PENSION INSURANCE CORPORATION
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PENSION INSURANCE CORPORATION PLC ANNUAL REVIEW 2017

PENSION INSURANCE CORPORATION

PENSION RISKS SECURED

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

PIC'S PURPOSE

Our purpose is to pay the pensions of our policyholders.

WHO WE ARE

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

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

PENSION INSURANCE CORPORATION PLC
ANNUAL REVIEW 2017

AT A GLANCE

Paying the pensions of our policyholders, removing risk
from defined benefit pensions, creating certainty for employers and trustees

Our business

A specialist insurer, focused on securing the pensions of our growing policyholder base

> We secure the risks associated with defined benefit pension funds in the UK.
> We stand for customer service and integrity in our dealings with all our stakeholders.
> We are straightforward to deal with and do what we say we'll do.

A leader in the established, expanding market for pension insurance

> We specialise in pension insurance buyouts and buy-ins (bulk annuities).
> We price and structure transactions that meet individual client needs.
> We have robust risk management.
> We are authorised by the Prudential Regulation Authority (PRA) and regulated by the PRA and Financial Conduct Authority (FCA).

A focused business model

> We offer superior client service for policyholders, trustees and pension fund sponsors.
> We have no legacy business lines or product exposures.
> We deploy capital only if it meets internal economic criteria.
> We have an efficient operating model with economies of scale.
> We have fit-for-purpose IT and specialised processes.

AT A GLANCE

BUSINESS MODEL

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ADDITIONAL INFORMATION

2017 HIGHLIGHTS

Providing long-term financial security and stability for our policyholders and attractive returns for our shareholders

Premiums
£3,704M

2017	£3,704m
2016	£2,598m
2015	£3,755m
2014	£2,646m
2013	£3,663m

Financial investments
£25.7BN

2017	£25.7bn
2016	£22.6bn
2015	£16.6bn
2014	£13.3bn
2013	£8.9bn

IFRS Profit before tax
£391M

2017	£391m
2016	£276m
2015	£104m
2014	£170m
2013	£114m

MCEV
£2,926M

2017	£2,926m
2016	£2,579m
2015	£1,998m

Underlying operating profit
£195M

2017	£195m
2016	£177m
2015	£133m
2014	£116m
2013	£80m

Assets held to meet solvency and risk margin
£4.3BN

2017	£4.3bn
2016	£4.3bn
2015	£2.8bn

Solvency ratio
160%(1)

2017	160%
2016	164%
2015	151%

Customer satisfaction
98.3%

2017	98.3%
2016	98.5%
2015	99.3%
2014	99.8%
2013	99.3%

(1) Estimated and unaudited

STRATEGIC REVIEW

WHAT WE DO

Policyholders

“ACTIONS SPEAK LOUDER THAN WORDS AND PIC’S CUSTOMER SERVICE LEVELS HAVE GONE BEYOND MY EXPECTATIONS ”

I have been a PIC policyholder for six years, when the Morris Ashby Pension Fund was bought out. PIC was very supportive and responsive during the transaction, and from the way they dealt with taking on the Morris Ashby Pension Fund, they do a good job of focusing on their core purpose of securing our pensions. This was pleasing as when I first heard that my benefits were moving from a pension scheme to an insurance company, there were some concerns. However, everything ran smoothly and as they say, actions speak louder than words and PIC’s customer service levels have gone beyond my expectations.

I’ve been to some of the policyholder events that the company has put on and like having the chance to meet with old colleagues and members of the PIC team. The letters and documents are all easy to understand, and PIC has always been very helpful whether I am dealing with them by phone, online or through email.

Ray Parker, former Morris Ashby Pension Fund member, now a proud PIC policyholder

Employees

“I FEEL VALUED HERE ”

I have worked at PIC for almost seven years, having previously worked as an actuarial analyst at a pensions consultancy. Working for a growing and successful company has allowed me to develop my knowledge and skills across a range of areas as the business is evolving. I get a lot of variety in my work and I can shape how we implement changes into our regular processes. Senior colleagues are very approachable and supportive and I get to work with and share ideas with colleagues from other teams, which I wouldn’t be able to do as easily in a larger firm. I feel valued here.

When I heard about the Actuarial Mentoring Programme (see page 31), I was really attracted to it. I wanted more direction on where my career as an actuary was heading and how I could progress. It’s great to have the support network available to female actuaries and I’m already finding it of great benefit. Looking forward, I am hopeful for a long career as an actuary and a bright career ahead of me at PIC.

Rachel Ives, PIC actuary

STRATEGIC REVIEW

CHAIRMAN'S STATEMENT

Jon Aisbitt
Chairman

I am delighted to report that PIC had an outstanding year in 2017, with strong new business flows, increased profitability and high levels of customer and employee satisfaction. It was a year of strong, profitable growth in which we successfully completed several internal projects to further improve productivity, as well as the consistency and robustness of governance across the business.

The macro context within which PIC operates was broadly stable during the year. On the regulatory front, Solvency II is well bedded in and the bulk annuity market has shown that it can function effectively within this regulatory environment. However, the regulatory regime is not perfect, and we continue to work with industry counterparts on further refining it. In terms of markets, there was nothing significant to note from PIC's perspective during the year, although as ever, we would very much welcome more opportunities to invest in secure, long-term assets, such as infrastructure.

Politically, the major area of uncertainty for most financial services companies, Brexit, is not as relevant for us as it is for many others, given our UK focus. Any market volatility arising from Brexit would affect us, but the operational impacts are minimal. As a major consolidator of pension scheme assets and liabilities, we responded to the Government's consultation on the possibility of pension scheme superfunds, emphasising the need for pension scheme consolidators to be properly regulated, capitalised and governed.

In aggregate, the bulk annuity market had a creditable year, with £11 billion of liabilities being insured, which is the fourth year in a row the market has exceeded £10 billion. What was particularly interesting about 2017 was that this level of market activity was achieved without any individual bulk annuity transaction exceeding £1 billion. The largest transaction of the year was the £725 million buy-in we completed for the Dock Workers Pension Fund.

The outlook for the sector remains positive, with trustees of pension schemes having increased the certainty of their funding positions by investing a greater proportion of their assets in fixed income than ever before. These are assets that could back a future pension insurance buyout or buy-in.

As Chairman, the two criteria that I see as key to judging our success in managing the business are: whether our policyholders have full confidence in the security of their pension benefits; and whether our shareholders and bondholders receive an attractive return on their investment over time, commensurate with the level of risk to which they are exposed. My belief is that as we focus on our purpose of paying the pensions of our policyholders in a secure and sustainable way, these two objectives are both compatible and desirable, with the interests of these stakeholders being fully aligned.

> "SOLVENCY II IS WELL BEDDED IN AND THE BULK ANNUITY MARKET HAS SHOWN THAT IT CAN FUNCTION HIGHLY EFFECTIVELY WITHIN THIS REGULATORY ENVIRONMENT"

Consistent with our stated objectives, PIC has a conservative capital structure and a deep-rooted risk management culture. So, whilst we wrote £3.7 billion of new business in 2017 (2016: £2.6 billion), our second-best year, we maintained strict pricing discipline. Our focus on excellence in customer care has helped our reputation grow as our business has developed and this has in turn become increasingly important in winning new business.

As described in the Chief Financial Officer's review on page 40, the Company achieved strong results in the year.

During 2017, the Board focused on important issues including the on-going validation of the Company's regulatory capital model, share schemes for employees and governance arrangements such as the structure and membership of the Board and its committees, including diversity related matters. In terms of capabilities, an external review of the Board concluded that PIC's directors have a high level of industry experience, with strong expertise in the actuarial, finance and investment fields.

In Q1 2017 we welcomed CVC as a new, major shareholder and I am very pleased that we have a group of committed shareholders who have the means and desire to support the business in the long term.

Also during 2017, John Coomber stepped down from the Board, ending a long association with PIC, including a very successful period as CEO. PIC was fortunate to benefit from his many years of insurance experience, including as CEO of Swiss Re, and I want to thank him for his insights, guidance and dedication.

I very much look forward to chairing PIC's Board for a second year.

> "OUR FOCUS ON EXCELLENCE IN CUSTOMER CARE HAS HELPED OUR REPUTATION GROW AS OUR BUSINESS HAS DEVELOPED"

STRATEGIC REVIEW

SECTOR REVIEW

A significant, growing market, driven by an increasing desire by pension fund trustees to reduce risk, combined with a healthy and competitive bulk annuity sector providing them with the opportunity to do so at an affordable price

UK DEFINED BENEFIT PENSIONS: THE KEY NUMBERS

A GROWING MARKET

Assets held within UK defined benefit pension schemes[1]

2016: £1.3 TRILLION
2017: £1.5 TRILLION

Gilts and fixed income assets to securely match liabilities[2]

2016: £650 BILLION
2017: £840 BILLION

Percentage of FTSE 100 companies over 80% funded on a buyout basis[3]

2016: 10%
2017: 20%

Defined benefit pension liabilities insured through buyouts and buy-ins[4]

2016: £70 BILLION
2017: £81 BILLION

(1) PPF Purple Book 2017
(2) PPF Purple Book 2017
(3) LCP Pensions Derisking Report January 2018
(4) LCP and Willis Towers Watson (Data from 2017 includes transactions announced at time of going to press)

Buy-in and buyout volumes (£bn)

£11BN[1]

	£bn
2017	11.0
2016	10.2
2015	12.3
2014	13.2
2013	7.5

Since 2008, when PIC wrote its first transaction, the Company has maintained an average market share of 27% for buyouts and buy-ins[2]

"INSURER COMPETITION AND ASSET OPPORTUNITIES ARE DRIVING ATTRACTIVE PRICING"

Hymans Robertson buy-in monitoring service, October 2017

"THE AVERAGE BUYOUT FUNDING LEVEL IS NOW AT ITS HIGHEST LEVEL SINCE BEFORE THE BANKING CRISIS IN 2008"

LCP Derisking Report, January 2018

(1) LCP and Willis Towers Watson buyout reports (Data from 2017 includes transactions announced at time of going to press)
(2) Source: Hymans Robertson and LCP reports. Only business with a UK pension scheme is included.

STRATEGIC REVIEW

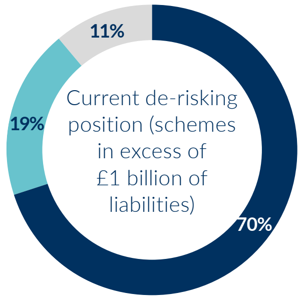
SECTOR REVIEW

CONTINUED

Pension schemes are increasingly showing a desire to de-risk which, combined with more closely matching assets and liabilities and a healthy bulk annuity sector, has meant that full buyouts are a realistic prospect for more pension schemes. In the meantime, many trustee boards are conducting multiple buy-ins

Intention

Do schemes want to de-risk?



Q. What is your scheme's current position with regard to de-risking?

- Expect to reduce risk in the next 24 months
- Expect to make no changes in the next 24 months
- Intend to increase risk to target higher returns

Source: Professional Pensions/PIC research, 2017

Opportunity

A healthy bulk annuity sector

Repeat buy-in strategy

Market data shows that the majority of transactions during 2016 and 2017 have been pensioner buy-ins.

The advantages to this include:

Tailoring
Opportunity to tailor the tranches, for example, according to the insurer's target market.

Optimal pricing
Prices vary according to the market and the liabilities being insured. Transacting in phases allows schemes to move at the right time for them.

Efficiency
Synergies with the overall investment strategy of the scheme can be realised through a phased approach.

Simplifies decision-making
Schemes can progressively remove risk, whilst achieving the scheme's long-term objectives.

Successful schemes typically:

- **Use specialist advisors**
- **Have realistic pricing expectations**
- **Have clear decision milestones and lines of authority**
- **Don't delay implementing the decision**

Move to full buyout

Improved investment returns, changes to interest rates and indications of a slow-down in longevity improvements are leading to improved funding levels for pension schemes, potentially fuelling an increase in demand for buyouts.

Means

Are schemes in a position to consider securing their liabilities through a buy-in or buyout?

Preparatory steps

Pension schemes are positioning themselves to take advantage of a competitive market and the ability to move quickly. Being prepared can increase the likelihood of securing a transaction and attractive pricing.

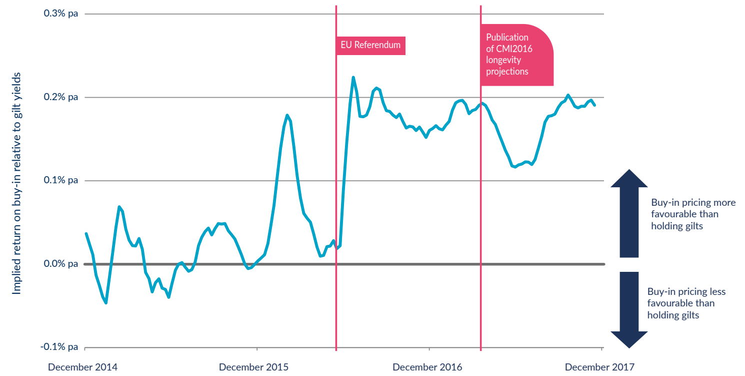
Q. Which of the following risk reduction strategies has your scheme implemented?

51%	33%	13%	21%	17%
Increasing proportion held in close matching assets	Increasing interest rate and/or inflation hedging ratio	Managing liabilities through Pension Increase Exchanges, ETVs etc	Sponsor pledged assets	Buy-ins/buyouts

The cost of a buy-in versus gilts

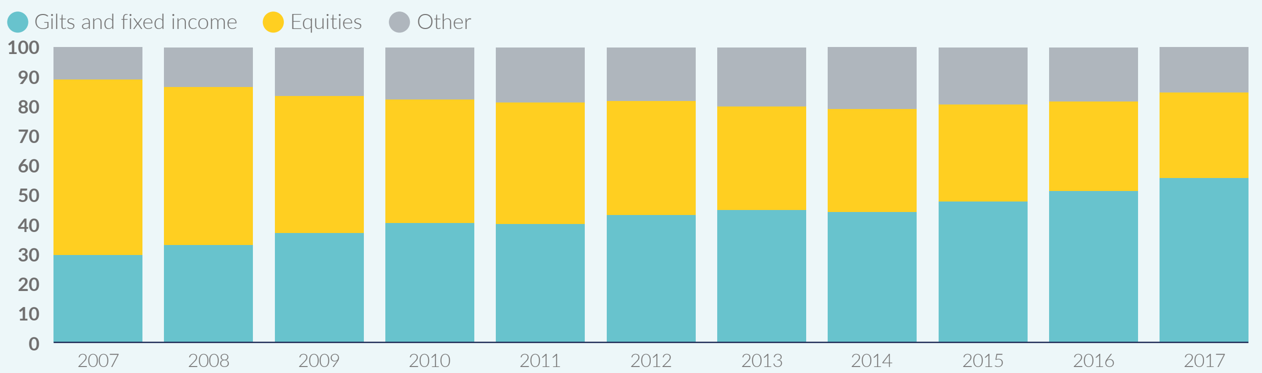
Gilts, assets which are used to closely match pension liabilities, can be used to purchase a pensioner buy-in for little or no incremental cost.

Pensioner buy-in pricing relative to holding gilts



Source: LCP Pensions Derisking Report January 2018

Asset allocation of defined benefit pension schemes (%)



Source: PPF Purple Book 2017

STRATEGIC REVIEW

WHAT WE DO

New business

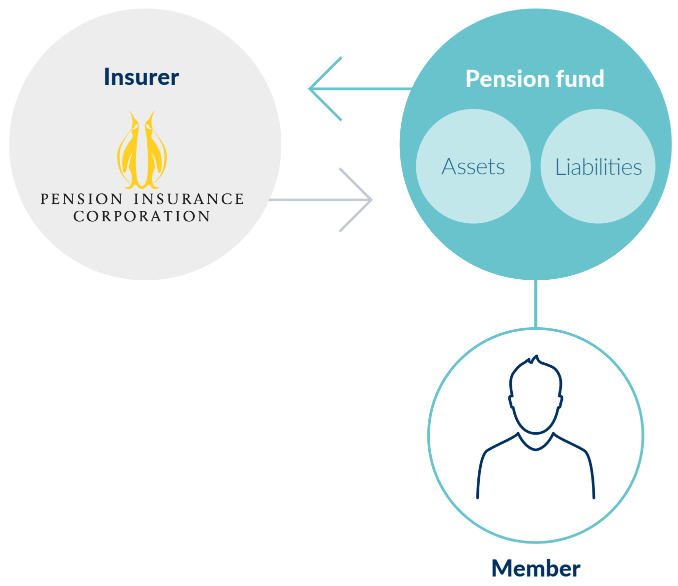
What is a pension insurance buy-in?

> The pension fund purchases a bulk annuity insurance policy to cover its obligations to a subset of the fund members. The insurance policy is held as an asset of the pension plan.

> A buy-in is a perfectly matching investment for the insured liabilities.

> A buy-in removes the pension fund's longevity, market interest rate, inflation and other risks, as these are transferred to PIC.

> PIC has no direct relationship with pension fund members, who continue to be managed by the trustees.

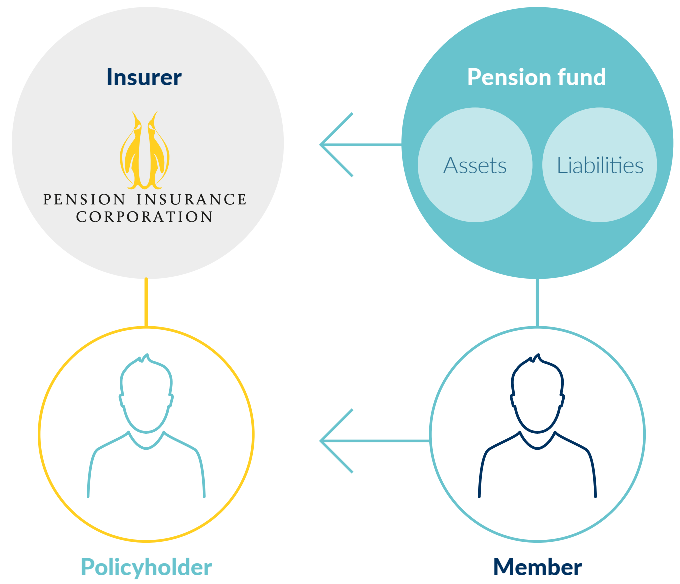


What is a pension insurance buyout?

> A buyout removes pension assets and liabilities from a pension fund and employer's financial reports i.e. a full settlement of the pension fund and employer's obligations to the fund members.

> PIC issues individual annuity insurance policies to the members of the pension fund as a replacement for their claim on the pension fund.

> The pension fund is typically wound up and assets pass across to PIC.



Examples of 2017 new schemes

Pirelli pension schemes

- PIC concluded a c.£100 million full scheme buy-in with the Trustees of three defined benefit pension schemes sponsored by Pirelli UK Limited and Pirelli Tyres Limited.
- Each of the three schemes were completely de-risked providing greater security to members.

WPP pension schemes

- PIC simultaneously insured £140 million of liabilities of five pension schemes sponsored by WPP, covering pensioner and deferred liabilities.
- WPP is a British multinational advertising and public relations company, listed on the LSE and is a constituent of the FTSE 100.

Wolseley Group Pension Plan

- PIC concluded a £600 million pension insurance buy-in of the Wolseley Group Retirement Benefits Plan covering all of the pensioner liabilities.
- The Trustees de-risking strategy allowed them to take advantage of market conditions.

Our clients

We have successfully completed buy-in and buyout transactions for clients including:

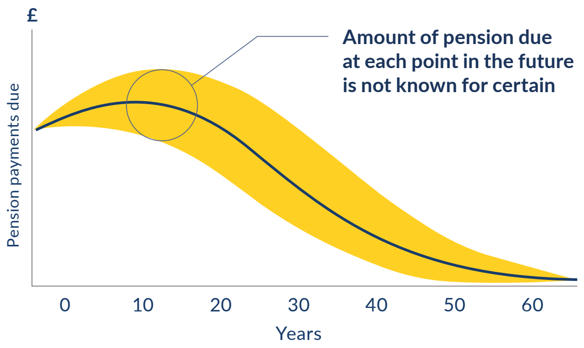
STRATEGIC REVIEW

OUR BUSINESS MODEL

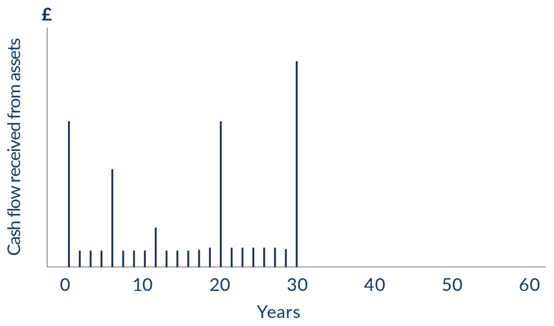
Three key steps in securing pensions and generating long-term shareholder returns

1 What we receive

Pension liabilities taken on are uncertain in both timing and amount (longevity and inflation uncertainty)



Assets are typically received in cash and gilts and are not cash flow matched to the liabilities



The profile of cash returns from the assets are typically very different to the profile of the cash payments due to pensioners (see chart above)

2 What we do

LIABILITIES ARE HEDGED FOR INTEREST RATE AND INFLATION EXPOSURE

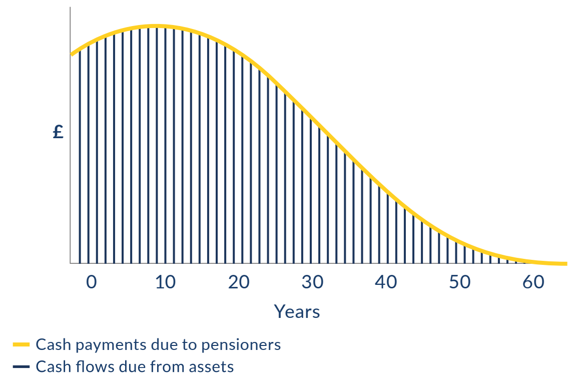
ASSETS RECEIVED ARE REINVESTED TO OPTIMISE RETURNS ON A CASH FLOW MATCHED AND RISK-ADJUSTED BASIS

LONGEVITY RISK IS REINSURED TO REMOVE RISK, CREATE CERTAIN LIABILITY CASH FLOWS AND OPTIMISE CAPITAL DEPLOYMENT

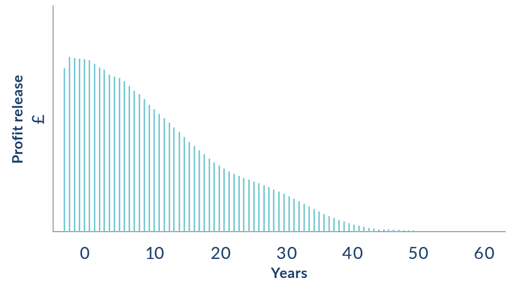
PIC CAPITAL RESOURCES COMMITTED

3 The outcome

Best estimate liabilities are made more certain and cash flow matched with high quality assets to provide secure long-term pensions for our policyholders



Underlying profit profile in premium is optimised and, together with the committed capital resources, is released over time, generating attractive risk-adjusted returns on capital employed



Keys to success

PIC is a specialist insurer completely focused on the activities required to succeed in its chosen sector

Success in the bulk annuity market requires expertise in

- looking after policyholders
- structuring transactions
- investing assets
- hedging liabilities
- reinsuring longevity risk
- raising capital
- bringing all these skills together on a coordinated and efficient basis for transacting and transitioning new business.

PIC's track record in all of these areas underpins its position as a leader in providing bulk annuities.

STRATEGIC REVIEW

CHIEF EXECUTIVE OFFICER'S REPORT

Tracy Blackwell
Chief Executive Officer

PIC had a very successful year in 2017 across a number of fronts including our focus on customer care, the amount of new business transacted, the record level of longevity risk reinsured, our overall financial results, and levels of support from our employees.

Our key financial metrics demonstrate the strength of the business. We finished the year with total new business premiums of £3.7 billion, across 20 pension schemes, and took on responsibility for the pension payments of an additional 24,000 policyholders. Our IFRS profit before tax for the year of £391 million represents a 42% increase on the prior year.

PIC's underlying operating profit, which better reflects management's view of the profitability of the business and its activities (see page 41 for an explanation of this metric), grew to £195 million (2016: £177 million), an increase of 10% year-on-year. PIC's Market Consistent Embedded Value (MCEV) rose to £2,926 million (2016: £2,579 million), an increase of 13% in the year. Due to strong new business numbers, our investment portfolio is now £25.7 billion (2016: £22.6 billion), and PIC's solvency ratio at year-end was 160% (2016: 164%).

To fulfil our main purpose of providing financially secure pensions to our policyholders, as well as transacting new business and growing that pool of policyholders, there are several key areas in which we, as a specialist insurance company, need to excel. These include a very clear and strong focus on getting the best outcome for our customers, the ability to source the right sort of assets, the development of strong working relationships with reinsurers and the need to retain excellent staff.

Excellence in customer service is an area that is very close to my heart, as well as one of our key values. We were therefore proud to attain the Institute of Customer Service's (ICS) ServiceMark with Distinction – the only financial services company in the country to have done so. As the ICS noted, "Their dedication to, and passion for, great customer service marks PIC out as a standard bearer – one that others should follow." Our customers also continue to give us excellent feedback, with over 98% of policyholders expressing overall satisfaction with our service.

Over the past few years, PIC has built a team capable of sourcing, analysing and investing in secure, inflation-linked assets, on a private basis, to back very long-term liabilities. The rationale for this strategy is that compared to what is available in the public bond markets we are able to achieve better pricing for equivalent credit risk, obtain both higher and more reliable levels of security and source cash flows that more precisely match our long-term liabilities. The team invested more than £1 billion in 17 private debt transactions, in areas such as social housing, university accommodation and offshore wind power generation. Not only is this beneficial for those pensioners these assets are helping to secure, it is also beneficial for future generations who will benefit from our investment today in the country's infrastructure.

The main issue for us is that demand for these types of assets continues to outstrip supply. As well as developing the necessary levels of expertise, innovation and flexibility in-house to ensure we are a lender of choice for borrowers, we have consistently raised this issue with Government Ministers to encourage them to increase the supply of infrastructure assets in which we can invest. Separately, we were pleased to provide our first line of funding for equity release mortgages during the year. We see equity release mortgages as a product that fills an important need in our ageing society and we believe we can play an effective role in its development.

> "OVER THE PAST FEW YEARS, PIC HAS BUILT A TEAM CAPABLE OF SOURCING, ANALYSING AND INVESTING IN SECURE, INFLATION-LINKED ASSETS, ON A PRIVATE BASIS, TO BACK VERY LONG-TERM LIABILITIES"

At PIC we have always sought to carefully manage our longevity risk, signing our first longevity reinsurance contract as long ago as 2008. However, our latest reinsurance transaction is particularly pleasing. In December, we were able to reinsure the entirety of our longevity exposure to the Dock Workers Pension Fund (which we fully insured in November 2017), with PartnerRe, a new counterparty for us. We also added SCOR as a new reinsurance counterparty in the year, as well as Challenger Life. We now have strong working relationships with ten major reinsurance companies, providing us with a deep pool of risk mitigation counterparties.

As I noted in my half year report, we welcomed CVC as the latest shareholder in PIC's ultimate parent company, Pension Insurance Corporation Group, following their purchase of shares from historical long-term shareholders. We have a supportive group of shareholders who are able and willing to enable us to meet any significant increase in demand from trustees.

The results of our latest employee survey have also been very pleasing. 97% of our employees believe PIC is customer focused (2016: 95%), 92% feel proud to work for PIC (2016: 90%), and 99% of employees believe PIC will be successful over the next few years (2016: 98%). I want to thank our employees for all their hard work in making 2017 so successful.

Finally, we are fast approaching the tenth anniversary of the collapse of Lehman Brothers and the depths of the financial crisis. It is my firm conviction that we in the finance industry have not done enough in those ten years to rebuild trust with society. I believe that financial services companies have a duty of responsibility that goes well beyond our shareholders and even our customers. I was delighted therefore to progress two initiatives that demonstrate PIC's commitment to playing our part in society: a project to encourage discussion and action based on "The Purpose of Finance", which has engendered interest from senior politicians and leaders in finance alike; and a pioneering mentoring scheme for female actuaries, "Project AMP", in conjunction with the Institute and Faculty of Actuaries, to help increase levels of female talent at the top of the profession over time.

As a business we are passionate about ensuring the best outcomes for our stakeholders including our customers (our policyholders, as well as pension scheme trustees and their sponsoring companies), our investors, and our employees. 2017 was a very successful year for us, and I believe that this focus will mean continued success.

STRATEGIC REVIEW
OUR STRATEGY

Continued progress in meeting our key strategic objectives

Strategic objectives	2017 progress	KPIs
Growth and focus Grow the value of the business on a focused, secure and sustainable basis	> Maintained long-term market share of c.27%, with a focus on pricing discipline > New business comprises an increased number of repeat transactions via buy-ins > More than £1 billion invested directly with long-term borrowers to provide higher yielding, secure assets to back pension cash flows > Reinsurance of £4 billion of longevity risk > Solvency position of 160%	> More than 30% organic growth in PIC's embedded value since year-end 2015 > Investment portfolio has grown by 30% Compound Annual Growth Rate ("CAGR") since year-end 2013
Reputation Long-term value creation through market-leading customer service	> Awarded ServiceMark with Distinction by the Institute of Customer Service > Senior management hosted almost 3,000 policyholders and guests at complimentary events > Annual survey of employees completed to assess their understanding of, and grounding in, PIC's customer service culture and values	> 98% of policyholders are satisfied or highly satisfied with PIC's service levels > 97% of employees believe PIC is customer focused (always seeking to understand and meet customer needs) (2016: 95%)
Returns Deliver attractive risk adjusted total shareholder returns	> £3.7 billion of new business written in 2017 on terms consistent with PIC's long-term IRR targets > IFRS profit before tax was £391 million (2016: £276 million), an increase of 42% > PIC's underlying operating profit before tax was £195 million (2016: £177 million), an increase of 10% in 2017 > Market Consistent Embedded Value (MCEV) increased to £2,926 million (2016: £2,579 million), a rise of 13% during the year > £4.3 billion of assets (2016: £4.3 billion), in excess of best estimate liabilities	> 25% CAGR in PIC's underlying operating profit over the past four years > Over 30% organic growth in embedded value over the past two years > 30% CAGR in financial investments over four years
Cost efficient A scalable business model that optimises internal and external resources	> Expenses reflect investment in business infrastructure to capture future economies of scale > Reduction in debt yield indicates lower future cost of capital > Continued development of Board committees and structure to enhance decision making	> Improving efficiency as the business develops > The yield on the two subordinated debt issues fell over the year
Knowledge and conduct Ensure that our behaviours reflect our values	> Proposed and funded mentoring programme for junior female actuaries, in conjunction with the Institute and Faculty of Actuaries > Published ground-breaking report on "The Purpose of Finance" to encourage financial services businesses to think about why they exist and how to rebuild trust with society	> Knowledge and conduct are not a formal KPI; however, they provide an important foundation stone on which business support is built > 95% of employees said they had a good understanding of PIC's values (2016: 94%)

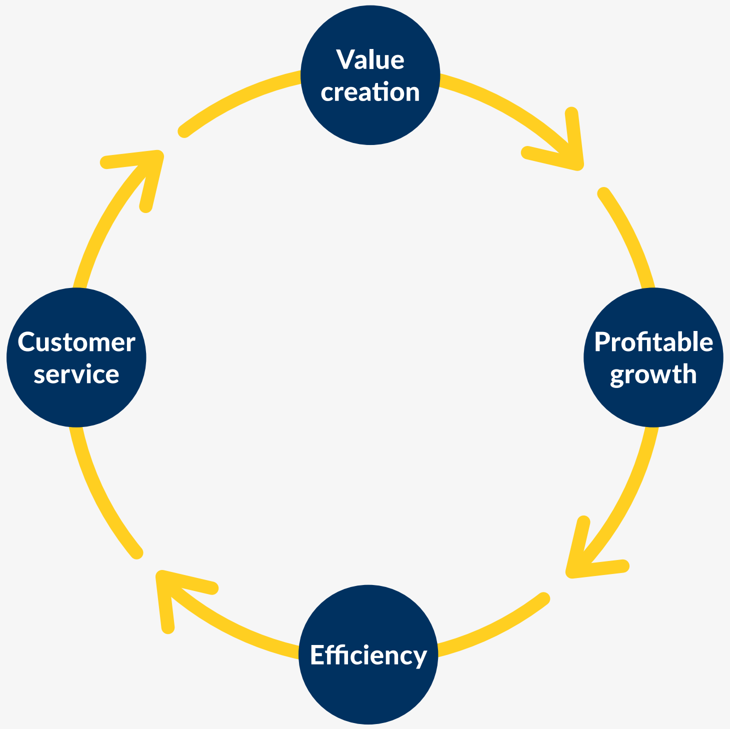
"PRUDENTIAL IS PROUD TO STRENGTHEN ITS GROWING PARTNERSHIP WITH PENSION INSURANCE CORPORATION"

William McCloskey, Prudential Insurance Company of America's head of transactions for international longevity reinsurance (£900 million longevity reinsurance transaction)

STRATEGIC REVIEW

KEY PERFORMANCE INDICATORS

Proven track record of growth across all metrics

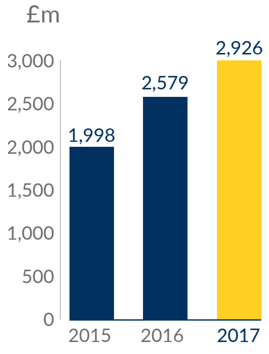


PIC focuses on five Key Performance Indicators (KPIs) to measure its performance in four main areas[1]:

Growth and overall value of the business, total shareholder returns, scale and efficiency, and customer satisfaction.

1 Full list of performance indicators are included on page 41

MCEV



- From 1 January 2017, PIC has adopted the European Insurance CFO Forum Market Consistent Embedded Values Principles ("MCEV Principles")[2] for its embedded value measurement and reporting.
- Embedded value gives a snapshot of the value created to date and facilitates market comparisons.
- MCEV is the key financial metric the Board uses to evaluate the progress of the business.

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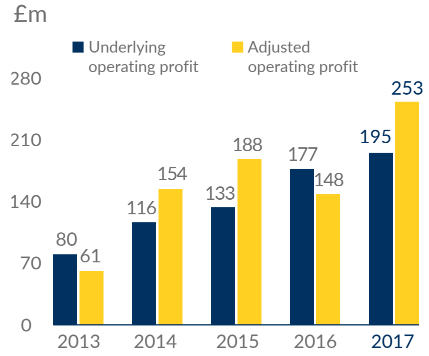
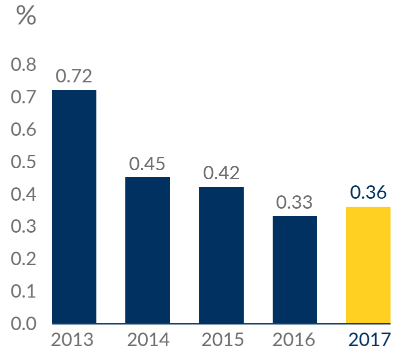
Profitability



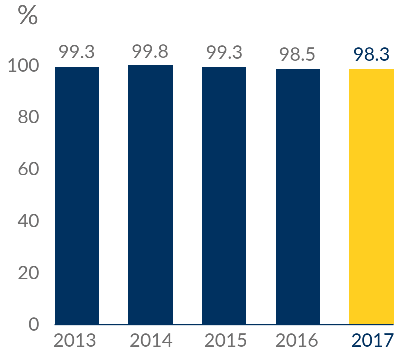
- Underlying operating profit evidences the translation of embedded value into reported profits.
- Underlying operating profit captures the returns made from the in-force book of insurance liabilities, and expected long-term returns from surplus assets.
- Growth of underlying operating profit evidences the levels of growth we are achieving in building long-term profitability.
- Adjusted operating profit includes the immediate short-term impact of new business and reinsurance.

Expense ratio



- Expenses as a % of closing financial investments under management evidences how our cost base relates to our financial investments and hence our relative efficiency.
- PIC is more financially efficient as we have gained scale and capability.

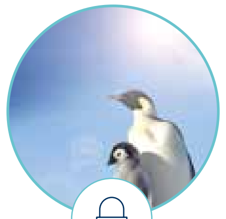
Customer satisfaction



- As well as the financial metrics, the business also uses customer satisfaction as a KPI with an emphasis on excellent customer service. This is done by measuring:
  - % of customers surveyed who give PIC a satisfied or very satisfied rating, evidencing the quality of the service we have given.
  - The average number of complaints per 1,000 policyholders over the past five years, which evidences how proactive our service is and the clarity and efficiency of our policyholder communications (see page 22).

STRATEGIC REVIEW
STAKEHOLDER ENGAGEMENT

Our values



Providing security

The resilience to withstand even the harshest of economic storms

We are committed to managing risk and providing long-term stability and financial security for our customers. We respect boundaries and regulate ourselves at a level in excess of regulations. Our strong, conservatively managed balance sheet ensures resilience against tough economic events.

Valuing our customers

Our customers are our priority and our purpose is to pay the pensions of our policyholders on a financially secure basis. We value all our customers (policyholders, trustees and sponsors) and work hard to provide exceptional service. We listen to and will be responsive to their requirements acknowledging the need for fair and sustainable commercial practices.

Being a team

Our nature? To nurture

We know the benefit of working together as a team. We respect, value and nurture our people both in terms of their development and engagement. And we're open to new ideas, perspectives and opinions.

Doing the right thing

All-weather friends

Our policyholders are our partners for life, which is why our strong ethos around doing the right thing is so important to us. Our policyholders must be able to trust us. So, we live by a set of ethical principles and standards of behaviour and genuinely believe that fairness and honesty really count.

Embracing new ideas

Adaptable enough to operate successfully in any environment

We pride ourselves on doing things differently, being adaptable enough to operate successfully in any environment and match any challenge. We go beyond existing ways of thinking to come up with innovative, personalised solutions.

Striving to be the best

Leadership is second nature

We provide sector-leading expertise, operating at a level of excellence in everything we do. We listen carefully, are not afraid to learn and challenge ourselves and deliver a consistently high-quality offering.

"I BELIEVE THAT FINANCIAL SERVICES COMPANIES HAVE A DUTY OF RESPONSIBILITY THAT GOES BEYOND OUR SHAREHOLDERS AND EVEN OUR CUSTOMERS"

Tracy Blackwell, PIC CEO

STRATEGIC REVIEW

STAKEHOLDER ENGAGEMENT

CONTINUED

Key statistics

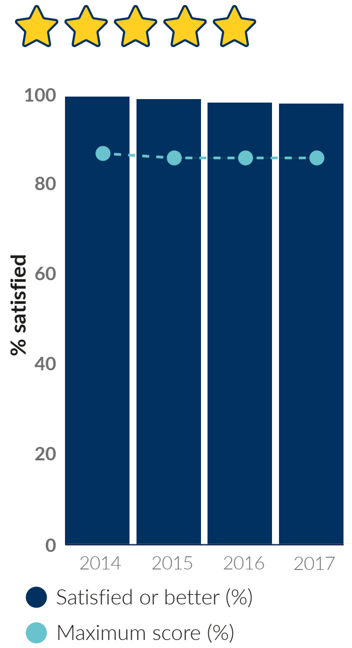
Number of pensioners insured

The number of pensioners insured grew by 12% in 2017 to 151,600 (2016: 134,900).

Annuities paid

Payment of annuities grew by 21% in 2017 to £725 million (2016: £600 million).

Extremely high levels of member satisfaction:



We have extremely high levels of policyholder satisfaction and have maintained over 98% satisfaction in the last seven years.

Total claims paid

Total claim amounts paid were £1,003 million (2016: £797 million), an increase of 26% as the growth in annuities was supplemented by the increases in lump sum and other payments compared to the previous year.

Individual policies in issue

At the end of 2017, PIC had 84,300 current individual policies in issue, in respect of 90 pension schemes, compared to 80,900 in respect of 74 schemes in 2016.

Policyholder satisfaction

Policyholder satisfaction is measured in a number of ways and is a key part of PIC's ongoing commitment to market-leading customer service:

- Member satisfaction levels are monitored via telephone and paper surveys.
- Close monitoring of complaint levels and analysis of complaint root cause.
- Stringent oversight of outsourced administrators, such as:
  - monthly file and call review;
  - regular site visits; and
  - weekly operational catch-ups and formal monthly service reviews.
- Face-to-face feedback at our six policyholder events.
- Institute of Customer Service ServiceMark survey.
- Complaints reviewed by senior management and the Board.
- 98.3% of policyholders expressed overall satisfaction with our service and 86% gave us the maximum score.
- Our complaints level has averaged only 1.4 complaints per thousand policyholders over the past 5 years.

A selection of pictures from PIC's Policyholder Days in 2017

PIC Board member Mark Stephen chats to policyholders

A policyholder completes her feedback form at one of PIC's events

Policyholders enjoying refreshments and socialising at the London Policyholder Day

Policyholders chat to one another at one of PIC's events

STRATEGIC REVIEW
STAKEHOLDER ENGAGEMENT
CONTINUED

Customer service

"ATTAINING SERVICEMARK IN 2015 WAS A REAL ACHIEVEMENT AND I AM DELIGHTED THAT WE HAVE NOW BEEN ABLE TO AWARD PIC SERVICEMARK WITH DISTINCTION. THEIR DEDICATION TO, AND PASSION FOR, GREAT CUSTOMER SERVICE MARKS PIC OUT AS A STANDARD BEARER – ONE THAT OTHERS SHOULD FOLLOW... PIC CLEARLY UNDERSTANDS HOW A RELENTLESS DEMONSTRATION OF SERVICE EXCELLENCE MAKES A REAL DIFFERENCE"

Jo Causon, CEO of the Institute for Customer Service, on PIC's attainment of ServiceMark with Distinction, 2017

Putting customers first through exceptional customer service for our trustees and policyholders

PIC was awarded ServiceMark with Distinction by the Institute for Customer Service (ICS) for "...dedication to, and passion for, great customer service". PIC is the only financial services company in the country to hold this award.

PIC has been developing and monitoring its customer service levels with the ICS for a number of years, and in 2015 was awarded the ICS's ServiceMark. In March 2017 PIC won the Quality Service Provider Award at the ICS's Customer Service Awards.

The ICS noted, as part of the award assessment process, that: "The commitment to the company's vision to be the best service provider and to do the right thing filters through from the top down... **the team at PIC works hard to build and maintain trust with their customers**... the 'no blame' culture was well documented and any complaints are viewed as learning opportunities... plenty of evidence was seen that **PIC look at the process from the customer's point of view...** staff are recruited in the first instance for the right attitude towards customers and colleagues... **PIC makes it easy for customers to deal with them**... they are keen to be seen as a champion for great service in the industry."

Customer service – policyholders

PIC's CEO Tracy Blackwell and the Executive Management team take questions from the audience at the London Policyholder Day 2017

Policyholder events

PIC has welcomed more than 15,000 policyholders to complimentary events around the country over the past few years. These include Christmas lunches, as well as full-day events where our policyholders have the opportunity to meet with and question senior management and other members of the PIC team. Speakers regularly include our Chairman, CEO, CFO or other members of PIC's Board and senior management who talk about the security of our policyholders' pension benefits; PIC's financial strength; and why providing high levels of customer service is so important to us. A talk by a famous face as our headline speaker rounds off the day, giving a positive message of staying active in later life. PIC's administration team is on hand so policyholders can discuss pension queries face-to-face, and we invite local charities and social groups to give free information and advice. This helps to ensure that our policyholders enjoy the day as a whole, giving them the chance to enjoy a day out as well as being educated and informed.

Whilst isolation and loneliness are much discussed issues affecting many of the older generation, we recognise the role that companies such as ours can play in helping to establish vital connections with friends, family and the occasional new face. Many of the attendees enjoy these events as they give an opportunity to reconnect with former colleagues and reminisce about days gone by.

We believe the opportunity for our employees to engage directly with our policyholders is essential in making sure they understand the centrality of our policyholders to our business.

Case study

"IT'S NICE THAT PIC TREATS ME AS AN INDIVIDUAL"

PIC have been looking after my pension since October 2014, when they took on responsibility for the Leaf Pension Fund. PIC's purpose of securing pensions is at the heart of what the company is all about and they certainly do a good job of it. The transition to PIC was seamless and I was very impressed with how they kept us informed on all issues every step of the way. The service levels are different to other companies, they communicate well and letters and other documents are easy to follow and jargon free.

It's nice that PIC genuinely treats me as an individual. I have now attended three of the Christmas lunches, which I think is a really nice idea. It's good to meet other PIC policyholders and a number of the PIC team.

Ian Gillard, former Leaf Pension Fund member, now a proud PIC policyholder

STRATEGIC REVIEW

STAKEHOLDER ENGAGEMENT

CONTINUED

Customer service – trustee engagement

Former Registered Dock Workers Pension Fund: the largest bulk annuity market transaction of 2017

In November 2017, PIC completed a £725 million full buy-in with the Trustee of the Former Registered Dock Workers Pension Fund (the "Fund"). Together with existing insurance policies, the transaction completely removed the risk in respect of the Fund's pension liabilities.

The transaction benefitted from significant preparatory work undertaken by the Fund, putting it in a position where the Trustee could move quickly to secure attractive pricing and obtain comprehensive risk cover.

Unusually the transaction was funded entirely from the Fund's assets without need for further contributions from the sponsoring employers. For details of the longevity reinsurance transaction see page 48.

"WE ARE DELIGHTED TO HAVE SECURED THE BENEFITS FOR ALL MEMBERS IN FULL WITH AN ESTABLISHED, UK REGULATED INSURANCE COMPANY. THE TRUSTEE IS GRATEFUL TO ... PIC FOR DEALING WITH THE TRANSACTION SO EFFICIENTLY"

Ian Forrest, Chairman of the Trustee of The Former Registered Dock Workers Pension Fund (£725 million full buy-in)

"THE PLAN HAS BEEN DE-RISKING FOR A NUMBER OF YEARS, PRIMARILY BY MOVING OUR ASSET MIX TO FAVOUR INDEX-LINKED GILTS. WE ARE VERY PLEASED TO HAVE BEEN ABLE TO COMPLETE THIS LOGICAL NEXT STEP IN OUR LONG-TERM DE-RISKING PROGRAMME. PIC DEMONSTRATED SIGNIFICANT EXPERTISE WHILE HELPING US TO MANAGE A COMPLEX PROJECT AND ULTIMATELY DELIVER THE TRANSACTION WE REQUIRED"

Carol Woodley, Chairman of Trustees, 3i Pension Scheme (£200 million buy-in)

STRATEGIC REVIEW

STAKEHOLDER ENGAGEMENT

CONTINUED

Employees

"EXTREMELY WELL-RUN ORGANISATION WITH AN INCREDIBLY BRIGHT FUTURE. THE CULTURE RUNS RIGHT THROUGH THE HEART OF THE BUSINESS AND EVERYONE WORKS TOGETHER AND IS PULLING IN THE SAME DIRECTION TO MEET OUR COMMON GOALS"

PIC Employee Survey, December 2017

"PIC IS A COMPANY WORTH ADMIRATION... IT IS NOT ONLY A LEADER IN ITS INDUSTRY, BUT A LEADER ON HOW TO ENGAGE AND ENABLE ITS EMPLOYEES TO BE THE BEST THEY CAN BE..."

PIC Employee Survey, December 2017

The ability to fulfil our purpose – paying the pensions of our policyholders – is down to the skills, knowledge and experience of each of our employees. As a growing company, we are committed to ensuring that our culture is part of the recruitment process, where candidates are assessed against the behaviours we expect from our staff.

We are proud to have a flat structure with short reporting lines. Our open plan office means senior management and employees sit together, resulting in increased accessibility and responsiveness. Together this encourages entrepreneurial and innovative behaviours, supported by a strong team ethic.

The views and opinions of our employees are important to us in helping to enhance our culture, and as part of our desire to be the best, we conduct an annual staff survey to gather views from all our staff. The results provide clear evidence that our culture and values really do make PIC an attractive place to work and help us to manage conduct risk. More than 93% of employees would recommend PIC as a place to work and our employee engagement scores put us in the top quartile of UK companies.

SAYE

PIC operates an annual Save As You Earn Scheme, which gives staff members the opportunity to acquire PIC shares at a favourable price. This is not a common practice for a private company, but is designed to develop a pride of ownership, laying the foundations for a sustainable and successful company for many years to come. Since it launched in 2013, a majority of PIC staff have participated in the scheme each year with many subscribing every year, demonstrating their belief in the future prospects of the company and aligning their interests more closely with those of other stakeholders.

Employee benefits

We believe in rewarding the hard work of our employees and for that reason we offer a wide range of benefits, which include:

- Generous pension contributions;
- Private medical cover;
- Season ticket loan;
- Company-sponsored events (including a discretionary weekend away for our staff and their families as a thank you for the support given over the year); and
- Travel insurance.

What our employees said about our values

EMPLOYEE FEEDBACK

97% (2016: 95%)
believe PIC is customer focused (always seeking to understand and meet customer needs)

"Valuing our customers"
We pride ourselves on our customer focus and work hard to ensure that employees feel they can serve our customers' interests efficiently and effectively without undue red tape.

92% (2016: 90%)
feel proud to work for PIC

"Doing the right thing"
The result clearly demonstrates that a good understanding of the values and a focus on purpose brings pride. Employees expressed very high levels of trust and confidence in the senior leadership team.

93% (2016: 92%)
would recommend PIC as a place to work

"Being a team" and "Embracing new ideas"
Many employees commented on the recognition they received and the appreciation that managers and the leadership team showed to them for their contribution, reinforcing the team ethos and commitment to innovation that these values represent.

99% (2016: 98%)
believe that PIC will be successful over the next 2-3 years

"Striving to be the best" and "Providing security"
Employees have a demonstrable understanding of PIC's purpose, strategy and focus on the customer. The vast majority of employees feel that PIC is effectively managed and well run.

95% (2016: 94%)
say they have a good understanding of PIC's values

"Good understanding of PIC values"
Our values are integral to the way that we work. Every effort is made to hire those individuals who are alive to the importance of organisational purpose, culture and the values which flow from this.

STRATEGIC REVIEW

STAKEHOLDER ENGAGEMENT

CONTINUED

Employees and their families

Case study

"THE WHOLE WEEKEND WAS A NICE REWARD FOR STAFF"

My husband, Paul, has worked for PIC for almost two years. Initially, we were unsure about spending a weekend with Paul's colleagues but our concerns were quickly assuaged by the friendly and relaxed atmosphere that was obvious as soon as we arrived. It was lovely to meet the other families, and the location, entertainment and food were fantastic. It was also very nice to meet people from different areas of the company who have been at PIC for various amounts of time.

The whole weekend was a nice reward for staff, who could spend this quality time with their families and colleagues. It helped those of us external to PIC to put the sometimes long working hours into context. PIC is not just a faceless employer; it is now a company that we can relate to and one in which we have a better understanding of its goals and values. Everyone we met, including management, was approachable, friendly and down-to-earth.

Overall PIC comes across as being ambitious and driven, but at the same time balancing this with a sense of fun and a lack of arrogance despite its success to date.

Malini McCauley, wife of PIC employee Paul McCauley

Away Weekend

PIC recognises how central our employees are to the success of the organisation and in 2017 we asked all staff and their families to join us for an Away Weekend in congenial surroundings, a perhaps unique staff benefit.

The Away Weekend was a thank you to staff for their hard work and also to their families for their support and understanding of any late nights worked. It was incredibly useful, and enjoyable, for everyone – from Board members to more junior members of the team – to get to know one another outside the office.

One of PIC's core values is "being a team", and this event reinforced that value, providing a motivating and energising experience for our employees.

Industry diversity

The Actuarial Mentoring Programme ("Project AMP")

In 2017, PIC, in collaboration with the Institute and Faculty of Actuaries (IFoA), launched a pioneering mentoring scheme for female actuaries called Project AMP. The programme was launched to help improve diversity at senior levels of the actuarial profession, after research found non-retiring female actuaries were leaving the profession 13 years earlier than their male counterparts.

In its first year, PIC, together with eight other organisations – the Prudential Regulation Authority, Aviva, Phoenix Group, Mercer, Lane Clark & Peacock, Barnett Waddingham, Xafinity and the Government's Actuary Department – signed up to the scheme, with 100 male and female mentors and mentees signed up to participate.

Case study

"PIC REALLY IS LIKE ONE BIG TEAM"

My job at PIC principally consists of transferring PIC's longevity risk to the global reinsurance market. I wanted to complement my technical experience by volunteering for the IFoA, so when I found out PIC was sponsoring Project AMP, it seemed like the perfect opportunity. The scheme enables you to build relationships with peers across the industry and it is a great example of our company values in action. I am very pleased to be part of Project AMP and give something back to the actuarial profession.

One of the best things about working at PIC is that it is easy to see how your team contributes to the success of the company, which I find really motivating. PIC really is like one big team, with lots of different departments working together during a buy-in or buyout. PIC just wouldn't function without this collaboration.

Rachel Jervis, PIC longevity risk manager and Project AMP Mentor

PROJECT AMP

STRATEGIC REVIEW

ASSET AND LIABILITY MANAGEMENT

Rob Groves
Chief Investment Officer

PIC's investment philosophy is designed to ensure that we can pay the pensions of our policyholders on a secure basis.

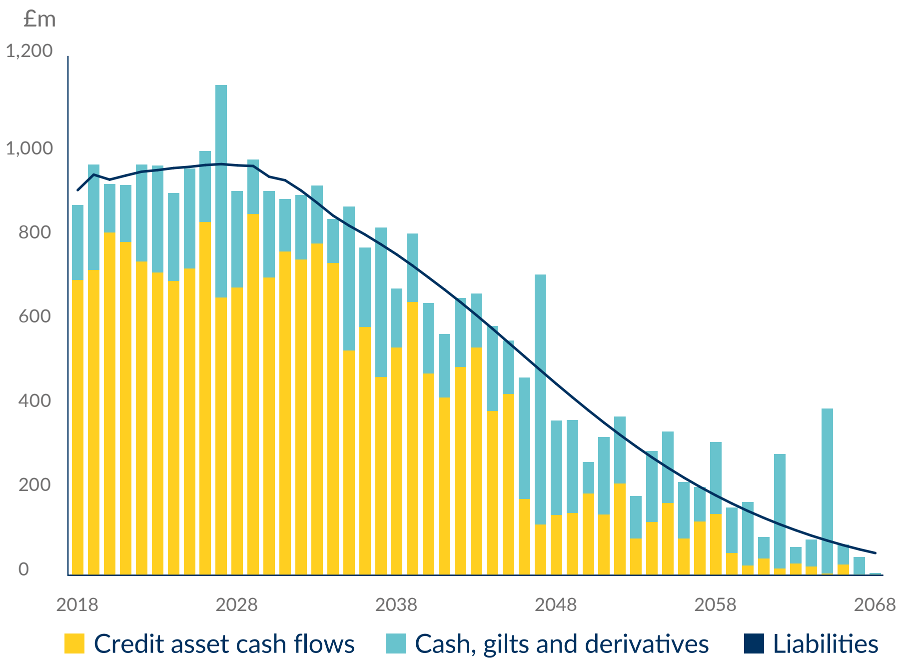
Whilst we have views on potential downside scenarios, including economic and political risks, we do not seek to directly predict the future, but rather we seek to build an investment portfolio that will perform well whatever happens in the future, i.e. is "weatherproofed". This means a high-quality, low-risk portfolio that protects against economic and market events. The majority of our portfolio is invested in cash flow matching, fixed income assets with a derivative overlay, to remove unwanted risks. Our principal unwanted risks are interest rates, inflation and currency.

We seek to take advantage of attractive investment opportunities but take a disciplined approach to our due diligence and only invest in assets we fully understand. Recent examples include debt investments in the universities, social housing and renewable energy sectors.

As the majority of our liabilities are non-callable and have a predictable cash flow profile, we are able, and have a requirement under Solvency II, to closely match our asset and liability cash flows by year. We also ensure we have appropriate liquidity in the portfolio in order to pay pensions and transfer values, post collateral for derivatives and reinsurance contracts and to pay the interest due on PIC's subordinated debt issuance.

Each annual liability cash flow is matched with assets such as corporate bonds, private debt, government bonds and derivatives. Each new business transaction is priced on a bespoke basis incorporating the team's forward-looking assessment of the attractiveness of the available asset universe. The assets are then adjusted for investment management fees, hedging costs and capital costs to create the most efficient cash flow matched portfolio.

Asset risk: cashflow matching



Just under 50% of our portfolio is managed externally, with mandates to invest in UK and US dollar (including Emerging Market) investment grade credit portfolios. Importantly, our managers are not benchmarked against their competitors or the market. Managers are measured by their ability to select bonds with lower probabilities of default and downgrade.

The other half of our portfolio is managed by a growing in-house team of specialists, focused on investing in assets that offer superior risk-adjusted returns through having features such as better security (for example, through physical assets, contractually agreed seniority and strong covenants), and crucially in a Solvency II world, have cash flows in years where there are few assets or there are liquidity constraints, to match our liability cash flows more precisely.

To date, we have a historic default experience of about 1bps per annum, against a Solvency II best estimate reserving assumption of 20bps per annum. We also hold a significant additional reserve for the cost of downgrades (the cost of maintaining the portfolio's overall rating following a downgrade in our portfolio). In total, the reserve held on our Solvency II balance sheet against the cost of defaults and downgrades exceeds £1.2 billion.

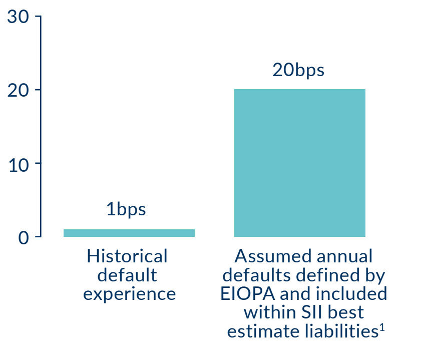
We currently have more than £8 billion of highly liquid assets (c.33% of our total assets) within the portfolio, consisting predominantly of gilts and cash. The size of our collateral requirement under extreme market moves (calibrated to be a 1 in 200 year stress scenario) is c.£4 billion. Thus we have over £4 billion of highly liquid assets in excess of what we would expect to need even in very extreme market conditions.

We invested over £1 billion directly in 2017 through 17 different transactions, which included £250 million of university related lending and over £320 million lent to UK housing associations, supporting the building or refurbishment of thousands of homes. Other innovative deals included a CPI-linked debt backed by renewable energy (offshore wind power generation). PIC also entered the equity release mortgage market in April 2017, providing a long-term funding commitment which allows our partner provider to expand its product range, with a focus on customer care that matches our own focus on policyholder care.

As a constant, PIC retains pricing and credit discipline when investing in private debt. The £1 billion we actually invested last year represents a conservative conversion rate when set against the c.£16 billion of potential investment opportunities that we looked at during the year. On average we reject 15 opportunities for every deal that we invest in.

All in all, 2017 was a very strong year for the investment team, as we compete against larger investors, or pension fund-backed investors who are subject to less regulatory oversight.

Historical default experience



The actual default experience is an average of five years. We have not experienced any defaults since 2013.

[1] The European Insurance and Occupational Pensions Authority ("EIOPA") is a European Union financial regulatory institution that replaced the Committee of European Insurance and Occupational Pensions Supervisors. It is established under EU Regulation 1094/2010.

Portfolio highlights

- 93% of financial investments in government and corporate securities.
- Corporate securities: 97% investment grade rated.
- No single counterparty (excluding UK government) represents more than 1.70% of total investment assets.
- 48% of financial investments managed by external asset managers.
- 52% of PIC's total investment assets managed directly, including UK gilts, supranational bonds and debt private placements.
- Investment strategy designed for long-dated assets to match long-dated liabilities.
- Discount rate applied to liabilities is set based on the asset portfolio yield net of adjustments for defaults and downgrades.

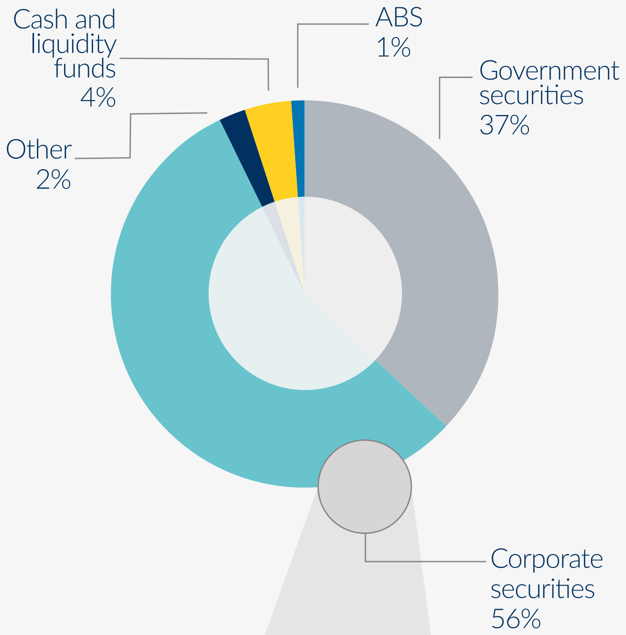
STRATEGIC REVIEW

ASSET AND LIABILITY MANAGEMENT

CONTINUED

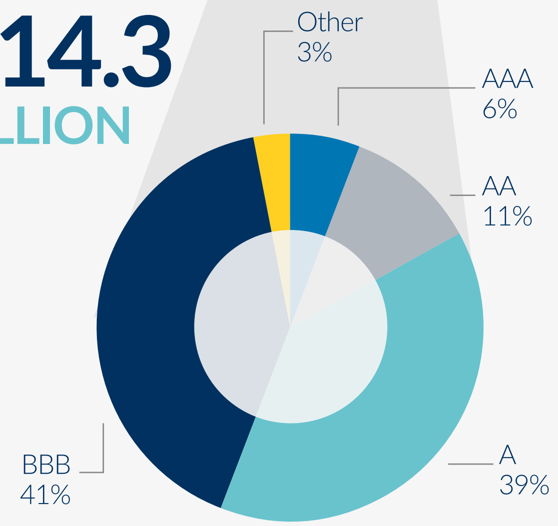
Asset portfolio by asset class (31 December 2017)

£25.7 BILLION



Corporate securities by rating

£14.3 BILLION



Corporate securities by industry

Industry sector	31 December 2017 Market value (£m)	%
Financial	4,096	28.6
Utilities	1,548	10.9
Consumer, non-cyclical	1,548	10.9
Energy	1,415	9.9
Communications	1,371	9.6
PFI and direct investment loans (unlisted)	1,463	10.2
Consumer, cyclical	940	6.6
Technology	733	5.1
Industrial	572	4.0
Basic materials	506	3.5
Diversified	101	0.7
Quasi-Government	6	0.0
Total	**14,299**	**100.0**

Corporate securities by region

Country	31 December 2017 Market value (£m)	%
UK	6,409	44.8
US	4,965	34.7
Europe	1,506	10.5
Rest of the world	1,419	10.0
Total	**14,299**	**100.0**

Patient capital: backing our policyholders' pensions with investments that promote economic growth

As banks have withdrawn from long-term lending, life insurance companies with long-term liability cash flows, have taken their place and now play an increasingly important, and socially useful, role in the development of the UK's economy. In short, we are enhancing and improving the quality of life for future generations whilst securely backing the benefits of our pensioners.

By working directly with potential borrowers, typically on private debt issuance under £200 million, PIC is able to structure deals that are innovative, flexible and, importantly from our policyholders' perspective, very secure. In particular, these types of projects provide inflation-linked cash flows that can be shaped to mature in specific years, and provide us with security over the physical asset.

As natural consolidators of UK defined benefit pension fund assets and liabilities, the scale and investment in expertise of bulk annuity insurers allows us to do this type of investment more effectively than the majority of pension funds. Sectors that we have invested in include social housing (see case study overleaf), offshore wind power generation (see case study overleaf), biomass, student accommodation, healthcare, solar power generation and the rail network.

The internal investment process is tightly governed, with separate internal committees providing both detailed scrutiny on the credit quality of an asset, and giving final approval to ensure that the asset matches the company's risk appetite.

However, infrastructure development in the UK has focused on a small number of large-scale (and high-risk) trophy projects, as opposed to a larger number of smaller deals. The feeling among private investors remains that there is a lack of suitable projects. There is also a need for more ready-to-finance opportunities where there is no requirement for investors to involve themselves in the earlier, riskier stages of infrastructure development.

STRATEGIC REVIEW

ASSET AND LIABILITY MANAGEMENT

CONTINUED

Case study
Aldwyck Housing Group

In April 2017, PIC invested £40 million in secured debt issued by Aldwyck Housing Group, a housing association providing more than 11,000 homes and management services for around 25,000 people. The debt, which has a fixed rate, matures in 2033 matching PIC's pension liability cash flows. It will be used to refinance existing debt and build new homes.

PIC has invested more than £1 billion in social and affordable housing in the UK. The company anticipates investing considerably more in the sector over the coming years.

Ian McDermott, Group Chief Executive of Aldwyck Housing Group, said: "Aldwyck is delighted to have secured this £40 million private placement. We have a long and successful track record in development and over the next four years will be building over 800 much needed new homes to meet the needs of local communities. We are very pleased to work with PIC, who have a strong understanding of the needs of social housing providers and a demonstrable commitment to the sector."

ALDWYCK HOUSING
@aldwyckofficial • Apr 11 2017

BREAKING NEWS: Aldwyck and @PensionCorp complete £40 million investment deal. Read all about it here: aldwyck.co.uk/latest-news/al...

Case study
Walney Offshore Wind Farm

In November 2017 PIC invested £115 million in the Walney Extension Offshore Wind Farm Project. Situated off the coast of Cumbria, the offshore wind farm will have a total capacity of 659MW and power more than 500,000 UK homes. PIC has previously invested in renewable energy including solar power generation and biomass. The investment provides a very good match for PIC's pension liabilities.

Key aspects of the transaction:

- CPI-linked, secured debt which matures in 2033 to match specific pensioner cash-flows.
- Backed by the Government's Contract for Difference (CfD), ensuring predictable, secure cash flows.
- Once built, the Walney Extension will be the world's largest offshore wind farm.

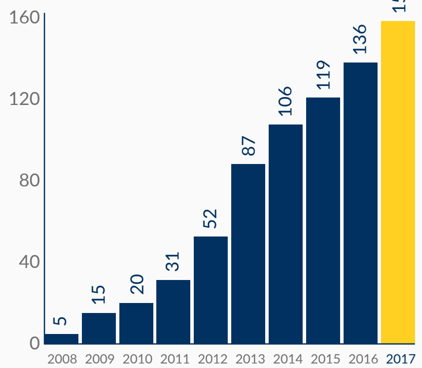
STRATEGIC REVIEW

FINANCIAL RESULTS SUMMARY

PIC's financial track record – continuous growth

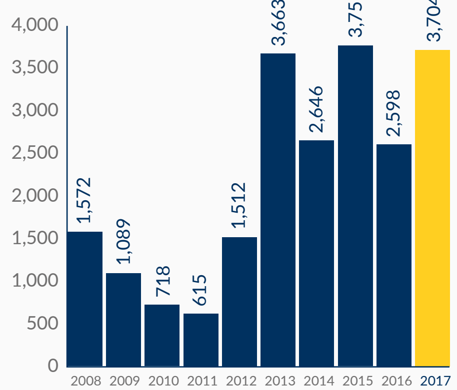
Number of pension schemes insured (cumulative)

156 with 20 insured in 2017



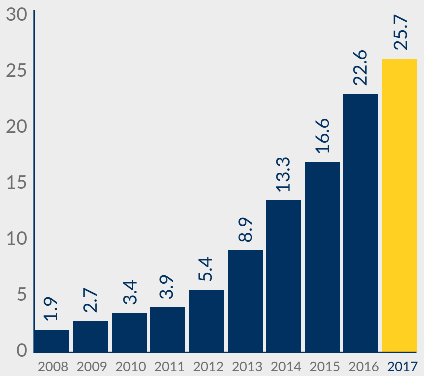
New business premium (£m)

Premiums £3,704 million



Financial investments (£bn)

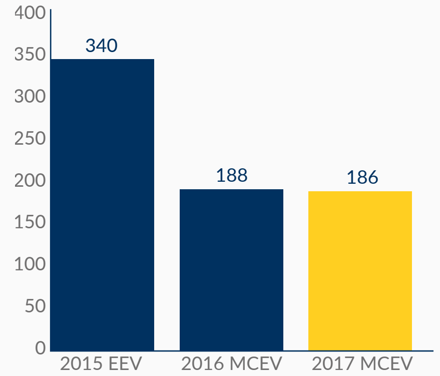
Financial assets £25.7 billion



PIC's financial track record – significant value generation

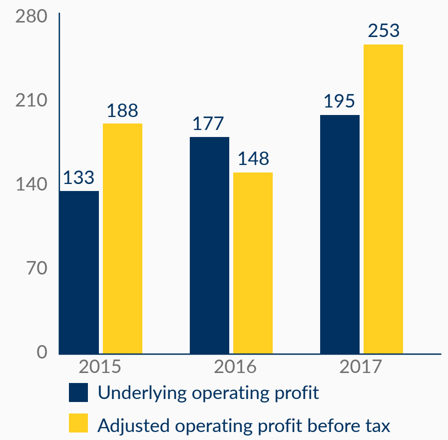
New business value (post tax) (£m)

£186 million



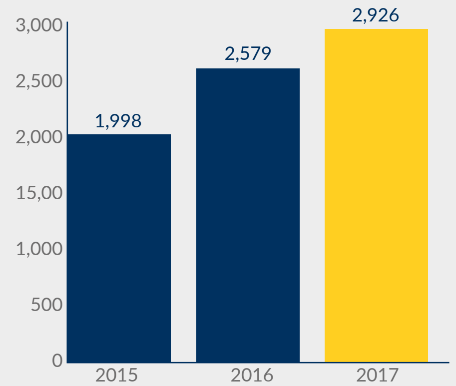
Profitability (£m)

Underlying operating profit £195 million



Market Consistent Embedded Value (£m)

£2,926 million



STRATEGIC REVIEW

CHIEF FINANCIAL OFFICER'S REVIEW

Rob Sewell
Chief Financial Officer

2017 was a successful year for PIC, with strong new business volumes, good profitability, growth in embedded value and very satisfactory solvency levels.

PIC's profit before tax in 2017 was £391 million (2016: £276 million) and its underlying operating profit before tax was £195 million (2016: £177 million). The increase of 10% in underlying operating profit was driven by our ability to write business that delivers long-term profits and support this with high-quality, high-performance assets.

PIC's measure of underlying operating profit captures the long-term returns we make from the release of prudent margins in our in-force book of insurance assets and liabilities, and the investment returns on our surplus assets, based on our long-term return assumptions. Our IFRS approach means that these prudent margins are material, which serves to reduce the amount of profit recognised at the point of sale but increase the profits released over the remaining lifetime of the policy. This approach leads to long-term profit generation from the in-force book, which will continue to grow over time and aligns the timing of IFRS profit recognition with the actual run-off of the underlying insurance contracts.

Our overall profit in any one year is therefore less reliant on the new business written in the year and more reflective of the profits actually earned on our whole in-force business, as the anticipated profit loading in the premium represented by prudent margins is translated into actual earned profits. This long-term profit recognition approach is reflective of the long-term ownership culture of PIC's shareholders.

Adjusted operating profit adds the outcome of new business and reinsurance activities to the underlying operating profit and in 2017 we had a particularly strong reinsurance performance. Pre-tax profits were additionally aided by an assumption change in respect of our prudent margins, where around £170 million of additional prudent margins were released to profit during the year. However the balance sheet remains very conservative, with a further £1.7 billion of prudent margins yet to be released into profit in the coming years.

PIC has £4.3 billion of assets in excess of its best estimate of liabilities (2016: £4.3 billion).

During the year, PIC reinsured longevity exposure on £4 billion of reserves, a record amount and at year-end 73% of the Company's total longevity exposure had been reinsured (2016: 68%). In December, PIC completed a £725 million longevity swap reinsurance deal covering the Dock Workers Pension Fund with PartnerRe, another new reinsurance counterparty for PIC. This takes the total number of PIC's reinsurance counterparties to ten, all of which are investment grade. Three new relationships were developed during 2017.

Over the last few years we have seen a shortening of life expectancies versus our original assumptions. Whilst we are adopting the new improvement tables (CMI 2016) for our future longevity projections, we are not taking any benefit at the moment for the beneficial experience we have seen to date. We will do further work on this, with an expectation of further updating our longevity assumptions during the course of 2018.

PIC's solvency ratio at the end of 2017 remained strong, at 160% (2016: 164%). Despite the significant new business volumes written during the year, a combination of effective capital management, careful underwriting and reinsurance ensured that our solvency levels remain very secure.

Finally, it is worth noting that PIC's debt leverage remains very comfortable at 21% on an IFRS basis. This is reflective of our wider conservative approach to financial management for the business.

Key performance indicators

The Company has identified a number of financial and non-financial key performance indicators ("KPIs") and performance measures that it considers relevant at this point in its development. These indicators are shown below. As the business continues to develop, management will determine whether these indicators remain the most appropriate metrics by which to measure the risk and profitability of the business.

	As at 31 December 2017	As at 31 December 2016
Financial KPIs		
Measures of profit or loss		
Underlying operating profit before tax	**£195m**	£177m
Adjusted operating profit before tax	**£253m**	£148m
IFRS profit before tax	**£391m**	£276m
Measures of assets and liabilities		
IFRS net asset value ("NAV")	**£2,076m**	£1,760m
Market Consistent Embedded Value	**£2,926m**	£2,579m
Measures of financial strength		
Solvency II regulatory solvency ratio	**160%**	164%
Measures of income and expenditure		
New business premiums written	**£3,704m**	£2,598m
Cost base		
Operating expenses as a % of closing financial investments under management	**0.36%**	0.33%
Non-financial KPIs		
Customer satisfaction ratio	**98.3%**	98.5%

A summary of the alternative measures of profit or loss follows below:

- 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 characteristics 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.

	2017 £m	2016 £m
Return earned on insurance book	**143**	122
Expected return earned on surplus assets	**52**	55
Underlying operating profit before tax	**195**	177
New business and reinsurance	**70**	(26)
Other changes to in-force business	**(12)**	(3)
Adjusted operating profit before tax	**253**	148
Non-economic assumption changes	**170**	21
Finance costs	**(41)**	(22)
Other movements	**9**	129
IFRS profit before tax	**391**	276

- Underlying operating profit reflects stable emergence of profits from in-force business (i.e. if no new business was written);
- Total adjusted operating profit includes impact from new business and reinsurance:
  - New business profits can be positive or negative at inception subject to characteristics of plans acquired;
  - Non-operating profit can be further impacted by short-term fluctuations in investment return, model and assumption changes and non-recurring expenses. The Company does not believe this measure is reflective of the long-term nature of PIC's business, and therefore does not use it as an alternative profit measure.

Adjusted operating profit before tax 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. These encompass the writing and management of pension insurance contracts, the management of risk through reinsurance, and the day-to-day investment and management of the insurance assets and liabilities. Within this, management have defined a measure of "underlying operating profit before tax" which captures the returns made from the in-force book of insurance liabilities and expected long-term returns from surplus assets.

The adjusted operating profit basis is aligned to the way management view the business, and the decisions which management make around the Company's core activities.

Non-operating profit includes the impacts of the external 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 Embedded Value ("EV") analysis was prepared under the European Insurance CFO Forum MCEV Principles issued in April 2016. The starting point is the Solvency II 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 prudent margins built into the actuarial valuation of the in-force business. Further adjustments to the regulatory balance sheet are made in respect of the subordinated loan notes, frictional cost of capital and cost of residual non-hedgeable risks so as to arrive at a more appropriate quantification of the Company's value.

STRATEGIC REVIEW

CHIEF FINANCIAL OFFICER'S REVIEW

CONTINUED

Reconciliation of adjusted operating profit

	2017 £m	2016 £m
Total IFRS revenue	**4,756**	5,794
Less IFRS net claims paid	**(909)**	(768)
Less IFRS net change in liabilities	**(3,324)**	(4,656)
	523	370
Less non-economic assumption changes included in non-operating profit	**(170)**	(21)
Less acquisition and other operating expenses	**(91)**	(72)
Less other movements included in non-operating profit	**(9)**	(129)
Adjusted operating profit before tax	**253**	148
Adjusted operating profit before tax consists of:		
Underlying operating profit	**195**	177
New business and reinsurance	**70**	(26)
Other changes to in-force business	**(12)**	(3)
	253	148

2017 financial performance

As explained above, management chooses to analyse its IFRS results on an adjusted operating profit basis, reflecting the activities of the Company rather than the statutory income and expense categories. The table on the preceding page takes all the items in the IFRS income statement and apportions them between the various categories.

Underlying operating profit before tax

Underlying operating profit before tax in 2017 was £195 million (2016: £177 million). The return earned from the insurance book (£143 million) is higher than 2016, reflecting the growth in the in-force book over the past 12 months. The expected return on surplus assets (£52 million) is slightly lower than 2016, reflecting lower rates of expected returns compared to 2016.

Adjusted operating profit before tax

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

PIC concluded seven longevity (2016: two) reinsurance transactions during the year, which covered longevity exposure on £4.0 billion (2016: £1.4 billion) of reserves, a record amount. At 31 December 2017, 73% of the Company's total longevity exposure had been reinsured (2016: 68%).

In December 2017, PIC completed a £725 million longevity swap reinsurance deal covering the Dock Workers Pension Fund with PartnerRe, another new reinsurance counterparty for PIC. This takes the total number of PIC's reinsurance counterparties to ten, all of which are investment grade. Three new relationships were developed during 2017.

Taking into account the requirement to set up technical provisions in respect of liabilities acquired in new business transactions, together with the costs incurred, but offset by the impact of reinsurance completed during the year, these items contributed a positive £70 million (2016: £26 million loss) to the adjusted operating profit.

Other changes to in-force business represents the impact of differences between actual and expected deaths and the impact of policyholders retiring earlier or later than expected and taking lump sum benefits.

Non-operating profit before tax

Non-operating profit before tax for the year was £138 million (2016: £128 million profit).

During the year, as a part of its annual examination of the IFRS reserving basis, the Company updated its actuarial assumptions in respect of the prudent margins held within the IFRS insurance liabilities, principally around future improvements in mortality rates and credit defaults. This, together with positive impacts from updates to policy data, offset by an increase in reserves due to updated long-term expense assumptions, contributed £170 million to the profits.

The Company has two series of subordinated debt instruments in issue, on which it incurs an annual interest expense of £41 million per year. This amount is also included within non-operating profit before tax.

Other movements, including short-term market movements and project costs, have had a net positive impact on the Company in 2017 of £9 million compared to £129 million gain in 2016. The net gain in 2017 consisted of £7 million gain due to market fluctuations and £2 million net gain from other minor items. The net gain in 2016 was mainly due to the impact of significant fluctuations in interest and inflation rates in particular. The Company's preferred hedging benchmark in 2016 was focused on the regulatory balance sheet which resulted in the IFRS balance sheet being not fully hedged. The fluctuations in market rates in 2016 resulted in £151 million of gains, offset by some smaller losses elsewhere, leading to the overall £129 million gain.

Statement of comprehensive income highlights

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

Premiums

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

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

Investment return

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

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

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

Claims paid

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

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

Change in insurance liabilities

Change in insurance liabilities represents the change in the gross insurance liabilities less the reinsurance assets. The increase in liabilities was due to the new business written in 2017, claims paid and the impact of market fluctuations.

Operating expenses

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

Finance costs

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

Balance sheet review

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

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

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

Gross derivative assets and derivative liabilities have both reduced since 31 December 2016, as the Company sought to close out certain swap contracts during the year. IFRS NAV increased from £1,760 million in 2016 to £2,076 million in 2017 reflecting the profits generated during the year.

MCEV results

At 31 December 2017, the Company's MCEV was £2,926 million (2016: £2,579 million). The increase in MCEV since December 2016 of £347 million reflects the beneficial impacts of new business written during the year, the in-force business contribution, the positive impacts of investment market movements and changes to the Company's internal model during 2017, offset by increases in the cost of capital and fair value of the subordinated loan notes.

Other operational highlights

Operating expenses as a % of closing financial investments under management, which is a measure of how the cost base of the Company compares to the size of the asset base which it manages, has risen slightly during 2017 from 0.33% to 0.36%. This largely reflects additional acquisition expenses incurred in 2017, reflecting the increase in new business volume in 2017 compared to the prior year.

Customer focus is a central element of the activities and culture of the Company, and the customer satisfaction ratio of 98.3%, compared to 98.6% in the prior year continues to reflect PIC's industry-leading customer service capabilities as well as the continued focus on putting our policyholders at the centre of everything we do.

STRATEGIC REVIEW
CHIEF FINANCIAL OFFICER'S REVIEW
CONTINUED

Regulatory solvency

PIC is required to comply with the Solvency II regulatory framework which has been in place since 1 January 2016. Solvency II is based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessments of risk and enhanced disclosure requirements.

Solvency II requires firms to either follow a prescribed approach to calculating required regulatory capital (the standard formula approach), or to apply to the PRA to use an "internal model", developed by the Company but subject to comprehensive review and approval by the regulator.

PIC has received PRA approval to apply an internal model, which is a better reflection of the risk profile of the Company's business than the Standard Formula.

PIC also applies the Matching Adjustment, Volatility Adjustment and Transitional Measures, which are all related to how elements of the Solvency II balance sheet are calculated. These were also subject to applications made by the Company and subject to approval by the PRA.

During 2017, PIC developed and implemented a major change to its internal model, which enabled the Company to update the capital it is required to hold against inflation and longevity risks. This change was approved by the PRA.

The Company has complied with the Solvency Capital Requirements under Solvency II as set out in the relevant PRA rules (see Note 18 in the Annual Report and Financial Statements 2017) throughout the year. At 31 December 2017, the Company's solvency ratio on the Solvency II basis was 160% (2016: 164%) and it had surplus funds which were £1,246 million (2016: £1,222 million) in excess of Solvency Capital Requirements (SCR).

PIC has been granted a regulatory waiver, such that it is required to submit only one regulatory Solvency & Financial Condition Report ("SFCR") by 15 June 2018, covering both PIC and the consolidated Pension Insurance Corporation Group (the "Group"). This is in place of submitting separate reports for each of PIC and the Group. Once submitted, the document will be available on the Company's website.

Solvency II results presented below are estimated and have not been audited at the date of publishing this report.

	2017 £m	2016 £m
Net assets held in excess of best estimate liabilities (BEL)	**4,279**	4,256
Risk margin net of transitionals	**(951)**	(1,122)
Own funds	**3,328**	3,134
Solvency II capital requirements	**(2,082)**	(1,912)
Solvency II surplus	**1,246**	1,222
Solvency ratio	**160%**	164%

Key solvency sensitivities

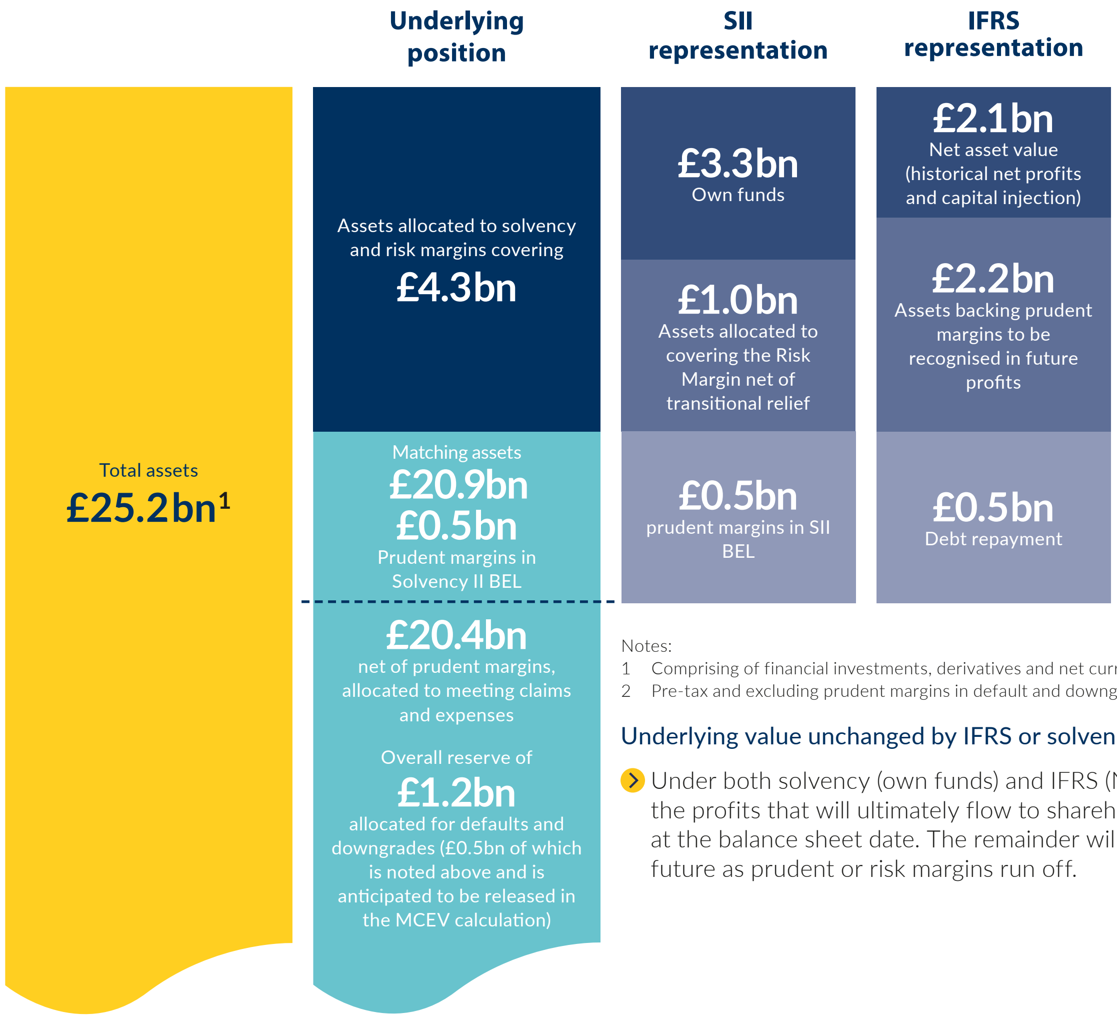
- **PIC uses various management tools to mitigate the impact of market fluctuations and manage its capital position:**
  - Pricing applied to new business and control of new business volumes.
  - New business is only transacted provided it meets the Company's return on capital targets.
- **Hedging strategy 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	2017	2016
As at 31 December	**160%**	164%
25 bps increase in interest rates[1]	**6.0%**	5.7%
25 bps reduction in interest rates[1]	**(6.5)%**	(5.9)%
£100 million credit default (no recovery)	**(4.8)%**	(5.7)%
5% reduction in base mortality[2]	**(9.3)%**	(8.0)%

Notes:
1 This allows for a transitional measure for technical provisions recalculation.
2 Equivalent to a 0.4 year increase in life expectancy from 21.7 years to 22.1 years for a typical male aged 65.

Regulatory solvency

Solvency II and IFRS balance sheets



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

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.

Solvency II to MCEV reconciliation

With effect from 1 January 2017 the Company has adopted the MCEV Principles 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.

31 December 2017 (£m)	Solvency II balance sheet	Allow for sub-debt	Recognise the FCoC	Release (RM, DTL minus transitionals) recognise CRNHR	Release MA margins	Tax on future profits	MCEV (£m)
Assets	25,155						
Best estimate liabilities (net of reinsurance)	(20,876)						
Risk margin (RM), Deferred tax liability (DTL) net of transitional measures	(951)						
SII Own Funds	3,328						3,328
Present value of future profits				951	512	(355)	1,108
Cost of residual non-hedgeable risks (CRNHR)				(675)			(675)
Frictional cost of required capital (FCoC)			(161)				(161)
Subordinated debt		(674)					(674)
MCEV							**2,926**

STRATEGIC REVIEW

RISK MANAGEMENT

Chief Risk Officer Review

Giles Fairhead
Chief Risk Officer

Since my appointment as Chief Risk Officer at the beginning of 2017, we have invested considerable time and resource ensuring that managing risk remains at the core of everything we do at PIC. It is very important that we maintain an appropriately skilled risk team, independent of those people at the "coal face", who can effectively challenge decisions and actions. This helps ensure that we protect our policyholders and strike an appropriate balance between risk and return. Given our recent growth, and aspirations for the future, the risk team has seen significant reorganisation and increase in headcount during 2017. This increase in resource and change in structure will ensure that we are very well placed for continued growth and have the appropriate skills and expertise to manage risk effectively in these uncertain times.

Given the increased level of uncertainty within the macro-economic, political, regulatory and social environments in which we operate, a key area is our ability to carry out stress and scenario testing. This gives us the capability to better consider the "what if" scenarios and then assess their impact on the business. We have also focused on enhancing our capabilities in relation to financial risk, with a particular focus on credit and counterparty risk management. Given the continued low interest rate environment, sourcing high-quality, long-term assets remains difficult. PIC looks to a broad range of sources (corporate credit in the UK and US, government debt, infrastructure and property to name but a few) to find these assets which help ensure we maintain a well-diversified, high-quality portfolio. In this context, we have increased the skills and expertise in my team to ensure that we can continue to effectively assess, and when required challenge, these investment decisions.

PIC operates a three lines of defence model (see page 50), with risk management being implemented by the first line and then oversight and challenge provided by the second line (risk and compliance) and third line (audit). This means that the risk team involves itself in all significant decisions across the business to ensure they are made in line with the Board's risk preferences and appetites. We also operate a process of independent monitoring across the business to ensure that on an ongoing basis the business operates within the Board defined thresholds.

One of our key monitoring tools is our full internal model which we use to quantify the risks in the business and thus the amount of capital we should hold as a mitigant for these risks. This model was approved by the PRA at the beginning of 2016 and because it is calibrated to the specific risks that PIC has as a business it allows us to better understand and mitigate our risks. At the end of 2017 our model calculated that we needed to hold £2.1 billion of risk based capital, and as an additional buffer we held £1.2 billion in excess of this on our Solvency II Balance Sheet.

We carried out considerable development of our internal model in 2017. Bringing together people from across the business we have set up a new team in the finance function to manage and develop our thinking in relation to risk based capital. We have also carried out our first major change of the model. Major changes to our internal model must be approved by the PRA and I am delighted that we managed to achieve regulatory approval for our change at the end of 2017. This has allowed us to update our model to ensure that the risk based capital we hold for inflation and longevity risk remains appropriate. This change, and the formation of a new team focused on the management of our regulatory capital, means that the model is now well embedded into our business as usual environment.

> "WE HAVE INVESTED CONSIDERABLE TIME AND RESOURCE ENSURING THAT MANAGING RISK REMAINS AT THE CORE OF EVERYTHING WE DO HERE AT PIC"
>
> **Giles Fairhead, Chief Risk Officer**

Whilst our business is not directly affected by Brexit, the macro environment will remain uncertain throughout 2018, which could affect us. Our "horizon scanning" allows us to consider fully the potential scenarios that these uncertain times might bring. We can then use our stress and scenario capabilities to assess their potential impact on the business which in turn allows us to consider what, if any, action we need to take. We are also looking to enhance our monitoring of the business to ensure that the management information we receive continues to be well aligned to our key risks and covers all areas of the business. This will have a particular emphasis on more recent emerging risks such as cyber and data security.

STRATEGIC REVIEW
RISK MANAGEMENT
CONTINUED

Case study

"PARTNER RE IS DELIGHTED TO PROVIDE A REINSURANCE SOLUTION THAT WILL HELP PIC TO MANAGE THEIR CAPITAL MORE EFFICIENTLY...WE LOOK FORWARD TO SUPPORTING THE PIC TEAM ON FUTURE TRANSACTIONS."

Kevin O'Regan, Head of Longevity and Portfolio Reinsurance at PartnerRe

Former Registered Dock Workers Pension Fund longevity risk reinsurance

At the end of 2017, PIC and PartnerRe entered into a £725 million longevity reinsurance transaction. This was the first time the two companies had entered into a reinsurance deal.

The deal followed a full market tender process and covered the longevity risk acquired when PIC insured the Former Registered Dock Workers Pension Fund in a full buy-in. As a result of this agreement, PIC's total number of highly rated reinsurance counterparties increased to ten, with three of the new relationships developed in 2017.

Longevity

Longevity Risk Management at PIC
The cornerstone of PIC's longevity risk management is the use of reinsurance. PIC has always been active in reinsuring its longevity risk exposure, completing its first transaction in 2008. The Company has now reinsured 73% of total longevity exposure on our regulatory solvency basis across ten highly rated counterparties. The introduction of the Solvency II regulatory regime (on 1 January 2016) increased the importance of the role of longevity reinsurance in the business models of many UK annuity investors. Longevity reinsurance reduces the uncertainty around mortality rates for firms, allowing them to reduce the capital they hold as a buffer against this risk, in the form of the solvency capital requirement ("SCR") and the risk margin ("RM").

Assumptions about future rates of mortality are typically made by considering the expected mortality rates over the coming year ("base mortality"), and the expected changes in these rates over time, known as "improvements" or "trends". In March 2017, the Continuous Mortality Investigation released a revised model for projecting future mortality improvement rates (CMI 2016). This model reflects the heavy mortality experience seen in the England and Wales population since 2011 and, all else being equal, acts to reduce projected life expectancies. PIC has made a partial allowance for CMI 2016 in its mortality improvement rate assumption, recognising the uncertainty as to whether observed heavy mortality experience will continue. A further review is expected during H1 2018.

PIC also takes a number of internal steps to manage its longevity exposure:

- Reviews mortality experience and assumptions regularly, i.e. have the assumptions made in the past proved accurate when compared to the actual patterns of deaths;
- Regular benchmarking of its assumptions using industry surveys and other sources;
- PIC's Board Risk Committee must approve any proposed reinsurance counterparty; and
- The Committee may also choose to put limits on exposures to single counterparties, for example by approving them only for a single deal or up to a certain amount of liabilities.

PIC added three new major reinsurance counterparties during 2017, taking the total number to ten.

The reinsurers with which PIC currently has longevity swap reinsurance contracts are Hannover Rück SE, Munich Reinsurance Company, Pacific Life Re Limited, Prudential Insurance Company of America, Canada Life Assurance Company, PartnerRe, SCOR, Challenger Life and RGA Global Reinsurance Company Limited.

In addition, PIC has entered into a number of tail-risk quota share arrangements with Berkshire Hathaway Life Insurance Company of Nebraska, a US-regulated insurer. All transactions have appropriate collateral arrangements in place to manage PIC's credit exposures.

STRATEGIC REVIEW
SOLVENCY AND RISKS

Risk management framework

Risk management
The overall strength of our insurance company is determined by our solvency position, our approach to managing risks and our ability to manage the assets and liabilities through the lifetime of each insurance policy. The key aspects of our financial covenant are:

- A strong solvency ratio;
- Reserving assumptions which are suitably prudent;
- Capital focused solely on securing and managing pension liabilities, free from distraction from other lines of insurance;
- A disciplined risk management approach, where we focus our risk taking on those areas where we excel (investment risk) and seek to minimise unrewarded risks, for example interest rates and inflation, which are hedged and transferred;
- An active approach to reinsurance of longevity risk, where in 2017 we have reinsured 73% of our longevity exposure, taking advantage of the reinsurers' ability to diversify the longevity risk with their substantial mortality risks;
- A secure and prudent investment approach, where the majority of our liabilities are matched by income streams from long-dated and secure assets;
- Active and proficient investor in the UK's infrastructure, including schools, hospitals, social housing and universities; and
- Proven track record of successfully managing investments through volatile economic conditions.

The role of risk management at PIC
PIC has a key focus on effective risk management, facilitated through a strong risk-aware culture throughout the organisation. This is designed to:

- Protect the Company's obligations to policyholders and to always treat them fairly; and
- Seek to grow shareholder value through making informed risk-return based business decisions resulting from a balanced awareness of the opportunities and threats. Critically, the Company will only seek to take risks which it has the capability to understand and manage.

Our risk management approach is designed to support our business ambitions and has the following core objectives:

- To define the risks that we are able and willing to accept that can give us sustainable returns, and to set out risks we believe are unrewarded and require closely managing;
- To optimise the capital that we hold so that we can deliver our strategy;
- To provide a framework within which authority for taking risks can be appropriately delegated and controlled throughout the organisation. This enables the Board to draw assurance that the risks to which we are exposed are being appropriately identified, managed and where necessary minimised;
- To ensure we remain forward thinking in assessing what could happen to the business and what actions could be taken to manage or mitigate the risks; and
- Effective risk management is integral to our success and is embedded through the organisation.

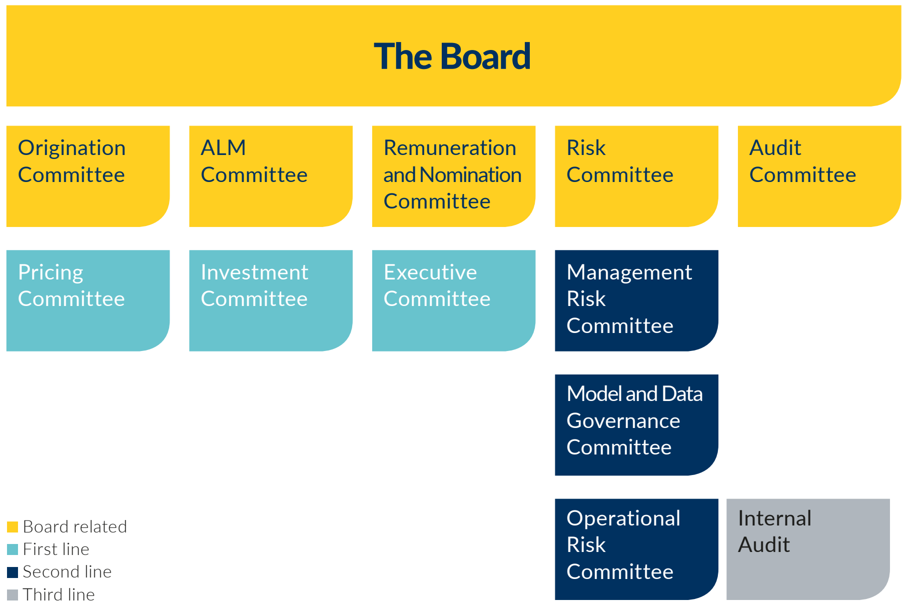
STRATEGIC REVIEW

SOLVENCY AND RISKS

CONTINUED

Governance and control framework

PIC operates a three lines of defence model as part of its risk governance framework. Under this model, the "first line" is the business operating areas, which have prime day-to-day responsibility for the management of risks within the agreed risk management framework; the "second line" consists of independent risk and compliance functions and risk management committees, with responsibility for setting and monitoring the risk framework within which the first line operates, and the actuarial function; and the "third line" is Internal Audit, External Audit and the Audit Committee, which have responsibility for assessing operation of the risk and control environment.



The role of the Board and its Committees is explained more fully in the Corporate Governance Overview.

First line

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

Second line

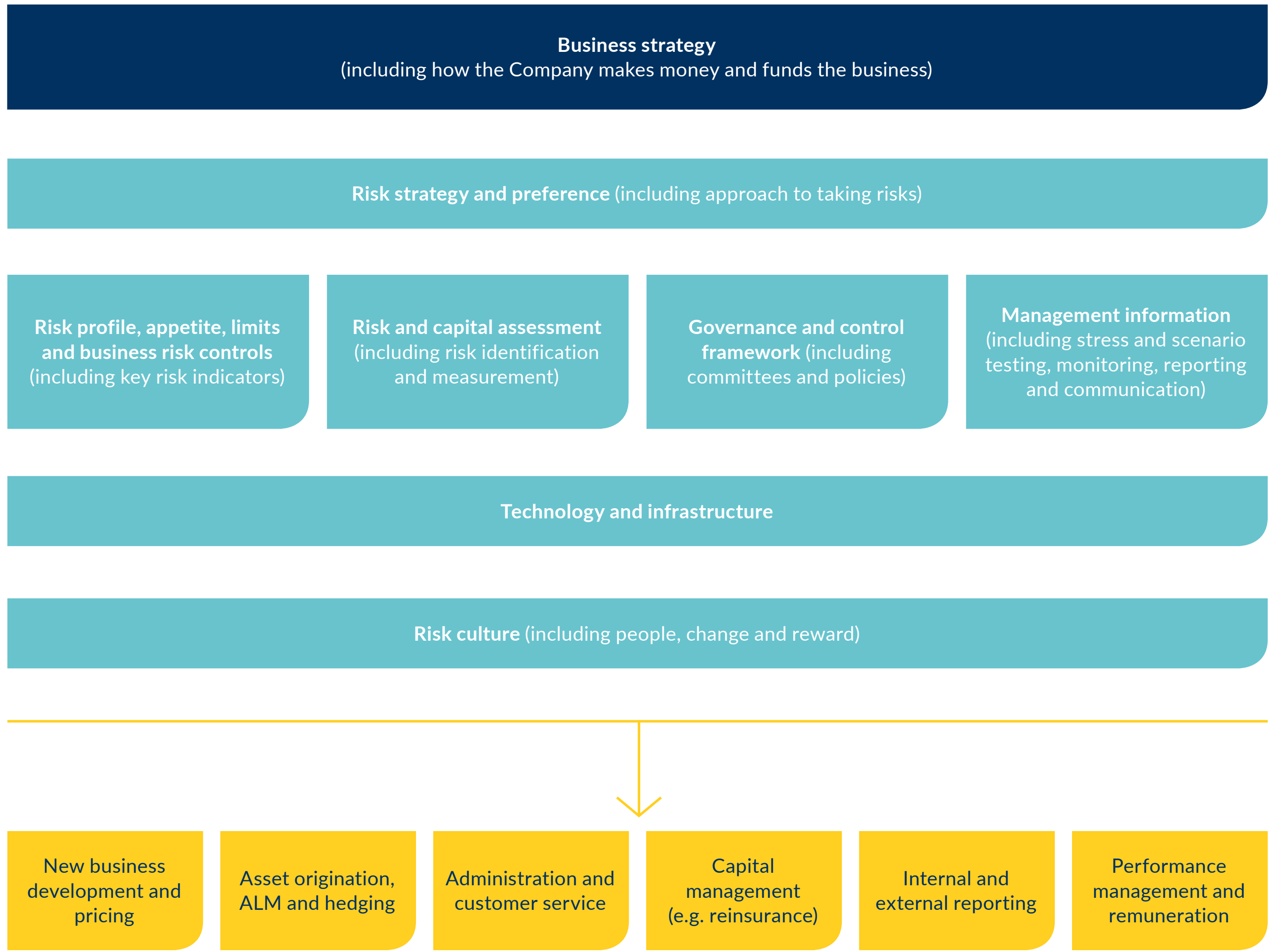
- Independent of first line.
- Includes Risk function, Actuarial function and Compliance function.
- Responsible for providing the framework within which the strategy is delivered.
- Provides information, oversight, support and challenge to decision making.
- Advises Board on forward-looking assessment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

Third line

- Provides independent assurance on the overall systems of internal control.

Risk management framework

PIC's risk management framework has the objective of linking its business strategy objectives and its approach to risk management through the key business processes of the Company.



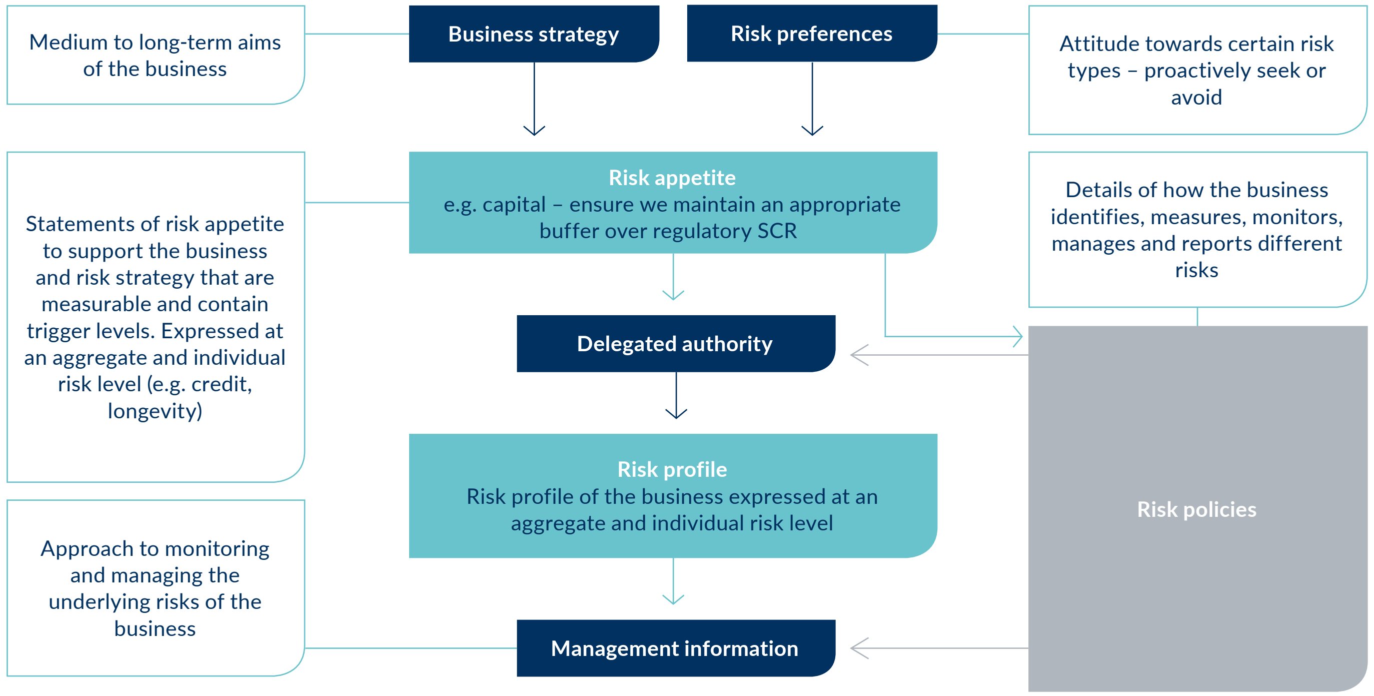
STRATEGIC REVIEW

SOLVENCY AND RISKS

CONTINUED

Risk appetite framework

The risk appetite framework considers the material risks to the business, its strategy and to PIC's reputation with trustees, policyholders and investors. It also includes risk tolerances and limits, and outlines the roles and responsibilities of those who implement and monitor the Company's risk appetite.



Risk strategy and preferences

PIC's risk preferences define the Board's appetite towards taking different types of risks that the Company may be exposed to in pursuit of its strategic objectives. Risks are categorised as those the Company actively seeks, those the Company seeks to minimise and those the Company seeks to avoid or transfer. The Board's preferences for taking risk are reflected in the development of the risk appetite statements and associated limits.

Actively seeks risks that are:

- aligned with business strategy, and expectations given to policyholders and other stakeholder groups;
- within the expertise, experience and capacity of its staff to understand, price, monitor and manage;
- within the capabilities and capacity of its systems to price, monitor and manage;
- expected to contribute to risk-adjusted return on capital that PIC needs to hold against the risk; and
- beneficial to enhancing diversification benefits (i.e. reducing the aggregated risk capital requirement) when viewed holistically across the business.

Minimises risks that are:

- necessary to incur as a by-product of exposure to the risks the Company actively seeks;
- necessary to incur as a by-product of avoiding risks it actively wishes not to be exposed to; and
- necessary to incur as part of being authorised to conduct insurance business in a competitive market place (i.e. incurred as part of "being in business").

Avoids or transfers risks which are:

- give rise to undue concentration of risk within PIC's portfolio;
- jeopardise the Company's ability to meet obligations to policyholders, staff and other stakeholders;
- are terminal to the strategy of the Company should they arise;
- are not within the experience, expertise and capacity of its staff to price, understand, monitor and manage; and
- are not within the capabilities and capacity of its systems to price, monitor and manage.

STRATEGIC REVIEW
SOLVENCY AND RISKS
CONTINUED

Risk strategy and preferences

Risk appetite
PIC has a risk appetite which is closely aligned with its business strategy. This is defined for the medium term (typically three-to-five years) and reviewed annually.

The Company has developed risk appetite metrics, which are designed to align with supporting the safe delivery of the business strategy objectives. A target, threshold and limit are set for each of the risk appetite metrics. As one of the risk appetite metrics passes through a threshold or limit, it necessitates escalation and possible management action.

Risk assessment and measurement
PIC's risk management system outlines how risks are identified, assessed, controlled and managed. Risk assessment is a continuous process incorporating regular monitoring, stress and scenario testing and deep dive reviews.

Quantifiable and material risks over the coming year which are mitigated through holding capital are measured using PIC's Internal Model which is used to determine the solvency capital requirements (SCR) for the business. Presently, the categories approved by the Board and used in the internal model are:

- Market risk
- Counterparty risk
- Insurance risk
- Expense risk
- Operational risk

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

Management information
A consolidated pack of management information is regularly presented to Executives and the Risk Committee of the Board detailing the position of the business against the risk appetite metrics and expected evolution of these positions.

Own Risk and Solvency Assessment
The annual ORSA report provides an ongoing assessment of the risks to PIC's business plan and solvency over the five-year business planning horizon.

The ORSA report summarises the output of a process which addresses the following questions:

1. What are the Company's current risks (risk profile)?
2. What is the Company's assessment of the capital it currently needs to hold to cover these risks (economic capital)?
3. What risks does the Company want to be exposed to (the target position)?
4. If the Company is exposed to these risks, what capital will it need to hold?
5. How is the Company going to get from current position to target position (the business plan)?
6. What could go wrong over this time horizon?

The ORSA process comprises a set of static and dynamic documents that are compiled and maintained over the year.

The ORSA documents are reviewed and approved throughout the year by the Board. These are summarised in the annual ORSA report.

STRATEGIC REVIEW
PRINCIPAL RISKS

The principal risks affecting the Company's business and its strategy for managing those risks are set out below.

More details are also included in Note 15 to the Annual Report and Financial Statements 2017.

Risks and uncertainties	Trend and outlook	Mitigation
Political risk – Political and/or regulatory intervention.	While DB pensions remained on the political and regulatory agenda during 2017, including a Government consultation on the future of defined benefit pension schemes, published in early 2017, the greater focus has been on the implications of the UK's decision to leave the EU. The findings of the Treasury Select Committee review of the Solvency II regulations in the context of the decision to leave the EU recommended that the PRA move quickly in adapting Solvency II to more closely fit the UK's insurance landscape. This was viewed as positive for the UK bulk annuity market and was seen as a step forward towards increasing cooperation in the UK insurance industry.	• PIC maintains an open dialogue with regulators and policymakers, and closely monitors regulatory and legislative developments. Regular horizon scanning helps identify key risks to best position PIC's strategy.
Market risk – Impact of market and/or economic volatility on PIC's capital position.	The UK financial markets experienced significantly less volatility during 2017 than was seen in the previous 12 months (although spikes were seen around the results of the UK general election). The expectation is of continued uncertainty and volatility as markets react to developments such as the UK's future relationship with the EU, changing political trends across the world and threats to global trade/a rise of protectionism.	• PIC closely manages its balance sheet, such that the Company actively hedges its balance sheet against adverse movements in financial markets. However, the residual Risk Margin results in a capital requirement that remains sensitive to interest and inflation rates. • PIC monitors areas of potential pricing bubbles that may see market corrections in order to limit exposures where appropriate. • Regular stress and scenario analysis is carried out to assess the impact of different possibilities. • The business holds a significant amount of risk based capital to protect against market movements.

STRATEGIC REVIEW

PRINCIPAL RISKS

CONTINUED

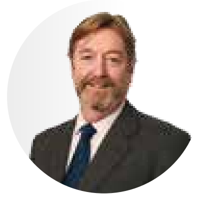
Risks and uncertainties	Trend and outlook	Mitigation
Economic risk – Prolonged low interest rates may affect PIC's capital position and cause difficulties in sourcing appropriate long-dated assets.	The costs associated with maintaining the Risk Margin in a prolonged low interest rate environment may impact PIC's profitability. While the Bank of England made its first increase to the UK base rate in over a decade in November 2017, in response to a reduction in the level of economic slack and increasing inflation, the expectation is of a continuing low rate environment in the short-to-medium term.	Hedging helps protect PIC's capital position against adverse movements in interest rates. However, Risk Margin volatility in a lower interest rate environment may impact PIC's solvency.
Default risk – On credit/debt assets in the portfolio.	While PIC has historically experienced low levels of default in the portfolio (see page 33 for historical experience), this risk continues to be significant given the growth of our balance sheet and the increased volatility of financial markets.	PIC selects and monitors its investment holdings very closely, either directly or through high-quality external managers. £1.2 billion provision held for defaults and downgrades in the Solvency II balance sheet in addition to the risk-based capital requirements.
Counterparty and outsourcer risk – The possibility of failure by our reinsurance and swap counterparties and outsourcers who are contracted to honour their obligations in a timely manner.	The impact of Solvency II and the increased volatility in the financial markets has increased the importance of third party risk transfers, for example longevity risk.	PIC transacts with highly rated reinsurance counterparties, and also includes collateral provisions to improve overall security, for example interest rate swaps, which are fully collateralised on a daily basis. PIC carries out continuous monitoring of our counterparties to ensure issues can be identified earlier, allowing actions to be taken to reduce the risk. The Board provides an oversight of oursourcer risk.
Longevity risk – PIC's insured policyholders may live longer than was originally assumed when pricing new business.	PIC is exposed to factors that may lead to increases in life expectancy, such as improvements in medical science beyond those anticipated. The UK has experienced another year of heavier-than-expected pensioner mortality, which has been attributed to a number of factors including increased deaths from dementia and influenza, and the increased strain on the NHS and social care budgets impacting the level of care provided to the ageing population. Offsetting this are continued improvements in awareness of the impact of lifestyle on health, and technology increasingly providing new opportunities for individuals to track and monitor their own health, and even to carry out screening tests for diseases using their mobile phones.	PIC regularly reviews its longevity experience to ensure assumptions remain appropriate, and continually seeks to enhance its understanding of the evolution of annuitant mortality. PIC holds a significant amount of risk-based capital to protect the business against potential increases in longevity. This is calculated using our PRA approved internal model. PIC aims to reinsure more than 60% of its longevity risk exposure. As at 31 December 2017, PIC had reinsured 73% of its total longevity exposure.

Risks and uncertainties	Trend and outlook	Mitigation
New business risk – Business is written for a price which fails to generate an appropriate risk-adjusted return in line with our strategic objectives. This may lead to reduced profits, or even financial loss.	PIC's specialisation and historical experience in the bulk annuity sector gives the Board and management comfort that this risk can be managed within risk tolerances.	PIC ensures that any new business meets risk appetite criteria, and that all assumptions that go into the new business quotation process are subject to rigorous governance and control. The business plan is fully stress tested to ensure decision makers are clear of the consequences of this risk.
Cyber risk – The financial services sector is increasingly becoming a target for cyber crime. This might include the risks that third parties may seek to disrupt PIC's operations, steal personal data or perpetrate acts of fraud.	The drivers of this risk continue to evolve rapidly as technology is changing the way firms do business and society operates. The financial services sector has seen a significant increase in the number of attempts by third parties to seek and exploit vulnerabilities in IT systems.	PIC maintains a robust IT environment to ensure protection of its data and security of its systems and those of outsourced or third parties that we work with. PIC works with its business partners to maintain controls and regular monitoring to proactively address emerging threats. The IT environment is regularly tested internally and externally to maintain up-to-date awareness of latest threats and how these may impact PIC. PIC is on target to deliver its obligations under General Data Protection Regulation, which is intended to provide enhanced protection for policyholder data.

Corporate Governance

CORPORATE GOVERNANCE

CHAIRMAN'S INTRODUCTION TO CORPORATE GOVERNANCE



PIC continues to be managed by a Board of Directors consisting of 13 members (2016: 13), a majority of whom are independent. The Group structure, as the diagram below shows, remains straightforward, with PIC's ultimate parent company, Pension Insurance Corporation Group ("PICG"), being incorporated in the UK. PIC is the main operating company of PICG. Pension Services Corporation Limited provides services for the Group and employs all staff.

In last year's Governance section of this report, I set out two main areas of focus for Board development during the year. The first was continued integration of the Board and its Committees to allow a more streamlined decision-making process. I am very pleased therefore that in my first full year as Chairman, we have made considerable progress in refining and improving the Board Committee structure.

We have now shaped the membership of the Committees to best reflect the skills of our Directors. At the same time, we have enhanced the interfaces between the Committees such that the deliberations of one Committee are now routinely shared with other, related Committees. Having Board members play an active role on related Committees in this way has proved a remarkably efficient way of sharing information, made best use of the wide talent base of the Board, and has also ensured that decisions are not taken in isolation by individual Committees. In addition, we regularly seek input from employees, using their deep sector expertise to develop our thinking.

The second action point was to develop the diversity of the Board, in particular the number of female Board members. On this, and despite welcoming Amanda Bowe to the Board early in the year, I regret that we have been less successful, although not through lack of effort. We will refocus on this in 2018.

In 2018, the Board will continue to consider the potential for expanding the scope of opportunities for investing our assets and how this could support the Company's new business pipeline, as well as enhancing the security and value of our in-force business. We will also concentrate on implementing the Board Diversity Policy, adopted in 2017.

Pension Insurance Corporation Group Limited

PIC Holdings Limited

Pension Insurance Corporation plc ("PIC")

Pension Services Corporation Limited

CORPORATE GOVERNANCE OVERVIEW

Structure of the Board and Board Committees

The role of the Board

The Company is led by a Board of Directors (the "Board"). The appointment of the Directors is pursuant to the Articles of Association last updated on 9 June 2014. The Board comprises an independent non-executive Chairman, the Chief Executive Officer, the Chief Financial Officer and ten Non-Executive Directors. Biographical details of all Directors are included on pages 64 to 67. The Directors are covered by the Company's Directors' and Officers' indemnity insurance policy.

The Directors who served during the year are listed on page 62.

The Board's primary focus is on promoting the sustainable long-term success of the Company and providing leadership within a framework of prudent and effective controls which enable risks to be assessed and managed. The Board influences the Company by promoting high standards of conduct and an ethical culture across the organisation. The Board believes that good governance means strong values and doing what is right for employees, policyholders, shareholders and other stakeholders. The Board acknowledges its collective responsibility for setting the Company's strategic aims, ensuring that the necessary financial and human resources are in place and reviewing management performance. The principal responsibilities of the Board are included in its terms of reference which also list matters specifically reserved for decision by the Board.

How the Board operates

The Board is led by the Chairman, Jon Aisbitt, and the day-to-day management of the Company is led by the Chief Executive Officer, Tracy Blackwell. The responsibilities of the Chairman and the Chief Executive Officer are clearly defined and agreed by the Board. As Chairman, Jon focuses on the leadership of the Board, ensuring its effectiveness and promoting a culture of openness and constructive debate among the Directors. He also advocates effective, fair and transparent communication with stakeholders including policyholders, employees and shareholders. As Chief Executive Officer, Tracy leads the executives in the day-to-day management of the business and effective implementation of Board decisions. The Board also has a Senior Independent Director, Nick Lyons, who acts as a sounding board for the Chairman and a trusted intermediary for the other Directors.

The Board meets formally on a regular basis and attends to various matters by way of written resolutions. The Chairman and the Company Secretary ensure that, prior to each meeting, the Directors receive accurate, clear and timely information which aids the decision making process. The Board materials are distributed through a secure board portal. At each meeting, the Board receives updates from the Chief Executive Officer and Chief Financial Officer on the execution against strategy and performance against plan. The Board also reviews regular executive reports from different business areas, including matters relating to new business pipeline and associated investments, policyholders and our obligation to treat them fairly. The Chief Risk Officer attends each meeting and also provides regular updates. The Chairmen of the Board Committees, (Risk, Audit, Asset Liability Management, Origination and Nomination and Remuneration), also report to the Board on the work carried out during the year on matters within the authority delegated to those Committees. The Board's work is not limited to scheduled formal Board meetings. There is an ongoing dialogue between the Executive and Non-Executive Directors outside of the formal meetings.

Board effectiveness

The Directors ensure that the Board is structured in such a way that each member of the Board is able to bring different experiences and skills to the operation of the Company. The Board encourages and supports each Director to regularly update and refresh their skills and knowledge. The Company arranges a formal induction for all new Directors and there is a Board training programme in place. The Board is aware of the other commitments of the Directors and considers that these do not conflict with the commitment to the Company.

The Board evaluates its effectiveness each year and identifies any areas for development. Every three years the evaluation process is facilitated by an external consulting firm. In 2017, an external evaluation of Board effectiveness was carried out which focused on the composition, skills and size of the Board. It also addressed how the role of the Board is understood and how meetings are chaired and conducted, whether information provided is of good quality and whether the Board focuses on the right matters with an appropriate balance between strategy, risk, operations, performance, people and regulatory matters. The review further explored the relationship between executive and non-executive directors, and how well they challenged and helped each other to be effective in their roles and relationships between the Board and its Committees. It also considered the Board's relationships with stakeholders. The Board continued to have a majority of independent directors throughout 2017. The strengths and areas for development for the Board are listed overleaf.

Board strengths

- PIC benefits from a group of diligent and committed Directors with a high level of industry experience and in which actuarial, finance and investment expertise remains strong.
- The Board continued to have a good connection to the business and maintained a culture of challenging the management team in a constructive way. Whilst operating in a collaborative way, independent views continued to be encouraged and heard by the Board.
- The Board and Committees' structure and composition were reviewed and updated so that each Director is able to use their experiences and skills to best effect in active engagement with the business and to ensure good communication between Committees.
- During the year the Board considered succession plans for Board members and adopted the Board Diversity Policy to maintain continuity on the Board and further build diversity of skills and knowledge.
- The Board continued to update and refresh their skills and knowledge. A series of targeted teach-in sessions was held during 2017 for the Board and Committee members which included security awareness, credit sensitivities/hedging, IFRS 17, Diversified Capital Fund and EMIR and central clearing.

Areas for Board development

- Further development of understanding of new asset classes and how these could support the Company's new business pipeline.
- The Board is committed to diversity through its Board Diversity Policy adopted in 2017 and now needs to concentrate on implementation of that policy.

Board focus 2017

In 2017, the Board met five times and attended to matters by written resolutions. Some of the key matters considered at its meeting are listed below:

- Q1 2017 – changes in shareholder base at PIC Group level and bringing onboard CVC as a significant investor in the PIC Group; 2016 Annual Report and Financial Statements, consolidated validation of the Company's internal model, remuneration matters including share schemes and governance arrangements including structure and membership of Board committees; 2016 Own Risk and Solvency Assessment report.
- Q2 2017 – business improvement projects, contingency planning for Brexit, own risk assessment and stress and scenario testing, Solvency and Financial Condition Report, Regular Supervisory Report, Anti-Slavery and Human Trafficking Policy and its implementation, framework for 2018 five-year plan, Board effectiveness review by external independent party and recovery and resolution plans, oversight of operational matters, in particular, performance of significant outsourcers, consideration of new assets strategy and mid-year review of the integrated assurance report.
- Q3 2017 – general strategy, draft 2018 five-year business plan, review of the Company's values and standards and overall culture, continued oversight of significant outsourcers, IT strategy, reinsurance strategy, hedging programme, internal model changes, risk appetite and tolerances framework, Board succession planning and Board Diversity Policy.
- Q4 2017 – 2018 five-year business plan and its key risks, budget, compensation, strategic projects, stress and scenario testing results, integrated assurance report and plan and actuarial function holder report.

CORPORATE GOVERNANCE OVERVIEW

CONTINUED

Board attendance

	21/03/2017	22/05/2017	19/07/2017	25/09/2017	07/12/2017	
Jon Aisbitt	●	●	●	●	●	5/5
Tracy Blackwell	●	●	●	●	●	5/5
Amanda Bowe[1]	●	●	●	●	●	5/5
John Coomber[2]	●	●	○	○	○	2/2
Tim Hanford	●	●	apologies	●	●	4/5
Arno Kitts	●	●	●	●	●	5/5
Nick Lyons	●	●	●	●	●	5/5
Roger Marshall	●	●	●	●	●	5/5
Eloy Michotte	●	●	●	●	●	5/5
Peter Rutland[3]	○	●	●	●	●	4/4
Steve Sarjant	●	●	apologies	●	●	4/5
Rob Sewell	●	●	●	●	●	5/5
Mark Stephen	apologies	●	●	●	●	4/5
Wilhelm Van Zyl	●	●	●	●	●	5/5

○ Not on the Board ● On the Board

1 Amanda Bowe was appointed with effect from 1 January 2017
2 John Coomber resigned with effect from 22 May 2017 close of business
3 Peter Rutland was appointed with effect from 5 May 2017

Governance framework

The Board delegates specific responsibilities to five Board Committees which assist the Board in its oversight and control of the business. The Committees include Audit, Risk, Nomination and Remuneration, Asset Liability Management and Origination. Members of the Committees are appointed by the Board on recommendation of the Nomination and Remuneration Committee in consultation with the Committees' Chairmen. There are a number of executive and operating committees which assist executives with business management and oversight.

Pension Insurance Corporation Group Limited

PIC Holdings Limited

Pension Insurance Corporation plc

The Board of Directors

Audit Committee | Risk Committee | Nomination and Remuneration Committee | Asset Liability Management Committee | Origination Committee

PIC'S BOARD OF DIRECTORS

Nomination and Remuneration Committee

- Reviews the structure, size, succession plans and composition (including the skills, knowledge, experience and diversity) of the Board and makes recommendations with regard to any changes.
- Determines and agrees with the Board the framework or broad policy for the remuneration and recruitment of the Company's Chairman, Non-Executive Directors, Chief Executive, the Executive Directors and other members of the executive management.
- Reviews PIC's Talent Management programme and overall remuneration arrangements and approves share incentive plans.
- Met six times in 2017 and its primary focus was on compliance with Solvency II remuneration requirements, Material Risk Taker identification, culture, diversity and succession planning.

Asset Liability Management Committee

- Oversees the management of all aspects of investment policy and strategy for the Company and provides oversight of the operation of the Company's investment portfolios within the established strategy and risk frameworks.
- Focuses on asset strategies to support new business pricing and reviews the Company's hedging strategy.
- Met five times in 2017 and its primary focus was on an ongoing oversight of the Company's portfolio and performance, reviewing the Investment Policy and operational framework, consideration of new asset class proposals, backbook optimisation, debt origination strategy, and liquidity management framework in the context of EMIR central clearing.

Origination Committee

- Oversees the management of all aspects of the Company's new business and reinsurance origination within established strategy and risk frameworks, including conduct risk.
- Also oversees all aspects of interaction with policyholders including administration, tracing and complaints; and recommends to the Board any actions needed to ensure policyholders are treated fairly.
- Met eight times in 2017 and attended to various matters via written resolutions. Its primary focus was on the oversight of new business and reinsurance, the review and approval of pricing for large deals and approval of new counterparties. The Committee also oversaw the administration and transition of pension schemes to the PIC portfolio in 2017, and attended to customer related matters.

Audit Committee

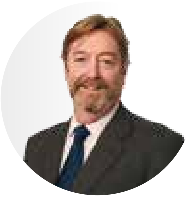
- Assists the Board with the discharge of its responsibilities with regard to internal and external audits, financial reporting, systems of internal controls and risk management.
- Other areas of consideration include data governance, oversight of business continuity planning and disaster recovery, oversight of the relationship with external auditors and making recommendations to the Board in relation to appointment of external auditors.
- Met seven times in 2017 and its primary focus was on reviewing the annual financial statements including review of significant judgements, the Company's going concern assumptions, and considering and approving the Internal Audit plan. The Committee also reviewed the Annual Solvency and Financial Condition Report, considered recalculation of transitional measures for technical provisions, oversaw various business improvement projects and reviewed the Half Year 2017 Investor Report. The Committee's considerations were supported by the integrated assurance reporting from the assurance functions. Throughout the year the Committee also received regular updates on compliance, anti-bribery and corruption as well as anti-money laundering and interactions with the regulator.

Risk Committee

- Assists the Board in its oversight of the Company's current and likely risk exposures, tolerances and appetite, risk measurement and risk management performance.
- Has oversight of the Company's risk policies and procedures and risk controls.
- Is responsible for oversight of the internal model and for reporting to the Board on any areas needing improvement.
- Met eight times in 2017 and its primary focus was on assisting the Board with monitoring and reviewing the Company's risk appetite and tolerances, reviewing PIC's approach to hedging, considering different aspects of the ORSA processes, reviewing the Company's risk framework and risk policies, and the recovery and resolution plan. The Committee provided ongoing monitoring of the Company's Internal Model and made recommendations to the Board with regard to its calibration and in respect of the Internal Model major change application. Furthermore, the Committee considered the CRO's report to the Nomination and Remuneration Committee to ensure that risk management was properly incorporated in the incentive structure for the executives.

CORPORATE GOVERNANCE

BOARD OF DIRECTORS



Jon Aisbitt

Chairman of the Board, Co-Chair of the Origination Committee and Chairman of the Nomination Committee

DATE OF APPOINTMENT

Jon was appointed to the Board as independent Non-Executive Chairman in October 2016.

BACKGROUND AND CAREER

Jon was Chairman of Man Group plc until he stepped down in May 2016. Prior to joining Man Group plc, Jon held senior roles at Goldman Sachs. He was previously Deputy Chairman of Ocean Rig plc and Honorary Treasurer of the NSPCC. He is a Fellow of the Institute of Chartered Accountants of England and Wales.

AREAS OF EXPERTISE

Jon has over 20 years' experience in international corporate finance. He has significant technical knowledge of capital markets and the complex regulatory backdrop in which they operate. He has significant change management experience.

CURRENT EXTERNAL ROLES

Jon is a director of New Forests Company Holdings Limited (African sustainable forestry and timber processing) and a Non-Executive Director of Pro Bono Bio plc (biotechnology).

COMMITTEE MEMBERSHIP

Jon is Chairman of the Nomination Committee and a member of the Remuneration Committee. He is Co-Chair of the Origination Committee. He attends Audit and Risk Committee meetings by invitation.

Tracy Blackwell

Chief Executive Officer and Co-Chair of the Origination Committee

DATE OF APPOINTMENT

Tracy was appointed to the Board as an executive director in July 2011 and appointed as Chief Executive Officer in July 2015.

BACKGROUND AND CAREER

Tracy joined PIC at its founding in 2006 as Chief Investment Officer. Prior to PIC, she held senior roles in Goldman Sachs, including as Head of Risk Management, EMEA at Goldman Sachs Asset Management, working with pension fund and insurance company clients on investment, risk and strategic issues.

AREAS OF EXPERTISE

Tracy has more than 25 years' experience of investment markets, including matching pension assets to liabilities and risk hedging strategies. She has a strong knowledge and understanding of the regulatory landscape.

CURRENT EXTERNAL ROLES

Tracy is a Non-Executive Director of United Trust Bank. She is also the Honorary Treasurer of the Elton John AIDS Foundation.

COMMITTEE MEMBERSHIP

Tracy is Co-Chair of the Origination Committee. She attends Audit, Risk Committee, and Remuneration and Nomination Committee meetings by invitation.

Amanda Bowe

Independent Non-Executive Director

DATE OF APPOINTMENT

Amanda was appointed to the Board as an independent Non-Executive Director in January 2017.

BACKGROUND AND CAREER

Amanda was the Group Regulatory Risk Director for Aegon UK where she provided advice, guidance and assurance on customer, conduct and prudential regulatory matters and managed the relationship with the PRA and FCA. Before joining Aegon, Amanda spent over 20 years with the Financial Services Authority where she undertook a variety of supervisory roles. Amanda is a member of the Chartered Institute of Securities and Investments, London.

AREAS OF EXPERTISE

Amanda has considerable expertise as a financial services regulator, focused in particular on the pensions, savings and investment sectors. She also has experience of managing the risks associated with financial crime and data protection

CURRENT EXTERNAL ROLES

Amanda is an Independent Board Director of Standard Life Assurance and Chair of the Standard Life Risk and Capital Committee. She is also an independent Board Director of Standard Life Savings, Elevate Portfolio Services, Equatex AG and Post Office Management Services, where she also chairs the Audit and Risk Committee.

COMMITTEE MEMBERSHIP

Amanda is a member of the Audit Committee.

Tim Hanford

Non-Executive Director

DATE OF APPOINTMENT

Tim was appointed to the Board as a Non-Executive Director in January 2009.

BACKGROUND AND CAREER

Tim is Managing Director for Europe of J.C. Flowers & Co. Tim has previously held senior roles at FPK Capital and at Dresdner Bank. Tim has been an independent director of Schroders. Tim has an M.S. in Management from Stanford University Graduate School of Business where he was a Sloan Fellow.

AREAS OF EXPERTISE

Tim has over 25 years' experience in banking and investment, including credit strategies, risk management, mergers and acquisitions.

CURRENT EXTERNAL ROLES

Tim serves on the Boards of OneSavings Bank plc, Castle Trust and Cabot Credit Management and is the Managing Director in charge of JCF Europe.

COMMITTEE MEMBERSHIP

Tim is a Non-Executive Director and member of the Asset and Liability Management and Nomination and Remuneration Committees.

Arno Kitts

Independent Non-Executive Director and Chairman of Asset and Liability Management Committee

DATE OF APPOINTMENT

Arno was appointed to the Board as an independent Non-Executive Director in July 2016.

BACKGROUND AND CAREER

Arno has held senior roles at BlackRock, Henderson Global Investors and JPMorgan Asset Management and JPMorgan Life. He served as a Director of Alphagen Capella Fund and the Pensions and Lifetime Savings Association (PLSA). Arno was a Member of the Council and Finance & Investment Board of the Actuarial Profession. He is a Fellow of the Institute of Actuaries and holds a PhD from Southampton University.

AREAS OF EXPERTISE

Arno was responsible for distribution and institutional business with clients worldwide, encompassing sales and marketing, product development and client consultant relationship management and service. He has been involved in investment management since 1989.

CURRENT EXTERNAL ROLES

Arno is a director of Perspective Capital Management Limited. He is the Governor of the Pensions Policy Institute and a Director of Wake Trade Technologies.

COMMITTEE MEMBERSHIP

Arno is an independent Non-Executive Director and Chairman of the Asset and Liability Management Committee and a member of the Risk Committee.

Nick Lyons

Senior Independent Director and Chairman of the Remuneration Committee

DATE OF APPOINTMENT

Nick was appointed to the Board as Senior Independent Director in February 2016.

BACKGROUND AND CAREER

Nick headed the European Financial Institutions Group at Lehman Brothers Europe until 2003. Previous roles include executive positions at JP Morgan and Salomon Brothers. Nick served as Non-Executive Chairman of Miller Insurance Services LLP, as well as a director of Catlin Group, Friends Life Group plc, Price Forbes and Quayle Munro plc.

AREAS OF EXPERTISE

Nick has considerable expertise and experience in the financial services and insurance industries. Nick also has extensive experience in serving as an independent Non-Executive Director.

CURRENT EXTERNAL ROLES

Nick serves on the Boards of Directors of Clipstone Logistics Reit plc and Temple Bar Investment Trust plc. Nick is also the Chairman of Longbow Capital LLP and Alderman for the City of London Corporation.

COMMITTEE MEMBERSHIP

Nick is the Senior Independent Director, Chairman of the Remuneration Committee and a member of the Risk Committee.

Roger Marshall

Independent Non-Executive Director and Chairman of the Audit Committee

DATE OF APPOINTMENT

Roger was appointed to the Board as an independent Non-Executive Director in September 2015.

BACKGROUND AND CAREER

Roger held senior roles at PricewaterhouseCoopers, including the Chairmanship of PwC's Global Audit Policy Board and its global Corporate Reporting Task Force. Roger is a Fellow of the Institute of Chartered Accountants in England and Wales.

AREAS OF EXPERTISE

Roger has gained substantial financial services expertise through his career at PwC and subsequent non-executive roles.

CURRENT EXTERNAL ROLES

Roger is a member of the FRC Board, the FRC Codes and Standards Committee and the FRC Corporate Reporting Council. Roger also serves on the Boards of the European Financial Reporting Advisory Group and Old Mutual plc.

COMMITTEE MEMBERSHIP

Roger is an independent Non-Executive Director, Chairman of the Audit Committee and a member of the Risk Committee.

CORPORATE GOVERNANCE

BOARD OF DIRECTORS

CONTINUED

Eloy Michotte

Non-Executive Director

DATE OF APPOINTMENT

Eloy was appointed to the Board as a Non-Executive Director in October 2012.

BACKGROUND AND CAREER

Eloy has held senior roles at Compagnie Financière Richemont S.A., Reinet Investments Manager S.A. and Reinet Fund Manager S.A.. He has previously worked for Ford, McKinsey & Co and Bankers Trust Company prior to joining Richemont at the time of its formation in 1988. He graduated in engineering and applied mathematics from the University of Louvain in Belgium and holds an MBA from the University of Chicago.

AREAS OF EXPERTISE

Eloy has extensive experience in international business and finance, including mergers and acquisitions.

CURRENT EXTERNAL ROLES

Eloy serves on the Boards of a number of companies in which Reinet Investments S.C.A. and Richemont hold interests.

COMMITTEE MEMBERSHIP

Eloy is a Non-Executive Director and member of the Origination, Asset and Liability Management, Nomination and Remuneration Committees.

Steve Sarjant

Independent Non-Executive Director and Chairman of the Risk Committee

DATE OF APPOINTMENT

Steve was appointed to the Board as an independent Non-Executive Director in November 2014.

BACKGROUND AND CAREER

Steve spent 20 years at Towers Watson (previously Watson Wyatt) where he was a Managing Director in its Risk and Financial Services segment and Global Leader, Mergers and Acquisitions. Prior to this Steve held roles at Criterion Assurance Group and National Provident Institution in a variety of roles. Steve has a BSc in Mathematics from the University of Bristol. He is a Fellow of the Institute and Faculty of Actuaries.

AREAS OF EXPERTISE

Steve has over 30 years' experience in the financial services industry.

CURRENT EXTERNAL ROLES

Steve is a Non-Executive Director and Chairman of the Actuarial Committee for Vitality Health and Vitality Life, and an Independent Member of the With Profits Committee of Liverpool Victoria Friendly Society.

COMMITTEE MEMBERSHIP

Steve is an independent Non-Executive Director, Chair of the Risk Committee and member of the Origination Committee.

Rob Sewell

Chief Financial Officer

DATE OF APPOINTMENT

Rob was appointed to the Board as an Executive Director in July 2008.

BACKGROUND AND CAREER

In a professional career of over 30 years, Rob's previous roles have included being UK CFO for Legal & General Group plc, and CEO of National Westminster Life Assurance. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

AREAS OF EXPERTISE

Rob has extensive managerial, financial and accounting experience in the insurance and regulatory markets.

CURRENT EXTERNAL ROLES

Rob serves as a Non-Executive Director of HCT Group.

COMMITTEE MEMBERSHIP

Rob is an Executive member of the Board and a member of the Origination Committee. He attends Audit, ALM and Risk Committee meetings by invitation.

Mark Stephen

Independent Non-Executive Director

DATE OF APPOINTMENT

Mark was appointed to the Board as an independent Non-Executive Director in November 2014.

BACKGROUND AND CAREER

Mark was previously a partner at PricewaterhouseCoopers LLP. He is a member of the Institute of Chartered Accountants in England and Wales.

AREAS OF EXPERTISE

Mark has over 30 years' experience of advising and working with insurance company Boards on many aspects of business, including how they adapt to the changing regulatory and business landscape.

CURRENT EXTERNAL ROLES

Mark serves as a Director of TransRe London Limited.

COMMITTEE MEMBERSHIP

Mark is an independent Non-Executive Director and member of the Asset and Liability Management and Audit Committees.

Wilhelm Van Zyl

Non-Executive Director

DATE OF APPOINTMENT

Wilhelm was appointed to the Board as a Non-Executive Director in May 2015.

BACKGROUND AND CAREER

Wilhelm is the Chief Executive of Reinet Investments Manager S.A. and Reinet Fund Manager S.A.. Prior to this Wilhelm held senior roles in a long career at Metropolitan Holdings and MMI Holdings. Wilhelm holds a BCom degree from the University of Stellenbosch and is a Fellow of the Institute and Faculty of Actuaries (UK) and Fellow of the Actuarial Society of South Africa.

AREAS OF EXPERTISE

Wilhelm has a strong background in the international financial services sector, including investment strategy.

CURRENT EXTERNAL ROLES

Wilhelm is the Chief Executive of Reinet Investments Manager S.A. and Reinet Fund Manager S.A.. He serves on the Boards of a number of companies in which Reinet holds interests.

COMMITTEE MEMBERSHIP

Wilhelm is a Non-Executive Director and member of the Risk and Audit Committees.

Peter Rutland

Non-Executive Director

DATE OF APPOINTMENT

Peter was appointed to the Board as a Non-Executive Director in May 2017.

BACKGROUND AND CAREER

Peter is Co-Head of CVC's Financial Services Group and is based in London. He also serves on the Board of Domestic & General Group, Newday and dxc.technology. Prior to joining CVC, he worked for Advent International since 2002. Prior to working at Advent, Peter worked for Goldman Sachs in the Investment Banking Division. Peter holds an MA Degree from the University of Cambridge and an MBA from INSEAD.

AREAS OF EXPERTISE

Peter has 16 years' experience in the banking, investment and insurance industries as well as experience as a Director of both private and listed companies.

CURRENT EXTERNAL ROLES

Peter is a Director of Newday Group UK Limited, DXC. Technology Company and Domestic & General Group. He is a partner and global co-head of financial services at CVC Capital Partners Limited and serves on the Boards of a number of companies in which CVC holds interests.

COMMITTEE MEMBERSHIP

Peter is a Non-Executive Director and member of the Origination and Asset and Liability Management Committees.

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 their spouse and/or dependents. 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 dependent's or on a bulk purchase basis for groups of individuals.

Best Estimate Liabilities (BEL)
The expected present value of future cash flows for a company's current insurance obligations, calculated using best estimate assumptions, projected over the contract's run-off period, taking into account all up-to-date financial market and actuarial information.

Bulk Purchase Annuity (BPA)
Bulk annuities are annuity policies that insure a group of individuals under a single contract, typically the members of a Defined Benefit Pension Plan, or a defined subset of such members.

Deferred Tax Liability (DTL)
Liability arising due to timing differences between tax computations and the recognition of items in company accounts.

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.

Defined Contribution (DC) Pension Plan
A pension plan on which the employer and / or the employee make regular contributions, where the amount received by the employee on retirement is based on the accumulated fund. The employee normally has the responsibility of deciding how the contributions are invested (though investment choices may be limited by the actual pension fund provider).

Financial Conduct Authority (FCA)
One of the two bodies (along with the PRA) which replaced the Financial Services Authority from 1 April 2013. The FCA is a company limited by guarantee and is independent of the Bank of England. It is responsible for the conduct business regulation of all firms (including those firms subject to prudential regulation by the PRA) and the prudential regulation of firms not regulated by the PRA. The FCA has three statutory objectives: securing an appropriate degree of protection for consumers, protecting and enhancing the integrity of the UK financial system and promoting effective competition in the interests of consumers.

Internal Rate of Return (IRR)
A discount rate used to measure profitability. The rate used is that which will bring a series of cash flows to a net present value of nil.

Market Consistent Embedded Value ("MCEV")
The methodology for calculating and reporting Embedded Value, as set out by the Market Consistent Embedded Value Principles. It is made up of five components: Adjusted Net Worth plus Present Value of Future Profits less Cost of Residual Non-Hedgeable Risks less Frictional Cost of Required Capital less Subordinated Debt.

Matching Adjustment (MA)
An adjustment made to the risk-free interest rate when the insurer holds certain long-term assets to back a portfolio of their liabilities.

MCEV – Adjusted Net Worth
Adjusted net worth is equal to the unadjusted Own Funds under Solvency II.

MCEV – Cost of Residual Non-Hedgeable Risks (CRNHR)
Under the MCEV methodology allowance is made 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.

MCEV – Frictional Cost of Required Capital (FCoC)
There is a cost associated with the assets which cover the minimum amount of regulatory capital the Company expects to hold (the Required Capital). This is principally in respect of investment management fees and tax on investment income. This cost is captured as the "Frictional Cost of Required Capital".

MCEV – Present Value of Future Profits (PVFP)
There are certain regulatory margins within the Solvency II own funds which, in a "best estimate" scenario, are expected to be released to shareholders as free capital over time. These regulatory margins principally relate to prudence within the liability discount rate (also known as the fundamental spread), and the Risk Margin (net of any adjustment for the impact of Transitional Measures on the Own Funds). The present value, after tax, of the future release of these regulatory margins is equal to the "Present Value of Future Profits".

New Business Strain
The impact of writing new business on the regulatory capital position, including the cost of acquiring new business and the setting up of regulatory reserves.

Own Funds
The amount of capital a firm actually holds under Solvency II on a market value basis. This is the sum of the economic value of assets less the economic value of liabilities. Basic own funds are calculated as the difference between the assets (including transitional measure on technical provisions) and liabilities (including subordinated liabilities) calculated on a combination of best estimate and market consistent assumptions. Eligible own funds reflect any tiering restrictions and are the amount of own funds eligible to cover the SCR and MCR.

Prudential Regulation Authority (PRA)
One of the two bodies (along with the FCA) which replaced the Financial Services Authority from 1 April 2013. 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. The PRA has two statutory objectives: to promote the safety and soundness of these firms and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders.

Risk Margin (RM)
The amount an insurance company would require, in excess of best estimate liabilities, in order to take over and meet the whole portfolio of insurance and reinsurance obligations. It reflects the cost of providing capital equal to the solvency capital requirement for non-hedgeable risks necessary to support the insurance obligations over their lifetime.

Solvency II
EU-wide regulatory regime which intends to align solvency capital to an insurers risk profile. Solvency II became effective from 1 January 2016.

Solvency Capital Requirement (SCR)
Is the amount of capital the Regulator requires an insurer to hold to meet the requirements under the Solvency II regulatory framework. Firms may use their own internal model e.g. PIC, the European Insurance and Occupational Pensions Authority (EIOPA) prescribed standard formula or a partial internal model to determine SCR.

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