PENSION INSURANCE CORPORATION GROUP LIMITED

PENSION RISKS SECURED

PENSION INSURANCE CORPORATION GROUP LIMITED

HALF YEAR REPORT 2018

The Pension Insurance Corporation Group consists of Pension Insurance Corporation Group Limited (PICG), the Group holding company; Pension Insurance Corporation plc (PIC), the Group's regulated insurer, and Pension Services Corporation Ltd, the Group's service company.

Pension Insurance Corporation Group Limited is incorporated and registered in England and Wales under company number 09740110.
Its registered office is at 14 Cornhill, London EC3V 3ND.

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

HALF YEAR TO 30 JUNE 2018

HIGHLIGHTS

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

Premiums (£m)

£3,261m

HY 2018	£3,261m
HY 2017	£1,913m
FY 2017	£3,704m
FY 2016	£2,598m
FY 2015	£3,755m
FY 2014	£2,646m

IFRS profit before tax (£m)

£123m

HY 2018	£123m
HY 2017	£140m
FY 2017	£383m
FY 2016	£266m
FY 2015	£136m
FY 2014	£163m

Market Consistent Embedded Value[1] (£m)

£3,402m

HY 2018	£3,402m
FY 2017	£2,932m
FY 2016	£2,600m

Financial investments (£bn)

£27.9bn

HY 2018	£27.9bn
FY 2017	£25.7bn
FY 2016	£22.6bn
FY 2015	£16.6bn
FY 2014	£13.8bn

Solvency II ratio (PIC)[2] (%)

175%

HY 2018	175%
FY 2017	160%
FY 2016	164%
FY 2015	151%

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

£4.8bn

HY 2018	£4.8bn
FY 2017	£4.3bn
FY 2016	£4.3bn
FY 2015	£2.8bn

Customer satisfaction (%)

97.4%

HY 2018	97.4%
FY 2017	98.3%
FY 2016	98.5%
FY 2015	99.3%
FY 2014	99.8%

1 The Group adopted the Market Consistent Embedded Value (MCEV) basis from 1 January 2017, therefore comparative information for the 2014 and 2015 financial years is not available. 2016 numbers represent the opening balance at 1 January 2017.
2 The Solvency II regime was implemented on 1 January 2016 with comparative information prepared for 2015, therefore there is no 2014 comparative available.

HALF YEAR REPORT
CHIEF EXECUTIVE OFFICER'S REVIEW

Tracy Blackwell PIC Chief Executive Officer

I'm pleased to say that the business enjoyed considerable success during the first half of the year, being ideally positioned to help our clients remove risk from their pension schemes in what we expect to be the busiest year yet for buyouts and buy-ins. From the amount of new business written so far this year, as well as from the size of the market pipeline, we expect the market to surpass £20 billion for buyouts and buy-ins, compared to market volumes of £10 billion to £12 billion experienced in the last few years.

As we announced to the market in July, we had our best ever first half, insuring £3.3 billion of liabilities (HY 2017: £1.9 billion). Our transactions included a £1.3 billion buy-in concluded with the Trustees of the Siemens Benefits Scheme, the third bulk annuity arrangement between us and a Siemens-sponsored defined benefit scheme. We also concluded a £0.9 billion buyout with the PA Consulting Pension Scheme. PIC, our wholly owned insurance subsidiary, was selected as the preferred insurer based on our flexibility, innovation and customer care, a recurring theme for our successful new business wins.

Most of this new business was won towards the end of June, and we were still transitioning the premiums received into our long-term asset portfolio at the half year point. So, whilst the Group reports profit before tax for the first six months of the year of £123 million (HY 2017: £140 million), some sources of profit from the new business have been deferred. We expect this deferred profit to emerge as we complete the asset transition and reinsurance in the second half of 2018.

At 30 June 2018, PIC's solvency ratio was 175%. As we acquire further assets to support the business written in the first half of the year, and continue to write new business, we would expect this solvency level to fall slightly, although it should remain at a level consistent with recent years.

The keys to our success, as I have previously noted, include our ability to look after policyholders, invest assets and reinsure longevity risk.

> “THE BUSINESS ENJOYED CONSIDERABLE SUCCESS DURING THE FIRST HALF OF THE YEAR”
>
> **Tracy Blackwell** PIC Chief Executive Officer

During the first half of the year we reinsured £1.1 billion of longevity risk (HY 2017: £1.8 billion), including a sixth reinsurance agreement with the Prudential Insurance Company of America (PICA), reinsuring £900 million of longevity exposure relating to the pension liabilities of c.7,500 pensioners across two pension schemes. As we noted in the 2017 year-end report, we now have a panel of ten major reinsurance counterparties and will continue to work with them to reinsure further tranches of longevity risk.

I am delighted that as our asset team continues to source secure, long-term cash flows to back our liabilities, we are being increasingly recognised as an established and well-respected funder to sectors including social housing. During the first six months of the year we invested £260 million with social housing associations (in which we have invested more than £1 billion in total), providers of student accommodation and other areas of social infrastructure, as we recycle capital through the economy to where it is most needed.

Our customer service offering for policyholders continues to set our business apart, and we were very pleased when PIC won the “Customer Focus – Large Enterprise” award at the Institute of Customer Service’s annual awards ceremony in March.

As the business continues to grow, it is imperative that we are able to maintain high levels of customer service, particularly the scale and sophistication of our policyholder service provision. Following a review of our outsourced administration services, focused on future service development, PIC appointed Capita Employee Benefits (Capita) as our new administration service provider. They replace Mercer, who we have worked with for the past seven years.

Once the service transition is complete, the Group’s administration and payroll services will be entirely based in Capita’s centre of excellence and its flagship office, in Darlington, County Durham. Of real importance to us in making this appointment was the alignment of the Darlington team with our culture and values. We look forward to working with their team in developing this very important part of our business.

Part of the reason for our ongoing success has been our very supportive shareholder base. As was announced in June, the Abu Dhabi Investment Authority (ADIA) reached agreement with JC Flowers (JCF) to acquire a significant shareholding in the Group, from funds advised by JCF. We are delighted that ADIA will be joining our small group of committed shareholders. They have financial services expertise and long-term investment horizons, and we look forward to working with them. At the same time, we are sorry to see JCF leave – they have provided invaluable support and challenge to the business over the past 12 years.

We continue to take our public policy responsibilities seriously and have engaged in debates and discussions, including around the consolidation of defined benefit pension funds, the need for increased infrastructure development, how to increase diversity and retain women in the financial industry, and the purpose of finance. In particular, the first year of the actuarial mentoring scheme for female actuaries, sponsored by PIC and supported by the Institute and Faculty of Actuaries, reached a very successful conclusion. We look forward to the launch later in the year of an expanded programme.

On the purpose of finance project, through which we facilitate debate about how we can best build productive and robust financial institutions that serve the needs of society, we were delighted to launch our latest paper, the “Purpose of Asset Management”. The paper engendered debate and drew comments from the asset management industry, asset owners and from MPs and policymakers at a number of events. All papers in the project are available on our website.

Finally, we completed our latest employee survey, which showed that 93% of our employees would recommend PIC as a place to work and 97% consider PIC to be customer focused. I am genuinely delighted that this is the case, and I believe that this is a direct result of our focus on building a strong culture with a clear sense of purpose.

In summary, we have had a very strong first half of the year, with record new business volumes, a strong balance sheet and our commitment to operational excellence in particular for our customers. I look forward to an equally successful conclusion to the year.

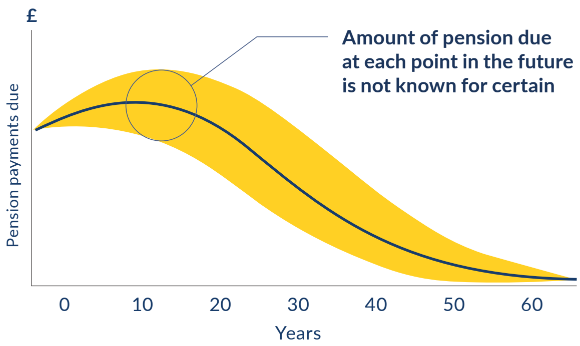
Tracy Blackwell
PIC Chief Executive Officer

OUR BUSINESS MODEL

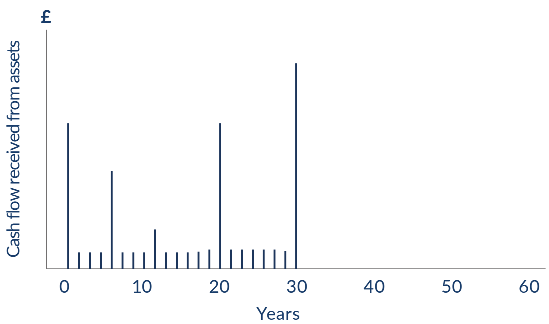
Three key steps in securing pensions and generating long-term shareholder returns

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

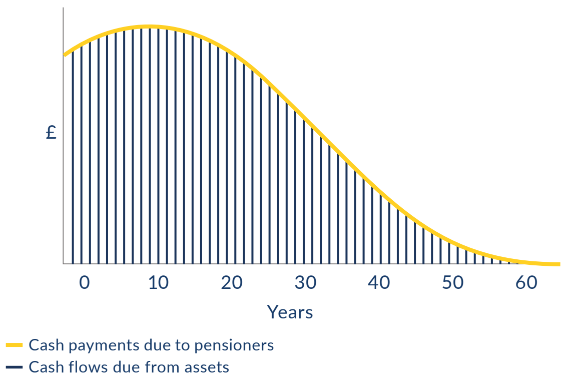
ASSETS RECEIVED ARE REINVESTED TO OPTIMISE RETURNS ON A CASH FLOW MATCHED AND RISK-ADJUSTED BASIS

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

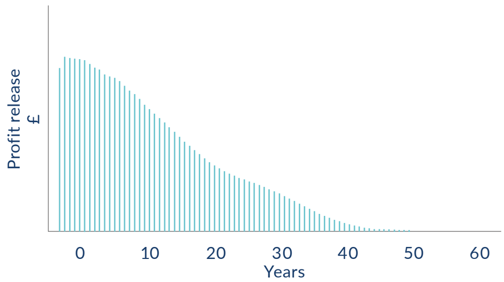
PIC CAPITAL RESOURCES ARE COMMITTED

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.

FINANCIAL RESULTS SUMMARY

Pension Insurance Corporation Group Limited

IFRS statement of comprehensive income

	2018 Half year (£m)	2017 Half year (£m)	2017 Full year (£m)
Revenue			
Gross premiums written	**3,261**	1,913	3,704
Outward reinsurance premiums	**(16)**	(26)	(41)
Net premium revenue earned	**3,245**	1,887	3,663
Investment return	**(619)**	378	1,092
Commissions earned	**–**	–	1
Total revenue (net of reinsurance premiums)	**2,626**	2,265	4,756
Expenses			
Claims paid – gross	**(545)**	(469)	(1,003)
Reinsurers' share of claims paid	**43**	35	94
	(502)	(434)	(909)
Increase in insurance liabilities – gross	**(1,369)**	(1,669)	(3,252)
(Decrease)/increase in reinsurers' share of insurance liabilities	**(551)**	42	(72)
	(1,920)	(1,627)	(3,324)
Acquisition expenses	**(27)**	(24)	(51)
Other operating expenses	**(34)**	(20)	(48)
Finance costs	**(20)**	(20)	(41)
	(81)	(64)	(140)
Total claims and expenses	**(2,503)**	(2,125)	(4,373)
Profit before taxation	**123**	140	383
Tax charge	**(24)**	(25)	(73)
Profit or loss and total comprehensive income for the period	**99**	115	310

Profit before tax by entity

	2018 Half year (£m)	2017 Half year (£m)	2017 Full year (£m)
Pension Insurance Corporation plc	**126**	143	391
Other Group entities	**(3)**	(3)	(8)
Pension Insurance Corporation Group	**123**	140	383

IFRS balance sheet

(£m)	**30 June 2018**	30 June 2017	31 December 2017
Assets			
Investment properties	**99**	97	99
Reinsurers' share of insurance liabilities	**1,900**	2,564	2,450
Receivables and other financial assets	**248**	243	320
Deferred tax asset	**3**	–	3
Prepayments	**72**	58	45
Financial investments	**27,885**	24,257	25,671
Derivative assets	**9,276**	7,113	8,775
Cash and cash equivalents	**51**	16	43
Total assets	**39,534**	34,348	37,406
Equity			
Share capital	**2**	2	2
Share premium	**120**	120	120
Treasury shares	**(9)**	(3)	(12)
Merger reserve	**34**	34	34
Capital reduction reserve	**1,055**	1,055	1,055
Share-based payment reserve	**13**	8	10
Retained profit	**966**	680	874
Total equity	**2,181**	1,896	2,083
Liabilities			
Gross insurance liabilities	**26,363**	23,410	24,993
Borrowings	**544**	543	543
Deferred tax liability	**4**	1	4
Derivative liabilities	**10,331**	8,216	9,663
Insurance and other payables	**13**	182	21
Current taxation	**23**	28	43
Accruals	**75**	72	56
Total liabilities	**37,353**	32,452	35,323
Total equity and liabilities	**39,534**	34,348	37,406

Net assets by entity

(£m)	**30 June 2018**	30 June 2017	31 December 2017
Pension Insurance Corporation plc	**2,178**	1,875	2,076
Other Group entities	**3**	21	7
Pension Insurance Corporation Group	**2,181**	1,896	2,083

FINANCIAL RESULTS SUMMARY

Statutory statement of comprehensive income and balance sheet review
Group IFRS profit before tax was £123 million, compared to £140 million for the same period in 2017. The slight drop in profits reflects the initial strain from the new business written; a slightly lower level of reinsurance activity than in the prior year, especially in the context of the new business written; and ongoing work in transitioning new business premiums received fully into target asset allocations, reflecting that most of the new business was written towards the end of the period. We expect that as assets are fully invested and reinsurance in respect of first half business is completed, these activities will lead to profits emerging in the second half of the year.

During the first half of the year, PIC insured 15 (HY 2017: 10) defined benefit pension schemes with a total premium value of £3.3 billion (HY 2017: £1.9 billion). Claims paid during the first half of the year were £545 million (HY 2017: £469 million), an increase of 16% mainly due to the growth in the insurance book over the past 12 months. As at 30 June, PIC was responsible for paying the pensions of approximately 162,800 individuals (31 December 2017: 151,600).

The assets in which PIC invests are carefully chosen in order to match the policyholder obligations that they are designed to pay. Our investment strategy is to select assets that generate cash flows that match our future claims payments in both timing and amount. This means that the value of our assets and our liabilities should move in tandem as factors such as interest rates and inflation rates change. Whilst our overall investment return (which comprises both investment income received, and changes in market value of assets) in HY 2018 was negative, this was offset by reductions in our corresponding liability valuations. Whilst gross premiums written were £3.3 billion, the increase in insurance liabilities net of reinsurance was only £1.9 billion, with the net gain of £1.4 billion partially offsetting the impact of the investment return and claims paid of £1.2 billion.

Expenses and finance costs have increased from £64 million for HY 2017 to £81 million for HY 2018. This reflects the increased new business activity in the first half of 2018, as well as additional asset origination costs as the Group continues to invest in developing its asset portfolio.

At 30 June 2018, the Group had total financial investments of £27.9 billion, compared with £25.7 billion at the end of 2017. The increase of £2.2 billion in 2018 was principally due to the new business written in the six months, offset by decreases in market value of the assets and claims payments made to policyholders during the period.

Gross derivative assets and derivative liabilities have both increased since 31 December 2017, as the Group implements hedges on the assets and liabilities associated with new business written during the period, as well as on the existing book.

The IFRS insurance liabilities, which have increased significantly due to the new business in the period, include certain prudent margins which are expected to be translated into actual earned future profits as they are released over the run-off of the underlying insurance contracts. At 30 June 2018, these prudent margins rose to approximately £2.1 billion (31 December 2017: £1.7 billion), with the increase largely reflecting the new business won during 2018, and changes due to economic factors.

Management is currently undertaking a review of these margins to ensure the assumptions and estimates stay current and appropriate, which is expected to be concluded in the second half of the year.

> "DURING THE FIRST HALF, THE GROUP INSURED 15 DEFINED BENEFIT PENSION SCHEMES WITH A TOTAL PREMIUM VALUE OF £3.3 BILLION"

Alternative performance measures

Adjusted operating profit basis

In addition to the statutory results presentation outlined above, management also chooses to analyse its IFRS results on an adjusted operating profit basis, reflecting the activities of the Group rather than the statutory income and expense categories.

We have defined adjusted operating profit before tax to reflect the activities which are core to the Group'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 "return on back book" which captures the returns made from the in-force book of insurance liabilities and expected long-term returns from surplus assets.

The Group's adjusted operating profit before tax for the six months to 30 June 2018 was £88 million (HY 2017: £136 million). The return earned from the back book of £105 million has grown since the same period last year (£93 million), reflecting the growth in the in-force book over that time.

PIC concluded two longevity swap reinsurance transactions during the first six months of the year covering longevity risk on c.£1.1 billion (HY 2017: c.£1.8 billion) of insurance liabilities. At 30 June 2018, 67% of PIC's total longevity exposure on a regulatory solvency basis was reinsured to third party, investment grade reinsurance counterparties (31 December 2017: 73%). Together, the initial strain from the new business transactions and the reinsurance deals concluded during the period resulted in a loss of £17 million (HY 2017: profit of £51 million) to adjusted operating profits.

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

Non-operating profit before tax for the period was £35 million (HY 2017: £4 million profit), mainly due to the positive impact of fully adopting the CMI 2016 mortality basis table (in 2017, CMI 2016 was implemented to reflect future improvements to mortality only), offset by other smaller assumption changes.

Return on back book is generated from the release of prudent margins for business written in previous years, along with the expected 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 released over life of contract.
- Emergence of future profits de-risked through hedges and reinsurance.

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

Adjusted operating profits

IFRS adjusted operating profits

(£m)	**2018 Half year**	2017 Half year	2017 Full year
Return on back book	**105**	93	195
New business and reinsurance operating profit/(loss)	**(17)**	51	70
Other changes to in-force business	**–**	(8)	(18)
Adjusted operating profit before tax	**88**	136	247
Non-economic assumption changes	**59**	(12)	170
Finance costs	**(20)**	(20)	(41)
Other movements	**(4)**	36	7
IFRS profit before tax	**123**	140	383

Adjusted operating profit by entity

IFRS adjusted operating profits

(£m)	**2018 Half year**	2017 Half year	2017 Full year
Pension Insurance Corporation plc	**90**	139	253
Other Group entities	**(2)**	(3)	(6)
Pension Insurance Corporation Group	**88**	136	247

FINANCIAL RESULTS SUMMARY

CONTINUED

PIC solvency ratio

(£m)	**30 June 2018**	30 June 2017	31 December 2017
Net assets held in excess of best estimate liabilities (BEL)	**4,797**	4,370	4,279
Risk margin net of transitional measures	**(1,120)**	(987)	(951)
Own funds	**3,677**	3,383	3,328
Solvency II capital requirements (SCR)	**(2,106)**	(2,085)	(2,082)
Solvency II surplus	**1,571**	1,298	1,246
Solvency ratio	**175%**	162%	160%

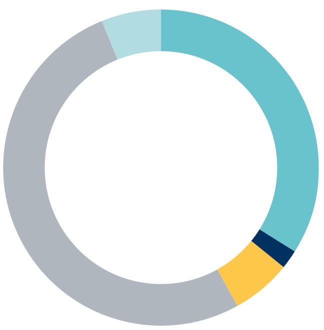
Key solvency sensitivities

- **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 business volumes.
  - New business only transacted provided it meets the Company's return on capital targets.
- **Hedging strategy structured to protect regulatory solvency balance sheet.**
  - Interest rate, inflation and FX risk are hedged to manage solvency balance sheet.
  - Longevity risk is managed through reinsurance where majority of risk is transferred.

PIC sensitivity of solvency ratio to changes in assumptions (£m)	Change in solvency ratio
As at 30 June 2018	175%[1]
25 bps increase in interest rates	7.2%[2]
25 bps reduction in interest rates	(7.1)%[2]
£100 million credit default (no recovery)	(4.9)%
5% reduction in base mortality[3]	(8.7)%[2]

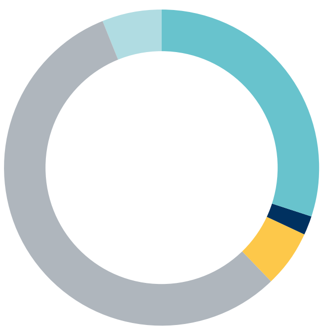
Solvency II SCR by type of risk (pre-diversification)

SCR by type of risk HY 2018



Insurance risk	34%
Counterparty risk	2%
Expense risk	6%
Market risk	52%
Operational risk	6%

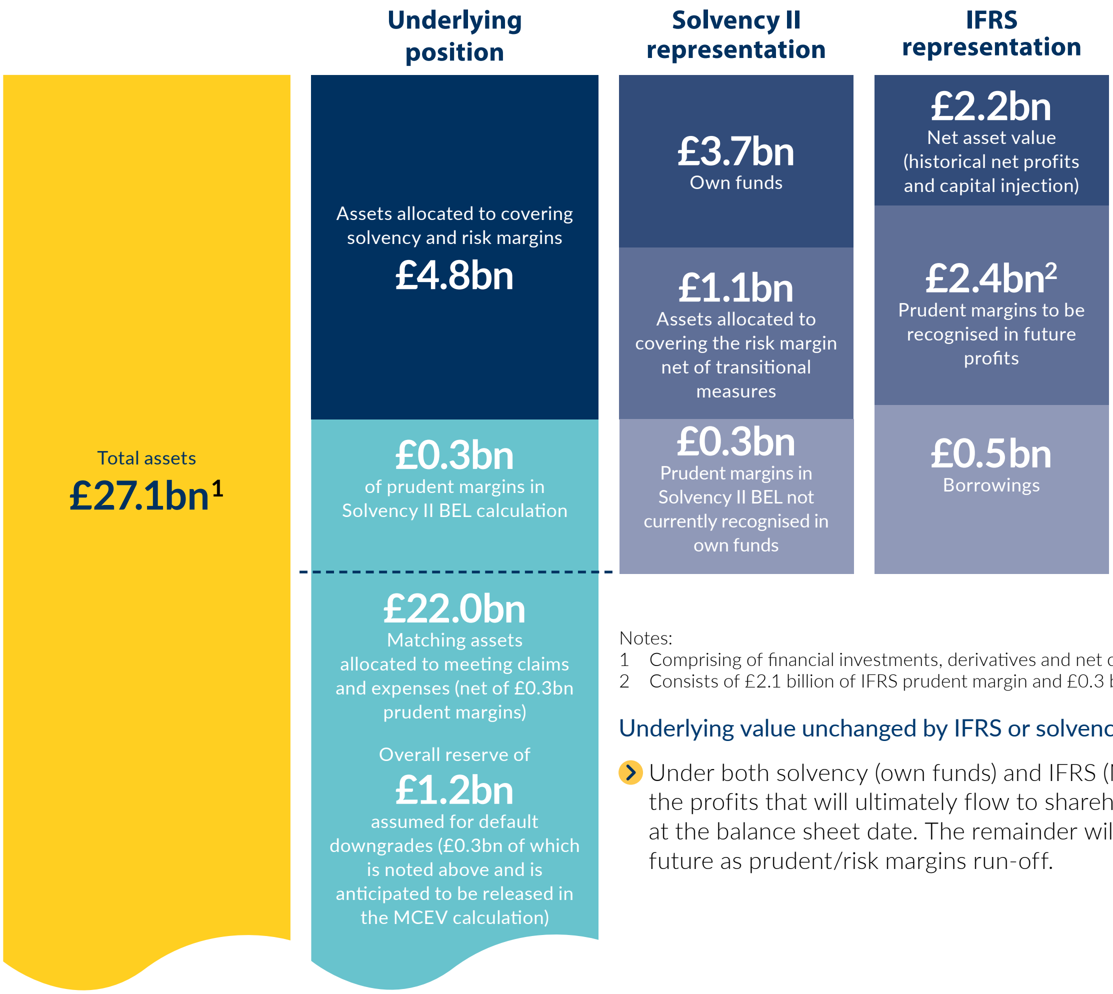
SCR by type of risk YE 2017



Insurance risk	30%
Counterparty risk	2%
Expense risk	6%
Market risk	56%
Operational risk	6%

Notes:
1 No update to the transitional measures (TMTPs) have been included in the above solvency ratio. If there had been an update, the solvency ratio would have fallen marginally.
2 After recalculation of TMTPs.
3 Equivalent to a 0.4 year increase in life expectancy from 22.6 years to 23.0 years for a typical male aged 65.

Solvency and IFRS balance sheets



Notes:
1 Comprising of financial investments, derivatives and net current assets.
2 Consists of £2.1 billion of IFRS prudent margin and £0.3 billion inherent within the BEL.

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/risk margins run-off.

Market Consistent Embedded Value (MCEV)

The MCEV analysis was prepared under the European Insurance CFO Forum MCEV Principles (Copyright© Stichting CFO Forum Foundation 2008) (MCEV Principles) issued in April 2016. The starting point is the Solvency II balance sheet, and 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 Group's value.

The Group's MCEV at 30 June 2018 was £3,402 million compared to £2,932 million at 31 December 2017. The increase in MCEV since December 2017 of £470 million reflects the beneficial impacts of new business written during the period, the in-force business contribution, assumption changes and the positive impacts of investment market movements during the period.

The calculation of the Cost of Residual Non-hedgeable Risks (CRNHR) was updated in the period to treat the longevity risk associated with all pensioner business (pensions in payment) as hedgeable. Previously only longevity risk associated with business that had been reinsured at the balance sheet date was treated as hedgeable. Given the success of the Group in reinsuring pensioner business, and the continued maturing of the longevity reinsurance market, it was felt appropriate to make this change. This assumption change increased the MCEV by £226 million (included within non-economic variances overleaf).

The assumption in respect of deferred business (policies yet to move to in-payment status) remains the same, where only reinsured deferred business is treated as hedgeable, as the market is considered less well developed.

FINANCIAL RESULTS SUMMARY

CONTINUED

- In-force business contribution primarily relates to the unwinding of the MCEV discount rate and the release of the cost of capital and cost of non-hedgeable risks for the business in force at the start of the period, as well as the impact of reinsurance.
- Economic variances capture the impact of the movements in the market variables (interest, inflation and credit spreads) during the period.
- Non-economic variances include project costs, modelling changes, data updates, emerging claims experience, changes in frictional cost of required capital and CRNHR and tax variances.

Change in embedded value (£m)	**2018 Half year**	2017 Half year	2017 Full year
Opening embedded value	**2,932**	**2,600**	**2,600**
New business contribution	228	95	195
In-force business contribution	(46)	18	16
MCEV operating profit	182	113	211
Economic variances	25	41	37
Non-economic variances	254	(31)	197
Change in fair value of subordinated debt	9	(65)	(113)
MCEV movement in the period	**470**	**58**	**332**
Closing embedded value	**3,402**	**2,658**	**2,932**

MCEV by entity

(£m)	**30 June 2018**	30 June 2017	31 December 2017
Pension Insurance Corporation	**3,402**	2,638	2,926
Other Group entities	**–**	20	6
Pension Insurance Corporation Group	**3,402**	2,658	2,932

Solvency II to MCEV reconciliation

30 June 2018 (£m)	Solvency II balance sheet	Allow for sub-debt	Recognise the FCoC	Release (RM, DTL minus transitional measures) recognise CRNHR	Release MA margins	Tax on future profits	MCEV (£m)
Assets	27,126						
Best estimate liabilities	(22,329)						
Risk margin (RM), deferred tax liability (DTL) net of transitional measures	(1,120)						
Solvency II own funds	**3,677**						**3,677**
Present value of future profits (PVFP)				1,120	323	(346)	1,097
Cost of residual non-hedgeable risks				(520)			(520)
Frictional cost of required capital (FCoC)			(171)				(171)
Subordinated debt		(681)					(681)
MCEV							**3,402**

ASSET AND LIABILITY MANAGEMENT

PIC's investment portfolio summary at 30 June 2018

- 90% of financial investments in government and corporate securities.
- Corporate securities: 97% investment grade rated.
- No single counterparty (excluding UK government) represents more than 1.6% of total investment assets.
- 45% of financial investments managed by external asset managers.
- 55% 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.
- Debt private placements, including in social housing and renewable energy, totalled £3.8 billion at 30 June 2018.
- Continued investment in equity release mortgages (ERM), with £219 million held at the period end.

Corporate securities split by regions

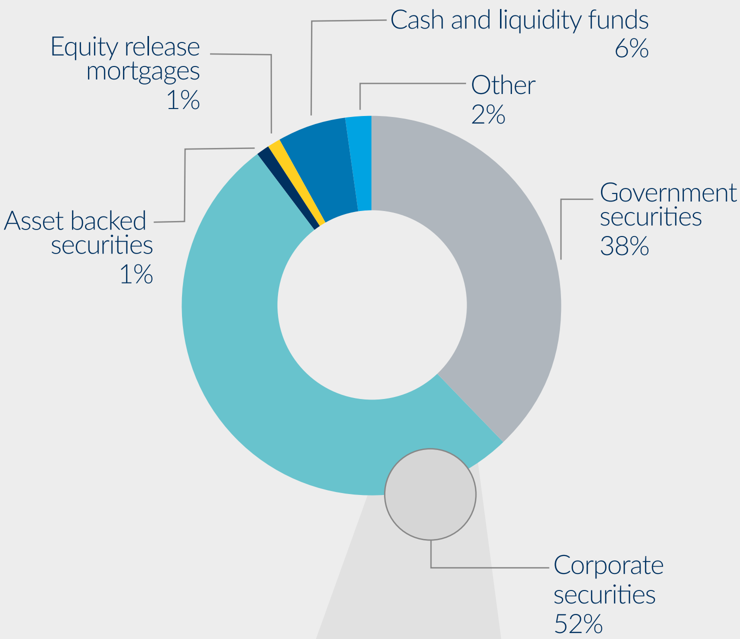
Country	30 June 2018 Market value (£m)	%
UK	7,109	49.1
US	4,465	30.9
Europe	1,565	10.8
Rest of the world	1,333	9.2
Total	**14,472**	**100.0**

Corporate securities split by industry sector

Industry sector	30 June 2018 Market value (£m)	%
Financial	4,161	28.7
PFI and direct investment loans (unlisted)	1,745	12.1
Utilities	1,740	12.0
Consumer, non-cyclical	1,589	11.0
Communications	1,363	9.4
Energy	1,263	8.7
Consumer, cyclical	828	5.7
Technology	717	5.0
Industrial	577	4.0
Basic materials	353	2.4
Diversified	111	0.8
Quasi-government	25	0.2
Total	**14,472**	**100.0**

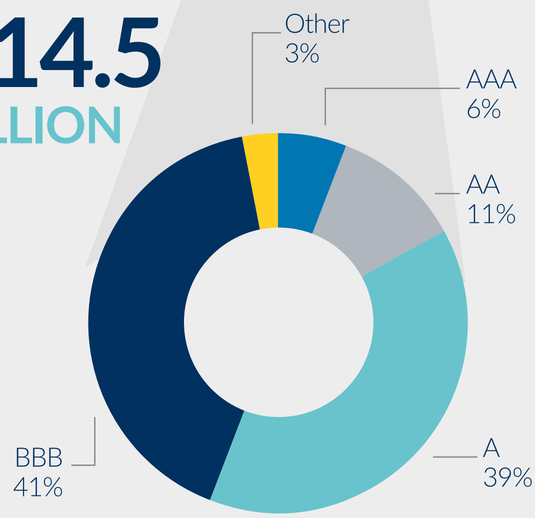
PIC's asset portfolio by asset class (30 June 2018)

£27.9 BILLION



Corporate securities by rating

£14.5 BILLION



APPENDIX 1

OVERVIEW OF REPORTING BASES

The financial model

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

The Group, through its operating entity, Pension Insurance Corporation plc is authorised to write long-term insurance business by the Prudential Regulation Authority (PRA) and is regulated by the PRA and the Financial Conduct Authority (FCA). We operate in a highly regulated environment where our UK prudential regulator, the PRA, requires us to invest our assets and measure our liabilities in accordance with strict and detailed rules and guidance. The PRA also requires us to hold capital over and above the assets required to pay out policyholder benefits, as an additional safeguard for policyholders.

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

As a long-term business we complement our IFRS and Solvency II disclosures with additional information on an "embedded value" basis, which captures the inherent future value of the emerging margins in our business.

Presentation of financial results

The IFRS basis results for the 2018 and 2017 half years are unaudited and they have not been reviewed in accordance with International Standard on Review Engagements 2410. The 2017 full year IFRS basis results have been derived from the 2017 statutory accounts. The auditors have reported on the 2017 statutory accounts. The auditors' reports were: (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The embedded value results for the 2018 half year are unaudited. The 2017 year end embedded value results have been derived from the 2017 year end PIC market consistent embedded value report, which included an unqualified audit report from the auditors in respect of compliance with the MCEV Principles set out by the European CFO Forum.

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

Solvency II

The Solvency II results are prepared in accordance with the financial reporting provisions of the PRA Rules and Solvency II Regulations.

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

PIC obtained approval from the PRA for its internal model, which we believe better reflects the risk profile of the Company's business, in December 2016. This was updated by a "major model" change application, which was approved in December 2017. The PRA also approved other Solvency II related applications made by the Company in respect of the Matching Adjustment, Volatility Adjustment and Transitional Measures, which are all related to how elements of the Solvency II balance sheet are calculated.

Market Consistent Embedded Value

The Group has adopted the MCEV Principles for its embedded value measurement and reporting. The MCEV methodology is based on Solvency II, rather than IFRS.

The MCEV results are prepared in accordance with the MCEV Principles issued in April 2016. MCEV breaks down the solvency balance sheet sufficiently to demonstrate the present value of shareholders' interest in the expected distributable profits of the business over the long-term, after making sufficient allowance for residual risks. It consists of the following components:

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

Key MCEV assumptions:

- Economic MA is similar to the solvency matching adjustment but with a more realistic view on the cost of default and downgrade. This assumption is driven by the actual asset spread, net of the expected cost of defaults and downgrades.
- Cost of residual non-hedgeable risks is an allowance for the cost of the risks which cannot be readily hedged in a liquid market. In MCEV calculations the following categorisations are made for the risks:

  – The longevity risk associated with all pensioner business, whether reinsured at the balance sheet date or not, is treated as hedgeable for a cost. This is a change from previous periods, where only the longevity risk associated with reinsured pensioner business was treated as hedgeable. This is relevant for the calculation of the CRNHR.
  – The longevity risk associated with deferred business (where the insured individuals have not yet retired) is only treated as hedgeable provided it has been reinsured. Unreinsured deferred business is treated as non-hedgeable for the purposes of calculating the CRNHR.
  – We treat all market related risks as hedgeable or having symmetric impact on shareholder value.

Other differences between Solvency II and MCEV assumptions relate to:

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

IFRS

The half year IFRS results are prepared on the same basis as those required for annual statutory reporting purposes. The results are prepared on a "prudent" basis, recognising liabilities in full using best-estimate assumptions to which margins for prudence are added, with no credit taken for future earnings or for the release of the prudent margins.

The discount rate used to value the future liabilities is derived from the yield on the asset portfolio that we hold, but with appropriate adjustments to ensure that the discount rate itself is on a prudent basis.

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

Alternative measures of profit or loss ("Adjusted operating profit")

Adjusted operating profit adds the outcome of new business and reinsurance activities to the return on the back book.

The return on the back book 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 the Group's shareholders.

APPENDIX 2

PIC FINANCIAL STATEMENTS

FOR THE HALF YEAR ENDED 30 JUNE 2018

Statement of comprehensive income

	2018 Half year (£m)	2017 Half year (£m)	2017 Full year (£m)
Revenue			
Gross premiums written	**3,261**	1,913	3,704
Outward reinsurance premiums	**(16)**	(26)	(41)
Net premium revenue earned	**3,245**	1,887	3,663
Investment return	**(619)**	378	1,092
Commissions earned	**–**	–	1
Total revenue (net of reinsurance premiums)	**2,626**	2,265	4,756
Expenses			
Claims paid – gross	**(545)**	(469)	(1,003)
Reinsurers' share of claims paid	**43**	35	94
	(502)	(434)	(909)
Increase in insurance liabilities – gross	**(1,369)**	(1,669)	(3,252)
(Decrease)/increase in reinsurers' share of insurance liabilities	**(551)**	42	(72)
	(1,920)	(1,627)	(3,324)
Acquisition expenses	**(27)**	(24)	(51)
Other operating expenses	**(31)**	(17)	(40)
Finance costs	**(20)**	(20)	(41)
	(78)	(61)	(132)
Total claims and expenses	**(2,500)**	(2,122)	(4,365)
Profit before taxation	**126**	143	391
Tax charge	**(24)**	(28)	(75)
Profit or loss and total comprehensive income for the period	**102**	115	316

Adjusted operating profit statement

IFRS adjusted operating profits

(£m)	**2018 Half year**	2017 Half year	2017 Full year
Return on back book	**105**	93	195
New business and reinsurance operating profit/(loss)	**(17)**	51	70
Other changes to in-force business	**2**	(5)	(12)
Adjusted operating profit before tax	**90**	139	253
Non-economic assumption changes	**59**	(12)	170
Finance costs	**(20)**	(20)	(41)
Other movements	**(3)**	36	9
IFRS profit before tax	**126**	143	391

Statement of financial position

(£m)	30 June 2018	30 June 2017	31 December 2017
Assets			
Investment properties	**99**	97	99
Reinsurers' share of insurance liabilities	**1,900**	2,564	2,450
Receivables and other financial assets	**244**	239	316
Prepayments	**69**	56	43
Financial investments	**27,885**	24,247	25,671
Derivative assets	**9,276**	7,113	8,775
Cash and cash equivalents	**44**	3	33
Total assets	**39,517**	34,319	37,387
Equity			
Share capital	**1,000**	1,000	1,000
Other reserves	**60**	60	60
Retained profit	**1,118**	815	1,016
Total equity	**2,178**	1,875	2,076
Liabilities			
Gross insurance liabilities	**26,363**	23,410	24,993
Borrowings	**544**	543	543
Deferred tax liability	**4**	4	4
Derivative liabilities	**10,331**	8,216	9,663
Insurance and other payables	**36**	204	48
Current taxation	**25**	28	44
Accruals	**36**	39	16
Total liabilities	**37,339**	32,444	35,311
Total equity and liabilities	**39,517**	34,319	37,387

Statement of changes in equity

30 June 2018

(£m)	Share capital	Other reserves	Retained profit	Total
At beginning of period	**1,000**	**60**	**1,016**	**2,076**
Total comprehensive income for the period	–	–	102	102
Share capital issued in the period	–	–	–	–
At end of period	**1,000**	**60**	**1,118**	**2,178**

30 June 2017

(£m)	Share capital	Other reserves	Retained profit	Total
At beginning of period	**1,000**	**60**	**700**	**1,760**
Total comprehensive income for the period	–	–	115	115
Share capital issued in the period	–	–	–	–
At end of period	**1,000**	**60**	**815**	**1,875**

31 December 2017

(£m)	Share capital	Other reserves	Retained profit	Total
At beginning of year	**1,000**	**60**	**700**	**1,760**
Total comprehensive income for the period	–	–	316	316
Share capital issued in the period	–	–	–	–
At end of year	**1,000**	**60**	**1,016**	**2,076**

GLOSSARY

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

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

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

Cost of residual non-hedgeable risks (CRNHR)
Under MCEV, allowance for the cost of holding capital in respect of non-hedgeable risks. Market risks are assumed to be hedgeable and so no cost is allowed for any capital that might be held under the regulatory solvency regime. Longevity risk is treated as hedgeable but only to the extent that the risks have actually been hedged, typically using reinsurance. At 30 June 2018, a methodology change was made to treat current unreinsured pensioner longevity risk as reinsurable; previously all longevity risk that had not been reinsured at the balance sheet date was treated as non-hedgeable for the purpose of calculating the cost of non-hedgeable risks.

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

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

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

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

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

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

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

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

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

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

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

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

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

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