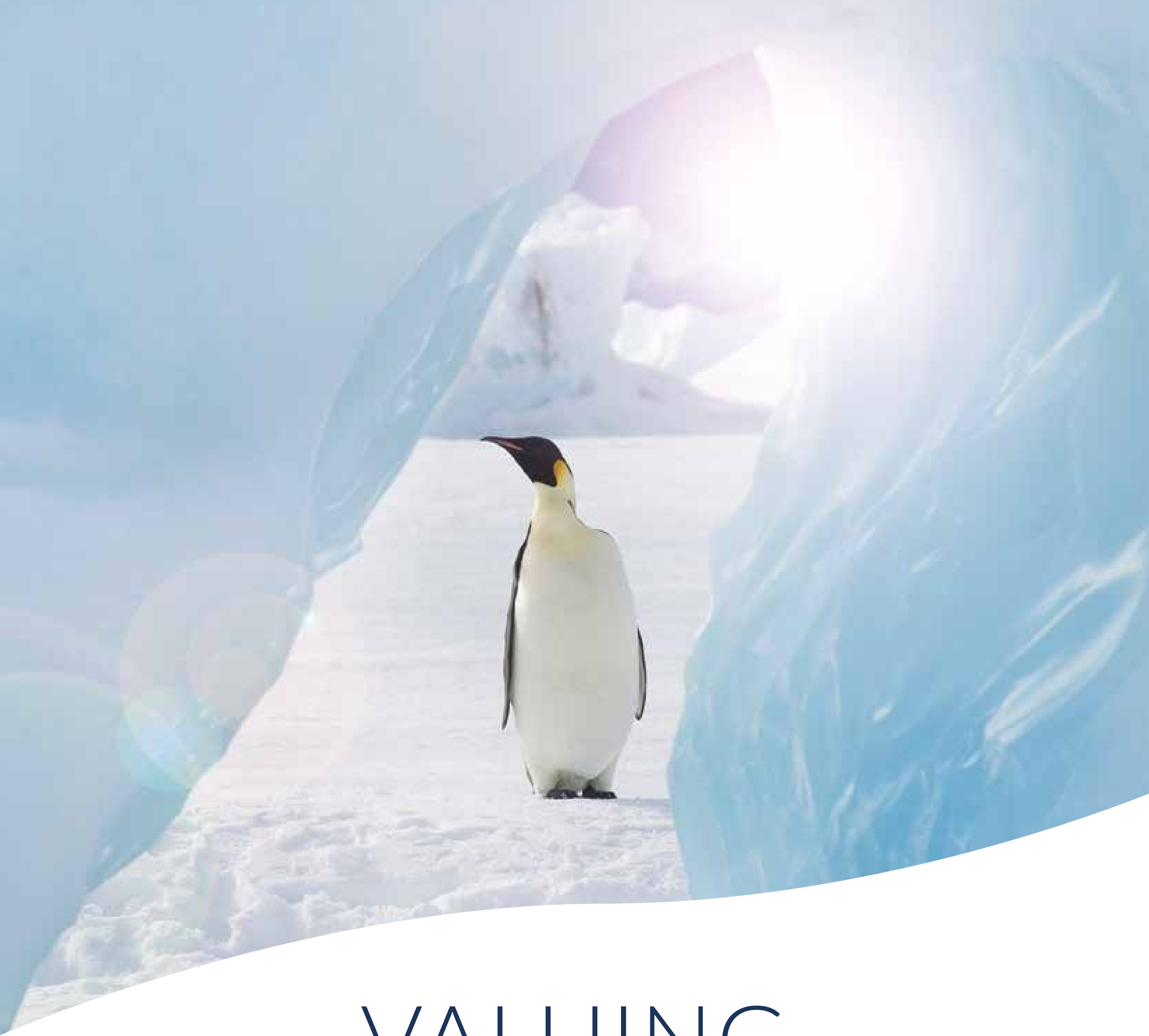
PENSION INSURANCE
CORPORATION GROUP LIMITED



VALUING
OUR CUSTOMERS

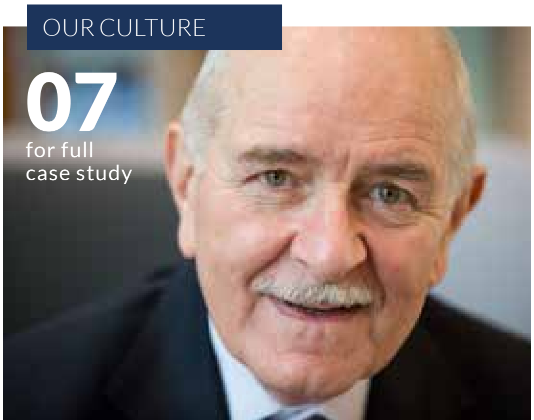
PENSION INSURANCE CORPORATION GROUP
ANNUAL REPORT AND ACCOUNTS 2018

The purpose of Pension Insurance Corporation plc ("PIC") is to pay the pensions of its current and future policyholders. PIC is a specialist insurer which provides secure and stable retirement incomes through financial strength, leading customer service, comprehensive risk management and excellence in asset and liability management. Delivering on this purpose provides attractive returns for shareholders and fulfilling careers for employees.

PIC has insured 192,100 pension scheme members and has £31.4 billion in financial investments, accumulated through the provision of 186 tailored pension insurance buyouts and buy-ins to the trustees and sponsors of UK defined benefit pension schemes.

CONTENTS

OUR CULTURE



07 for full case study

"PIC IS A COMPANY TOTALLY FOCUSED ON THE BUSINESS OF PAYING PENSIONS TO ITS POLICYHOLDERS. IT IS ALSO ONE OF THE BEST FOR CUSTOMER SERVICE. FOR ME, THE EXPERIENCE TO DATE HAS BEEN FAULTLESS.

Ray Dawson, former member of the Honda pension fund and proud PIC policyholder

2018 HIGHLIGHTS

A RECORD YEAR

HIGHLIGHTS

New premiums
£7,150m 2017: £3,704m

2018	7,150
2017	3,704
2016	2,598
2015	3,755
2014	2,646

Financial investments
£31.4bn 2017: £25.7bn

2018	31.4
2017	25.7
2016	22.6
2015	16.6
2014	13.3

Profit before tax
£477m 2017: £383m

2018	477
2017	383
2016	266
2015	136
2014	163

Embedded value
£3,638m 2017: £2,932m

2018	3,638
2017	2,932
2016	2,600

Adjusted operating profit[1]
£649m 2017: £438m

2018	649
2017	438
2016	114
2015	220
2014	51

Assets held to meet solvency and risk margin
£5.2bn 2017: £4.3bn

2018	5.2
2017	4.3
2016	4.3
2015	2.8

PIC solvency ratio[2]
167% 2017: 160%

2018	167
2017	160
2016	164
2015	151

Customer satisfaction
97.3% 2017: 98.3%

2018	97.3
2017	98.3
2016	98.5
2015	99.3
2014	99.8

1 Figures have been stated on a new methodology (see page 45).

2 Unaudited.

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; Pension Services Corporation Limited, the Group's service company; and PIC Holdings Limited, a holding company. This Annual Report is for PICG, but reference is made to PIC where it is the activity of the insurance company being reported on.

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.

SOME OF OUR CLIENTS

AON
BHS
Cadbury
citi
Civil Aviation Authority
co op
Department for Environment Food & Rural Affairs
EMI
HONDA
Institute and Faculty of Actuaries
Kingfisher
London Stock Exchange
PENSIONS AND LIFETIME SAVINGS ASSOCIATION
Rentokil Initial
TOTAL
WPP

FitchRatings
A+

Fitch Ratings has assigned Pension Insurance Corporation plc (PIC) an 'A+' (Strong) Insurer Financial Strength (IFS) rating.

OUR VALUES

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.

STRATEGIC REPORT

In this section

OUR BUSINESS AT A GLANCE

PIC IS A SPECIALIST INSURER WHICH HAS ESTABLISHED ITSELF AS A LEADER IN THE UK BULK ANNUITY SECTOR:

WHAT WE DO

MANAGE OUR LIABILITIES

Liabilities are hedged for interest rate and inflation exposure

FOCUS ON CUSTOMER CARE

We always aim for delivery of superior customer service for trustees and policyholders

MANAGE OUR RISKS

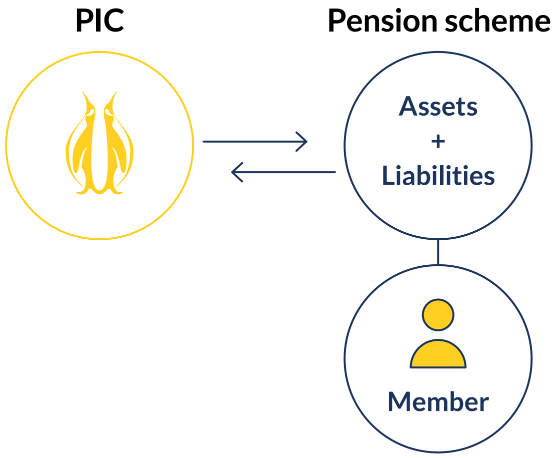
Longevity risk is reinsured to create dependable liability cash flows and manage capital

INVEST OUR ASSETS

Assets are matched to pension cash flows, optimising returns and security for policyholders

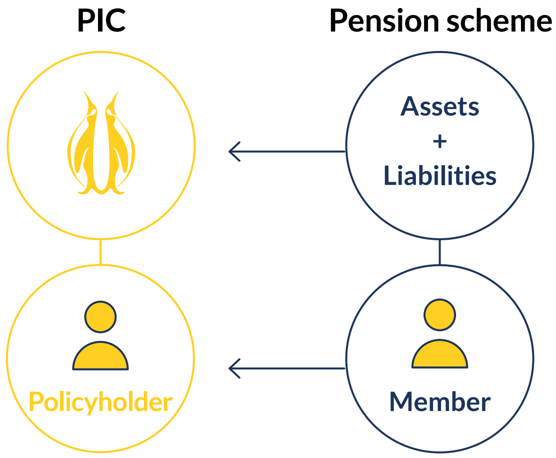
WHAT IS A PENSION INSURANCE BUY-IN?

- The pension scheme purchases a bulk annuity insurance policy to cover its obligations to a subset of the scheme members. The insurance policy is held as an asset of the pension scheme.
- A buy-in is a perfectly matching investment for the insured liabilities.
- A buy-in removes the pension scheme's longevity, market interest rate, inflation and other risks, as these are transferred to PIC.
- PIC has no direct relationship with pension scheme members, whose benefits continue to be managed by the trustees.



WHAT IS A PENSION INSURANCE BUYOUT?

- A buyout removes pension assets and liabilities from a pension scheme and employer's balance sheet. It is a full settlement of the scheme and employer's obligations to the scheme members.
- PIC issues individual annuity insurance policies to the members of the pension scheme as a direct replacement for their claim on the pension scheme.
- Typically, the pension scheme is wound up and assets pass across to PIC.
- The scheme members become policyholders of PIC.



SIEMENS

PENSION BUY-IN

In July 2018, PIC concluded a pension insurance buy-in with the Trustees of the Siemens Benefits Scheme covering c.£1.3 billion of liabilities and around 6,000 pensioners.

This deal was the third bulk annuity arrangement between PIC and a Siemens-sponsored defined benefit scheme. This wider relationship assisted in reaching a rapid conclusion of this transaction.

John Smith, Head of Pensions at Siemens plc, said: "We are proud of what we have achieved with this latest buy-in, which is part of Siemens' long-term pension de-risking strategy… PIC once again showed a great deal of flexibility and innovation in helping us achieve our aims."

BHS

BUYOUT

In August 2018, PIC concluded a full buyout of the BHS2 Pension Scheme, covering £800 million of liabilities and 9,000 pension scheme members. The BHS2 Scheme was a new pension scheme set up in 2017 following the collapse of BHS and the subsequent cash injection by Sir Philip Green.

The buyout happened far earlier than expected due to the Trustees' investment strategy.

Chris Martin, of Independent Trustee Services Limited, said: "It has always been our goal to deliver the best possible outcome for the members of this scheme. A buyout… is the most secure solution for the members of this scheme. I want to thank… PIC for its flexibility and innovation in the transaction."

CHAIRMAN'S STATEMENT

CUSTOMER CARE IS CENTRAL TO OUR PERFORMANCE

PIC has had a very successful 2018, which was also a record year for the bulk annuity market. Our exclusive focus on pension scheme buyouts and buy-ins has once again helped us meet the needs of our trustee clients in a year in which we wrote almost twice as much business compared to the prior year. This focus allows us to coordinate all the attributes needed to successfully complete multiple, profitable transactions whilst maintaining an absolute focus on client and policyholder satisfaction.

The increased pace of the bulk annuity market has inevitably led to an increased level of Board activity, reviewing and approving new bulk annuity transactions, the investment process needed to back these pension liabilities, especially our illiquid asset investments, and satisfying ourselves that we are working within our agreed risk appetite.

As I noted in last year's Annual Report, Brexit is expected to have much less impact on our business than on that of many other financial services companies. Despite this, we have devoted considerable time as a Board to overseeing preparations for the potential implications for us, our policyholders and for our clients.

Other areas that have been discussed at length by the Board include the debate around the proposals to allow the consolidation of defined benefit pension scheme liabilities by superfunds operating outside the insurance regulatory framework. We have played an active role in responding to the Department for Work and Pensions' consultation on their plans. There is a risk that the proposals as they stand could leave the superfund members' benefits at increased risk. When there has been so much recent focus on pension security, including the entirely correct banning of cold calling, this development is counterintuitive, as well as concerning, and I hope proves not to be the case.

A key part of the Board's role is to encourage and endorse a culture at PIC which allows the business to meet its business goals, whilst always doing the right thing. In practice, this includes cross-business collaboration, risk management, respectful challenge and personal integrity. The Board's strongly held view is that the positive, well-developed culture at PIC is an outcome of our focus on our purpose, which is to pay the pensions of our current and future policyholders. During the year, the Board formally adopted this purpose statement. We believe that enhancing understanding of this will further nurture the very high standards we expect of our employees. At the same time, I very much appreciate the depth of insight and levels of experience the Board brings to bear in helping us steer our path.

Our three major shareholders each hold in excess of 10% of Group shares and represent more than 75% of all issued shares on the Board. PIC's successful track record therefore demonstrates that their interests are aligned with those of our policyholders and other stakeholders. There was one major change to the Board during the year, when a wholly owned subsidiary of the Abu Dhabi Investment Authority ("ADIA") acquired 17.1% of the shares in Pension Insurance Corporation Group ("PICG") from funds advised by J.C. Flowers & Co., one of PICG's founding investors. We would like to thank J.C.Flowers for their support.

The success of our business is due to the effort and abilities of our employees and I want to thank them for their continued commitment and dedication. Our success in 2018 is down to them.

Jon Aisbitt
Chairman

"

PIC IS FOCUSED ON DELIVERING A PENSION SERVICE AND NOTHING ELSE… THEY HAVE BEEN FAULTLESS IN MY EXPERIENCE

"

I worked as a factory manager at the Honda Racing Development in Bracknell, responsible for the assembly and servicing of engines for the Honda Racing Formula 1 team.

Moving from the pension scheme to PIC has been a positive development. From my viewpoint, PIC is focused on delivering a pension service and nothing else.

The thing that frustrates me about a large number of companies is their ability to ensure you cannot get in touch with them – it gives the impression that the last thing they want to do is talk to you! In contrast, PIC has been faultless in my experience.

Correspondence by post or email has provided everything I required, and I use the website to refer to documents such as my P60. The Policyholder Days are fantastic. I have been to one every year. They make a nice day out and I particularly enjoy the guest speakers. Some of these have been hilarious, others fascinating and some commanding the utmost respect. I also treasure my collection of penguins!

PIC is a company totally focused on the business of paying pensions to its policyholders. It is also one of the best for customer service. For me, the experience to date has been faultless. Thank you for the service you provide.

Ray Dawson
Former member of the Honda pension fund and proud PIC policyholder

CHIEF EXECUTIVE OFFICER'S REVIEW

A FLEXIBLE, INNOVATIVE AND CUSTOMER-FOCUSED BUSINESS

The Board and I were proud and delighted that the whole business seamlessly moved up a gear to complete almost double the new business levels of the previous year, in line with the largest ever year for the bulk annuity market in total. The record £7.1 billion we wrote last year was with 30 pension schemes (2017: £3.7 billion across 20 pension schemes). As a result we took responsibility for paying the pensions of an additional 45,900 policyholders and we now insure 186 pension schemes in total.

The primary dynamic driving the growth of the market is the hard work done by pension scheme trustees over the past few years to better match their assets and liabilities and de-risk in stages. This work will be the foundation of the bulk annuity market for many years to come.

New business levels were partly backed with a record £2.5 billion invested in secure long-term assets on a private basis, such as infrastructure debt. In the last year we have invested £265 million in UK social housing, £400 million in university accommodation, and more than £250 million in renewable energy. This is really important for the country because assets backing pension payments to older generations are being recycled back into the economy and used to fund the assets that will be enjoyed by younger, and future, generations – a real example of intergenerational transfer.

We also reinsured £5.6 billion of longevity risk, a record amount, and our pool of highly rated reinsurance counterparties now stands at eleven. In total, PIC has now reinsured 74% of total longevity risk (2017: 73%).

In what was the tenth anniversary of our first transaction, signed in the summer of 2008, the overall value of the business, as measured under Market Consistent Embedded Value ("MCEV") methodology, now stands at £3,638 million (2017: £2,932 million), an increase of 24% in the year. The Group's IFRS profit before tax was £477 million (2017: £383 million), an increase of 25% in the year. The investment portfolio is now £31.4 billion (2017: £25.7 billion), reflecting strong new business flows, payments to existing policyholders and market movements. Finally, PIC's solvency ratio of 167% is particularly pleasing given the amount of new business we wrote. It is a clear demonstration of the strength of the business, the careful capital management strategy pursued by the Group, and the resilience of our portfolio in what has, at times, been challenging market conditions.

Customer service really is at the heart of our business and 2018 was no exception to this. 97% of our policyholders expressed overall satisfaction with our service levels, a level consistent with our high performance over the last seven years.

We are committed to maintaining this level of customer satisfaction by giving the best possible service to our policyholders. As part of our long-term plan to develop the scale and sophistication of our customer offering, we moved administration services to Capita Employee Benefits ("Capita") during the year, replacing Mercer who we have worked with for the past seven years. Our payroll and administration services are now based at Capita's centre of excellence in Darlington. This specific team won our business in part because of their focus on culture and values, which very much match our own.

We were delighted to win another award for excellence in customer service from the Institute of Customer Service ("ICS"), following a similar award in 2017. We continue to hold ServiceMark with Distinction from the ICS and are one of very few companies in the country to do so.

We also completed the latest of our surveys of our trustee clients. The feedback has been excellent, with PIC's human approach to transactions and the high levels of support and guidance offered to trustees at all stages of their dealings with us being particularly cited. Trustees commented that our focus on customer care, and policyholder service in particular, puts us "ahead of the competition".

On the employee front we were delighted to be named an "Outstanding Employer of the Year" by Korn Ferry, based on employee responses to our staff survey, including that 92% of employees feel proud to work for PIC, and 93% would recommend PIC as a place to work.

We were also very pleased to sponsor, for the second year, the Actuarial Mentoring Programme ("AMP"), run in conjunction with the Institute and Faculty of Actuaries. AMP seeks to improve diversity at senior levels of the actuarial profession by helping female actuaries remain in the industry for longer. In its second year, AMP had an 80% increase in participating institutions, including some of the largest employers of actuaries in the country.

Finally, we made significant progress in the year in our project on the Purpose of Finance, with the publication of two papers, respectively on the purpose of asset management and the cost efficiency of financial services. The main aim of the Purpose of Finance is to facilitate a debate about how we can repair the relationship between society and financial services, an industry that is of fundamental importance to the UK economy.

I look forward to an equally busy, and productive 2019.

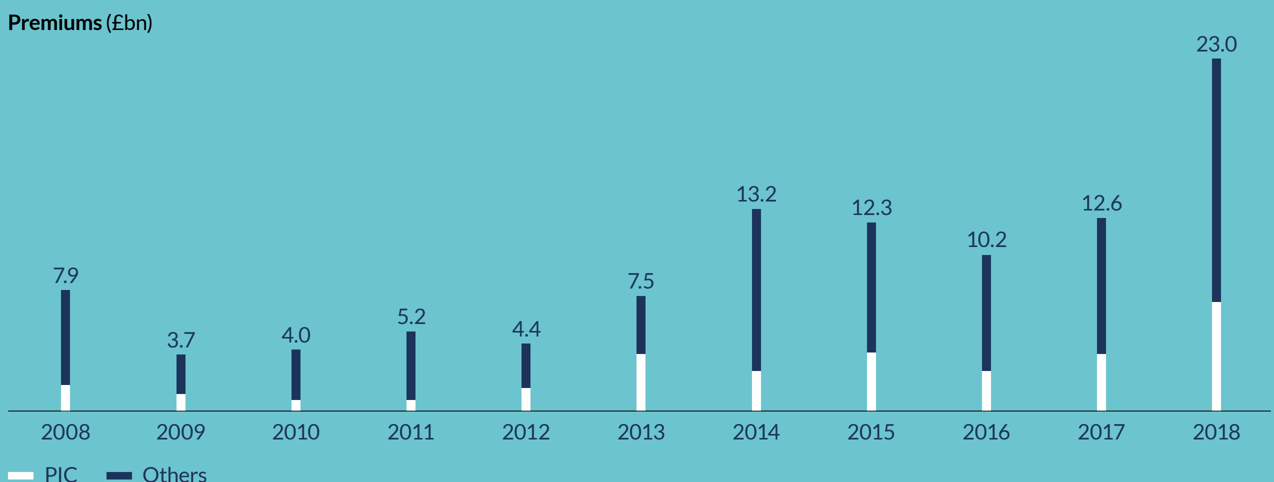
Tracy Blackwell
Chief Executive Officer

92% OF EMPLOYEES ARE PROUD TO WORK AT PIC

MARKET REVIEW

THE BULK ANNUITY MARKET GOES FROM STRENGTH TO STRENGTH

BUY-IN AND BUYOUT VOLUMES SINCE 2008



Source: LCP, Willis Towers Watson and company estimate

"

100% OF INDEPENDENT TRUSTEES SURVEYED BELIEVE 2019 WILL SEE HIGHER TRANSACTION VALUES THAN 2018[1]

MARKET OVERVIEW

Assets held within UK defined benefit pension schemes[2]

2017
£1.5
TRILLION

→

2018
£1.6
TRILLION

Gilts and fixed income assets to match liabilities[3]

2017
£840
BILLION

→

2018
£928
BILLION

Life expectancy age 65[4]

2017
22.2
(Male)
24.1
(Female)

→

2018
22.1
(Male)
24.0
(Female)

Total defined benefit pension liabilities insured through buyouts and buy-ins since 2008[5]

2017
£82
BILLION

→

2018
£105
BILLION

1 Hymans Robertson Risk Transfer Report 2018, November 2018
2 PPF Purple Book 2017, 2018
3 PPF Purple Book, 2017, 2018
4 Institute and Faculty of Actuaries, professionalpensions.com
5 PPF Purple Book 2018 and company estimate

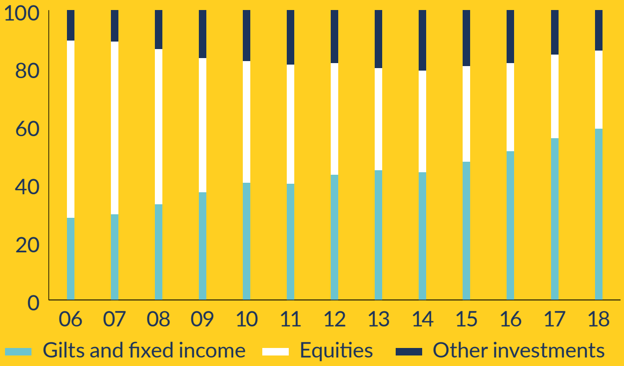
MARKET REVIEW (continued)

MARKET DRIVERS

DRIVER	OPPORTUNITY	OUR RESPONSE	SEE TABLES BELOW
Scheme funding	Scheme funding levels continued to rise during 2018, creating the conditions for a record year, and setting increasing numbers of schemes on a path to de-risk over the next two to three years Improved funding has been driven by three main factors: > Better matched assets and liabilities within pension schemes > A slowdown in mortality improvements > Increasing number of members transferring out	PIC has been working with trustees and their advisers to ensure that they are able to transact when they want to, making the market more efficient and flexible In practice this means locking pricing in for a period whilst contractual terms are agreed, concluding all risk transfer transactions, and working with reinsurers to allow seamless reinsurance of longevity risk	1 Asset allocation of defined benefit pension schemes 2006–2018
Mortality assumptions	Life expectancy at age 65 years in the UK did not improve for males and females between 2015 and 2017[1] 2015 to 2017 saw the lowest improvements in life expectancy since the start of the series in 1980 to 1982[1]	PIC has now expanded its panel of investment grade reinsurance counterparties to 11, concluding a record amount of longevity reinsurance in 2018	2 Cohort life expectancies as at 1 January 2018 at age 65
Insurance pricing	Insurance pricing has remained very competitive, even as volumes reach record levels. Trustees that are most prepared have seen significant falls in the cost of buying out their full scheme. In some cases this can be as much as a 5% difference This has been driven by significant levels of competition in the market, improved asset sourcing by insurers, and trustees improving their ability to manage their liabilities	PIC has remained focused on developing its capabilities to ensure a competitive offering: > Structuring transactions that meet trustees' needs > Sourcing of illiquid assets > Reinsuring longevity risk > Hedging liabilities > Raising capital	

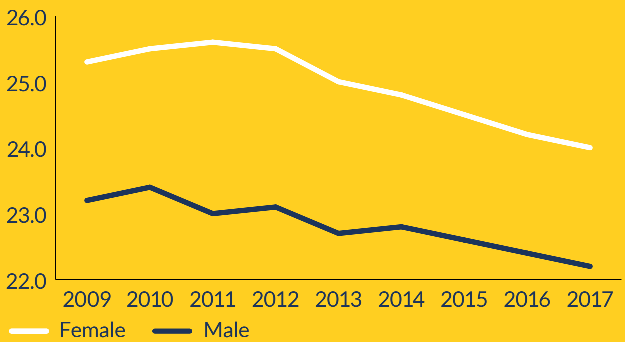
1 ONS National life tables, UK: 2015 to 2017

1 Asset allocation of defined benefit pension schemes (%)



Source: PPF's Purple Book 2018

2 Cohort life expectancies as at 1 January 2018 at age 65 from CMI_2017 and earlier versions



Source: Insititute and Faculty of Actuaries, Professional Pensions

STAKEHOLDER ENGAGEMENT AT A GLANCE

LISTENING AND RESPONDING TO OUR STAKEHOLDERS

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 accreditation

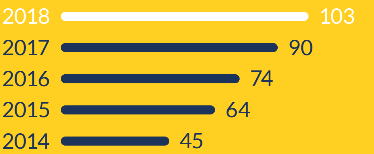
> Complaints reviewed by senior management and the Board

> 97.3% of policyholders expressed overall satisfaction with our service and 85% gave us the maximum score

> Our complaints level has averaged 1.4 complaints per thousand policyholders over the past five years

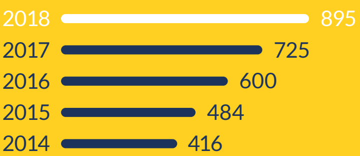
A GROWING BOOK OF POLICYHOLDERS, WITH HIGH LEVELS OF CUSTOMER SATISFACTION

Number of schemes that have transitioned to full buy out



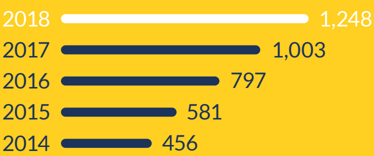
The number of schemes grew by 14% in 2018 to 103 (2017: 90).

Annuities paid (£m)



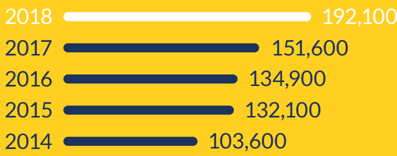
Payment of annuities grew by 23% in 2018 to £895 million (2017: £725 million).

Total claims paid (£m)



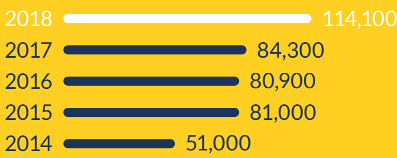
Total claim amounts paid were £1,248 million (2017: £1,003 million), an increase of 24% as the growth in annuities was supplemented by the increases in lump sum and other payments compared with the previous year.

Number of pensioners insured



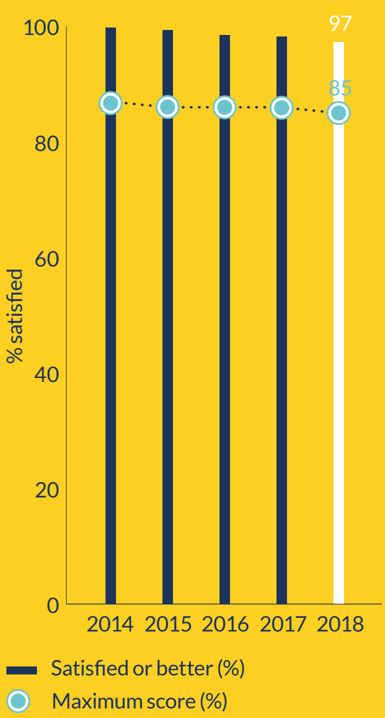
The number of pensioners insured grew by 27% in 2018 to 192,100 (2017: 151,600).

Individual policies in issue



At the end of 2018, PIC had 114,100 current individual policies in issue, in respect of 103 pension schemes, compared with 84,300 in respect of 90 schemes in 2017.

Extremely high levels of member satisfaction:



We have extremely high levels of policyholder satisfaction and have maintained over 97% satisfaction in the last seven years.

STAKEHOLDER ENGAGEMENT AT A GLANCE (continued)

STAKEHOLDER	WHAT OUR STAKEHOLDERS CAN EXPECT FROM PIC
Policyholders	Our policyholders are our customers for life. They depend on PIC to pay their pensions. The purpose of PIC is to pay the pensions of our current and future policyholders and this dictates the decisions we make on risk management and asset and liability management. We pride ourselves on our exceptional customer service. At all times we consider the long-term needs of our policyholders.
Defined benefit pension scheme trustees	Trustees look to us to secure their members' benefits over the long-term. They trust us to deliver the promised pensions and to offer the best customer service. Their trust in us to deliver the promised pensions is based on PIC's position as an insurance specialist working within a well-defined regulatory framework, in contrast to the former sponsor whose business expertise typically lies elsewhere. With PIC, trustees know that their pension fund members' benefits are guaranteed.
Employees	Our values-focused culture aims to provide employees with a challenging and stimulating work environment. High expectations and performance come with a respectful and nurturing environment and an accessible and responsive leadership team. We are committed to improving diversity within our workforce and strive to be a place where our employees are proud to work.
Shareholders and debt holders	We work closely with our major shareholders and provide clear and transparent communications that allow all investors to understand our business and our strategy. This includes how we generate long-term value through focused growth, which is intended to flow back to investors over the long term.

HOW WE ENGAGE	RELEVANCE TO OUR BUSINESS MODEL AND STRATEGY
We communicate with our policyholders through written, telephone and face-to-face interactions. All relevant letters are crystal marked by Plain English Campaign, ensuring jargon-free, simple and straightforward language is used when providing information to our policyholders. We want policyholders to experience a first-class level of service. Policyholders are invited to unique, complimentary policyholder events where they are able to question management in open forums, and learn more about the Company in a relaxed and enjoyable setting.	We believe in the value of treating our customers well and want policyholders to experience the very best customer service, whether through outstanding levels of care, responsiveness to their needs or a willingness to listen and learn. Customer service is the foundation on which PIC's reputation rests.
We closely tailor each transaction to the precise requirements of the trustees. Close communication with the trustees is crucial as we transition pension scheme members over to becoming our policyholders. We work hard to ensure that the quality of service the trustees receive is of a high standard, conducting regular independent research to measure and benchmark their experience.	Understanding the needs of trustees and their sponsors, working flexibly and being competitive are vital to our ability to write new transactions and maintain our reputation. We have completed multiple transactions with repeat clients, for example through phased buy-ins for the same sponsor.
As a growing company, the views and input of our employees become ever more important. Regular employee surveys provide an opportunity for senior management to understand the issues that are of importance to our people. Consistently high levels of satisfaction and engagement in our values demonstrate our desire to be the best and make PIC an attractive place to work. An open-plan office, flat structure and short reporting lines are all designed to encourage collaboration, innovation, risk management and entrepreneurial behaviour.	Our people are the face of the Company, and demonstrate our values in action. Together, as a team, we fulfil our purpose: paying the pensions of our current and future policyholders.
We hold regular meetings with debt holders and have an annual debt holder conference call. Business updates are communicated regularly to our shareholders and debt holders through our website and the Regulatory News Service.	Our investors, both equity and debt holders, provide capital-efficient funding to enable us to continue to write new business and grow on a focused, secure and sustainable basis.

STAKEHOLDER ENGAGEMENT IN ACTION

DELIVERING VALUE FOR ALL OUR STAKEHOLDERS

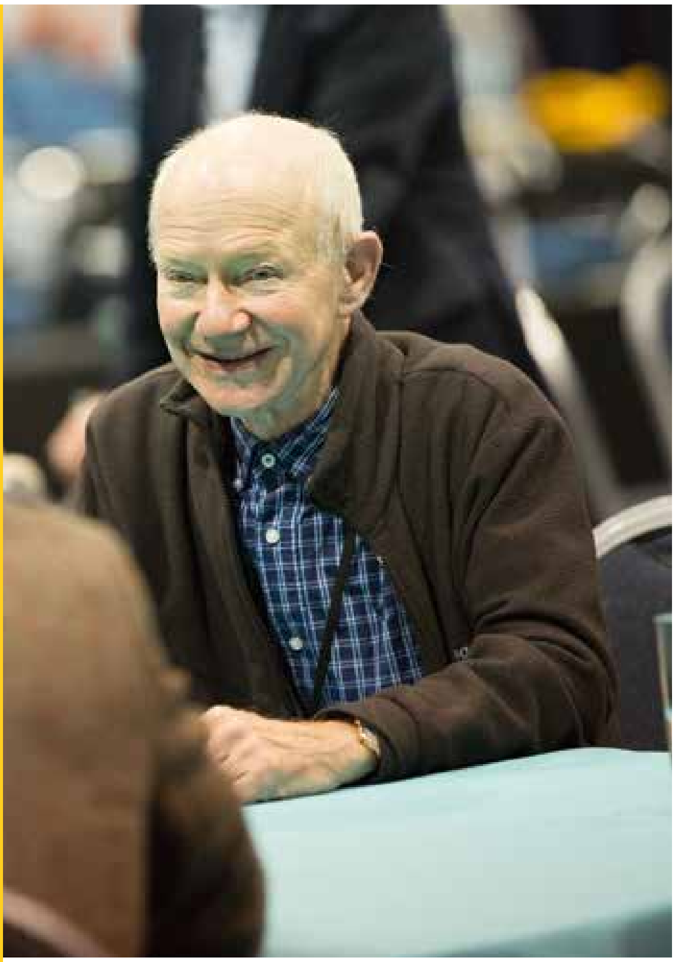
POLICYHOLDERS

In 2018, PIC changed its administration partner, moving to Capita Employee Benefits ("Capita"). PIC focuses on one line of business, bulk annuities. This focus gives us the flexibility to outsource our administration to experts. Following a market-wide review, the Capita team was found to be best suited to serve our expanding policyholder base, as we continue to underwrite more and more pension schemes. In choosing Capita, we are confident that we have found a long-term strategic partner that shares our vision for growth, innovation and outstanding customer service.

Our interactions with our policyholders can cover straightforward administrative requirements such as a change of address, or more sensitive scenarios such as bereavement. All relevant letters are crystal marked, ensuring jargon-free, simple and straightforward language is used when providing information that our policyholders need.

Typically, pension scheme members become policyholders of PIC because of decisions made by pension scheme trustees and sponsoring companies. It is therefore important that our policyholders have an opportunity to know the people behind the Company. Our complimentary policyholder events are unique in our industry. Since our first event in 2011, we have welcomed more than 20,000 guests to meet the people who look after their benefits. Policyholder Days feature presentations from PIC's leadership team, talks by inspirational external guests, and opportunities for our customers to learn more about the company that looks after their pensions.

Our approach to customer care and the emphasis the whole Company, from senior management to front-line staff, places on customer service, has led to our accreditation by the Institute of Customer Service ("ICS"). We are holders of the ICS ServiceMark with Distinction, the highest attainable award, and were the first financial services company to attain it. The award is based on customer satisfaction feedback and employee engagement with our customer service strategy.



Above: One of our policyholders enjoys attending a PIC Policyholder Day

Right: Motivational speaker Alex Lewis, at PIC's Manchester Policyholder Day 2018

ServiceMark with Distinction
Accredited from Oct '17 to Jun '20
The Institute of Customer Service

TRUSTEES

To successfully secure a bulk annuity transaction, trustees, their advisers, the pension scheme's corporate sponsor and PIC typically collaborate closely on complex and detailed matters. Throughout the process, PIC ensures that trustees are listened to. We believe in taking a proactive, problem-solving approach to requests, while remaining mindful of the risks and responsibilities that pension insurance contracts cover and always being respectful of the ultimate purpose of the transaction – paying the pensions of our current and future policyholders.

We are committed to delivering high standards of customer care. Ensuring that trustees receive the type of service we want to deliver is paramount. We therefore conduct regular, independent surveys to get clear and honest feedback on how PIC performed and whether we lived up to our expectations. We invite all trustee clients to provide their feedback on PIC.

The most recent set of findings showed that the feedback has been overwhelmingly positive. Three overarching themes emerge that make PIC stand out. These are our human approach, the high levels of support and guidance offered and strong evidence of Treating Customers Fairly.

Trustees have commented: "They are very efficient. They get the job done, they do what they say they're going to do and if there's a problem they will help you sort it out."

"PIC were by far the best between the other competitors in any number of ways. PIC simply impressed in all aspects."

"They have been absolutely superb generally. They are always on the side of the customer."

"

I worked with pride for Philips at Simonstone, near Burnley in Lancashire. They were a quality company and I greatly enjoyed my time there. I had long discussions over pensions in those years as we all saw it as the one great payback for employees. I paid in as much as I could and encouraged others to see the bigger picture. Redundancy came along and at 60 I began receiving my Philips pension, already making our lives so much easier.

A few years later, we were informed about being taken over for our pensions provision by PIC. Did I relish this? No. I was digging around finding out as much as I could about them and talking to people already under PIC's scheme. I heard no voices of dissent, quite the opposite in fact, and I felt greatly encouraged. The transition to PIC went ahead seamlessly. All the material they sent out I read over and over. It was easily understandable with a lot of the mystique about pensions providers explained in plain English.

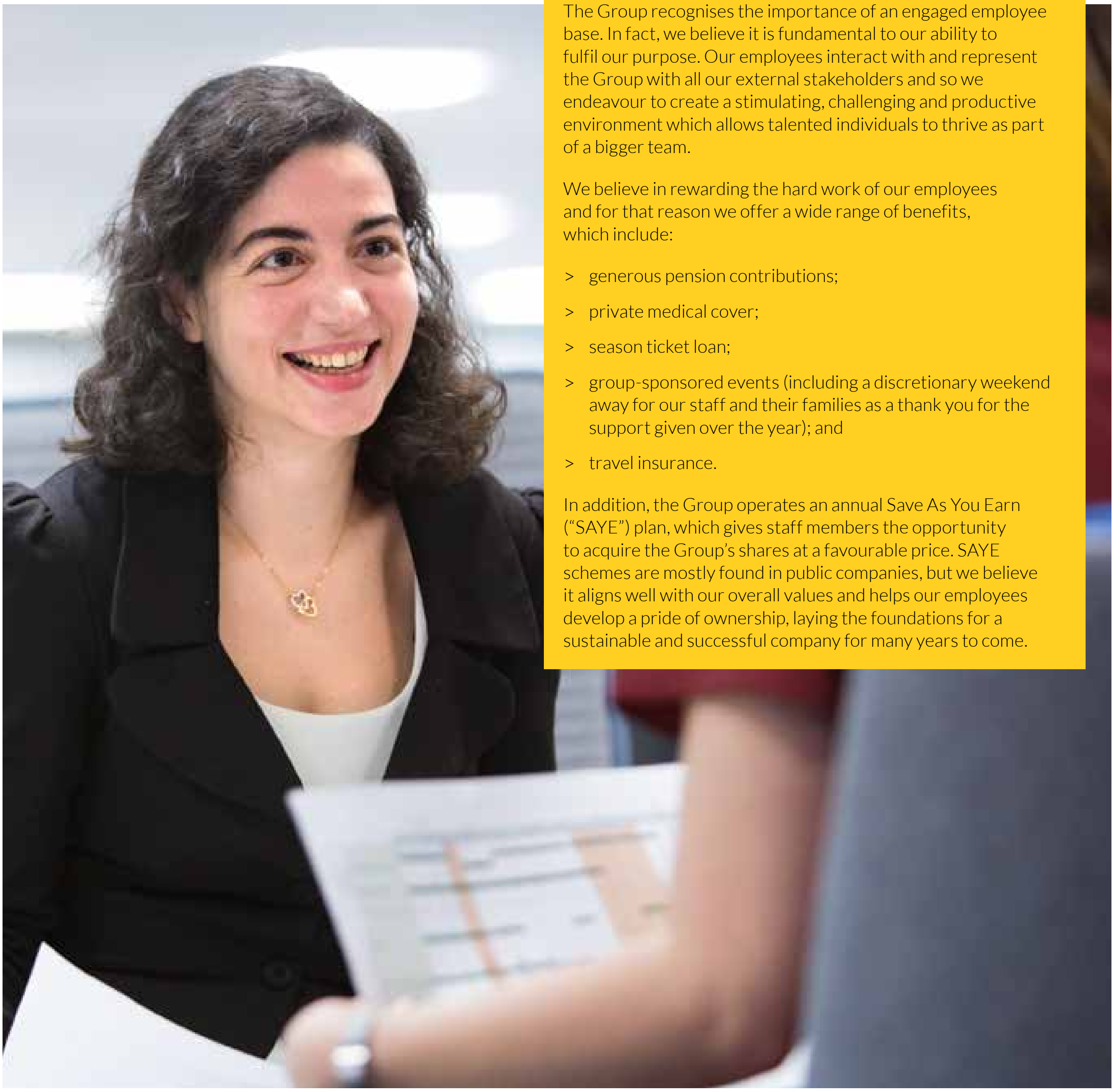
I have been very pleased to attend their Policyholder Days, year after year. I find them fascinating, and am greatly reassured to hear of PIC's strategy for managing our pensions and to cover all scenarios.

External speakers have been equally as interesting – Simon Callow was great value, inspirational and charismatic. Paul Lewis, a media figure who gave a very interesting talk on all financial matters from mortgages to insurance policies. Alex Lewis, a quadriplegic, gave a brilliant talk on "A minor setback", a talk that Debbie and I were enthralled with.

I have great confidence in PIC and hope more old colleagues will join Debbie and me at the Manchester Policyholder Day 2019.

Ken and Debbie Heaton
Ken is a former member of the Philips Pension Fund and proud PIC policyholder

STAKEHOLDER ENGAGEMENT IN ACTION (continued)



EMPLOYEES

The Group recognises the importance of an engaged employee base. In fact, we believe it is fundamental to our ability to fulfil our purpose. Our employees interact with and represent the Group with all our external stakeholders and so we endeavour to create a stimulating, challenging and productive environment which allows talented individuals to thrive as part of a bigger team.

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;
- group-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.

In addition, the Group operates an annual Save As You Earn ("SAYE") plan, which gives staff members the opportunity to acquire the Group's shares at a favourable price. SAYE schemes are mostly found in public companies, but we believe it aligns well with our overall values and helps our employees develop a pride of ownership, laying the foundations for a sustainable and successful company for many years to come.

SHAREHOLDERS

Our newest shareholder

As a private company, PICG is fortunate to have a small group of very supportive shareholders, each of whom shares a commitment to the Group's business strategy and its long-term view. In June 2018 Luxinva, a wholly owned subsidiary of the Abu Dhabi Investment Authority (ADIA), announced that they had reached an agreement to acquire a significant shareholding, comprising a majority of the shares in PICG held by funds advised by J.C. Flowers & Co. We are very pleased to say that this transaction formally completed in June 2018.

Tracy Blackwell, CEO of PIC, said: "We are delighted to welcome Luxinva to our small group of committed shareholders with financial services expertise and long-term investment horizons. We are confident that, together, they will continue to ensure that PIC is ideally placed to meet the increased demand from pension fund trustees."

OUR VALUES AND PURPOSE

OUR VALUES ARE KEY TO DELIVERING OUR STRATEGY

OUR PURPOSE IS TO PAY THE PENSIONS OF OUR CURRENT AND FUTURE POLICYHOLDERS, BY PROVIDING SECURE AND STABLE RETIREMENT INCOMES THROUGH LEADING CUSTOMER SERVICE, COMPREHENSIVE RISK MANAGEMENT AND EXCELLENCE IN ASSET AND LIABILITY MANAGEMENT.

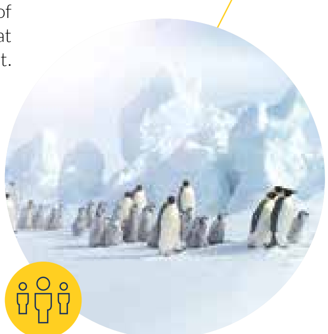
Striving to be the best
We provide sector-leading expertise, operating at a level of excellence in everything we do. We listen carefully, are not afraid to learn and challenge ourselves, and deliver a consistently high-quality offering.

Doing the right thing
Our policyholders are our customers 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.

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 are responsive to their requirements, acknowledging the need for fair and sustainable commercial practices.

Providing security
We are committed to managing risk and providing long-term stability and financial security for our customers. Our strong, conservatively managed balance sheet ensures resilience against difficult economic events.



Being a team
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.

Embracing new ideas
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.

OUR VALUES

PROVIDING SECURITY

THE RESILIENCE TO WITHSTAND THE HARSHEST OF ECONOMIC STORMS

We are committed to managing risk and providing long-term stability and financial security for our customers. Our strong, conservatively managed balance sheet ensures resilience against difficult economic events.

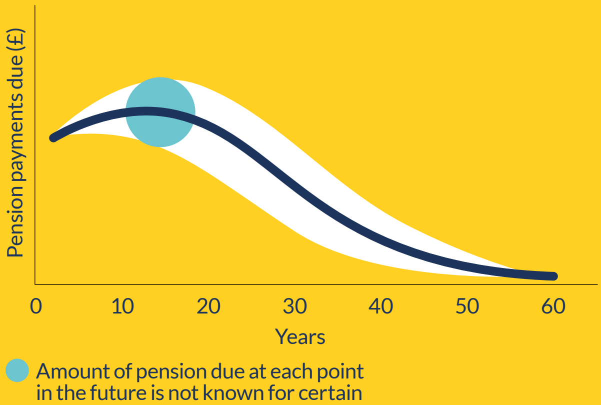
BUSINESS MODEL

GENERATING LONG-TERM SHAREHOLDER RETURNS

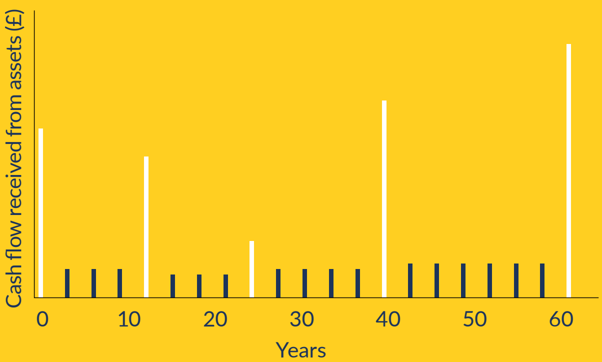
THREE KEY STEPS IN SECURING PENSIONS AND GENERATING LONG-TERM SHAREHOLDER RETURNS:

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 investment 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.

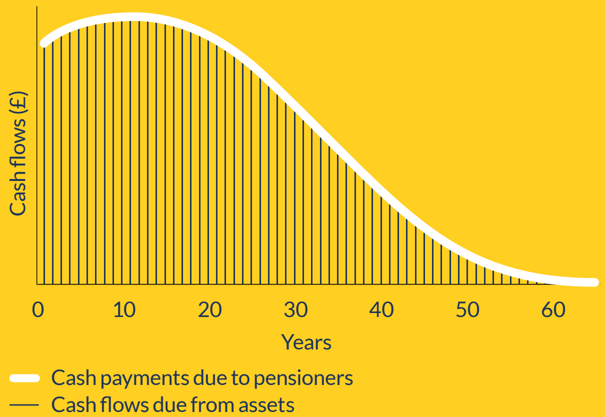
Assets received are reinvested to optimise returns on a cash flow matched and risk-adjusted basis.

Longevity risk is reinsured to remove risk, create certain liability cash flows and optimise capital deployment.

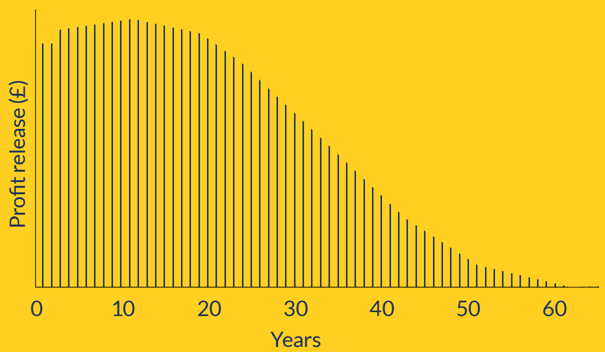
The Group's **capital resources** are committed for the full term of the liabilities.

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.



Margins in the liability together with the committed capital resources, are released over time, generating attractive risk-adjusted returns on capital employed.



KEYS TO SUCCESS

Success in the bulk annuity market requires expertise in:

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

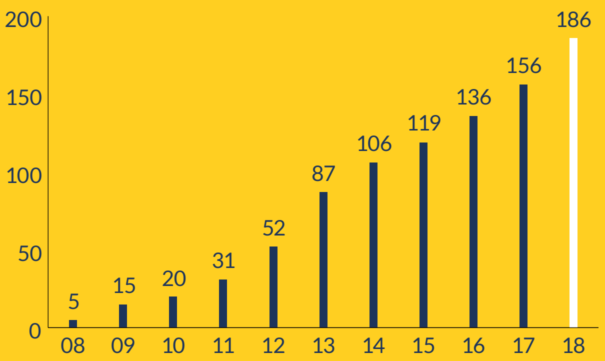
The Group's track record in all of these areas underpins its position as a leader in providing bulk annuities.

CONSISTENT GROWTH

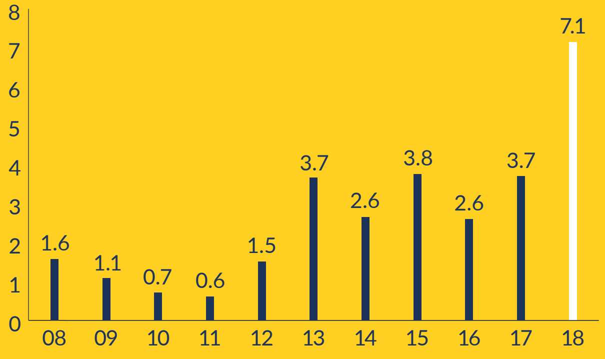
OUR 2018 PROGRESS BUILDS ON CONSISTENT GROWTH

SINCE ITS FIRST DEAL IN 2008 PIC HAS WRITTEN OVER £28 BILLION OF NEW BUSINESS PREMIUMS. THIS HAS DRIVEN ANNUAL GROWTH OF 32% IN FINANCIAL INVESTMENTS. SINCE 2016, EMBEDDED VALUE HAS GROWN BY 18% PER ANNUM.

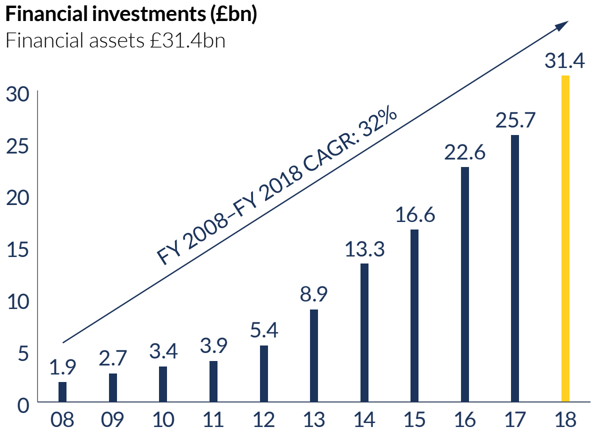
Number of pension schemes insured (cumulative)
186 with 30 insured in 2018



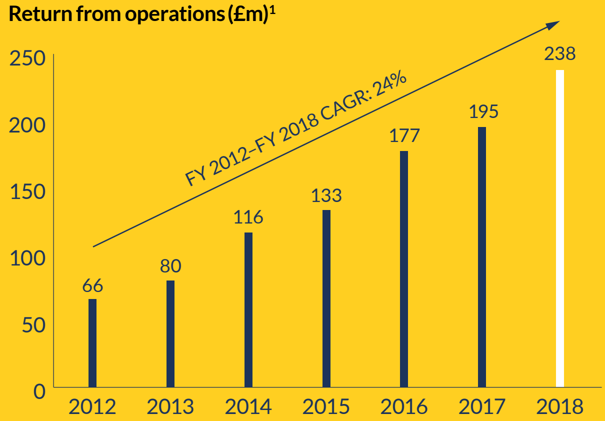
New business premium (£bn)
Premiums £7.1bn in 2018



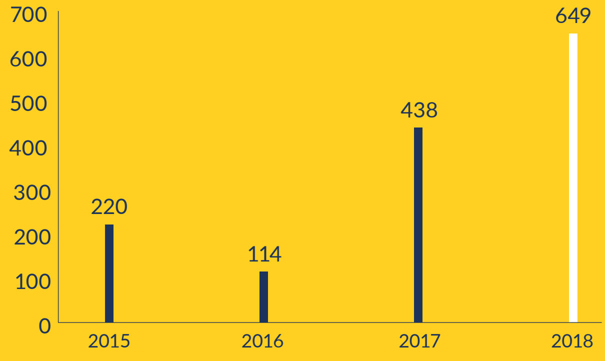
Financial investments (£bn)
Financial assets £31.4bn



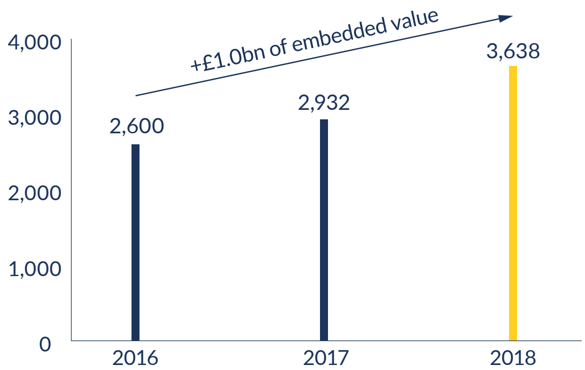
Return from operations (£m)[1]



Profitability (£m)
Adjusted operating profit £649m[2]



MCEV growth (£m)[3]
+ £1.0bn of embedded value since 2016



1 Return from operations, which is part of adjusted operating profit, represents long-term profits earned on the in-force book, and surplus assets.
2 Adjusted operating profit has been restated to include the impact of actuarial assumption changes and other items. See page 45 for further details.
3 Includes £0.3bn of new equity capital raised in 2016.

CONSISTENT GROWTH (continued)

PIC SOLVENCY II AND IFRS BALANCE SHEETS
UNDERLYING VALUE UNCHANGED BY IFRS OR SOLVENCY REPRESENTATION:

> Under both Solvency II (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 and risk margins run off.

Total assets

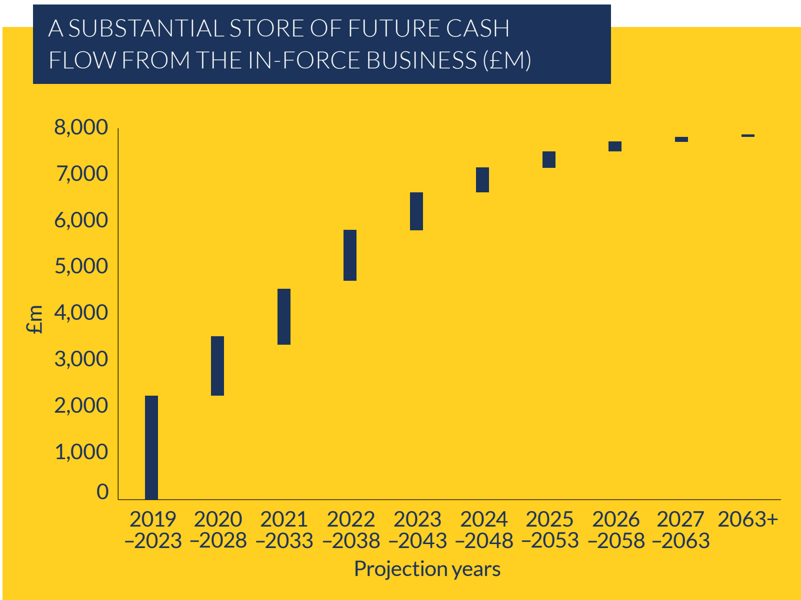
£30.2bn
Financial Investments net of derivative positions and current assets

Assets held for claims and expenses

£24.4bn
Best estimate liability net of reinsurance and prudent margins

Excess assets

£5.8bn
Assets allocated to cover solvency risk and prudent margins that will generate future cash flows for capital providers (debt and equity)



Illustrative future cash generation after tax prior to debt coupon and principal

IFRS	Solvency II
£0.9bn Borrowings	**£0.9bn** Subordinated debt
£2.5bn Assets backing prudent margins to be recognised in future profits	**£1.9bn** Solvency II prudent margins[1]
£2.4bn Net asset value (historical net profits and capital injection)	**£3.0bn** Shareholder own funds (Solvency II own funds less subordinated debt)

1 Solvency II prudent margins and risk margins net of transitional measure on technical provision, Solvency II and IFRS valuation differences including deferred tax

OUR STRATEGY AT A GLANCE

STRATEGIC OBJECTIVES	2018 PROGRESS	10 YEARS OF EXCELLENCE	LINK TO STRATEGY IN ACTION
Growth and focus Grow the value of the business on a focussed, secure and sustainable basis	> Record levels of new business (£7.1 billion) in a watershed year for the bulk annuity market > Record level of longevity risk reinsured (£5.6 billion) > Robust solvency ratio of 167%, with active management of interest rate and inflation movement risk	> 32% Compound annual growth rate ("CAGR") in PIC's investment portfolio > 186 defined benefit pension schemes insured > Long-term market share of 27%	Read more on pages 24, 28 and 38
Reputation Long-term value creation through market-leading customer service	> £1.6 billion of repeat business with nine existing clients > 2018 survey of trustee clients showed PIC is seen as 'class-leading' > 97% of policyholders are satisfied or highly satisfied with PIC's service levels	> More than 20,000 pensioners have attended our unique policyholder events to date > Policyholder satisfaction levels maintained at over 97% over the long-term > Awarded "ServiceMark with Distinction" by the Institute of Customer Service and won multiple industry awards including Pensions Age Risk Management Provider of the Year > Policyholder communications crystal marked by Plain English Campaign	Read more on page 29
Returns Deliver attractive risk-adjusted total shareholder returns	> Focused, disciplined pricing, consistent with long-term Internal Rate of Return targets > £5.2 billion of assets (excluding prudent margins in BEL, 2017: £4.3 billion) held in excess of best estimate liabilities > Profit before tax of £477 million (FY 2017: £383 million), demonstrating strength of underlying cash-flows	> 24% CAGR in PIC's Return from Operations > Conservative and highly rated asset portfolio with 90% of financial investments in government and corporate securities. Low historical default experience of 2 basis points ("bps") per annum since 2013	Read more on pages 24, 25, 26 and 42
Cost and capital efficiency A scalable business model that optimises internal and external resources	> PIC was awarded Insurance Financial Strength rating of A+ from Fitch > £350 million bond issued in September 2018 was PIC's third issue > Operating expense ratio continues to decline	> Reduction in expense ratio from 1.03% in 2012 to 0.35% in 2018 > PIC's leverage ratio consistently declines between debt issues, reflecting the profits generated and retained from the in-force book	Read more on page 30
Knowledge and conduct Ensure that our behaviours reflect our values	> Successfully launched second year of mentoring programme for female actuaries, in conjunction with the Institute and Faculty of Actuaries > Successful second year of ground-breaking "Purpose of Finance" series	> Focus on the purpose of PIC: paying the pensions of our current and future policyholders > Development of a set of values from the ground up, with all staff participating. Core value is: valuing the customer	Read more on page 31

OUR STRATEGY IN ACTION

GROWTH AND FOCUS

GROWING THE VALUE OF THE BUSINESS

NEW BUSINESS CASE STUDY

In November 2018, PIC transacted one of the largest full buyouts ever undertaken in the UK.

The deal, covering liabilities of £1.5 billion of the Rentokil Initial 2015 Pension Scheme ("the Scheme"), secures the benefits of all 14,200 members, providing certainty and security to 7,500 current pensioners and 6,700 deferred pensioners. The Scheme is now fully hedged against longevity, interest rate and inflation risks.

The buyout completely removes the pension liabilities from Rentokil Initial's balance sheet and the transaction was achieved with no sponsor company cash payments being necessary. This feature indicates the evolution and affordability of bulk annuity insurance, with more such deals highly likely to occur in the future.

Chris Pearce, Chairman of Trustees', said: "This is great news for members. After many years of support from Rentokil Initial and careful management…we can now secure our members' benefits through Pension Insurance Corporation (PIC), a company which has strong financial credentials and a track record of excellent customer service."

Rentokil Initial

“

THE COMPANY IS DOING A FINE JOB AT FULFILLING ITS PURPOSE OF PAYING THE PENSIONS OF ITS POLICYHOLDERS AND SEEMS TO ME TO BE DOING IT IN AN EXEMPLARY FASHION.

Peter Chapman
Former Thomson Regional Newspapers Pension Fund member, now a proud PIC policyholder

REPUTATION

MARKET-LEADING CUSTOMER SERVICE

I was part of the Thomson Regional Newspapers (TRN) pension fund through my work as Chief Librarian at The Scotsman newspaper in the early 1990s. The fund was bought out by PIC in 2009 so I've been a policyholder for a while now. I wasn't worried about my benefits moving from my pension fund to an insurance company. In fact, I am very pleased that my TRN pension is being paid by PIC.

The Company is doing a fine job at fulfilling its purpose of paying the pensions of its policyholders and seems to me to be doing it in an exemplary fashion.

PIC is very easy to interact with. Written communications are always clear. They are easy to read and understand and PIC's customer service is exceptionally good. They are efficient and effective. The thing that makes PIC's personal service different to other financial services companies I know of, or even deal with, is that you feel PIC is there for your benefit rather than the Company's. PIC's Policyholder Days are really useful and enjoyable, and they are a definite plus to being a policyholder of PIC. PIC is a friendly company, whose staff go out of their way to help.

OUR STRATEGY IN ACTION (continued)

COST AND CAPITAL EFFICIENCY

FITCH RATING AND 2018 DEBT ISSUE

In March 2018, PIC announced it had been assigned an inaugural Insurer Financial Strength rating of A+ by Fitch. In addition, Fitch rated PIC's outstanding Tier 2 bonds, due in 2024 and 2026, as BBB+. The ratings reflect PIC's very strong capitalisation, low investment risk and considerable asset and liability management capabilities.

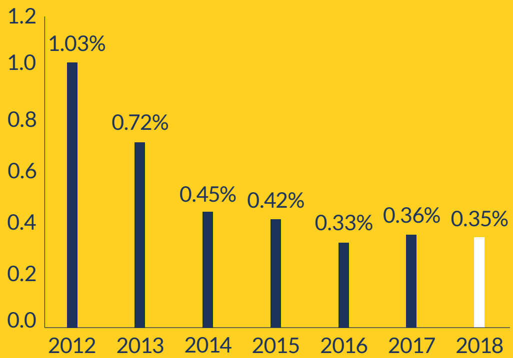
The balance sheet was further bolstered in September 2018 with the issuance of £350 million of subordinated debt. The 12-year bond represents the Group's largest debt issuance to date, following two earlier issuances of £300 million and £250 million in 2014 and 2016 respectively.

A consistent downward trend in the leverage ratio between debt issues reflects the retained profits generated from the in-force book. PIC has a conservative leverage ratio of 27.0% at 2018 (2017: 20.9%). The profit from the return from operations in 2018 of £238 million (2017: £195 million), demonstrates the strength of PIC's long-term profit generation.

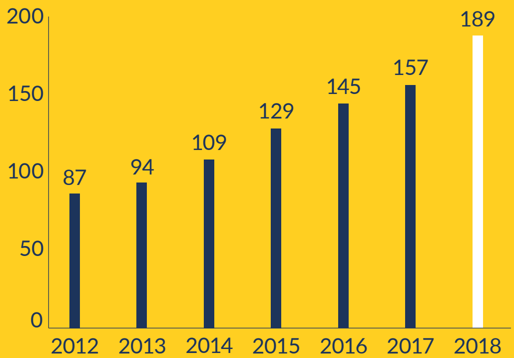
Importantly, the insurance business is proving highly scalable. PIC wrote a record amount of new business in 2018 (£7.1 billion) and, as the chart below demonstrates, decreased the expense ratio, which shows operating expenses as percentage of financial investments, by 4 basis points, continuing the overall trend since 2012. In total, PIC has reduced its expense ratio from 1.03% in 2012 to 0.35% in 2018.

EXPENSE RATIO HAS DECREASED, EVEN AS STAFF NUMBERS HAVE RISEN

Operating expenses as a % financial investments



Average number of employees (Group)



KNOWLEDGE AND CONDUCT
AMP – THE ACTUARIAL MENTORING PROGRAMME

The actuarial profession's pioneering mentoring programme (AMP) launched its second year with an 80% increase in supporting organisations. This year, AMP welcomed 84 mentoring pairs onto the programme, including some very senior managers at participating organisations. AMP is sponsored by PIC and is run in conjunction with the Institute and Faculty of Actuaries.

AMP is designed to improve diversity at senior levels of the profession by helping retain female actuaries for longer through ongoing career advice and support, with the active engagement of employers of actuaries. Non-retiring female actuaries leave the profession 13 years earlier than their male counterparts, leading to a lack of diversity at senior levels, despite there being near parity of numbers between male and female junior actuaries.

Nicky Morgan MP, Chair of the Treasury Select Committee, who is a supporter of AMP, wrote to the programme's organisers to say: "Congratulations to everyone involved in the AMP and good luck for year two. It is great to see so many senior champions advocating mentoring and diversity. We know there is still a lack of diversity at the top of the financial services sector, including the actuarial profession. I am sure that the AMP will play a key part in changing that."

ZOHRA HASHAM – ACTUARIAL ANALYST AND AMP MENTEE

"Leaving any job for a new opportunity is always a leap of faith – no matter how much research you've done. Joining PIC in 2017 was one of the best choices I have made, and I have grown and developed in many aspects of my role. PIC continually challenges employees and helps them grow, with our roles constantly evolving in response to market developments. The Actuarial Mentoring Programme (AMP) is just one of the many ways that PIC invests in its employees.

AMP had launched a short while before I joined, and so I was excited to have a chance to be part of it this year. My mentor has been very responsive, and we have our monthly meetings in the diary. Hearing about the success and experiences of last year's mentors and mentees at the launch event means I am confident that my mentor will have a big influence on my career. I think it is a great initiative and provides a brilliant opportunity to speak to and learn from senior actuaries. I particularly like that AMP connects me with a mentor outside PIC, allowing for objective advice and guidance that can continue (I hope) beyond the scope of the programme.

In addition, there are many other features to working life at PIC that make it a stimulating and enjoyable place to work. PIC's flat structure means I can get exposure to people at all levels throughout the organisation, which is a real plus. It's also great to see the qualities that make PIC a market leader in action, such as our innovative approach and personal and attentive service.

Altogether, it makes for a fun culture, working alongside open-minded colleagues who are not afraid to challenge each other. I am confident it will continue to be a great place to learn and develop."

"

PIC CONTINUALLY CHALLENGES EMPLOYEES AND HELPS THEM GROW

Zohra Hasham
Actuarial Analyst and AMP mentee

KEY PERFORMANCE INDICATORS

MEASURING OUR PROGRESS

PIC FOCUSES ON FOUR KEY PERFORMANCE INDICATORS ("KPIS") TO MEASURE PERFORMANCE IN FOUR MAIN AREAS: GROWTH AND OVERALL VALUE OF THE BUSINESS, TOTAL SHAREHOLDER RETURNS, SCALE AND EFFICIENCY, AND CUSTOMER SATISFACTION.

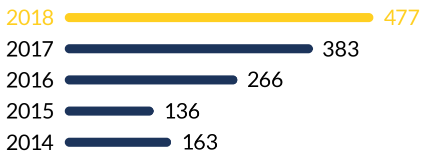
Embedded value ("EV") (£m)

KPI definition
On 1 January 2017, PIC adopted the European Insurance CFO Forum Market Consistent Embedded Values Principles[1] ("MCEV Principles") for its embedded value measurement and reporting.

Comment
Embedded value gives a snapshot of the value created to date and facilitates market comparisons.

Link to strategy
Embedded value is the key financial metric the Board uses to evaluate the value of the business.

Profit before tax (£m)



KPI definition
Profit before tax ("PBT") is a measure of PIC's ability to generate profit during the year.

Comment
PBT is an IFRS metric, which demonstrates the transition of the Group's activities into profits and returns available to its shareholders.

Link to strategy
Delivering attractive returns is one of our key strategic objectives.

PIC solvency ratio (%)

KPI definition
PIC's solvency ratio demonstrates the proportion of surplus funds in excess of Solvency Capital Requirements.

Comment
PIC's solvency ratio has consistently been above the regulatory limits and internal targets, which demonstrates the financial strength and resilience of the business.

Link to strategy
A robust solvency ratio reflects the prudent management of interest, inflation and longevity risks, underpinned by capital optimisation, including hybrid debt issuance.

Customer satisfaction (%)

KPI definition
PIC uses customer satisfaction as a KPI to ensure continued focus on the purpose of the business.

Comment
These numbers show the percentage of customers surveyed who give PIC a satisfied or very satisfied rating, evidencing the quality of the service we have given.

Link to strategy
Excellent customer outcomes are at the heart of our long-term business model.

1 Copyright @ Stichting CFO Forum Foundation 2008

OUR PEOPLE ARE CENTRAL TO OUR SUCCESS

OUR CULTURE AND VALUES

Our people and the culture we have developed at PIC are vital to our success as an organisation. We recognise our place as a corporate citizen, the impact of our actions and behaviours, and the responsibilities we have to each of our stakeholders.

We are proud to be a values-led company. Our offices are open plan, and our organisational structure is flat, with short reporting lines to encourage close collaboration and innovation. Employees often comment on the benefits of having accessible senior management.

The views of our staff are important to PIC. Regular staff surveys help us keep in touch with individual experiences of working at PIC and help the whole organisation learn and develop. During the year, we introduced short 'pulse' surveys focused on specific topics. The first of these was on flexible working, with the feedback and suggestions informing the Company's policy. We expect the revised policy to be embedded during 2019, helping our employees benefit from a good work/life balance.

JOINING PIC

In the last 12 months, PIC's total staff numbers have increased by 25%. At December 2018, PIC had around 200 employees. In line with this expansion, PIC has invested in maintaining its positive culture as the business continues to meet strong demand from a thriving bulk annuity market.

In particular, we have developed an induction programme the helps to keep our culture and values embedded at all levels and across the whole business. New hires undertake a series of mini inductions over the course of six months to ensure that they are familiar with PIC and how it operates. This builds on a recruitment process that assesses candidates on the behaviours we expect from our staff.

LEARNING AND DEVELOPMENT

Learning and Development continues to be a big priority at PIC, providing a very wide range of soft skills, technical, management and leadership skills, in addition to the mandatory training required so that our employees are kept up to date with the latest regulations and requirements.

In 2018, PIC launched an in-house management development programme, which is a series of short training modules to support the development of our managers. The modules are designed using a combination of best practice in people management and our capability framework, which is aligned to our values. We use a variety of training methods to ensure the training is engaging and impactful, which includes the use of professional actors and psychometric tools.

HEALTH AND WELLBEING

We want to continue to attract and retain the very best talent as the employer of choice within our industry. One of PIC's focus areas for 2019 will be on employee wellbeing and health. While physical health is important, we recognise that overall wellbeing, including mental health, happiness and how well an individual can cope with day-to-day life, is equally important.

"

EXTREMELY WELL RUN ORGANISATION WITH AN INCREDIBLY BRIGHT FUTURE. THE CULTURE RUNS THROUGH THE HEART OF THE BUSINESS

PIC employee
2018

OUR PEOPLE AND CULTURE (continued)

"PIC is an empowering and exciting place to work. If you do well you will be recognised for it. It has a lovely atmosphere and work ethic. It is very different to most insurance firms, much more edgy and fun."

"Nice friendly atmosphere with lots of respect. Very interesting work, with very talented people."

"Great people. Everyone pulling together – it's great to hear when other departments have 'smashed it'. Like the amazing results from the engagement with the Institute of Customer Service, reinsurance activity or some great new investment we've made. Gives a sense of all being in it together."

"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."

"Working for a consistently successful company which acts with integrity and performs to high ethical standards – in particular when treating customers but also how it behaves within the regulatory environment. I feel the organisation has developed a strong identifiable brand within the pension insurance industry and I personally feel proud to say I work for PIC when dealing with external parties."

"I feel valued as part of the PIC family. Senior management have an open door policy and always seem to help out when they can."

"The benefits are fantastic, especially the away weekend. It shows that staff are genuinely valued."

PIC employees
2018

CASE STUDY

PIC has changed a lot since we wrote our first transaction 10 years ago and I have been fortunate to be part of a team that has built a strong, successful company. But more importantly for me, over that time, I have had the luxury and privilege of recruiting my own team from scratch. Of course, line managing ten people in a rapidly growing company has its challenges. I've always relished the opportunity to nurture and develop talent and feel very lucky that PIC has provided me with the chance to build a team I am proud of.

Over the last few years, I have had several new members join the investment operations team and when the new management development programme was launched I was keen to try it out. The bespoke training designed with PIC's culture in mind provided me with very practical tools and techniques. I particularly enjoyed the use of actors to role play characters, which gave me a chance to practice challenging scenarios in a risk-free way, giving plenty of opportunity to learn the softer skills. Overall, the training has not only helped me ensure I recruit the right people, but also helped me motivate, inspire and retain talented individuals. This is easier said than done! That's where the management development programme has really added value.

Denise Lennon
Head of Investment and Derivatives Operations

CASE STUDY

I joined PIC as an actuarial student in 2011 as a junior member of the Origination team where I assisted with the pricing of new pension scheme transactions. Alongside working, I continued my studies and went on to qualify as an actuary in 2014. PIC has really supported me in my career, and over the years has enabled me to complete my actuarial exams and expand my knowledge into other areas of business such as contract negotiation, investment and financing. Having started out as an analyst assisting on deals, thanks to the support I received I now regularly lead on transactions such as the £1.3 billion pensioner buy-in with Siemens in 2018. I am delighted at how far my career has come.

At PIC, there is more to life than just work which I think is a great thing; I really look forward, to the annual away weekend, which is a real treat and a great chance to socialise with colleagues and their families. Additionally PIC provides plenty of opportunities for extra learning and networking; for example, I am deputy chair on the charity committee, a role which I find very hugely rewarding and interesting.

I see PIC continuing to be a great success in the future and I hope to continue to play my part in the Company's growth and achievements.

Matt Richards
Senior Actuary

OUR VALUES

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.

ASSET AND LIABILITY MANAGEMENT

AN INVESTMENT STRATEGY TO WEATHER VOLATILE MARKETS

Rob Groves
Chief Investment Officer

OVERVIEW

Reflecting the significant growth in the bulk annuity market in 2018, as well as the ongoing volatility in the markets, the Investment Team has had two considerable challenges this year. The first has been managing risk in volatile political and market conditions. The second has been the sourcing of suitable assets to underpin pricing of new business.

The first, and major focus of the team, has been managing risk within the portfolio. Government bond yields have been driven higher by the end of the Quantitative Easing programmes of the major central banks and concerns around the prospects for economic growth. This has been compounded by political uncertainty caused by the US-China trade war, the looming Italian debt crisis (we hold no Italian sovereign debt) and the UK's own political travails.

For PIC, widening credit spreads in this circumstance present opportunities to buy what we consider to be undervalued assets. In practice, this means selling a similarly secure, but lower-yielding, credit we already own and buying a higher-yielding asset. We have also been able to move into more secure credits without reducing the yield on the portfolio.

HIGHLIGHTS OF THE YEAR

> Total portfolio now £31.4 billion

> £2.5 billion of direct debt investments, including £250 million invested in renewable energy

> Wider credit spreads have presented buying opportunities

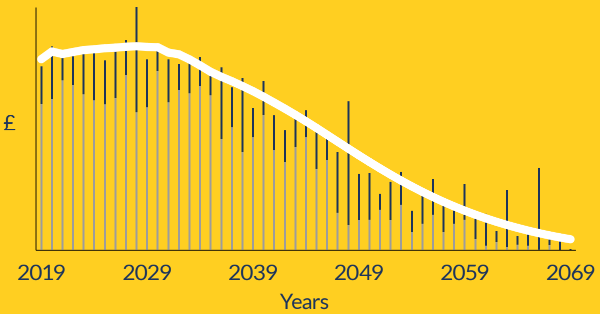
The second challenge, sourcing suitable assets to underpin the pricing of new business, has also been a big area of focus for the team this year. I have been incredibly proud to lead a team that has risen to the challenge of sourcing assets to manage £7.1 billion of new business premiums, almost double last year's total. In particular, we have had considerable success in investing in direct, private (illiquid) investments, including £250 million invested in offshore wind (see page 40) and a continuation of our investments in social housing.

RISK MANAGEMENT: CASH FLOW MATCHING

PIC has very long-dated liabilities, stretching out 50 years and beyond. The cash flow profile that this presents is predictable, because the vast majority of our liabilities are non-callable: if we are paying your pension, you are with us for life. Within the Solvency II regulatory framework we are required to match cash flows from our investments closely to specific pension liabilities (see chart opposite).

HIGHLIGHTS

Asset risk: cash flow matching



Liabilities
Credit asset cash flows
Cash, gilts and derivatives

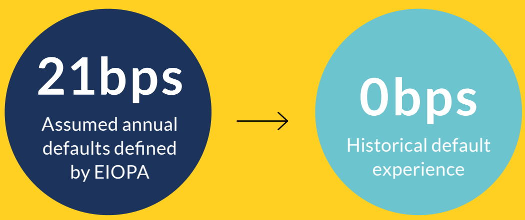
Financial investments by asset class
(31 December 2018)

- Government securities 37%
- Corporate securities 53%
- Asset Backed Securities ("ABS") 1%
- Equity Release Mortgages ("ERM")1%
- Cash and liquidity funds 5%
- Other 3%

Corporate securities by rating

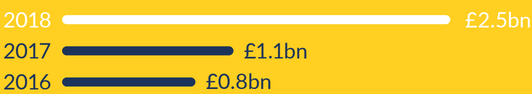
- AAA 6%
- AA 12%
- A 38%
- BBB 42%
- Other 2%

Historical default experience
bps per annum



We have not experienced any defaults since 2013.

Direct debt investments originated in the year



Our entire focus is therefore on getting our money back at maturity, not on the mark-to-mark valuation of portfolio assets each quarter. We are very long-term investors; whether our assets rise or fall in value, they still generate the same cash flows to pay our policyholders' pensions.

MANAGING THE PORTFOLIO

The watchword for us in managing the portfolio is risk management. We aim for a high-quality, low risk portfolio that protects our pension payments against political and economic upheaval. I call this the weather-proof investment strategy.

In practice this means that 90% of our portfolio is invested in government and corporate bonds, with 98% rated investment grade. Aside from the UK Government, no single counterparty represents more than 2% of our total investments.

53% of our assets are managed internally, including gilts, supranational bonds and debt private placements. The remainder are managed by our external asset managers, the largest of which are Schroders, Janus Henderson and JPMorgan.

HISTORICAL DEFAULT EXPERIENCE

Whilst credit markets have been generally benign over the past few years, we remain proud of our record of not experiencing any defaults for the last five years. This compares with a prescribed Solvency II best estimate reserving assumption of 21bps each year.

Downgrades are treated separately within the portfolio and PIC holds a specific reserve to protect the portfolio against the consequences of widescale downgrades. This reserve is intended to maintain the portfolio's overall rating. At year-end, this reserve was £1.5 billion.

DIRECT DEBT INVESTMENTS

The team has had a very successful year in both the quantity invested in directly sourced, private debt, and in the quality of the borrowers, including the National Trust, the Mercer's Company and Durham University. We have secured investments of £2.5 billion in sectors including social housing, renewable energy, student accommodation, healthcare and education. This compares with £1.1 billion in 2017 and £850 million in 2016, with a total amount of private debt on the balance sheet of £5.8 billion, representing about 18% of the portfolio.

ASSET AND LIABILITY MANAGEMENT (continued)

PRIVATE INVESTMENTS

PIC has a long-term track record of investing in secure, long-term assets that are sourced privately alongside those invested in the listed debt markets. These private investments, which constitute about 18% of the overall portfolio, play an important role in helping us match our pension liabilities in years where it is difficult to source cash flows in the public bond markets (see chart 1). These types of investment grade, illiquid investments provide additional return and less risk compared to listed debt. In 2018, PIC invested £2.5 billion (2017: £1.1 billion) in direct investments across nearly 40 different transactions.

In a typical private placement, the borrower will be seeking less than £150 million, making these types of transactions too small for the listed corporate bond market. PIC will work directly with the borrower, allowing us to shape the transaction to meet the needs of both parties, particularly where we are the sole lender, as we are in significant proportion of these types of transactions.

For example, the borrower is able to negotiate deferred drawdown, allowing them to have funds available when they need them rather than on signing of the contract, which reduces the time they pay interest on their debt (cost of carry). From our perspective, we are often able to tailor the maturity profile to match our pension liability cash flows, as well as negotiate documentation that suits our credit appetite, including security covenants or merger consents. This is designed to protect our pension payments and in the unlikely event of a default by the borrower, PIC also receives the benefits of diversification away from public credit markets for wide-ranging projects including in education, healthcare and renewable energy, as well as from high-profile borrowers such as the National Trust.

2018 deal highlights (see chart 2) include:

> £100 million for the National Trust to support improved facilities across the UK;

> £250 million in two offshore wind farms, bringing our support to this nascent sector to around £350 million;

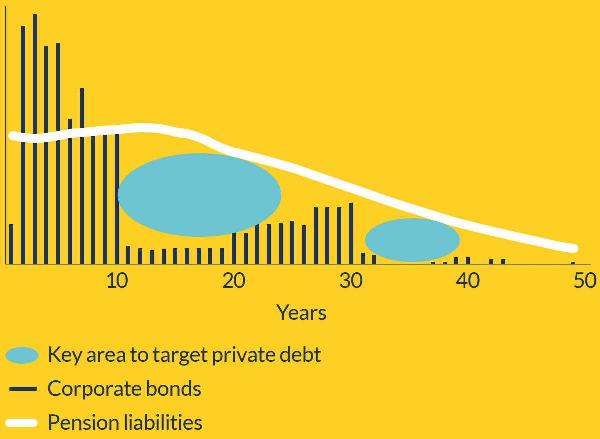
> £265 million invested in social housing, and more than £1.5 billion invested in aggregate; and

> £100 million to help construct a new hospital in London, providing leading edge treatment

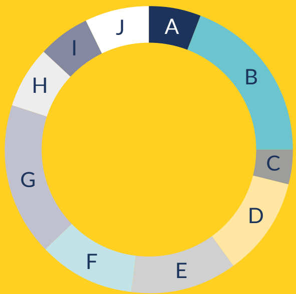
These deals often have a pleasing symmetry, helping to secure the pension payments of older generations, by investing in long-term projects which will benefit younger, and future generations. This includes the development of thousands of houses in the social housing sector and the construction of critical infrastructure.

DIRECT DEBT PLACEMENT

1. Finding cash flows for years with low levels of listed bonds in issuance



2. Breakdown by sector of direct investments (2018)



- A Commercial property 6%
- B Education 19%
- C Financials 4%
- D Not for profit 11%
- E Project finance 12%
- F Social housing 11%
- G Student accommodation 17%
- H Student loans 7%
- I Transport 6%
- J Utilities 7%

CASE STUDIES

The Mercers' Company
PIC agreed a £60 million, 50-year debt investment with the Mercers' Company (the "Company"), to fund refurbishments and additions to existing property, as well as to support the Company's philanthropic activities. This financing deal builds on an existing relationship, following PIC's £35 million pension insurance buyout of the Mercers' Staff Pension Scheme in 2012.

Key points of the transaction:
> 50-year term (2068 maturity).

> PIC is the sole investor.

> Repayment sculpted to provide the Company with a bespoke amortisation profile and PIC with very long-dated cash flows, beyond that typically available in the listed debt market.

> Deferred drawdown, reducing the cost of carry for the borrower.

Rob Abernethy, Clerk and Chief Executive Officer at the Mercers' Company, said: "The Mercers' Company has been delighted with the support provided through a very competitive 50-year term private placement bond for £60 million resulting in this investment by PIC. This will enable the Company to continue with its programme of developing its existing investment property portfolio, to increase long-term returns and support its philanthropic activity across Young People & Education, Older People & Housing, and Church & Communities."

Durham University
PIC invested £145 million in debt issued by Durham University to support an extensive Estate Masterplan, with proposals to develop new buildings while delivering significant refurbishment. PIC was able to offer very long-dated funding with £70 million maturing in 2058 and £75 million maturing in 2067, to match PIC's pension payments. PIC has now invested more than £500 million in the UK's universities.

Professor Stuart Corbridge, Vice-Chancellor of Durham University, said: "We are pleased to have worked with PIC on this debt issuance. The PIC team has a very good understanding of the needs of universities as a result of their extensive experience of investing in this sector and were flexible and responsive in helping us achieve our aims."

The National Trust
PIC completed a £100 million debt investment with the National Trust (the "Trust"), one of the UK's largest charities and Europe's largest conservation body. The funds will be used to maintain and invest in existing heritage assets and conservation, including supporting a programme of improvements to visitor facilities at the Trust's properties across the UK.

Key aspects of the transaction:
> Structured as two tranches of £50 million, deferred until 2020 and 2022 to match the Trust's requirements.

> Debt matures in 2063, matching PIC's pension liability cash flows.

Peter Vermeulen, Chief Financial Officer at the National Trust said: "We are pleased to have worked with PIC on this transaction. The team has extensive experience in structuring innovative, flexible deals and are well respected investors. We look forward to improving our visitor facilities with this much needed investment so that people across the country can continue to enjoy the rich history of our land and properties."

Accord Housing Association
PIC entered a long-dated, senior secured private placement worth £100 million with Accord Housing Association ("Accord"), a regulated housing association providing 13,000 affordable homes and a range of support and care services to over 80,000 people across central and northern England. PIC was chosen as sole lender following a full market tender due to its flexibility on maturity and deferral capabilities. The money will be used to repay existing maturing loans and fund the future development of 1,500 homes over the next five years.

Key points of the transaction:
> Range of maturities spanning over 30 years.

> Maturity profile tailored to match PIC's pension liabilities in years where it is difficult to source cash flows in the public bond markets.

> Deferred drawdown, reducing the cost of carry for the borrower.

> The debt is secured on housing assets.

Stuart Fisher, Executive Director of Resources at Accord Housing Association, said: "We are delighted to have secured a £100 million funding facility with a new investment partner, PIC, an established and well-respected provider of funds to the social housing sector."

FINANCIAL REVIEW

STRONG FINANCIAL PERFORMANCE AND IMPROVED CAPITAL STRUCTURE

Rob Sewell
Chief Financial Officer

OVERVIEW

2018 was a successful year for the Group, with significant new business volumes written at good margins, good profitability, significant growth in embedded value and strong solvency levels.

The Group wrote new business premiums of £7.1 billion in 2018 compared with £3.7 billion in 2017. This level of new business activity was supported by the Group's own internal capital resources and a successful £350 million debt raise in September 2018.

ASSUMPTION AND METHODOLOGY CHANGES

The Group focuses on long-term profitability, which is achieved by setting prudent assumptions in respect of the in-force liabilities and new business acquired during the year. These assumptions are carefully managed and regularly reviewed throughout the year to ensure they reflect the characteristics of our book and wider market practice. As part of the 2018 review, the Group implemented two major assumption changes, in respect of our mortality assumptions and the provision for defaults allowed for in our liability discount rate.

Over the last few years we have seen a shortening of life expectancies versus our original assumptions. A new longevity improvement model (CMI 2016, issued by the Continuous Mortality Investigation) was adopted in 2017 for future longevity improvement projections. In 2018, following the review of longevity experience, the CMI 2016 model was also applied to our base longevity assumptions (excluding any future changes), which positively impacted the profits in the year by approximately £144 million.

“

THE GROUP FOCUSES ON LONG-TERM PROFITABILITY

We also took the opportunity during the year to review how we calculate the amount of credit spread which represents default risk. This is an important assumption, which feeds into the discount rate applied to our liabilities. Two changes to the methodology were made. The first was to move from a method that takes a variable percentage of spread as the default allowance

ACTIVELY HEDGING LONGEVITY RISK

In 2018, PIC reinsured a record £5.6 billion of longevity risk exposure. This takes the total of PIC's longevity risk reinsured to £17.9 billion since 2008 and means that the Company has now reinsured 74% of total longevity risk exposure.

Longevity reinsurance is an intrinsic part of PIC's business model, reducing longevity and other demographic-related risks, optimising reserving and solvency capital requirements as prescribed under Solvency II, and providing for a more certain and stable liability profile.

PIC manages its longevity exposure by:

> reviewing 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 wrote its first longevity reinsurance contract in 2008 and now has 11 highly rated reinsurance counterparties. The reinsurers with which PIC currently has longevity swap reinsurance contracts are: Canada Life Assurance Company, Challenger Life, Hannover Rück SE, Munich Reinsurance Company, Pacific Life Re Limited, PartnerRe, Prudential Insurance Company of America, RGA Global Reinsurance Company Limited, SCOR and Swiss Re.

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 collateral arrangements in place to manage PIC's credit exposures.

to a method which is based on long-term rates of defaults as provided by Moody's Investor Services. To ensure that there is a suitable level of prudence, we have taken a multiple of three times the long-term rates of defaults as our assumption. Setting the level of prudence at this level though represents a reduction in the prudence compared to that which would have been in place under the old methodology. This reduction led to a decrease in the value of our liabilities and an increase in pre tax profit of £320 million.

Another consequence of our updated calculation approach is that the default assumption is now sensitive to credit upgrades and downgrades, rather than changes in credit spreads. We feel this better reflects the underlying credit performance and risks and is more in line with that adopted in our solvency calculations.

PRUDENT MARGINS

There are significant prudent margins within the IFRS accounting basis. These prudent margins take three forms. The first is in respect of key underlying assumptions, such as longevity and expenses. The second prudent margin is within the discount rate applied to the liabilities. The third prudent margin is within our best estimate liabilities (BEL) where the Fundamental Spread (a default assumption specified by our regulator) contains known prudent margins. Notwithstanding the change to the discount rate methodology that released £320 million, at end 2018 total prudent margins were at £2.5 billion, compared to £1.9 billion at end 2017.

Under our expected outcome, these prudent margins will be released over the long term and recognised as profits. They are essentially a future store of value that will emerge should our wider best estimate assumptions turn out to be correct. The impact of the above changes and the record high new business written in the period, combined with our reinsurance activity, increased the Group's profit before tax in 2018 to £477 million from £383 million in 2017, an increase of 25%.

REINSURANCE

During the year, the Group reinsured a record amount of longevity exposure on £5.6 billion of reserves, and at year-end 74% of the Group's total longevity exposure had been reinsured (2017: 73%). In November,

2018 FINANCIAL PERFORMANCE

Statement of comprehensive income highlights

	2018 £m	2017 £m
Gross premiums written	7,150	3,704
Net premiums revenue earned	7,121	3,663
Investment return (including commissions earned)	(977)	1,093
Total revenue	6,144	4,756
Claims paid	(1,174)	(909)
Change in insurance liabilities	(4,323)	(3,324)
Operating expenses	(124)	(99)
Finance costs	(46)	(41)
Total claims and expenses	(5,667)	(4,373)
Profit before tax	477	383

FINANCIAL REVIEW (continued)

the Group completed a £0.5 billion longevity swap reinsurance deal with SwissRe, a new reinsurance counterparty for the Group. This takes the total number of the Group's reinsurance counterparties to 11, all of which are investment grade.

FINANCIAL INVESTMENTS

The Group's financial investments increased by £5.7 billion to £31.4 billion (2017: £25.7 billion). The assets in which the Group 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 broadly 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 2018 was negative, this was offset by reductions in our corresponding liability valuations.

CAPITAL AND SOLVENCY

PIC successfully issued a £350 million 12 year subordinated debt during the year. This issuance led to the debt leverage increasing to 27.0% on an IFRS basis (2017: 20.9%). The leverage ratio remains below the Group's risk appetite and is expected to reduce as the Group generates profits in the future years.

PIC's solvency ratio at the end of 2018 remained strong at 167% (2017: 160%). Despite the significant new business volumes written during the year, a combination of effective capital management, debt issuance, careful underwriting and reinsurance ensured that our solvency levels remain very sound.

PREMIUMS

Gross premiums written have increased significantly from £3,704 million in 2017 to £7,150 million in 2018 as a result of 30 new business transactions during the year (2017: 20).

Net premiums earned represent the gross premiums written less the premiums ceded to reinsurers. These grew at broadly the same rate as gross premiums, following the seven (2017: seven) new reinsurance transactions concluded in 2018.

INVESTMENT RETURN

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

Interest received increased from £631 million in 2017 to £729 million in 2018 reflecting the growth in the investment portfolio.

The net movement in the fair value of assets, including realised and unrealised items, was a loss of £1,672 million compared with a gain of £526 million in 2017. This comprises realised gains of £163 million (2017: £310 million) and unrealised losses of £1,835 million (2017: £216 million gain). The significant increase in unrealised losses was mainly due to the negative impact of market movements.

CLAIMS PAID

Claims paid represents the total payments made to policyholders during the year. This was £1,248 million in 2018 (2017: £1,003 million).

Net claims paid are gross claims paid less the amounts recovered from reinsurers. Net claims paid increased from £909 million in 2017 to £1,174 million in 2018 reflecting the increase in the size of 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 record levels of new business written in 2018, claims paid to policyholders and the impact of market fluctuations offset by a decrease in liabilities due to the same factors impacting our financial investments. The assumption changes in respect of moving fully to the CMI 2016 longevity improvements model and the updated prudence level in our liability discount rate reduced the insurance liabilities by £464 million.

OPERATING EXPENSES

The increase in operating expenses from £99 million in 2017 to £124 million in 2018 was in line with the growth of the business.

FINANCE COSTS

Finance costs represent the interest payable on borrowings. The £46 million expenses in 2018 represents the interest payable on the three subordinated debt securities issued by PIC, the Group's main trading entity.

Balance sheet review

Balance sheet extract	2018 £m	2017 £m
Reinsurance assets	1,854	2,450
Financial investments	31,371	25,671
Derivative assets	9,757	8,775
Gross insurance liabilities	(28,720)	(24,993)
Derivative liabilities	(11,303)	(9,663)

By the end of 2018, the Group had total financial investments of £31.4 billion, compared with £25.7 billion at the end of 2017. The increase of £5.7 billion over 2018 was principally due to the effect of the new business premiums received and the proceeds from new subordinated debt issue, offset by the impact of market movements and claim payments made to policyholders. The majority of the market movements had a small impact on our balance sheet because of the close matching of our assets and liabilities.

The increase in insurance liabilities since December 2017 reflects the addition of new business written during 2018, less claims paid and the impact of changes in actuarial assumptions, as well as the impact of movements in macro-economic factors such as interest rates and inflation during the year.

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 in the year as well as rebalancing hedges on existing liabilities.

Alternative measures of profit or loss

In addition to the statutory results presentation outlined above, the Group 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. The following table takes all the items in the IFRS income statement and apportions them between various categories which the Group believe gives a better alignment with the activities of the business.

	2018 £m	2017 £m
Return from operations	238	195
New business and reinsurance surplus	59	69
Net release from operations	297	264
Changes in valuation assumptions	400	172
Experience Variances	16	53
Finance and project costs	(64)	(51)
Adjusted operating profit before tax	649	438
Investment volatility	(172)	(55)
IFRS profit before tax	477	383

ADJUSTED OPERATING PROFIT BASIS

Adjusted Operating Profit before tax has been defined 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 from operations" 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 Group's core activities.

During 2018, the Group has chosen to amend certain definitions and descriptions within the adjusted operating profit basis, with the main changes being as follows:

> The items previously captioned "Return on Surplus Assets", and "Return on in-force book" have been added together to be called "Return from Operations". The measurement of these items is, however, unchanged. This change was made as it was felt there was little value in providing this level of granularity.

> Actuarial valuation assumption changes, which previously were shown outside of adjusted operating profit, have been moved to be within adjusted operating profit. This change was made to reflect that assumptions made, and changes to those assumptions, are an integral part of the long-term value creation of the business, and to the extent that these assumptions prove to be either too prudent or too imprudent, this should be reflected alongside the core profit emergence rather than being excluded.

> Finance and project costs have been included within adjusted operating profit. Whilst these costs could be considered outside of operating profit, it was determined that as they support the ability to write new business it was more appropriate to include such costs within adjusted operating profit.

FINANCIAL REVIEW (continued)

These changes do not alter the total amount of profits or losses recognised within any accounting period, but the Group believes that making these changes serves to better describe the activities of the Group and the profits or losses arising.

2017 figures have been restated so as to align to the new presentation format.

The Group's adjusted operating profit before tax was £649 million in 2018, increased from £438 million in 2017. An explanation of the main components of this is set out below.

The item "net release from operations" comprises the returns arising from the management of the Group's assets and liabilities. This is derived by using assumptions about long term returns on the underlying investment portfolio backing liabilities, and on the surplus assets of the Group.

It also includes the impact on profit, on a pricing basis, from writing new buy in and buyout insurance contracts, and entering into new contracts of reinsurance. At £297 million for 2018, this is £33 million greater than the 2017 figure of £264 million, principally reflecting the growth in financial investments during the year.

The impact of new business and reinsurance was, as expected, relatively small, reflecting the prudent initial margins established for new business.

"Changes in valuation assumptions" gave rise to a positive £400 million in the year, due mainly to two significant assumption changes, as discussed previously. The first related to longevity assumptions, where we moved fully to the CMI 2016 model during the year. This change released £144 million.

The impact of the change to the liability discount rate prudence level involved a slight reduction in the level of prudence and released £320 million into profit before tax in 2018. These two changes, in addition to a number of smaller assumption changes totalling £(64) million made during the course of the year, resulted in the net £400 million assumption change impact.

Experience variances, which reflect both the actual claims experience compared to the expected amounts and the impacts of data updates on underlying policyholder information, were positive in 2018, totalling £16 million (2017: £53 million).

The interest costs of the subordinated debt capital issued by the Group's subsidiary, PIC, rose to £46 million in 2018 from £41 million the previous year, following the issuance of a further £350 million of debt in September 2018. Project costs in 2018 were £18 million (2017: £10 million).

Changes in the levels of actuarial assumptions have several impacts on the future profitability of the Group. Firstly, assumption changes in 2017 and 2018 had the effect of accelerating the recognition of future profits, meaning that amounts are recognised in the period that the assumption change is made rather than being released slowly into profit over many years as the prudent margins unwind. Secondly, the credit default assumption change serves to increase the reported profitability of new business when it is written on an IFRS basis, as there is less prudence in the reserves set up to meet the future policyholder payments.

Going forward, we would expect the return from operations in 2019 and future years to be lower than in 2018 due to the accelerated release of prudent margins in 2018 – albeit that this will be applied to an in-force book which is bigger due to the record levels of new business written in 2018. Against this, we would expect the amount of profits due to new business to be greater on an IFRS basis going forward, as less prudence will be built with the insurance liabilities for new business that would have applied previously.

RECONCILIATION TO PROFIT BEFORE TAX

To reconcile from adjusted operating profit before tax to the IFRS profit before tax figure, we adjust differences between our longer term assumptions about investment return and the returns experienced during the year.

Profit before tax includes actual investment returns earned on the surplus assets, whereas the adjusted operating profit is based on the expected returns which are calculated using the management assumption of long-term returns. The long-term rates of return earned on excess assets are derived with reference to longer term swap rates with additional spreads added to take into account the risk associated with the underlying type of asset. The difference between the actual and the expected long-term returns is included within Investment volatility, outside of Adjusted Operating Profit.

The long-term expected rate of return on surplus assets (i.e. those assets not backing liabilities, which consist mainly of UK government securities, cash and liquidity funds) and which represent 11% of total assets (2017: 10%), is weighted based on the asset classes held at the beginning of the year. For 2018, the rate was 2.26% (2017: 2.09%) for the surplus assets, which comprised government securities of 31% (2017: 21%), cash and liquidity funds of 40% (2017: 56%) and other asset classes (including hedge funds, ABS and MBS) of 29% (2017: 23%).

The impact of investment volatility on the Group's assets and liabilities was £(172) million in 2018 (2017: £(55) million). The Group carefully manages its exposures to factors such as interest rates, inflation, credit spreads and foreign exchange rates, and enters into derivative hedging contracts to manage these exposures in accordance with its risk appetite. The Group's hedging basis is designed around its solvency balance sheet, and accordingly there is a small degree of mismatch between the hedging basis and the IFRS balance sheet, meaning that some degree of volatility flows through into the annual IFRS results. This resulted in losses due to interest rates of £57 million and due to inflation movements of £21 million. Additionally, there was a loss of £94 million during the year relating to the differences between the long-term expected returns used within Adjusted Operating Profit, and the actual investment result for the year.

MCEV RESULTS

The Group prepares an embedded value ("EV") analysis under the European Insurance CFO Forum Market Consistent Embedded Value Principles issued in April 2016. The starting point is the Solvency II balance sheet; 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.

At 31 December 2018, the Group's EV had increased by 24% to £3,638 million (2017: £2,932 million), with the increase being mainly due to the significant levels of new business written in the year. The Group made one methodology change during the year, to treat the longevity risk on pensioner business, whether reinsured or not, as hedgeable. Previously only pensioner business that had actually been reinsured was treated as hedgeable. The impact of this change at end 2018 was to increase the EV by £135 million. No changes have been made to the assumption that deferred business (ie those policyholders who are yet to retire) is treated as hedgeable only if it has been reinsured.

OTHER OPERATIONAL HIGHLIGHTS

Operating expenses as a percentage of closing financial investments under management, which is a measure of how the cost base of the Group compares to the size of the asset base which it manages, fell slightly during 2018 from 0.36% to 0.35%. This largely reflects additional acquisition expenses incurred in 2018, reflecting the increase in new business volume in 2018 compared with the prior year, and an increased financial investment portfolio.

Customer focus is a central element of the activities and culture of the Group, and the customer satisfaction ratio of 97.3%, whilst a small decrease compared with 98.3% in the prior year, continues to reflect the Group's industry-leading customer service capabilities as well as the continued focus on the Group's policyholders.

REGULATORY SOLVENCY

PIC, the regulated subsidiary of the Group, 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 follow either 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.

The Company has complied with the Solvency Capital Requirements under Solvency II as set out in the relevant PRA rules throughout the year (see Note 20 to the financial statements). At 31 December 2018, PIC's unaudited solvency ratio on the Solvency II basis was 167% (2017: 160%) and it had surplus funds which were £1,574 million (2017: £1,246 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 and Financial Condition Report covering both PIC and the consolidated Group. This is in place of submitting separate reports for each of PIC and the Group. Once submitted, the document will be published on the Company's website.

PIC solvency

	2018 unaudited £m	2017 £m
Net assets held in excess of best estimate liabilities ("BEL")	5,122	4,279
Risk margin net of transitionals	(1,205)	(951)
Own Funds	3,917	3,328
Solvency II capital requirements	(2,343)	(2,082)
Solvency II surplus	1,574	1,246
Solvency ratio	167%	160%

FINANCIAL REVIEW (continued)

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 target return on capital targets.

> Hedging strategy structured to protect regulatory solvency balance sheet:

- Interest rate, inflation and foreign exchange 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	2018	2017
As at 31 December 2018	167%	160%
25bps increase in interest rates[1]	6.1%	6.0%
25 bps reduction in interest rates[1]	(6.9)%	(6.5)%
£100 million credit default (no recovery)	(4.3)%	(4.8)%
5% reduction in base mortality[2]	(8.3)%	(9.3)%

1 This allows for a transitional measure for technical provisions recalculation.
2 Equivalent to a 0.4 year increase in life expectancy from 22.7 years to 23.1 years for a typical male aged 65.

Group Solvency II to MCEV reconciliation

31 December 2018 (£m)	Solvency II b/sheet	Allow for sub-debt	Recognise the frictional cost of required capital	Release (RM, DTL minus transitional), recognise CRNHR	Release MA margins	Tax on future profits	MCEV (£m)
Assets	30,220						
BEL	(24,957)						
Risk margin, DTL net of transitional	(1,323)						
Solvency II Own Funds	**3,940**						**3,940**
Present value of future profits				1,323	579	(413)	1,489
Cost of residual non-hedgeable risks (CRNHR)				(622)			(622)
Frictional cost of required capital			(207)				(207)
Subordinated debt		(962)					(962)
EV							**3,638**

Giles Fairhead
Chief Risk Officer

During 2018 we have continued to develop the risk function and framework. The business has grown significantly over 2018 and we have kept pace with this by developing our approach and increasing resource in key risk areas. We have added additional people into our credit monitoring team to assist with the oversight of the increasing diversity and volume of the more illiquid assets we have acquired, and the Chief Information Security Officer now reports to me providing us with an improved skill set to effectively manage and monitor cyber risk.

We have also enhanced our risk appetite metrics and improved our operational risk capabilities to allow us to monitor and manage our business risk more effectively. This is particularly important in a company which continues to grow quickly as it helps us ensure that the control environment is keeping pace with the increase in size of the balance sheet.

The key risks of 2018 remained relatively unchanged from 2017, with political uncertainty, low interest rates and cyber being the big issues for the year. Given the need for additional assets to support the higher volumes of new business in 2018, as well as the potential for a turn in the credit cycle, we have put time and resource into ensuring we maintain a portfolio with an appropriate credit quality. The market for good quality long-dated assets remains very competitive and so this will continue to be a key area of focus for 2019 and beyond. We have also built on our reputation for customer service by enhancing our conduct risk framework, with a focus on Treating Customers Fairly and supporting vulnerable customers.

Given the political uncertainties we have only seen limited volatility in our key financial risk metrics over the year. This is as a result of our strategy to ensure our balance sheet remains as stable as possible through hedging interest rate, currency and inflation risks. This programme of hedging exposes us to liquidity risk and this year we carried out a deep dive into our liquidity framework. This was to ensure we have appropriate levels of liquid assets in the business, which includes the assets required as collateral, as these derivatives absorb market movements.

We have a well-embedded liquidity framework, which includes a series of clear metrics for the business to manage to. This includes a full stress test of our liquidity needs, which ensures that we have enough liquidity to manage through market cycles. As we carried out our review we ensured that we considered various potential Brexit scenarios to gain comfort that we would maintain sufficient liquidity under even the most severe scenarios.

Our stress and scenario testing in 2018 focused on the potential for a downturn in the credit cycle and on operational scenarios. We focused not only the financial effects of a weaker credit environment but also the operational aspects of managing credit in a more challenging environment. The actions we are taking as a result of this review will leave us better placed should we see a turn in the cycle.

We also tested a wider range, of operational scenarios in 2018 looking at low-likelihood high-impact events, including failure of outsourcers and cloud providers to assist in our continued monitoring of the operational resilience of the business.

The outlook for 2019 looks similar: continued political uncertainty; potential headwinds in the credit market; and the need to focus on operational resilience, especially cyber risk. I believe that the work carried out in 2018 leaves us well placed to manage what is likely to be another busy year for PIC.

RISK MANAGEMENT

OUR APPROACH TO RISK MANAGEMENT

Sound risk management is key to PIC's business strategy. PIC's risk management framework ensures that the risks we take on in the pursuit of our strategic objectives are consistent with the Board's risk preferences and are managed in an appropriate way.

Risk management is embedded at PIC through the Enterprise Risk Management Framework, comprising our systems of governance, our policies, our risk appetite framework and the application of the risk management system:

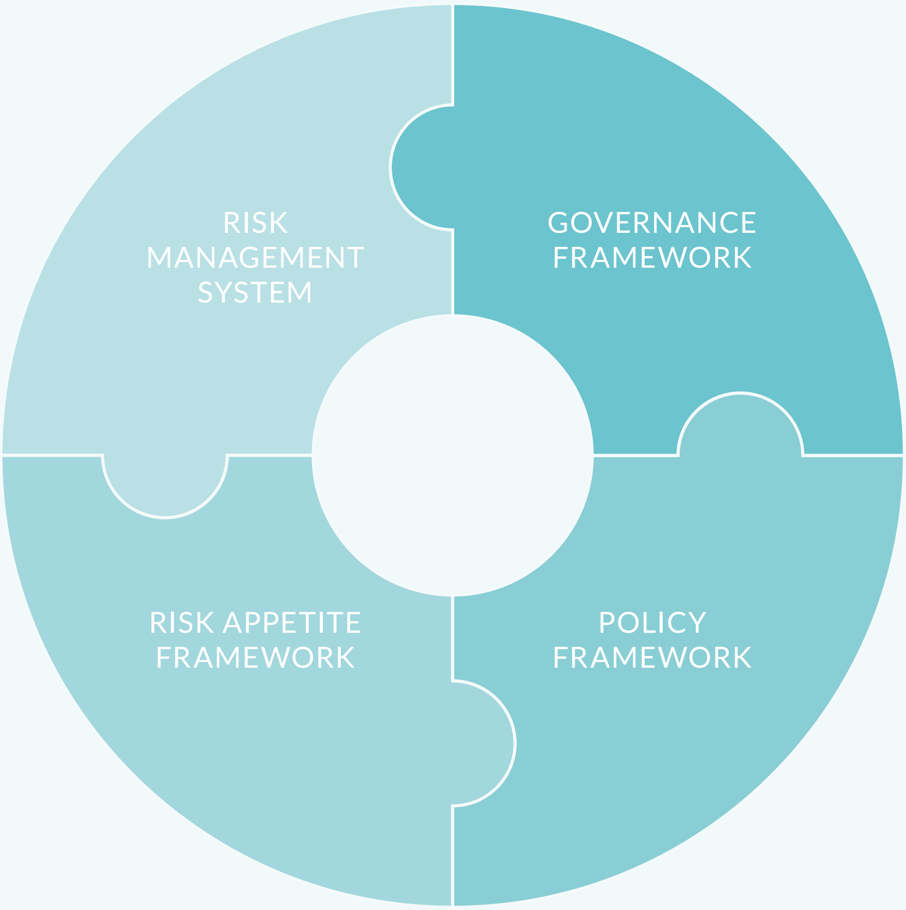
> the **Governance Framework** within which risk management responsibilities are delegated and governed, including the Three Lines of Defence model;

> the **Policy Framework** through which risk management expectations and requirements are embedded and consistently monitored across the business;

> the **Risk Appetite Framework** within which the Company's risk exposures are controlled and monitored in line with the Board's risk preferences and risk appetite; and

> the **Risk Management System** by which risks are identified, assessed, mitigated, monitored and reported throughout the Company.

Enterprise Risk Management Framework



RISK APPETITE FRAMEWORK

The Risk Appetite Framework considers the material risks to the business, its strategy and to PIC's reputation with key stakeholders (including policyholders, trustees, regulators and investors). It also includes risk metrics and limits within which the business operates, and outlines the roles and responsibilities of those who implement and monitor the Company's risk appetite.

BUSINESS STRATEGY

RISK STRATEGY
The Board's strategy for taking risk covering the types of risks we seek to minimise/avoid

RISK APPETITE STATEMENTS
Statements to support the risk strategy describing the amount and type of risk that PIC is willing to take in terms of key risk drivers

RISK PREFERENCES
Granular breakdown of preference for specific risks to which PIC is exposed to in pursuit of its long-term business goals

PRIMARY RISK APPETITE METRICS
Measurable limits to ensure that PIC achieves the aims set out in the Risk Appetite Statements – monitored by the Board Risk Committee and reported to the PIC Board

SECONDARY RISK APPETITE METRICS
More granular limits and constraints to support the Primary Risk Appetite Metrics – monitored by the Management Risk Committee and reported to the Board Risk Committee

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 SEEK RISKS THAT ARE:

> aligned with PIC's business strategy and expectations given to policyholders and other stakeholder groups;

> within the expertise, experience and capacity of PIC's staff to understand, price, monitor and manage;

> within the capabilities and capacity of PIC's systems to price, monitor and manage;

> expected to contribute to risk-adjusted return on the capital that PIC needs to hold against the risk;

> beneficial to enhancing diversification benefits (i.e. reducing the aggregated risk capital requirement) when viewed holistically across the business.

MINIMISE RISKS THAT ARE:

> necessary to incur as a by-product of exposure to the risks that PIC actively seeks;

> necessary to incur as a by-product of avoiding risks that PIC actively wishes not to be exposed to;

> 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").

AVOID OR TRANSFER RISKS WHICH:

> give rise to undue concentration of risk within PIC's portfolio;

> jeopardise PIC's ability to meet obligations to policyholders, staff and other stakeholders;

> are terminal to the strategy of PIC should they arise;

> are not within the experience, expertise and capacity of PIC's staff to price, understand, monitor and manage;

> are not within the capabilities and capacity of PIC's systems to price, monitor and manage.

RISK MANAGEMENT (continued)

RISK APPETITE

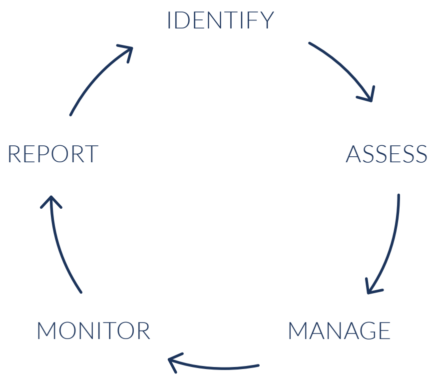
PIC's Risk Appetite Framework is closely aligned with its business strategy. This is defined for the medium term (typically three to five years) and reviewed annually.

The Company has developed primary and secondary 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. If one of the risk appetite metrics passes through a threshold or limit, it necessitates escalation and appropriate action.

RISK MANAGEMENT SYSTEM

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.

Risk Management System



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 appropriate solvency capital requirement ("SCR") for the business to mitigate the impact of these risks on PIC and its policyholders.

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, beyond the 12-month horizon of the SCR calculation, are not included within PIC's internal model. Instead, these are measured by considering their impact as part of the stress and scenario testing programme, and discussed in risk and solvency reports such as the Own Risk and Solvency Assessment ("ORSA"). The Risk spotlight on page 53 provides more detail on how PIC identifies and manages one of its key risks, conduct risk.

MANAGEMENT INFORMATION

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

OWN RISK AND SOLVENCY ASSESSMENT

The ORSA assessment provides an ongoing process to identify, assess, monitor and manage the risks to PIC's business plan and solvency over both the near term and the five-year business planning horizon.

The ORSA activities include:

> The assessment of the Company's current and projected risks;

> Assessment of risk mitigation, including capital and liquidity buffers;

> Stress and scenario testing, including reverse stress testing; and

> Strategic planning and financial projections.

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

RISK SPOTLIGHT

CONDUCT RISK

Given PIC's business model, appropriate identification and management of conduct risk is critical to ensure that our policyholders are protected and can continue to trust PIC to operate with integrity.

PIC defines conduct risk as:

"the risk that at any point in the business and policyholder lifecycle, PIC's business practice or behaviour:

> leads to unfair or poor outcomes for customers;

> brings the integrity of the markets in which we operate into question; and

> contributes to markets in which we operate failing to work well."

PIC provides secure and stable retirement incomes for our policyholders through leading customer service, comprehensive risk management, and excellence in asset and liability management. Our business has been built on providing good outcomes for customers and doing the right thing. This is at the heart of conduct.

We take our responsibility in the market and towards our policyholders very seriously. We recognise that we have an important role to play both for businesses, in reducing their risks and balance sheet liabilities, and for policyholders, insuring their pension benefits. We also play a part in ensuring integrity in all our dealings in the financial markets. This is particularly important given the number of potentially vulnerable customers in our policyholder base, and we continue to work towards good outcomes for policyholders in vulnerable circumstances.

The Board and CEO lead the way in championing Treating Customers Fairly and ensuring that we manage conduct risk across the business. The following is a statement from our Executive Committee:

"We are fully committed to treating our customers fairly at PIC. Customers are at the heart of our values, and indeed everything we do considers the fair treatment of customers. We have defined the purpose of our business, which is to pay the pensions of our policyholders. Conduct risk is essentially the risk that we fail to deliver this, or that as we go about our business our behaviour or conduct has a negative impact on customers or the integrity of the market. Conduct risk is a term that covers every area of our business and is everyone's responsibility. At any stage of carrying out our business, there is the potential to create good or poor outcomes for customers or the market. Understanding where the risks of poor customer or market outcomes lie is essential to enable proper risk management, monitoring and mitigation.

We are aware of the key role we play in ensuring market integrity in all our dealings with the financial markets. This includes conflicts of interest, pricing activities, sensitive market information in relation to new deals and market abuse around our investment activities.

It is important that we know 'what good looks like' and can define, document and evidence good customer and business outcomes. To do this, we will focus our attention on ensuring that conduct risks are clearly identified, managed, monitored and mitigated."

The tone from the top is supported by our framework documentation, including our policy and conduct risk principles, governance and control measures and management information. We manage and identify conduct risks through the process of mapping and monitoring policyholder touchpoints across the business.

The Board, the business and the risk team have focused significant attention on conduct risk and Treating Customers Fairly, enhancing our conduct risk framework to ensure that it continues to be robust as we scale and grow the business and the number of policyholders we serve increases.

PRINCIPAL RISKS AND UNCERTAINTIES

MITIGATING OUR KEY RISKS

The principal risks to the Company, and its strategy for managing those risks, are set out below. More details are also included in Note 15 to the financial statements.

RISKS AND UNCERTAINTIES	TREND AND OUTLOOK	MITIGATION
Political risk–political and/or regulatory intervention.	While defined benefit pensions remained on the political and regulatory agenda during 2018, the greater focus has continued to be on the implications of the UK's decision to leave the EU. Consultations continue around the UK Government's plans for defined benefit pension scheme consolidation, with further clarity expected during 2019.	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. A key consideration of the 2018 ORSA process has been around the risks associated with the UK leaving the EU and the potential impact that this may have on PIC's business model and its policyholders. This has included scenario assessments to assess whether appropriate controls are in place to ensure that PIC's contractual relationships with various stakeholders continue to operate as intended post Brexit, including the ability to pay policyholders, relationships with banking and reinsurance counterparties and legislation around data security. Scenarios have also been tested considering potential macro-economic impacts to ensure adequate controls are in place to mitigate the potential balance sheet impacts of market movements on PIC's solvency and liquidity position in a worst-case Brexit scenario.
Market risk – impact of market and/or economic volatility on PIC's capital position.	Uncertainty around the near-term UK economic growth outlook remains heightened – despite improving economic data – as Brexit continues to crowd the macro outlook. At a global level, risks include geopolitical risks from protectionist measures, a slight weakening of global trade, emerging market weakness, higher oil prices and potential for a late-cycle correction from an abrupt tightening of monetary conditions.	Close management of PIC's balance sheet, such that the Company actively hedges its balance sheet against adverse movements in financial markets. 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.
Default risk – on credit/debt assets in the portfolio.	While PIC has historically experienced very low levels of default in the portfolio (see page 39 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. Provisions are held for defaults and downgrades in addition to the risk-based capital requirements.
Counterparty risk – the possibility of failure by our reinsurance and swap counterparties, 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 only transacts with highly rated reinsurance counterparties, and includes collateral provisions to improve overall security. Interest rate swaps 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.

RISKS AND UNCERTAINTIES	TREND AND OUTLOOK	MITIGATION
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, with the slowdown in mortality improvements considered to be a change in trend as opposed to a one-off event. The drivers of the slowdown are believed to be a combination of the increased strain on the NHS and social care budgets, and a change in morbidity prevalences including influenza and dementia, offset by changes in lifestyle and health monitoring as technology continues to provide new opportunities.	PIC regularly reviews its longevity experience to ensure its 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 approved internal model. PIC aims to reinsure more than 60% of its longevity risk exposure. As at 31 December 2018, PIC had reinsured 74% of its total longevity exposure.
Cyber risk – the financial services sector is increasingly becoming a target for cyber crime. This might include the risks that third parties 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 carries out regular monitoring to proactively address emerging threats. The IT environment is regularly tested internally and externally to maintain awareness of the latest threats and how these might impact PIC.
Conduct risk – the risk that PIC policyholders receive a poor outcome.	PIC now has 192,100 policyholders whose pensions we administer. We also have a significant number of vulnerable customers. PIC has historically achieved excellent levels of customer service. The challenge is to maintain standards of service and ensure good outcomes for policyholders across the customer lifecycle despite increased numbers of policyholders.	PIC continues to embed its conduct and Treating Customers Fairly frameworks. This includes a focus on defining and evidencing good customer outcomes, and identifying and supporting vulnerable customers.

The Strategic Report on pages 1 to 55 was approved by the Board and signed on its behalf by:

Jon Aisbitt
Chairman

14 Cornhill
London
EC3V 3ND

6 March 2019

OUR VALUES

BEING A TEAM

CORPORATE GOVERNANCE

In this section

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.

CHAIRMAN'S INTRODUCTION

DRIVING PERFORMANCE THROUGH CULTURE

AS CHAIRMAN, WHAT IS YOUR VIEW ON THE ROLE OF GOVERNANCE?

The role of governance is vital in underpinning a sustainable, long-term strategy for the business that offers secure pensions to our current and future policyholders and long-term returns to our investors. Governance, at its best, means having a dynamic framework based on strong values that allows substantive decisions in real time, and which pays due regard to the needs of all stakeholders, including policyholders, employees, investors and others. The Board's leadership in this area means that the Group's business units operate within a clearly defined risk appetite framework, allowing prudent, timely decisions to be made.

During the year, we restructured the Board's committees to increase effectiveness and collaboration. This was driven by the rapid development and increased complexity of the business over the past few years. The Board reports on the following pages give some insight into the rationale for this.

It is also worth noting that we have a seasoned, skilled Board with a wealth of industry expertise, as well as enough outside business experience to provide perspective and challenge.

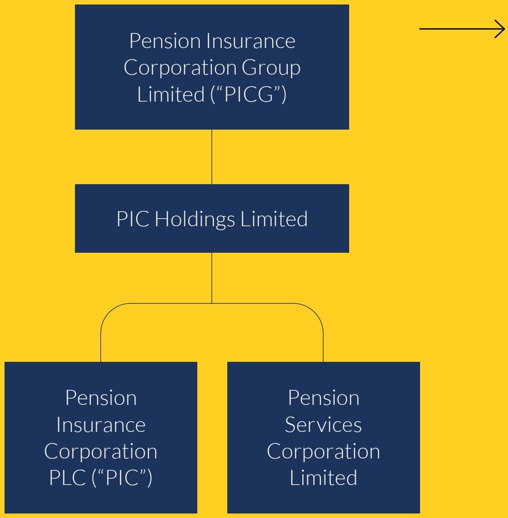
THE BOARD IS ACCOUNTABLE FOR THE MANAGEMENT OF RISK AT PIC. HOW DOES THE BOARD MANAGE THIS?

Risk management is of profound importance to the Group in fulfilling our purpose of paying the pensions of current and future policyholders. The Board therefore has a key role in setting the overall risk management framework and providing challenge to executives, as well as ensuring the effectiveness of the Group's risk management function.

A key focus for the Board in 2018 in this area was conduct risk, and the Board approved a new conduct risk framework and policy during the year. The Board also encouraged the business to invest further in risk management tools and techniques.

Finally, as a key area for supporting new business growth, and one in which the Group has now developed considerable presence, the Board reviewed our private debt investment processes and documentation. Given the nature of these assets, which typically have a tenor of decades, it is vital that our investment strategy sits firmly within our risk appetite.

Group structure



Committed shareholder base

Key shareholders	Shareholding (%)
Reinet Investment S.C.A.	43.7
CVC	17.3
Luxinva	17.1
Legend Holdings	5.3
Istithmar	4.7
Swiss Re	4.3

DOES THE GROUP HAVE DIVERSITY INITIATIVES AND ARE THEY LINKED TO THE ORGANISATIONAL STRATEGY?

Management have long been focused on the importance of diversity, including gender and ethnicity, within the Group, and the business has sponsored, for the second year, the cross-industry Actuarial Mentoring Programme for female actuaries, run in conjunction with the Institute and Faculty of Actuaries.

There has been some turnover of Directors during the year, somewhat impacting the gender diversity of the Board. We do, however, have a strong group of experienced Directors with deep technical expertise and the experience to challenge management. The new regulatory regime places significant responsibilities on individuals and this adds additional pressure to recruitment issues. We will, nevertheless, be looking to address the issue of gender diversity of independent non-executive directors in 2019.

HOW DOES THE BOARD ENSURE EMPLOYEES UNDERSTAND THE COMPANY’S VALUES?

The Group has a strong culture and values, which flow from our purpose. Whilst we have many employees who have been with the Company for five or more years, the Company has also grown rapidly, taking on significant numbers of new staff over the past couple of years. Our values are embedded from the beginning starting with the recruitment process, as we look to employ people who will benefit from, and enjoy, working for the Group.

For existing staff, we have an extended suite of training modules on everything from cyber risk to understanding our values. At the same time, and unusually for a private company, we run an employee share scheme, aligning interests. I am delighted that so far our employee shareholders have seen the value of their investment rise consistently. This will only be maintained over the long term through a continued focus on growing the business within a strong risk management framework and continuing to ensure that the interests of our policyholders are central to all that we do.

BOARD OF DIRECTORS

THE RIGHT SKILLS AND EXPERIENCE TO DELIVER OUR STRATEGY

	JON AISBITT	TRACY BLACKWELL	STUART KING
	Chairman of the Board and Chairman of the Nomination Committee	**Chief Executive Officer**	**Independent Non-Executive Director**
	PIC & PICG Director	**PIC & PICG Director**	**PIC & PICG Director**
Date of appointment	Jon was appointed to the Board as a Non-Executive Chairman in October 2016.	Tracy was appointed to the Board as an Executive Director in July 2011 and appointed as Chief Executive Officer in July 2015.	Stuart was appointed to the Board in January 2019.
Background and career	From 2007 until May 2016, Jon was Chairman of Man Group plc, the FTSE250 provider of alternative investment products with over $70 billion under management. Prior to joining Man Group plc, Jon was a Partner and Managing Director in the Investment Banking Division of Goldman Sachs based in New York, London and Sydney. He was previously Deputy Chairman of Ocean Rig plc and Honorary Treasurer of the NSPCC. He is a member of the Institute of Chartered Accountants of England and Wales.	Tracy was Chief Investment Officer on joining PIC in 2006 and had overall responsibility for managing PIC's asset and liability management strategy. Prior to joining PIC, Tracy spent 10 years at Goldman Sachs Asset Management, where she held a variety of roles including Head of Risk Management, EMEA and was an executive director in Goldman Sachs International's Pension Services Group, which involved advising large European and UK pension funds and insurance companies. In 2013, Tracy was appointed a Non-Executive Director at United Trust Bank.	Stuart has previously worked at the Bank of England before moving to become Head of UK Banks Regulation and then Head of Major Insurance Groups Regulation at the Financial Services Authority ("FSA") (predecessor of Financial Conduct Authority). After his time at the FSA, Stuart became Managing Director at advisory firm Promontory Financial Group and after that Group Compliance Director at Aviva plc.
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. While Chairman of Man Group, Jon navigated the Company and the Board through significant change through the introduction of new and diversified investment styles.	Tracy has 20 years' experience in asset management including over eight years at Goldman Sachs working in interest rate and foreign exchange derivatives, risk management and pension and insurance strategy. Tracy has a strong knowledge and understanding of the regulatory landscape.	Stuart has over 25 years' experience working in the UK financial regulation industry as both regulator and at regulated firms and led the enhanced supervision approach of major insurance groups following the financial crisis in 2007.
Current and external roles	Jon is a director of New Forests Company Holdings Limited (African sustainable forestry and timber processing) and a Non-Executive Director of Ascension Healthcare plc (biotechnology).	Tracy is a Non-Executive Director of United Trust Bank. Tracy is also Honorable Treasurer of the Elton John AIDS Foundation.	Stuart remains an external advisor for financial services firms.
Committee membership	Jon is Chair of the Nomination Committee and a member of the Remuneration Committee. He attends Audit, Risk and Investment & Origination Committee meetings by invitation.	Tracy is an Executive Director. She attends Audit, Risk, Nomination and Remuneration, and Investment & Origination Committee meetings by invitation.	Stuart is a member of the Audit Committee.

Committee memberships:

X Chairman
N Nomination Committee
R Remuneration Committee
AU Audit Committee
O Investment & Origination Committee
RI Risk Committee

O RI

ARNO KITTS

Independent Non-Executive Director and Chairman of Investment & Origination Committee

PIC & PICG Director

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

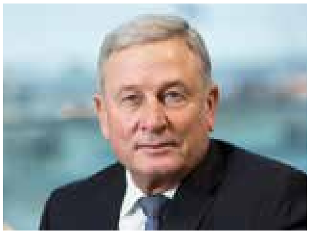
Arno is a Non-Executive Director and Chair of PIC's Investment & Origination Committee.

Arno's previous roles include Managing Director of Blackrock's £250 billion UK institutional business, Head of the Henderson Global Investors global distribution and Head of JPMorgan's Asset Management UK institutional business. Arno was a JPMorgan Managing Director, responsible for institutional and defined contribution business and he was the Chief Executive Officer of the JPMorgan Life business. He served as a Director of Alphagen Capella Fund Limited and was a former Board member of the Pensions and Lifetime Savings Association (PLSA). Arno is a Fellow of the Institute of Actuaries and holds a PhD from Southampton University.

Arno has been involved in investment management since 1989, including seven years as Head of Investments of an insurance company. Arno was a Member of the Council and Finance & Investment Board of the Actuarial Profession and is actively involved in industry matters as a member of the PLSA Defined Benefit Council.

Arno is the founder of Perspective Investments, an investment management fund and is also a Non-Executive Director of Wake Trade Technologies.

Arno is Chair of the Investment & Origination Committee. He is also a member of the Risk Committee.



JOSUA MALHERBE

Non-Executive Director Shareholder nominated by Reinet

PICG Director

Josua was appointed to the Board as a Non-Executive Director in December 2015.

Josua qualified as a chartered accountant in South Africa in 1984 having worked at a predecessor firm to PricewaterhouseCoopers. Josua became Chief Executive Officer of VenFin Limited in 2000 until 2006 when he held the position of Deputy Chairman. VenFin Limited was acquired by Remgro Limited and Josua now serves as Deputy Chairman of Remgro.

Josua has over 30 years' experience in Corporate Finance and has had executive experience at companies since 1993.

Josua is Deputy Chairman of Remgro Limited and Compagnie Financière Richemont SA. and is a Non-Executive Director at Reinet Investments SCA.

N/A

AU RI

ROGER MARSHALL

Senior Independent Director and Chairman of the Audit Committee

PIC & PICG Director

Roger was appointed to the Board as an Independent Non-Executive Director in April 2015.

Roger was a member of the Financial Reporting Council Board (FRC), member of the FRC Codes and Standards Committee and member of the FRC Corporate Reporting Council. He spent much of his career in PricewaterhouseCoopers, where he was an audit partner in London and Zurich. Roger chaired PwC's Global Audit Policy Board in 2003-2007 and its global Corporate Reporting Task Force in 2008-2009. He left PwC in 2009 and now serves on several Boards and committees including Old Mutual plc, where he is Chair of the Audit Committee. Roger is a Fellow of the Institute of Chartered Accountants in England and Wales.

Roger spent almost 40 years at PwC and six years on the Accounting Standards Board refining his skills and experience in the risk management, compliance, finance and audit functions in the financial services industry.

Roger serves on the Boards of European Financial Reporting Advisory Group, Old Mutual Public Limited Company.

Roger is Senior Independent Director, Chair of the Audit Committee and member of Risk Committee.

N O R

JEROME MOURGUE D'ALGUE

Non-Executive Director Shareholder nominated by Luxinva

PIC & PICG Director

Jerome was appointed to the Board as a Non-Executive Director in November 2018.

Jerome holds an MBA from the Wharton School and a BA from ESSEC. Jerome was previously an Associate at McKinsey & Company and Vice President of Morgan Stanley Capital Partners in London. Jerome was a Partner at private equity firm Englefield Capital LLP. Jerome has been an employee of Abu Dhabi Investment Authority (ADIA) since 2012, joining as Senior Portfolio Manager, Principal Investments before becoming Head of Financial Services, Private Equities in 2017 and Head of EMEA, Private Equities in 2018.

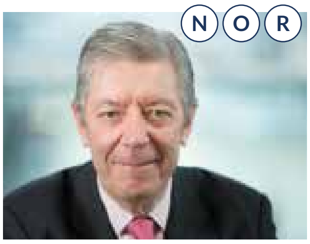
Jerome has spent 25 years working in the financial services industry with a strong background in asset management.

Jerome is currently Head of EMEA, Private Equities at ADIA and represents ADIA on the boards of various entities ADIA has invested in.

Jerome is a member of the Nomination and Remuneration Committees and Investment & Origination Committee

BOARD OF DIRECTORS (continued)

THE RIGHT SKILLS AND EXPERIENCE TO DELIVER OUR STRATEGY



	ELOY MICHOTTE	PETER RUTLAND	STEVE SARJANT
	Non-Executive Director Shareholder nominated by Reinet	**Non-Executive Director and Shareholder nominated by CVC**	**Independent Non-Executive Director and Chairman of the Risk Committee**
	PIC Director	**PIC & PICG Director**	**PIC Director**
Date of appointment	Eloy was appointed to the Board as a Non-Executive Director in October 2012.	Peter was appointed to the Board as a Non-Executive Director in May 2017.	Steve was appointed to the Board as an Independent Non-Executive Director in November 2014.
Background and career	Eloy was previously an Executive Director of Reinet Investments Manager S.A. and Reinet Fund Manager S.A. and Group Director of Corporate Finance for Compagnie Financière Richemont SA. He graduated in engineering and applied mathematics from the University of Louvain in Belgium and holds an MBA from the University of Chicago.	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. Peter has had previous roles for Goldman Sachs in the Investment Banking Division. Peter holds an MA Degree from the University of Cambridge and an MBA from INSEAD.	Steve spent 20 years at Towers Watson (previously Watson Wyatt) in a number of roles including London practice leader and member of the global management team for Watson Wyatt's insurance and financial service practice. Prior to joining Towers Watson, Steve worked at Criterion Assurance Group and National Provident Institution in a variety of roles. He graduated from the University of Bristol with a BSc in Mathematics in 1982 and subsequently trained as an actuary. Steve is a Fellow of the Institute and Faculty of Actuaries.
Areas of expertise	Eloy has extensive experience in international business and finance, having worked with Ford, McKinsey & Co and Bankers Trust Company prior to joining Richemont at the time of its formation in 1988.	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.	Steve has over 30 years' experience in the financial services industry including 20 years spent as an actuarial consultant at Towers Watson (previously Watson Wyatt), where he was a Managing Director in their Risk and Financial Services segment and Global Leader, Mergers and Acquisitions.
Current and external roles	Eloy is Reinet's appointed representative on behalf of Reinet PC Investments (Jersey) Limited.	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 a number of boards of companies CVC holds interests in.	Steve is a Non-Executive Director and Chair 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	Eloy is a member of the Investment & Origination, Nomination and Remuneration Committees.	Peter is a member of the Nomination and Remuneration Committees, and Investment & Origination Committee.	Steve is Chair of the Risk Committee and member of the Audit Committee.

Committee memberships:

- X Chairman
- AU Audit Committee
- N Nomination Committee
- O Investment & Origination Committee
- R Remuneration Committee
- RI Risk Committee

ROB SEWELL

Chief Financial Officer

PIC Director

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

Rob was previously Chief Executive of National Westminster Life Assurance and was the Finance Director for Legal & General Group's UK businesses. Rob is a Fellow of the Institute of Chartered Accountants in England & Wales.

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

Rob serves as a Non-Executive Director of HCT Group and Chair of its Audit Committee.

Rob is an Executive Director. He attends Investment & Origination, Audit and Risk Committee meetings by invitation.

AU N R

MARK STEPHEN

Independent Non-Executive Director

PIC & PICG Director

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

Mark was previously a partner at PricewaterhouseCoopers LLP where he led the insurance Consulting business and latterly was UK Insurance Industry leader. His clients included many leadinginsureres in the UK, Switzerland and South Africa. Mark left PWC in 2013 and now serves on the board of TransRe London where he chairs the investment committee and also on the Board of Hyperion Insurance Group Limited where he chairs the Audit Committee and the Remuneration Committee. Mark graduated from Royal Holloway College University of London with a BSc in Biochemistry and Chemistry and subsequently qualified as a chartered accountant.

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.

Mark serves as a director of TransRe London Limited. He is also a director of Hyperion Insurance Group Limited.

Mark is a member of the Audit Committee and the Nomination and Remuneration Committees.

RI

WILHELM VAN ZYL

Non-Executive Director
Shareholder nominated by Reinet

PIC & PICG Director

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

Wilhelm is the Chief Executive of Reinet Investments Manager S.A. and Reinet Fund Manager S.A. Prior to this Wilhelm was group actuary of the financial services group Metropolitan Holdings from 2001 and headed up its corporate business from 2006. In 2008 he was appointed as chief executive of Metropolitan Holdings. Following the listing of MMI Holdings in 2010, resulting from the merger between Metropolitan and Momentum, he was appointed as deputy group chief executive. 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.

Wilhelm has a strong background in the financial services sector in South Africa and overseas along with experience in investment strategy.

Wilhelm serves on the boards of directors of various Reinet entities.

Wilhelm is a member of the Risk Committee.

LEADERSHIP AND EFFECTIVENESS

THE ROLE OF THE BOARD

Pension Insurance Corporation Group Limited ("PICG"), the holding company, and Pension Insurance Corporation plc ("PIC") are each led by a Board of directors (the "Board") who are appointed pursuant to the Articles of Association. There is an overlap in membership of the Boards shown in the table on page 67 which lists directors who served during the year. The directors have the benefit of the Company's Directors' and Officers' indemnity insurance policy.

The Board's primary focus is on promoting the sustainable long-term success of both PIC and PICG (the "Group") and providing leadership within a framework of prudent and effective controls which enable risks to be assessed and managed. The Board promotes 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 Group'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.

DIVISION OF RESPONSIBILITIES

The responsibilities of the directors are clearly defined and agreed by the Board. This has been reinforced by the introduction of the Senior Managers and Certification Regime ("SMCR") in December 2018.

Role	Name	Responsibilities
Chairman	Jon Aisbitt	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 leads on the development of culture by the Board as well as the development and monitoring of the effective implementation of policies and procedures for the succession planning, induction, training and development of directors.
Chief Executive Officer	Tracy Blackwell	Tracy leads the executives in the day-to-day management of the business and effective implementation of Board decisions. Tracy is responsible for the Group's performance of its obligations under the SMCR regime, adoption of the culture in business as usual, outsourcing arrangements and the Group's obligations in respect of individual conduct rules for training and reporting.
Senior Independent Director	Roger Marshall	Roger acts as a sounding board for the Chairman and a trusted intermediary for the other directors and shareholders. Roger also acts as Chairman of the Audit Committee. Additionally, in his role as the Whistleblowing Champion he guards the independence, autonomy and effectiveness of the Group's policies and procedures on whistleblowing.
Chief Financial Officer	Rob Sewell	Rob is responsible for the financial and actuarial matters of the Group, including management, allocation and maintenance of the capital, funding and liquidity. He also manages and oversees the production and integrity of the firm's financial information and its regulatory reporting.
Non-Executive Directors	Stuart King Arno Kitts Eloy Michotte Josua Malherbe Jerome Mourgue D'Algue Peter Rutland Steve Sarjant Mark Stephen Wilhelm Van Zyl	Non-executive directors provide challenge to the Board, scrutinise performance of the Group and play key roles in the functioning of the Board committees.
Company Secretary	Louise Inward	Louise, through the Chairman, is responsible for advising the Board on all governance matters, ensuring that Board procedures are complied with and helping the Board and committees to function efficiently. She makes sure that there is a good information flow between the Board, its committees and senior management and non-executive directors.

BOARD MEETINGS

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 PIC Board meets at least five times a year. Two of those meetings are held jointly with the PICG Board to allow all-encompassing discussions of the key matters such as Group's strategy and business plan, annual report and financial statements and matters raised by the four assurance functions: Risk, Internal Audit, Actuarial function and Compliance. The PICG Board meets at least three times a year.

At each meeting, the Board receives updates from the Chief Executive Officer, Chief Financial Officer and other executives on the execution of the strategy, performance against plan and the policyholder administration. The Board also reviews regular executive reports from different business areas, including matters relating to the 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, Investment & 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. In addition to regular matters, the Board and committees also debate other topics arising in the course of business in any given year. These are outlined on pages 66 and 67.

CULTURE

The Board and the Group believe that culture is key to the delivery of its strategy and business model. The Board, under the Chairman's leadership establishes and endorses culture, which safeguards the Group's values by promoting attitudes and behaviours of high ethical standards and integrity in every day conduct of the business. The Board's purpose is to oversee and monitor the embeddedness of the culture and to hold the executives accountable, where there is a misalignment of the existing culture with the Group's purpose and values.

The Group's values continue to drive performance and help attract new business, build strong relationships with policyholders, trustees, employees and other stakeholders. More on our stakeholder engagement can be found on pages 13 to 18.

BOARD EFFECTIVENESS

Board composition and independence

The PIC Board is currently composed of an independent Chairman, Chief Executive Officer, Chief Financial Officer and nine non-executive directors, five of whom are independent and four of whom have been nominated by major shareholders of the Group. The PICG Board comprises the same Chairman as the PIC Board, Chief Executive Officer and eight non-executive directors, four of whom are independent and four nominated by major shareholders of the Group. The Board has spent time in 2018 recruiting additional independent non-executive directors.

In 2018, the following changes occurred on the Board. Nick Lyons stepped down from the PIC and PICG Boards on 31 July 2018. Tim Hanford resigned from PIC and PICG Boards on 18 October 2018 following the sale of J.C. Flowers' shareholding in PICG to Luxinva, a wholly owned subsidiary of Abu Dhabi Investment Authority ("ADIA"). He was replaced by Jérôme Mourgue D'Algue, who is Luxinva's representative.

Amanda Bowe stepped down from the PIC Board on 6 December 2018. Ed Giera, Mike Eves and Jing Li resigned from the PICG Board with effect from 31 December 2018.

Stuart King joined both PIC and PICG Boards on 1 January 2019. At least one other independent non-executive director is expected to join both Boards during the course of 2019.

Attendance at Board meetings

Each director is expected to attend all Board meetings and committee meetings of which he or she is a member. All meetings are planned at least a year in advance except for meetings which may be required ad hoc to address evolving business needs. In order to ensure that the Board operates effectively, directors' time commitments are assessed on appointment and on an ongoing basis. Any new appointments the directors wish to accept require clearance with the Chairman and the Company Secretary. At present the Board is satisfied that all non-executive directors are able to dedicate sufficient time to the Group's business.

Evaluation and development

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 Group. The Chairman encourages and supports each director to regularly update and refresh their skills and knowledge. The Group arranges a formal induction for all new directors and there is a Board training programme in place. The induction covers a series of sessions with each area of the business and follow-up sessions on areas of particular interest or unfamiliarity to the joining director. The training programme contains mandatory courses and specialised teach-ins, which assist directors with the understanding of the evolving business and changing regulatory landscape.

LEADERSHIP AND EFFECTIVENESS (continued)

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. The last external evaluation took place in 2017. In 2018, the Board and committees self-assessed their effectiveness. The process entailed a completion of a questionnaire and the preparation of the report, which was discussed at the Board meeting in December.

The areas of focus included the Board and committees structure, Board composition, induction, training and succession planning, Board process, strategy, Board behaviours, understanding of the Own Risk and Solvency Assessment (the "ORSA") and Chairman's performance.

The key strengths and areas for development for the Board identified in the self-assessment are listed below.

Areas for Board development from 2017 evaluation	Actions taken
Further development of understanding of new asset classes and how these could support the Company's new business pipeline	The committees and the Board considered and approved the new asset class strategies to increase PIC's competitive advantage.
The Board is committed to diversity through its Board Diversity Policy and needs to concentrate on implementation of that policy	A pool of diverse candidates is always considered. However, with the recent departures of Amanda Bowe from the PIC Board and Jing Li from the PICG Board, we are focussed on improving gender diversity on our Boards.

Board strengths

> The Board oversees the business effectively and constructively challenges the executive and senior management team

> The Board and committees structure was reviewed in 2017 and refreshed in 2018, which brought further clarity to the division of responsibilities

> The Board has a good understanding of PIC's culture and purpose, and is effective in taking business decisions

> There is a good understanding of the ORSA among directors

Areas for Board development

> There is a need to improve visibility to the Board of the succession planning activities undertaken by the Group and Nomination and Remuneration Committees.

> Further work is required on Board diversity, in particular given the recent changes to both PIC and PICG Board, which are noted on page 65.

> More time is needed for substantive discussions by the Board and more focus on key issues and long-term vision and strategy. This is being addressed by extending Board and committee meetings for 2019.

Board activities in 2018

In 2018, the PIC Board held six scheduled and eight ad hoc meetings, and attended to a number of matters by written resolution. The PICG Board held three scheduled meetings (two of which were held jointly with the PIC Board) and met twice to attend to ad hoc matters. It also passed several written resolutions during the year.

Some of the key matters considered at the meetings by the Boards are listed below.

> **Q1 2018** – considered several large business deals, the new business pipeline and reinsurance overall; reviewed and approved the internal model change application; reviewed the Internal Model Consolidated 2017 Validation Report; approved the 2018 Validation Plan; received annual written assessment on PIC Group controls, risk, management and governance processes; reviewed and approved the Actuarial Valuation Report, Annual Report and Financial Statements, MCEV Report, and the ORSA 2017 Report; approved the Remuneration Policy Statement and share schemes launch; and reviewed material outsourcers for the Group, particularly those covering the administration and IT services.

PIC and PICG Board attendance at scheduled meetings in 2018

Entity	PIC/ PICG	PIC 30/1	PIC/PICG 21/3	PIC 21/5	PIC 18/7	PIC 26/9	PICG 3/10	PIC/PICG 6/12	PIC	PICG
Jon Aisbitt	PIC/PICG	●	●	●	●	●	●	●	6/6	3/3
Tracy Blackwell	PIC/PICG	●	●	●	●	●	●	●	6/6	3/3
Amanda Bowe[1]	PIC	●	●	●	●	●	n/a	●	6/6	
Mike Eves[2]	PICG	n/a	●	n/a	n/a	n/a	●	●		3/3
Ed Giera[2]	PICG	n/a	●	n/a	n/a	n/a	●	●		3/3
Tim Hanford[3]	PIC/PICG	apologies	●	●	●	●	●	○	4/5	2/2
Arno Kitts	PIC/PICG	●	●	●	●	●	●	●	6/6	3/3
Jing Li[2]	PICG	n/a	●	n/a	n/a	n/a	apologies	●		2/3
Nick Lyons[4]	PIC/PICG	●	●	●	●	○	○	○	4/4	1/1
Josua Malherbe	PICG	n/a	apologies	n/a	n/a	n/a	●	●		2/3
Roger Marshall	PIC/PICG	●	●	●	●	●	●	●	6/6	3/3
Eloy Michotte	PIC	●	●	●	●	●	●	●	6/6	3/3
Jerome Mourgue D'Algue[5]	PIC/PICG	○	○	○	○	○	○	●	1/1	1/1
Peter Rutland	PIC/PICG	●	●	apologies	●	●	●	●	5/6	3/3
Steve Sarjant	PIC	apologies	●	●	●	●	n/a	●	5/6	
Rob Sewell	PIC	●	●	●	●	●	n/a	●	6/6	
Mark Stephen	PIC/PICG	●	●	●	●	●	●	●	6/6	3/3
Wilhelm Van Zyl	PIC/PICG	●	●	●	●	●	●	●	6/6	3/3

● On the Board ○ Not on the Board

1 Amanda Bowe resigned with effect from 6 December 2018
2 Mike Eves, Ed Giera and Jing Li resigned with effect from 31 December 2018
3 Tim Hanford resigned with effect from 18 October 2018
4 Nick Lyons resigned with effect from 31 July 2018
5 Jerome Mourgue D'Algue was appointed with effect from 20 November 2018

> **Q2 2018** – approved the change of outsourced administration provider and associated expense budget, the Vulnerable Customers Policy and the ORSA stress and scenario test plan 2018; reviewed the Group's competitive advantage, looking at sourcing of assets, and approved the real assets strategy; and reviewed the Group's strategy, IT strategy and security.

> **Q3 2018** – considered new large business deals, planning for Brexit and a review of asset portfolio implementation versus pricing of business; reviewed succession planning and talent management and approved an appointment of two new non-executive directors; discussed ongoing oversight of the embeddedness of the Group's culture and values; approved changes to the corporate governance structure; considered the Group's leverage risk appetite and approved the issuance of the tier 2 hybrid debt; received a report on the migration of policyholder administration; reviewed the 2019 business plan; approved the change of one of the major shareholders; and discussed the cyber risk framework and cyber security benchmark.

> **Q4 2018** – approved the 2019 business plan and expense budget; oversaw the implementation of the Senior Managers and Certification Regime; reviewed the migration of the administration services to the new provider; reviewed the actuarial annual report from the Actuarial Function Holder; received an update on Brexit planning; reviewed a report on brand and reputation matters; considered the annual integrated assurance report and report on illiquid assets; set the annual remuneration parameters; and discussed the results of the Board and committees effectiveness review.

LEADERSHIP AND EFFECTIVENESS (continued)

The Board delegates specific responsibilities to the Board committees, which assist the Board in its oversight and control of the business. To improve the effectiveness of the Board's oversight, in 2018, the Board decided to merge the Asset and liability Management Committee and the Origination Committee into the new Investment & Origination Committee, and appoint Steve Sarjant to the Audit Committee.

As a result of that change, there are currently four Board committees: Audit, Risk, Nomination and Remuneration and Investment & Origination. The Investment, and Origination Committee considers matters specific to PIC. The three remaining committees consider matters specific to PIC and the Group, as per the delegations in their terms of reference. 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. The remit of some of these is provided below.

> The Executive Committee assists the CEO with day-to-day management of the business.

> The Investment Committee acts as the supervisory body on investment matters within authority delegated to it by the Investment & Origination Committee.

> The Management Risk Committee advises the Board Risk Committee on all aspects of the risk management frameworks and inputs into the development of the risk strategy. It also makes recommendations to the Board Risk Committee on the overall risk appetite and risk exposure of the Group and monitors the Group's risk profile against the risk appetite.

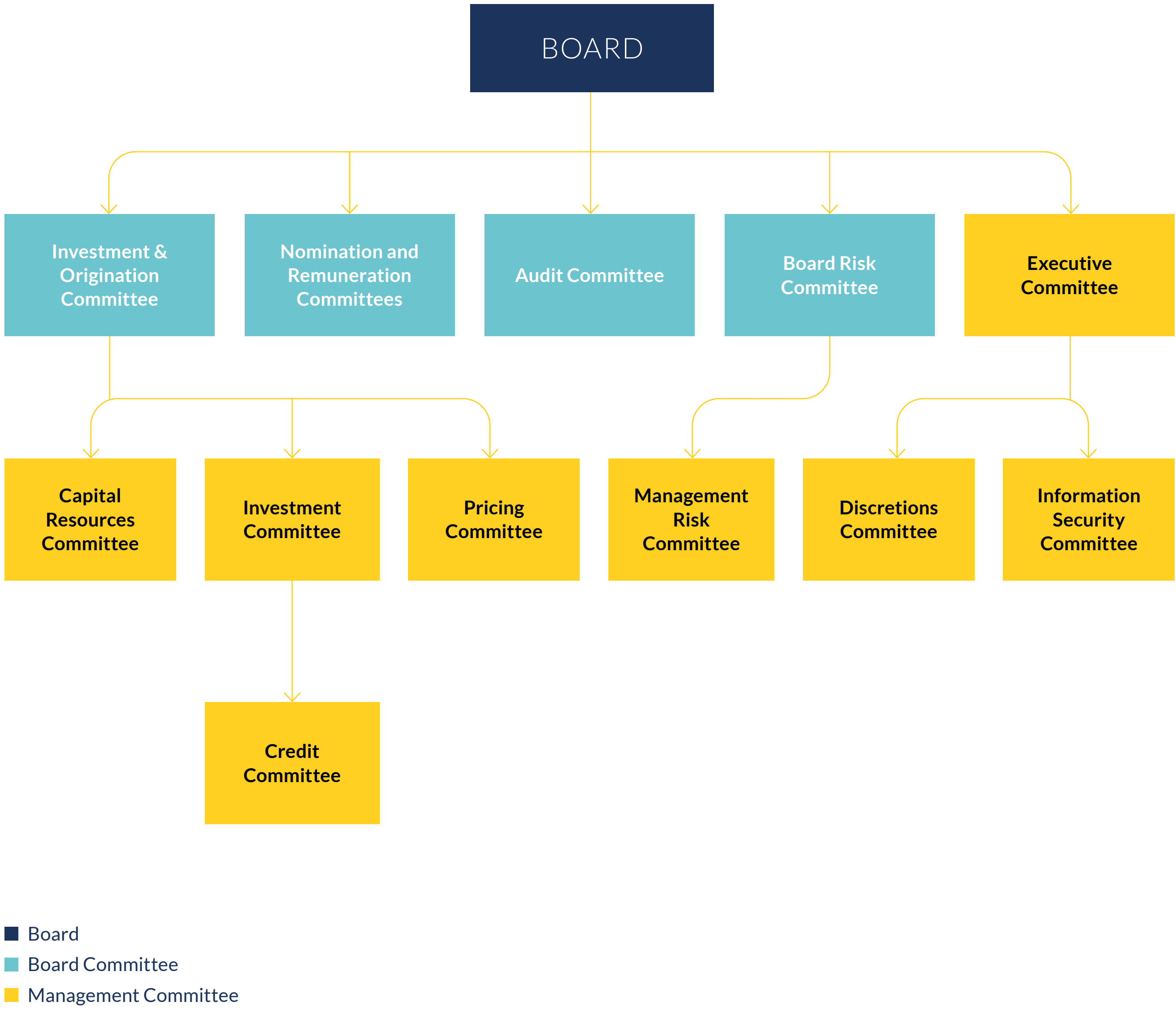
> The Pricing Committee considers all new business deals and keeps under review the pricing assumptions and recommends any changes to the Investment & Origination Committee. Deals above £1 billion are reviewed and approved by the Investment & Origination Committee or the Board.

> The Capital Resources Committee acts as the supervisory body on Matching Adjustment (the "MA") and non-MA related matters.

> The Credit Committee's role is to oversee the individual assets in PIC's internal portfolio, specifically their creditworthiness. It also provides expert credit advice on investment matters to the investment executives.

> The Discretions Committee reviews the principles, assumptions and application of the Actuarial Factors, including those relating to commutation of pension, recommends to the Board any changes proposed to the Actuarial Principles to be adopted by PIC and exercises any discretions required under policies issued by PIC.

GOVERNANCE AND CONTROL FRAMEWORK



NOMINATION AND REMUNERATION COMMITTEES REPORT

COMMITTEE AT A GLANCE

2018 has been a busy year for the Nomination and Remuneration Committees ("RemCo"). With several changes to the composition of the Board during the year the main focus has been on recruitment of new non-executive directors, as well as inducting the Board representative of Luxinva, which became a significant shareholder in the Group in Q3.

KEY ACTIVITIES OF THE COMMITTEES

> Oversight of the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board and to make recommendations with regards to any changes

> Determine and agree with the Board the framework or broad policy for the remuneration and recruitment of the Chairman, non-executive directors, Chief Executive Officer, the executive directors and such other members of the executive management as it is designated to consider

> Review and approve the Fit and Proper Persons Policy

> Oversee the implementation, and monitor the remuneration and risk management implications, of the Remuneration Policy for all Solvency II Identified Staff

> Oversee operational controls related to staff incentives and remuneration, and approve the remuneration and share incentives of all senior management

> Review the design of all share incentive plans for approval by the Board and shareholders, taking advice from the Board Risk Committee and CRO on risk management

ATTENDANCE TABLE

Name	Title	25/01	12/03	17/05	17/09	27/11	Attendance
Jon Aisbitt	Chairman – Nomination	✓	✓	✓	✓	✓	5/5
Nick Lyons[1]	Non-Executive Director	✓	✓	✓	n/a	n/a	3/3
Tim Hanford[2]	Non-Executive Director	✓	✓	✓	✓	n/a	4/4
Eloy Michotte	Non-Executive Director	✓	✓	✓	✓	✓	5/5
Jerome Mourgue d'Algue[3]	Non-Executive Director	n/a	n/a	n/a	n/a	✓	1/1
Peter Rutland[4]	Chairman – Remuneration	n/a	n/a	n/a	n/a	✓	1/1
Mark Stephen[5]	Non-Executive Director	n/a	n/a	n/a	n/a	✓	1/1

1 Nick Lyons resigned with effect from 31 July 2018
2 Tim Hanford resigned with effect from 18 October 2018
3 Jerome Mourgue d'Algue joined the committee on 20 November 2018
4 Peter Rutland joined the committee on 26 September 2018
5 Mark Stephen joined the committee on 26 September 2018

MEMBERSHIP AND ATTENDANCE

> Membership of the committees is held by the Chairman and four non-executive directors, one of whom is independent

> All members have appropriate levels of experience and knowledge of the subjects within the remit of the committee

> The committees meet jointly at least five times a year

ATTENDEES BY INVITATION

> Only members of the committees have the right to attend committee meetings. However, the Chief Executive Officer ("CEO") and the Chief People Officer shall normally attend all meetings at the invitation of the committee

> The CRO attends the Nomination and Remuneration Committee meetings to report on whether the Company has performed within its risk profile and appetite and to assist the committee in determining whether these have been met before making decisions relating to remuneration and employee/ management incentives

MAIN ACTIVITIES OF THE COMMITTEES DURING 2018

> The committees identified and nominated, for the approval of the Board, candidates to fill Board vacancies that arose during the year. This included the discussion concerning the appointment of Roger Marshall as Senior Independent Director.

> The committees reviewed and made recommendations to the Board on the Board Diversity Policy

> The committees also reviewed the structure and composition of the Board Committees, recommending changes to ensure an appropriate overlap of memberships

> Approve with the Board, the Group's Remuneration Policy, taking into account all factors which it deemed necessary including relevant legal and regulatory requirements, such as the implementation of the Senior Management and Certification Regime (SMCR) on 10 December 2018

> The committees discussed the results of the annual Board evaluation and the actions arising from that evaluation

AREAS OF FOCUS FOR 2019

> In the coming year the committees will continue a review of the leadership needs of the organisation, both executive and non-executive, in order to ensure the Company continues to compete effectively in the marketplace

> To progress the Board's Diversity agenda

GOVERNANCE OF REMUNERATION

RemCo has responsibility for setting the Remuneration Policy of the Group and for its implementation. Reports on the Committee activity are provided to the Board as appropriate.

RemCo is responsible for the determination, regular review and implementation of the Remuneration Policy. RemCo is also responsible for individual remuneration arrangements and outcomes for the Group's chairman, chief executive, executive directors, material risk takers and such other members of the executive management as it is designated to consider (all Solvency II Identified Staff). To minimise the risk of any conflicts of interest, no individual is involved in decisions regarding their own remuneration.

In its oversight of the remuneration structures, RemCo takes full account of strategic objectives and stakeholder views, as well as the interests of the customer/policyholder. The alignment of risk and reward is a prominent consideration, and RemCo seeks input from the CRO, Chair of the Board Risk Committee and the Chair of the Audit Committee in the design of remuneration policies and in determining collective and individual reward outcomes.

RemCo also has responsibility for compliance with all relevant legal and regulatory requirements on remuneration, including Solvency II which came into force on 1 January 2016. RemCo ensures that the Company's remuneration policies and practices are suitably aligned with the requirements of Solvency II, and is responsible for the oversight of individual remuneration arrangements and outcomes in respect of all Solvency II Identified Staff. The remuneration for the CEO and CFO are also approved by the Board.

REMUNERATION POLICY

The Group's remuneration policy is designed to enable the Group to recruit, retain and motivate employees of the appropriate calibre to deliver its strategy over the long term. The policy is intended to be consistent with and promote sound and effective risk management and to ensure that it does not encourage risk taking that exceeds the tolerated risk appetite of the Company.

A description of the different remuneration elements for 2018 is set out below.

Base salary	Salaries are reviewed annually and are set to be market competitive taking into account the individual's skills, as well as the size and scope of their role and that of the Group. Salaries are set at such a level that employees are not overly dependent on variable pay and to allow the Group to operate a fully flexible bonus policy.
Benefits	The following benefits are offered to all permanent employees: Private health cover; annual travel insurance; interest-free loans (up to £10,000) for season tickets; death in service life assurance; and participation in the Save As You Earn plan.
Pension	All employees who meet the minimum criteria are automatically enrolled in the Stakeholder Pension scheme. Employees who have reached their lifetime or annual allowance limit for pensions for tax purposes may receive a cash alternative in lieu of the Group's contribution that otherwise would have been made under the Stakeholder Pension arrangement.
Annual bonus	The annual bonus plan provides participants with an opportunity to receive a cash amount, subject to performance measured in respect of the relevant financial year. All employees may be invited to participate in the plan. Awards are based on the achievement of annual objectives. At all levels within the Group, individual performance metrics include compliance with standards relating to risk and compliance set by the Board. Other performance metrics assess alignment with the Group's values, which include good conduct both within the firm and in dealings with customers. For Solvency II Identified Staff, individual bonus payments will be determined by the Nomination and Remuneration Committee based on a review of both financial and strategic measures and assessment of individual performance over the year, including a review of individual performance by the CRO. Performance may be assessed against both financial and non-financial criteria. Financial performance will be reviewed against a basket of financial metrics agreed at the beginning of the year. Non-financial criteria could consider metrics such as compliance with risk appetite, compliance breaches, customer service measures and conduct, and findings of risk, compliance and internal audit reviews. The CRO, with input from the Chair of the BRC and the Chair of the Audit Committee, assesses the financial performance of the year against the Group's risk appetite and behaviours and attitude to risk and compliance. If the performance has been achieved by exceeding the risk appetite of the Group, as stated and approved by the Board and the Board Risk Committee, the bonus pool and/or individual outcomes may be adjusted downwards, potentially to zero. Performance against all of the above measures is assessed by the Remuneration Committee in the round. For staff in assurance functions, at least 75% of the annual bonus award is based on the achievement of objectives related to the individual's assurance function. The remaining 25% will relate to the performance of the Group. Awards for this population are subject to a prevailing affordability underpin, and no bonuses will be paid if overall financial performance is not sufficient to fund awards. The bonus opportunity will be expressed as a percentage of salary and will depend on an individual's role and responsibilities. The annual bonus comprises of a cash element and an award of nil-cost options. While the cash element of the bonus will be paid upfront, for Solvency II Identified staff at least 40% of annual bonuses will be in the form of nil-cost options which are subject to deferral over a three-year period using the Deferred Bonus Share Plan ("DBSP"), as detailed below.

Deferred Bonus Share Plan	The Deferred Bonus Share Plan (DBSP), seeks to align the long-term interests of the Group for all senior management and other key individuals through bonus deferral. Under DBSP, bonuses comprise a cash element awarded annually at the end of the financial year and paid in March of the next year. The deferred element is awarded in the form of nil-cost options which vest after three years. For Solvency II Identified Staff a minimum of 40% of any bonus award is deferred. Prior to vesting, RemCo can make adjustments to awards under the malus and clawback provisions. The Committee has the ability to reduce or extinguish the level of any award or require amounts to be reclaimed from individuals. This may be the case in the event of: > significant financial losses or material misstatement of the accounts for the Group or any group company; or > material failure of risk management for any period that the Committee reasonably considers is relevant; > discovery of a material error in relation to the assessment of annual performance on which an award was based; and/or > reasonable evidence of any act or omission by the participant which in the opinion of the Committee: – has contributed to material losses or serious reputational damage to the Group or any business area; or – has amounted to serious misconduct, fraud or misstatement (whether by exaggeration of financial performance or mismarking the valuation of any asset or otherwise).
2017 Growth Share Plan	Growth Share awards were granted in 2017 to certain senior employees and Executive Directors. No further grants will be made under this plan. Grant levels were determined based on an assessment of individual performance and future potential as determined at the time. These Growth Share awards are due to vest on 1 January 2021, depending on growth in value of the Group over the four-year performance period from 1 January 2017. Participants receive a portion of the growth in the Group's value above a hurdle. The level of reward at vesting is dependent on the growth achieved and can be zero if the growth in the Group's value is less than the hurdle rate. The proportion of growth above the hurdle allocated to participants reduces once the growth rate exceeds the upper end of expected performance. Prior to vesting, RemCo can make adjustments to awards under the malus provisions, and clawback provisions also apply following vesting.

LINK BETWEEN PAY AND RISK MANAGEMENT

The Group's Remuneration Policy includes the following elements which are intended to align employees' reward to the Group's risk management:

> Maintaining an appropriate ratio between fixed and variable pay.

> Performance measures – variable remuneration is subject to an assessment of financial and non-financial performance. Financial targets are set at a level consistent with the Group's risk appetite. For all employees, there is consideration of performance against risk and compliance criteria, thereby ensuring that there is risk adjustment at an individual level.

> Long-term incentives – alignment with the long-term interests of the Group for senior management is achieved by the award of variable remuneration in shares for a three-year vesting period.

> Risk adjustment process – RemCo, in formulating its recommendation on aggregate variable pay to the Board for approval, will review progress against strategic goals and financial targets. It will seek input from the CRO and Chair of the BRC and Chair of the Audit Committee for assessment of risk and compliance within established risk appetite limits as stated and approved by the Board and the Risk Committee. If the performance has been achieved out of line with risk appetite, the variable incentive pool may be adjusted downwards, including to zero.

> Malus and clawback provisions apply to all share-based variable remuneration paid to employees whereby awards may be reduced, withheld or reclaimed in certain circumstances, as outlined in the table above.

> For staff engaged in assurance functions, variable remuneration is mainly determined by reference to performance against functional/individual performance. RemCo signs off on all remuneration for senior assurance staff, ensuring independent review of achievements.

INVESTMENT & ORIGINATION COMMITTEE REPORT

COMMITTEE AT A GLANCE

I am pleased to present the Investment & Origination Committee report for 2018. This year saw a significant step with the merger of the Asset and Liability Management ("ALM") Committee and the Origination Committee. This was done so that the full breadth of new business can be considered by one committee in a comprehensive way. I believe that it simplifies the governance of approving the deals that the Group makes.

The other significant result of the merger has been the moving of policyholder matters and Treating Customers Fairly oversight from the committee up to the Board, reflecting the significance to the Group.

This report will cover the role of the committee, its activities during 2018, as well as the activities of the Origination and ALM committees that preceded it, and the focus for the coming year.

ROLE OF THE COMMITTEE

> Oversee the management of all aspects of investment policy and strategy.

> Provide oversight of the operation of the Group's investment portfolios.

> Oversee all aspects of the Group's new business and reinsurance origination.

> Recommend to the Board investment arrangements and pricing for significant transactions for approval.

MEMBERSHIP AND ATTENDANCE

The membership of the Committee was formed from the memberships of the ALM Committee and the Origination Committee, with Steve Sarjant and Mark Stephen not joining the new committee. Tim Hanford had also been a member of the ALM Committee before his retirement from the Board. We welcomed Jerome Mourgue D'Algue to the Committee following his appointment to the Board.

As a combined committee, we have met twice this year, in October and November. The ALM Committee met six times during the year and the Origination Committee met three times.

ATTENDANCE TABLE

Name	Title	Origination Committee	ALM Committee	25/10	20/11	Attendance
Arno Kitts	Chairman	n/a	6/6	✓	✓	2/2
Jon Aisbitt	Non-Executive Director	3/3	n/a	✓	✓	2/2
Eloy Michotte	Non-Executive Director	3/3	6/6	✓	✓	2/2
Jerome Mourgue D'Algue	Non-Executive Director	n/a	n/a	✓	✓	2/2
Peter Rutland	Non-Executive Director	3/3	6/6	✓	✓	2/2

ACTIVITIES DURING THE YEAR

The standing items for the Committee include review of performance of the Company's investment portfolio, a review of hedging and an update on the management of the surplus assets of the Group. The Committee will also receive regular updates from the Capital Resources, Investment and Pricing Committees.

> **Q1** – considered and approved three significant transaction bids and pricings; approved the best estimate assumptions to be used for pricing in 2018; discussed administration outsourcing; and approved changes to the governance of the circumstances when deals should be brought to the Committee.

> **Q2** – considered and approved two significant transaction bids, as well as one significant reinsurance deal; discussed and approved the Group's real assets strategy and plan, which included the approval of an additional asset class for the Group's investment portfolio; and approved the investment team's risk mandate.

> **Q3** – assessed the reviews of two external managers; and discussed the Group's responsible investment strategy.

> **Q4** – assessed the review of another external manager; considered and approved two significant transaction bids; discussed the illiquid asset review; and approved the new merged committee terms of reference.

AREAS OF FOCUS FOR 2019

The focus for the Committee in 2019 will involve assessing the appropriateness of the governance of the new committee and considering how this should fit best with the business to facilitate further sustainable growth.

The Committee will also keep a close eye on the progress of the actions that came out of the illiquid asset review, investment outcomes versus pricing assumptions, and the Group's performance in the new asset classes within the real assets strategy.

PERFORMANCE EVALUATION

The Committee conducted an evaluation of its performance as two separate committees before the merger into the one committee. This review brought out additional topics to be considered at the Committee, and additional training for committee members.

The Committee will continue to evaluate the performance of the single committee to monitor its effectiveness and ensure it continues to provide challenge to management as it had previously as two separate committees.

HOW THE GROUP APPROVES NEW BUSINESS

Pricing Committee
The Pricing Committee looks at the pricing proposed for all new business deals. Subject to delegated limits authority, the Pricing Committee will review and approve the submission of quotes for new business. If the proposed deal is of a larger size then this will be tabled at the Investment & Origination Committee for consideration.

Investment Committee
This committee assesses the asset strategy of new business deals when they reach a certain threshold. The committee will assess the assets being sourced for the new scheme and make recommendations for approval to the Investment & Origination Committee.

Investment & Origination Committee
Proposed transactions over a certain size are considered by the Investment & Origination Committee. These will be accompanied by a report from the CRO as well as detailed capital and solvency-based information.

The Board
The Board reserves the right to approve deals when they are over a particular size. Once this threshold is reached the Board will receive a report from the Investment & Origination Committee on that committee's opinion on the asset strategy, pricing approach, and capital and operational aspects. The Board will then assess the deal in relation to the overall strategy of the Group before approving the proposed new business deals.

AUDIT COMMITTEE REPORT

COMMITTEE AT A GLANCE

I am pleased to present the Audit Committee report for 2018. This year has seen changes to the membership of the committee, with Wilhelm van Zyl stepping down from the Committee and Amanda Bowe resigning from both this committee and the Board at the end of the year. We welcome Steve Sarjant, who re-joins the Committee and will bring a significant link between the Audit and Risk Committees, and we also welcome Stuart King who joined the Committee at the beginning of 2019. I would like to thank Wilhelm and Amanda for their contributions to the Committee's discussions and welcome Steve and Stuart. These changes mean that the Committee is now fully made up of independent non-executive directors in line with the provisions of the UK Corporate Governance Code and the Statutory Audit Directive, which is an important step in the maturing governance of the Group.

ROLE OF THE COMMITTEE

> Appoint and oversee the external auditor and annual audit

> Oversight of internal audit function

> Review systems of internal controls and governance

> Review of the Group's external reporting, including annual report and solvency reporting

FRC REVIEW OF 2017 AUDIT

The FRC's Audit Quality Review team conducted a review of KPMG's audit of PIC's 2017 financial statements. The FRC considered the audit work required limited improvements regarding the audit of the valuation of financial investments and confirmation of data used in the valuation of insurance contract liabilities. The Committee noted that KPMG have responded to the FRC on their proposed actions to provide clearer explanations and rationale and will monitor how KPMG addresses these points.

MEMBERSHIP AND ATTENDANCE

The committee comprises only independent non-executive directors. In addition to these members, regular attendees include the Chairman of the Board, CEO, CFO, Chief Risk Officer, General Counsel and Head of Internal Audit.

EXTERNAL AUDITOR

KPMG LLP has been the auditor for the Group for the last 12 years, with a tender process having taken place in 2016.

The Committee annually reviews the performance of the external auditor and conducted this review in Q3, taking into account the FRC's review. The Committee concluded that they were satisfied with the quality of the audit work completed, including the satisfactory level of challenge from the external audit team.

To ensure the continued independence of the external auditor, the Group has put in place a non-audit services policy, which is reviewed annually by the committee. The policy places a 70% cap on non-audit services fees relative to the statutory audit fees, with any fees over £25,000 requiring approval of the committee. Details of the remuneration paid to the external auditor are set out in Note 5.

ATTENDANCE TABLE

Name	Title	24/01	05/03	20/03	16/05	04/07	05/09	17/09	20/11	Attendance
Roger Marshall (Chair)	Chairman	✓	✓	✓	✓	✓	✓	✓	✓	8/8
Amanda Bowe	Non-Executive Director	✓	✓	✓	✓	✓	✓	✓	✓	8/8
Steve Sarjant	Non-Executive Director	n/a	n/a	n/a	n/a	n/a	n/a	n/a	✓	1/1
Mark Stephen	Non-Executive Director	✓	✓	✓	✓	✓	✓	✓	✓	8/8
Wilhelm van Zyl[2]	Non-Executive Director	✓	✓	✓	✓	✓	✓	✓	✓	8/8

1 Joined the committee on 26 October 2018
2 Stepped down from the committee on 31 December 2018

ACTIVITIES DURING THE YEAR

The Committee receives regular reports from the internal audit and compliance functions, as well as updates regarding progress of major projects being undertaken which affect the control framework of the Group. The Committee also receives regular financial performance reports.

> **Q1** – approved statutory accounts and reviewed the external audit opinion; received an update on IFRS 17; discussed the Group's arrangements for GDPR; approved the recalculation of the Transitional Measures for Technical Provision and approved the Committee's updated terms of reference.

> **Q2** – approved the Group's Solvency and Financial Condition Report and reviewed the External Auditor's report; and discussed IT strategy and security.

> **Q3** – conducted a review of the External Auditor; approved the Group's half yearly financial report; re-approved the non-audit services policy; and discussed cyber security.

> **Q4** – approved the internal audit plan for 2019; discussed the Equity Release Mortgage valuation model; and approved the year-end assumptions.

AREAS OF FOCUS FOR 2019

The Committee's focus will always primarily be on the quality of the Group's external reporting ensuring the effectiveness of the External Auditor; compliance and internal audit functions; and considering the effectiveness of the Group's internal controls.

The Group is planning to undertake a number of key projects in 2019 which the Committee will oversee regularly to ensure that the controls and governance of these projects remain appropriate.

WHISTLEBLOWING

The Group has put in place a whistleblowing policy to enable staff to raise concerns on suspected wrongdoing or dangers at work. The Committee receives reports on any whistleblowing incidents and reviews and approves the whistleblowing policy and procedures each year. During 2018, there were no instances of whistleblowing reports.

INTERNAL AUDIT AND COMPLIANCE

The Committee meets regularly with management, CRO, General Counsel and Head of Internal Audit to review the effectiveness of internal controls, risk management and compliance processes.

The internal audit plan and integrated assurance plan are brought to the committee each year for approval and there is an update from the Head of Internal Audit on the progress of implementation and monitoring of controls at each meeting. The General Counsel also provides a report on the effectiveness of the compliance function at each meeting.

Each year the Committee reviews the effectiveness of the Internal Audit function and of the performance of the Head of Internal Audit, to ensure high standards of oversight and challenge remain in the third line of defence.

FAIR, BALANCED AND UNDERSTANDABLE STATEMENT

Upon review of the financial statements, the Committee and the Board have confirmed that they are satisfied with the overall fairness, balance and clarity of the Annual Report. The Committee confirms this opinion based on the authors of each section of the Annual Report having sufficient expertise and the formal review process at all levels to ensure the Annual Report is factually correct.

PERFORMANCE EVALUATION

The Committee conducted an evaluation of its performance and of each individual member alongside the overall Board evaluation process. The review was carried out internally, with each committee member and regular attendees asked to complete a questionnaire.

The review concluded that the Committee was performing well overall, with the papers provided at each meeting being of a high quality. The members agreed that the Chairman was effective in his role.

The members concluded that some areas of additional training would be beneficial, and sessions of these topics will be provided to the Committee in 2019.

SIGNIFICANT ISSUES

Areas of focus	Actions taken by the committee
IFRS 17	The Committee has received regular updates from the Finance function about the proposed changes and their impact on the Group.
Embedded value methodology	Discussed and approved management's proposal to alter the calculation of non hedgeable risk to assume that mortality risks relating to current pensioners are reinsurable.
Recalculation of the Transitional Measures for Technical Provisions	The Committee considered and discussed the proposed bi-annual recalculation. The Committee approved the proposed revisions.
IFRS Credit Default Methodology	The Committee considered senior management proposals to make changes to the methodology. Following discussions over several meetings, the Committee approved the change in methodology. Whilst still prudent, the revised basis reduces volatility in the profit and loss account.
Mortality Assumptions	The Committee challenged and approved senior management's proposal to change the baseline mortality assumptions, specifically on the level of prudence the Group should apply.
Tier 3 Investments	The Committee considered the valuation methodology for such investments and received updates on two investments where valuation was particularly subjective.

RISK COMMITTEE REPORT

COMMITTEE AT A GLANCE

I am pleased to present the Risk Committee report for 2018. The Group's approach to risk management including its principal risks is covered in detail in the risk section of the annual report on pages 49 to 55. As it was a busy year for the Group as a whole, it has also been a busy year for the Risk Committee.

The Committee has reviewed and approved multiple new counterparties across all areas of the business and much time has been spent on updating various frameworks within the wider risk management framework to ensure they remain fit for purpose as the business continues to grow. A significant focus has been reinsurance counterparties, discussions around liquidity risk management, a proposed internal model major change and deep dives on credit and reinsurance risks.

The Committee recognises the importance of the conduct risk and operational resilience and discussed these matters in depth during the year.

Brexit has also been an important topic for the Committee this year as the date for the UK's exit from the EU draws closer.

This report describes the Committee's activities in more detail and provides shareholders with some insight on the focus the Committee will have in 2019.

ROLE OF THE COMMITTEE

> Provide oversight and advice to the Board on the Group's current and likely risk exposures; risk appetite; risk management; and risk controls

> Oversee the Internal Model and recommend improvements to the Board

> Ensure the effectiveness of the Risk function and the performance of the Chief Risk Officer

> Provide challenge to embed and maintain a supportive risk culture throughout the Group

> Review and oversee interactions between the Group and its regulators

MEMBERSHIP AND ATTENDANCE

The committee membership is a majority of its independent non-executive directors. Roger Marshall is also the Chairman of the Audit Committee and his membership, as well as Steve Sarjant's membership of the Audit Committee, ensure there is good collaboration between the two committees.

The Committee meetings are also attended by the Chief Risk Officer, Chief Executive Officer, Chief Financial Officer and the Chairman of the Board.

ATTENDANCE TABLE

Name	Title	17/01	05/03	16/05	04/07	18/09	21/11	Attendance
Steve Sarjant	Chairman	✓	✓	✓	✓	✓	✓	6/6
Arno Kitts	Non-Executive Director	✓	✓	✓	✓	✓	✓	6/6
Roger Marshall	Non-Executive Director	✓	✓	✓	✓	✓	✓	6/6
Wilhelm Van Zyl	Non-Executive Director	✓	✓	✓	✓	✓	✓	6/6

ACTIVITIES DURING THE YEAR

At each meeting, the Committee considers the Chief Risk Officer's report, receives an update from the Head of Internal Audit on internal audit matters of interest to the Committee, and receives updates on any interactions between the Group and its regulators. It also discusses matters brought to the Committee's attention from other Committees. This is to ensure a joined up approach to governance and oversight of the systems of internal control and risk management. Throughout the year the committee also reviews key policies within its remit.

> **Q1** – approved the Group's conduct risk appetite; challenged and approved the new counterparty limit framework for derivatives; approved the use of three new counterparties; approved the committee's updated terms of reference; recommended the ORSA 2017 report for approval by the Board; reviewed the Internal Model Validation report and Internal Model validation plan; considered the PRA's feedback on the Group's liquidity risk management; and reviewed the CRO's report to the Nomination and Remuneration Committee.

> **Q2** – reviewed the Group's reinsurance and asset counterparties and approved two new reinsurance additions to the existing portfolio; discussed the annual Actuarial Function opinion on the underwriting policy and the credit deep dive; approved the finalised conduct risk framework and policy and the ORSA stress and scenario testing plans for 2018; considered the integrated assurance report; and considered Capita as an outsourcer and advised the Board on that matter.

> **Q3** – made recommendations to the Board in respect of the reinsurance counterparty framework; considered updates to operational stress and scenario testing which would form part of the ORSA 2018; received an update on the credit deep dive; approved changes to secondary risk appetite metrics; recommended changes to the primary risk appetite metrics to the Board; and recommended the risk strategy and preference framework for approval by the Board.

> **Q4** – discussed the findings of the review of illiquid asset; reviewed further assessments of the potential impacts of Brexit; discussed the Group's proposed changes to the internal model; received a report on the cyber risk framework and the Group's operational resilience; reviewed the outcomes of the insurance risk deep dive; and approved the annual integrated assurance report and plan.

AREAS OF FOCUS FOR 2019

The Committee will consider any proposed major model change application that it is proposed be made to the PRA in 2019.

It will continue to focus on reviewing the risk management framework and ensuring it remains fit for purpose as the Group grows. This will also cover the approach to hedging and further improvements the Group can make to adjust to changing business needs.

The Committee will continue to maintain strict oversight of the Group's counterparties and will continue to scan the horizon for any emerging risks to the Group as a whole.

PERFORMANCE EVALUATION

The Committee conducted an evaluation of its performance, and of each individual member, alongside the overall Board evaluation process. The review was carried out internally, with each committee member and regular attendees asked to complete a questionnaire.

The review concluded that the Committee was performing well overall, and there were no major concerns raised in the evaluation. The members agreed that the committee chairman was effective in his role.

The members concluded that some areas of additional training would be beneficial, and sessions of these topics will be provided to the committee in 2019.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

CORPORATE GOVERNANCE STATEMENT

The Board and the executive management are committed to the principles and high standards of the Corporate Governance Code as they believe these underpin the success of the Company and are for the benefit of its shareholders and stakeholders, including policyholders. For this reason, the Company strives to adopt the provisions of the 2016 version of the UK Corporate Governance Code as far as they apply to a private limited company. In addition, the Group's subsidiary, Pension Insurance Corporation plc has listed securities in issue and complies with the applicable sections DTR7.1 and DTR7.2 of the FCA Handbook. Further information on the Company's governing body and its committees is included in the Corporate Governance Overview on pages 58 and 79.

PICG DIRECTORS AND THEIR INTERESTS

The Directors who served during the period and up to the date of the approval of these financial statements were:

Name	Position	Appointed/Resigned
Jonathan Robert Aisbitt	Chairman	
Roger Michael James Marshall	Senior Independent Director	
Tracy Blackwell	Chief Executive	
Jerome Mourgue d'Algue	Director	Appointed on 20/11/2018
Michael Eves	Director	Resigned on 31/12/2018
Edward Joseph Giera	Director	Resigned on 31/12/2018
Timothy John Hanford	Director	Resigned on 18/10/2018
Stuart King	Director	Appointed on 01/01/2019
Arno Kitts	Director	
Jing Li	Director	Resigned on 31/12/2018
Nicholas Stephen Lyons	Director	Resigned on 31/07/2018
Josua Malherbe	Director	
Peter William James Rutland	Director	
Thomas Mark Stephen	Director	
Frederik Wilhelm van Zyl	Director	

One Director who held office during the financial year is a beneficiary of the Company's share-based award schemes, details of which are given in Note 7 to the financial statements. This Director received 303,721 ordinary shares of the Company upon vesting of certain schemes during the year (2017: one Director received a total of 227,828 ordinary shares)

Additionally, as a result of the liquidity event offered in accordance with the Articles of Association of the Company, two Directors purchased 214,491 ordinary shares in the Company during 2018 (2017: four Directors purchased 675,000 ordinary shares).

SHARE CAPITAL AND MAJOR SHAREHOLDERS

Details of the Company's share capital, including changes during the year in the issued share capital and details of the rights attaching to the Company's ordinary shares are set out in Note 18.

The following are the major shareholders of PICG as at 31 December 2018:

Shareholder	No of ordinary shares held as at 31 December 2018	% of the issue ordinary share capital as at 31 December 2018
Reinet PC Investments (Jersey) Limited on behalf of Reinet investment S.C.A.	474,430,843	43.7
Blue Grass Holdings Limited on behalf of CVC	187,960,704	17.3
Luxinva S.A. on behalf of ADIA	185,932,865	17.1
Crest Success Limited on behalf of Legend Holdings	57,342,625	5.3
IFS IV Limited on behalf of Istithmar.	50,650,548	4.7
Swiss Re Direct Investments Company Limited on behalf of Swiss Re	46,801,575	4.3

OWN SHARES

At 31 December 2018, 8,303,984 ordinary shares of the Company were held in an Employee Benefit Trust (2017: 4,985,393), in accordance with the accounting policy in Note 1.

EVENTS AFTER THE BALANCE SHEET

There were no significant post balance sheet events.

DIVIDENDS

The Directors of the Company do not recommend a dividend for the year (2017: nil).

POLITICAL CONTRIBUTIONS

The Company made no political contributions during the year (2017: nil).

QUALIFYING THIRD PARTY INDEMNITIES

The Articles of Association of the Company provide for the Directors and officers of the Company to be indemnified in respect of liabilities incurred as a result of their office. The Company also provides certain forms of protection for its Directors and senior managers of companies within the Group against personal financial exposure that they may incur in their capacity as such. During the year and at the time the Directors' Report was approved under section 234 of the Companies Act 2006, this protection included qualifying third party indemnity provisions (as defined under section 234 of the Companies Act 2006) in force for the benefit of the Company's Directors.

GOING CONCERN

After making enquiries, including specific consideration of regulatory solvency, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

FINANCIAL INSTRUMENTS

The information relating to the Company's financial instruments is included in Note 13 to the financial statements.

FUTURE DEVELOPMENTS

The information that fulfils the reporting requirements relating to the likely future developments in the business of the Company is included in the Strategic Report, which is separate to this Directors' Report.

MATERIAL CONTRACTS

During the year, Pension Services Corporation Limited ("PSC"), a UK limited company that is an indirect subsidiary of Pension Insurance Corporation Group Limited, continued to provide management, staff, IT and office services to the Group under a defined service agreement.

INTERNAL CONTROLS AND RISK MANAGEMENT SYSTEM

The Board has overall responsibility for the system of risk management and internal controls, and for reviewing its effectiveness. The Group has a risk management and internal control system in place which is designed to manage and reduce rather than eliminate the risk of failing to achieve business objectives. It can only provide the Board with reasonable, and not absolute, assurance against material misstatement or loss. The Board has delegated responsibility to the Audit Committee and the Risk Committee for monitoring this system and reporting on its effectiveness to the Board. Each year, the Board approves an integrated assurance plan which is intended to provide the Board with assurance that the internal control and risk management system works effectively. The plan, which is effected by the Internal Audit, Compliance, Risk and Actuarial functions within the Group, is overseen by the Risk and Audit Committees as part of their delegated authority from the Board. The overlap in membership of those two Committees ensures that all areas of the system are adequately covered.

Financial reporting	Responsibility
Delegated authority	An established management structure operates across the Group with clearly defined levels of responsibility and delegated authorities.
Financial reporting	The Group has a robust system for reporting of the financial results to the Board. During the year, monthly and quarterly financial results are produced, which include comparison to forecast and prior year. The Board, Audit Committee, Risk Committee and executive management review the Group's performance throughout the year and monitor the operation of budgets and long-term business plans. The reports ensure that variances are investigated and acted upon.
Internal controls, processes and procedures	The Group has formal written procedures and controls in operation which are designed to facilitate effective and efficient business operation, robust financial reporting and compliance with laws and regulations. Procedures, processes and controls are updated regularly to ensure they are effective and in compliance with best practice. As part of the requirements of DTR 7.1.3 of the FCA handbook, the Board, in line with the delegated authority to the Audit Committee, specifically monitors the financial reporting process and the statutory audit of the annual financial statements through reporting provided by management and reporting received from the Audit Committee. The Audit Committee meets regularly with members of executive management and internal and external auditors to review the annual financial information and internal control matters, and to satisfy themselves that the internal control systems are operating effectively. The Audit Committee also reviews any follow-up actions to correct identified weaknesses. All Board members receive minutes of the Audit Committee meetings.
Internal audit assurance	The Audit Committee oversees the Group's Internal Audit function, which is managed by the Head of Internal Audit using a co-sourced model and has a direct reporting line to the Audit Committee. The Audit Committee approves an annual internal audit plan which is designed to review key areas of risk. Regular updates on progress of the internal audit plan are provided to the Audit Committee by the Head of Internal Audit, who is a standing attendee at the Audit Committee's meetings. Progress reports include results of individual audits. The Head of Internal Audit provides an annual report and opinion on internal controls, governance and culture.
External audit assurance	The work of the external auditor provides further independent assurance on the internal control environment, as described in its reporting to the Audit Committee. Furthermore, the Audit Committee reviews and monitors the independence of the statutory auditor and considers the relationship with the Group as part of its assessment, including provision of non-audit services.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2018 (continued)

Financial reporting	Responsibility
Risk management framework (more information is included on pages 49 to 55)	The Board has established a risk management and compliance system which includes a process for identifying, evaluating and managing the risks faced by the Group. The Risk Committee works closely with the Audit Committee and provides oversight and advice to the Board with regard to the Group's current and likely risk exposures, risk tolerances and appetite, risk measurement, risk management performance, and its risk policies, procedures and risk controls. All Board members receive minutes of the Risk Committee meetings. Procedures are in place to ensure the employment, retention, training and development of suitably qualified staff to manage activities.

The Board has reviewed the effectiveness of the system of internal controls, including risk management, for the year ended 31 December 2018 and up to the date of signing of these financial statements and the annual report. It has not identified any weaknesses sufficient to cause material misstatement or loss which requires disclosure in the financial statements.

DISCLOSURE OF INFORMATION TO AUDITOR

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditor is unaware; and each Director has taken all the steps that ought to have been taken as a Director to be aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

AUDITOR

In accordance with section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG LLP will therefore continue in office.

LONG-TERM VIABILITY STATEMENT

1. The assessment process

The long-term viability process is primarily carried out by strategic and financial planning. The Group's strategy (see page 27), and year-on-year activities combined with a focus on material factors which may impact the Group in the foreseeable future are central to the assessment that the Group can be reasonably expected to continue in operation and meet its liabilities as they fall due. The Group's business plan is prepared annually and covers a five-year period on a rolling basis. The plan covers projected performance and related profitability, cash and value generation and the capital position of the Group over the period. The plan is designed within the Group's risk appetite framework, which forms an integral part of the business planning process. The plan is tested against the risk appetite set for the Group by the Board. This includes a number of stress scenarios, which consider the Group's resilience and capacity to respond to relevant stresses and shock events, which may potentially impact the Group. The Group also evaluates various management actions designed to maintain and restore key capital and solvency metrics to within the Group's approved risk appetite over the planning period.

2. The assessment period

The Directors have assessed the viability of the Group by reference to the five-year planning period to December 2023, which has been chosen as appropriate because it reflects the Group's business model and the dynamics of the bulk annuity market as covered by the Group's five-year business plan.

3. Assessment of viability

The Directors have carried out an assessment by reference to the Group's current position and strategy, the Board's risk appetite and the Group's financial forecasts from December 2018 to December 2023. The Directors considered the draft business plan at the Board meeting held on 26 September 2018. The Directors also considered the Group's principal risks and how these are managed, as detailed on pages 54 to 55. The final business plan was reviewed and approved at the Board meeting held on 6 December 2018 and was supported by the assessment of key risks to the successful execution of the business plan. The risk assessment included stress and scenario testing of key assumptions, and horizon scanning to consider the key risks to the business and the potential impact of these on the business plan objectives.

The key areas considered in the risk assessment included:

> risks from the Group's existing assets and liabilities – including macro-economic events such as a potential turn in the credit cycle or a "hard Brexit" and adverse movements in longevity trends;

> risks to the Group's operational resilience – including operational scenarios associated with cyber exposures; and

> risks to new business generation – including analysis of scenarios associated with asset quality and increased volumes of new business generation. In addition, reverse stress and scenario testing has been performed considering theoretical scenarios chosen at the level of severity which creates outcomes that could threaten the viability of the Group. The risk section (pages 49 to 55) of the Strategic Report describes various mitigating and management actions available to manage and minimise the impact of risk events to the Group's business model. Additionally, the Directors have made certain assumptions around additional funding to maintain the growth forecast in the business plan.

4. Viability statement

Based on the results of the assessment of the Group's prospects and viability, the Directors confirm that they have a reasonable expectation that the Group will continue to operate and meet its liabilities as they fall due in the five-year assessment period.

On behalf of the Board

Jon Aisbitt
Chairman

14 Cornhill
London
EC3V 3ND

6 March 2019

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE STRATEGIC REPORT, THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare both the group and the parent company financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and parent company and of their profit or loss for that period. In preparing each of the group and parent company financial statements, the Directors are required to:

> select suitable accounting policies and then apply them consistently;

> make judgements and estimates that are reasonable, relevant and reliable;

> state whether they have been prepared in accordance with IFRSs as adopted by the EU;

> assess the group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and

> use the going concern basis of accounting unless they either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

OUR VALUES

DOING THE RIGHT THING

ALL-WEATHER FRIENDS

Our policyholders are our customers 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.

FINANCIAL STATEMENTS

In this section

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF PENSION INSURANCE CORPORATION GROUP LIMITED

Opinion

We have audited the financial statements of Pension Insurance Corporation Group Limited ("the company") for the year ended 31 December 2018 which comprise the consolidated Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and the related notes, including the accounting policies in Note 1.

In our opinion:

> the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2018 and of the group's profit for the year then ended;

> the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);

> the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and

> the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the group in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

The impact of uncertainties due to the UK exiting the European Union on our audit

Uncertainties related to the effects of Brexit are relevant to understanding our audit of the financial statements. All audits assess and challenge the reasonableness of estimates made by the directors, related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the group's future prospects and performance.

Brexit is one of the most significant economic events for the UK, and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown. We applied a standardised firm-wide approach in response to that uncertainty when assessing the group's future prospects and performance. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

Going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the group or the company or to cease their operations, and as they have concluded that the group and the company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. In our evaluation of the Directors' conclusions, we considered the inherent risks to the group's business model, including the impact of Brexit, and analysed how those risks might affect the group and company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the group or the company will continue in operation.

Strategic report and directors' report

The Directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the Strategic Report and the Directors' Report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

> we have not identified material misstatements in the strategic report and the directors' report;

> in our opinion the information given in those reports for the financial year is consistent with the financial statements; and

> in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception
Under the Companies Act 2006, we are required to report to you if, in our opinion:

> adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or

> the parent company financial statements are not in agreement with the accounting records and returns; or

> certain disclosures of directors' remuneration specified by law are not made; or

> we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

Directors' responsibilities
As explained more fully in their statement set out on page 83, the Directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

The purpose of our audit work and to whom we owe our responsibilities
This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Philip Smart

Philip Smart (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants

15 Canada Square
Canary Wharf
London
E14 5GL

6 March 2019

STATEMENT OF COMPREHENSIVE INCOME FOR THE GROUP

FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 £m	2017 £m
Revenue			
Gross premiums written		7,150	3,704
Outward reinsurance premiums	10f	(29)	(41)
Net premium revenue earned		7,121	3,663
Investment return	2	(978)	1,092
Commissions earned		1	1
Total revenue (net of reinsurance premiums)		6,144	4,756
Expenses			
Claims paid – gross		(1,248)	(1,003)
Reinsurers' share of claims paid	10f	74	94
		(1,174)	(909)
Increase in insurance liabilities – gross		(3,727)	(3,252)
(Decrease)/increase in reinsurers' share of insurance liabilities	10f	(596)	(72)
		(4,323)	(3,324)
Acquisition expenses	3	(52)	(51)
Other operating expenses	4	(72)	(48)
Finance costs	12	(46)	(41)
		(170)	(140)
Total claims and expenses		(5,667)	(4,373)
Profit before taxation		477	383
Tax charge	8	(91)	(73)
Profit and total comprehensive income for the year		386	310

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 95 to 127 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE GROUP

FOR THE YEAR ENDED 31 DECEMBER 2018

31 December 2018	Note	Share capital £m	Share premium £m	Treasury shares £m	Retained profit £m	Capital reduction reserve £m	Merger reserve £m	Share-based payment reserve £m	Total £m
At beginning of year		2	120	(12)	874	1,055	34	10	2,083
Total comprehensive income									
Profit for the year		–	–	–	386	–	–	–	386
Transactions with owners									
Vesting of the share-based payment schemes	7, 18	–	–	6	(4)	–	–	(2)	–
Employee related share-based payments	7	–	–	(18)	–	–	–	6	(12)
Tax relating to share-based payments		–	–	–	–	–	–	–	–
At end of year		2	120	(24)	1,256	1,055	34	14	2,457

31 December 2017	Note	Share capital £m	Share premium £m	Treasury shares £m	Retained profit £m	Capital reduction reserve £m	Merger reserve £m	Share-based payment reserve £m	Total £m
At beginning of year		2	118	(1)	565	1,055	34	6	1,779
Total comprehensive income									
Profit for the year		–	–	–	310	–	–	–	310
Transactions with owners									
Ordinary shares issued for cash consideration	18, 19	–	2	–	–	–	–	–	2
Vesting of the share-based payment schemes	7, 18	–	–	1	3	–	–	(4)	–
Employee related share-based payments	7	–	–	(12)	(4)	–	–	6	(10)
Tax relating to share-based payments		–	–	–	–	–	–	2	2
At end of year		2	120	(12)	874	1,055	34	10	2,083

The accounting policies and notes on pages 95 to 127 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE COMPANY

FOR THE YEAR ENDED 31 DECEMBER 2018

31 December 2018	Note	Share capital £m	Share premium £m	Treasury Shares £m	Retained profit £m	Capital reduction reserve £m	Merger reserve £m	Share-based payment reserve £m	Total £m
At beginning of year		2	120	(12)	(2)	1,055	34	8	1,205
Total comprehensive income									
Profit for the year		–	–	–	35	–	–	–	35
Transactions with owners									
Vesting of the share-based payment schemes	7, 18	–	–	6	(4)	–	–	(2)	–
Employee related share-based payments	7	–	–	(18)	–	–	–	6	(12)
At end of year		2	120	(24)	29	1,055	34	12	1,228

31 December 2017	Note	Share capital £m	Share premium £m	Treasury Shares £m	Retained profit £m	Capital reduction reserve £m	Merger reserve £m	Share-based payment reserve £m	Total £m
At beginning of year		2	118	–	7	1,055	34	6	1,222
Total comprehensive income									
Loss for the year		–	–	–	(9)	–	–	–	(9)
Transactions with owners									
Ordinary shares issued for cash consideration	18	–	2	–	–	–	–	–	2
Share issue costs recognised in equity	19	–	–	–	–	–	–	–	–
Vesting of the share-based payment schemes	7, 18	–	–	–	4	–	–	(4)	–
Employee related share-based payments	7	–	–	(12)	(4)	–	–	6	(10)
At end of year		2	120	(12)	(2)	1,055	34	8	1,205

The accounting policies and notes on pages 95 to 127 form an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION FOR THE GROUP

AS AT 31 DECEMBER 2018

	Note	2018 £m	2017 £m
Assets			
Investment properties	9	96	99
Reinsurers' share of insurance liabilities	10	1,854	2,450
Receivables and other financial assets	13	280	320
Deferred tax asset	11	3	3
Prepayments		61	45
Financial investments	13	31,371	25,671
Derivative assets	14	9,757	8,775
Cash and cash equivalents	13	79	43
Total Assets		43,501	37,406
Equity			
Share capital	18	2	2
Share premium	19	120	120
Treasury shares	19	(24)	(12)
Merger reserve	19	34	34
Capital reduction reserve	19	1,055	1,055
Share-based payment reserve	19	14	10
Retained (loss)/profit	19	1,256	874
Total Equity		2,457	2,083
Liabilities			
Gross insurance liabilities	10	28,720	24,993
Borrowings	12	891	543
Deferred tax liability	11	3	4
Derivative liabilities	14	11,303	9,663
Insurance and other payables	13	14	21
Current taxation		41	43
Accruals	13	72	56
Total Liabilities		41,044	35,323
Total Equity and Liabilities		43,501	37,406

The accounting policies and notes on pages 95 to 127 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 6 March 2019 and were signed on its behalf by:

Tracy Blackwell
Director

Registration number: 09740110

STATEMENT OF FINANCIAL POSITION FOR THE COMPANY

AS AT 31 DECEMBER 2018

	Note	2018 £m	2017 £m
Assets			
Investments in subsidiaries	17	1,202	1,203
Receivables and other financial assets	13	33	2
Cash and cash equivalents	13	2	6
Total Assets		1,237	1,211
Equity			
Share capital	18	2	2
Share premium	19	120	120
Treasury shares	19	(24)	(12)
Merger reserve	19	34	34
Capital reduction reserve	19	1,055	1,055
Share-based payment reserve	19	12	8
Retained profit	19	29	(2)
Total Equity		1,228	1,205
Liabilities			
Insurance and other payables	13	9	6
Total Liabilities		9	6
Total Equity and Liabilities		1,237	1,211

The accounting policies and notes on pages 95 to 127 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 6 March 2019 and were signed on its behalf by:

Tracy Blackwell
Director

Registered number: 09740110

GROUP STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 £m	2017 £m
Cash flows from operating activities			
Profit for the year		386	310
Adjustments for non-cash movements			
Interest income recognised in profit or loss	2	(729)	(631)
Other investment (loss)/income recognised in profit or loss		35	65
Interest expense recognised in profit or loss		45	40
Amortisation of subordinated debt issue costs and discount		1	1
Movement in tax provisions	8	91	73
Movement in fair value of investment properties	9	3	(2)
Equity settled share-based payments	7	6	6
		(548)	(448)
Changes in operating assets and liabilities			
Decrease/(Increase) in receivables and other financial assets		75	(92)
Increase in financial investments including derivative assets		(6,682)	(2,532)
(Increase)/Decrease in prepayments		(16)	(9)
Decrease/(Increase) in reinsurers' share of insurance liabilities	10	596	72
Increase in insurance liabilities	10	3,727	3,252
Increase/(Decrease) in financial liabilities including derivative liabilities		1,640	(991)
(Decrease)/Increase in insurance and other payables		(7)	1
Increase in accruals		16	6
		(651)	(293)
Cash flows used in operating activities		(813)	(431)
Interest income received		690	621
Interest paid		(35)	(65)
Taxation paid		(94)	(62)
Net (outflow)/inflow from operating activities		(252)	63
Cash flows from financing activities			
Proceeds from issue of share capital	18	–	2
Proceeds from issue of subordinated debt	12	350	–
Purchase of treasury shares		(18)	(16)
Interest paid on subordinated debt		(41)	(40)
Equity and debt issue costs	12, 18	(3)	–
		288	(54)
Net increase in cash and cash equivalents		36	9
Cash and cash equivalents at beginning of year		43	34
Cash and cash equivalents at end of year		79	43

The accounting policies and notes on pages 95 to 127 form an integral part of these financial statements.

COMPANY STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 £m	2017 £m
Cash flows from operating activities			
Profit/(loss) for the year		35	(9)
Adjustments for non-cash movements:			
Impairment of investment		1	1
Treasury share write off	7	6	6
Dividends received		(10)	–
		(3)	7
Changes in operating assets and liabilities			
(Increase)/ decrease in debtors		(31)	(2)
Increase in insurance and other payables		3	4
		(31)	9
Cash inflow from operating activities		4	–
Investing activities			
Dividend received		10	–
Cash inflow from investing activities		14	–
Financing activities			
Proceeds of issue of share capital	18	–	2
Purchase of treasury shares		(18)	(16)
Cash inflow from financing activities		(18)	(14)
Net increase in cash and cash equivalents		(4)	(14)
Cash and cash equivalents at beginning of year		6	20
Cash and cash equivalents at end of year		2	6

The accounting policies and notes on pages 95 to 127 form an integral part of these financial statements.

1. ACCOUNTING POLICIES

(a) Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") and those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

These financial statements have been presented in millions of pounds sterling (£m) unless otherwise stated.

The financial statements have been prepared on a going concern basis.

In publishing its own financial statements here together with the Group financial statements, the Company has taken advantage of the exemption in section 408(3) of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these financial statements.

The Group has applied all IFRS and interpretations that are adopted by the EU and are effective for accounting periods beginning on or after 1 January 2018. There is no material effect on the results of the Group arising from implementation of these standards.

The Group has not adopted the following standards which are not yet mandatory:

IFRS 9 – *Financial Instruments* – effective for accounting periods beginning on or after 1 January 2018.

The financial instruments held by the Group are classified as fair value through profit and loss, therefore the adoption of the standard will not have a material impact on the results of the Company.

Although this standard is now effective the IASB published Amendments to IFRS 4 "applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts", which includes an optional temporary exemption from applying IFRS 9 until IFRS 17 is adopted. This exception is available to insurance entities whose activities are "predominantly connected with insurance" by meeting certain eligibility criteria. As at 31 December 2018 the Group met the eligibility criteria and will defer the adoption of IFRS 9 to 1 January 2022.

IFRS 16 – *Leases* – effective for accounting periods beginning on or after 1 January 2019.

As disclosed in Note 21, the Group has operating lease liabilities amounting to £15m. On adoption of the standard, these lease liabilities are expected to be recognised on the Statement of financial position as an asset with a corresponding liability of equal value.

IFRS 17 – Insurance Contracts – not yet endorsed by the EU, effective for accounting periods beginning on or after 1 January 2022.

The Group intends to adopt IFRS 17 for its financial year beginning on 1 January 2022. The adoption of the standard is expected to have a significant impact on the financial statements as it transforms the way the Group measures, presents and discloses the insurance and reinsurance assets and liabilities in the Statement of Comprehensive Income, Statement of Financial Position and the notes to the financial statements.

Under IFRS 17, new business profits at inception are recognised as Contractual Service Margin ("CSM"), which is released into the Statement of Comprehensive Income over time. In addition to the CSM, an explicit margin called the Risk adjustment ("RA") is required to be held for non-financial risks. More quantitative and qualitative information will be disclosed, including the reconciliations of CSM, RA and present value of future cashflows.

The Statement of Comprehensive Income will no longer include premium and claim volumes, and instead will focus on new measures, such as insurance contract revenue and insurance service expense.

In addition, IFRS 17 is expected to introduce significant operational changes, including new models and significant updates to current systems and processes to account for new requirements for the collection, aggregation and analysis of data.

The Group has created an IFRS 17 implementation project team which is currently developing methodology documents based on the requirements of IFRS 17. Once the methodologies are agreed the team will start to develop and implement models and capabilities to meet the requirements of IFRS 17 over the next three years. However, the project is still in its early stages and, given the complexity of the requirements, the Group are not currently able to quantify the impact the adoption of the standard will have on its financial position.

(b) Recognition and derecognition of financial instruments

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire, or if either the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset are transferred to another party. Regular purchases and sales of financial assets are accounted for at date of trading. Financial liabilities are derecognised when the Group's obligations specified in the contract expire or are discharged or cancelled.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES (continued)

(c) Contract classification

IFRS 4 "*Insurance Contracts*" requires policyholder contracts written by insurers to be classified as either insurance contracts or investment contracts depending on the level of insurance risk transferred.

Insurance contracts are defined as those contracts containing significant insurance risk if, and only if, an insured event could cause an insurer to make significant additional payments in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract. Such contracts remain insurance contracts until all rights and obligations are extinguished or expire.

Policy contracts which do not transfer significant insurance risk to the insurer are classified as investment contracts.

The Group has classified all its policyholder contracts as insurance contracts.

(d) Premiums

Premiums are received in consideration for completing an insurance policy with the trustees of the pension scheme. They are recognised and valued on the day risk is accepted. Any adjustments to premiums following work performed during the transition of a scheme are recognised and valued at the date they become payable or receivable by the Group.

Premiums reported exclude any taxes or duties based on premiums.

(e) Acquisition costs

Acquisition costs comprise all direct and indirect costs of obtaining and processing new business. Indirect costs consist primarily of management, staff and related overhead costs.

A deferred acquisition cost asset has not been established in the Statement of Financial Position. The majority of acquisition costs incurred are not directly related to individual sales and the amount of directly attributable acquisition costs that would be deferrable is not considered to be material.

(f) Claims

Claims and benefits payable consist of regular annuities paid to pension scheme members and beneficiaries, and surrenders which consist of full settlements of transfers out and partial settlement of tax-free cash components of pension benefits. Annuities are recognised when due for payment. Surrenders are accounted for when paid. Death claims are accounted for when notified at which time the policy ceases to be included within the calculation of the insurance contract liabilities.

(g) Investment return

Interest income is calculated using the effective interest method.

Dividend income is recognised when the related investment goes "ex-dividend" and is grossed up where appropriate by the tax credit.

Realised gains or losses represent the difference between net sales proceeds and purchase price or in the case of investments valued at amortised cost, the latest carrying value prior to the date of sale.

Unrealised gains and losses on investments measure the difference between the fair value of investments held at the end of each financial year and their purchase price. The net movement reflects both unrealised gains and losses recognised during the year adjusted for any prior period unrealised gains and losses which have been realised in the current accounting period.

(h) Finance costs

Finance costs comprise the interest expense on borrowings, which is calculated using the effective interest method.

(i) Investment expenses and charges

Investment expenses comprise:

> fees payable to investment managers for advisory services including performance related fees; and

> transaction costs on financial assets at fair value through profit or loss.

Fees payable to investment managers are recognised on an accruals basis.

Performance fees are payable to certain investment managers who exceed certain targets measured over a number of financial years. The Group recognises the costs of such agreements during the life of each contract. No provision is made for fees on potential outperformance of targets in future years.

(j) Employee benefits

Defined contribution plans

Pension Services Corporation Limited ("PSC") operates a defined contribution pension plan into which PSC contributes 8% if the employee makes a minimum contribution of 2% of qualifying salary. Obligations for contributions to defined contribution plans are recognised as an employee benefit expense in the Statement of Comprehensive Income in the period during which the related services are rendered by employees.

Equity settled share-based payment transactions

The fair value on the grant date of equity settled share-based payment awards granted to directors and employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and performance conditions are expected to be met, such that the amount recognised as an expense is based on the number of awards that meet the relevant service conditions and performance conditions at vesting date.

Any ordinary shares required to fulfil entitlements under the share-based payment awards are provided by the Pension Corporation Group Employee Benefit Trust ("EBT"). The EBT is treated as a branch. Any shares purchased by the EBT to fund these awards and held at a period end date are accounted for as treasury shares within the Company and Group shareholders' equity.

When the awards vest and new shares are issued, the proceeds received, net of transaction costs, are credited to share capital (par value) and the balance, if any, to share premium. Where the shares are already held by the EBT, the net proceeds are credited against the cost of these shares, with the difference between cost and proceeds being taken to retained earnings. In both cases, the relevant amount in the share-based payments reserve is then credited to retained earnings.

(k) Investment properties

Investments in freehold properties not for occupation by the Group are carried at fair value, with changes in fair value included in the Statement of comprehensive income.

Properties are valued annually by professional external valuers using the Royal Institution of Chartered Surveyors ("RICS") guidelines. The RICS guidelines apply separate assumptions to the value of the land, buildings and tenancy associated with each property.

The external valuers also consider changes in market conditions and the status of the tenants in determining whether a full physical inspection is required each year. Irrespective of such considerations, each property is fully inspected as part of the valuation process at least once every three years. The cost of additions and renovations is capitalised.

Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific property.

(l) Financial instruments

Derivative financial instruments are measured at fair value through profit or loss ("FVTPL") and classified as held for trading. All other financial assets and financial liabilities, with the exception of short-term assets and liabilities and cash and cash equivalents are classified as fair value through profit or loss on initial recognition.

Financial investments are designated at FVTPL upon initial recognition where they are managed on a fair value basis in accordance with risk management and investment strategies, and information is provided internally to key management personnel on that basis. Financial instruments at FVTPL are initially recognised at fair value in the Statement of Financial Position with transaction costs and any subsequent change in fair value taken directly to the Statement of Comprehensive Income. All changes in fair value are recognised in the Statement of Comprehensive Income and are included within the "Investment return" category as explained in Note 1(g) above.

The amount of each class of financial asset and liability that has been designated at fair value through profit or loss and the methodology for determining the fair value for financial assets and liabilities are set out in Note 13.

(m) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the Statement of Financial Position only when there is an unconditional and a legally enforceable right to offset the recognised amounts in all circumstances (including the default by, or insolvency or bankruptcy of the Group and all counterparties), and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. Realisation of a financial asset and settlement of a financial liability are treated as simultaneous only when the settlements are executed at the same time, or within a single settlement process or cycle, resulting in no or insignificant credit and liquidity risk.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES (continued)

(n) Assets pledged as collateral

The Group receives and pledges collateral in the form of cash and non-cash assets in respect of certain derivative contracts in order to meet its contractual obligations. The amount of collateral required is determined by the valuation of each contract on a mark-to-market basis and the type of collateral to be deposited is specified within the agreement with each counterparty.

Collateral pledged in the form of cash and non-cash assets, which are not legally segregated from the Company, continue to be recognised in the Statement of Financial Position within the appropriate asset classification as the Group retains all rights relating to these assets. If the Group relinquishes the economic risks and rewards of ownership when pledging the assets, it derecognises the asset with a corresponding receivable recognised for its return.

Collateral received in the form of cash and non-cash assets are not recognised as an asset in the Statement of Financial Position unless the Group acquires the rights relating to the economic risks and rewards relating to these assets. Where such assets are recognised, the Group recognises a corresponding financial liability.

(o) Cash and cash equivalents

Cash and cash equivalents consist of cash balances, including any overdrawn balances, and deposits held at call with banks with less than 90 days maturity from date of acquisition.

(p) Foreign currencies

The functional currency of the Group is pounds sterling. The Company and the Group have chosen to present their financial statements in this currency.

Monetary assets and liabilities denominated in a foreign currency are translated into the functional currency at the foreign exchange rate ruling at the end of the financial year. Non-monetary assets and liabilities are translated into the functional currency using the historic rate. All revenue and expense items are reflected in the Statement of Comprehensive Income at the rate effective at the date the transaction took place.

(q) Taxation

Current taxation is provided on taxable profits at the corporation tax rate ruling in the year they are earned.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes, and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates ruling at the date the timing difference is expected to reverse.

A deferred tax asset is recognised only to the extent that it is probable that future profits will be available against which the asset can be utilised.

(r) Prepayments

Prepayments include annuity payments made to pension schemes in advance of the Statement of Financial Position date to ensure settlement of the following month's annuity payments to policyholders on a timely basis.

(s) Impairment of non-financial assets

Non-financial assets that are measured at amortised cost are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

(t) Borrowings

Borrowings are recognised initially at fair value, which is the cash consideration received net of transaction costs incurred. Borrowings classified as liabilities are subsequently stated at amortised cost. The difference between the net proceeds and the redemption value is recognised in the Statement of Comprehensive Income over the borrowing period using the effective interest method.

(u) Insurance liabilities
Insurance liabilities are determined by the Group's internal actuarial department, using methods and assumptions approved by the Directors, and using recognised actuarial methods. The liabilities are calculated using assumptions equivalent to those used for reporting under Solvency II but with the addition of prudential margins. The liabilities are then adjusted to remove certain items which are not required to be recognised as insurance liabilities under IFRS4.

Insurance liabilities comprise the present value of future obligations to current policyholders, increased to take due account of investment expenses and future administration costs associated with the maintenance of the in-force business. Estimates of future obligations to policyholders allow for the impact of mortality in line with the bases set out in Note 10. These bases have been derived from having regard to recent UK general population mortality experience, the demographic profile of the Group's in-force business and the Group's own internal mortality experience, and include an allowance for improvements in longevity in the future.

The interest rate used for discounting future claims payments and the associated expenses is derived from the yield on the assets held to back those liabilities and includes an allowance for risks, including credit risk, associated with holding these assets.

(v) Reinsurance
Amounts recoverable from or due to reinsurers are measured consistently with the amounts covered under each of the in-force reinsurance contracts and in accordance with the terms of each reinsurance contract.

Premiums payable under quota share reinsurance contracts are recognised at the inception of each reinsurance contract. In cases where the amount of premiums due to the reinsurer has not been finalised at the end of a reporting period, an estimate is made in accordance with the terms of each reinsurance contract. Subsequent adjustments to the premium payable are accounted for in the period in which the adjustment arises.

Premiums payable for reinsurance ceded are recognised in the period in which the benefit of the reinsurance treaty is recognised within insurance contract liabilities.

The benefits to which the Group is entitled under its reinsurance contracts are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers, together with longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts.

The Group has two types of quota share reinsurance arrangements. The first type is a quota share agreement with an external reinsurer covering all policyholder benefit payments for a proportion of the business reinsured. This proportion varies between 50% and 90% for certain discrete blocks of business. The second type is a tail-risk quota share arrangement with an external reinsurer under which 100% of all benefit payments after a fixed period (subject to certain treaty-specific limits) are covered in return for an initial single premium.

The Group has also entered into a number of longevity reinsurance contracts with external reinsurers under which it has committed to pay the reinsurer a schedule of fixed payments ("the fixed line") in respect of expected claims relating to defined tranches of policyholder benefits and in return the reinsurer undertakes to reimburse the actual cost of claims on those tranches to the Group. Separately, there is also an insurance fee on each of these contracts for which the Group is liable. Settlement of the contract is on a net basis. The amounts receivable from or payable to reinsurers are recognised as Reinsurers' share of insurance liabilities in the Statement of Financial Position.

Fees paid in respect of certain longevity reinsurance contracts which are contingent on surplus levels under the historical solvency regime are recognised as incurred and are included under outward reinsurance premiums.

Reinsurance recoveries are accounted for in the same period as the related claim is incurred.

The Group impairs its reinsurance assets if there is an objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that not all amounts due to it under the terms of the contract will be received and the impact of the event on the amount to be received from the reinsurer can be reliably measured. An impairment loss is recognised for the amount by which the reinsurance asset's carrying amount exceeds its recoverable amount.

(w) Critical accounting policies, estimates and judgements
Included in the financial statements are certain critical accounting judgements as described below:

Contract classification
IFRS 4 "Insurance Contracts" requires policyholder contracts written by insurers to be classified as either insurance contracts or investment contracts depending on the level of insurance risk transferred.

Insurance contracts are defined as those contracts containing significant insurance risk if, and only if, an insured event could cause an insurer to make significant additional payments in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract. Such contracts remain insurance contracts until all rights and obligations are extinguished or expire.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES (continued)

Policy contracts which do not transfer significant insurance risk to the insurer are classified as investment contracts. The Company has classified all its policyholder contracts as insurance contracts.

Included in the financial statements are certain critical accounting estimates as described below:

Insurance liabilities

Insurance liabilities are valued using projected cashflows of future retirement income and the cost of administrating payments to policyholders. The key assumptions relate to future mortality, discount rates and inflation.

The carrying value of insurance liabilities net of reinsurance at the end of the financial year is £26.9 billion (2017: £22.5 billion). The assumptions used to establish insurance contract liabilities and appropriate sensitivities relating to variations in these assumptions are disclosed in Note 10.

Financial instruments

Where an active market does not exist for a financial instrument, the Company uses financial modelling to ascertain fair value. The models consider the anticipated future cash flows expected to be derived from the assets or paid in respect of the liabilities and discount them to reflect the timing of payments and, for debt assets, the likelihood of default given the relative seniority of the holding in order of repayment. The relevant fair value disclosures are set out in Note 13.

2. INVESTMENT RETURN

	2018 £m	2017 £m
Income from debt securities	708	615
Interest income on cash deposits	19	15
Income from mortgage backed securities ("MBS")	2	1
Interest income	729	631
Rental income	6	5
Income from other investments		
> Investment schemes	3	3
> Other asset backed securities ("ABS")	10	8
> Net (loss) / income on other investments	(54)	(81)
	(35)	(65)
Total investment income	694	566
Realised gains on investments		
> Investments designated as FVTPL on initial recognition	256	320
> Investments classified as held for trading	28	11
Realised losses on investments		
> Investments designated as FVTPL on initial recognition	(1)	(4)
> Investments classified as held for trading	(120)	(17)
Net realised gains	163	310
Unrealised gains on investments		
> Investments designated as FVTPL on initial recognition	53	177
> Investments classified as held for trading	166	723
Unrealised losses on investments		
> Investments designated as FVTPL on initial recognition	(1,230)	(407)
> Investments classified as held for trading	(824)	(277)
Net unrealised gains/(losses)	(1,835)	216
Investment return	(978)	1,092

3. ACQUISITION EXPENSES

	2018 £m	2017 £m
Acquisition expenses	52	51

Acquisition costs include an element of the wages and salaries of employees involved in the activity of acquiring new contracts.

4. OTHER OPERATING EXPENSES

	2018 £m	2017 £m
Investment charges and related expenses	26	16
Project costs	18	10
Equity settled share-based payments	6	6
Other expenses	22	16
	72	48

Investment charges and related expenses include amounts due at the end of each financial year relating to investment performance fees payable on targets based over a number of financial years.

5.AUDITOR'S REMUNERATION

	2018 £	2017 £
Fees payable to the Company's auditor for the audit of the Company's annual accounts	21,049	20,636
Fees payable to the Company's auditor and its associates for other services:		
Audit of accounts of subsidiaries	278,582	245,295
Audit-related assurance services	149,754	146,818
All other services	57,000	88,938
Total fees paid to the auditor	506,385	501,687

6. DIRECTORS' REMUNERATION, EMPLOYEE COSTS AND HEADCOUNT

The cost of Directors and employees of the Group for the year were as follows:

	2018 £m	2017 £m
Wages and salaries	28	24
Social security costs	5	4
Other pension costs	1	1
	34	29

The fourteen Directors (2017 : fourteen) who served in the Company during the year received total remuneration of £1 million (2017: £1 million) for their services to the Company.

The amount of remuneration received by the highest paid Director was £1 million (2017: £1 million). This includes £1 million (2017: £1 million) in respect of services provided to other Group companies. In addition, the highest paid Director was awarded 303,721 ordinary shares on maturity of certain share incentive scheme's during 2018 along with nil (2017: 556) C shares awarded under the Share Growth Plan.

No Directors had money paid to money purchase pension schemes on behalf of the Company during the year (2017: £nil).

One Director of the Company was awarded share options during their tenure (2017: one). One Director of the Company received a total of 303,721 ordinary shares of the Company upon vesting of the Share Plans during the year (2017: one director received a total of 227,828 ordinary shares).

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

6. DIRECTORS' REMUNERATION, EMPLOYEE COSTS AND HEADCOUNT (continued)

The average number of persons employed by the Group (including Directors) during the year, analysed by category, was as follows:

	2018 No	2017 No
Employees	189	157
Directors	12	12

7. SHARE-BASED PAYMENT ARRANGEMENTS

The Group (via PSC) operates three types of share based incentive schemes for employees. All three meet the definition of equity settled share based payments under IFRS 2 "*Share Based Payment*".

All schemes contain clawback provisions which allow the PIC Nominations and Remuneration Committee to reduce or extinguish awards in certain specified circumstances.

Analysis of expense recognised in the Statement of comprehensive income

	2018 £m	2017 £m
Equity settled share based payment transactions		
Deferred Performance Share Plan	6	6
Total expense recognised for equity settled share based payments	6	6

Share Growth Plan 2017

The commercial objective of this plan is to deliver to participants (Directors and senior management of Group companies) a proportion of growth in value of the Company above the value of the Company on implementation of the Plan ("Initial Company Value"):

> 4.25% of the growth in the value of the Company between Hurdle 1 (10% p.a.) and Hurdle 2 (12% p.a.);

> 5.525% of the growth in the value of the Company between Hurdle 2 and Hurdle 3 (15% p.a.);

> 1.4% of the growth in the value of the Company between Hurdle 3 and Hurdle 4 (20% p.a.); and

> 0.85% of the growth in the value of the Company above Hurdle 4.

The Growth Shares (issued as C shares) will ordinarily vest four years from acquisition date, 1 January 2017 ("the Vesting Date"), subject to certain provisions. On the Vesting Date, the value of the Growth Shares will be determined and the Growth Shares will be converted into ordinary shares of equal value.

Participants will only be able to sell their ordinary shares received on conversion on the Vesting Date, in years 4, 5 and 6 in equal amounts, i.e. these shareholders will be able to sell a third each year after the growth plan vests.

If there is an exit event prior to the Vesting Date, the value of the Growth Shares will be determined on exit and the Growth Shares will vest as follows:

> on a sale or winding up of the Company, Growth Shares would vest in full;

> on a listing, the Growth Shares would convert into ordinary shares of an equal value. One third of the resulting ordinary shares would vest upon listing; one third would vest on the earlier of the 4th anniversary of the grant date and 12 months following the listing; and one-third would vest on the earlier of the 4th anniversary of the grant date and 24 months following the listing.

The fair value of the Growth Plan at inception was calculated to be £1.6 million, which was fully paid by the participants. As a result, no expense has been recognised in the Statement of Comprehensive Income in respect of this plan.

Deferred Performance Share Plan ("DPSP") (previously known as Performance Share Plan)

This plan is designed to incentivise key individuals to grow the business and build a sustained and successful future for the Group by rewarding and retaining them through a long-term incentive arrangement. Initial awards under the plan were made by the Company on 30 January 2013 and again on 12 February 2014, 25 February 2015, 26 February 2016, 20 February 2017 and 21 March 2018. Awards may be made on an annual basis in the future at the Company's discretion.

The awards under the DPSP are in the form of a nil cost option over a number of the Company's ordinary shares.

	Awarded	Lapsed/ forfeited	Exercised	Remaining
2013 awards	3,705,000	124,444	3,438,889	141,667
2014 awards	2,493,831	25,755	2,350,892	117,184
2015 awards	2,973,153	220,315	2,574,362	178,476
2016 awards	2,770,458	199,673	–	2,570,785
2017 awards	2,492,636	39,131	–	2,453,505
2018 awards	2,336,578	2,881	–	2,333,697
As at 31 December 2018	16,771,656	612,199	8,364,143	7,795,314

Save As You Earn Share Plan ("SAYE")

The SAYE plan is designed to incentivise all employees to grow the business and participate in the rewards this offers. There are two types of SAYE schemes: approved and unapproved by HMRC.

Initial awards under the plan were made by the Company on 9 April 2013 and again on 11 April 2014, 13 April 2015 and 16 May 2016 and again on 8 May 18. These were unapproved by HMRC.

On 11 May 2017 and again on 8 May 18, awards were made by the Company, which were approved by HMRC. Awards may be made on an annual basis in the future at the Company's discretion.

The SAYE plan is a savings plan that allows all staff to save a fixed amount each month over a three year period. At the start of the savings period staff are also granted an option over a number of ordinary shares in the Company at a discount of up to 20% of the market value of the Company's shares at the date of grant. The minimum and maximum amounts for a savings contract are £20 and £500 (or 10% of gross salary if lower) per month respectively. These limits apply per plan and are an annual amount.

	Awarded	Lapsed/ forfeited	Exercised	Remaining
2013 awards	780,300	103,950	675,450	900
2014 awards	502,255	103,561	395,719	2,975
2015 awards	336,455	36,843	241,471	58,141
2016 awards	439,738	72,109	–	367,629
2017 awards	571,094	36,581	–	534,513
2018 awards	447,377	17,499	–	429,878
As at 31 December 2018	3,077,219	370,543	1,312,640	1,394,036

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

8. CORPORATION TAX

Group

The Group's tax charge for the year is:

	2018 £m	2017 £m
Current taxation		
Corporation tax payable for the current year	92	74
Prior year under/(over) provision	–	–
Total current tax	92	74
Deferred taxation		
Recognition of deferred tax asset on temporary timing differences	–	(1)
Tax transitional adjustment	(1)	–
Effect of change in tax rates	–	–
Total deferred tax	(1)	(1)
Tax charge	91	73

The effective current tax charge for the period is the same as (2017: lower) than the standard rate of corporation tax in the United Kingdom of 19% (2017: 19.25%). The differences are explained below:

	2018 £m	2017 £m
Reconciliation of total income to the applicable tax rate		
Profit before taxation	477	383
Corporation tax at 19% (2017: 19.25%)	91	74
Effects of:		
Expenses not deductible for tax purposes	–	–
Allowable charge against tax	(1)	(2)
Deferred taxation movement	1	1
Tax charge	91	73

Factors that may affect future tax charges

The Group's tax charge is primarily based on the profits of PIC.

Following the January 2013 change in the taxation regime for insurance companies, the benefit of the differences between IFRS retained earnings and taxable profits at 31 December 2012 will reverse over a period of ten years. Consequently, the Group has recognised a deferred tax liability at 31 December 2018 of £3 million (2017: £4 million) in respect of these timing differences which total £16 million (2017: £20 million).

UK corporation tax rates are 19% from 1 April 2017 (enacted 18 November 2015) and 17% from 1 April 2020 (enacted 15 September 2016). These rates will reduce the Group's future current tax charge accordingly. The deferred tax liability at 31 December 2018 has been calculated based on these rates.

Company

The Company is subject to the standard company tax rate in the United Kingdom.

9. INVESTMENT PROPERTIES

	2018 £m	2017 £m
At beginning of year	99	97
Change in fair value during the year	(3)	2
At end of year	96	99

The Group classifies its investment in eight Guernsey registered property unit trusts ("GPUTs") as investment properties. The Group holds 100% of the issued units in the GPUTs. The GPUTs own the freehold of six properties and have a long leasehold interest in the remaining two properties. All eight properties are located in the United Kingdom.

In 2015, the GPUTs were restructured by changing a single unit into A and B units, representing income and capital streams.

Investment properties have been classified as Level 3 in the fair value hierarchy, due to the unobservable inputs used in the valuation model. The market value of the investment properties is determined based on a valuation approach, which applies investment yield to the rental income. The investment yield is derived from available transactional evidence of similar rental units considering the property specific factors such as its location, the unexpired term, current rent, size of the unit and other factors.

The sensitivities of the property values to +/- 10% change in the investment yield is +/- £2 million (2017: +/- £2 million).

Rental income received in relation to these properties of £6 million (2017: £5 million) is shown within investment return in Note 2.
There were no additions and disposals made during the year (2017: nil).

10. INSURANCE CONTRACTS AND RELATED INSURANCE LIABILITIES

In accordance with the accounting policy on product classification, all policyholder contracts have been classified as insurance contracts.

The Group's liabilities in relation to future policyholders' benefits are:

	2018 £m	2017 £m
Future policyholders' benefits		
Gross	28,720	24,993
Reinsurance	(1,854)	(2,450)
Net	26,866	22,543

The gross insurance liabilities shown above are stated in accordance with the Group's accounting policies as set out in Note 1. The figures exclude reserves which are required for the calculation of regulatory solvency under the PRA rules but which do not meet the definition of a liability under IFRS and therefore are excluded from insurance liabilities under IFRS 4 and IAS 37 "*Provisions, Contingent Assets and Contingent Liabilities*".

The reinsured liabilities include liabilities ceded under longevity reinsurance contracts with external counterparties and immediate and deferred annuity payments ceded under external quota share arrangements.

(a) Terms and conditions of insurance contracts

The Group's insurance liabilities represent contracts that provide immediate annuities for current pensioners and deferred annuities for members who have not yet reached pensionable age. Annuities in deferment and in payment can be level, subject to fixed increases or increases linked to inflation, or a mixture of the three, and in many cases are also subject to defined caps and floors on the increases that can be applied. The insurance liabilities also include member options, such as the option to commute part of the pension for a tax-free cash lump sum on vesting, and annuities payable to spouses or other dependants on the death of the main member.

The Group's insurance contracts are a mixture of "buy-in" policies, where the policyholder is the pension scheme and the insured liabilities cover defined benefits within the scheme, and "buyout" policies, where the policyholder is an individual.

Insurance liabilities are calculated as the present value of future annuity payments and expenses. The principal assumptions used in the calculation are set out overleaf.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

10. INSURANCE CONTRACTS AND RELATED INSURANCE LIABILITIES (continued)

(b) Principal assumptions used in the preparation of insurance liabilities

Mortality assumptions

The base mortality assumptions as at 31 December 2018 inherent in the projected cash flows used in the valuation of insurance contract liabilities are set with reference to the S2 series mortality tables published by the Continuous Mortality Investigation ("CMI", a research body with strong links to the Institute and Faculty of Actuaries in the UK).

Adjustments are applied to these according to a number of factors including, but not limited to, an individual's gender, age, pension amount, occupation and place of residence.

In 2018, as a result of our annual investigation of the base mortality assumptions against our observed experience, we updated the base mortality assumptions from those used in the 2017 valuation. This update involved the adoption of the CMI 2016 model for mortality improvements from 2007 (the effective date of the S2 series mortality tables) to 2017 (2017: based on a combination of the CMI 2012 and CMI 2014 improvements models from 2007 to 2017) and updating the proportion of the S2 table to 99% (2017: 100%). These two changes caused a net weakening of our mortality assumptions and released £144 million of reserves. (No updates were made to the base mortality assumptions in 2017.)

The assumption for future improvements to mortality is modelled using the CMI 2016 model. This was an update in 2017 (where previously we had used the CMI 2014 improvements model) and which caused a release of £113 million of reserves in 2017. No updates were made to the assumption for future improvements in 2018.

Valuation rate of interest ("VRI")

The VRI is set at 100% ofthe risk adjusted yield on assets backing liabilities. Risk adjustments are applied for credit risk associated with the assets held to match liabilities.

In 2018, the methodology to determine the risk adjustments was refined. This involved the release of some prudent margins and closer alignment to our Solvency II balance sheet, although with significant prudence built in. We updated our level of prudence so that, on an equivalent basis, at end 2017 we would have moved from assuming that 52% of spread related to defaults, to assuming that 44% of the spread related to defaults. This released £320 million of reserves. In addition, the calculation methodology was updated to be based on a fixed basis points default allowance by asset, based on historic levels of default and downgrade with prudent margins, rather than the "percentage of spread" approach used previously. This change has meant that the deduction related to defaults is now principally driven by ratings changes in our investment portfolio, rather than the spread on those assets. This methodology change makes the reported IFRS profits much less sensitive to changes in credit spreads going forwards.

The rate calculated in accordance with these rules as at 31 December 2018 was 2.69% for both index-linked liabilities and non-linked liabilities (2017: 2.06% combined rate).

Inflation

Assumptions for expected future Retail Price Index inflation and Consumer Price Index inflation are based on a curve derived from market prices of inflation-linked swap contracts. For Limited Price Index linked annuities, which are subject to maximum and minimum percentage annual increases, a mark-to-model approach is used to allow for the inherent optionality, as there is currently no deep and liquid market in appropriate swap contracts.

Other assumptions

The internal costs of maintaining the existing insurance contracts, the fees payable to third-party administrators engaged to manage payments due under the in-force policies, fees due to reinsurers and investment management expenses are factored into the calculation of liabilities by adding appropriate allowances, and include an estimate of the impact of future inflation where this is applicable. No allowances are included for expenses incurred in relation to the generation of new business.

(c) Movements

The following table analyses the movement between the insurance liabilities at the beginning and the end of the year into its major components. The main reasons for the increase are the new business written in the year and changes in underlying economic assumptions.

2018	Gross £m	Reinsurance £m	Net £m
At beginning of year	24,993	(2,450)	22,543
Increase in liability from new premiums or assets in respect of reinsurance	7,511	2	7,513
Impact of reinsurance entered into in the year	–	(215)	(215)
Reduction in liability from claims	(1,179)	6	(1,173)
Impact of investment volatility	(1,874)	318	(1,556)
Changes in valuation assumptions	(857)	457	(400)
Other movements (including net investment return)	126	28	154
At end of year	28,720	(1,854)	26,866

2017	Gross £m	Reinsurance £m	Net £m
At beginning of year	21,741	(2,522)	19,219
Increase in liability from new premiums or assets in respect of reinsurance	3,985	(9)	3,976
Impact of reinsurance entered into in the year	–	(164)	(164)
Reduction in liability from claims	(921)	6	(915)
Impact of investment volatility	643	(68)	575
Changes in valuation assumptions	(390)	220	(170)
Other movements (including net investment return)	(65)	87	22
At end of year	24,993	(2,450)	22,543

Changes in assumptions

The movements during the year relating to economic and non-economic assumptions, as shown in the above table, comprise the following items:

Impact of investment volatility

Assumptions follow the movement in long-term interest rates, inflation expectations and credit spreads.

The main driver of the movements is a change in the asset mix and duration of our credit risky asset portfolio, resulting in a reduction in the value of liabilities (2017: narrowing of credit spreads caused an increase in liabilities). In addition, foreign currency movements, interest rate movements and inflation movements also resulted in an increase in liabilities.

Changes in valuation assumptions

The movements during the year relating to valuation assumptions comprise the following items:

The assumption for base mortality was updated to reflect our most recent experience analysis, which caused a release of reserves.

The approach to determine the probability of default within the IFRS discount rate, has been revised to be based on a fixed basis point deduction, rather than a percentage of spread approach. This has also caused a release of reserves.

(d) Analysis of expected maturity of gross and net insurance contract liabilities

The table below indicates the net insurance contract liabilities analysed by duration, showing the discounted values of the policy cash flows estimated to arise during each period.

	Within one year £m	In 1–5 years £m	In 5–15 years £m	Over 15 years £m	Total £m
Deferred annuities					
Gross	52	457	1,548	4,328	6,385
Reinsurance	(3)	(24)	(107)	(976)	(1,110)
As at 31 December 2018	49	433	1,441	3,352	5,275
Annuities in payment					
Gross	1,131	4,274	8,713	8,217	22,335
Reinsurance	30	87	(59)	(802)	(744)
As at 31 December 2018	1,161	4,361	8,654	7,415	21,591

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

10. INSURANCE CONTRACTS AND RELATED INSURANCE LIABILITIES (continued)

	Within one year £m	In 1–5 years £m	In 5–15 years £m	Over 15 years £m	Total £m
Deferred annuities					
Gross	48	353	1,368	4,618	6,387
Reinsurance	(5)	(29)	(108)	(1,345)	(1,487)
As at 31 December 2017	43	324	1,260	3,273	4,900
Annuities in payment					
Gross	858	3,310	6,993	7,445	18,606
Reinsurance	22	57	(97)	(945)	(963)
As at 31 December 2017	880	3,367	6,896	6,500	17,643

(e) Sensitivity analysis

In accordance with IFRS 4 and IFRS 7 "Financial Instruments: Disclosures" the Directors have considered the effect on profits and equity at 31 December 2018 resulting from changes in a number of key assumptions. The effect of each of the assumption changes is considered in isolation on the basis that all other key assumptions remain unaltered. The impact of this sensitivity analysis on profits is set out in the table below.

	Interest rates		Inflation rates	
31 December 2018	Increase of 25bps £m	Fall of 25bps £m	Increase of 50bps £m	Fall of 50bps £m
Movement in assets	(873)	924	1,337	(1,190)
Movement in liabilities	831	(887)	(1,236)	1,169
Tax effect	8	(7)	(19)	4
Movement in profit and equity	(34)	30	82	(17)

	Base mortality (see below) £m	Mortality improvements (see below) £m	Renewal expenses (see below) £m	Exchange rates (see below) £m	Credit spreads increase of 25bps £m
Movement in assets	–	–	–	23	(524)
Movement in liabilities	(26)	(63)	(120)	(19)	536
Tax effect	5	12	23	(1)	(2)
Movement in profit and equity	(21)	(51)	(97)	3	10

	Interest rates		Inflation rates	
31 December 2017	Increase of 25bps £m	Fall of 25bps £m	Increase of 50bp £m	Fall of 50bps £m
Movement in assets	(775)	817	1,108	(989)
Movement in liabilities	791	(843)	(1,127)	1,070
Tax effect	(3)	5	4	(16)
Movement in profit and equity	13	(21)	(15)	65

	Base mortality (see below) £m	Mortality improvements (see below) £m	Renewal expenses (see below) £m	Exchange rates (see below) £m	Credit spreads increase of 25bps £m
Movement in assets	–	–	–	15	(442)
Movement in liabilities	(25)	(65)	(106)	(12)	325
Tax effect	5	12	20	(1)	23
Movement in profit and equity	(20)	(53)	(86)	2	(94)

(e) Sensitivity analysis (continued)
The sensitivity of the IFRS profits to changes in credit spreads has reduced significantly at the end of 2018 compared to the prior year. This is as a result of the methodology change made with regards to the allowance for credit defaults within the IFRS insurance liabilities (see note 10(b) for further details). The change in credit default methodology removed a large element of the credit spread sensitivity, with the assumption now being more dependent on upgrades/downgrades in credit ratings of assets in the underlying investment portfolio.

Parameters for exchange rate, longevity and renewal expense sensitivities
The exchange rate sensitivity is based on weakening of US Dollar and Euro against sterling by 1%.

The base mortality sensitivity is based on a 1% decrease in the base mortality rates. This is equivalent to a 0.1 year increase in life expectancy from 22.7 years to 22.8 years for a typical male aged 65.

The mortality improvements sensitivity is based on a 0.1% increase in annual mortality improvement rates. This is equivalent to a 0.1 year increase in life expectancy from 22.7 years to 22.8 years for a typical male aged 65.

The expense sensitivity is based on an increase in annual maintenance expenses (including third party administration costs) of 15%.

The key assumptions, methodology and limitations of the sensitivity analysis are as follows:

> The effects of the specified changes in factors are determined based on the year-end financial instrument values. The level of movements in market factors on which the sensitivity analyses are based were determined based on economic forecasts and historical experience of variations in these factors. The sensitivity analysis is based on the risks to which the Group is exposed at the end of the reporting period, and reflects the changes in relevant risk variables that are reasonably possible at this date and over the next reporting period. The sensitivities used are based around the core assumptions in the financial statements rather than considering more extreme scenarios.

> Each entry in the sensitivity table demonstrates the effect of a change in a single key assumption while other assumptions remain unchanged. However, the occurrence of a change in a single market factor will often lead to changes in other market factors. In particular, the Group's use of derivatives is designed to ensure that its exposure to interest and inflation risks is carefully managed.

(f) Reinsurance results
The effect of reinsurance contracts entered into by the Group on profit before taxation is as follows:

	2018 £m	2017 £m
Outward reinsurance premiums	(29)	(41)
Reinsurers' share of claims paid	74	94
Changes in reinsurers' share of insurance liabilities	(596)	(72)
Net effect of reinsurance contracts on profit before taxation	(551)	(19)

Reinsurance assets have reduced significantly during the year due to the impact of the annual update to reflect our experience to the base mortality assumptions, which resulted in lower expected recoveries from our longevity swaps.

Outward reinsurance premiums include amounts payable in respect of quota share arrangements and insurance fees payable in respect of longevity reinsurance contracts. The charge for the year comprises the following items:

	2018 £m	2017 £m
Amounts payable in respect of insurance fees	29	41
Current year premiums payable in respect of quota share arrangements	–	–
Outward reinsurance premiums	29	41

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

11. DEFERRED TAX

At 31 December 2018, the Group's deferred tax balances calculated in accordance with IAS 12 "Income Taxes" were as follows:

	Asset £m	Liability £m	Total £m
31 December 2018			
Timing differences	3	(3)	–
31 December 2017			
Timing differences	3	(4)	(1)

The movement in the deferred tax balance during the year was as follows:

	2018 £m	2017 £m
At beginning of year	(1)	(4)
Recognition of deferred tax asset on temporary timing differences	1	3
At end of year	–	(1)

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that sufficient future taxable profits will arise from which the underlying temporary differences can be deducted.

The Group has no other timing differences or tax losses carried forward at 31 December 2018 (2017: £nil) which may give rise to reduced tax charges in future periods.

12. BORROWINGS

	2018		2017	
Loan notes	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
£300m notes maturing 2024	297	332	296	354
£250m notes maturing 2026	247	289	247	320
£350m notes maturing 2030	347	341	–	–
Total	891	962	543	674

On 3 July 2014, the Group's main subsidiary entity, PIC, issued £300 million subordinated loan notes due 2024 with a fixed coupon of 6.5% paid annually in arrears. The notes were issued at 99.107% of par.

On 23 November 2016, PIC issued a further tranche of £250 million subordinated loan notes due 2026 with a fixed coupon of 8.0% paid annually in arrears. These notes were issued at 98.916% of par.

On 21 September 2018, PIC issued a further tranche of £350 million subordinated loan notes due 2030 with a fixed coupon of 5.625% paid annually in arrears. These notes were issued at 99.693% of par.

All notes represent direct, unsecured and subordinated obligations of PIC, and are classified as qualifying dated Tier 2 securities for the purposes of regulatory capital requirements. The notes are listed on the London Stock Exchange.

The fair value has been calculated by applying an adjustment to the quoted price to reflect market illiquidity. The loan notes have been classified as Level 2 in the fair value hierarchy.

For the year ended 31 December 2018 an interest expense of £46 million (2017: £41 million), which was calculated using the amortised cost method, was recognised in the Statement of Comprehensive Income in respect of the notes.

13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

All of the Group's financial assets and liabilities have been designated as fair value through profit and loss or categorised as loans and receivables (and accounted for at amortised cost) as detailed below.

Group

	2018		2017	
Financial assets	Fair value through profit and loss £m	Amortised cost £m	Fair value through profit and loss £m	Amortised cost £m
Financial investments				
Debt securities	28,288	–	23,723	–
MBS and ABS	356	–	240	–
Equity release mortgages	294	–	107	–
Deposits with credit institutions	1,095	–	577	–
Participation in investment schemes	1,338	–	1,024	–
Total financial investments	31,371	–	25,671	–
Derivative assets	9,757	–	8,775	–
Loans and receivables and other financial assets				
Debtors arising out of direct insurance operations	–	52	–	120
Other debtors	–	5	–	15
Accrued interest	–	223	–	185
Total receivables and other financial assets	–	280	–	320
Cash and cash equivalents	–	79	–	43
Total financial assets	41,128	359	34,446	363
Financial liabilities				
Derivative liabilities	11,303	–	9,663	–
Creditors arising out of reinsurance operations	–	11	–	9
Other creditors	–	3	–	12
Insurance and other payables	–	14	–	21
Borrowings	–	891	–	543
Accruals	–	72	–	56
Total financial liabilities	11,303	977	9,663	620

Amounts due to be received in more than one year in the above table are as follows:

	2018 £m	2017 £m
Financial assets designated as fair value through profit or loss	38,741	32,636
Debtors arising out of direct insurance operations	–	–

All amounts relating to insurance and other payables and accruals are expected to be settled within one year.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

Deposits with credit institutions

Deposits with credit institutions include £18 million (2017: £18 million) in two bank accounts operated by PIC which are designated fee collateral bank accounts. These accounts were established under deeds of charge dated 9 July 2012 and 11 December 2012 between PIC and Münchener Rückversicherungsgesellschaft ("Munich Re") in respect of longevity reinsurance agreements. The amount deposited in each account represents a proportion of PIC's liability for the payment of fees due over the life of each agreement ("fee collateral amount") and is subject to annual review by each party.

PIC retains control of the cash deposited in these accounts; however, it must maintain a balance at least equal to the agreed fee collateral amount and Munich Re has a fixed first charge over the accounts which gives it the right to withdraw an amount equivalent to its outstanding fees due under the agreement on the occurrence of certain specified default events.

Assets pledged as collateral

As explained in Note 14, the Group uses derivative financial instruments as part of its risk management strategy. Most over the counter derivative transactions require collateral to be received or pledged by the Group or its counterparty to mitigate the counterparty credit risk. The Group has collateral agreements with each counterparty based on standard ISDA master netting agreements, which specify minimum thresholds, asset class and credit quality of collateral and the frequency of valuation. While each party to the contract has a legal right to the collateral received if the counterparty does not meet its obligations, there is no economic benefit from holding the assets as each party has the right to substitute the collateral delivered for another asset of the same value and quality at any time. Therefore, these agreements do not meet the criteria for offsetting under IAS 32.

The Group returns/receives the collateral received/pledged upon contract termination or settlement. The amount of collateral received/pledged fluctuates due to the changes in fair value of the derivative subject to the minimum thresholds.

At 31 December 2018, the Group has included £2,338 million (2017: £1,688 million) of financial assets which have been pledged as security under the terms of derivative contracts. The Group retains substantially all the risks and rewards of ownership in respect of the transferred assets and consequently none of these assets have been derecognised in the financial statements.

At 31 December 2018, the amount of collateral received by the Group was £591 million (2017: £662 million). While the Group is permitted to sell or repledge collateral received, no collateral was actually sold or repledged in the absence of default during the year (2017: £nil).

In 2014, PIC concluded a pension insurance buy-in transaction to underwrite approximately £1.6 billion of pension liabilities. Under the terms of the agreement, a security structure was put in place which required PIC to transfer legal title to certain assets back to the Trustee as collateral against PIC default.

Under the terms of the security, the Trustee is free to use the assets without constraint; however, it is obliged to deliver equivalent assets (defined as "an asset of the same type, nominal value, description and amount"), as well as the income earned and gains or losses incurred on these assets to PIC. PIC retains the right to replace any of the assets with assets of similar nature.

Collateral is returned to PIC as it services the insured pension liabilities under the policy. This, in theory, exposes PIC to counterparty credit risk, which is, however, fully mitigated as PIC has contractual right to offset its obligation to pay under the policy in the event of default by the Trustee. PIC retains substantially all the risks and rewards of ownership in respect of the transferred assets and accordingly PIC continues to recognise the assets which it has pledged under title transfer security in its financial statements. At 31 December 2018, this totalled £1.7 billion (2017: £1.8 billion).

In 2018, the Group has included £150 million of financial assets which have been pledged as collateral under the terms of certain reinsurance contracts (2017: £116 million). The Group retains substantially all the risks and rewards of ownership in respect of the transferred assets and consequently none of these assets have been derecognised in the financial statements.

At 31 December 2018, the Group held £1 million (2017: £7 million pledged) cash as collateral under the terms of certain reinsurance contracts.

The Group enters into a number of securities lending, sale and repurchase arrangements and reverse sale and repurchase arrangements.

Assets pledged as collateral (continued)
In securities lending arrangements, the Group lends an agreed debt security to a counterparty and receives collateral in the form of eligible, investment grade debt securities as a security against potential counterparty default. In sale and repurchase agreements the Company receives cash for a specified period in return for providing collateral in the form of UK gilts or other sovereign bonds. In reverse sale and repurchase arrangements, the Group provides cash for a specified period and receives collateral in the form of UK gilts or other sovereign bonds.

In all cases the Group retains substantially all the risks and rewards of ownership in respect of the transferred assets and consequently none of these assets have been derecognised in the financial statements. At 31 December 2018, the Group had £1,399 million (2017: £1,209 million) assets related to securities lending and reverse sale and repurchase agreements, and held £1,399 million (2017: £1,209 million) in gilts and eligible securities as collateral in respect of these arrangements.

Offsetting
The Group does not offset financial assets and liabilities in the Statement of financial position unless there is a legally enforceable right to offset and the Group has the intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously. Except for foreign exchange forward agreements, the Group has no financial assets and financial liabilities that have been offset in the Statement of Financial Position as at 31 December 2018 (2017: £nil).

The table below contains disclosures related to financial assets and financial liabilities that are subject to enforceable master netting arrangements or similar agreements as required by IFRS7.

31 December 2018	Gross amounts of recognised financial assets/ (liabilities) £m	Amounts offset in accordance with IAS 32 £m	Net amounts as recognised in the Statement of financial position £m	Related amounts not offset in the Statement of financial position: Financial instruments (received)/ pledged £m	Cash collateral (received)/ pledged £m	Derivative (liabilities)/ assets £m	Net amount £m
Financial assets							
Derivatives	12,639	(2,882)	9,757	–	(591)	(8,910)	256
Debt securities	651	–	651	(651)	–	–	–
Deposits with credit institutions	748	–	748	(748)	–	–	–
Financial liabilities							
Derivatives	(14,185)	2,882	(11,303)	2,338	–	8,910	(55)

31 December 2017	Gross amounts of recognised financial assets/ (liabilities) £m	Amounts offset in accordance with IAS 32 £m	Net amounts as recognised in the Statement of financial position £m	Related amounts not offset in the Statement of financial position: Financial instruments (received)/ pledged £m	Cash collateral (received)/ pledged £m	Derivative (liabilities)/ assets £m	Net amount £m
Financial assets							
Derivatives	9,784	(1,009)	8,775	(57)	(605)	(7,846)	267
Debt securities	838	–	838	(838)	–	–	–
Deposits with credit institutions	371	–	371	(371)	–	–	–
Financial liabilities							
Derivatives	(10,672)	1,009	(9,663)	1,688	–	7,846	(129)

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

Company

All of the Company's financial assets and liabilities are valued at amortised cost as detailed below:

	2018 Amortised cost £m	2017 Amortised cost £m
Financial Assets		
Cash and cash equivalents	2	6
Receivables and other financial assets	33	2
Total Financial Assets	35	8
Financial Liabilities		
Insurance and other payables	9	6
Total Financial Liabilities	9	6

Included within receivables and other assets are amounts totalling £2m (2017: £2m) due to be received in more than one year. All amounts relating to insurance and other payables and accruals are expected to be settled within one year.

Measurement of financial assets and liabilities

The Group's financial assets and liabilities have been valued using the following methods in accordance with IAS 39 "*Financial Instruments*".

The fair values of investments quoted in an active market are based on their bid market prices. For unlisted securities and all other financial assets for which there is no active market, the Group establishes fair value using appropriate valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, counterparty and broker valuations and option pricing models. These assessments are based largely on observable market data.

The specific valuation techniques used for the main classifications of financial assets and liabilities are:

(a) Investments in shares, debt securities, unit trusts and participation in investment schemes

The fair value of shares and debt securities is determined by reference to their quoted bid price at the reporting date. For instruments quoted on a recognised stock exchange, these would generally be considered as Level 1 within the fair value hierarchy.

Fair values for unlisted shares and variable yield schemes are estimated using applicable valuation techniques such as price/earnings or price/cash flow ratios or other measures refined to reflect the specific circumstances of the issuer. Fair values for unlisted debt securities are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. Where the inputs for these calculations are readily observable, these would generally be classified as Level 2 within the fair value hierarchy.

Some debt securities are valued as mark to model, where no observable market data exists. These include infrastructure and other loans in respect of capital projects, which are valued on a discounted cash flow method with the primary assumption being the discount rate used. These investments have been included in Level 3 within the fair value hierarchy.

(b) Derivatives

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. The fair value of foreign exchange forward contracts, futures and swaps are based on market prices, where available. For swaps, market prices are calculated using discounted cash flow techniques based on adjusted market data such as composite curves derived from a number of market counterparties. Derivative contracts may not be readily tradeable and consequently they have been classified as Level 2 assets within the fair value hierarchy.

All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Net gains or losses arising from changes in the fair value of the derivative financial instruments are recognised immediately in the Statement of Comprehensive Income within the heading investment return.

The Group makes use of derivatives to convert investment returns on overseas assets denominated in currencies other than Sterling to fixed rate Sterling returns. This is necessary in order to ensure that the cashflows from these assets provide a close match to the cashflows from the Company's insurance liabilities. PIC also uses derivatives to hedge its solvency position against changes in interest rates and inflation.

(c) MBS and ABS

The fair value of mortgage backed and other asset backed securities is determined by reference to their listed market price. Due to the types of markets in which these instruments are traded, such instruments would usually be classified as Level 2 within the fair value hierarchy.

Included within MBS and ABS investments are credit linked notes, which are classified as Level 3 within the fair value hierarchy. The fair value of these notes is determined using a discounted cash flow model taking into account the cash flows, the capital structure and risk profile of each note and available market data such as recently traded prices for comparable notes.

(d) Deposits with credit institutions

The fair value of deposits held with credit institutions represents their cash value in current terms. All deposits are redeemable within three months and consequently no discounting adjustment has been made at the year end. Deposits with credit institutions are classified as Level 1 within the fair value hierarchy.

(e) Equity release mortgages

Equity release mortgages ("ERM") are loans secured against property that are repayable on death or entry into long-term care of the borrower. The fair value of ERM assets is determined using an internal model which calculates the discounted value of future cash flows expected to arise from each loan. In addition to market observable inputs (such as interest and inflation rates), key inputs to the model also include assumptions relating to property growth, property volatility, equivalent spread, mortality, morbidity and early repayment rates, which are not market observable. The valuation allows for the 'no negative equity guarantee', which restricts the amount recoverable by the Group on repayment of the mortgage to the net sale proceeds of the property. The value of this guarantee is calculated using option pricing models. Due to the impact of the unobservable inputs, the ERMs are classified as Level 3 assets within the fair value hierarchy.

Principal assumptions underlying the calculation of ERM assets include:

Equivalent spread

The loan-by-loan equivalent spread is solved at the point of each loan's inception to equate the present value of the expected cash flows to its face value. Subsequently each loan's equivalent spread is updated in line with changes in the spread of a reference corporate bond index.

Future property prices

The property values at the reporting date are estimated using the most recent property valuation adjusted using a property index. The projected property values reflect future property growth in line with the retail price index plus 50 bps and property volatility of 15%.

Early repayment rates

The Group has assumed early repayment rates of between 0.5% and 9% p.a. depending on the projection term and the loan's term since inception.

Mortality

The mortality assumptions are derived using the CMI 2016 mortality improvements and a multiple of the PXA08 mortality tables which varies by property postcode.

Dilapidation and sales costs

The valuation model allows for dilapidation and sales costs, both of which are set as a fixed percentage of the value of the property at the point of sale.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

Measurement of fair value

The following table analyses the Group's financial investments according to the basis of measurement required by IFRS 13 *"Fair Value Measurement"*:

31 December 2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Debt securities	11,648	14,680	1,960	28,288
MBS and ABS	–	332	24	356
Equity release mortgage	–	–	294	294
Deposits with credit institutions	1,095	–	–	1,095
Participation in investment schemes	538	651	149	1,338
Financial investments	13,281	15,663	2,427	31,371
Derivative assets	–	9,757	–	9,757
Financial assets	13,281	25,420	2,427	41,128
Derivative liabilities	–	(11,303)	–	(11,303)

31 December 2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Debt securities	9,266	13,296	1,161	23,723
MBS and ABS	–	196	44	240
Equity release mortgage	–	–	107	107
Deposits with credit institutions	577	–	–	577
Participation in investment schemes	538	486	–	1,024
Financial investments	10,381	13,978	1,312	25,671
Derivative assets	–	8,775	–	8,775
Financial assets	10,381	22,753	1,312	34,446
Derivative liabilities	–	(9,663)	–	(9,663)

Level 1 assets are those assets for which the fair value has been measured using quoted prices, without adjustment, in an active market.

Level 2 assets are those assets for which the fair value has been measured using observable inputs other than quoted prices included in Level 1.

Assets classified as Level 3 are those assets for which no observable data exists in relation to a significant element of the fair value measurement.

Transfers between levels of the fair value hierarchy

For recurring fair value measurements, the Group's policy is to recognise transfers into and out of fair value hierarchy levels at the end of the year in which the event or change in circumstances that caused the transfer has occurred.

Transfers between Level 1 and Level 2

There have been no transfers during the year between Levels 1 and 2 (2017: £nil).

Transfers into and out of Level 3

During the year, £313 million of debt securities were transferred from Level 2 to Level 3 (2017: £144 million) and £66 million of debt securities were transferred out of Level 3 to Level 2 (2017: £nil).

Transfers into and out of Level 3 relate to debt securities which are valued using discounted cash flow models. Within the model, interest rate, inflation rate and credit risk assumptions are derived from market data with adjustments applied to ensure they are relevant to the debt securities held by the Group. Where the impact of the adjustments on the value of the debt securities become significant, these securities would be classified as Level 3 and transferred from Level 2 to Level 3 at the end of the year. Conversely, where the impact becomes less significant, the securities would be classified as Level 2 and transferred out of Level 3 to Level 2.

Movements relating to Level 3 assets during the reporting period are analysed as follows:

31 December 2018	Participation in investment schemes	ERM £m	MBS and ABS £m	Debt securities £m	Total £m
Opening balance	–	107	44	1,161	1,312
Unrealised gains or losses	–	–	8	(103)	(95)
Acquisitions in year	–	187	–	814	1,001
Transfers in to Level 3	149	–	–	164	313
Transfers out of Level 3	–	–	–	(66)	(66)
Disposals in year	–	–	(28)	(10)	(38)
Closing balance	149	294	24	1,960	2,427

31 December 2017	ERM £m	MBS and ABS £m	Debt securities £m	Total £m
Opening balance	–	59	620	679
Unrealised gains or losses	3	(1)	18	20
Acquisitions in year	104	–	381	485
Transfers in to Level 3	–	–	144	144
Transfers out of Level 3	–	–	–	–
Disposals in year	–	(14)	(2)	(16)
Closing balance	107	44	1,161	1,312

The investment return within the Statement of comprehensive income includes the following income and investment gains and losses relating to Level 3 assets:

31 December 2018	Participation in investment schemes	ERM £m	MBS and ABS £m	Debt securities £m	Total £m
Income from securities	–	–	2	22	24
Realised gains or losses	–	–	–	1	1
Unrealised gains or losses	–	–	8	(103)	(95)
Investment return on Level 3 assets	–	–	10	(80)	(70)

31 December 2017	ERM £m	MBS and ABS £m	Debt securities £m	Total £m
Income from securities	–	4	14	18
Realised gains or losses	–	1	–	1
Unrealised gains or losses	3	(1)	18	20
Investment return on Level 3 assets	3	4	32	39

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

As discussed above, the valuations of financial assets classified as Level 3 are, under certain circumstances, measured using valuation techniques that incorporate assumptions based on unobservable inputs which cannot be evidenced by readily available market information.

The following table shows the effect on the fair value of Level 3 financial instruments from changes in unobservable input assumptions.

31 December 2018	Main assumptions	Sensitivity	Current fair value £m	Increase in fair value £m	Decrease in fair value £m
Debt securities	Discount rates	+/- 50bps credit spread	1,960	260	(228)
Participation in investment schemes	Expected loss ("EL")	+/- £10m increase in EL	149	10	(10)
MBS and ABS	Expected loss (“EL”)	+/- 30% change in EL	24	–	–
ERM	Mortality	+/-5% change in mortality assumption	294	–	(1)
	Property price	+/-20% change in property prices		5	(9)
	Property growth	+/- 1% change in property growth assumption		5	(8)
	Voluntary redemptions	+/-10% change in voluntary redemption assumption		1	(1)
			2,427	281	(257)

31 December 2017	Main assumptions	Sensitivity	Current fair value £m	Increase in fair value £m	Decrease in fair value £m
Debt securities	Discount rates	+/- 50bps credit spread	1,161	130	(113)
MBS and ABS	Expected loss (“EL”)	+/- 30% change in EL	44	1	(1)
ERM	Mortality	+/-5% change in mortality assumption	107	–	–
	Property price	+/-20% change in property prices		2	(3)
	Property growth	+/- 1% change in property growth assumption		2	(3)
	Voluntary redemptions	+/-10% change in voluntary redemption assumption		–	–
			1,312	135	(120)

14. DERIVATIVE FINANCIAL INSTRUMENTS

The Group enters into a number of inflation rate and interest rate swap agreements during the ordinary course of business as part of its risk management strategy. Inflation swaps protect the Group against the adverse effects of inflation over a period of time while the Group enters into interest rate swap transactions to assist in hedging contractual liabilities. Currency swaps and forward contracts are entered into to eliminate the majority of the currency risk on financial assets invested in non-sterling based debt securities where liabilities are denominated in sterling.

	31 December 2018		31 December 2017	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	8,856	(9,117)	7,884	(8,147)
Inflation swaps	715	(1,107)	638	(1,117)
Credit default swaps	118	(100)	19	(32)
Currency swaps	48	(950)	223	(360)
Foreign exchange forward contracts	14	(14)	11	(7)
Total return swaps	6	(15)	–	–
Total derivative position	9,757	(11,303)	8,775	(9,663)

15. RISK MANAGEMENT

As a provider of insurance solutions to defined benefit pension schemes, the Group's business involves the acceptance and management of risk to achieve its strategic objectives.

The principal risk factors which affect the Group's operating results and financial condition include financial risks such as market risk, credit risk and liquidity risk, insurance risk, and other risks such as operational risk, regulatory risk and reputational risk.

Insurance risk is implicit in the Group's business and mainly arises from exposure to longevity in respect of annuity payments. Regulatory risk stems principally from the risk of changes to the regulatory environment in which PIC operates. The main reputational risks relate to the need to maintain a good reputation with trustees of pension schemes and their advisers in order to attract new business and with its own policyholders through treating them fairly. Maintaining a good internal culture is recognised as a key tool in mitigating these risks.

The Directors have overall responsibility for the management of the exposure to these risks. They are supported through the formal committees of the PIC Board including the Investment & Committee, Audit Committee, Nomination and Remuneration Committee and Risk Committee. The membership of these committees is mainly comprised of non-executive directors. Executive directors and relevant senior management attend meetings as requested. The Board retains direct responsibility for reputational risk. The PIC Board has instigated a co-ordinated approach between Risk, Compliance, Actuarial and Internal Audit Functions to provide integrated assurance in the monitoring of the internal risk and control environment.

The management and control of the Group's risks is a significant focus area for the Board as an uncontrolled and unmanaged development in various risks may affect the Group's performance and capital adequacy. The Group adopts an integrated view to the management and qualitative assessment of risk under risk acceptance guidelines and policies set by the Board and aims to minimise its exposure to risks such as interest rate risk and inflation risk, which carry little reward for the Group. Risks such as longevity risk are mitigated through reinsurance to the extent that it is economic to do so.

The Group uses derivatives for the purpose of efficient portfolio management or to reduce risk in aspects of the Group's investment activities such as the implementation of tactical asset allocation changes around the strategic benchmark, the hedging of cash flows, and the control of the risk profile of an identified strategy. The Group uses cross currency swaps, forward exchange contracts and futures for these purposes. It also uses interest and inflation rate swaps for the purpose of matching assets and liabilities, and credit default swaps to manage credit risk.

(a) Market risk

The Group is exposed to market risk as a consequence of fluctuations in values or returns on assets and liabilities which are influenced by one or more external factors. These include changes and volatility in interest rates, credit spreads, inflation expectations and currency exchange rates.

The Group manages market risk through an asset liability management ("ALM") framework that has been developed to closely match the investment portfolio duration and income to its obligations under insurance contracts.

Within the context of the ALM framework the Group uses derivative financial instruments to reduce market risk. Interest rate and inflation swaps are entered into to improve the matching of asset and liability cash flows, and ensure that risk driver sensitivities are aligned across the maturity spectrum. The quality of the interest rate and inflation matching strategies is carefully monitored by management, and is operated within tightly defined limits. Currency forwards and swaps are entered into to eliminate the majority of the currency risk on financial assets invested in non-Sterling based debt securities where liabilities are denominated in Sterling.

The Group is also exposed to risks of movements in the property market through its investment in the GPUTs. The short-term market risk is mitigated by the fact that all eight of its properties are occupied on leases extending to 1 April 2033. The Group performs regular reviews of both the movement in the property market specific to these properties and the financial status of the tenants.

Further asset exposures include investments in hedge funds, insurance linked funds and public finance initiative related debt, including Social Housing. Where appropriate the management of these alternative exposures is delegated to specialist fund managers, in line with defined investment management mandates. In all cases the Group ensures regular oversight of the investment management activities, and maintains detailed risk models for all investment types, incorporating analysis of alternative investments in its risk and capital assessment.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

15. RISK MANAGEMENT (continued)

(b) Credit risk

Credit risk is the risk of loss due to the default of another party in performing its financial obligations to the Group. The Group is primarily exposed to credit risk through its investment in debt securities and cash deposits.

Credit risk also arises in respect of derivative contracts to the extent that there is the potential for the counterparties to default on their obligations.

The Group manages exposure to credit risk by placing limits on exposures to individual counterparties as well as groups of counterparties. Counterparty risk on derivatives is controlled through establishment of collateral agreements and master netting agreements on interest rate and currency swaps. To further minimise credit risk, the financial condition of counterparties is monitored on a regular basis.

The table below sets out the credit risk exposure and ratings of financial assets which are susceptible to credit risk. The ratings used have been sourced from S&P, Moody's or Fitch or have been assigned internally where the ratings from these agencies were not available.
The remaining unrated assets are not classified by S&P, Moody's, Fitch or internally.

31 December 2018	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Total £m
Loans and debt securities							
Debt securities[1]	1,407	12,035	6,934	7,508	244	160	28,288
MBS and ABS[2]	–	17	290	21	–	28	356
Equity release mortgages	–	–	–	–	–	294	294
	1,407	12,052	7,224	7,529	244	482	28,938
Other assets							
Derivative assets	–	–	–	–	–	9,757	9,757
Participation in investment schemes	538	–	–	–	–	800	1,338
Receivables and other financial assets	18	34	66	103	2	57	280
Deposits with credit institutions	–	290	805	–	–	–	1,095
Cash and cash equivalents	–	–	1	78	–	–	79
	556	324	872	181	2	10,614	12,549

1 Within Debt securities there are £69 million AAA rated, £848 million AA rated, £1,288 million A rated, £747 million BBB rated and £121 million BB rated securities, which have been rated using internally assessed credit ratings.
2 Within MBS and ABS there are £4 million A rated securities which have been rated using internally assessed credit ratings.

31 December 2017	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Total £m
Loans and debt securities							
Debt securities[1]	1,191	10,092	5,832	6,216	203	189	23,723
MBS and ABS[2]	12	23	130	30	–	45	240
Equity release mortgages	–	–	–	–	–	107	107
	1,203	10,115	5,962	6,246	203	341	24,070
Other assets							
Derivative assets	–	–	–	–	–	8,775	8,775
Participation in investment schemes	538	–	–	–	–	486	1,024
Receivables and other financial assets	15	30	59	80	1	135	320
Deposits with credit institutions	–	–	577	–	–	–	577
Cash and cash equivalents	–	–	–	43	–	–	43
	553	30	636	123	1	9,396	10,739

1 Within Debt securities there are £59 million AAA rated, £381 million AA rated, £768 million A rated, £641 million BBB rated and £59 million BB rated securities, which have been rated using internally assessed credit ratings.
2 Within MBS and ABS there are £4 million A rated securities and £1 million BBB rated securities which have been rated using internally assessed credit ratings.

(b) Credit risk (continued)
Although the instruments themselves are unrated, the ultimate issuing party for most derivative assets do have a credit rating. Additionally, the derivatives are fully collateralised with highly rated instruments, so as to mitigate any credit or counterparty risk. Applying the issuer rating to the assets held at 31 December 2018 produces the following split:

31 December 2018	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Total £m
Derivative assets	–	2,823	4,786	2,148	–	–	9,757

31 December 2017	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Total £m
Derivative assets	–	943	6,173	1,659	–	–	8,775

These assets are included with regular stress testing undertaken by the Group which assesses the impact of a number of scenarios on the Group's solvency position.

Reinsurance counterparties
The Group has reinsurance contracts in place with eleven external reinsurers with an exposure of £1,854 million at 31 December 2018 (2017: £2,450 million). Measures are in place with respect to the reinsurance contracts to manage counterparty exposure, including collateral arrangements and other protections. The credit rating of each reinsurer is reported to management on a monthly basis. The credit rating of each reinsurer was A or higher at both 31 December 2018 and 31 December 2017.

Impaired assets
The Group did not have any impaired or past due date assets at 31 December 2018 (2017: £nil).

(c) Liquidity risk
Liquidity risk is the risk that the Group may not have liquid assets available at the right times to be able to pay its liabilities, despite the fact that it meets its regulatory solvency requirements. This would typically arise if derivative contracts to manage inflation and interest rates required collateral to be posted, a large proportion of deferred policyholders opted to take transfer values, or if a large proportion of assets were invested in assets which are not easy or straightforward to liquidate.

In order to manage this, projected cash flows for all new policy liabilities taken on are determined as a part of the new business origination process to identify the expected profile of liability payments, including expected mortality experience. This is then used to identify appropriate assets which provide matching cash flows at an acceptable price.

The Group's risk policies define a minimum proportion of its assets to be held in highly liquid cash and gilts, and stress testing is conducted to ensure that there are sufficient liquid assets at all times to meet potential demands from derivative movements under extreme scenarios.

The projected cash flows are updated regularly, and assumptions are updated at least annually, taking into account factors such as mortality experience and how this affects the required cash flows in the future.

The following table sets out the contractual maturity analysis of financial liabilities:

31 December 2018	Within one year £m	In 1–5 years £m	In 5–15 years £m	Over 15 years £m	Total £m
Creditors arising out of reinsurance operations	11	–	–	–	11
Other creditors	3	–	–	–	3
Accruals	72	–	–	–	72
Borrowings	–	–	891	–	891
Derivative liabilities	94	450	1,182	9,577	11,303
	180	450	2,073	9,577	12,280

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

15. RISK MANAGEMENT (continued)

31 December 2017	Within one year £m	In 1–5 years £m	In 5–15 years £m	Over 15 years £m	Total £m
Creditors arising out of reinsurance operations	9	–	–	–	9
Other creditors	12	–	–	–	12
Accruals	56	–	–	–	56
Borrowings	–	–	543	–	543
Derivative liabilities	49	371	1,062	8,181	9,663
	126	371	1,605	8,181	10,283

All amounts due to other creditors are expected to be paid in the next financial year.

The amounts disclosed in more than 1 year columns in the above table are expected to be settled more than 12 months after the reporting date.

(d) Insurance risk
Longevity risk is the risk that mortality experience of the Group's policyholders is lighter than assumed, thus requiring pensions to be paid for a longer period than anticipated, resulting in a higher than expected cost to the Group.

In order to help minimise this risk and also uncertainty arising through future longevity experience, the Group adopts an active approach to reinsuring these risks where it is economic to do so. This reinsurance can be classified into two broad categories:

Longevity only reinsurance
This provides longevity cover in respect of certain policyholders. Under these contracts, the Group has committed to pay the reinsurer a fixed line of cash flows for specified sets of liabilities relating to members / former members of particular pension schemes. The reinsurer undertakes to reimburse the actual cost of claims to the Group. Separately, there is also an insurance fee for which the Group is liable. Settlement of the contract is on a net basis. These contracts also transfer the contingent longevity risk relating to any eligible dependants of relevant policyholders.

Longevity reinsurance via the transfer of assets
Under such contracts, in return for a premium, the reinsurer agrees to reimburse the actual cost of future claims to the Group in respect of an agreed set of policyholders. These contracts also transfer the contingent risks relating to eligible dependants of relevant policyholders.

The Group monitors the levels of its counterparty risk and actively seeks to reinsure with a wide range of providers to help mitigate its exposure to any one such entity.

One aspect of deriving overall best estimate longevity assumptions is to establish the "current" or "initial" rates of mortality. These assumptions are set by applying appropriate mortality factors to each individual member / policyholder. Individual variations are subject to a number of factors including, but not limited to, an individual's gender, age, pension amount, occupation and place of residence.

The other aspect is the allowance for future improvements in mortality. The pattern in which mortality is expected to improve over time is an important but complex assumption for cash flow and liability calculations. This is regularly reviewed in the light of a number of factors including evolving methodologies for these projections together with views from industry and professional bodies on the factors driving mortality change.

Whilst longevity risk is the fundamental risk relating to its insurance liability portfolio, the Group also considers the following risks:

Risk arising from a specific insurance contract
The Group considers, as part of its risk management process, the risk attached to each new contract accepted and the mitigation of such risk.

Exposure to changes in financial market conditions
The Group prepares information based upon a range of possible market conditions. The results of this exercise are then considered with regard to the effect on the current insurance liability portfolio. A key consideration of the 2018 ORSA process has been around the risks associated with the UK leaving the EU and the potential impact that this may have on PIC's business model and its policyholders. This has included scenario assessments to assess whether appropriate controls are in place to ensure PIC's contractual relationships with various stakeholders continue to operate as intended post Brexit–including the ability to pay policyholders, relationships with banking and reinsurance counterparties and legislation around data security. Scenarios have also been performed considering potential macro-economic impacts to ensure adequate controls are in place to mitigate the potential balance sheet impacts of market movements in a worst-case Brexit scenario on PIC's solvency and liquidity position.

(e) Operational risk
Operational risk is the potential for loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Group's internal control processes are supported by an operational risk committee, the maintenance of a central risk register and an independent internal audit review. The risk of internal fraud is managed through a number of processes including the screening of staff at recruitment, regular compliance training, segregation of duties and whistle-blowing policies.

The Group has significant outsourcing arrangements in respect of pension administration and other functions. These arrangements are subject to agreements with formal service levels, operate within agreed authority limits and are subject to regular review by senior management.

Emergency and business continuity plans have also been established to counter adverse occurrences.

16. RELATED PARTY TRANSACTIONS

Group
At its discretion and as approved by the Remuneration Committee, the Group may settle personal tax liabilities on behalf of certain employees, including the Directors and key management personnel, who exercises their options upon vesting of Performance Share Plan. The settlement is made on the condition that the employees would repay this amount to the Group within 90 days after the end of the relevant tax year.

At 31 December 2018, the Group recognised a loan asset of £2,801,429 (2017: £1,892,652) in respect of this transaction; of this amount £1,853,790 (2017: £1,209,077) was due from the Directors and key management personnel. The loan does not bear any interest, and except for the repayment period, does not have any other condition attached to it.

The Group had no other transactions with related parties during the period other than awards made under the Share Growth Plan which are detailed in Note 7.

Company
The Company had no transactions with related parties during the period other than awards made under the Share Growth Plan which are detailed in Note 7.

17. INVESTMENTS IN SUBSIDIARIES

The Company's investments in subsidiary undertakings is as follows:

	2018 £m	2017 £m
Cost		
At start of year	1,203	1,204
Acquired during the period	–	–
Reclassification of the EBT from a subsidiary to a branch	–	(1)
Impairment of investment in subsidiary	(1)	–
At end of the year	1,202	1,203
Net book value		
31 December	1,202	1,203

PICG owns 100% of the ordinary share capital of all the following companies. All subsidiaries have been consolidated in the accounts.

Subsidiary Undertakings	Principal Activity	Country of incorporation	Notes
PIC Holdings Limited[1]	Holding Company	England	Trading company
Pension Insurance Corporation plc	Bulk Annuity Insurance	England	Trading company
Pension Services Corporation Limited	Service Company	England	Trading company

1 Denotes investment held directly by the Company at 31 December 2018.
2 Pension Corporation Group Limited, which was PICG's Guernsey based subsidiary, was liquidated in January 2018

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2018

18. SHARE CAPITAL

	2018 Number of shares	2018 £m	2017 Number of shares	2017 £m
Ordinary Shares				
Authorised, issued and fully paid				
At beginning of year	1,085,093,439	2	1,084,405,273	2
Shares issued at premium	–	–	–	–
Shares issued to satisfy share-based payment awards	–	–	688,166	–
Share reduction	–	–	–	–
B share conversion to ordinary shares	–	–	–	–
At end of year	1,085,093,439	2	1,085,093,439	2
C Shares				
At beginning of year	2,000	–	–	–
C shares of £0.00161678179673884 each issued	–	–	2,000	–
At end of year	2,000	–	2,000	–

No ordinary shares were issued during 2018. The Company issued 688,166 ordinary shares with nominal value of £0.00161678179673884 at par on 4 July 2017 to satisfy the vesting of these awards under the Group's share based payment schemes in 2017.

The rights attaching to each class of shares existing at 31 December 2018 are as follows:

Ordinary shares

Voting rights are only conferred on the holders of ordinary shares, except when a resolution relates to a change of rights or privileges of convertible deferred shares or the winding up of the Company.

Ordinary shares are the only class entitled to dividends or distributions of income unless otherwise determined by the Board.

C shares

2,000 C shares were issued at a subscription price of £815 per share and a nominal value of £0.00161678179673884 per share on 29 June 2017 to satisfy the requirements of the 2017 Share Growth Plan awarded to certain members of the Company's Executive Management team.

C shares are fully paid up and subscribed by the share plan participants.

C shares can be converted into Ordinary shares on 1 January 2021, under the terms set out in the Company's Articles.

On winding up of the Company the holders of C shares have the right to receive in priority to the holders of Ordinary shares an amount equal to the lower of the C Share Value on the date the Royal Court makes a compulsory winding up order in respect of the Company and the C Share original cost.

The Board in its absolute discretion may recommend a dividend in respect of C shares.

19. RESERVES

Group

31 December 2018	Share premium £m	Treasury shares £m	Retained profit £m	Capital reduction reserves £m	Merger reserve £m	Share-based payment reserve £m
At beginning of year	120	(12)	874	1,055	34	10
Total comprehensive income	–	–	386	–	–	–
Vesting of the share-based payment schemes	–	6	(4)	–	–	(2)
Employee related share-based payments	–	(18)	–	–	–	6
Tax relating to share-based payments	–	–	–	–	–	–
At end of year	120	(24)	1,256	1,055	34	14

31 December 2017	Share premium £m	Treasury shares £m	Retained profit £m	Capital reduction reserves £m	Merger reserve £m	Share-based payment reserve £m
At beginning of year	118	(1)	565	1,055	34	6
Total comprehensive income	–	–	310	–	–	–
Ordinary shares issued for cash consideration	2	–	–	–	–	–
Vesting of the share-based payment schemes	–	1	3	–	–	(4)
Employee related share-based payments	–	(12)	(4)	–	–	6
Tax relating to share-based payments	–	–	–	–	–	2
At end of year	120	(12)	874	1,055	34	10

Company

31 December 2018	Share premium £m	Treasury shares £m	Retained profit £m	Capital reduction reserves £m	Merger reserve £m	Share-based payment reserve £m
At beginning of year	120	(12)	(2)	1,055	34	8
Total comprehensive income	–	–	35	–	–	-
Vesting of the share-based payment schemes	–	6	–	–	–	(2)
Employee related share-based payments	–	(18)	(4)	–	–	6
At end of year	120	(24)	29	1,055	34	12

31 December 2017	Share premium £m	Treasury shares £m	Retained profit £m	Capital reduction reserves £m	Merger reserve £m	Share-based payment reserve £m
At beginning of year	118	–	7	1,055	34	6
Total comprehensive income	–	–	(9)	–	–	–
Ordinary shares issued for cash consideration	2	–	–	–	–	–
Vesting of the share-based payment schemes	–	–	4	–	–	(4)
Employee related share-based payments	–	(12)	(4)	–	–	6
At end of year	120	(12)	(2)	1,055	34	8

A Capital Reduction reserve was established on 21 October 2016, when the Company reduced the nominal value of its ordinary shares from £1 to £0.00161678179673884 in accordance with the relevant Special Resolution.

The Group carried out a group reorganisation in December 2015, which led to a recognition of a merger reserve of £34m in respect of the amount by which the book value of the PCG Group exceeded the nominal value of shares issued by PICG to acquire the PCG Group.

Share-based payment reserve is recognised in respect of the equity settled share-based payment awards in accordance with the accounting policy in Note 1 (j). The relevant disclosures in respect of the share-based payment schemes are provided in Note 7.

Treasury shares relate to the shares purchased by the EBT in respect of the Company's share based payment awards.

NOTES TO THE FINANCIAL STATEMENTS (continued)

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20. CAPITAL RESOURCES

The Board's policy is to maintain a strong capital base to protect policyholders' and creditors' interests and ensure compliance with the relevant financial services regulations, whilst still creating shareholder value. The Group's capital resources comprise equity and debt capital. The details of the Group's capital resources are given in the Statement of changes in equity.

The Group's main subsidiary, PIC, is required to measure and manage its capital in accordance with the requirements of the EU Solvency II Framework Directive ("Solvency II"), as adopted by the PRA. There are certain valuation differences between the IFRS balance sheet and the Solvency II balance sheet, for example between IFRS insurance liabilities and Solvency II technical provisions. Also, under Solvency II PIC is able to treat the subordinated debt referred to in Note 12 as regulatory capital. PIC has complied with the capital requirements under Solvency II throughout the year.

PIC's objectives in managing its capital are:

> to match the profile of its assets and liabilities closely, taking account of the risks inherent in the business;

> to maintain financial strength sufficient to support new business growth in line with PIC's business plan;

> to satisfy the contractual entitlements of its policyholders and the requirements of its regulators;

> to ensure financial flexibility by maintaining strong liquidity and access to a range of capital markets;

> to allocate capital efficiently to support growth;

> to manage exposure to changes in interest and inflation rates by way of a comprehensive hedging programme; and

> to manage exposure to movements in exchange rates.

PIC currently has sufficient capital resources available to meet all its present capital requirements and does not utilise financial reinsurance or securitisation.

Under Solvency II, PIC uses an internal model to set its statutory solvency capital requirement. This evaluates market risk, insurance risk, operational risk, expense risk and counterparty risk. In addition, PIC produces an own risk and solvency assessment report annually, which provides an analysis of the risks facing PIC and its capital resources.

PIC manages its business according to the risk strategy, appetite and tolerances set out in its risk policies. Specifically, PIC's "risk appetite" policy defines a target level of capital that it wishes to maintain, which PIC regularly monitors and reports. Capital volatility is managed through risk management techniques, including the use of inflation rate, interest rate and currency hedging instruments to reduce exposure to potential adverse market movements. PIC is also able to manage its capital position through the level of new business it writes and its broader investment and reinsurance strategies.

PIC focuses on hedging its Solvency II balance sheet through hedging its best estimate liabilities and solvency capital requirement to interest rates and inflation rates. This provides a proxy to IFRS and embedded value sensitivities, although some basis risk remains. PIC aims to remove all foreign exchange risk through cross-currency hedging. Longevity risk is managed through reinsurance, where 74% of exposure has been transferred as at 31 December 2018, based on regulatory liabilities.

21. FINANCIAL COMMITMENTS AND CONTINGENCIES

Operating lease commitment

Operating lease rental commitments arise where a Group company is the lessee in respect of non-cancellable operating lease agreements. Payments made under operating leases (net of any incentives received from the lessor) are charged to the profit and loss on a straight-line basis over the period of the lease.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2018 £m	2017 £m
Within 1 year	3	3
In 1–5 years	11	11
Over 5 years	1	4
	15	18

Other commitments

During the year the Group executed transactions to purchase partly funded securities. The Group expects to pay a further £855 million within the next 5 years (2017: £351 million), £122 million of this being due within 12 months of the financial reporting date (2017: £92 million).

	2018 £m	2017 £m
Within 1 year	122	92
In 1–5 years	733	259
Over 5 years	–	–
	855	351

Contingent liabilities

The Group has certain reinsurance agreements, which include fees that are contingent on occurrence of specific events. Such fees do not meet the definition of a liability, therefore are not recognised on the statement of financial position. At 31 December 2018, the estimated value of the contingent fees payable was £9 million (2017: £10 million).

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