PENSION INSURANCE
CORPORATION

REMOVING RISK FROM PENSION SCHEMES

PENSION INSURANCE CORPORATION PLC

HALF YEAR REPORT 2017

HALF YEAR REPORT

2017 HIGHLIGHTS

Pension Insurance Corporation plc ("PIC") is a specialist insurer, providing long-term security for our policyholders' pensions, based on superior customer service, robust risk management and expertise in asset and liability management.

HY 2017 premiums (£m)

£1,913m

HY 2017	1,913
HY 2016	918
FY 2016	2,598
FY 2015	3,755
FY 2014	2,646
FY 2013	3,663

Financial investments (£bn)

£24.2bn

HY 2017	24.2
FY 2016	22.6
FY 2015	16.6
FY 2014	13.3
FY 2013	8.9

Market Consistent Embedded Value (£m)

£2,638m

HY 2017	2,638
FY 2016	2,579

Underlying operating profit before tax (£m)

£93m

HY 2017	93
HY 2016	79
FY 2016	177
FY 2015	133
FY 2014	116
FY 2013	80

Assets held to meet solvency and risk margins (£bn)

£4.4bn

HY 2017	4.4
FY 2016	4.3
FY 2015	2.8

Solvency ratio (%)

162%

HY 2017	162
FY 2016	164
FY 2015	151

Customer satisfaction (%)

98.6%

HY 2017	98.6
FY 2016	98.5
FY 2015	99.3
FY 2014	99.8
FY 2013	99.3

Source: Internal company data

CHIEF EXECUTIVE OFFICER'S REVIEW

Tracy Blackwell, Chief Executive Officer

STRONG PROGRESS

We continue to see significant progress in the bulk annuity sector, as the trustees of defined benefit pension schemes increasingly de-risk their liabilities. Our pipeline of new business was stronger at the start of the year than it has ever been at that point in the annual cycle, carrying over the momentum of transaction volumes from the final few months of last year.

We were able to capitalise on this strong level of interest by insuring £1.9 billion of pension liabilities in the first six months of the year, our strongest ever first half, for clients including 3i and Alcatel-Lucent. This compares to a very respectable £918 million of new business in the same period last year. Whilst the market remains competitive, we have maintained a disciplined approach to transaction pricing. We continue to see high levels of interest in bulk annuities, with trustees currently seeking quotes from the market to insure more than £12 billion of defined benefit pension liabilities.

Our record first half new business means we now manage a portfolio of financial investments which is just over £24 billion in value. The value of our business, as captured by Market Consistent Embedded Value ("MCEV"), continues to grow and now stands at £2,638 million. Excluding the strong performance of our issued debt in the period, this is a rise of nearly 5%.

Our continued focus on risk management, including an ongoing program of longevity reinsurance, allows us to report a healthy solvency ratio of 162% (YE 2016: 164%). PIC's underlying operating profit in the first half was £93 million (H1 2016: £79 million), and our own funds now stand at £3.4 billion (YE 2016: £3.1 billion).

> “WE HAVE CONTINUED TO ADD VALUE BY APPLYING OUR EXPERTISE AND RISK MANAGEMENT DISCIPLINE, PROVIDING LONG-TERM SECURITY WITH A FOCUS ON EXCELLENT SERVICE TO OUR CUSTOMERS.”
>
> **Tracy Blackwell,** Chief Executive Officer

It is very pleasing that our focus on customer service is recognised by our policyholders. Alongside the very good informal feedback we get when we meet our policyholders at the complimentary events we put on for them, our Customer Satisfaction surveys show that once again almost 99% expressed overall satisfaction with our service (H1 2016: 99%).

In April we were delighted to welcome CVC as a significant shareholder in PIC’s ultimate parent company, Pension Insurance Corporation Group, after they acquired a 13% stake from some of our historical long-term shareholders. We have a strong ownership structure, with a group of shareholders who will work with us to meet any significant increase in demand from trustees.

Alongside the work of our new business team in securing new business transactions, our asset and liability management team have been evolving our investment strategy to deploy the new premiums we receive and continue diversifying our portfolio. In particular, we have developed our direct investment strategy, which allows us to work with borrowers on secured lending that matches our very specific, and very long-term, liability cash flows. During the period, we have invested a further £500 million in financing to fund direct investments, primarily in university accommodation and social housing. We have now invested around £800 million in social and affordable housing across the UK. This strategy allows the funds backing the pension liabilities to be invested in ways which also benefit those needing low-cost accommodation, such as university students. This helps balance inter-generational equity.

We have also entered the equity release mortgage (“ERM”) market through a partnership with an award-winning ERM provider. This partnership meets with one of our broader aims of engaging in those areas of financial services which support the provision of financial safety and security to pensioners.

In other projects, we are very pleased to be working with the Institute and Faculty of Actuaries on a mentoring scheme for female actuaries across the industry. The aim of the scheme is to help promote diversity in the higher echelons of the profession – research has shown that non-retiring female actuaries leave the profession 13 years earlier than their male counterparts, at the respective ages of 40 and 53. We also launched our introductory paper on the Purpose of Finance, kicking off a long-term initiative to help find practical ways to reform the finance industry and make it fit for purpose. This paper, which helps to set the terms of the debate, is available on our website. Further papers on specific sectors are planned for the coming months.

Overall it has been a very positive period in which we have continued to add value by applying our expertise and risk management discipline, providing long-term security with a focus on excellent service to our customers. I look forward to continued success in the second half of the year.

Tracy Blackwell
Chief Executive Officer

OUR BUSINESS MODEL

PIC's asset base of £23.3 billion will be either used to meet claims and expenses or ultimately returned to capital providers

TOTAL ASSETS: £23.3 billion[1]

£18.9bn

ALLOCATED TO MEETING CLAIMS AND EXPENSES, INCLUDING

£1.2bn

ALLOCATED TO RESERVE FOR DEFAULTS AND DOWNGRADES (£0.3 BILLION OF WHICH IS ANTICIPATED TO BE RELEASED IN THE MCEV CALCULATION)

ASSETS AVAILABLE TO COVER SOLVENCY REQUIREMENTS AND RISK MARGIN

£4.4bn

DEBT HOLDERS

£0.6bn

(FAIR VALUE)

£3.8bn[2]

OF SURPLUS AND UNDERLYING VALUE, EXPECTED TO BE RELEASED OVER TIME AS CAPITAL, RISK AND PRUDENT MARGINS RUN OFF

Notes:
1 Comprising of financial investments, derivatives and net current assets.
2 Pre-tax and excluding prudent margins in default and downgrade reserve.

FINANCIAL RESULTS SUMMARY

Continued strong growth in financial investments and underlying operating profit

"PIC'S SOLVENCY RATIO STOOD AT 162% AT 30 JUNE 2017, DEMONSTRATING CAREFUL CAPITAL MANAGEMENT IN A PERIOD OF SIGNIFICANT NEW BUSINESS FLOWS."

Rob Sewell, Chief Financial Officer, PIC

During the first half of the year, PIC insured 10 (HY 2016: two) defined benefit pension schemes with a total premium value of £1.9 billion (HY 2016: £0.9 billion).

Partly as result of this new business, PIC's financial investments grew to £24.2 billion (2016: £22.6 billion), a 7% increase since year end. However, market movements also had a significant impact on financial assets, with positive movements in credit spreads being more than offset by interest and inflation rate movements, resulting in a decrease in the overall portfolio value prior to new business inflows. The net derivative position has reduced from £(1.3) billion at 31 December 2016 to £(1.1) billion at 30 June 2017, mainly due to currency and interest rate movements.

As part of the overall portfolio, PIC now has £4.4 billion of assets held in excess of best estimate liabilities (YE 2016: £4.3 billion).

The Company's MCEV at 30 June 2017 was £2,638 million compared to £2,579 million at 31 December 2016. PIC's MCEV increased by £124 million in the period, offset by a cost of £65 million due to changes in the market value of PIC's issued debt.

During the period, PIC's IFRS underlying operating profit before tax was £93 million, significantly ahead of the same period of 2016 (HY 2016: £79 million). At the same time, PIC recorded an overall operating profit before tax of £139 million (HY 2016: £81 million) and total IFRS profit before tax of £143 million (HY 2016: £152 million).

PIC concluded three longevity swap reinsurance transactions during the year covering longevity risk on c.£1.8 billion (HY 2016: £0.9 billion) of insurance liabilities. At 30 June 2017, around 70% of PIC's total longevity exposure on a regulatory solvency basis was reinsured to third party, investment grade reinsurance counterparties (YE 2016: 68%).

New business transactions, together with costs incurred, and the reinsurance deals concluded during the period, resulted in a contribution of £51 million (HY 2016: profit of £10 million) to operating profits.

PIC's non-operating profit, which over the long term is expected to be broadly neutral, was £4 million in the first half of the year. This profit mainly arose from positive impacts of the market movements, offset by the interest expense PIC incurs on its listed debt securities.

FINANCIAL RESULTS SUMMARY

Continued

- Profits generated from release of prudent margins for business written in previous years.

- Return on shareholder funds based on long-term investment return assumptions.

- Profit depends on mix of plans acquired.
- New business written to target IRRs.
- Prudent margins and capital released over life of contract.
- Creates VIF asset, resulting in increased EV.
- Emergence of future profits de-risked through hedges and reinsurance.

- Short-term fluctuations in investment return, model and assumption changes and non-recurring expenses.

IFRS operating profits

£m	**2017 Half year**	2016 Full year	2016 Half year
Return earned on insurance book	**70**	122	54
Return on surplus assets	**23**	55	25
Underlying operating profit	**93**	177	79
New business and reinsurance operating profit/(loss)[1]	**51**	(26)	10
Other changes to in-force business	**(5)**	(3)	(8)
Operating profit before tax	**139**	148	81
Non-operating profit before tax	**4**	128	71
Profit before tax	**143**	276	152

IFRS balance sheet

£m	**2017 Half year**	2016 Full year	2016 Half year
Assets			
Investment properties	**97**	97	96
Reinsurers' share of insurance liabilities	**2,564**	2,522	2,501
Receivables and other financial assets	**239**	216	171
Prepayments	**56**	34	32
Financial investments	**24,247**	22,594	19,859
Derivative assets	**7,113**	9,320	11,534
Cash and cash equivalents	**3**	6	10
Total assets	**34,319**	34,789	34,203
Equity			
Share capital	**1,000**	1,000	757
Other reserves	**60**	60	60
Retained profit	**815**	700	600
Total equity	**1,875**	1,760	1,417
Liabilities			
Gross insurance liabilities	**23,410**	21,741	19,354
Borrowings	**543**	542	295
Deferred tax liability	**4**	4	5
Derivative liabilities	**8,216**	10,654	13,027
Insurance and other payables	**204**	38	46
Current taxation	**28**	32	31
Accruals	**39**	18	28
Total liabilities	**32,444**	33,029	32,786
Total equity and liabilities	**34,319**	34,789	34,203

Note:
1 For 2017, the Company has amended its operating profits approach relating to the presentation of the impact of the new business and reinsurance deals to align more closely with the long-term expected profitability of the contracts. Previously, the new business and reinsurance profit or loss was calculated as at risk transfer date, based on the assets that were received at that time rather than the expected asset portfolio. Prior year comparatives have not been restated for this change in methodology.

PIC solvency ratio

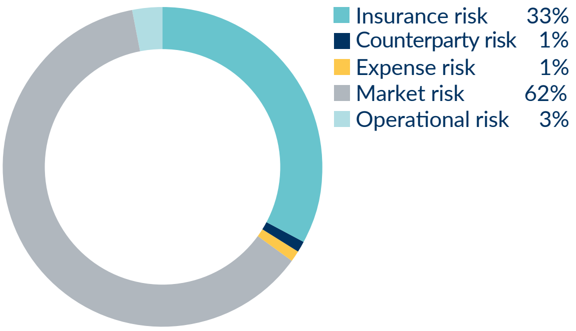
£m	2017 Half year	2016 Full year	2016 Half year
Net assets held in excess of best estimate liabilities (BEL)	**4,370**	4,256	3,628
Risk margin net of transitionals	**(987)**	(1,122)	(965)
Own funds	**3,383**	3,134	2,663
Solvency capital requirement (SCR)	**(2,085)**	(1,912)	(1,825)
Solvency surplus	**1,298**	1,222	838
Solvency ratio	**162%**[1]	164%	146%

Key solvency sensitivities

- **PIC uses various management tools to mitigate the impact of market fluctuations and manage its capital position.**
  - Pricing applied to new business and control of new business volumes.
  - New business only transacted provided it meets the Company's return on capital targets.
- **Hedging strategy structured to protect regulatory solvency balance sheet.**
  - Interest rate, inflation and FX risks are hedged to manage solvency balance sheet.
  - Longevity risk is managed through reinsurance where majority of risk is transferred.

PIC sensitivity of solvency ratio to changes in assumptions (£m)	Change in solvency ratio
As at 30 June 2017	162%
25bps increase in interest rates	4.1%[2]
25bps reduction in interest rates	(4.1)%[2]
£100 million credit default (no recovery)	(4.0)%
5% reduction in base mortality rates[3]	(7.9)%[2]

SCR by type of risk

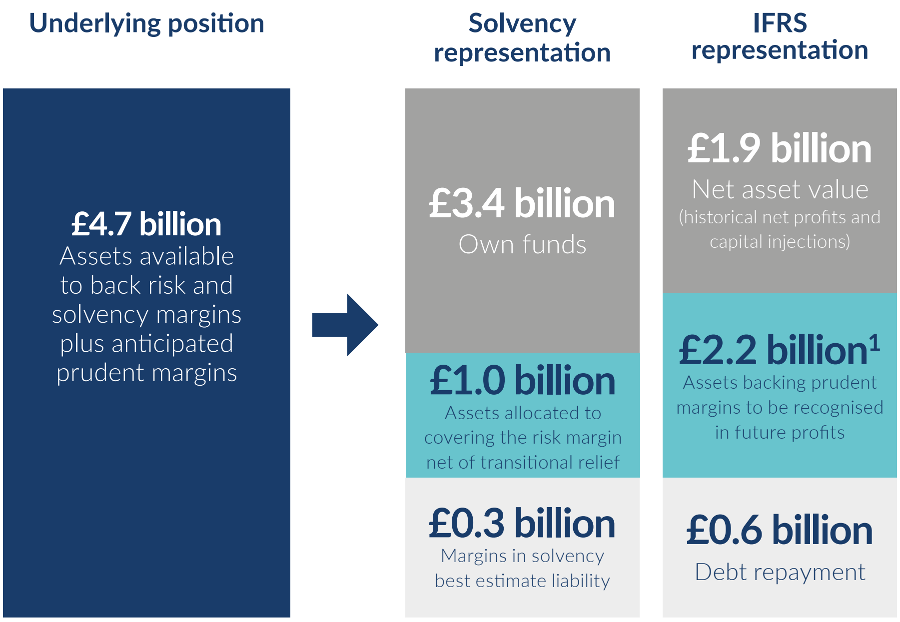


Notes:
1 No update to the TMTPs (Transitionals) has been included in the above solvency ratio. We estimate that if there had been an update, then the solvency ratio would have fallen marginally.
2 After recalculation of transitional relief.
3 Equivalent to a 0.4 year increase in life expectancy from 22.0 years to 22.4 years for a typical male aged 65.

FINANCIAL RESULTS SUMMARY

Continued

Solvency and IFRS balance sheets



Underlying value unchanged by IFRS or solvency representation

- Under both solvency (own funds) and IFRS (NAV), only a portion of the profits that will ultimately flow to shareholders are recognised at the balance sheet date. The remainder will be recognised in the future as prudent or risk margins run off.

MCEV

With effect from 1 January 2017 the Company has adopted the European Insurance CFO Forum Market Consistent Embedded Values Principles (the MCEV Principles)[2] for its embedded value measurement and reporting. The Company intends to follow the MCEV methodology going forward, and will no longer prepare financial information under the EEV principles.

30 June 2017 (£m)	Solvency balance sheet	Remove sub-debt	Recognise the frictional cost of required capital	Release (RM, DTL minus transitional), recognise CRNHR	Release matching adjustment margins	Tax on future profits	MCEV £m
Assets	23,305						
BEL	(18,935)						
Risk margin and deferred tax liability (DTL), net of transitional	(987)						
Solvency own funds	**3,383**						**3,383**
Present value of future profits				987	302	(393)	896
Cost of residual non-hedgeable risks				(830)			(830)
Frictional cost of required capital			(168)				(168)
Subordinated debt		(643)					(643)
MCEV							**2,638**

1 Prior to deducting the deferred tax liabilities.
2 Copyright© Stichting CFO Forum Foundation 2008.

Roll-forward and release of prudent margins primarily relates to the unwinding of the MCEV discount rate and the release of the cost of capital and cost of non-hedgeable risks for the business in force at the start of the period.

Economic variances capture the impact of the movements in the market variables (interest, inflation and credit spreads) during the period.

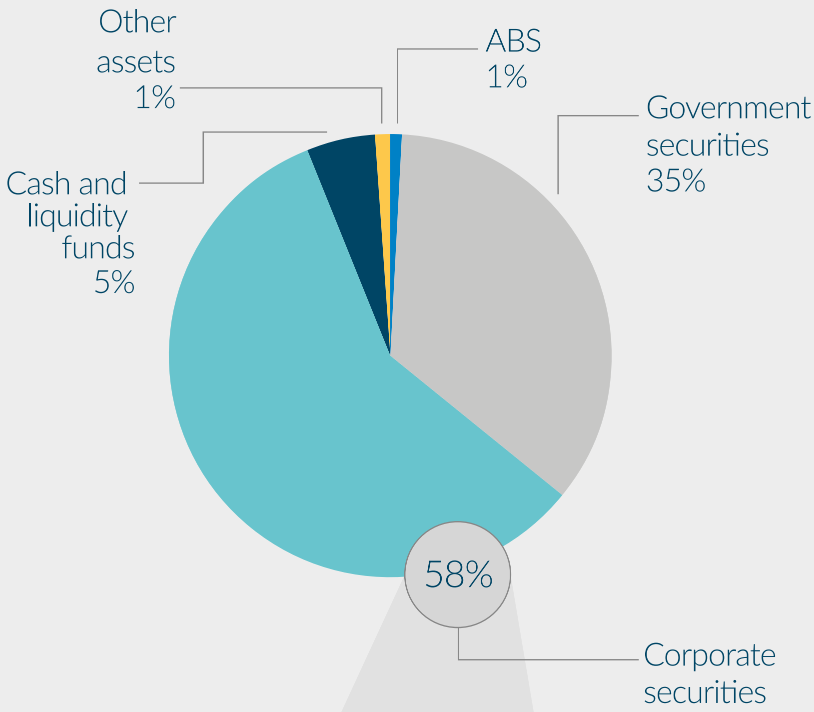
Non-economic variances include project costs, modelling changes, data updates, emerging claims experience and tax variances.

Change in embedded value (£m)	2017 Half year
Opening embedded value	**2,579**
Roll-forward and release of prudent margins	34
New business and reinsurance contribution	79
MCEV operating profit	113
Economic variances	23
Non-economic variances	(12)
Change in fair value of subordinated debt	(65)
MCEV movement in the period	**59**
Closing embedded value	**2,638**

ASSET AND LIABILITY MANAGEMENT

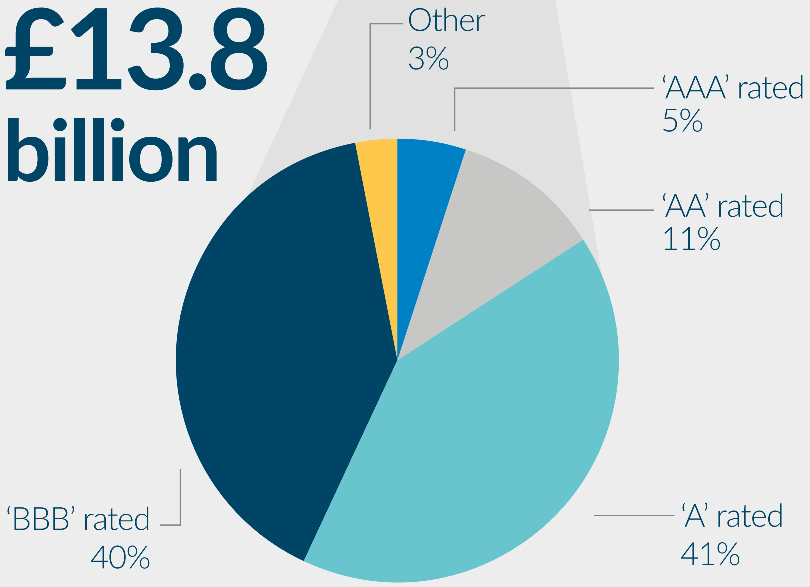
Financial investments portfolio by asset class (30 June 2017)

£24.2 billion



Corporate securities by rating

£13.8 billion



PORTFOLIO HIGHLIGHTS

- Investment strategy designed to invest in long-dated assets to match long-dated liability cash flows.
  - Discount rate applied to liabilities is based on the financial investments portfolio yield net of adjustments for expected defaults and downgrades.
- 90% of government securities were issued by, or guaranteed by, the UK government.
- 93% of financial investments in government and corporate securities.
- Corporate securities: 97% investment grade rated.
- No single counterparty (excluding UK government) represents more than c.2.6% of total financial investments.
- 49% of PIC's total financial investments run by in-house asset management team, including UK gilts, supranational bonds and private debt placements.
- 51% of financial investments managed by external asset managers, who manage the majority of our UK, US and emerging markets corporate bond portfolio.

Corporate securities split by regions

Country	30 June 2017 Market value (£m)	%
UK	6,174	44.8
US	4,845	35.1
Europe	1,294	9.4
Rest of the world	1,483	10.7
Total	**13,796**	**100.0**

Corporate securities split by industry sector

Industry sector	30 June 2017 Market value (£m)	%
Financial	4,100	29.7
Consumer, non-cyclical	1,570	11.4
Utilities	1,566	11.4
Energy	1,328	9.6
Communications	1,327	9.6
Direct investments (unlisted)	1,179	8.6
Consumer, cyclical	816	5.9
Technology	618	4.5
Industrial	603	4.4
Basic materials	567	4.1
Diversified	103	0.7
Quasi-government (non-risk free)	19	0.1
Grand total	**13,796**	**100.0**

Internal ratings methodology

PIC uses credit ratings on its debt portfolio to calculate the appropriate default and downgrade provisions and the Solvency Capital Requirement capital to be held. Where there is no external rating PIC assigns an internal rating.

PIC has currently c.£1.9 billion of internally rated assets covering a range of sectors including housing associations, student accommodation and renewable energy. The vast majority of such assets are rated as investment grade debt instruments originated by PIC as part of its direct investment strategy.

PIC invests in these types of assets for two reasons. The first is because of the enhanced levels of risk adjusted returns available, underpinned by underlying assets being financed. The second is the ability to work with the lender to design the asset cash flows match the cash flows of the liabilities PIC expects to pay over the coming decades.

PIC adheres to a robust internal credit rating process and governance in respect of the assignment of internal ratings which it believes are equivalent to external ratings. All internal ratings are approved by PIC's Credit Committee, which includes members with prior experience at external rating agencies.

APPENDIX 1

OVERVIEW OF REPORTING BASES

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.

PIC is authorised to write long-term insurance business by the Prudential Regulation Authority ("PRA") and is regulated by the PRA and the Financial Conduct Authority ("FCA"). We operate in a highly regulated environment where our UK prudential regulator, the 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 policyholder benefits, as an additional safeguard for policyholders.

Our main income derives from new business premiums and investment returns. Our principal outgoings are pension-related payments to policyholders, 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 and solvency disclosures with additional information on an "embedded value" basis, which captures the full value of the business over the long term and recognising the realisation of prudent margins held on the balance sheet.

Presentation of financial results

The IFRS basis results for the 2017 and 2016 half years are unaudited and they have not been reviewed in accordance with International Standard on Review Engagements 2410. The 2016 full year IFRS basis results have been derived from the 2016 statutory accounts. The auditors have reported on the 2016 statutory accounts. The auditors' reports were: (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 Market Consistent Embedded Value ("MCEV") results for the 2017 half year are unaudited. The 2016 year end MCEV results have been derived from the 2016 year end PIC MCEV report, which included an unqualified audit report from the auditors in respect of compliance with the MCEV Principles set out by the European CFO Forum.

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.

Solvency

The Solvency II regulatory framework was implemented on 1 January 2016. It is based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessments of risk and enhanced disclosure requirements. The solvency results are prepared in accordance with the financial reporting provisions of the PRA Rules and Solvency Regulations.

Under the solvency regime, firms can either follow a prescribed approach to calculating required regulatory capital (the standard formula approach), or they can apply to the supervisory regulatory body to use an "internal model", developed by the Company but subject to comprehensive review and approval by the regulatory body, in our case the PRA.

PIC obtained the PRA approval for its internal model, which we believe better reflects the risk profile of the Company's business, in December 2015. The PRA also approved other solvency related applications made by the Company in respect of the Matching Adjustment, Volatility Adjustment and Transitional Measures, which are all related to how elements of the solvency balance sheet are calculated.

PIC has successfully transitioned into the solvency regime, and published its first Solvency and Financial Condition Report in June 2017. This report is available on the PIC website.

Market Consistent Embedded Value

From 1 January 2017, PIC adopted the European Insurance CFO Forum MCEV Principles for its embedded value measurement and reporting. The MCEV methodology is based on the Solvency II framework, rather than IFRS. PIC will no longer prepare financial information under the previously used EEV principles.

MCEV breaks down the solvency balance sheet sufficiently to demonstrate the present value of shareholders' interest in the expected distributable profits of the business over the long-term, after making sufficient allowance for residual risks.

The MCEV results are prepared in accordance with the European Insurance CFO Forum MCEV Principles issued in April 2016. MCEV represents the present value of shareholders' interest in the distributable profits of the business after making sufficient allowance for the aggregate risks. It consists of following components:

- Free surplus – the market value of any excess assets allocated to the in-force business at the valuation date;
- Required capital – the market value of assets over and above that required to back liabilities and whose distribution to shareholders is restricted until such time when it becomes available for distribution based on the regulatory requirements. Required capital is presented from a shareholder perspective and therefore subordinated debt is excluded. The minimum amount of required capital the Company expects to hold is set equal to 130% of the Solvency Capital Requirement; and
- Value of in-force business – the sum of present value of future profits (post-tax, net of reinsurance cash flows), frictional cost of required capital and cost of residual non-hedgeable risks.

Key MCEV assumptions:

- Economic matching adjustment ("MA") is similar to the solvency matching adjustment but with a more realistic view of the cost of defaults and downgrades. This assumption is driven by the actual asset spread, net of the expected cost of defaults and downgrades.

- Cost of residual non-hedgeable risks is an allowance for the cost of the risks which cannot be readily hedged in a liquid market. In MCEV calculations the following categorisations are made for the risks:
  – We have assumed that longevity reinsurance is not a readily available hedge for insurance risk, hence this is included within the CRNHR calculation.
  – We treat all market related risks as hedgeable or having symmetric impact on shareholder value.

Other differences between Solvency II and MCEV assumptions relate to:

- Subordinated debt, which is treated as Tier 2 capital under Solvency II, is recognised at fair value for the purposes of MCEV;
- SCR, which is released over time and is replaced with frictional cost of capital for MCEV; and
- Risk margin, which is released over time and is replaced with CRNHR, with a cost of capital rate of 3.2%.

IFRS

The half year IFRS results are prepared on the same basis as those required for annual statutory reporting purposes. The results 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 or for the release of the prudent margins.

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.

This results in new business having a financial impact on Day 1 (reported as "New business operating profit/(loss)"), and also over the life time of the business as prudent margins are released. The release of these prudent margins is reported under "Return earned on insurance book".

IFRS-based measures of profit or loss ("Operating and non-operating profit")

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.

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 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 assets and liabilities, and return from our surplus assets based on our long-term return assumptions.

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 each discrete accounting period.

APPENDIX 2

GLOSSARY

Annuities
A type of insurance policy that pays out regular amounts of benefit to the policyholder for the remainder of insured individual's lifetime and, in certain cases, that of their spouse and/or dependants.

The payments may commence immediately ("immediate annuity") or may be deferred to commence from a future date, such as the date of retirement ("deferred annuity"). Immediate annuities and deferred annuities may be purchased for an individual and his or her dependants or on a bulk purchase basis for groups of individuals.

Assets under management (AUM)
Represents all assets actively managed or administered by or on behalf of the institution including those funds managed by third parties.

Best estimate liability (BEL)
The best estimate liability represents the value of future liability and expense cash flows. It is based on realistic assumptions with no prudent margins (other than in the default and downgrade assumptions stipulated for the calculation of the valuation discount rate) and is calculated using well-established actuarial and statistical methods.

Cost of residual non-hedgeable risks (CRNHR)
Under MCEV, allowance for the cost of holding capital in respect of non-hedgeable risks. Market risks are assumed to be hedgeable and so no cost is allowed for any capital that might be held under the regulatory solvency regime. Longevity risk is treated as hedgeable but only to the extent that the risks have actually been hedged, typically using reinsurance. Longevity risk that has not been reinsured at the balance sheet date is treated as non-hedgeable for the purpose of calculating the cost of non-hedgeable risks.

Defined benefit (DB) pension plan
An employer-sponsored retirement benefit plan where the benefits promised to the members of the plan are defined according to a formula typically based on factors such as salary history and duration of employment. Investment risk and portfolio management are entirely under the control of the trustees of the pension plan and not the employee or employer.

Frictional cost of required capital (FCoC)
The cost associated with the assets used to support required capital under MCEV, principally in respect of investment management fees and tax on investment income.

Minimum capital requirement (MCR)
The lower of the two capital levels required by Solvency II. It represents the minimum level of capital required to be held by an insurer before ultimate regulatory intervention is triggered.

PIC's internal model
A risk management system developed by PIC to analyse its overall risk position, to quantify risks and to determine the capital required to meet those risks. PIC has obtained appropriate approval from the PRA to use its internal model to calculate its solvency capital requirement under Solvency II.

Present value of future profits (PVFP)
Represents the present value, after tax, of the future release of regulatory margins, such as risk margin.

Prudential Regulation Authority (PRA)
The PRA is a part of the Bank of England and is responsible for the prudential regulation of deposit-taking institutions, insurers and major investment firms.

Risk margin (RM)
Life insurance companies hold technical provisions (reserves) calculated using actuarial principles to ensure they have sufficient funds available to pay their technical liabilities when they fall due. The technical provisions comprise a best estimate liability (BEL) and a risk margin (RM). The RM calculation, which is prescribed under the Solvency II regulations, is determined by considering the amount that a notional third party, a reference undertaking, would require in order to take over the liabilities and have sufficient capital to support them over their future lifetime.

Solvency II
An EU-wide regulatory regime which intends to align solvency capital to an insurers' risk profile. Solvency II was implemented on 1 January 2016.

Solvency capital requirement (SCR)
The SCR represents the capital that the Company needs to hold in order to be able to survive a 1-in-200 year risk event over the 12 months following the balance sheet date. PIC calculates its SCR using a Company-specific model (the internal model) which has been approved by the PRA. The main components of the SCR are market risk and insurance risk, but the internal model also covers counterparty default risk, expense risk and operational risk.

Standard formula
A risk-based mathematical formula used by insurers to calculate their solvency capital requirement under Solvency II. The standard formula is intended for use by most EU insurers, although they may use an internal model instead, subject to regulatory approval.

Technical provisions (TP)
The value of technical provisions on the Solvency II basis is equal to the sum of a best estimate liability (BEL) and a risk margin (RM).

Transitional measures (TMTP)
PIC uses a transitional measures deduction on technical provisions in its Solvency II balance sheet. The TMTP allows companies to smooth the transition from the previous regulatory regime to the Solvency II approach, for example in having to set up the risk margin, and is deducted from the overall Technical Provisions. The TMTP only applies in respect of business that was in force at 31 December 2015, and it runs off linearly to zero over 16 years.

VIF
Value of In-Force. This is the discounted value of after-tax profits expected to emerge from the in-force business over time, and is used in the embedded value calculation.

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