policyholders. Under these contracts, the Company has committed to pay the reinsurer a fixed line of cash flows for specified sets of liabilities relating to members/former members of particular pension schemes. The reinsurer undertakes to reimburse the actual cost of claims to the Company. Separately, there is also an insurance fee for which the Company is liable. Settlement of the contract is on a net basis. These contracts also transfer the contingent longevity risk relating to any eligible dependants of relevant policyholders.

Longevity reinsurance via the transfer of assets

Under such contracts, in return for a premium, the reinsurer agrees to reimburse the actual cost of future claims to the Company in respect of an agreed set of policyholders. These contracts also transfer the contingent risks relating to eligible dependants of relevant policyholders.

The Company monitors the levels of its counterparty risk and actively seeks to reinsure with a range of providers to help mitigate its exposure to any one such entity.

One aspect of deriving overall best estimate longevity assumptions is to establish the "current" or "initial" rates of mortality. These assumptions are set by applying appropriate mortality factors to each individual member/policyholder. Individual variations are subject to a number of factors including, but not limited to, an individual's gender, age, pension amount, occupation and place of residence.

The other aspect is the allowance for future improvements in mortality. The pattern in which mortality is expected to improve over time is an important but complex assumption for cash flow and liability calculations. This is regularly reviewed in the light of a number of factors, including evolving methodologies for these projections together with views from industry and professional bodies on the factors driving mortality change.

Whilst longevity risk is the fundamental risk relating to its insurance liability portfolio, the Company also considers the following risks:

Risk arising from a specific insurance contract

The Company considers, as part of its risk management process, the risk attached to each new contract accepted and the mitigation of such risk.

Exposure to changes in financial market conditions

The Company prepares information based upon a range of possible market conditions. The results of this exercise are then considered with regard to the effect on the current insurance liability portfolio.

C.2 Market risk

The Company is exposed to market risk as a consequence of fluctuations in values or returns on assets and liabilities which are influenced by one or more external factors. These include changes and volatility in interest rates, credit spreads, inflation expectations and currency exchange rates.

The Company manages market risk through an asset liability management ("ALM") framework that has been developed to closely match the investment portfolio duration and income to its obligations under insurance contracts.

Within the context of the ALM framework, the Company uses derivative financial instruments to reduce market risk. Interest rate and inflation swaps are entered into to improve the matching of asset and liability cash flows, and ensure that risk driver sensitivities are aligned across the maturity spectrum. The quality of the interest rate and inflation matching strategies is carefully monitored by management, and is operated within tightly defined limits. Currency forwards and swaps are entered into to eliminate the majority of the currency risk on financial assets invested in non-sterling based debt securities where liabilities are denominated in sterling.

The Company is also exposed to risks of movements in the property market through its investment in the GPUTs. The short-term market risk is mitigated by the fact that all eight of its properties are occupied on leases extending to 1 April 2033. The Company performs regular reviews of both the movement in the property market specific to these properties and the financial status of the tenants.

Further asset exposures include investments in hedge funds, insurance linked funds and public finance initiative related debt, including social housing. Where appropriate, the management of these alternative exposures is delegated to specialist fund managers, in line with defined investment management mandates. In all cases the Company ensures regular oversight of the investment management activities, and maintains detailed risk models for all investment types, incorporating analysis of alternative investments in its risk and capital assessment.

C.3 Credit risk

Credit risk is the risk of loss due to the default of another party in performing its financial obligations to the Company. The Company is primarily exposed to credit risk through its investment in debt securities and cash deposits.

Credit risk also arises in respect of derivative contracts to the extent that there is the potential for the counterparties to default on their obligations.

The Company manages exposure to credit risk by placing limits on exposures to individual counterparties as well as groups of counterparties. Counterparty risk on derivatives is controlled through establishment of collateral agreements and master netting agreements on interest rate and currency swaps. To further minimise credit risk, the financial condition of counterparties is monitored on a regular basis

C.4 Liquidity risk

Liquidity risk is the risk that the Company may not have liquid assets available at the right times to be able to pay its liabilities, despite the fact that it meets its regulatory solvency requirements. This would typically arise if derivative contracts to manage inflation and interest rates required collateral to be posted, a large proportion of deferred policyholders opted to take transfer values, or if a large proportion of assets were invested in assets which are not easy or straightforward to liquidate.

In order to manage this, projected cash flows for all new policy liabilities taken on are determined as a part of the new business origination process to identify the expected profile of liability payments, including expected mortality experience. This is then used to identify appropriate assets, which provide matching cash flows at an acceptable price.

The Company's risk policies define a minimum proportion of its assets to be held in highly liquid cash and gilts, and stress testing is conducted to ensure that there are sufficient liquid assets at all times to meet potential demands from derivative movements under extreme scenarios.

The projected cash flows are updated regularly, and assumptions are updated at least annually, taking into account factors such as mortality experience and how this affects the required cash flows in the future.

C.5 Operational risk

Operational risk is the potential for loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Company's internal control processes are supported by an operational risk committee, the maintenance of a central risk register and an independent internal audit review. The risk of internal fraud is managed through a number of processes including the screening of staff at recruitment, a continuous training programme, segregation of duties and whistleblowing policies.

The Company has significant outsourcing arrangements in respect of pension administration and other functions. These arrangements are subject to agreements with formal service levels, operate within agreed authority limits and are subject to regular review by senior management.

Emergency and business continuity plans have also been established to counter adverse occurrences.

C.6 Other material risks

The only other risk category within the Internal Model not mentioned above is Expense risk. This is the risk that the Company's expenses are higher than expected. This includes investment management expenses and policy maintenance expenses. Expenses are managed through a strict internal budgeting and monitoring process and through careful oversight of external investment managers and other outsourced service providers.

C.7 Any other information

The risk exposures highlighted above are the same in nature to those the Group was exposed to in the previous year. No material new risk exposures have been introduced during 2017.

D. VALUATION FOR SOLVENCY PURPOSES

D.1 Assets

D.1.1 Assets: PIC

The value of each material class of assets of the Company for solvency purposes at the reporting date is as follows. The valuation basis used is the same for the solvency valuation as for the statutory accounts valuation, except for the Reinsurance recoverables, which are valued as described in D.2.6.

2017	Solvency II value £m	Statutory accounts value £m	Valuation basis	Explanation of valuation difference
Property	99	99	Marked to market	
Bonds	23,247	23,198	Marked to market	
Investment funds	1,194	1,194	Marked to market/model	
Derivative assets	8,774	8,774	Marked to market/model	
Total Investments	**33,314**	**33,265**		
Loans and Mortgages	1,227	1,207	Marked to market	
Reinsurance recoverables	1,629	2,451	Marked to model	Solvency II regulations
Other assets	42	42	Marked to market	
Receivables	131	125	Marked to market	
Cash and cash equivalents	297	297	Marked to market	
	36,640	**37,387**		

2016	Solvency II value £m	Statutory accounts value £m	Valuation basis	Explanation of valuation difference
Property	97	97	Marked to market	
Bonds	20,662	20,662	Marked to market	
Investment funds	1,297	1,297	Marked to market/model	
Derivative assets	10,733	9,320	Marked to market/model	Presentation of cross-currency derivatives are amended to a net basis in 2017. In 2016, cross currency derivatives represented as net values under IFRS are included gross under Solvency II
Total Investments	**32,789**	**31,376**		
Loans and Mortgages	554	554	Marked to market	
Reinsurance recoverables	1,590	2,523	Marked to market	Solvency II regulations
Other assets	48	48	Marked to market	
Receivables	40	40	Marked to market	
Cash and cash equivalents	248	248	Marked to market	
	35,269	**34,789**		

D.1.2 Assets: PICG

The value of each material class of assets of the Group for solvency purposes at the reporting date is as follows. The valuation basis used is the same for the solvency valuation as for the statutory accounts valuation, except for the Reinsurance recoverables, which are valued as described in D.2.6.

2017	Solvency II value £m	Statutory accounts value £m	Valuation basis	Explanation of valuation difference
Property	99	99	Marked to market	
Bonds	23,247	23,198	Marked to market	
Investment funds	1,194	1,194	Marked to market/model	
Derivative assets	8,775	8,775	Marked to market/model	
Total Investments	**33,315**	**33,266**		
Loans and Mortgages	1,227	1,207	Marked to market	
Reinsurance recoverables	1,629	2,450	Marked to model	Solvency II regulations
Other assets	43	43	Marked to market	
Deferred tax asset	3	3		
Receivables	134	129	Marked to model	
Cash and cash equivalents	308	308	Marked to market	
Own shares held directly	12	–	Marked to model	Solvency II regulations
	36,671	**37,406**		

2016	Solvency II value £m	Statutory accounts value £m	Valuation basis	Explanation of valuation difference
Property	97	97	Marked to market	
Bonds	20,662	20,662	Marked to market	
Investment funds	1,297	1,297	Marked to market/model	
Derivative assets	10,733	9,320	Marked to market/model	Presentation of cross-currency derivatives are amended to a net basis in 2017. In 2016, cross currency derivatives represented as net values under IFRS are included gross under Solvency II
Total Investments	**32,789**	**31,376**		
Loans and Mortgages	554	554	Marked to market	
Reinsurance recoverables	1,590	2,523	Marked to model	Solvency II regulations
Other assets	49	49	Marked to market	
Receivables	43	43	Marked to market	
Cash and cash equivalents	276	276	Marked to market	
Own shares held directly	1	–	Marked to model	Solvency II regulations
	35,302	**34,821**		

D.1.3 Asset recognition and derecognition (PIC and PICG)

The basis for recognition and derecognition of financial instruments is as follows:

A financial instrument is recognised if the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Company's contractual rights to the cash flows from the financial assets expire, or if either the Company transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset are transferred to another party. Regular purchases and sales of financial assets are accounted for at the date of trading. Financial liabilities are derecognised when the Company's obligations specified in the contract expire or are discharged or cancelled.

D.1.4 Asset valuation basis

The general valuation basis applied to each material class of investments is as follows:

The fair values of investments quoted in an active market are based on their bid market prices. For unlisted securities and all other financial assets for which there is no active market, the Company establishes fair value using appropriate valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, counterparty and broker valuations and option pricing models.

These assessments are based largely on observable market data.

Where an active market does not exist for a financial instrument, the Company uses financial modelling to ascertain fair value. The models consider the anticipated future cash flows expected to be derived from the assets, and discount them to reflect the timing of payments and, for debt assets, the likelihood of default given the relative seniority of the holding in order of repayment.

Property (other than for own use)

Investments in freehold properties not for occupation by the Company are carried at fair value, which is calculated using discounted cash flow techniques on a mark to model basis. Refer to D.4 for more details.

Government and corporate bonds

The Group's and the Company's investments in government and corporate bonds are valued for Solvency II purposes on the same basis as the annual financial statements, which follow IFRS. The fair value of government bonds and the majority of corporate bonds is determined by reference to their quoted bid price at the reporting date.

Fair values of unlisted corporate bonds, such as bilateral investments, are determined as the present value of future cash flows, discounted at the market rate of interest at the reporting date. The details of the valuation method are provided in D.4.

The difference in valuation between IFRS and Solvency II relates to the allocation of accrued interest, which for the purposes of Solvency II has been included in the value of the bonds.

Assets valued on this basis are included in the tables above as "Bonds".

Collateralised securities

This asset class contains mortgage backed securities, other asset backed securities, and other collateralised securities.

The fair value of mortgage backed and other asset backed securities is determined by reference to their listed market price.

The fair value of the unlisted collateralised securities is determined using alternative valuation methods as described in D.4.

Assets valued on this basis are included in the tables above within the "Investment funds" or "Loans and mortgages" headings.

Collective investment undertakings

The fair value of collective investment undertakings is determined by reference to their quoted bid price at the reporting date where available.

Fair values of unlisted collective investments are calculated using alternative valuation methods as described in D.4.

Assets valued on this basis are included in the tables above within the "Investment Funds" or "Loans and Mortgages" headings.

Derivatives

Derivative financial instruments are measured at fair value.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. The fair value of foreign exchange forward contracts, futures and swaps is based on market prices, where available. For swaps, market prices are calculated using discounted cash flow techniques based on adjusted market data such as composite curves derived from a number of market counterparties. The difference in value above is offset by an equal and opposite difference in value on derivative liabilities (see section D.3), reflecting the different classifications used under the two bases. During the year, the presentation of cross-currency derivative assets has been changed to a net presentation to align with the IFRS presentation.

Deposits other than cash equivalents, and cash and cash equivalents

The fair value of deposits held with credit institutions represents their cash value in current terms. All deposits are redeemable within three months and consequently no discounting adjustment is made at period end.

Reinsurance recoverables

As this asset is directly related to the regulatory technical provisions, the valuation is discussed in the technical provisions section D.2.

Receivables

These assets are held at the values for which they could be exchanged between knowledgeable willing parties in an arm's length transaction, which is equivalent to the value for IFRS accounting purposes.

Own shares directly held

These assets are treated as a deduction from equity in the IFRS financial statements of PICG. For regulatory purposes, they are held as an asset and are marked to model in accordance with Solvency II regulations, using an estimate of the valuation of PICG as a whole. The amounts involved are considered not to be material.

Other assets

There are no other material tangible assets.

D.2 Technical provisions

PIC writes only one line of business, i.e. bulk annuities in relation to UK defined benefit pension schemes. All of the Company's insurance liabilities represent contracts that provide immediate annuities for current pensioners and deferred annuities for members who have not yet reached pensionable age. Annuities are payable for the life of the policyholder, with in some cases a reversionary annuity paid to spouses or other dependants on the death of the main member.

Annuities in deferment and in payment can be level, subject to fixed increases or increases linked to inflation, or a mixture of the three. In many cases, the increases applied are also subject to defined caps and floors, so-called limited price indexation or LPI.

The insurance liabilities also include a limited number of member options, such as the option to commute part of the pension for a tax-free cash lump sum on vesting, the option to transfer deferred benefits to another pension scheme and the option to take early or late retirement. In these cases, the bulk of the options are set on a basis which is broadly financially neutral to the Company. There are no other material options and guarantees such as guaranteed annuity options.

The Company's insurance contracts are a mixture of "buy-in" policies, where the policyholder is the pension scheme and the insured liabilities cover defined benefits within the scheme, and "buyout" policies, where the policyholder is an individual.

D.2.1 Technical provisions on regulatory solvency basis

The following table summarises the technical provisions of PIC as at 31 December 2017 on the regulatory solvency basis. The equivalent figures for 31 December 2016 are also shown.

Technical provisions, Solvency II basis £m	2017	2016
Best estimate liabilities ("BEL")		
• Liabilities gross of reinsurance	**22,505**	18,911
• Value of reinsurance recoverables	**(1,629)**	(1,590)
• Net-of-reinsurance liabilities	**20,876**	17,321
Risk margin ("RM")	**1,570**	2,176
Transitional measures deduction ("TMTP")	**(746)**	(1,270)
Total net technical provisions	**21,700**	18,227

Technical provisions represent the value of policyholder obligations if these were to be transferred to a third party in an arm's length transaction at the valuation date. The technical provisions comprise a best estimate liability (determined using a Matching Adjustment or Volatility Adjustment) and a risk margin, reduced by the transitional measures deduction.

The total technical provisions, gross of reinsurance, as at 31 December 2017 were £23,329 million, (2016: £19,817 million).

There are no additional technical provisions maintained by the Group outside PIC.

D.2.2 Valuation methods and assumptions for the solvency valuation

The principal methods and assumptions used in the valuation of the technical provisions for solvency purposes are as follows:

Valuation methodology for BEL:

For the vast majority of the business, the best estimate liability is calculated as the present value of future annuity and other benefit payments plus an allowance for future expenses. This calculation involves projecting each individual policy for its expected natural lifetime and discounting the resultant cash flows to the valuation date at the valuation discount rate, using methodology which confirms to the requirements of Section 3, subsection 1 (and in particular Articles 22 – 26) of Chapter III of the Solvency II Delegated Acts.

For a very small proportion of the best estimate liabilities, approximate methods are used which are appropriate to the nature of the liabilities in question.

Valuation discount rate:

The discount rate used is derived from the basic risk-free rate, which is taken as the swaps rate less the prescribed credit risk adjustment. For all of the business in force, this is increased by use of either a matching adjustment or a volatility adjustment as described below.

Mortality and demographic assumptions:

The base mortality assumptions as at 31 December 2017 inherent in the projected cash flows used in the valuation of insurance contract liabilities are set with reference to the S2 series of mortality tables published by the Continuous Mortality Investigation ("CMI", a research body with strong links to the Institute and Faculty of Actuaries in the UK).

The assumption for future improvements to mortality is modelled using the CMI 2016 table. The long-term improvement rate is assumed to taper from 2.6% p.a. at age 60 to zero at age 120 for both men and women.

Adjustments are applied according to a number of factors including, but not limited to, an individual's gender, age, pension amount, occupation and place of residence. In addition, an adjustment is made to allow for the risk of anti-selection.

Assumptions are also made in respect of the take-up rates on policyholder options, such as the option to take a pension contribution lump sum payment on vesting and certain early retirement options. For policyholder options where the observed take-up rates are very low and the financial impact is broadly neutral, no assumptions are applied in the actuarial valuation.

In addition other, less material assumptions are required for items such as the age difference between main members and spouses and proportions married, in cases where the relevant information is not available from the valuation data.

Inflation assumptions:

Assumptions for expected future Retail Price Index ("RPI") inflation are based on a curve derived from market prices of inflation-linked swap contracts. Assumptions for expected Consumer Price Index ("CPI") inflation are based on the RPI curve less a flat deduction. The projected liabilities for annuities linked to RPI or CPI use these curves.

The most common type of LPI – linked benefit is LPI(0,5), under which increases are capped at 5.0% and floored at zero, but a range of other types of LPI exist. These are not regarded as "options" in the sense that neither the policyholder nor the Company can elect to change the benefit, but are simply a special form of indexation. However, an option-based methodology is required to allow for the reserving and capital impacts of the caps and floors. PIC uses a mark-to-model approach to derive appropriate inflation curves for each LPI type to allow for the inherent optionality, as there is currently no deep and liquid market in appropriate swap contracts.

Expense assumptions:

The internal costs of maintaining the existing insurance contracts, the fees payable to third-party administrators engaged to manage payments due under the in-force policies, fees due to reinsurers, investment management expenses and certain specific project costs are factored into the calculation of liabilities by adding appropriate allowances, and include an estimate of the impact of future inflation where this is applicable. No allowances are included for expenses incurred by the Company in relation to the generation of new business.

Risk margins (unaudited):

The risk margin is determined as the amount that would be required in addition to best estimate liabilities by a hypothetical third party (the "reference undertaking") taking on the Company's insurance obligations, to provide an amount of eligible Own Funds equal to the capital necessary to support those obligations over their future lifetime and assuming that all hedgeable risks had been eliminated.

The risk margin is calculated by estimating the solvency capital requirement of the reference undertaking in each future year over the period in which the in-force business runs off. A cost-of-capital calculation is then performed using a prescribed rate of 6.0% per annum on each future year's estimated reference SCR, with the results discounted at the basic risk free rate.

The principal drivers underlying the estimate of reference undertaking's SCR are longevity risk, counterparty credit risk (with respect to reinsurance contracts and other material exposures), expense risk and residual economic risk relating to inflation volatility, in particular LPI and the basis between RPI and CPI and operational risk. Longevity risk is assessed by considering separately the risk of mis-estimation of base mortality rates, future mortality improvement rates and other, less material influences on future demographic experience, and allowing for the mitigation afforded by existing reinsurance arrangements.

The projection of the reference SCR over the lifetime of the business is carried out by approximate means allowing for the expected changes in the size and relative impacts of the respective risk drivers as the in-force business continues to mature.

Transitional measures deduction on technical provisions (unaudited)

PIC applies a transitional measures deduction in respect of technical provisions ("TMTP"). The deduction, which is consistent with the requirements of Article 308d of the Solvency II directive, is expected to amortise linearly to zero over a 16-year period starting from 1 January 2016.

Uncertainty in the valuation of technical provisions

The best estimate liabilities are calculated using data and assumptions which reflect the Company's best estimate of the position as at the valuation date. However, there are a number of uncertainties in the valuation. In particular:

- A key assumption is the rate of future policyholder mortality, which is expressed as a combination of a base mortality rate (reflecting the current observed experience) and a rate of future mortality improvements. Changes in these assumptions could have a material impact on the BEL calculation.
- For deferred annuity policyholders, assumptions have to be made about the extent to which certain options will be taken up prior to retirement. The most important option is the commutation of part of the pension benefit for a lump sum. While this take-up has been reasonably stable in the past, there remains uncertainty as to whether future take-up rates will be as expected.
- The discount rate used in the valuation is determined allowing implicitly for an assumed level of future defaults arising in relation to the supporting assets. The allowance, which is stipulated by EIOPA, may not be a good representation of the actual level of defaults arising in practice, and variations in experience (positive or negative) will arise as a result.
- A significant proportion of the annuity benefits escalate in line with defined inflation indices. A range of indices applies, including CPI and LPI linkages, and assumptions have to be made as to how these indices will relate to the standard Retail Prices Index going forward.
- The expenses allowed for in the valuation are based on the Company's view of its likely expense outgo required to manage the business in force. Variations in these expense levels and in the impact of inflation of these expense levels also introduce uncertainty.

In addition, projection of the run-off over time of the reference SCR used in the risk margin calculation requires a significant degree of judgement, given the length and nature of PIC's annuity liability cash flows.

D.2.3 Use of matching adjustment

In December 2015, PIC was granted permission by the PRA to apply a matching adjustment in relation to the value of its insurance liabilities. As at 31 December 2017, all of the business in force was eligible for use with the matching adjustment, and 99% of the business was held within the matching adjustment fund and valued using the matching adjustment. A small percentage of the liabilities, amounting to 1% of the total net liabilities, was held outside the matching adjustment fund and valued using the volatility adjustment.

The assets used comprise a mixture of UK government bonds and UK and overseas corporate bonds, together with a relatively small amount of cash and cash equivalents, loans and mortgages and property assets. In addition, the assets include derivatives designed to transform overseas cash flows to sterling, and to transform floating rate cash flows to fixed rates. All of the assets, once transformed through the use of appropriate derivatives, meet the requirements of Article 77b(1) of the Solvency II Delegated Acts.

PIC holds all assets and liabilities for which the matching adjustment applies in a clearly ring-fenced fund, the MA Fund. The matching adjustment calculation relies on close matching of the asset cash flows and the liability cash flows in this fund. In making this assessment, the liability cash flows are the net-of-reinsurance best estimate liability cash flows for the business taken from the Company's liability projection model, and the asset cash flows are the aggregate of the cash flows on each individual asset adjusted for the default component of the "fundamental spread" to allow for the credit risks retained by the Company.

The initial matching adjustment is then calculated as a difference between two annual effective internal rates of return, i.e. (a) the flat discount rate which, if applied to the liability cash flows, would equate these to the market value of the matching assets; and (b) the flat rate which, if applied to the liability cash flows, would equate these to the value of those liability cash flows calculated using the basic risk-free rate curve.

The matching adjustment is then further adjusted for the cost-of-downgrade component of the fundamental spread.

The assets in the MA Fund used in the matching adjustment calculation can be summarised as follows:

MA Fund assets £m	**2017**	2016
Property	**82**	84
Government bonds	**8,470**	6,950
Corporate bonds	**13,038**	12,378
Derivative assets	**3,152**	1,664
Loans and mortgages	**1,158**	518
Collateralised securities	**87**	–
Cash and cash equivalents	**208**	175
Total assets	**26,195**	21,769
Less derivative liabilities	**(5,462)**	(4,439)
Net value of assets	**20,733**	17,330

PIC maintains close control of the asset and liability cash flow matching in order to ensure that at all times it can meet the requirements of Article 77(b)(i)(c) of the Solvency II Delegated Acts. In addition, PIC monitors the asset and liability matching of the MA Fund against the three specific tests required by its local regulator, the PRA. As at 31 December 2017, all of the PRA test results were within the required limits.

The impact of not applying the matching adjustment but instead valuing the liabilities using the basic risk-free curve would have been as follows. Note that under this scenario the VA is assumed to continue to apply to those liabilities to which it is currently applied, and it is assumed that there is no change to the TMTP.

2017 Impact of matching adjustment £m	Including matching adjustment	Excluding matching adjustment	Impact of not applying MA
Technical provisions	**23,329**	**27,175**	**3,846**
Basic Own Funds	**3,328**	**491**	**(2,837)**
Eligible Own Funds to meet SCR	**3,328**	**491**	**(2,837)**
SCR	**2,082**	**5,251**	**3,169**
Excess assets over SCR	**1,246**	**(4,760)**	**(6,006)**
Eligible Own Funds to meet MCR	**2,843**	**(267)**	**(3,110)**
MCR	**521**	**1,313**	**792**
Excess assets	**2,322**	**(1,580)**	**(3,902)**

2016 Impact of matching adjustment £m	Including matching adjustment	Excluding matching adjustment	Impact of not applying MA
Eligible Own Funds to meet SCR	3,134	(38)	(3,172)
SCR	1,912	4,665	2,753
Excess assets over SCR	1,222	(4,703)	(5,925)
Eligible Own Funds to meet MCR	2,636	(1,047)	(3,683)
MCR	478	1,166	688
Excess assets over MCR	2,158	(2,213)	(4,371)

D.2.4 Use of volatility adjustment

In December 2015, PIC was granted permission by the PRA to apply a volatility adjustment in relation to the value of its insurance liabilities.

As at 31 December 2017, all of the business in force was eligible for use with the matching adjustment, but a small percentage of the liabilities, amounting to 1% of the total net liabilities, was held outside the matching adjustment fund and valued using the volatility adjustment. The impact of not applying the volatility adjustment to these liabilities but instead valuing them using the basic risk-free curve would have been as follows. Note that under this scenario the MA is assumed to continue to apply to those liabilities to which it is currently applied, and it is assumed that there is no change to the TMTP.

Impact of volatility adjustment £m	Including volatility adjustment	Excluding volatility adjustment	Impact of not applying VA
Technical provisions	**23,329**	**23,336**	**7**
Basic Own Funds	**3,328**	**3,322**	**(6)**
Eligible Own Funds to meet SCR	**3,328**	**3,322**	**(6)**
SCR	**2,082**	**2,083**	**1**
Excess assets over SCR	**1,246**	**1,239**	**(7)**
Eligible Own Funds to meet MCR	**2,843**	**2,837**	**(6)**
MCR	**521**	**521**	**0**
Excess assets over MCR	**2,322**	**2,316**	**(6)**

At 31 December 2016, all the business in force was eligible for use with the matching adjustment. An immaterial amount of liabilities was held outside the matching adjustment fund and valued using the volatility adjustment.

D.2.5 Use of transitional measures adjustment

PIC does not apply any adjustment to the risk-free interest rate term structure referred to in Article 308c of Directive 2009/138/EC.

In December 2015, PIC was granted permission to apply a transitional measures deduction to technical provisions ("TMTP") in accordance with Article 308d of Directive 2009/138/EC.

PIC calculated the TMTP as at 31 December 2015 as £1,355 million. This amount, which is gross of any deferred tax impacts, has since been amortised on a 16-year basis. In addition, PIC was granted permission to recalculate the TMTP as at 31 December 2017. Allowing for both amortisation and re-calculation, the TMTP as at 31 December 2017 is £746 million.

The impact of not applying the TMTP would have been as follows. Under this scenario, the MA and VA are assumed to continue to apply.

2017 Impact of TMTP £m	Including TMTP	Excluding TMTP	Impact of excluding TMTP
Technical provisions	**23,329**	**24,074**	**746**
Basic Own Funds	**3,328**	**2,709**	**(619)**
Eligible Own Funds available to meet SCR	**3,328**	**2,709**	**(619)**
SCR	**2,082**	**2,209**	**127**
Excess assets	**1,246**	**(500)**	**(746)**
Eligible Own Funds to meet MCR	**2,843**	**2,230**	**(613)**
MCR	**521**	**552**	**31**
Excess assets	**2,322**	**1,678**	**(644)**
Solvency ratio based on MCR	**546%**	**404%**	

2016 Impact of TMTP £m	Including TMTP	Excluding TMTP	Impact of excluding TMTP
Solvency II Own Funds available to meet SCR	3,134	2,080	(1,054)
SCR	1,912	2,087	175
Excess assets	1,222	(7)	(1,229)
Solvency II Own Funds available to meet MCR	2,636	1,549	(1,087)
MCR	478	522	44
Excess assets	2,158	1,027	(1,131)
Solvency ratio based on MCR	551%	297%	

D.2.6 Reinsurance

PIC seeks to limit its exposure to longevity risk by entering into reinsurance arrangements with third party reinsurers. As at 31 December 2017, approximately 73% (as measured by best estimate liabilities) of the longevity risk was reinsured (2016: 68%).

PIC has entered into two types of reinsurance arrangements:

- Longevity swap arrangements, whereby PIC pays to the reinsurer a fixed, agreed stream of annuity benefit cash flows, together with a defined reinsurance fee, and the reinsurer pays PIC annuity benefits based on the actual mortality experience of the lives in question. All of the longevity swap arrangements are similar in nature. PIC has entered into these arrangements with nine reinsurers. The total net value of the longevity swap asset, excluding the fees payable to the reinsurers, was £77 million as at 31 December 2017 (2016: £100 million).

- Quota share reinsurance arrangements, whereby in return for an upfront single premium PIC will receive from the reinsurer a percentage share of a defined sub-set of the annuity liabilities paid out in future. PIC has entered into these arrangements with two reinsurers. The total value of the quota share reinsurance asset was £1,553 million as at 31 December 2017 (2016: £1,524 million).

The value of the amounts recoverable from reinsurance is calculated using the same projection model and assumptions as are used for the gross best estimate liabilities, by projecting forward both the payments due to reinsurers and the payments expected from reinsurers, in each case calculated on a policy-by-policy basis.

The value of the reinsurance recoverables is reduced by a counterparty default adjustment of £15 million (2016: £42 million), which is calculated by applying (for each reinsurer) an assumed probability of default to an estimated loss given default, allowing for an assumed rate of recovery, measured over the lifetime of the reinsurance contracts in question.

In addition, there is a recoverable amount of £14 million (2016: £7 million) in respect of a small tranche of annuities where PIC has undertaken inwards reinsurance.

Therefore, the total value of the reinsurance recoverables asset is £1,629 million (2016: £1,590 million).

PIC does not have any arrangements with special purpose vehicles in respect of its gross or net liabilities.

D.2.7 Review of valuation methods and assumptions

PIC reviews its technical provisions valuation assumptions and methodology regularly to ensure that they are fit for purpose and meet the requirements of Section 3.1 of Chapter III of the Solvency II Delegated Acts.

For the purposes of the valuation as at 31 December 2017, a number of changes were made to the assumptions used in order to reflect emerging experience better. The most material of these changes were in respect of future mortality improvements, maintenance expenses and third party administration expenses, and expense inflation. In aggregate, the assumption changes applied increased Own Funds by £32 million.

In addition, the valuation assumptions were updated to reflect current expectations of future interest rates and inflation rates, and to reflect the changes to the prescribed fundamental spread assumptions underlying the derivation of the matching adjustment.

D.2.8 Valuation methods and assumptions for the financial statements

Apart from the valuation discount rate, the methods and assumptions used to value the technical provisions for the purposes of the financial statements are derived from the same best-estimate assumptions as are used in the valuation for solvency purposes. To these assumptions, prudential margins are added; these margins are consistent with those previously used under the regulatory regime which preceded the introduction of Solvency II. PIC's practice at the time was to use the same margins in the calculation of its technical provisions for the purposes of the financial statements as in statutory reporting. PIC is satisfied that the basis used continues to meet the relevant requirements of IFRS and that the margins used remain appropriate, based upon the current business mix and environment.

As the impact of applying these prudential margins is to change the cash flow profile of the liabilities, it is not possible simply to use the same matching asset profile as is used for the best estimate liabilities. Instead, PIC notionally hypothecates a basket of assets for backing the liabilities and calculates the valuation rate of interest using a "portfolio IRR" approach which considers the yield for the whole basket. Using this approach, PIC is able to take into account both the level of the risk-adjusted yields on the assets and the terms over which the returns would be received.

The projected asset cash flows are also adjusted to allow for credit risk to take account of the specific rules on risk adjustments to asset yields and reinvestment rates that applied under the regulatory regime which preceded the introduction of Solvency II, with one revision. The revision was that the 2.5% margin, that was previously included in the valuation discount rate, was removed in 2017. Using this methodology, the valuation rate of interest derived for the valuation for the financial statements was LIBOR swaps plus 69 bps, equivalent to a flat rate of 2.06% p.a. (2016: 2.11%).

The impact of applying the prudential margins is summarised in the following table, which shows the transition from the Own Funds under Solvency II to the IFRS net assets presented in the Company's financial statements. The equivalent figures as at 31 December 2016 are shown for comparison.

Reconciliation between Solvency II and IFRS technical provisions balance sheets

£m	**2017**	2016
Solvency II technical provisions (gross or reinsurance)	**23,329**	19,817
Less:		
• Value of reinsurance recoverables on SII basis	**(1,629)**	(1,590)
Solvency II technical provisions (net of reinsurance)	**21,700**	18,227
Less:		
• Risk margin	**(1,570)**	(2,176)
• Transitional measures deduction	**746**	1,270
Solvency II best estimate liability (net of reinsurance)	**20,876**	17,321
Add:		
• Impact of valuation discount rate margin	**765**	1,031
• Impact of other IFRS valuation margins	**902**	867
IFRS technical provisions (net of reinsurance)	**22,543**	19,219
Add:		
• Value of reinsurance recoverables on IFRS basis	**2,450**	2,522
IFRS technical provisions (gross of reinsurance)	**24,993**	21,741

D.3 Other liabilities

Other liabilities at 31 December reflect derivative liabilities, deferred tax and accounting accruals and creditors, as follows:

	2017			
	IFRS value		**Regulatory value**	
	Group £m	**Company £m**	**Group £m**	**Company £m**
Derivative liabilities	**9,663**	**9,663**	**9,663**	**9,663**
Insurance and other payables	**120**	**108**	**185**	**172**
Deferred tax	**4**	**4**	**149**	**149**
Subordinated debt instruments	**543**	**543**	**589**	**589**
Other liabilities	**10,330**	**10,318**	**10,586**	**10,573**

	2016			
	IFRS value		Regulatory value	
	Group £m	Company £m	Group £m	Company £m
Derivative liabilities	10,653	10,653	12,066	12,066
Insurance and other payables	101	89	89	76
Deferred tax	4	4	175	175
Subordinated debt instruments	542	542	594	594
Other liabilities	11,300	11,288	12,924	12,911

Other than as noted below, other liabilities are valued at fair value for the purposes of solvency rules, which is equivalent to the IFRS values in the Group's and Company's financial statements. There are no significant estimates or judgements in the valuation of these liabilities.

D.3.1 Derivative liabilities

This represents the liability valuation, at fair value, of derivatives held by the Company for managing its currency, interest and inflation exposures. These are "level 2" valuations for IFRS purposes, and the value of overall derivative assets and liabilities is the same under IFRS as under Solvency II. The difference in value above is offset by an equal and opposite difference in value on derivative assets (see section D.1), reflecting the different classifications used under the two bases.

D.3.2 Insurance and other payables

This represents amounts payable, at fair value, relating to sundry business creditors and accruals, current taxation payments due and reinsurance fees payable. These items are payable within the next year. Given the short timescales, no discounting has been applied.

D.3.3 Deferred tax liabilities

A deferred tax asset or liability is recognised to the extent that there is a temporary difference between the Company's tax base balance sheet (which is IFRS) and the balance sheet for Solvency II purposes. At 31 December 2017, this resulted in a deferred tax liability of £149 million (2016: £175 million) including a deferred tax liability of £4 million (2016: £4 million) held on the IFRS balance sheet, relating to transitional arrangements on the UK Life tax regime.

At 31 December 2017, a recognised deferred tax asset of £2,742,000 existed within the Group. The corresponding asset of £2,879,000 had not been recognised in 2016. The amount represents an estimate of the potential future tax deduction available on vesting of existing share incentive schemes.

There are no other unused tax losses or unused tax credits for which no deferred tax asset or liability has been recognised on the balance sheet.

D.3.4 Subordinated debt instruments

For regulatory purposes, the subordinated debt instruments issued by the Company are valued in accordance with Article 75 of Directive 2009/138/EC, taking no adjustment to take account of the own credit standing of the Company. This differs from the valuation used for IFRS accounting purposes, where the subordinated debt instruments are valued at amortised cost.

In addition, the subordinated debt instruments are treated as liabilities for the purposes of IFRS accounting; for the purposes of regulatory accounting, whilst they are shown on the balance sheet (S.02.01) within liabilities, they form a part of the Own Funds of the Company (S.23.01).

The subordinated debt instruments fall due in 2024 (£300 million face value) and 2026 (£250 million face value).

D.3.5 Reconciliation between regulatory value and financial statements' value of other liabilities

At 31 December 2017, differences between the value of other liabilities for regulatory reporting and IFRS financial statements were as follows:

	2017	
	Group £m	**Company £m**
Regulatory solvency "other liabilities"	**10,586**	**10,573**
Adjustment to creditor balances offset in assets	**(77)**	**(76)**
Reduction in subordinated debt valuation (held at amortised cost for IFRS purposes) and removal of associated accrued interest	**(34)**	**(34)**
Deferred tax (as above)	**(145)**	**(145)**
Other liabilities under IFRS	**10,330**	**10,318**

	2016	
	Group £m	Company £m
Regulatory solvency "other liabilities"	12,924	12,911
Reduction in derivative liabilities (included within derivative assets for IFRS purposes)	(1,413)	(1,413)
Reduction in subordinated debt valuation (held at amortised cost for IFRS purposes) and removal of associated accrued interest	(40)	(40)
Deferred tax (as above)	(171)	(171)
Other liabilities under IFRS	11,300	11,288

D.3.6 Leases and contingent liabilities

PIC does not have any material liabilities in respect of leases, or contingent liabilities.

PICG does not have any material contingent liabilities. The Group has an operating lease for the floors of 14 Cornhill which it occupies. Future payments totalling £18 million (2016: £16 million) will fall due over the coming seven years (2016: eight years). There are no other material lease arrangements.

D.3.7 Employee benefits

The Company pays expenses to a service company owned by the Group holding company, which funds employee benefits.

There are no defined benefit obligations in connection with employees.

D.4 Alternative methods for valuation

The Group and the Company use alternative valuation methods, as defined in the Solvency II regulations, to determine the fair values of certain investments as explained in section D.1.4. Given the methodology used below is the same as the one used to value the investments for IFRS purposes, no differences arise between IFRS and Solvency II values, except for the accrued interest, which is allocated to the individual security under Solvency II, but shown as its own separate category under IFRS.

The details of these alternative valuation methods are provided below; the values shown represent the fair value for the assets where alternative methods for valuation have been used.

Property (other than for own use) – £99 million (2016: £97 million) (PIC and PICG)

Fair value of the properties are determined annually by professional external valuers using the Royal Institution of Chartered Surveyors ("RICS") guidelines. The RICS guidelines apply separate assumptions to the value of the land, buildings and tenancy associated with each property.

The external valuers also consider changes in market conditions and the status of the tenants in determining whether a full physical inspection is required each year. Irrespective of such considerations, each property is fully inspected periodically as part of the valuation process. The cost of additions and renovations is capitalised and considered when estimating fair value.

The main inputs used in the valuation model relate to the rental income, the property's tenure, location, lease length and other factors specific to each property.

Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific property.

Unlisted bonds (direct investment) – £2,613 million (2016: £1,660 million) (PIC and PICG)

Under both IFRS and Solvency II, unlisted bonds are valued using discounted cash flow techniques on a mark to model basis. The models consider the anticipated future cash flows expected to be derived from the assets and discount them to reflect the timing of payments and the likelihood of default given the relative seniority of the holding in order of repayment. The discount rate is derived based on the credit spreads observed on other, quoted instruments that are substantially the same.

This category also includes directly invested bonds where PIC holds the greater part of the issuance and as such values these investments using discounted cash flow techniques on a mark to model basis.

Unlisted collateralised securities – £59 million (2016: £68 million) (PIC and PICG)

The fair value of unlisted collateralised securities is calculated using discounted cash flow techniques on a mark to model basis.

The valuation models use the security specific observable (interest rates and yield curves) and unobservable (implied volatilities, loss given default) inputs.

The unobservable inputs reflect the assumptions market participants would use in pricing the asset or liability based on sources independent of the entity pricing the asset or liability.

In addition, unobservable inputs are developed based on the best information available relating to a particular security and can be adjusted if information indicating that market participants would use different assumptions is reasonably available without undue cost and effort or when corroborated by evidence such as market transactions or quoted prices of other similar securities where available.

Unlisted (private equity) collective investment undertakings – £42 million (2016: £46 million) (PIC and PICG)

The fair value of unlisted collective investments is determined using the discounted cash flow method, which calculates the present value of future cash flows, discounted at the market rate of interest at the reporting date. The main inputs used in these calculations relate to interest rates, which are market observable.

Equity release mortgages ("ERM") – £107 million (2016: £Nil) (PIC and PICG)

The fair value of equity release mortgages ("ERM") is determined on a mark to model basis. The fair value of each individual mortgage is calculated using a discounted cash flow model, in which the future cash flows are projected using a number of unobservable inputs including mortality, morbidity, interest rates and property prices. These cash flows are discounted at a rate equivalent to the risk-free rate based on the swap curve plus an equivalent spread. The equivalent spread is calculated separately for each mortgage at the date of the initial advance for that mortgage.

Under the terms of the ERM, a guarantee is provided that when a property is sold on the event of death or move into long-term care and the mortgage repaid, the amount repayable will be capped at the sale value of the underlying property after deducting reasonable costs of selling the property. The value of the "No Negative Equity Guarantee" has been calculated using option pricing techniques in which an explicit house price growth assumption is used.

The fair value of equity release mortgages is determined by means of an internal model which uses a number of unobservable inputs including mortality, morbidity, interest rates and property prices.

Own shares held directly – PICG £12 million (2016: PICG £1 million)

This is determined using a modelled valuation of the PICG Group, derived from its audited Market Consistent Embedded Value at the valuation date.

D.5 Any other information

There is no other material information to disclose regarding the valuation of assets and liabilities for solvency purposes.

E. CAPITAL MANAGEMENT

E.1 Own Funds

E.1.1 Objectives, policies and processes

The objectives, policies and processes employed by the Group and Company to manage its Own Funds are set out in its Capital Management Policy, which is approved by the Company's Board.

As a part of this, the Board ensures that a Medium Term Capital Plan is prepared on an annual basis for approval as part of the overall Business Planning cycle. The Medium Term Capital Plan covers at least a five year period, and includes consideration of the need for further Own Funds, the type of Own Funds, repayment of any Own Funds and Dividend/Distribution Policy.

The Company's regulatory solvency ratio (measured as its Solvency Capital Requirement divided by its eligible Own Funds) is a key metric in the management of the financial position of the Company and Group.

The Board has a risk appetite limit and tolerance for the Company's solvency level, and monitors this regularly. Where solvency is above 140%, no formal action is deemed necessary. Where solvency is between 130% and 140%, information should be provided to the Board explaining the current solvency level and its outlook, together with information on the actions that can be taken if required. Where solvency falls below 130% of SCR, action should be taken to rectify the position.

As a part of its day-to-day management of the Company's solvency position, management employs solvency monitoring techniques and measurements which are run at a minimum weekly, or more often where required. Management is also able to employ various techniques to manage its capital and solvency, including (but not limited to):

- Managing the type and volume of new business written;
- Reinsurance of existing business;
- Risk mitigation techniques;
- Hedging strategies to manage key exposures such as credit risk, interest rate risk or inflation risk;
- Efficient asset management strategy; and
- Seeking further external debt or equity capital.

E.1.2 Own Funds at the reporting date

The amount of Own Funds of the Group and Company at the end of the reporting period was:

	Group				Company			
2017 **£m**	Tier 1	Tier 2	Tier 3	Total	Tier 1	Tier 2	Tier 3	Total
Balance at 31 December 2017	2,744	589	–	3,333	2,739	589	–	3,328
Amount of basic Own Funds available to cover SCR	2,744	589	–	3,333	2,739	589	–	3,328
Amount of basic Own Funds available to cover MCR	2,744	104	n/a	2,848	2,739	104	n/a	2,843

	Group				Company			
2016 £m	Tier 1	Tier 2	Tier 3	Total	Tier 1	Tier 2	Tier 3	Total
Balance at 31 December 2016	2,560	594	–	3,154	2,540	594	–	3,134
mount of basic Own Funds available to cover SCR	2,560	594	–	3,154	2,540	594	–	3,134
Amount of basic Own Funds available to cover MCR	2,560	96	n/a	2,656	2,540	96	n/a	2,636

As at 31 December 2017, the ratio of eligible Own Funds to Solvency Capital Requirement of PICG was 160% (2016: 165%) and of PIC was 160% (2016: 164%).

There are no items of ancillary Own Funds at 31 December 2017 (2016: nil).

No restrictions have been made to the amounts of basic Own Funds which can be used to cover the Company's SCR requirement.

For the purposes of MCR coverage, the amount of Tier 2 basic Own Funds which can be used to cover MCR has been restricted to £104 million (or 20% of the MCR amount). In the event that any Tier 3 basic Own Funds items were held by the Group, no Tier 3 basic Own Funds could be used to provide MCR coverage.

E.1.3 Reconciliation of opening and closing Own Funds

E.1.3.1 Reconciliation of opening and closing Own Funds: PICG

2017 **£m**	**Tier 1** **Share capital**	**Share premium**	**Reconciliation reserve**	**Tier 2** **Subordinated debt**	**Total**
At start of year	**2**	**118**	**2,440**	**594**	**3,154**
Issued in year	**–**	**–**	**–**	**–**	**–**
Movements in year	**–**	**1**	**183**	**(5)**	**179**
At end of year	**2**	**119**	**2,623**	**589**	**3,333**

2016 £m	Tier 1 Share capital	Share premium	Reconciliation reserve	Tier 2 Subordinated debt	Total
At start of year	925	–	1,136	325	2,386
Issued in year	129	–	–	250	379
Movements in year	(1,052)	118	1,304	19	389
At end of year	2	118	2,440	594	3,154

E.1.3.2 Reconciliation of opening and closing Own Funds: PIC

2017 **£m**	**Tier 1** **Share capital**	**Reconciliation reserve**	**Tier 2** **Subordinated debt**	**Total**
At start of year	**1,000**	**1,540**	**594**	**3,134**
Issued in year	**–**	**–**	**–**	**–**
Movements in year	**–**	**199**	**(5)**	**194**
At end of year	**1,000**	**1,739**	**589**	**3,328**

2016 £m	Tier 1 Share capital	Reconciliation reserve	Tier 2 Subordinated debt	Total
At start of year	757	1,288	325	2,370
Issued in year	243	–	250	493
Movements in year	–	252	19	271
At end of year	1,000	1,540	594	3,134

E.1.4 Restrictions to Own Funds and capital tiering

No restrictions have been made to the amount of basic Own Funds available to cover the Company's SCR as a result of the impact of limits on eligible Tier 2 and Tier 3 capital, and on restricted Tier 1 capital.

The Company's Tier 2 capital consists of £300 million nominal of subordinated loan notes due 2024 with a fixed coupon of 6.5% paid annually in arrears that were issued at 99.107% of par in July 2014, and £250 million nominal of subordinated loan notes due 2026 with a fixed coupon of 8% paid annually in arrears that were issued at 98.916% of par in November 2016. The notes represent direct, unsecured and subordinated obligations of the Company, and are classified as qualifying dated Tier 2 securities for the purposes of regulatory capital requirements.

The Tier 2 instruments are valued in accordance with Article 75 of the Solvency II directive, being economic value, and therefore at a different value than that used in the Company's IFRS financial statements. Changes arising from movements in the risk-free rate between the dates of issue (3 July 2014 and 23 November 2016) and the reporting date have led to an increase in the value of the subordinated debt (including accrued interest) of £35 million (2016: £40 million). The difference in value between the two bases is offset by an equal and opposite amount included within the Reconciliation Reserve.

The Tier 2 instruments are classified as Tier 2 Capital, in line with Solvency II requirements, as opposed to financial liabilities, as classified in the Company's IFRS financial statements.

E.1.5 Reconciliation of Own Funds to IFRS Equity

The following differences exist between Equity as shown in the Company's IFRS Financial Statements at the reporting date, and Own Funds under regulatory classifications:

	Group		Company	
£m	**2017**	2016	**2017**	2016
Equity per IFRS financial statements	**2,082**	1,779	**2,076**	1,760
Add: Reclassification of subordinated debt as Tier 2 capital for regulatory purposes, included at regulatory value	**589**	594	**589**	594
* Adjustment of subordinated debt value between IFRS and regulatory value	**(35)**	(40)	**(35)**	(40)
* Decrease in technical provisions under regulatory rules	**1,665**	1,925	**1,665**	1,925
* Increase in deferred tax liability under regulatory rules	**(145)**	(171)	**(145)**	(171)
* Decrease in reinsurance recoverable asset under regulatory rules	**(823)**	(933)	**(822)**	(934)
Own Funds per regulatory requirements	**3,333**	3,154	**3,328**	3,134

Items marked with a '*' above form part of the regulatory Reconciliation Reserve (see E.1.6 below), which totals £1,739 million for PIC (2016: £1,540 million): and £2,623 million for PICG (2016: £2,440 million) at 31 December 2017.

There are no restrictions on the availability and transferability of Own Funds within the Company or Group.

E.1.6 Constituents of reconciliation reserve

The reconciliation reserve at 31 December is formed of the following elements:

2017 £m	**Group**	**Company**
IFRS retained earnings per financial statements	**918**	**1,016**
Capital contribution reserve per financial statements	**–**	**60**
Capital reduction reserve per financial statements	**1,055**	**–**
Differences between IFRS rules and Solvency II rules (marked with '*' above)	**662**	**663**
Treasury shares per financial statements	**(12)**	**–**
Reconciliation reserve at 31 December 2017	**2,623**	**1,739**

2016 £m	Group	Company
IFRS retained earnings per financial statements	605	699
Capital contribution reserve per financial statements	–	60
Capital reduction reserve per financial statements	1,055	–
Differences between IFRS rules and Solvency II rules (marked with '*' above)	781	781
Treasury shares per financial statements	(1)	–
Reconciliation reserve at 31 December 2016	2,440	1,540

E. CAPITAL MANAGEMENT

E.2 SCR and MCR (Unaudited)

As at 31 December 2017, PICG's and PIC's Solvency Capital Requirement amounted to £2,082 million (2016: £1,912 million), and its Minimum Capital Requirement amounted to £521 million (2016: £478 million), being 25% of SCR.

The Group and Company's risk profile is best measured by its Internal Model, which was approved for use by the PRA in December 2015. Note that a Major Model Change was approved by the PRA in December 2017 to the Internal Model, related to the treatment of longevity and inflation risk.

PIC is therefore satisfied that the SCR as at 31 December 2017 is not subject to supervisory assessment.

No adjustment to the Solvency Capital Requirement has been made by the PRA, in respect of the third subparagraph of Article 51(2) of Directive 2009/138/EC.

Over 2017, the Solvency Capital Requirement has increased from £1,912 million to £2,082 million (2016: £1,574 million to £1,912 million), and the Minimum Capital Requirement has increased from £478 million to £521 million (2016: £394 million to £478 million).

The principal reasons for the movements in these items are:

- A general increase in the volume of business in force, due to insurance contracts written during 2017;
- The impact of changes in economic conditions over the year, in particular the reduction in interest rates;
- Major Model Changes implemented for the treatment of longevity risk and inflation risk; and
- The impact of the reinsurance programme effected by the Company, which has served to reduce the insurance risk element of the SCR.

These reasons reflect the natural progression of the business. Other than related to the Major Model Changes mentioned above, there have been no additional material changes to the underlying methodology or assumptions used on the calculation of either item.

E.2.1 Components of SCR

PIC uses an Internal Model agreed with the PRA to calculate its Solvency Capital Requirement. It does not apply the Standard Formula in the business.

The split of the Solvency Capital Requirement by risk category as at 31 December 2017 is as follows:

Summary of SCR	2017	2016
Risk capital before diversification:		
– Market risk	**1,853**	1,524
– Counterparty credit risk	**73**	64
– Insurance risk	**994**	1,227
– Expense risk	**211**	115
– Operational risk	**202**	171
Total before diversification	**3,333**	3,101
Diversification benefit	**(1,027)**	(959)
Loss absorbing capacity of deferred tax	**(224)**	(230)
Total diversified SCR after LACDT	**2,082**	1,912

E.2.2 Key inputs for the calculation of the MCR

The Minimum Capital Requirement has been calculated as follows:

1. The higher of 2.1% of the value of best-estimate liabilities net of reinsurance recoverables and 25% of the Solvency Capital Requirement.
2. The lower of the result from Step 1 and 45% of the Solvency Capital Requirement.

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

This section is not applicable to PIC and PICG. PIC and PICG do not use the duration-based equity risk sub-module.

E.4 Difference between the Standard Formula and any internal model used (unaudited)

The Internal Model is used to calculate PIC's regulatory capital requirements. The output from the Internal Model also helps support strategic decision-making, including in the following areas:

- Business planning;
- Pricing of new business;
- Asset allocation; and
- Reinsurance transactions and hedging activities.

PIC uses a full Internal Model.

PIC uses a variety of methods to calculate the probability distribution forecast and the Solvency Capital Requirement, ranging from statistical analysis of historic data (e.g. market risk) to expert judgements determined by panels of experts (e.g. insurance risk). Each method is appropriate to the particular risk in question.

PIC's Internal Model methodologies and assumptions use a more bespoke and granular approach than the "one-size-fits-all" approach underpinning the Standard Formula. The main differences are as follows:

Insurance risk: PIC's risk profile includes substantial long-term liabilities so the Internal Model applies capital stresses for base mortality and future mortality improvement risk, rather than solely base mortality as prescribed by the Standard Formula, to ensure we more accurately capture the nature of insurance risks for annuitants. PIC also holds capital against uncertainty in second life assumptions and lump sum commutation assumptions, which are excluded from the Standard Formula.

Operational risk: PIC's Internal Model for operational risk is based on an assessment of the actual operational risks that PIC is exposed to, including underwriting, asset management, hedging, reserving and outsourcer-related risks. By comparison, the Standard Formula for operational risk is a function of premium income received in the previous year which can bear little relationship to where operational risks may arise.

PIC uses the same risk measure and time period as set out in Article 101(3) of the Solvency II requirements, namely the Value-at-Risk of basic Own Funds subject to a confidence level of 99.5% over a one-year period.

PIC uses a variety of data sources in its Internal Model, both internal and external. Internal data includes policyholder data and PIC's own historic company experience. External data are used to support the calibration of market, insurance and counterparty default risk. For market risk the main external providers of data are organisations such as Moody's, Merrill Lynch and Bloomberg, who provide the majority of historical market data to support the calibration of the Solvency Capital Requirement. The counterparty default risk module also uses Moody's historical data. For insurance risk the primary external data source is the Office for National Statistics, which provides national population data and data on the number of deaths.

All data sources are reviewed internally for completeness, appropriateness and accuracy prior to use in the Internal Model.

E.4.1 Comparison of the Company's Internal Model with the Standard Formula (Unaudited)

The following table compares the Solvency Capital Requirement ("SCR") calculated on the Standard Formula basis and using the Company's Internal Model.

	Internal Model with matching adjustment 2017 £m	**Standard Formula with matching adjustment 2017 £m**
Market risk	**1,853**	**2,366**
Insurance risk	**994**	**469**
Operational risk	**202**	**170**
Expense risk	**211**	**185**
Counterparty default risk	**73**	**68**
Benefit of diversification	**(1,027)**	**(493)**
Loss-absorbing capacity of deferred tax	**(224)**	**(290)**
Solvency Capital Requirement	**2,082**	**2,475**

	Internal Model with matching adjustment 2016 £m	Standard Formula with matching adjustment 2016 £m
Market risk	1,524	2,042
Insurance risk	1,227	465
Operational risk	171	104
Expense risk	115	144
Counterparty default risk	64	51
Benefit of diversification	(959)	(435)
Loss-absorbing capacity of deferred tax	(230)	(382)
Solvency Capital Requirement	1,912	1,989

Of note, the Standard Formula was calibrated with respect to an average European insurance entity. As PIC is a UK specialist insurance provider, the Company's business is not well represented by the Standard Formula. Using a risk capital model that does not represent the risks to the business does not incentivise good risk management, with actions being taken to optimise a position under a formula rather than aligned to the risks.

In particular, the design and calibration of the Standard Formula is not deemed appropriate to reflect PIC's internal view of its main risk drivers – market risk, including inflation risk and basis risk, and insurance risk, particularly the allowance for the risks associated with mortality improvements. PIC's Internal Model adopts a more granular approach to determining the capital requirements for both of these major risks as well as incorporating additional risks such as those associated with taking on liabilities with inflation-linked benefits.

For PIC's less important risks, the Internal Model calibration is also more bespoke than the Standard Formula. For Operational risk, the capital is based on an assessment of the actual operational risks that PIC is exposed to, including underwriting, asset management, hedging, reserving and outsourcer-related risks. By comparison, the Standard Formula for operational risk is a function of premium income received in the previous year, which can bear little relationship to where operational risks may arise. For counterparty default risk, PIC uses a bespoke stochastic model allowing for all risk mitigants it deploys to manage such risks. For expense risk, PIC again has a bespoke calibration reflecting the key source of expense risk such as investment management fees and policy maintenance costs.

PIC uses its Internal Model within the key business processes outlined below:

Key business processes	Responsible oversight committee
Strategy and business planning (including ORSA)	Board
Origination of new business and ceding of reinsurance	Origination Committee
Risk management	Board Risk Committee
Asset-liability management	ALM Committee
Performance management	Nomination and Remuneration Committee
Financial reporting	Audit Committee

Each "responsible oversight committee" performs an assessment of their use of the model in decision making and any areas for enhancement. Additionally, the Board performs an assessment based on its enterprise-wide responsibilities.

The nature of their assessments includes the extent to which:

- The Board or Committee feels it has sufficient understanding of the Internal Model;
- The Internal Model is embedded in all relevant decision-making processes; and
- The papers and proposals presented to the Board/Committee and resulting minutes from discussions reflect the Internal Model.

Suitable and clearly defined governance and oversight structures exist within PIC to support the use of the Internal Model.

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

Both PIC and PICG have been fully compliant with both the Minimum Capital Requirement and the Solvency Capital Requirement throughout 2017 and up to the date of approval of this report.

APPENDIX A

Appendix A
Glossary of terms

BEL
Best Estimate Liability.

EIOPA
European Insurance and Occupational Pensions Authority. This is the European regulator that sets Solvency II regulations.

IFRS
International Financial Reporting Standards, also known as International Accounting Standards. The accounting framework used by the Group and Company in their statutory accounts.

LACDT
Loss absorbing capacity of deferred tax. A reduction to the capital requirements to allow for tax losses that may arise as a result of a shock event.

ORSA
The name given to the entirety of the processes and procedures employed by an insurer to identify, assess, monitor, manage and report the short and long-term risks it faces or may face and to determine the capital necessary to ensure that the insurer's overall solvency needs are met at all times.

Own Funds
Own Funds represent the equity base of the Company under the Solvency II regime. Own Funds can be classified as "basic Own Funds" and "ancillary Own Funds", and are structured into tiers (Tier 1, Tier 2, and Tier 3) which broadly represent the quality and permanency of the capital.

QRT
Quantitative Reporting Templates. Quarterly solvency returns submitted to the national regulator.

Risk Margin
The Risk Margin is a regulatory requirement introduced by Solvency II. Although it forms a part of the technical provisions, it can be thought of as a part of the wider capital requirements of a regulated insurance company. It is designed to represent the amount which another insurer would require to take on the insurance obligations of an insurer, in the event that it used up all of its surplus and capital as a result of a shock.

SCR
Solvency Capital Requirement – the risk based capital assessment under Solvency II. Can either be set by standard formula or a regulatory-approved internal model.

SFCR
A public disclosure report which is required to be published annually by all insurers and will contain detailed quantitative and qualitative elements.

Technical provisions
The liabilities arising under insurance contracts. Under the Solvency II framework, these represent the sum of best estimate liability, risk margin and the TMTP.

TMTP
Transitional Measures on technical provisions. A transitional arrangement whereby differences between the Solvency II regime and an insurer's previous regulatory capital regime can be phased in over a period, generally a maximum of 16 years.

APPENDIX B

PENSION INSURANCE CORPORATION PLC

Appendix B – Index of QRTs attached

The following QRTs are required to be included in the SFCR:

Pension Insurance Corporation plc	
QRT Ref	**QRT name**
S.02.01.02	Balance sheet
S.05.01.02	Premiums, claims and expenses by line of business
S.05.02.01	Premiums, claims and expenses by country
S.12.01.02	Life and Health SLT technical provisions
S.22.01.21	Impact of long-term guarantees, measures and transitionals
S.23.01.01	Own Funds
S.25.03.21	SCR – for undertakings on Full Internal Models
S.28.01.01	MCR – Only life or only non-life insurance or reinsurance activity

S.02.01.02
Balance sheet – 31 December 2017

		Solvency II value **C0010**
	Assets	
R0010	Goodwill	
R0020	Deferred acquisition costs	
R0030	Intangible assets	
R0040	Deferred tax assets	
R0050	Pension benefit surplus	
R0060	Property, plant & equipment held for own use	0
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	**33,314,064,785**
R0080	*Property (other than for own use)*	98,676,052
R0090	*Holdings in related undertakings, including participations*	0
R0100	*Equities*	**0**
R0110	*Equities – listed*	
R0120	*Equities – unlisted*	
R0130	*Bonds*	**23,246,905,594**
R0140	*Government Bonds*	9,493,801,895
R0150	*Corporate Bonds*	13,542,518,081
R0160	*Structured notes*	0
R0170	*Collateralised securities*	210,585,618
R0180	*Collective Investments Undertakings*	1,193,763,552
R0190	*Derivatives*	8,774,719,586
R0200	*Deposits other than cash equivalents*	0
R0210	*Other investments*	0
R0220	Assets held for index-linked and unit-linked contracts	
R0230	Loans and mortgages	**1,226,715,913**
R0240	*Loans on policies*	0
R0250	*Loans and mortgages to individuals*	
R0260	*Other loans and mortgages*	1,226,715,913
R0270	Reinsurance recoverables from:	**1,628,953,753**
R0280	*Non-life and health similar to non-life*	**0**
R0290	*Non-life excluding health*	
R0300	*Health similar to non-life*	
R0310	*Life and health similar to life, excluding index-linked and unit-linked*	1,628,953,753
R0320	*Health similar to life*	0
R0330	*Life excluding health and index-linked and unit-linked*	1,628,953,753
R0340	*Life index-linked and unit-linked*	0
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	119,835,946
R0370	Reinsurance receivables	
R0380	Receivables (trade, not insurance)	10,951,413
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	297,289,694
R0420	Any other assets, not elsewhere shown	42,526,996
R0500	**Total assets**	**36,640,338,499**

S.02.01.02 – continued
Balance sheet – 31 December 2017

		Solvency II value **C0010**
	Liabilities	
R0510	Technical provisions – non-life	0
R0520	*Technical provisions – non-life (excluding health)*	0
R0530	*TP calculated as a whole*	
R0540	*Best Estimate*	
R0550	*Risk margin*	
R0560	*Technical provisions – health (similar to non-life)*	0
R0570	*TP calculated as a whole*	
R0580	*Best Estimate*	
R0590	*Risk margin*	
R0600	Technical provisions – life (excluding index-linked and unit-linked)	**23,328,750,312**
R0610	*Technical provisions – health (similar to life)*	0
R0620	*TP calculated as a whole*	0
R0630	*Best Estimate*	0
R0640	*Risk margin*	0
R0650	Technical provisions – life (excluding health and index-linked and unit-linked)	**23,328,750,312**
R0660	*TP calculated as a whole*	0
R0670	*Best Estimate*	22,504,964,680
R0680	*Risk margin*	823,785,632
R0690	Technical provisions – index-linked and unit-linked	**0**
R0700	*TP calculated as a whole*	0
R0710	*Best Estimate*	0
R0720	*Risk margin*	0
R0730	Other technical provisions	
R0740	Contingent liabilities	
R0750	Provisions other than technical provisions	
R0760	Pension benefit obligations	
R0770	Deposits from reinsurers	
R0780	Deferred tax liabilities	149,000,501
R0790	Derivatives	9,662,572,469
R0800	Debts owed to credit institutions	
R0810	Financial liabilities other than debts owed to credit institutions	78,976,354
R0820	Insurance & intermediaries payables	44,283,854
R0830	Reinsurance payables	
R0840	Payables (trade, not insurance)	48,944,860
R0850	Subordinated liabilities	**588,900,349**
R0860	*Subordinated liabilities not in BOF*	
R0870	*Subordinated liabilities in BOF*	588,900,349
R0880	Any other liabilities, not elsewhere shown	
R0900	**Total liabilities**	**33,901,428,698**
R1000	**Excess of assets over liabilities**	**2,738,909,801**

APPENDIX B

PENSION INSURANCE CORPORATION PLC
CONTINUED

S.05.01.02
Premiums, claims and expenses by line of business – 31 December 2017

		Line of Business for: life insurance obligations	
	Life	Other life insurance **C0240**	Total **C0300**
	Premiums written		
R1410	Gross	3,703,720,118	**3,703,720,118**
R1420	Reinsurers' share	40,307,547	**40,307,547**
R1500	Net	**3,663,412,571**	**3,663,412,571**
	Premiums earned		
R1510	Gross	3,703,720,118	**3,703,720,118**
R1520	Reinsurers' share	40,307,547	**40,307,547**
R1600	Net	**3,663,412,571**	**3,663,412,571**
	Claims incurred		
R1610	Gross	1,003,479,479	**1,003,479,479**
R1620	Reinsurers' share	94,301,647	**94,301,647**
R1700	Net	**909,177,832**	**909,177,832**
	Changes in other technical provisions		
R1710	Gross	3,251,997,118	**3,251,997,118**
R1720	Reinsurers' share	-72,123,317	**-72,123,317**
R1800	Net	**3,324,120,435**	**3,324,120,435**
R1900	Expenses incurred	**91,731,633**	**91,731,633**
R2500	Other expenses		916,594
R2600	Total expenses		**92,648,227**

S.05.02.01
Premiums, claims and expenses by country – 31 December 2017

		C0150	C0160	C0170	C0180	C0190	C0200	C0210
R1400			Top 5 countries (by amount of gross premiums written) – life obligations					Total Top 5 and home country
	Life	Home Country C0220	C0230	C0240	C0250	C0260	C0270	C0280
	Premiums written							
R1410	Gross	3,703,720,118						**3,703,720,118**
R1420	Reinsurers' share	40,307,547						**40,307,547**
R1500	Net	**3,663,412,571**	**0**	**0**	**0**	**0**	**0**	**3,663,412,571**
	Premiums earned							
R1510	Gross	3,703,720,118						**3,703,720,118**
R1520	Reinsurers' share	40,307,547						**40,307,547**
R1600	Net	**3,663,412,571**	**0**	**0**	**0**	**0**	**0**	**3,663,412,571**
	Claims incurred							
R1610	Gross	1,003,479,479						**1,003,479,479**
R1620	Reinsurers' share	94,301,647						**94,301,647**
R1700	Net	**909,177,832**	**0**	**0**	**0**	**0**	**0**	**909,177,832**
	Changes in other technical provisions							
R1710	Gross	3,251,997,118						**3,251,997,118**
R1720	Reinsurers' share	-72,123,317						**-72,123,317**
R1800	Net	**3,324,120,435**	**0**	**0**	**0**	**0**	**0**	**3,324,120,435**
R1900	Expenses incurred	91,731,633						**91,731,633**
R2500	Other expenses							916,594
R2600	Total expenses							**92,648,227**

S.12.01.02
Life and Health SLT Technical provisions – 31 December 2017

			Other life insurance		
			Contracts without options and guarantees	Contracts with options or guarantees	Total (Life other than health Insurance, Incl Unit-linked)
		C0060	**C0070**	**C0080**	**C0150**
R0010	**Technical provisions calculated as a whole**				**0.00**
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				**0.00**
	Technical provisions calculated as a sum of BE and RM				
	Best estimate				
R0030	**Gross Best Estimate**		22,504,964,680		**22,504,964,680**
R0080	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default		1,628,953,753		**1,628,953,753**
R0090	Best estimate minus recoverables from reinsurance/SPV and Finite Re		**20,876,010,927**	**0**	**20,876,010,927**
R0100	**Risk margin**	1,569,385,632			**1,569,385,632**
	Amount of the transitional on Technical Provisions				
R0110	Technical provisions calculated as a whole				**0.00**
R0120	Best estimate				**0.00**
R0130	Risk margin	-745,600,000			**-745,600,000**
R0200	**Technical provisions – total**	**23,328,750,312**			**23,328,750,312**

S.22.01.21

Impact of long term guarantees measures and transitionals – 31 December 2017

		Amount with Long Term Guarantee measures and transitionals **C0010**	Impact of transitional on technical provisions **C0030**	Impact of transitional on interest rate **C0050**	Impact of volatility adjustment set to zero **C0070**	Impact of matching adjustment set to zero **C0090**
R0010	Technical provisions	23,328,750,312	745,600,000	0	6,768,721	3,846,649,627
R0020	Basic own funds	3,327,810,150	-618,854,199	0	-5,580,383	-2,836,786,042
R0050	Eligible own funds to meet Solvency Capital Requirement	3,327,810,150	-618,854,197	0	-5,580,385	-2,836,786,042
R0090	Solvency Capital Requirement	2,082,047,989	126,752,000	0	1,013,255	3,041,138,111
R0100	Eligible own funds to meet Minimum Capital Requirement	2,843,012,201	-612,516,597	0	-5,529,722	-3,244,652,072
R0110	Minimum Capital Requirement	520,511,997	31,688,000	0	253,314	760,284,528

APPENDIX B

PENSION INSURANCE CORPORATION PLC CONTINUED

S.23.01.01
Own Funds – 31 December 2017

		Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
	Basic own funds before deduction for participations in other financial sector as foreseen in Article 68 of Delegated Regulation 2015/35	C0010	C0020	C0030	C0040	C0050
R0010	Ordinary share capital (gross of own shares)	999,810,351	999,810,351		0	
R0030	Share premium account related to ordinary share capital	0	0		0	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual type undertakings	0	0		0	
R0050	Subordinated mutual member accounts	0		0	0	0
R0070	Surplus funds	0	0			
R0090	Preference shares	0		0	0	0
R0110	Share premium account related to preference shares	0		0	0	0
R0130	Reconciliation reserve	1,739,099,450	1,739,099,450			
R0140	Subordinated liabilities	588,900,349		0	588,900,349	0
R0160	An amount equal to the value of net deferred tax assets	0				0
R0180	Other items approved by supervisory authority as basic own funds not specified above	0	0	0	0	0
	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds					
R0220	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	0				
	Deductions					
R0230	Deductions for participations in other financial and credit institutions	0	0	0	0	
R0290	Total basic own funds after deductions	3,327,810,150	2,738,909,801	0	588,900,349	0
	Ancillary own funds					
R0300	Unpaid and uncalled ordinary share capital callable on demand	0				
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual-type undertakings, callable on demand	0				
R0320	Unpaid and uncalled preference shares callable on demand	0				
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0				
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0				
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0				
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0370	Supplementary members calls – other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0390	Other ancillary own funds	0				
R0400	Total ancillary own funds	0			0	0
	Available and eligible own funds					
R0500	Total available own funds to meet the SCR	3,327,810,150	2,738,909,801	0	588,900,349	0
R0510	Total available own funds to meet the MCR	3,327,810,150	2,738,909,801	0	588,900,349	
R0540	Total eligible own funds to meet the SCR	3,327,810,150	2,738,909,801	0	588,900,349	0
R0550	Total eligible own funds to meet the MCR	2,843,012,201	2,738,909,801	0	104,102,399	
R0580	SCR	2,082,047,989				
R0600	MCR	520,511,997				
R0620	Ratio of Eligible own funds to SCR	159.83%				
R0640	Ratio of Eligible own funds to MCR	546.20%				
	Reconciliation reserve	C0060				
R0700	Excess of assets over liabilities	2,738,909,801				
R0710	Own shares (held directly and indirectly)	0				
R0720	Forseeable dividends, distributions and charges					
R0730	Other basic own fund items	999,810,351				
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0				
R0760	Reconciliation reserve	1,739,099,450				
	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)	0				

S.25.03.21

Solvency Capital Requirement – for undertakings on Full Internal Models – 31 December 2017

	Unique number of component **C0010**	Component description **C0020**	Calculation of the Solvency Capital Requirement **C0030**
1	10320I	Interest rate risk – interest rate up more onerous	551,000,315
2	10600I	Property Risk	40,636,525
3	10700I	Spread risk – if matching adjustment impact not identified	1,904,983,284
4	10900I	Currency risk	12,157,627
5	11010I	Other market risk – inflation risk	180,607,003
6	11020I	Other market risk – implied volatility risk	334,725,810
7	11030I	Other market risk – RPI/CPI basis risk	293,149,293
8	11090I	Other market risk – funds risk	156,233,527
9	19900I	Diversification within market risk	-1,619,544,900
10	20120I	Type 1 counterparty risk – external reinsurance	33,510,781
11	20190I	Type 1 counterparty risk – asset counterparty	39,033,683
12	30210I	Longevity risk – longevity mis-estimation	304,323,946
13	30220I	Longevity risk – longevity trend	899,926,769
14	30290I	Longevity risk – other longevity risks	261,582,877
15	30299I	Longevity risk – longevity diversification	-471,471,845
16	30600I	Expense risk	334,681,297
17	39900I	Life underwriting risk diversification	-123,812,109
18	70100I	Operational risk	201,746,000
19	80300I	Loss-absorbing capacity of deferred tax	-224,286,566

	Calculation of Solvency Capital Requirement	**C0100**
R0110	Total undiversified components	**3,109,183,314**
R0060	Diversification	-1,027,135,325
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	
R0200	Solvency capital requirement excluding capital add-on	**2,082,047,989**
R0210	Capital add-ons already set	
R0220	Solvency capital requirement	**2,082,047,989**

	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	-224,286,566
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	-234,500,019
R0420	Total amount of Notional Solvency Capital Requirement for ring fenced funds	
R0430	Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	2,316,548,008
R0440	Diversification effects due to RFF nSCR aggregation for article 304	

S.28.01.01

Minimum Capital Requirement – Only life or only non-life insurance or reinsurance activity – 31 December 2017

	Linear formula component for non-life insurance and reinsurance obligations	C0010
R0010	MCR_{NL} Result	0.00

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

	Linear formula component for life insurance and reinsurance obligations	C0040
R0200	MCR_L Result	438,396,229

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole C0050	Net (of reinsurance/SPV) total capital at risk 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	20,876,010,927	
R0250	Total capital at risk for all life (re)insurance obligations		

	Overall MCR calculation	C0070
R0300	Linear MCR	438,396,229
R0310	SCR	2,082,047,989
R0320	MCR cap	936,921,595
R0330	MCR floor	520,511,997
R0340	Combined MCR	520,511,997
R0350	Absolute floor of the MCR	**3,250,561**
R0400	**Minimum Capital Requirement**	520,511,997

APPENDIX B

PENSION INSURANCE CORPORATION GROUP LIMITED

Pension Insurance Corporation Group Limited	
QRT Ref	**QRT name**
S.02.01.02	Balance sheet
S.05.01.02	Premiums, claims and expenses by line of business
S.05.02.01	Premiums, claims and expenses by country
S.22.01.22	Impact of long-term guarantees, measures and transitionals
S.23.01.22	Own Funds
S.25.03.22	SCR – for undertakings on Full Internal Models
S.32.01.22	Undertakings in the scope of the Group

APPENDIX B

PENSION INSURANCE CORPORATION GROUP LIMITED
CONTINUED

S.02.01.02
Balance sheet – 31 December 2017

		Solvency II value **C0010**
	Assets	
R0010	Goodwill	
R0020	Deferred acquisition costs	
R0030	Intangible assets	
R0040	Deferred tax assets	2,742,761
R0050	Pension benefit surplus	
R0060	Property, plant & equipment held for own use	219,822
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	**33,314,163,641**
R0080	*Property (other than for own use)*	98,774,827
R0090	*Holdings in related undertakings, including participations*	
R0100	*Equities*	
R0110	*Equities – listed*	
R0120	*Equities – unlisted*	
R0130	*Bonds*	**23,246,905,594**
R0140	*Government Bonds*	9,493,801,895
R0150	*Corporate Bonds*	13,542,518,081
R0160	*Structured notes*	
R0170	*Collateralised securities*	210,585,618
R0180	*Collective Investments Undertakings*	1,193,763,633
R0190	*Derivatives*	8,774,719,586
R0200	*Deposits other than cash equivalents*	0
R0210	*Other investments*	0
R0220	Assets held for index-linked and unit-linked contracts	
R0230	Loans and mortgages	**1,226,715,913**
R0240	*Loans on policies*	0
R0250	*Loans and mortgages to individuals*	
R0260	*Other loans and mortgages*	1,226,715,913
R0270	Reinsurance recoverables from:	**1,628,953,753**
R0280	*Non-life and health similar to non-life*	**0**
R0290	*Non-life excluding health*	
R0300	*Health similar to non-life*	
R0310	*Life and health similar to life, excluding index-linked and unit-linked*	1,628,953,753
R0320	*Health similar to life*	
R0330	*Life excluding health and index-linked and unit-linked*	1,628,953,753
R0340	*Life index-linked and unit-linked*	
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	121,709,801
R0370	Reinsurance receivables	
R0380	Receivables (trade, not insurance)	13,602,543
R0390	Own shares (held directly)	12,214,213
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	307,819,931
R0420	Any other assets, not elsewhere shown	42,526,996
R0500	**Total assets**	**36,670,669,373**

S.02.01.02 – continued

Balance sheet – 31 December 2017

		Solvency II value **C0010**
	Liabilities	
R0510	Technical provisions – non-life	**0**
R0520	*Technical provisions – non-life (excluding health)*	**0**
R0530	*TP calculated as a whole*	
R0540	*Best Estimate*	
R0550	*Risk margin*	
R0560	*Technical provisions – health (similar to non-life)*	**0**
R0570	*TP calculated as a whole*	
R0580	*Best Estimate*	
R0590	*Risk margin*	
R0600	Technical provisions – life (excluding index-linked and unit-linked)	**23,328,750,312**
R0610	*Technical provisions – health (similar to life)*	**0**
R0620	*TP calculated as a whole*	
R0630	*Best Estimate*	
R0640	*Risk margin*	
R0650	Technical provisions – life (excluding health and index-linked and unit-linked)	**23,328,750,312**
R0660	*TP calculated as a whole*	
R0670	*Best Estimate*	22,504,964,680
R0680	*Risk margin*	823,785,632
R0690	Technical provisions – index-linked and unit-linked	**0**
R0700	*TP calculated as a whole*	
R0710	*Best Estimate*	
R0720	*Risk margin*	
R0730	Other technical provisions	
R0740	Contingent liabilities	
R0750	Provisions other than technical provisions	
R0760	Pension benefit obligations	
R0770	Deposits from reinsurers	
R0780	Deferred tax liabilities	149,000,501
R0790	Derivatives	9,662,572,469
R0800	Debts owed to credit institutions	
R0810	Financial liabilities other than debts owed to credit institutions	78,976,354
R0820	Insurance & intermediaries payables	50,963,152
R0830	Reinsurance payables	
R0840	Payables (trade, not insurance)	54,788,425
R0850	Subordinated liabilities	**588,900,349**
R0860	*Subordinated liabilities not in BOF*	
R0870	*Subordinated liabilities in BOF*	588,900,349
R0880	Any other liabilities, not elsewhere shown	
R0900	**Total liabilities**	**33,913,951,562**
R1000	**Excess of assets over liabilities**	**2,756,717,811**

S.05.01.02
Premiums, claims and expenses by line of business – 31 December 2017

	Life	Line of Business for: life insurance obligations Other life insurance **C0240**	Total **C0300**
	Premiums written		
R1410	Gross	3,703,720,118	**3,703,720,118**
R1420	Reinsurers' share	40,307,547	**40,307,547**
R1500	Net	**3,663,412,571**	**3,663,412,571**
	Premiums earned		
R1510	Gross	3,703,720,118	**3,703,720,118**
R1520	Reinsurers' share	40,307,547	**40,307,547**
R1600	Net	**3,663,412,571**	**3,663,412,571**
	Claims incurred		
R1610	Gross	1,003,479,479	**1,003,479,479**
R1620	Reinsurers' share	94,301,647	**94,301,647**
R1700	Net	**909,177,832**	**909,177,832**
	Changes in other technical provisions		
R1710	Gross	3,251,997,118	**3,251,997,118**
R1720	Reinsurers' share	-72,123,317	**-72,123,317**
R1800	Net	**3,324,120,435**	**3,324,120,435**
R1900	Expenses incurred	**91,731,633**	**91,731,633**
R2500	Other expenses		916,594
R2600	Total expenses		**92,648,227**

S.05.02.01

Premiums, claims and expenses by country – 31 December 2017

		C0150	C0160	C0170	C0180	C0190	C0200	C0210
			Top 5 countries (by amount of gross premiums written) – life obligations					Total Top 5 and home country
R1400	Life	Home Country C0220	C0230	C0240	C0250	C0260	C0270	C0280
	Premiums written							
R1410	Gross	3,703,720,118						**3,703,720,118**
R1420	Reinsurers' share	40,307,547						**40,307,547**
R1500	Net	**3,663,412,571**	**0**	**0**	**0**	**0**	**0**	**3,663,412,571**
	Premiums earned							
R1510	Gross	3,703,720,118						**3,703,720,118**
R1520	Reinsurers' share	40,307,547						**40,307,547**
R1600	Net	**3,663,412,571**	**0**	**0**	**0**	**0**	**0**	**3,663,412,571**
	Claims incurred							
R1610	Gross	1,003,479,479						**1,003,479,479**
R1620	Reinsurers' share	94,301,647						**94,301,647**
R1700	Net	**909,177,832**	**0**	**0**	**0**	**0**	**0**	**909,177,832**
	Changes in other technical provisions							
R1710	Gross	3,251,997,118						**3,251,997,118**
R1720	Reinsurers' share	-72,123,317						**-72,123,317**
R1800	Net	**3,324,120,435**	**0**	**0**	**0**	**0**	**0**	**3,324,120,435**
R1900	Expenses incurred	91,731,633						**91,731,633**
R2500	Other expenses							916,594
R2600	Total expenses							**92,648,227**

S.22.01.22

Impact of long term guarantees measures and transitionals – 31 December 2017

		Amount with Long Term Guarantee measures and transitionals C0010	Impact of transitional on technical provisions C0030	Impact of transitional on interest rate C0050	Impact of volatility adjustment set to zero C0070	Impact of matching adjustment set to zero C0090
R0010	Technical provisions	23,328,750,312	745,600,000	0	6,768,721	3,846,649,627
R0020	Basic own funds	3,333,403,947	-618,854,199	0	-5,580,385	-2,836,786,042
R0050	Eligible own funds to meet Solvency Capital Requirement	3,333,403,947	-618,854,199	0	-5,580,385	-2,836,786,042
R0090	Solvency Capital Requirement	2,082,047,989	126,752,000	0	1,013,255	3,041,138,111

APPENDIX B

PENSION INSURANCE CORPORATION GROUP LIMITED CONTINUED

S.23.01.22
Own Funds – 31 December 2017

		Total C0010	Tier 1 unrestricted C0020	Tier 1 restricted C0030	Tier 2 C0040	Tier 3 C0050
	Basic own funds before deduction for participations in other financial sector					
R0010	Ordinary share capital (gross of own shares)	1,753,359	1,753,359		0	
R0020	*Non-available called but not paid in ordinary share capital at group level*	0				
R0030	Share premium account related to ordinary share capital	119,841,960	119,841,960		0	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	0	0		0	
R0050	Subordinated mutual member accounts	0		0	0	0
R0060	*Non-available subordinated mutual member accounts at group level*	0				
R0070	Surplus funds	0	0			
R0080	*Non-available surplus funds at group level*	0	0			
R0090	Preference shares	0		0	0	0
R0100	*Non-available preference shares at group level*	0				
R0110	Share premium account related to preference shares	0		0	0	0
R0120	*Non-available share premium account related to preference shares at group level*	0				
R0130	Reconciliation reserve	2,622,908,279	2,622,908,279			
R0140	Subordinated liabilities	588,900,349		0	588,900,349	0
R0150	*Non-available subordinated liabilities at group level*	0				
R0160	An amount equal to the value of net deferred tax assets	0				0
R0170	*The amount equal to the value of net deferred tax assets not available at the group level*	0				0
R0180	Other items approved by supervisory authority as basic own funds not specified above	0	0	0	0	0
R0190	*Non available own funds related to other own funds items approved by supervisory authority*	0				
R0200	Minority interests (if not reported as part of a specific own fund item)	0				
R0210	*Non-available minority interests at group level*	0				
	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds					
R0220	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds					
	Deductions					
R0230	Deductions for participations in other financial undertakings, including non-regulated undertakings carrying out financial activities	0				
R0240	*whereof deducted according to art 228 of the Directive 2009/138/EC*	0				
R0250	Deductions for participations where there is non-availability of information (Article 229)	0				
R0260	Deduction for participations included by using D&A when a combination of methods is used	0				
R0270	**Total of non-available own fund items**	0	0	0	0	0
R0280	**Total deductions**	0	0	0	0	0
R0290	**Total basic own funds after deductions**	**3,333,403,947**	**2,744,503,598**	**0**	**588,900,349**	**0**
	Ancillary own funds					
R0300	Unpaid and uncalled ordinary share capital callable on demand	0				
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual – type undertakings, callable on demand	0				
R0320	Unpaid and uncalled preference shares callable on demand	0				
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0				
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0				
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0				
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0370	Supplementary members calls – other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0380	Non available ancillary own funds at group level	0				
R0390	Other ancillary own funds	0				
R0400	**Total ancillary own funds**	0			0	0
	Own funds of other financial sectors					
R0410	Credit Institutions, investment firms, financial institutions, alternative investment fund manager, financial institutions	0				
R0420	Institutions for occupational retirement provision	0				
R0430	Non regulated entities carrying out financial activities	0				
R0440	**Total own funds of other financial sectors**	0	0	0	0	0
	Own funds when using the D&A, exclusively or in combination of method 1					
R0450	Own funds aggregated when using the D&A and combination of method	0				
R0460	Own funds aggregated when using the D&A and combination of method net of IGT	0				
R0520	Total available own funds to meet the consolidated group SCR (excluding own funds from other financial sector and from the undertakings included via D&A)	**3,333,403,947**	**2,744,503,598**	**0**	**588,900,349**	**0**
R0530	Total available own funds to meet the minimum consolidated group SCR	**3,333,403,947**	**2,744,503,598**	**0**	**588,900,349**	
R0560	Total eligible own funds to meet the consolidated group SCR (excluding own funds from other financial sector and from the undertakings included via D&A)	**3,333,403,947**	**2,744,503,598**	**0**	588,900,349	0
R0570	Total eligible own funds to meet the minimum consolidated group SCR (group)	**2,848,605,997**	**2,744,503,598**	**0**	**104,102,399**	
R0590	**Consolidated Group SCR**	2,082,047,989				
R0610	**Minimum consolidated Group SCR**	520,511,997				
R0630	**Ratio of Eligible own funds to the consolidated Group SCR (excluding other financial sectors and the undertakings included via D&A)**	160.10%				
R0650	**Ratio of Eligible own funds to Minimum Consolidated Group SCR**	**547.27%**				
R0660	**Total eligible own funds to meet the group SCR (including own funds from other financial sector and from the undertakings included via D&A)**	**3,333,403,947**	**2,744,503,598**	**0**	**588,900,349**	**0**
R0670	**SCR for entities included with D&A method**					
R0680	**Group SCR**	**2,082,047,989**				
R0690	**Ratio of Eligible own funds to group SCR including other financial sectors and the undertakings included via D&A**	**160.10%**				

	Reconciliation reserve	**C0060**
R0700	Excess of assets over liabilities	2,756,717,811
R0710	Own shares (held directly and indirectly)	12,214,213
R0720	Foreseeable dividends, distributions and charges	
R0730	Other basic own fund items	**121,595,319**
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0
R0750	Other non available own funds	
R0760	**Reconciliation reserve**	**2,622,908,279**
	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)**	**0**

S.25.03.22

Solvency Capital Requirement – for Groups on Full Internal Models – 31 December 2017

	Unique number of component **C0010**	Component description **C0020**	Calculation of the Solvency Capital Requirement **C0030**
1	10320I	Interest rate risk – interest rate up more onerous	551,000,315
2	10600I	Property Risk	40,636,525
3	10700I	Spread risk – if matching adjustment impact not identified	1,904,983,284
4	10900I	Currency risk	12,157,627
5	11010I	Other market risk – inflation risk	180,607,003
6	11020I	Other market risk – implied volatility risk	334,725,810
7	11030I	Other market risk – RPI/CPI basis risk	293,149,293
8	11090I	Other market risk – funds risk	156,233,527
9	19900I	Diversification within market risk	-1,619,544,900
10	20120I	Type 1 counterparty risk – external reinsurance	33,510,781
11	20190I	Type 1 counterparty risk – asset counterparty	39,033,683
12	30210I	Longevity risk – longevity mis-estimation	304,323,946
13	30220I	Longevity risk – longevity trend	899,926,769
14	30290I	Longevity risk – other longevity risks	261,582,877
15	30299I	Longevity risk – longevity diversification	-471,471,845
16	30600I	Expense risk	334,681,297
17	39900I	Life underwriting risk diversification	-123,812,109
18	70100I	Operational risk	201,746,000
19	80300I	Loss-absorbing capacity of deferred tax	-224,286,566

	Calculation of Solvency Capital Requirement	**C0100**
R0110	Total undiversified components	**3,109,183,314**
R0060	Diversification	-1,027,135,325
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	
R0200	**Solvency capital requirement excluding capital add-on**	**2,082,047,989**
R0210	Capital add-ons already set	
R0220	**Solvency capital requirement**	**2,082,047,989**
	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	-224,286,566
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	-234,500,019
R0420	Total amount of Notional Solvency Capital Requirement for ring fenced funds	
R0430	Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	2,316,548,008
R0440	Diversification effects due to RFF nSCR aggregation for article 304	
R0470	Minimum consolidated group solvency capital requirement	520,511,997
	Information on other entities	
R0500	Capital requirement for other financial sectors (Non-insurance capital requirements)	0
R0510	Credit institutions, investment firms and financial institutions, alternative investment funds managers, UCITS management companies	
R0520	Institutions for occupational retirement provisions	
R0530	Capital requirement for non-regulated entities carrying out financial activities	
R0540	Capital requirement for non-controlled participation requirements	
R0550	Capital requirement for residual undertakings	

APPENDIX B

PENSION INSURANCE CORPORATION GROUP LIMITED CONTINUED

S.32.01.22

Undertakings in the scope of the group – 31 December 2017

										Criteria of influence						Inclusion in the scope of Group supervision		Group solvency calculation
	Country **C0010**	Identification code of the undertaking **C0020**	Type of code of the ID of the undertaking **C0030**	Legal Name of the undertaking **C0040**	Type of undertaking **C0050**	Legal form **C0060**	Category (Mutual/ non-mutual) **C0070**	Supervisory Authority **C0080**	% capital share **C0180**	% used for the establishment of consolidated accounts **C0190**	% voting rights **C0200**	Other criteria **C0210**	Level of influence **C0220**	Proportional share used for group solvency calculation **C0230**	YES/NO **C0240**	Date of decision if art. 214 is applied **C0250**	Method used and under method 1, treatment of the undertaking **C0260**
1	GB	549300UN2IF0TWMZYC35	LEI	Pension Insurance Corporation Group Limited	5		2						Dominant		Included in the scope		Method 1: Full consolidation
2	GB	M31AVDIX8NY21MAUQF46	LEI	Pension Insurance Corporation Plc	1	Company limited by shares or guarantee	2	Prudential Regulation Authority	100.00%	100.00%	100.00%		Dominant	100.00%	Included in the scope		Method 1: Full consolidation
3	GB	549300Q8BH2WRUKFLA05	LEI	PIC Holding Limited	5		2		100.00%	100.00%	100.00%		Dominant	100.00%	Included in the scope		Method 1: Full consolidation
4	GB	PSC	Specific code	Pension Services Corporation Limited	10		2		100.00%	100.00%	100.00%		Dominant	100.00%	Included in the scope		Method 1: Full consolidation

NOTES

NOTES

Designed and produced by Emperor
emperor.works +44 (0)20 7729 9090

PENSION INSURANCE CORPORATION
14 CORNHILL, LONDON EC3V 3ND

www.pensioncorporation.com