



PENSION INSURANCE
CORPORATION

Half Year Report 2014

Pension Insurance Corporation plc





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Summary of Half Year Results

IFRS Underlying Operating profit (£m)	
<i>Change from H1 2013 of 59%</i>	
H1 2013:	34
FY 2013:	80
H1 2014:	54

IFRS Operating profit (£m)	
<i>Change from H1 2013 of 200%</i>	
H1 2013:	35
FY 2013:	61
H1 2014:	105

New Business Premium (£m)	
<i>Change from H1 2013 of 133%</i>	
H1 2013:	804
FY 2013:	3,663
H1 2014:	1,871

IFRS pre-tax profit (£m)	
<i>Change from H1 2013 of 90%</i>	
H1 2013:	60
FY 2013:	114
H1 2014:	114

Assets Under Management (£m)	
<i>Change from FY 2013 of 25%</i>	
H1 2013:	6,740
FY 2013:	8,988
H1 2014:	11,228

Pillar 1 Solvency Ratio	
<i>Change from FY 2013 of (25)%</i>	
H1 2013:	249%
FY 2013:	249%
H1 2014:	224%

£m	2008	2009	2010	2011	2012	2013	2014 YTD
New business premiums	1,572	1,089	718	615	1,512	3,663	1,871
Profit before tax	(60)	18	90	12	184	114	114
Pillar 1 solvency ratio	232%	189%	209%	190%	251%	249%	224%
Embedded value	n/a*	n/a*	n/a*	619	830	1,226	1,365

* Embedded value for 2008-2010 was not prepared on a stand-alone PIC basis.

Note: PIC raised £300m of Tier 2 debt on 3 July 2014. This is not included in the half year numbers above.



Financial Commentary

The Financial Model

PIC's strategy is to manage the assets associated with defined benefit pension scheme liabilities and to make a consistent margin on these assets over the very long term. The liabilities that we acquire are in respect of the obligations to pay the pensions of members or former members of pension schemes. As these obligations are highly predictable and the majority are non-callable, we are able to invest in assets with a very long-term investment horizon.

We operate in a highly regulated environment where our prudential regulator, the Prudential Regulation Authority (PRA), requires us to invest our assets and measure our liabilities in accordance with strict and detailed rules and guidance. The PRA also requires us to hold capital over and above the assets required to pay out member benefits, as an additional safeguard for policyholders. The published statutory measure of our regulatory capital strength is referred to as the Pillar 1 basis, but we are also required to calculate our capital strength on a private basis referred to as Pillar 2, which is agreed with the PRA, having regard to our particular circumstances.

Our main income derives from new business premiums and investment returns. Our principal outgoings are pension related payments to individuals, investment management expenses and general management expenses, against which we maintain actuarially calculated reserves and provisions.

As a long-term business we complement our IFRS disclosures with additional information on an "embedded value" basis, which attempts to capture the inherent future value of the emerging margins in our business that are not recognised in our IFRS reporting. Ultimately our embedded value will be realised as cash in our IFRS accounts.

Presentation of Financial Results

The IFRS basis results for the 2014 and 2013 half years are unaudited and they have not been reviewed in accordance with International Standard on Review Engagements 2410. The 2013 full year IFRS basis results (excluding operating profit) have been derived from the 2013 statutory accounts. The auditors have reported on the 2013 statutory accounts which have been delivered to the Registrar of Companies. The auditors' report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The Embedded Value basis results are unaudited and they have not been reviewed in accordance with International Standard on Review Engagements 2410.

Because of the nature of our business, we present our results on a number of different bases, all of which provide different insights into the Company. The following paragraphs provide a summary of the different methods and insights offered by each basis.

IFRS

The half year IFRS results are prepared on the same basis as those required for annual statutory reporting purposes. For the Company, these results are closely aligned with the methodology used to prepare the Pillar 1 capital basis. This means that they are prepared on a "prudent" basis, recognising liabilities in full using best-estimate assumptions, to which margins for prudence are added, with no credit taken for future earnings. The discount rate used to value the future liabilities is derived from the yield on the asset portfolio that we hold, but with appropriate adjustments to ensure that the discount rate itself is on a prudent basis.

Because of this prudent approach, the impact of new business on the accounts is typically fairly small, and can be negative. The value arising from new business acquired emerges over many years, and the IFRS accounts will only reflect this emerging value over the lifetime of the acquired business.

IFRS Operating profit

We have enhanced our statutory IFRS results by including an "operating profit" measure. Operating profit has been defined to reflect the activities which are core to PIC's business, and to reflect the management choices and decisions around those activities. This encompasses the writing and management of insurance bulk annuity contracts, the management of risk through reinsurance, and the day-to-day investment and management of the insurance assets and liabilities.

Within this, we have defined a measure of "underlying operating profit", which captures the returns we make from our in-force book of insurance liabilities and expected long term returns from our assets.

Non-operating profit encompasses the impacts of the wider economic environment on the Company, as well as one-off expenses and the effects of actuarial assumption changes, where PIC is required to recognise the overall impact of changes within one discrete accounting period.

The operating profit basis is more aligned to the way management views the business, and the decisions which management makes around the Company's core activities. Accordingly, commentary will be presented on an operating profit basis going forwards, rather than on the statutory income statement basis.



Embedded value

The embedded value result seeks to build on the IFRS results. The starting point is the IFRS balance sheet, but to this is added an estimate of the after-tax value that is expected to emerge in the future from the release of the margins built in to the actuarial valuation of the in-force business. It is essentially a discounted cashflow valuation of the business. The embedded value result is prepared in accordance with principles laid down in 2004 by the CFO Forum, a representative body of the European insurance industry. These principles act as an industry standard on the preparation of embedded values.

The embedded value consists of three main elements:

- The "net worth" is essentially the IFRS net assets, but with some small adjustments to reflect differences between IFRS and Pillar 1 solvency reporting.
- The "Value of in Force Business" (VIF) is designed to capture the present value of the after-tax return for shareholders that will be generated by policies currently on our books. It represents a combination of the release of the prudent margins we are required to hold for regulatory purposes and the investment return on the reserves held over and above that assumed in the actuarial valuation.
- The "cost of capital" is the frictional cost applied to the regulatory capital that is required to be held in the business to meet our regulatory obligations.

Solvency Capital Requirement

The Solvency Capital Requirement sets out the calculation of net assets over and above the minimum capital that the PRA requires regulated companies to hold. This is typically expressed as a percentage of the required capital. At the end of June 2014, the ratio for PIC was 224%, calculated on a Pillar 1 basis.



Pension Insurance Corporation plc – IFRS Results

Income Statement – statutory basis

£m	6 months ended 30 June 2014	6 months ended 30 June 2013	Year ended 31 December 2013
New business premiums	1,871	804	3,663
Reinsurance premiums	(6)	(5)	(323)
Net premiums	1,865	799	3,340
Investment income	146	104	236
Realised and unrealised investment movements	382	(194)	(181)
Total revenue	2,393	709	3,395
Net claims payments	(198)	(128)	(330)
Acquisition and management expenses	(25)	(20)	(45)
Change in insurance liabilities	(2,056)	(501)	(2,906)
Total claims and expenses	(2,279)	(649)	(3,281)
Net profit before taxation	114	60	114
Tax on net profit	(23)	(14)	(27)
Net profit after taxation	91	46	87



Income Statement – Operating profit basis

£m	6 months ended 30 June 2014	6 months ended 30 June 2013	Year ended 31 December 2013
Return earned on insurance book	31	19	48
Return earned on surplus assets	23	15	32
Underlying operating profit	54	34	80
New business and reinsurance	49	5	(11)
Other changes to in-force business	2	(4)	(8)
Operating profit before tax	105	35	61
Short term fluctuations in return	13	29	112
Model and assumption changes	-	(3)	(55)
Non-recurring costs	(4)	(1)	(4)
Total non-operating profit	9	25	53
Net profit before taxation	114	60	114
Tax on net profit	(23)	(14)	(27)
Net profit after taxation	91	46	87



Commentary

Definitions of terms used in operating profit presentation

Underlying operating profit is defined as the net spread earned on the assets backing the Company's insurance liabilities, plus the return earned in the period on surplus assets, based on a long-term expectation of the returns that are achievable.

Operating profit, in addition to these categories, also contains the IFRS impacts of the new business and reinsurance contracts which have been written during the period.

Other items are treated as non-operating profits or losses, and are presented "below the line". Items shown as non-operating profits or losses have the nature of:

- items arising from market events / movements;
- items of a one-off or exceptional nature which are not expected to recur; or
- items where, due to the nature of insurance accounting, PIC is obliged to capitalise a multi-year effect and show it within a single accounting period.

Items treated as non-operating include:

- short-term variations from the long-term investment assumptions used above;
- one-off costs, such as project costs; and
- changes in long-term insurance assumptions, where multiple years' worth of income or expense must be recognised in a single accounting period.

Overall

PIC's IFRS underlying operating profit before tax was £54m, ahead of the same period in 2013 (£34m), and operating profit before tax was £105m (H1 2013: £35m).

IFRS profit before tax for the first half of 2014 was £114m, significantly up on the first half of last year (£60m).

Further commentary, and explanations of the classifications used are given here.

Return earned on insurance book

The return earned on the insurance book represents the spread which is earned on the assets which are held to back the insurance liabilities. During the first half of 2014 this was £31m, compared to £19m in the same period of 2013. During the first six months of 2014, the return which PIC has been able to make on its insurance book has fallen in basis point terms, but has been applied to a larger base of assets. This reflects the significant new business written by PIC over the last 12 months, and the rise in insurance liabilities from £5,676m at 30 June 2013 to £10,137m at 30 June 2014.

Return earned on surplus assets

The return earned on surplus assets is calculated using an expectation of the long-term rate which the surplus assets will earn, but which will vary according to the mix of surplus assets held. This means that any short-term variations – up or down – in market movements, outside the long-term expectation, are smoothed out. The amounts are still recorded and accounted for, but are recognised outside of operating profit, and instead are included in non-operating profit.

During H1 2014, the return earned on surplus assets was £23m, compared to £15m in the same period of the prior year. The amount has risen due to the increase in surplus assets in PIC over that time – from £595m at the start of 2013 to £1,054m at the end of June 2014 – offset by a decrease in the overall rate that portfolio of assets was expected to earn.

New business and reinsurance

PIC has completed nine new business transactions in the first half of 2014, including the Total UK deal in June, which insured approximately £1.6bn of insurance liabilities for nearly 8,000 new policyholders. PIC also completed two reinsurance deals during the first half of the year, including the reinsurance of the Total deal with Hannover Re, which was finalised on the same day that the new business deal was concluded.

Other changes to in-force business

This primarily represents the variance between actual and expected claims and demographic experience, and is slightly positive at £2m in 2014, compared to £(4)m for the same period in 2013.



Items in Non-operating profit

Short term fluctuations in return

This item mainly relates to the differences between the 'expected' returns that are included within Operating Profit, and the actual amounts that are recorded for that period.

During the first half of 2014, short-term fluctuations in return were £13m, compared to £29m in the same period of the prior year. Credit spreads have continued to narrow during the first half of 2014, which has led to increased returns from PIC's assets which are exposed to credit spread risk. This is partially offset by the impact of holding a greater proportion of assets invested in Gilts at the end of June 2014 than at prior period ends.

Model and assumption changes

This represents the one-time impacts of changes that are made to actuarial modelling of liabilities, and the impacts of any changes which are made to the assumptions which underpin the calculation of insurance liabilities. Two offsetting movements have occurred during the first half of 2014: cost savings driven by a decision to move some of PIC's hedging operations in-house during 2014, offset by provisions made for strengthening of expense and credit assumptions.

Non-recurring costs

Non-recurring costs are those costs which are generally one-off and which have been incurred for specific, limited purposes. Generally these are project costs for ongoing discrete projects which have a defined lifespan. These total £4m in the first half of 2014.

Tax

The taxation charge for the first six months of 2014 is marginally below the average rate of tax of 21.5% which PIC expects to apply to overall FY2014 profits, due to a small amount of non-taxable income received during the first half of 2014.

Events after the balance sheet date

On 3 July 2014, PIC raised £300m of Tier 2 debt. This is not included in the half year numbers above.



Balance Sheet

£m	30 June 2014	30 June 2013	31 December 2013
Assets			
Receivables and other financial assets	149	114	118
Financial Investments	11,228	6,740	8,988
Cash and cash equivalents	6	-	-
Total assets	11,383	6,854	9,106
Liabilities			
Insurance liabilities	(10,137)	(5,676)	(8,081)
Deferred tax liability	(7)	(9)	(7)
Current tax liability	(25)	(14)	(12)
Insurance and other payables	(110)	(424)	(60)
Total liabilities	(10,279)	(6,123)	(8,160)
Net assets	1,104	731	946
Equity			
Share capital	692	451	625
Reserves	412	280	321
Total equity	1,104	731	946

Commentary

Net assets have increased by £158m in the first half of 2014, reflecting both £67m additional share capital during 2014 and the profits made by PIC during the period, and by £373m compared to 30 June 2013. Of the latter increase, £241m was due to capital drawdowns made during the second half of 2013 and first half of 2014.

The rises in both financial investments and insurance liabilities since December 2013 reflect both the new business written during the first half of 2014, and the impact of market movements on our assets and associated insurance liabilities.

Pension Insurance Corporation plc – European Embedded Value

Embedded Value Balance Sheet

£m	30 June 2014	31 December 2013
Net assets	1,104	946
Effect of movement from IFRS to embedded value valuation basis	(50)	(48)
Net worth	1,054	898
Value of in force business ("VIF")	526	509
Embedded value before cost of capital	1,580	1,407
Cost of capital at 3.20% pa	(215)	(181)
Embedded value post cost of capital	1,365	1,226

Commentary

The increase in embedded value (EV) since December 2013, of £139m, reflects the beneficial impacts of new business written during H1 2014 and the addition of £67m of new share capital into PIC during June 2014, offset by the impacts of investment market movements and increases in the cost of capital.



Analysis of movement in Embedded Value

£m	6 months to 30 June 2014	Year ended 31 December 2013
New business contribution	125	331
In force business contribution	6	(47)
Operating return (including new business)	131	284
Investment variances	(38)	(105)
Other economic variances	13	64
Non-operating return	(25)	(41)
Change in EV (before cost of capital)	106	243
Change in cost of capital	(34)	(71)
Capital injection less costs	67	224
EV at start of period	1,226	830
EV at end of period	1,365	1,226



Commentary

The movement in the EV over the period is split into a number of categories:

New Business (NB) Contribution

The NB contribution represents the increase in EV from the new business written in the period. The total NB contribution of £125m in the first half of 2014 was equivalent to an average new business margin of 6.7% of the gross premiums written in the period.

In Force Business (IF) Contribution

The IF contribution represents the net contribution arising from business already on the books. There are certain items, such as the expected return on net assets and unwinding of the discount rate margin on the VIF, which will emerge in a reasonably predictable way each month. In addition there are periodic adjustments to the actuarial modelling and assumptions used in the calculation of the current reserves and future expected profits, such as the impact of changes to the assumed future longevity and expense assumptions and the impact of variances between actual and expected experience over the year.

The IF contribution for the first half of 2014 was £6m, compared to £(47)m for the whole of 2013. Within this, the expected return and natural unwinding together contributed roughly £5m per month. This was offset by the impact of reinsurance deals completed in the period, which has the effect of reducing the overall EV.

Non-operating Return (investment variances and other economic variances)

Investment variances, from changes in interest rates, inflation and credit spreads, gave rise to a reduction in EV profit of £38m during the first half of 2014. Our interest rate hedging strategy is focussed on minimising interest rate and inflation risk on our regulatory capital rather than on our EV. As such, the VIF is exposed to interest rate volatility, leading to a degree of variability in non-operating returns from period to period.

Together with the impact of other general economic movements in the period, the net impact in the 6 months to 30 June 2014 was a reduction in EV of £(25)m.

Change in cost of capital

The cost of capital is 3.20% per annum, the same rate as at 31 December 2013. This reflects a deduction to account for the perceived opportunity cost of having to hold capital which is not immediately available for distribution to shareholders.



Embedded Value – Key Metrics

The VIF is calculated by looking at the future after-tax profits (surpluses) that will emerge from policies currently on the books, taking into account the expected investment returns on the assets backing the actuarial reserves, claims costs, management expenses and the release of prudent margins in the actuarial valuation. These projected future surpluses are then discounted to the valuation date at a rate referred to as the Risk Discount Rate (RDR), to give a present value.

The expected investment return, or earned rate, is derived by considering the yields on the backing assets and applying a reduction to allow for the expected impact of future credit defaults. It is usually expressed in terms of a margin over the underlying risk-free rate, and varies with the spread and average credit rating of the assets in the portfolio. The earned rate margin has fallen over the year, from 117bps over swaps at the 2013 year end to 88 bps over swaps at 30 June 2014. This reflects the continued narrowing of credit spreads during the latter part of the year, as well as the composition of assets taken on with new business, which has led to a greater proportion of risk-free assets being held than at the previous year end.

There are two elements to the RDR; the Risk Margin (RM) and the underlying risk free rate. The RM is intended to capture the inherent uncertainties in predicting the emergence of the future surpluses, both in their timing and in their amounts. It was reduced during 2013 from 450 bps to 425 bps over swaps, reflecting management's view of an appropriate margin, having regard to the profile of the risks in the group.



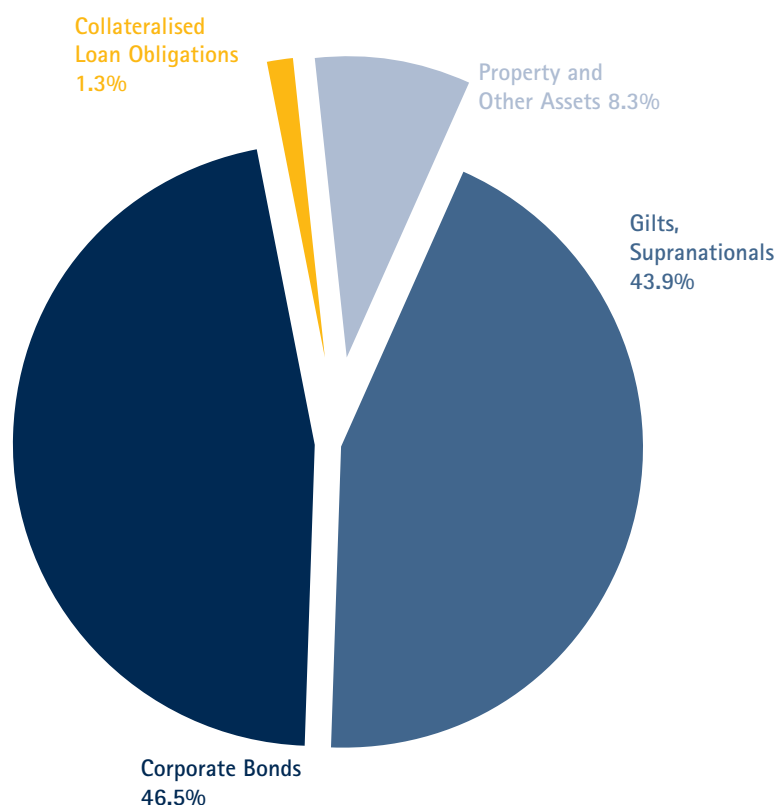
Financial Investments

ASSET POSITION AS OF 30 JUNE 2014						
PIC Assets (£m)	30 June 2014 MV (£m)	30 June 2014	30 June 2013 MV (£m)	30 June 2013	31 December 2013 MV (£m)	31 December 2013
Gilts, Supranationals	4,925	43.9%	2,285	33.9%	3,003	33.4%
Corporate Bonds*	5,229	46.5%	3,713	55.1%	4,924	54.8%
Collateralised Loan Obligations	145	1.3%	162	2.4%	167	1.9%
Property and Other Assets**	929	8.3%	580	8.6%	894	9.9%
Total Investments (£m)	11,228	100.0%	6,740	100.0%	8,988	100.0%

* Corporate bonds includes Asset Backed Securities.

** Property and other assets includes property, insurance linked securities, hedge funds, private equity, PFI, and Bilateral loans or Bonds.

Breakdown of Aggregate Assets 30 June 2014



Commentary

The overall level of investment assets has increased by 25% during 2014, and by 67% since H1 2013, driven principally by new business and additional Reinet capital subscriptions.

Whilst the holdings of Corporate Bonds have increased in absolute terms over the period, they have fallen significantly as a percentage of the overall book. The holdings of Gilts and Supranationals have significantly increased during H1 2014, reflecting the composition of assets acquired in new business transactions in the period.

No defaults have been recorded in H1 2014 (2013 full year: £3m).

Capital and Reserves

Solvency

Pillar 1 basis

£m	30 June 2014	30 June 2013	31 December 2013
Shareholder fund assets	616	574	554
Long-term fund assets	10,625	5,834	8,474
Reserves and provisions	(10,187)	(5,716)	(8,130)
Available capital resources	1,054	692	898
Statutory capital requirements	(471)	(278)	(361)
Pillar 1 surplus	583	414	537
Pillar 1 solvency ratio	224%	249%	249%

Commentary

Under regulatory rules for insurance companies, the capital position is measured by looking at the Available Capital Resources versus the Capital Requirements set out by the PRA.

PIC has consistently maintained a Pillar 1 solvency ratio (the ratio of Available Capital Resources to Capital Requirements) of around 200% or more since inception. Whilst this level is not a target, it nevertheless indicates the financial strength that allows the company to continue to write new business.

At 30 June 2014, the Pillar 1 solvency ratio was 224%, down by 25 percentage points from the 249% ratio reported at the end of 2013.



Risk Management

Key risks faced by PIC and how these risks are managed

Effective risk management is integral to the success of our business. Our risk management framework seeks to support our overall business strategy, enabling us to manage and mitigate those risks that we believe are unrewarded, and to optimise the capital that we hold to support our business strategy.

The following sections are intended to set out the nature of the key risks that we face, and how we manage and mitigate them. A comprehensive governance framework is in place to ensure that risks to our business are appropriately monitored and managed. Our risk universe – overseen by the Board of Directors, together with the Board sub-committees – ensures that risks are properly identified and understood.

(a) Insurance Risk

Insurance risk is principally longevity risk, i.e. the risk that our insured policyholders live for longer than we had assumed in our pricing. It also covers the risk that our management expenses are greater than we have assumed for pricing purposes.

Once this risk is on our books, we can use reinsurance, where it is economic to do so, to pass a proportion on to established, highly rated reinsurance companies. This process ensures that the risks on our balance sheet are managed appropriately, and also acts to validate the assumptions we have made at the point of pricing. We have criteria that reinsurance counterparties must meet in order to be a business partner, which are monitored on a regular basis.

In respect of expense risk we have a comprehensive expense planning, approval and monitoring framework in place to ensure that expenses are appropriately managed.

(b) Market risk

Market risk for PIC arises in three ways:

Investment performance

The accounting basis for the vast majority of our assets is fair value. Therefore, we are at risk of volatility in investment performance as prices of our assets rise or fall. The basis of our liability discounting is such that a portion of any rise or fall in investment values due to credit spreads (as opposed to interest rate changes) is factored into the discount rate applied to our liabilities, so that the overall financial impact of such spread changes is dampened. Whilst we have a predominantly buy and hold investment strategy, we closely monitor the performance and credit quality of our financial investments and, where appropriate, take preventative action.

Interest rates and inflation

Interest rate and inflation movements have the potential to impact the value of our financial investments. We hedge interest rate and inflation exposures on both our assets and liabilities to minimise the impact of movements on our financial strength. This hedging is predominantly done through the use of swaps with highly rated counterparties. We hedge our liabilities plus regulatory required capital and, in consequence, the EV has some exposure to these risk factors.

Currency

A portion of our investment portfolio is held in non sterling denominated assets. We mitigate the exposure by using currency swaps to convert any non sterling exposure back to sterling, with limits on the amount of exposure to foreign currencies that we are willing to accept.

(c) Credit Risk

Credit risk for PIC arises in three ways:

Financial investment default

Our holdings of predominantly fixed income securities are used to fund our highly predictable policyholder obligations. Defaults of any of our fixed income securities put at risk our ability to fund our policyholder obligations. To ensure that any risk of default is managed effectively we monitor our investment holdings very closely. Where we use external managers we are careful to ensure that only high quality and expert managers are used to place our investments. Our holdings are subject to on-going monitoring to ensure credit quality is appropriate, and timely action can be taken to manage exposures.

Swap counterparty default

All of our swaps are placed with bank counterparties. All swaps that we enter into are fully collateralised on a daily basis to ensure that any potential losses are minimised.

Reinsurer counterparty default

We make use of extensive reinsurance of our longevity risk and use highly rated reinsurance counterparties. If one of these reinsurers were to default on its obligations this would require us to increase our longevity related reserves. We only transact with highly rated (at least A rated) reinsurance counterparties and include collateral provisions where necessary to ensure that any monies due under the contracts are suitably secure.



(d) Liquidity risk

Liquidity risk is the risk that PIC may not have liquid assets available at the right times to be able to pay its liabilities – despite the fact that it is solvent. 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 mitigate this, projected cashflows for all new schemes 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 cashflows at an acceptable price.

PIC's risk policies defines 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 cashflows are updated regularly, and assumptions are updated annually, taking into account factors such as mortality experience and how this affects the required cashflows in the future.

(e) Origination risk

Origination risk is the risk that all of the various risks associated with accepting new business are not adequately identified, and that business is written for a price which fails to generate an appropriate risk-adjusted return. Generally, this would result in reduced profits for the Company, but in extreme circumstances this could lead to PIC being loss-making.

There is a clear and detailed process in place to ensure that any new business sought is within the risk appetite of the business, and that all assumptions that go into the new business quotation process are appropriately checked. There is also a post completion reconciliation process to ensure that the terms on which any new business proposal was entered into were those anticipated.

(f) Regulatory risk

Regulatory risk stems principally from the risk of changed solvency requirements including, but not only, uncertainties over the impact and timing of the Solvency II regulations.

PIC maintains an open dialogue with regulators and closely monitors developments in Solvency II. It has a dedicated steering committee to ensure that it is prepared for the final requirements.

(g) 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 systems are supported by an operational risk committee, the maintenance of a central risk register and an independent internal audit review.

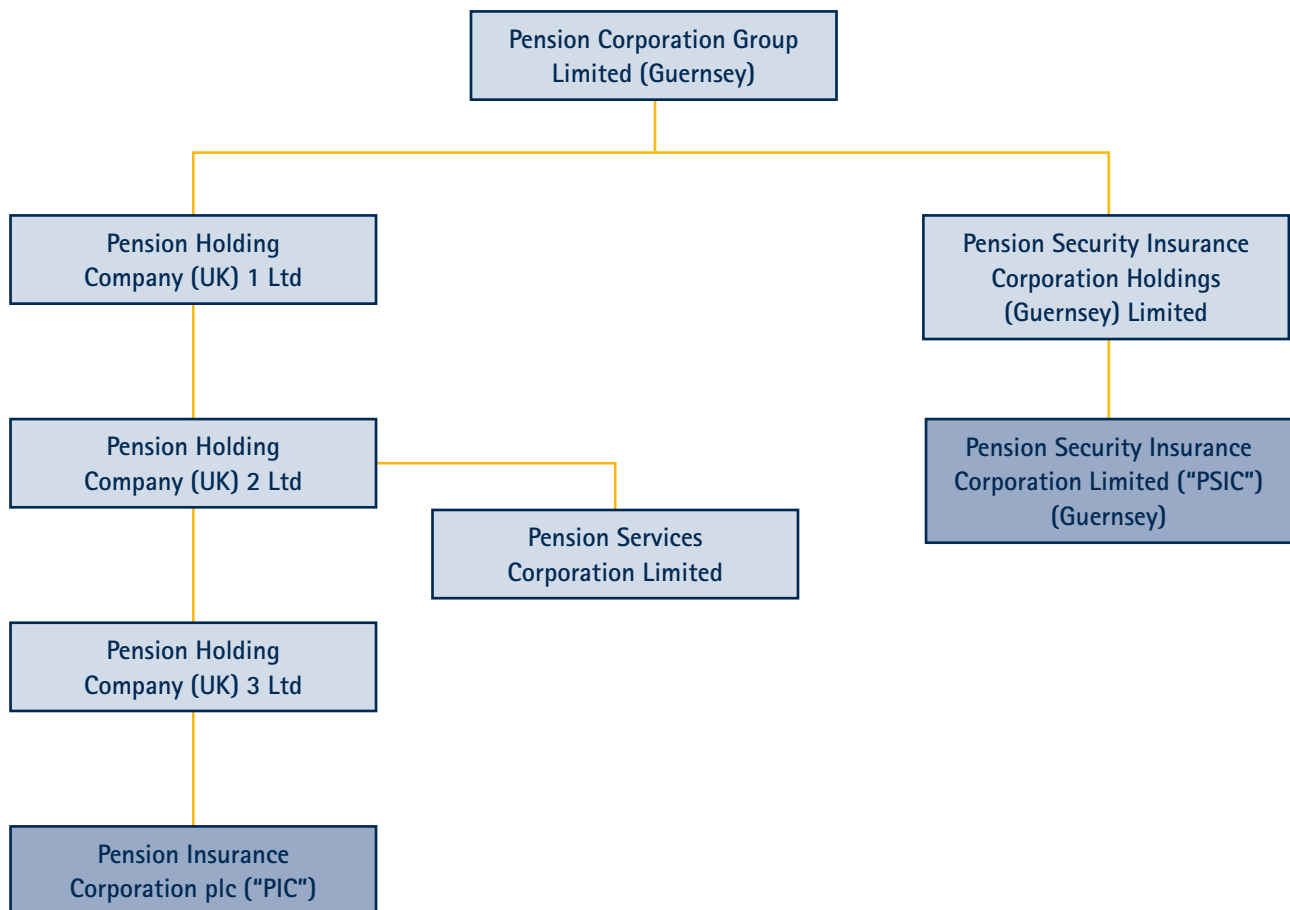
PIC has significant outsourcing arrangements for pension payrolls and other functions. These arrangements are subject to agreements with formal service levels, require the outsourcer to have appropriate business continuity arrangements, operate within agreed authority limits and are subject to regular review by senior management.

(h) Reputation risks

The main reputation risks relate to the need for PIC to maintain a good reputation with trustees of pension schemes and their advisors in order to attract new business, and with its own policyholders through treating its customers fairly.

Maintenance of good professional relationships with our trustees and their advisers is key and our service level commitments are underpinned by using best in class administrators and monitoring their performance. Staff are given regular training in how to treat customers fairly.

Appendix: Organisational structure of the PCG Group



Pension Holding Company (UK) 1, 2 and 3 are non-trading intermediate holding companies.

PCG Group Structure Chart

PIC is the main operating subsidiary in the Pension Corporation ('PCG') Group. PSIC is a Guernsey-authorized insurer which provides a small amount of internal reinsurance to PIC (approximately 3.2 per cent of its gross insurance liabilities at the end of 2013). PSIC has provided reinsurance to PIC only.

Pension Services Corporation Limited is the PCG services company, employing all employees within the PCG Group. PIC is dependent upon Pension Services Corporation Limited for the provision of services from its employees, directors and consultants.



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