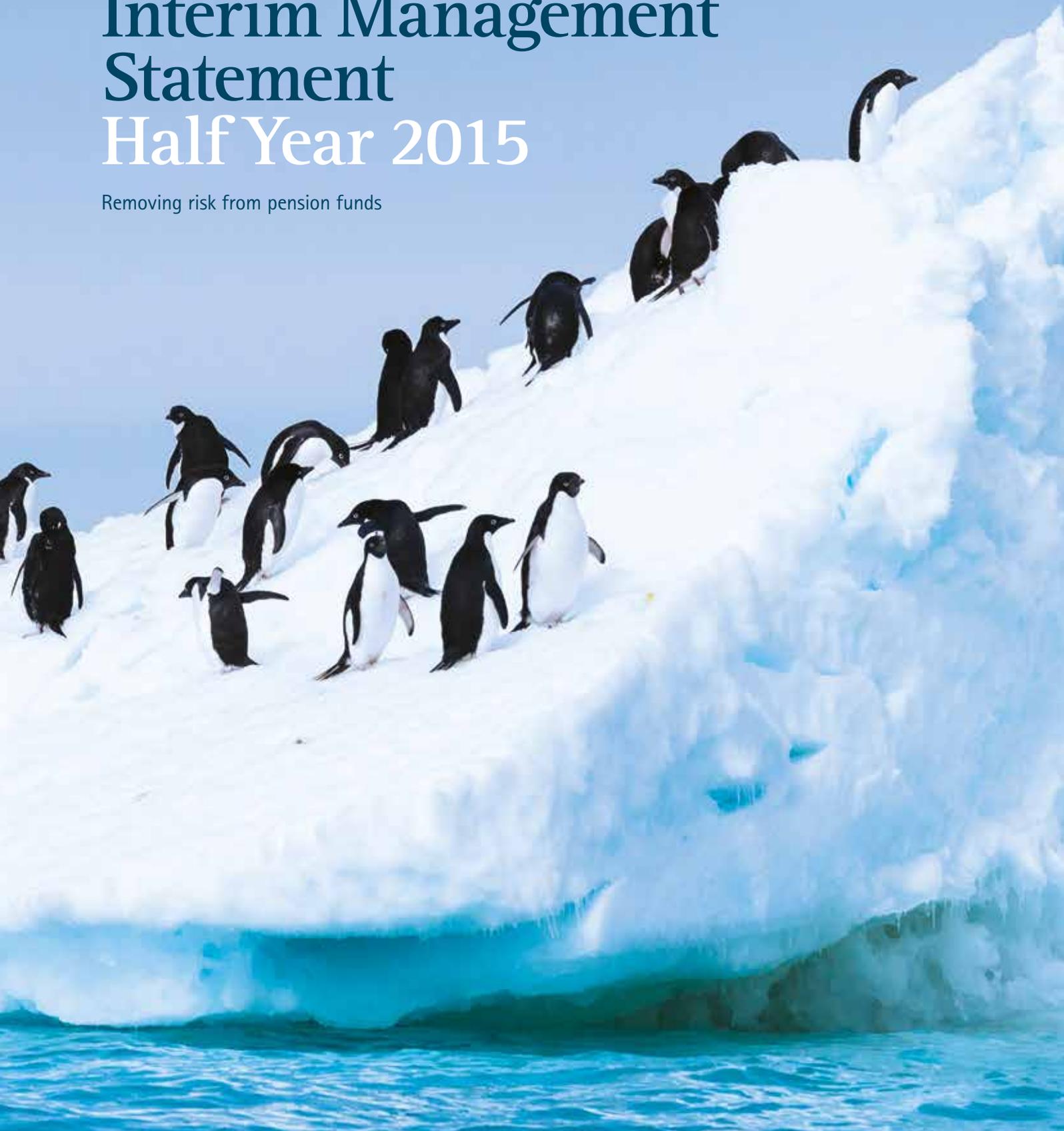


Pension Insurance Corporation plc

Interim Management Statement Half Year 2015

Removing risk from pension funds



PENSION INSURANCE
CORPORATION

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Pension Insurance Corporation plc is a public limited company 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). Pension Services Corporation Limited is a limited company registered in England and Wales under company number 8019046 and provides services to PIC. Registered offices of both companies are at 14 Cornhill, London EC3V 3ND.

Summary of Half Year 2015 Results

IFRS Underlying Operating Profit (£m)

Change from H1 2014 of 17%

H1 2015:	63
H1 2014:	54
FY 2014:	116

IFRS Operating Profit (£m)

Change from H1 2014 of 12%

H1 2015:	118
H1 2014:	105
FY 2014:	154

IFRS Pre-tax Profit (£m)

Change from H1 2014 of (53)%

H1 2015:	54
H1 2014:	114
FY 2014:	170

New Business Premium (£m)

Change from H1 2014 of (62)%

H1 2015:	702
H1 2014:	1,871
FY 2014:	2,646

Assets Under Management (£m)

Change from FY 2014 of 5%

H1 2015:	13,817
H1 2014:	11,228
FY 2014:	13,189

Pillar 1 Solvency Ratio

Change from FY 2014 of (2)%

H1 2015:	268%
H1 2014:	224%
FY 2014:	270%

£m	2008	2009	2010	2011	2012	2013	2014	H1 2015
New business premiums	1,572	1,089	718	615	1,512	3,663	2,646	702
Profit before tax	(60)	18	90	12	184	114	170	54
Period end Pillar 1 solvency ratio	232%	189%	209%	190%	251%	249%	270%	268%
Period end embedded value	n/a ¹	n/a ¹	n/a ¹	619	830	1,226	1,550	1,673

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

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 take on 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 UK 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 2015 and 2014 half years are unaudited and they have not been reviewed in accordance with International Standard on Review Engagements 2410. The 2014 full year IFRS basis results have been derived from the 2014 statutory accounts. The auditors have reported on the 2014 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 results for the 2015 and 2014 half years are unaudited. The 2014 year end embedded value results have been derived from the PIC embedded value report for the year ended 31 December 2014, which included an unqualified audit report from the auditors.

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 written emerges over many years, and the IFRS accounts will only reflect this emerging value over the lifetime of the new business.

IFRS Based Measures of Profit or Loss ("Operating Profit")

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 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 surplus 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 view the business, and the decisions which management makes around the Company's core activities. Accordingly, commentary is presented on an operating profit basis, rather than on the statutory income statement basis.

Financial Commentary

Embedded Value

The embedded value ("EV") 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 cash flow 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 adjustments to reflect fair value movements in the Company's debt as well as 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 Ratio

The Solvency Capital Ratio sets out the ratio of available 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 2015, the ratio for PIC was 268%, calculated on a Pillar 1 basis.

IFRS Results

Income Statement – Statutory Basis

£m	Half year ended 30 June 2015	Half year ended 30 June 2014	Year ended 31 December 2014
New business premiums	702	1,871	2,646
Reinsurance premiums	(9)	(6)	(176)
Reinsurance recapture received	356	–	–
Net premiums	1,049	1,865	2,470
Investment income	180	146	314
Realised and unrealised investment movements	(296)	382	1,471
Total revenue	933	2,393	4,255
Net claims payments	(268)	(198)	(436)
Acquisition and management expenses	(30)	(25)	(60)
Debt interest	(10)	–	(10)
Change in insurance liabilities	(571)	(2,056)	(3,579)
Total claims and expenses	(879)	(2,279)	(4,085)
Net profit before taxation	54	114	170
Tax on net profit	(11)	(23)	(35)
Net profit after taxation	43	91	135

Income Statement – Operating Profit Basis

£m	Half year ended 30 June 2015	Half year ended 30 June 2014	Year ended 31 December 2014
Return earned on insurance book	40	31	65
Return earned on surplus assets	23	23	51
Underlying operating profit	63	54	116
New business and reinsurance	59	49	38
Other changes to in-force business	(4)	2	–
Operating profit before tax	118	105	154
Short-term fluctuations in return	(30)	13	118
Model and assumption changes	(4)	–	(85)
Non-recurring costs	(20)	(4)	(7)
Debt interest	(10)	–	(10)
Total non-operating profit	(64)	9	16
Net profit before taxation	54	114	170
Tax on net profit	(11)	(23)	(35)
Net profit after taxation	43	91	135

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 expected 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 items, 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, the Company 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 or restructuring costs;
- financing costs, such as the interest payable on the subordinated debt issued by PIC; 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 £63m for the first half of 2015, ahead of the same period in 2014 (£54m), and operating profit before tax was £118m (H1 2014: £105m).

IFRS profit before tax for the first half of 2015 was £54m, significantly down on the same period of last year (£114m).

IFRS Results

Further commentary and explanations of the classifications used are given below.

Operating profit items

Return earned on insurance book

The return earned on the insurance book represents the spread earned on the assets which are held to back the insurance liabilities. During the first half of 2015 this was £40m, compared to £31m for the same period in 2014. During the first six months of 2015, the return which PIC has been able to generate 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 £10,137m at 30 June 2014 to £12,231m at 30 June 2015.

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 at the start of each quarter. This means that any short-term variations, up or down, in market movements outside the long-term expectation, are smoothed out. The variations are still recorded and accounted for, but are recognised outside of operating profit, and instead are included in non-operating profit.

During the period to 30 June 2015, the expected return earned on surplus assets was £23m, the same as in the first six months of 2014. While the surplus assets in PIC have increased significantly over that time, from £898m at the start of 2014 to £1,478m at the end of June 2015, the impact of this increase was offset by a decrease in the overall rate that portfolio of assets was expected to earn, reflecting falls in long-term interest rate expectations, particularly in the second half of 2014.

New business and reinsurance

As expected, new business activity gained momentum in Q2 2015 with PIC successfully concluding four new business transactions, including one significant buy-in deal in April, which insured approximately £0.5bn of insurance liabilities.

PIC continued to successfully implement its longevity risk management strategy and entered into two reinsurance agreements with Prudential Insurance Company of America in Q2 2015, which cover longevity risk on approximately £1.7bn of liabilities across 75 schemes. This brings the total amount of reinsured liabilities to circa 75% of PIC's total longevity exposure.

The reinsurance treaty with Pension Security Insurance Corporation Limited ("PSIC") was recaptured in March 2015. The impact of this is included in the non-recurring costs section below.

New business and reinsurance activity, together with the premium related adjustments, contributed £59m to the operating profit in the period to 30 June 2015 compared to £49m in the same period of 2014.

Other changes to in-force business

This primarily represents the variance between actual and expected claims and demographic experience, and is an adverse £(4)m in the first half of 2015, compared to a £2m profit in the same period of 2014.

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 2015, short-term fluctuations in return came to £(30)m, compared to £13m in the same period of the prior year.

PIC uses interest and inflation rate hedges to protect against the adverse impact of interest and inflation rates on regulatory capital levels. However, as regulatory capital differs from IFRS liabilities, there will be a degree of volatility in IFRS earnings as inflation and interest rates change.

Both interest and inflation rates have gradually increased during the first half of 2015, whilst there were negative movements in credit spreads over the same period of time. The movements in interest and inflation rates and credit spreads, together with the changes in liquidity premium, second order impacts of interest and inflation rate changes on credit related items and other smaller investment related variances, contributed a net £30m loss during the half year.

Some of the movements that have arisen have been due to PIC transitioning its asset portfolio to be more in line with the new Solvency II requirements. We expect to see further movement due to this over Q3 and Q4 2015.

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. These net to £(4)m at 30 June 2015, and will be updated further during H2 2015 as PIC completes its year end actuarial assumptions processes.

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 costs for ongoing discrete projects which have a defined lifespan. Such costs amounted to £5m in the first half of 2015. In addition, the reinsurance treaty between PIC and its sister company, PSIC, was recaptured in March 2015. This resulted in a premium received from PSIC of £356m and a loss on recapture of £15m, although the impact on the EV was a positive £12m (pre cost of capital).

Debt interest

PIC bears an interest cost of approximately £5m per quarter (pre-tax) on its listed loan notes (contractual maturity is July 2024).

Tax

The taxation charge for the half year ended 30 June 2015 is in line with the effective rate of tax of 20.25% which PIC expects to apply to overall FY 2015 profits.

Balance Sheet

£m	30 June 2015	30 June 2014	31 December 2014
Assets			
Receivables and other financial assets	160	149	64
Financial investments	13,817	11,228	13,189
Cash and cash equivalents	–	6	5
Total assets	13,977	11,383	13,258
Liabilities			
Insurance liabilities	(12,231)	(10,137)	(11,660)
Borrowings	(294)	–	(294)
Deferred tax liability	(6)	(7)	(6)
Current tax liability	(11)	(25)	(15)
Insurance and other payables	(180)	(110)	(135)
Total liabilities	(12,722)	(10,279)	(12,110)
Net assets	1,255	1,104	1,148
Equity			
Share capital	757	692	692
Reserves	498	412	456
Total equity	1,255	1,104	1,148

Commentary

Net assets increased by £107m in the first half of 2015, reflecting the additional £65m share capital from PIC's ultimate parent company, Pension Corporation Group Limited ("PCG"), and the profits made by PIC during the half year.

The increases in both financial investments and insurance liabilities since December 2014 reflect the new business written during the first half of 2015, the recapture of the reinsurance arrangement with PSIC in March 2015, as well as the impact of market movements on PIC's assets and associated insurance liabilities during the half year.

European Embedded Value

Embedded Value Balance Sheet

£m	30 June 2015	30 June 2014	31 December 2014
Net assets	1,255	1,104	1,148
Effect of movement from IFRS to EV valuation basis	(80)	(50)	(83)
Net worth	1,175	1,054	1,065
Value of in-force business	777	526	748
Embedded value before cost of capital	1,952	1,580	1,813
Cost of capital at 3.20% pa	(279)	(215)	(263)
Embedded value post cost of capital	1,673	1,365	1,550

Analysis of movement in Embedded Value

£m	6 months to 30 June 2015	6 months to 30 June 2014	Year ended 31 December 2014
New business contribution	65	125	167
In-force business contribution	42	6	28
Operating return (including new business)	107	131	195
Investment variances	(61)	(38)	174
Other economic variances	20	13	(13)
Non-operating return	(41)	(25)	161
Change in EV (before cost of capital)	66	106	356
Change in cost of capital	(17)	(34)	(82)
Capital injection less costs	65	67	67
Movement in fair value of subordinated debt	9	-	(17)
EV at start of period	1,550	1,226	1,226
EV at end of period	1,673	1,365	1,550

Commentary

The increase in EV since December 2014 of £123m reflects the beneficial impacts of new business written during the period, the in-force business contribution, the addition of £65m of new share capital into PIC in March 2015 and the positive EV impacts of PSIC recapture on the embedded value, offset by the adverse impacts of investment market movements, additional management provisions and the increase in the cost of capital.

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

New business contribution

The new business contribution of £65m represents the increase in EV from the six new business transactions written in the period.

In-force business contribution

The in-force business 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 in-force business contribution for the half year was £42m, compared to £28m for the whole of 2014. Within this, the expected return and discount rate margin unwind together contributed in the region of £7m per month. The reinsurance deals completed in the period and the favourable actual versus expected claims experience had a positive impact on the EV of approximately £4m.

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

Investment variances, in particular changes in interest rates, inflation and credit spreads, gave rise to a £61m loss on EV basis in the first half of 2015. PIC's interest and inflation rate hedging strategy is focused on minimising interest rate and inflation risk on its regulatory capital rather than on its 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.

The impact of other general economic movements was a positive £20m in the first half of 2015. This gain was mainly due to the impact of lower investment management fees which were negotiated on contract renewal with certain investment managers earlier in the year.

Capital injection

In connection with the recapture of the PSIC reinsurance, PCG provided £65m of equity share capital in the period.

Change in cost of capital

The cost of capital is 3.20% per annum, the same rate as at 31 December 2014. 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.

Change in fair value of subordinated debt

Under EV principles, PIC's subordinated debt is included at its fair value (based on the market value). During the period this decreased by £9m, providing an increase in the embedded value.

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, 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 slightly during the period, from 118bps over swaps at the 2014 year end to 115bps over swaps at 30 June 2015. This reflects the changes in credit spreads during the half year, as well as the composition of assets taken on with new business, which has led to a slightly greater proportion of risk-free assets being held than at the previous year end.

There are two elements to the Risk Discount Rate: these are the Risk Margin and the underlying risk free rate. The Risk Margin is intended to capture the inherent uncertainties in predicting the emergence of the future surpluses, both in their timing and in their amounts.

At the end of June 2015 the flat Risk Discount Rate was 6.44%, versus 6.28% at 2014 year end. This increase reflects overall increases in interest rates during the half year.

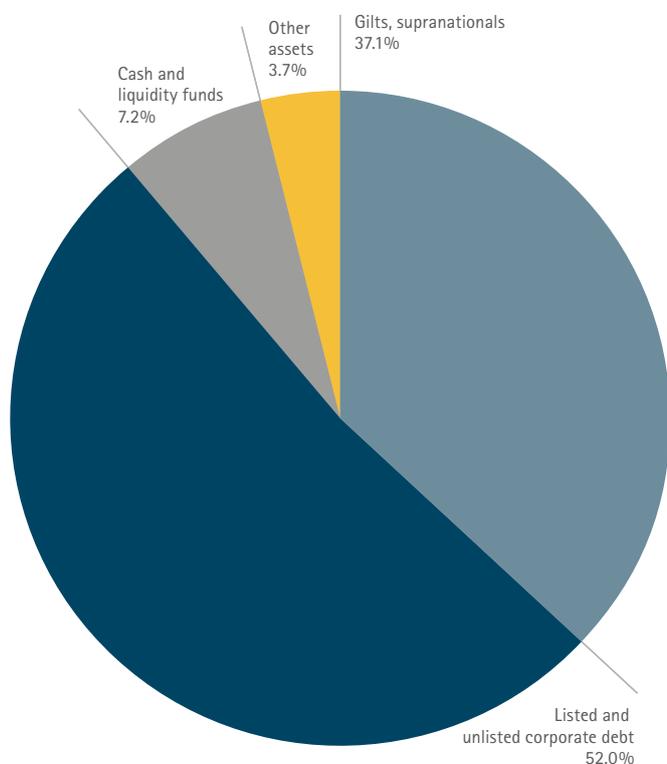
Financial Investments

Asset position as of 30 June 2015

PIC Assets (£m)	30 June 2015 MV (£m)	30 June 2015	30 June 2014 MV (£m)	30 June 2014	31 December 2014 MV (£m)	31 December 2014
Gilts, supranationals Listed and unlisted corporate debt ¹	5,129	37.1%	4,343	38.7%	4,574	34.7%
Cash and liquidity funds ²	7,183	52.0%	5,807	51.7%	6,843	51.9%
Other assets ³	989	7.2%	582	5.2%	1,235	9.3%
	516	3.7%	496	4.4%	537	4.1%
Total Investments	13,817	100.0%	11,228	100.0%	13,189	100.0%

- 1 Listed and unlisted corporate debt includes corporate bonds, Asset Backed Securities, PFI, bilateral loans and bonds.
- 2 Cash and liquidity funds includes cash at bank, bank deposits and holdings in liquidity funds.
- 3 Other assets includes property, collateralised loan obligations, as well as smaller holdings of other asset classes.

Breakdown of Aggregate Assets 30 June 2015



Commentary

The overall level of financial investments increased by 5% during H1 2015, and by 23% since H1 2014, driven principally by assets acquired on PSIC recapture, new business, new capital and the impact of investment market movements.

Whilst the holdings of corporate bonds remained broadly comparable to the 2014 year end, the holding in gilts and supranationals has increased slightly as a percentage of the overall book. This reflects the composition of assets acquired in new business transactions during the first half of 2015.

No defaults have been recorded in H1 2015 (2014 full year: £nil).

Capital and Reserves

Solvency Pillar 1 basis

£m	30 June 2015	30 June 2014	31 December 2014
Shareholder fund assets	868	616	917
Long-term fund assets	12,912	10,625	12,184
Reserves and provisions	(12,302)	(10,187)	(11,726)
Available capital resources	1,478	1,054	1,375
Statutory capital requirements	(552)	(471)	(510)
Pillar 1 surplus	926	583	865
Pillar 1 solvency ratio	268%	224%	270%

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 2015 the Pillar 1 solvency ratio was 268%, 2 percentage points lower than the 270% ratio reported at the end of 2014.

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, overseen by the Board of Directors, together with the Board sub-committees, is in place to ensure that risks to our business are appropriately identified, understood, monitored and managed.

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 insurance risk is on our books, we 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. Reinsurance counterparties are regularly monitored to ensure they continue to meet our criteria for counterparties.

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

Market risk

Predominantly, market risk for PIC arises in three ways:

- i. 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 to mitigate the impact of downgrades and defaults.
- ii. 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 so as 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.
- iii. 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.

Counterparty credit risk

Predominantly, credit risk for PIC arises in three ways:

- i. 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 ongoing monitoring to ensure credit quality is appropriate, and timely action can be taken to manage exposures.
- ii. 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.
- iii. 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 then this would require us to increase our longevity related reserves. We monitor the rating of our reinsurance counterparties, and also use collateral provisions where appropriate to minimise our potential loss should a reinsurer default.

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 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 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 cash flows at an acceptable price.

PIC'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.

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.

Regulatory and Conduct risk

Regulatory risk stems principally from the risk of changed solvency requirements including, but not only, uncertainties over the impact 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.

Conduct risk is the risk that our behaviours lead to outcomes that are not in the interests of our policyholders. We have a strong ethical culture in place led by the Board to ensure that we minimise any Conduct Risk together with a values and behaviours based performance appraisal system. We monitor conduct risk through measuring customer outcomes and complaints, and reviewing breaches to note the cause and in particular what, if any, behaviour has led to the breach and take action as appropriate.

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 operational risk register and an independent internal audit function.

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

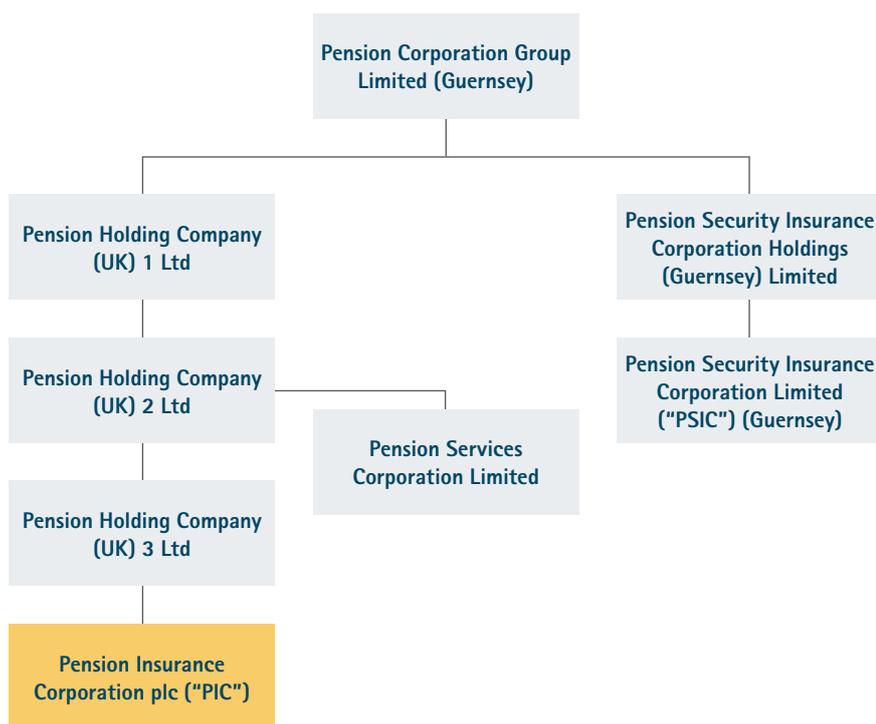
Reputation risk

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

Maintenance of good professional relationships with the trustees of pension schemes we insure 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 to ensure we continue to treat customers fairly.

Appendix:

Summary 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 PCG Group. PSIC was a Guernsey-authorized insurer which provided a small amount of internal reinsurance to PIC (approximately 2.7% of its gross insurance liabilities at the end of 2014). In March 2015, PIC recaptured the PSIC reinsurance treaty, and as a result PSIC has returned its Guernsey insurance authorisation and no longer contains any insurance business.

Pension Services Corporation Limited is the PCG Group's 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.

Contact Information

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Half Year 2015 Report, please contact:

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PENSION INSURANCE
CORPORATION