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PROSPECTUS DATED 1 JULY 2014

Pension Insurance Corporation plc

(Incorporated with limited liability in England and Wales with Registered no.05706720)

£300,000,000
6.50 per cent. Fixed Rate Subordinated Notes due 2024

Issue price: 99.107 per cent.

The £300,000,000 6.50 per cent. Fixed Rate Subordinated Notes due 2024 (the "**Notes**") are issued by Pension Insurance Corporation plc ("**PIC**" or the "**Issuer**") and constituted by a trust deed to be dated on or about 3 July 2014 (as amended or supplemented from time to time, the "**Trust Deed**") between the Issuer and the Trustee (as defined in "Terms and Conditions of the Notes" (the "**Conditions**", and references herein to a numbered "**Condition**" shall be construed accordingly)).

Application has been made to the UK Financial Conduct Authority (the "**FCA**") in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "**UKLA**" and the "**FSMA**", respectively) for the Notes to be admitted to the official list of the UKLA (the "**Official List**") and to the London Stock Exchange plc (the "**London Stock Exchange**") for the Notes to be admitted to trading on the London Stock Exchange's regulated market. The London Stock Exchange's regulated market is a regulated market for the purposes of Directive 2004/39/EC (the "**Markets in Financial Instruments Directive**"). This Prospectus has been approved by the UKLA for the purposes of Article 5.4 of Directive 2003/71/EC, as amended (the "**Prospectus Directive**"). This document comprises a prospectus for the purposes of the Prospectus Directive.

The Notes will bear interest from 3 July 2014 (the "**Issue Date**") at the rate of 6.50 per cent. per annum, payable (subject to the following proviso) annually in arrear on 3 July in each year commencing on 3 July 2015; provided that the Issuer will be required to defer any payment of interest which is otherwise scheduled to be paid if (i) such payment cannot be made in compliance with the solvency condition described in Condition 2.2 (the "**Solvency Condition**") or (ii) a Regulatory Deficiency Interest Deferral Event (as defined herein) has occurred and is continuing, or would occur if such interest payment were made. Any interest so deferred shall, for so long as the same remains unpaid, constitute "**Arrears of Interest**". Arrears of Interest will not themselves bear interest, and will be payable as provided in Condition 4.2.

Unless previously redeemed or purchased and cancelled, the Notes will mature on 3 July 2024 (the "**Maturity Date**") and shall, subject to the satisfaction of the Solvency Condition and to no Regulatory Deficiency Redemption Deferral Event (as each such term is defined herein) having occurred, be redeemed on the Maturity Date. Prior to any notice of redemption before the Maturity Date or any substitution, variation or purchase of the Notes, the Issuer will be required to have complied with relevant legal or regulatory requirements including as to notifications to, or consent or non-objection from, (in each case, if and to the extent required) the Relevant Regulator (as defined herein) and to be in continued compliance with Regulatory Capital Requirements (as defined herein) applicable to it. Subject to that, to the Relevant Rules implementing Solvency II, to satisfaction of the Solvency Condition and to no Regulatory Deficiency Redemption Deferral Event having occurred, the Notes may be redeemed at the option of the Issuer before the Maturity Date upon the occurrence of certain specified events relating to taxation or a Capital Disqualification Event (as each such term is defined herein) at their principal amount together with any accrued but unpaid interest to (but excluding) the date of redemption and any Arrears of Interest (as defined herein) and the Issuer will, in such circumstance, also have the right to substitute the Notes for, or vary the terms of the Notes so that they remain or become, Qualifying Dated Tier 2 Securities, as described in *"Terms and Conditions of the Notes - Redemption, Substitution, Variation and Purchase"*.

The Notes will be direct, unsecured and subordinated obligations of the Issuer, ranking pari passu and without preference amongst themselves, and will, in the event of the winding-up of the Issuer or in the event of an administrator of the Issuer being appointed and giving notice that it intends to declare and distribute a dividend, be subordinated to the claims of all Senior Creditors (as defined herein) of the Issuer.

The Notes will initially be represented by global Notes in classic global note ("**CGN**") form, which will be deposited with a common depositary ("**Common Depositary**") for Euroclear Bank S.A./N.V. ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**") on or about the Issue Date. Definitive Notes will be issued only in the limited circumstances described in the permanent global note – see *"Summary of Provisions relating to the Notes while in Global Form"*. The denomination of the Notes shall be £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000 each.

An investment in the Notes involves certain risks. Prospective investors should have regard to the factors described under the section headed "Risk Factors" in this Prospectus. The Notes will not be rated on issue.

Joint Lead Managers

MORGAN STANLEY
Sole Structuring Advisor

THE ROYAL BANK OF SCOTLAND

The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

Any information contained in this Prospectus which has been sourced from a third party has been accurately reproduced and, as far as the Issuer is aware and is able to ascertain from information published by third party, no facts have been omitted which would render the reproduced information inaccurate or misleading.

No person is or has been authorised to give any information or to make any representation other than those contained in or consistent with this Prospectus in connection with the issue or sale of the Notes and, if given or made, such information or representations must not be relied upon as having been authorised by or on behalf of the Issuer, any of the Managers (as defined in *"Subscription and Sale"* below) or the Trustee. Neither the delivery of this Prospectus nor any sale made in connection herewith shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer since the date hereof or that there has been no adverse change in the financial position of the Issuer since the date hereof or that any other information supplied in connection with the Notes is correct as of any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same.

The Managers and the Trustee have not separately verified the information contained in this Prospectus. Neither the Managers nor the Trustee makes any representation, express or implied, or accepts any responsibility, with respect to the accuracy or completeness of any of the information contained in this Prospectus or any other information provided by the Issuer in connection with the offering of the Notes. None of the Managers or the Trustee accepts any liability in relation to the information contained in this Prospectus or any other information provided by the Issuer in connection with the offering of the Notes or their distribution. Neither this Prospectus nor any other information supplied in connection with the offering of the Notes is intended to constitute, and should not be considered as, a recommendation by any of the Issuer, the Managers or the Trustee that any recipient of this Prospectus or any other information supplied in connection with the offering of the Notes should purchase the Notes. Each potential purchaser of Notes should determine for itself the relevance of the information contained in this Prospectus and its purchase of Notes should be based upon such investigation as it deems necessary. None of the Managers or the Trustee undertakes to review the financial condition or affairs of the Issuer during the life of the arrangements contemplated by this Prospectus nor to advise any investor or potential investor in the Notes of any information coming to their attention.

In the ordinary course of business, each of the Managers has engaged and may in the future engage in normal banking or investment banking transactions with the Issuer and its affiliates or any of them.

Neither this Prospectus nor any other information provided by the Issuer in connection with the offering of the Notes constitutes an offer of, or an invitation by or on behalf of, the Issuer or the Managers or the Trustee or any of them to subscribe for, or purchase, any of the Notes (see *"Subscription and Sale"* below). This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy the Notes in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Prospectus and the offer or sale of Notes may be restricted by law in certain jurisdictions. The Issuer, the Trustee and the Managers do not represent that this Prospectus may be lawfully distributed, or that the Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer, the Trustee or the Managers or any of them which is intended to permit a public offering of the Notes or the distribution of this Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Notes may be offered or sold, directly or indirectly, and neither this Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Prospectus or any Notes may come must inform themselves about, and observe, any such restrictions on the distribution of this Prospectus and the offering and sale of Notes. In particular, there are restrictions on the distribution of this Prospectus and the offer or sale of Notes in the U.S. and the United Kingdom. Persons in receipt of this Prospectus are required by the Issuer, the Trustee and the Managers to inform themselves about and to observe any such restrictions. For a description of certain further restrictions on offers and sales of Notes and distribution of this Prospectus, see "*Subscription and Sale*" below.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the "**Securities Act**") and are subject to U.S. tax law requirements. Subject to certain exceptions, Notes may not be offered, sold or delivered within the U.S. or to U.S. persons, as defined in Regulation S under the Securities Act. For a description of certain restrictions on offers and sales of Notes and on distribution of this Prospectus, see "*Subscription and Sale*" below.

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) the Notes are legal investments for it, (2) the Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of the Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk-based capital or similar rules.

In this Prospectus, unless otherwise specified, all references to "**pounds**", "**sterling**", "**£**", "**p**" or "**pence**" are to the lawful currency of the United Kingdom.

Forward-Looking Statements

This Prospectus includes certain "forward-looking statements". Statements that are not historical facts, including statements about the beliefs and expectations of the Issuer, Pension Corporation Group Limited and its subsidiaries (the "**PCG Group**") and their respective directors or management, are forward-looking statements. Words such as "believes", "anticipates", "estimates", "expects", "intends", "plans", "aims", "potential", "will", "would", "could", "considered", "likely", "estimate" and variations of these words and similar future or conditional expressions, are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend upon future circumstances that may or may not occur, many of which are beyond the control of the Issuer or the PCG Group and all of which are based on their current beliefs and expectations about future events. Such forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements of the Issuer or the PCG Group, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such forward-looking statements are based on numerous assumptions regarding the present and future business strategies of the Issuer and the PCG Group and the environment in which the Issuer and the PCG Group will operate in the future. These forward-looking statements speak only as at the date of this Prospectus.

Except as required by the FCA, the London Stock Exchange, the Listing Rules, the Prospectus Rules, the Disclosure and Transparency Rules or any other applicable law or regulation, the Issuer expressly disclaims any obligations or undertakings to release publicly any updates or revisions to any forward-looking statements contained in this Prospectus to reflect any change in the Issuer's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

In connection with the offering of the Notes, one or more of the Managers (the "**Stabilising Manager**") (or persons acting on behalf of the Stabilising Manager) may over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager (or persons acting on behalf of the Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by the Stabilising Manager (or persons acting on behalf of the Stabilising Manager) in accordance with all applicable laws and rules.

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Supplemental Prospectus

Following the publication of this Prospectus a supplement may be prepared by the Issuer and approved by the UKLA in accordance with Article 16 of the Prospectus Directive.

Statements contained in any such supplement (or contained in any document incorporated by reference therein) shall, to the extent applicable (whether expressly, by implication or otherwise), be deemed to modify or supersede statements contained in this Prospectus. Any statement so modified or superseded shall not, except as so modified or superseded, constitute part of this Prospectus.

The Issuer will, in the event of any significant new factor, material mistake or inaccuracy relating to information included in this Prospectus prior to the Issue Date which is capable of affecting the assessment of the Notes, prepare a supplement to this Prospectus. The Issuer has undertaken to the Managers that it will comply with section 87G of the FSMA.

Overview of the Principal Features of the Notes

The following overview refers to certain provisions of the terms and conditions of the Notes and the Trust Deed and is qualified by the more detailed information contained elsewhere in this Prospectus. Terms which are defined in "Terms and Conditions of the Notes" below have the same meaning when used in this overview, and references herein to a numbered "Condition" shall refer to the relevant Condition in "Terms and Conditions of the Notes".

Issue	£300,000,000 6.50 per cent. Fixed Rate Subordinated Notes due 2024.
Issuer	Pension Insurance Corporation plc.
Trustee	Citicorp Trustee Company Limited.
Status and Subordination	The Notes will constitute direct, unsecured and subordinated obligations of the Issuer and will rank *pari passu* and without any preference among themselves. The rights and claims of the Noteholders and Couponholders against the Issuer are subordinated in a winding-up of the Issuer in accordance with Condition 2.1 and the provisions of the Trust Deed.
Solvency Condition	Except in a winding-up, all payments in respect of the Notes (including, without limitation, payments of interest, Arrears of Interest and principal) will be conditional upon the Issuer satisfying the solvency condition described in Condition 2.2 (the "**Solvency Condition**"), and no amount will be payable in respect of the Notes until such time as the same can be paid in compliance with the Solvency Condition.
Interest	The Notes will bear interest from (and including) the Issue Date at the rate of 6.50 per cent. per annum, payable (subject as provided under "*Deferral of Interest*" below) annually in arrear on each Interest Payment Date.
Interest Payment Dates	3 July of each year, starting on 3 July 2015.
Deferral of Interest	The Issuer will be required to defer any payments of interest on the Notes which would otherwise be due on any Interest Payment Date if (i) such payment cannot be made in compliance with the Solvency Condition, or (ii) a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or would occur if such payment of interest was made on such Interest Payment Date. "**Regulatory Deficiency Interest Deferral Event**" means any event (including, without limitation, any event which causes any Solvency Capital Requirement or Minimum Capital Requirement applicable to the Issuer, all or part of the Group (which part includes the Issuer and at least one other member of the Group) or any insurance undertaking within the Group to be breached and such

breach is an event) which under Solvency II and/or under the Relevant Rules means that the Issuer must defer payment of interest (or, if applicable, Arrears of Interest) in respect of the Notes (in order that the Notes qualify, and/or on the basis that the Notes are intended to qualify, as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions). See Condition 4.1.

Arrears of Interest

Any interest in respect of the Notes not paid on an Interest Payment Date due to the occurrence of a Regulatory Deficiency Interest Deferral Event or due to the operation of the Solvency Condition will, so long as the same remains unpaid, constitute "**Arrears of Interest**".

Arrears of Interest will be payable, in whole or in part, at any time at the option of the Issuer (subject to regulatory consent (if then required) and to the Solvency Condition and provided that a Regulatory Deficiency Interest Deferral Event is not subsisting and would not occur upon payment of the same) upon notice to Noteholders, and in any event all Arrears of Interest will (subject, in the case of (i) and (iii) below, to regulatory consent (if then required) and to the Solvency Condition) become payable upon the earliest of the following dates:

(i) the next Interest Payment Date which is not a Mandatory Interest Deferral Date; or

(ii) the date on which an order is made or a resolution is passed for the winding-up of the Issuer (other than an Approved Winding-up) or the date on which any administrator of the Issuer gives notice that it intends to declare and distribute a dividend; or

(iii) the date fixed for any redemption or purchase of Notes by or on behalf of the Issuer or any of its Subsidiaries pursuant to Condition 5.

No interest will accrue on Arrears of Interest. See Condition 4.2.

Redemption at Maturity

The Notes will, subject as provided under "*Deferral of Redemption*" below, be redeemed on 3 July 2024.

Deferral of Redemption

The Issuer will be required to defer any scheduled redemption of the Notes (whether at maturity or if it has given notice of early redemption in the circumstances described below under "*Early Redemption at the Option of the Issuer upon the occurrence of a Tax Event or a Capital Disqualification Event*") if (i) the Notes cannot be redeemed in compliance with the Solvency Condition, (ii) a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if the Notes were redeemed or (iii) (if then required) regulatory consent has not been obtained or redemption cannot be made in compliance with the Relevant Rules at such time.

In the event of any deferral of redemption of the Notes, the Notes will become due for redemption only in the circumstances described in Condition 5.1.

"**Regulatory Deficiency Redemption Deferral Event**" means any event (including, without limitation, any event which causes any Solvency Capital Requirement or Minimum Capital Requirement applicable to the Issuer, all or part of the Group (which part includes the Issuer and at least one other member of the Group) or any insurance undertaking within the Group to be breached and such breach is an event) which under Solvency II and/or under the Relevant Rules means that the Issuer must defer or suspend repayment or redemption of the Notes (in order that the Notes qualify, and/or on the basis that the Notes are intended to qualify, as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions).

Early Redemption at the Option of the Issuer upon the occurrence of a Tax Event or a Capital Disqualification Event

The Issuer may, subject to certain conditions and upon notice to Noteholders, at any time elect to redeem the Notes, at their principal amount together with Arrears of Interest (if any) and any other accrued and unpaid interest to (but excluding) the date of redemption, if a Tax Event or Capital Disqualification Event has occurred and is continuing.

A "**Tax Event**" will occur if:

(i) as a result of a Tax Law Change (as defined in Condition 5.3(a)), in making any payments on the Notes, the Issuer has paid or will or would on the next payment date be required to pay Additional Amounts (as defined in Condition 7) on the Notes and the Issuer cannot avoid the foregoing in connection with the Notes by taking measures reasonably available to it; or

(ii) as a result of a Tax Law Change, in respect of the Issuer's obligation to make any payment of interest on the next following Interest Payment Date, (x) the Issuer would not be entitled to claim a deduction in respect of computing its taxation liabilities in the United Kingdom, or such entitlement is materially reduced; or (y) the Issuer would not to any material extent be entitled to have such deduction set against the profits of companies with which it is grouped for applicable United Kingdom tax purposes (whether under the group relief system current as at the date of the Tax Law Change or any similar system or systems having like effect as may from time to time exist), and in each such case the Issuer cannot avoid the foregoing in connection with the Notes by taking measures reasonably available to it.

A "**Capital Disqualification Event**" is deemed to have occurred if as a result of the implementation of Solvency II or any change to (or change to the interpretation by any court or authority entitled to do so of) the Relevant Rules, the Directive or (following its implementation) Solvency II:

(i) the entire principal amount of the Notes is fully excluded from counting; or

(ii) in the circumstances where such capability derives only from transitional or grandfathering provisions under the Directive, Solvency II or the Relevant Rules, as appropriate, less than 100 per cent. of the principal amount of the Notes outstanding at such time is capable of counting,

as Tier 2 Capital for the purposes of the Issuer or all or any part of the Group (which part includes the Issuer and at least one other member of the Group), whether on a solo, group or consolidated basis, except (in either case) where such non-qualification is only as a result of any applicable limitation on the amount of such capital (other than a limitation derived from transitional or grandfathering provisions as set out in (ii) above). See Conditions 5.2, 5.3 and 5.4.

Substitution and Variation

The Issuer may, subject to certain conditions and upon notice to Noteholders, at any time elect to substitute the Notes for, or vary the terms of the Notes so that they remain or become (as applicable), Qualifying Dated Tier 2 Securities if, immediately prior to the giving of the relevant notice to Noteholders, a Tax Event or Capital Disqualification Event has occurred and is continuing.

Additional Amounts

Payments on the Notes will be made without deduction or withholding for or on account of United Kingdom tax, unless such withholding or deduction is required by law. In the event that any such withholding or deduction is required by law, the Issuer will pay such additional amounts as shall be necessary in order that the amounts received by the Noteholders or Couponholders after such withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes or Coupons, as the case may be, in the absence of the withholding or deduction ("**Additional Amounts**"), subject to some exceptions, as described in Condition 7.

Events of Default and Enforcement

If default is made for a period of 14 days or more in the payment of any interest (including, without limitation, Arrears of Interest) or principal due in respect of the Notes or any of them, the Trustee in its discretion may, and if so requested by Noteholders of at least one quarter in principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution shall (subject in each case to Condition 9.4), institute proceedings for the winding-up of the Issuer and/or prove in the winding-up or administration of the Issuer and/or claim in the liquidation of the Issuer for such payment, but may take no further or other action to enforce, prove or claim for any such payment. No payment in respect of the Notes, the Coupons or the Trust Deed may be made by the Issuer pursuant to Condition 9.1, nor will the Trustee accept the same, otherwise than during or after a winding-up of the Issuer or after an administrator of the Issuer has given notice that it intends to declare and distribute a dividend, unless the Issuer has given prior written notice (with a copy to the Trustee) to, and received consent or non-objection from, the Relevant Regulator which the Issuer shall confirm in writing to the Trustee.

Form and Denomination	The Notes will be issued in bearer form in denominations of £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000. No definitive Notes will be issued with a denomination below £100,000 or above £199,000.
Listing	Application has been made for the Notes to be admitted to the Official List of the UKLA and for the Notes to be admitted to trading on the London Stock Exchange's regulated market.
Ratings	The Notes will be unrated on issue and the Issuer does not currently intend to seek a rating in respect of the Notes.
Governing Law	The Notes, the Coupons and the Trust Deed, and any non-contractual obligations arising out of or in connection therewith, will be governed by and construed in accordance with English law.

Risk Factors

The Issuer believes that the following factors may affect its ability to fulfil its obligations under the Notes. All of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.

Any of these risk factors, individually or in the aggregate, could have an adverse effect on the Issuer and the impact each risk could have on the Issuer is set out below.

Factors which the Issuer believes may be material for the purpose of assessing the market risks associated with the Notes are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in the Notes, but the Issuer may be unable to pay interest, principal or other amounts on or in connection with the Notes for other reasons, and the Issuer does not represent that the statements below regarding the risks of holding the Notes are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision.

INSURANCE, BUSINESS AND ECONOMIC RISKS

1. Risks relating to the insurance business of the Issuer

1.1 *The Issuer only writes one line of insurance business and therefore any increase in the costs associated with that type of insurance or any failure to accurately assess the value of the liabilities insured could have an adverse effect on the Issuer's business*

The Issuer's insurance business is currently limited to insuring the liabilities of defined benefit pension funds, in-payment annuities and deferred annuities for which the benefit amounts are well defined either in real or nominal terms, and where sufficient data is available to enable assessment of the value of those liabilities. If the data on which the Issuer relies in order to assess the liabilities is incorrect or unreliable, or the cost of such liabilities becomes subject to a sudden, unexpected or unprotected increase, in the absence of sufficient reinsurance arrangements and other reserves, the Issuer may not be prepared or able to cover the increased cost of such liabilities. As the Issuer does not write diversified lines of business, this could have an adverse impact on the Issuer's business, results of operations and financial condition.

There can be no assurance that the Issuer will continue to write a single line of insurance business and any decision by the Issuer to change its business strategy or to write new types of insurance business could result in the Issuer being subject to different solvency or other regulatory requirements. Future diversification of the Issuer's business could also subject it to risk which could affect its existing business. This in turn could have an adverse impact on the Issuer's business, results of operations and financial condition.

1.2 *The Issuer's capital position may be impacted by sudden increases in longevity expectations*

The Issuer has a specific risk appetite, with its primary insurance-related risk being longevity risk. The Issuer currently aims to reinsure the majority of longevity risk within a target range, subject to its defined counterparty risk limits, and its approach is to mitigate longevity risk by entering into reinsurance treaties after a buy-in or buy-out pension insurance transaction is executed. The Issuer is subject to limitations as to the liabilities for which it can obtain reinsurance cover; for example, there are limitations as regards deferred members and small pension insurance transactions and the Issuer will in any event only obtain reinsurance cover where it is economical to do so. The proportion of risk retained by the Issuer will depend not only on the availability and cost of suitable reinsurance cover but also the nature of the risks requiring cover.

There is additional uncertainty associated with longevity risk due to the length of the period for which the risk persists and the difficulty in predicting future drivers of longevity improvements. There is a risk that the Issuer's assumptions as regards longevity are incorrect or inaccurate, such that policyholders live longer than expected. The Issuer is also exposed to longevity "basis risk", whereby patterns detected on, for example, a national level, are not necessarily commensurate with any given subgroup relevant to the Issuer (such as the membership of UK defined benefit schemes), and "measurement lag risk", where it is often not until a period of time has elapsed that well-defined improvement patterns become apparent in the data.

Changes in longevity expectations may result in the Issuer having to hold a higher level of reserves and/or capital and/or may impact the Issuer's profitability, which could have an adverse impact on the Issuer's business, results of operations and financial condition.

1.3 *Inaccurate data, incorrect projections or incorrect assumptions may result in the Issuer holding insufficient reserves to support its liabilities*

The Issuer makes assumptions relating to the proportion of policyholders who are married, the age of a policyholder's spouse and the proportion of benefits that will be taken as a lump sum as compared with those taken as regular payments. There may be instances in which the proportion of policyholders who are married is higher than expected and a greater number of spouses than anticipated are eligible to receive benefits following the deaths of policyholders, requiring the Issuer to pay a greater than expected amount of contingent spouse benefits. Similarly, the Issuer may be required to pay out more than expected where a deceased policyholder's spouse, who is eligible to receive benefits following the death of a policyholder, is younger than assumed, leading to a longer than expected stream of benefit payments. In the event that a greater proportion of benefits across the policyholder base are drawn down as a lump sum than is anticipated, the Issuer could be required to meet more upfront payments than expected, although in this instance the Issuer is released from the obligation to pay the regular annuity benefits that are being settled via the lump sum payment, with a corresponding release of reserve margins and capital.

The Issuer holds reserves to ensure that it has sufficient funds available to pay its technical liabilities when they fall due. The liabilities are based on, among other things, the assumptions reflecting the Issuer's best estimate at the time, allowing a margin for risk and adverse deviation. The Issuer monitors actual experience as compared with the actuarial assumptions used and it refines its assumptions on the basis of experience. While the Issuer currently believes that the reserves established in respect of the Issuer's business are sufficiently conservative to meet its obligations to policyholders, and which include reserving for the expenses associated with servicing these obligations, the Issuer's assumptions may prove to be incorrect or inaccurate (whether as a result of miscalculation by the Issuer, or changes in factors such as longevity which are outside the Issuer's control), and as such the Issuer could be required to establish additional reserves which would have a material impact on the Issuer's results of operations and financial condition.

Inaccuracies in data held by the Issuer or in projections or assumptions made by the Issuer may result in the Issuer having to hold a higher level of reserves and / or capital and/or may have an adverse impact on the Issuer's business, results of operations and financial condition.

1.4 *The unavailability of adequate reinsurance coverage may adversely impact the Issuer*

The Issuer enters into longevity and tail risk quota share reinsurance arrangements with third party reinsurers and, on a much smaller scale, with Pension Security Insurance Corporation Limited ("**PSIC**"), a Guernsey based reinsurer which is a subsidiary of the PCG Group, in order to cover a proportion of its risk. The availability and cost of reinsurance depends upon market conditions, and reinsurers' own financial condition. Reinsurers are also subject to changes in legislation and regulation, which could have a material impact on the Issuer's ability to obtain reinsurance coverage, particularly where such changes give rise to increases in pricing or a reluctance on the part of reinsurers to reinsure certain types of risk.

It is possible that the Issuer could enter into a buy-in or buy-out transaction and then be unable to obtain reinsurance in respect of the liabilities assumed. If the Issuer is unable to obtain reinsurance, either because there is a lack of reinsurance coverage available due to changes in the reinsurance market, or reinsurance cover is available but only on terms the Issuer is not willing or able to meet, the Issuer would be required to retain a significant portion of risk and could be subject to higher capital requirements as a result. This could have a material adverse effect on the Issuer's business, results of operations and financial condition.

1.5 *Failure by the Issuer appropriately to hedge its liabilities in relation to a buy-in or buy-out transaction could adversely impact the Issuer*

Where the Issuer quotes pricing for a buy-in or buy-out transaction and such pricing is made available for acceptance for a defined period but the Issuer has not entered into hedging contracts with respect to the interest rate and inflation assumptions on which such pricing quotes are based, there is a risk that the Issuer may not be able to enter into appropriate hedging arrangements, or a risk to do so at a reasonable cost, following the execution of the transaction. The Issuer is further exposed more generally to execution risk in respect of hedging transactions entered into after the completion of buy-in and buy-out transactions and in respect of future replacements or renewals of such hedging arrangements. Failure by the Issuer to adequately hedge its liabilities could have a material impact on the Issuer's business, results of operations and financial condition.

1.6 *The Issuer enters into reinsurance treaties, agreements, investments and hedging contracts with a range of counterparties. Any failure by those counterparties to meet their obligations to the Issuer could have a material adverse effect on the Issuer’s financial condition*

The Issuer enters into both quota share and longevity swap reinsurance arrangements in respect of its longevity related liabilities. In the event of default or other failure by any reinsurance counterparty to meet its obligations to the Issuer, the Issuer’s ability to meet its own obligations to the policyholder may be affected. This could have a material adverse effect on the Issuer's business, results of operations and financial condition. The largest reinsurance related exposures are to Hannover Rück SE, Berkshire Hathaway Life Insurance Company of Nebraska and PSIC. As such, a failure of one of these reinsurers in particular could have a material adverse effect on the Issuer’s business, results of operations and financial condition.

The Issuer is exposed to counterparty risk in relation to the interest rate and inflation hedging contracts to which it is a party. A default by a hedging counterparty could have an adverse effect on the Issuer’s business, results of operations and financial condition.

Counterparty risk also arises by virtue of the Issuer’s relationships with its third party service providers and its outsourcing arrangements. A default by such a third party service provider or a failure by such a service provider to perform its obligations to the Issuer could have a material impact on the Issuer’s business, results of operations and financial condition.

1.7 *The Issuer operates in a sector in which results of operations and in particular the volume of new business can vary from year to year*

The volume of pension fund buy-ins and buy-outs will fluctuate over time and from year to year as a result of, among other things, changes in the affordability of pension fund buy-in and buy-out transactions. A prolonged low interest rate environment in the future may, for example, adversely impact the affordability of such transactions.

Past performance is not an indicator of future performance and there can be no assurance that the Issuer will write the same volume of business as in previous years or that there will be linear transaction growth in the pension fund buy-in/buy-out sector. Similarly, there can be no assurance that the Issuer’s business will not be affected by any adverse publicity arising from any difference between the Issuer’s results of operations in any financial year and commentators’ expectations for such results.

1.8 *Circumstances may arise which result in the Issuer ceasing to write new business in the future*

There are a variety of factors which could result in the Issuer being unable to write new business in the future including, but not limited to, the actions of key personnel, regulatory intervention and/or adverse market conditions.

Changes in pensions regulation and legislation in particular may have an adverse effect on the volume of new business written by the Issuer. The Pensions Act 2004 (the "**Pensions Act**") introduced changes to the way in which pension fund liabilities are managed by increasing the regulatory requirements for defined benefit occupational pension funds. This included, among others, introducing a requirement for the pension fund sponsor to meet any deficit in the pension fund on the funding basis agreed between the trustees and the sponsor. This means that the sponsor must meet the cost of insuring the pension fund liabilities on a buy-out basis (and the pension fund must then enter into an insurance buy-in in respect of all such liabilities) in order to remove the obligation to make any further deficit contributions. Following this, there has been a growth in the volume of pension buy-outs and buy-ins per annum; however, any future changes to pensions legislation and/or the regulation of pension funds could have a negative impact on the volume of policies underwritten by the Issuer or increase the Issuer's cost of doing so, which could adversely affect the Issuer's business, results of operations and financial condition.

Failure to continue writing new business would have an adverse effect on the financial position of the Issuer in circumstances where the Issuer fails to scale back its cost base to correspond with the reduction in new business volumes. Similarly, any increase in the volume of business written by the Issuer may have an adverse impact on the Issuer's business, results of operations and financial condition if the Issuer fails to charge an adequate premium or to have adequate capital to support an increase in its liabilities.

1.9 *Competition in the UK market could affect the profitability of the Issuer and the long-term viability of its business model*

The UK insurance industry has experienced significant change in the last decade and increased competition could displace smaller and weaker companies from the market. In addition, companies may merge, cease to write business and go into run-off or otherwise withdraw from major lines of business. In line with other participants in the UK insurance industry, the Issuer faces strong competition in its business, and its continuing profitability, and the long term viability of its product range depends upon an adequate response to such competition. The Issuer's ability to generate an appropriate return depends upon its capacity to anticipate and respond appropriately to these competitive pressures, and a failure to do so may have a material adverse effect on the Issuer's business, results of operations and financial condition.

1.10 *The Issuer's business is concentrated in the UK and is exposed to events affecting the UK*

The Issuer writes all of its business in the UK and is therefore exposed to the economic, market, fiscal, regulatory, legislative, political and social conditions in the UK. Adverse events affecting the economy of the UK and its citizens could have a material adverse effect on the Issuer's business. The Issuer is particularly sensitive to UK market and economic conditions in respect of its investment portfolio and any events which have an adverse impact on the UK economy could have a significant impact on the Issuer's business, results of operations and financial condition.

There can be no assurance that the Issuer's business will continue to be concentrated in the UK. Although the Issuer does not currently intend to do so, the Issuer may in future seek to carry out business overseas. As a result, the Issuer could become subject to risks which could affect its business. This in turn could have an adverse impact on the Issuer's business, results of operations and financial condition.

1.11 *Potential constitutional changes affecting the UK more generally, such as Scottish independence, and the departure of the UK from the European Union, may have an adverse impact on the Issuer*

The Scottish Government has stated its intention to hold a referendum in September 2014 on the issue of Scottish independence from the UK. In addition, the UK Government has announced the possibility of a referendum on the UK's membership of the EU. The Issuer considers it unlikely that Scottish independence itself would have a significant impact on its business; however, subject to the effect any such departure has on the UK more generally, it could potentially have an adverse effect on the Issuer. It is also not possible to predict the manner and extent to which the UK's potential departure from the EU would affect the Issuer's business but, as the Issuer operates a UK-based business, such an event could have an adverse impact on the Issuer's business, results of operations and financial condition.

CREDIT, MARKET AND LIQUIDITY RISKS

2. Risks relating to the Issuer's investments

2.1 *The Issuer has exposure to various investment assets and any losses on the Issuer's investments may have a material adverse impact on the Issuer's financial position*

The Issuer's primary investment classes comprise corporate bonds, gilts and collateralised derivative assets, with other investments which include property and infrastructure, covered bonds, asset backed securities, insurance linked securities, hedge funds, private equity funds and collateralised loan obligations. The Issuer holds investments in order to meet its liabilities, and its profitability depends to a large extent on the returns achieved on its investment portfolio. However, the value of investment assets fluctuates, which can have a sudden and unexpected impact on the Issuer's capital levels. In the event of a downturn in the fixed income and/or other investment markets, there is a risk that the Issuer's liabilities will exceed the value of its assets due to asset values falling. This could have an adverse impact on the Issuer's financial position.

2.2 *The Issuer has exposure to default risk in relation to its investments*

The majority of the Issuer's investment assets comprise bonds, gilts and collateralised derivative assets, pursuant to which the Issuer is entitled to receive payments of interest and repayment of principal from the issuers of such instruments. The Issuer is therefore exposed to the risk of a default in payment by the issuers of the instruments held in the Issuer's investment portfolio. The loss of all or part of the cash flow generated by the Issuer's investment assets could have a direct, immediate and materially adverse impact on the value of the Issuer's investment portfolio and on the income and returns which the Issuer expects to realise on such investments. If the investments held by the Issuer are subject to defaults, this will have a material adverse impact on the Issuer's business, results of operations and financial condition.

2.3 *Credit spread volatility may adversely affect the net unrealised value of the Issuer's investment portfolio*

Credit spreads are sensitive to many factors including governmental policies, changes in tax policy or legislation, default on fixed income securities, domestic and international economic and political considerations, inflationary factors, regulatory requirements, fiscal deficits and other factors beyond the Issuer's control. Any widening of credit spreads will generally reduce the value of fixed income securities, which could have a material adverse effect on the Issuer's regulatory capital position and may result in the Issuer being required to sell its investments in order to meet its liabilities. Credit spread tightening will generally increase the value of fixed income securities. In the event that credit spreads widen in anticipation of a default, the fall in the value of the Issuer's assets may not be matched by an equivalent fall in the value of the Issuer's liabilities.

2.4 *Changes in interest rates, inflation and foreign exchange rates may adversely affect the value of the Issuer's assets and liabilities*

As is the case for credit spreads, interest rates are sensitive to many factors. Fluctuations in interest rates in particular affect the returns the Issuer may earn on fixed interest investments or other interest rate sensitive investments. Changes in interest rates affect the market values of the fixed interest securities that the Issuer holds. Interest rate risk arises primarily where assets and liabilities are structurally mismatched in relation to the Issuer's rate curve exposure.

The Issuer seeks to meet the cash outflows with respect to its liabilities with the cash flows and proceeds of its assets. As interest rates decrease or continue to be at low levels, and investments held by the Issuer reach maturity, the Issuer may be required to reinvest the proceeds of these matured investments at lower yields, which could impact the Issuer's capital position.

Inflation, as measured by reference to consumer and retail price indices, is a continuing risk for the Issuer. Although some of the Issuer's liabilities are protected from inflation rises, inflation risk typically arises where the Issuer's assets and liabilities are structurally mismatched in relation to the inflation rate expectation curve. Fluctuations in inflation affect the value of the Issuer's liabilities, as they are typically index-linked. They may also impact the returns the Issuer earns on its index-linked investments as well as the market values of those investments. In particular, a sustained fall in inflation and move to a deflationary environment may have a material adverse impact on the valuation of certain of the Issuer's assets and liabilities.

The Issuer's assets and liabilities are primarily denominated in sterling but the Issuer also holds some investments which are denominated in other currencies. Exchange rate fluctuations could affect the value of the Issuer's investment assets and the cash flows deriving from them.

The Issuer seeks to hedge its liability cash flows to interest rates, inflation rates and exposure to changes in foreign exchange rates, but there can be no assurance that such hedging will be effective in protecting the Issuer from such risk.

2.5 *Challenging conditions in the capital and credit markets may significantly impact the Issuer's ability to meet its liquidity needs*

The Issuer needs liquidity in order to fund its insurance operations, and to meet claims and operating expenses. The Issuer depends on its holdings of liquid assets, investment income and premiums to meet its liquidity requirements. Difficult market conditions may reduce the availability of such liquidity sources which, in extreme circumstances, could have an impact on the Issuer's ability to meet its obligations to policyholders and third parties as they arise.

In the event of an illiquid market, the Issuer may need to seek additional financing in order to meet its short-term cash flow requirements as they fall due. Depending on the availability of credit and/or ease with which the Issuer can access other forms of financing (such as the debt capital markets), the Issuer may have difficulty in obtaining the necessary capital required to operate its business and may have to realise investments at a depressed value. The Issuer seeks to mitigate liquidity risk by dedicating sufficient of its investment resources to liquid assets, enabling it to meet short term liabilities. Liquidity risk is not considered to be a significant risk for the Issuer and is likely to affect the Issuer only in the event of extremely challenging market conditions.

In addition, large short-term cash flow requirements may arise from the collateral calls generated by the Issuer's portfolio of hedging instruments such as interest rate swaps, inflation swaps and foreign exchange contracts. Although the Issuer seeks to ensure that it has adequate collateral arrangements in place to support such transactions, there can be no assurance that these arrangements will always be sufficient, particularly in times of severe market volatility.

3. Risks relating to the financial markets, the financial strength and financial condition of the Issuer

3.1 *A deterioration in the global financial markets and in UK and global economic and market conditions could have a material adverse impact on the Issuer's operations and its financial position*

Like other insurance companies, the Issuer is affected by changes in the general economic and financial market conditions. This can cause its results to fluctuate and potentially adversely affect its financial condition and its ability to meet its solvency obligations. Adverse economic conditions can also influence the counterparty credit risks to which the Issuer is exposed.

The global financial crisis and the subsequent Eurozone sovereign debt crisis have led to periods of marked deterioration and severe volatility in financial markets across the globe. The current economic climate, following the global financial crisis, is characterised by a higher number of economic risks than expected in a normal economic cycle. Governments around the world, including in the UK, have intervened to stabilise financial markets through fiscal stimulus and injection of funds, with a particular focus being to avoid the failure of key financial institutions. In the UK, the Bank of England has maintained a policy of low interest rates and implemented quantitative easing in order to support the economic recovery. Due to the nature of some of the Issuer's investments, it is also exposed to economic volatility in emerging markets.

The existing uncertainties, coupled with a risk of deterioration in the global financial markets, could have significant consequences for the business and operations of the Issuer. The increased volatility in asset markets could result in marked losses in the value of the Issuer's investment portfolio. A significant reduction in market values of the Issuer's investment portfolio could have a material impact on the Issuer's ability to meet its liabilities to policyholders and clients.

3.2 *Events leading to a negative perception of the financial services sector as a whole could adversely affect the Issuer*

The Issuer's creditworthiness is influenced by the perception and confidence of wholesale investors in relation to the UK financial services sector as a whole. Factors impacting this perception include the adverse performance of investment markets, actions by regulators against organisations operating in the UK financial services sector and shock events such as significant market failures, although the Issuer seeks wherever practicable to mitigate the effects of these risks. The financial crisis, subsequent investment performance and the low interest rate environment together with customers' perceptions of the robustness of financial institutions may also impact customer attitudes to long-term savings. Recent regulatory actions, for example with regard to Payment Protection Insurance ("**PPI**"), may also adversely impact customers' perception of the value of insurance products and result in changes to the regulatory and legislative environment in which the Issuer operates, which could adversely affect the creditworthiness of the Issuer.

3.3 *The Issuer does not have listed equity in issue and therefore it has no ready access to the equity capital markets*

As a wholly-owned subsidiary within the PCG Group, the Issuer does not have equity securities listed on a regulated market. The Issuer therefore does not have ready access to the equity capital markets.

The shareholders of the Issuer's ultimate parent company are under no obligation to contribute further equity.

OPERATIONAL AND STRATEGIC RISKS

4. Risks relating to the Issuer's strategy and business plan, including those relating to reliance on individuals within the PCG Group and/or third party service providers

4.1 *The Issuer relies on the contributions of key individuals for the continued success of its business, and its ability to attract, train, motivate and retain such individuals, the loss of which could have an impact on the Issuer's operations and profitability*

The Issuer's future success depends on the continued services and performance of key personnel and on its ability to attract, train, motivate and retain high quality and highly skilled personnel. The Issuer is substantially dependent upon the continued services and performance of its board of directors and other members of the senior management team. While the Issuer has entered into employment contracts or letters of appointment with these key personnel, no assurance can be given that they will continue to be employed by, and provide services to the Issuer. The loss of their services, whether through retirement or otherwise, could have a material adverse effect on the Issuer's business, financial condition and/or operating or financial results.

The Issuer's success also requires its continued ability to attract, train, motivate and retain a growing team of employees of suitable skill and experience for all areas of the Issuer's business. The Issuer may in future be unable to attract, motivate and retain such people. The Issuer's continued success and profitability depends on its ability not only to attract and retain increasing numbers of staff, but also to dedicate sufficient resources to their training and professional development.

4.2 *The Issuer relies on Pension Services Corporation Limited for the provision of its employees*

The Issuer's sister company, Pension Services Corporation Limited ("**PSC**"), is the PCG Group's services company, which provides the Issuer with employment services. The Issuer is dependent upon PSC for the provision of services from employees, directors and consultants and any significant event affecting PSC or any other failure by PSC to continue to provide services to the Issuer could have an adverse effect on the Issuer's business, results of operations and financial condition.

4.3 *The Issuer's brand and reputation are of significant importance to the Issuer's ability to attract clients and any damage to that brand could have a material impact on the Issuer's business and profitability*

The Issuer's brand is becoming more recognisable as the Issuer expands and grows its business. Any damage to the Issuer's brand or reputation or a decline in policyholder, trustee, client or counterparty confidence in the Issuer or its products could have a material adverse effect on the Issuer's business, results of operations and/or financial position.

The Issuer's success and results are, to a large extent, dependent upon the Issuer's brand as well as the reputation of the Issuer's board of directors and senior management team. Integrity, customer trust and confidence are paramount to the Issuer's brand and reputation. Any adverse publicity (whether well-founded or not) associated with the Issuer could result in a loss of business. A material operational loss, any adverse regulatory or legal actions impairing the Issuer's brand or any adverse publicity or fines could damage the public image of the Issuer and its brand and negatively affect customer confidence in the Issuer, resulting in a loss of current business in respect of that portion of the Issuer's business which can be surrendered by the policyholder, and a downturn in new business volumes and sales.

4.4 *The Issuer is reliant on its internal and external systems, processes and controls (including information technology) and any failure of such systems, processes and controls could have a material adverse effect on the Issuer's business*

Operational risks are inherent within the Issuer's business, including the risk of direct or indirect loss resulting from inadequate or failed internal and external processes and controls, systems, human error, negligence, fraud, external events and failure to attract, motivate and retain skilled personnel.

The Issuer is heavily reliant on its operational systems, business resilience systems and IT capabilities to conduct its business. IT is key to a number of the functions within the Issuer's business including calculating and measuring its capital requirements, taking into account its liabilities, assessing risk exposure, producing financial and management reports, processing and retaining data relating to the pension funds and members which it has underwritten and maintaining accurate data and records. In the event of any damage, failure, harm to or interruption in the IT deployed in respect of these functions, whether as a result of human error, unauthorised usage, natural disasters or other matters outside the Issuer's control, the Issuer's operations may be severely disrupted and/or the Issuer may be subject to customer and/or counterparty complaints or litigation and could incur significant costs which in turn could have a material adverse effect on the Issuer's profitability, results of operations and financial condition.

Although the Issuer has disaster recovery and business continuity plans in place, there is no guarantee that these will be sufficient in the event of a particular issue or disaster which the Issuer's systems, processes and controls are not equipped to deal with. Any material loss or damage to the information or data stored in the Issuer's systems could significantly impair the Issuer's ability to conduct its business and may have an adverse effect on the Issuer's results of operations and financial condition.

Notwithstanding anything in this risk factor, it should not be taken as implying that either the Issuer or the Group will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FCA and the PRA.

4.5 *The Issuer collects, retains and maintains policyholder and pension fund information and data and any failure to protect such information could have a material adverse effect on the Issuer*

The Issuer is required to collect and maintain certain information and data, including personal data. The collection and retention of such data is subject to the UK Data Protection Act 1998 (the "**DPA**") (for more details see *"Regulatory Overview"* below). Failure by the Issuer or any of its third party service providers to comply with the DPA could result in significant fines or other action by the UK's Information Commissioner, which could have a material impact on the Issuer's financial condition. Any loss or unauthorised use or sharing of data held by the Issuer could also result in adverse publicity, which could affect the Issuer's business and results of operations.

4.6 *The Issuer relies on various third party service providers to which it outsources key functions and services. Any loss of, or any negative financial consequences arising in* *connection with, the provision of these functions or services could have a material impact on the Issuer's business*

The Issuer outsources certain activities to outsourcing partners: Xafinity Consulting and Hymans Robertson provide liability pricing services; asset managers including Henderson Global Investors, Schroders and M&G provide asset management services; Mercer and Ensign provide services relating to the administration and servicing of policies; JPMorgan provides services relating to investment accounting, custody, investment fund and performance reporting; Northern Trust provides custody and transaction services; Ernst & Young provides internal audit services; and Towers Watson provides Actuarial Function Holder services.

The Issuer is therefore reliant upon the operational processing performance of these and other outsourcing partners, as well as investment decisions by its asset managers, and if the services provided by such third parties were to prove insufficient or inadequate, or result in financial losses, or if they cease to provide services for any reason, this could have a material adverse effect on the Issuer's business, financial condition and/or operating or financial results.

LEGAL AND REGULATORY RISKS

5. Risks relating to the regulatory and legislative environment, including those relating to accounting standards and taxation

5.1 *The structure of the financial regulatory authorities in the UK and the UK regulatory framework that applies to insurers, including the Issuer, is the subject of reform and reorganisation*

The Issuer is authorised by the Prudential Regulation Authority (the "**PRA**") and is regulated by both the FCA and the PRA. The PRA has responsibility for the prudential regulation of insurers and the FCA has responsibility for the regulation of conduct of business.

As the regulatory approach of the PRA and FCA evolves, there may be future changes to the nature of, or policies for, prudential regulation and conduct of business supervision which differ from the approach previously taken by the Financial Services Authority ("**FSA**") and this could lead to a period of uncertainty for the Issuer. No assurance can be given about the likelihood of further changes to the regulatory regime. Any such changes may have a material adverse effect on the business of the Issuer and its strategy and profitability, and therefore on its financial condition, results of operations and prospects.

The Issuer is required to obtain and maintain certain permissions from the PRA and to comply with various rules and regulations in order to conduct its insurance business lawfully in the UK. For more details about the regulatory environment within which the Issuer operates, please see *"Regulatory Overview"* below. Failure to comply with any regulatory requirements may result in the PRA and/or the FCA taking action against the Issuer, which could include imposing fines or sanctions or limiting or revoking the necessary permissions, as well as resulting in adverse publicity for the Issuer. This could ultimately result in the Issuer being unable to carry on its insurance business.

5.2 *The Issuer is required to comply with capital adequacy requirements, failure to do so could have a material adverse effect on the Issuer's business*

The Issuer is required to maintain a minimum level of assets (regulatory capital) in excess of the value of its liabilities in order to comply with certain regulatory requirements. These requirements as regards solvency are set out in more detail in *"Regulatory Overview" below*. Currently, the Issuer must assess its capital on a Pillar 1 (regulatory capital) and Pillar 2 (individual capital assessment) basis and must hold sufficient qualifying regulatory capital to satisfy both tests. In the event that the Issuer is unable to meet its regulatory capital requirements, the PRA may intervene and require the Issuer to take certain steps to restore its regulatory capital to acceptable levels, for example, by requiring the Issuer to cease to write or reduce writing new business. The Issuer might also need to re-allocate capital across its business, increase prices, increase reinsurance coverage or adopt a new investment strategy, including by making significant changes to its investment portfolio.

The Issuer is required to publicly disclose its Solvency (Pillar 1) position whereas the Issuer is required by the PRA to keep its Solvency (Pillar 2) position confidential.

While the Issuer is currently able to meet its regulatory capital requirements, changes in legislation, regulation, regulatory requirements or market conditions may result in the Issuer being unable to do so in the future. This could lead to the PRA limiting or revoking the permissions which the Issuer requires in order to carry out insurance business, which could materially impact the Issuer's results of operations and/or financial position.

In relation to those pension funds which the Issuer has insured by way of buy-in transactions only, an adverse event which results in a deterioration in the Issuer's solvency could result in the recapture of the relevant assets and an unwinding of the transaction by the fund's trustees, releasing PIC's obligations, if such a recapture is a right of the trustee under the relevant buy-in insurance policy. There is currently only one such buy-in insurance policy with recapture rights. However, the Issuer may in the future enter into new buy-in insurance policies where a trustee recapture right is a feature of the policy. Such recapture could have an adverse effect on the Issuer's business, results of operations and financial condition.

5.3 *The current solvency regime with which the Issuer is required to comply is undergoing significant change, the outcome of which remains uncertain*

A new solvency regime applicable to the EU insurance sector, known as Solvency II, has been developed with the aim of codifying and harmonising prudential regulation for insurers, and applying more consistent risk sensitive standards to insurers' capital requirements. This new framework is the result of the European Commission's review into the prudential regulation of insurers, and covers areas such as regulatory capital, the valuation of assets and liabilities, calculating technical provisions and regulatory reporting. The Solvency II Directive, which was adopted by the European Council in November 2009, will replace the existing life, non-life, reinsurance and insurance groups directives and is currently due to come into force on 1 January 2016. Solvency II will be amended by the Omnibus II Directive ("**Omnibus II**"), the agreed text of which was formally adopted by the European Council in March 2014. Omnibus II will introduce a number of changes to Solvency II, designed to reflect the revised EU financial services supervisory framework (in particular, the replacement of the Committee of European Insurance and Occupational Pensions Supervisors with the European Insurance and Occupational Pensions Authority ("**EIOPA**") from 1 January 2011) and align it with the legislative process introduced by the Lisbon Treaty. The Solvency II "Level 1" Directive will be implemented by means of both "Level 2" measures, including delegated acts and binding technical standards, and "Level 3" guidance, including non-binding supervisory standards, recommendations and guidelines.

The new regime for insurers and reinsurers under Solvency II will be such that these entities may be permitted to make use of internal economic capital models when calculating their capital requirements, provided the prior approval of the relevant regulator has been obtained. The Issuer has yet to determine whether it will seek approval of the PRA to enable it to make use of an internal capital model.

Although the underlying intention and purpose behind the incoming regime are generally understood, there is continued uncertainty regarding the impact of Solvency II on insurance companies. Implementing measures, which are currently being developed, are expected to clarify the uncertainty surrounding a number of issues on a wide range of topics. It is anticipated that the draft Level 2 delegated acts, which are expected to take the form of an EU Regulation, will be published later this year. EIOPA has already published its first sets of draft implementing technical standards and draft Level 3 guidelines for consultation, and intends to consult on and finalise the implementing technical standards and guidelines required under Solvency II throughout the remainder of 2014 and the first half of 2015. For further details of Solvency II, please see *"Regulatory Overview" below*.

The implementation of Solvency II may lead to increases in the Issuer's capital requirements. In addition, following any implementation date of Solvency II, regulators may continue to issue guidance and other interpretations of applicable requirements, which could require further adjustments by the Issuer in the future. A failure by the Issuer to implement the measures required by Solvency II in a timely manner could also lead to regulatory action and have a material adverse effect on the Issuer's business, results of operations and financial condition.

There is also a risk that the Notes and any capital instruments issued in the future will cease to qualify as regulatory capital. This could require the Issuer to raise additional capital in order to meet its regulatory capital requirements under Solvency II and failure to do so could have a significant impact on the Issuer's business, results of operations and financial condition.

5.4 *A change of law or regulation or changes in the interpretation or operation of existing legislation or regulation may adversely affect the Issuer's business, results of operations and financial condition*

The Issuer will not always be able to predict the impact of future legislation or regulation or changes in the interpretation or operation of existing legislation or regulation on its business, results of operations and financial condition. Changes in government policy, legislation or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which the Issuer operates, which may be applied retrospectively, may adversely affect its capital requirements, its ability to meet its obligations in respect of the Notes and, consequently, results and financing requirements.

The Issuer may also face increased compliance costs due to the need to set up additional compliance controls because of changes to financial services legislation or regulation.

On 19 March 2014 the UK Government announced a set of reforms which are intended to allow individuals more choice over how they access their defined contribution pension savings at the point of retirement. The reforms announced specifically did not directly affect pension benefits in defined benefit arrangements. However, the UK Government has stated that it is open to various options, including extending such reforms to members of private sector defined benefit pension funds and has requested views, as part of a consultation exercise, with submissions requested by 11 June 2014. The UK Government expects to publish the outcome of the consultation by 22 July 2014. It is not yet known whether the reforms, once finalised, will have an impact on the Issuer's business, results of operations or financial condition. There is a risk that the reforms may have an adverse impact on the Issuer's business, results of operations or financial condition if the reforms result in the entry, or increased activity, of other industry participants in the bulk annuity sector leading to increased competition.

5.5 *The Issuer is subject to the FCA's "Treating Customers Fairly" or "TCF" principles, which are central to the FCA's regulatory approach*

The TCF regime was implemented by the predecessor to the FCA and PRA, the FSA. It requires the Issuer to have due regard to the interests of its customers in the conduct of its business, with an overriding requirement to treat them fairly. Any determination by the FCA that the Issuer is failing to respect and pay due regard to the interests of its policyholders could lead to enforcement action against the Issuer, which could have a material adverse effect on the Issuer's reputation and its business.

5.6 *The Issuer is subject to competition and consumer protection legislation, failure to comply with which could result in the imposition of fines or sanctions on the Issuer or a requirement to make significant changes to the Issuer's business model*

The Issuer is required to comply with competition laws and regulations as well as those relating to consumer protection, such as consumer credit, enforced by the Office of Fair Trading ("**OFT**"), the UK Competition Commission (which are soon to be superseded by the UK Competition and Markets Authority and, in relation to consumer credit only, the FCA) and the European Competition Commission. The competition laws and regulations applicable to the Issuer relate to matters such as price fixing, collusion and other forms of anti-competitive behaviour. The FCA is also concerned with the promotion of competition in the UK.

A determination that the Issuer has failed to comply with any applicable laws and/or regulations relating to matters of competition or consumer protection, or any regulatory action in respect thereof could result in fines and losses as well as adverse publicity for the Issuer. This could have a material impact on the Issuer's reputation and its business, financial condition and future prospects.

5.7 *Changes to tax or accounting legislation could materially impact the Issuer's business and/or decisions of customers*

Corporate and individual tax rules are subject to change and any changes could have both a prospective and retrospective impact on the Issuer's business, financial condition and results of operations. The introduction of new tax legislation, or amendments to existing tax rules or rates (individual or corporate) could materially impact the Issuer's business and the choices policyholders make with respect to the nature of their relationship with the Issuer and/or the Issuer's policies. Although the implications of any future changes in tax legislation or rules for the Issuer and policyholders cannot be predicted, specific changes to the taxation of insurance companies could have a material adverse effect on the Issuer's financial condition and prospects.

5.8 *Changes to IFRS generally or specifically for insurance companies may have an adverse impact on the Issuer's business*

The Issuer's financial statements conform to the International Financial Reporting Standards ("**IFRS**") as published by the International Accounting Standards Board ("**IASB**"), as adopted by the European Union ("**EU**").

Changes to IFRS for insurance companies have been proposed in recent years and the IASB has published proposals in its IFRS 4 Insurance Contracts Phase II for Insurers Exposure Draft ("**Phase II**") that may introduce significant changes in the statutory reporting of insurance companies which prepare their financial statements in accordance with IFRS. The proposals are still under discussion and the final standard, once issued, is not likely to come into effect before 2018. It currently includes changes to the presentation and measurement of insurance contracts, which would also affect the effect of technical reserves and reinsurance on the value of insurance contracts. At this stage it is unclear the extent of the impact that the proposals outlined in Phase II would have on the Issuer if they become definitive standards under IFRS.

5.9 *The Issuer may be subject to litigation, legal proceedings and/or regulatory investigations in the future (including investigation and intervention by the FCA and/or PRA), which could have a material adverse effect on its business and results of operations*

Following the onset of the recent financial crisis, the PRA and the FCA have adopted a more intrusive and direct style of regulation, which means that PRA and/or FCA-authorised firms, including the Issuer, are facing increasing supervisory scrutiny. The PRA and the FCA have the power to take a range of investigative, disciplinary and enforcement actions, penalties for which can include public censure, restitution, fines and sanctions. The regulators may also make enquiries of the firms which they regulate and require the provision of particular information or documents. The regulators may take such action or make such enquiries in relation to aspects of the Issuer's business and operations, including its systems and controls, IT systems, capital requirements, capital adequacy and permitted investments. Regulatory action may be specific to the Issuer or part of more general action in respect of firms that operate in the Issuer's sector. The Issuer has regular dialogue with its regulators to ensure compliance with applicable regulatory standards. In the normal course of its business, the Issuer is engaged in discussions with the PRA and FCA in relation to a range of business matters; however, there are currently no issues of material regulatory concern under discussion.

Whilst the Issuer believes that its systems, controls and operations are compliant with applicable regulations, given the growth in its business since its establishment, there is a risk that one or more regulators could find that the Issuer has failed to fully comply with all relevant regulatory requirements, or has not undertaken any corrective action as required.

More generally, it is possible that the Issuer may be subject to legal and/or regulatory action from time to time. This may or may not arise during the ordinary course of business and could potentially have a significant impact on the Issuer's business. It is not possible to predict the significance of any proceedings that may be brought against, or any investigations that may be conducted into, the Issuer nor is it possible to predict the financial impact of a successful claim, fine or penalty to which the Issuer may become subject.

RISKS RELATED TO THE NOTES

Defined terms used in these risk factors have the same meaning as in the Conditions

6. Risks relating to the structure of the Notes

6.1 *The Issuer may redeem the Notes at par before maturity in certain circumstances, and an investor may not be able to reinvest the redemption proceeds at as effective a rate of return as that in respect of the Notes*

The Notes may, subject as provided in Condition 5, be redeemed before the maturity date at the sole discretion of the Issuer in the event of certain specified events relating to taxation or if the Notes or (in certain circumstances) any part thereof cease to qualify as Tier 2 Capital of the Issuer or all or any part of the Group (which part includes the Issuer and at least one other member of the Group), whether on a solo, group or consolidated basis, in each case at their principal amount together with interest accrued but unpaid to (but excluding) the date of redemption and any Arrears of Interest.

The Issuer currently expects the Notes, upon the implementation of Solvency II, to qualify (but for any applicable limitations on the amount of such capital) as Tier 2 Capital, potentially via the application of transitional provisions set out in Solvency II. However, details of the implementation of Solvency II are not expected to be known until the Level 2 delegated acts, which are expected to take the form of an EU Regulation, are presented to and approved by the European Parliament and the Council (it is currently expected that these will be published later this year, and that they will be approved by the end of 2014). The first sets of draft implementing technical standards and draft Level 3 guidelines have been published for consultation, and the implementing technical standards and guidelines required under Solvency II are expected to be consulted on and finalised throughout the remainder of 2014 and the first half of 2015. There can be no assurance that, following publication of such delegated acts, the Level

2 implementation measures will not be amended. Although prior to the publication of the proposed Level 2 implementation measures, the Committee of European Insurance and Occupational Pensions Supervisors (now the European Insurance and Occupational Pensions Authority ("**EIOPA**")) has given indications as to what the required characteristics of regulatory capital might be, for example those set out in the QIS5 Technical Specifications and the Technical Specifications published on 30 April 2014 for the purposes of the EIOPA Stress Tests in respect of the insurance sector (the "**Indicative Features**"), the Indicative Features are preliminary and there can be no assurance that the Level 2 implementation measures and any rules and regulations to be adopted pursuant to such implementation measures will not require features which are wholly or substantially different from the Indicative Features. In addition, even though PIC has given consideration to the Indicative Features in the Conditions, there is considerable uncertainty as to their precise requirements.

Accordingly, there is a risk that, upon implementation of Solvency II in the United Kingdom or following any other change to the Relevant Rules, the Notes will cease to qualify as Tier 2 Capital of the Issuer or all or any part of the Group (which part includes the Issuer and at least one other member of the Group), which would entitle the Issuer to redeem the Notes early at their principal amount together with interest accrued but unpaid to (but excluding) the date of redemption and any Arrears of Interest.

The cash paid to investors upon such a redemption may be less than the then current market value of the Notes or the price at which investors purchased the Notes. Subject to the contractual and regulatory restrictions on doing so set out in the Conditions, the Issuer might be expected to redeem the Notes when its cost of borrowing for an instrument with a comparable regulatory capital treatment at the time is lower than the interest payable on them. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest payable on the Notes being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in the light of other investments available at that time.

An investor may not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Notes being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

6.2 *The Notes are unsecured and subordinated obligations of the Issuer. On a winding-up of the Issuer, investors in the Notes may lose their entire investment in the Notes*

The Issuer's payment obligations under the Notes will be unsecured and will be subordinated (i) on a winding-up of the Issuer and (ii) in the event that an administrator is appointed to the Issuer and gives notice that it intends to declare and distribute a dividend and, in each case, will rank junior to the claims of all policyholders and other unsubordinated creditors of the Issuer and to claims in respect of any subordinated indebtedness of the Issuer other than indebtedness which ranks, or is expressed to rank, pari passu with or junior to the Notes. Accordingly, the assets of the Issuer would be applied first in satisfying all senior-ranking claims in full, and payments would be made to holders of the Notes, pro rata and proportionately with payments made to holders of any other pari passu instruments (if any), only if and to the extent that there are any assets remaining after satisfaction in full of all such senior-ranking claims. If the Issuer's assets are insufficient to meet all its obligations to senior-ranking and pari passu creditors, the holders of the Notes will lose all or some of their investment in the Notes.

There is no restriction on the amount of securities which the Issuer may issue and which rank senior to, or pari passu with, the Notes and, accordingly, the Issuer may at any time incur further obligations (including by issue of further debt securities) which rank senior to, or pari passu with, the Notes. Consequently there can be no assurance that the current level of senior or pari passu debt of the Issuer will not change. The issue of any such securities may reduce the amount (if any) recoverable by Noteholders on a winding-up of the Issuer.

If the Issuer's financial condition deteriorates such that there is an increased risk that the Issuer may be wound-up or enter into administration, such circumstances can be expected to have a material adverse effect on the market price of the Notes. Investors in the Notes may find it difficult to sell their Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such a sale, investors may lose some or substantially all of their investment in the Notes, whether or not the Issuer is wound up or enters into administration.

Although the Notes may pay a higher rate of interest than comparable notes which are not subordinated, there is a material risk that an investor in the Notes will lose all or some of its investment should the Issuer become insolvent.

6.3 *Payments of interest on, and redemption of, the Notes must in certain circumstances be deferred by the Issuer*

The payment obligations by the Issuer under the Notes are conditional upon (i) there being no breach of the Solvency Condition (as described in Condition 2.2) at the time of such payment and no such breach occurring as a result of such payment, (ii) in the case of the payment of interest, there being no Regulatory Deficiency Interest Deferral Event at the time of such payment and no such event occurring as a result of such payment, (iii) in the case of the redemption of the Notes, there being no Regulatory Deficiency Redemption Deferral Event at the time of such payment and no such event occurring as a result of such payment and (if then required) regulatory consent having been obtained and such redemption being made in compliance with the Relevant Rules at such time, and (iv) in the case of the redemption of the Notes, notification to, or consent or non-objection from, the Relevant Regulator (to the extent then required by the Relevant Regulator or the Relevant Rules). Any amounts of principal, interest, Arrears of Interest and any other amounts in respect of the Notes which cannot be paid on the scheduled payment date by virtue of such provisions must be deferred by the Issuer, and non-payment of the amounts so deferred shall not constitute a default under the Notes or the Trust Deed for any purpose, including enforcement action against PIC.

Any interest in respect of the Notes so deferred will, so long as the same remains unpaid, constitute Arrears of Interest. Arrears of Interest will not themselves bear interest. The holders of the Notes have no right to require payment of Arrears of

Interest, and Arrears of Interest will become payable only at the discretion of the Issuer or upon the earliest of the dates set out in Condition 4.2 (a) to (c) (*Arrears of Interest*).

If redemption of the Notes is deferred, the Notes will only become due for redemption in the circumstances described in Condition 5.1(c) and (d) (*Redemption, Substitution, Variation, Purchase and Options – Redemption*).

The circumstances in which a Regulatory Deficiency Interest Deferral Event or a Regulatory Deficiency Redemption Deferral Event may occur are dependent upon the solvency position of the Issuer under Solvency II and the requirements of Solvency II and/or the Relevant Rules, which themselves are subject to finalisation and subsequent amendment.

Any actual or anticipated deferral of interest or redemption can be expected to have a material adverse effect on the market price of the Notes. Investors in the Notes may find it difficult to sell their Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such a sale, investors may lose some or substantially all of their investment in the Notes. In addition, as a result of the deferral provisions of the Notes, the market price of the Notes may be more volatile than the market prices of other securities or instruments that do not require deferral of interest or principal, and may be more sensitive generally to adverse changes in the Issuer's financial condition.

6.4 *The terms of the Notes may be modified, or the Notes may be substituted, by the Issuer without the consent of the Noteholders in certain circumstances, subject to certain restrictions*

In the event of certain specified events relating to taxation or if the Notes cease to qualify as Tier 2 Capital of the Issuer, the Issuer may (subject to certain conditions) at any time substitute all (but not some only) of the Notes for, or vary the terms of the Notes so that they remain or become (as applicable), Qualifying Dated Tier 2 Securities, without the consent of the Noteholders.

Qualifying Dated Tier 2 Securities must have terms not materially less favourable to holders than the terms of the Notes, as reasonably determined by the Issuer in consultation with an independent investment bank of international standing. However, there can be no assurance that, due to the particular circumstances of a holder of Notes, such Qualifying Dated Tier 2 Securities will be as favourable to each investor in all respects or that, if it were entitled to do so, a particular investor would make the same determination as the Issuer as to whether the terms of the Qualifying Dated Tier 2 Securities are not materially less favourable to holders than the terms of the Notes.

6.5 *The terms of the Notes may be modified with the consent of specified majorities of the Noteholders at a duly convened meeting, and the Trustee may consent to certain modifications to the Notes, or substitution of the Issuer, without the consent of the Noteholders*

The Trust Deed constituting the Notes contains provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The Trust Deed constituting the Notes also provides that, subject to the prior consent of the Relevant Regulator being obtained (to the extent that such consent is required), the Trustee may (except as set out in the Trust Deed), without the consent of Noteholders, agree to certain modifications of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of the Notes or to the substitution of another company as principal debtor or guarantor under the Notes in place of the Issuer in the circumstances described in Condition 10.

6.6 *Restricted remedy for non-payment when due*

In accordance with the current requirements for eligible Tier 2 Capital, the sole remedy against the Issuer available to the Trustee or (where the Trustee has failed to proceed against the Issuer as provided in the Conditions) any Noteholder for recovery of amounts which have become due in respect of the Notes and Coupons will be the institution of proceedings for the winding-up of the Issuer and/or proving in such winding-up or administration and/or claiming in the liquidation of the Issuer. In particular, a deferral of payments as described in section 6.3 above shall not constitute a default under the Notes or the Trust Deed for any purpose, including enforcement action against the Issuer.

7. Risks relating to the Notes generally

7.1 *EU Savings Directive*

Under Council Directive 2003/48/EC on the taxation of savings income (the "**Savings Directive**") each Member State of the European Union is required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State.

Amendments to the Savings Directive adopted by the Council of the European Union on 24 March 2014 will expand the circumstances in which payments which indirectly benefit an individual resident in another Member State must be reported, including where the payment is made to, or secured for, certain trusts or certain other legal arrangements. The amendments will also expand the range of payments covered by the Savings Directive, in particular to include additional types of income payable on securities. Member States are required to apply these new requirements from 1 January 2017.

For a transitional period, Luxembourg and Austria are instead required, unless during such period those countries elect otherwise, to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). Once the amendments referred to above are implemented, investors should be aware that withholding in the relevant Member State(s) may occur in a wider range of circumstances than at present. In April 2013, the Luxembourg Government announced its intention to abolish the withholding system with effect from 1 January 2015, in favour of automatic information exchange under the Savings Directive.

A number of other non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland).

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note or Coupon as a result of the imposition of such withholding tax. The Issuer will be required to maintain a Paying Agent in a Member State that will not be obliged to operate a withholding system pursuant to the Savings Directive or any law implementing or complying with or introduced to conform to such directive.

7.2 *Change of law*

The Conditions are based on English law in effect as at the date of issue of the Notes. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of issue of the Notes.

7.3 *Integral multiples of less than £100,000*

The denomination of the Notes is £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000. Accordingly, it is possible that the Notes may be traded in the clearing systems in amounts in excess of £100,000 that are not integral multiples of £100,000. Should definitive Notes be required to be issued, they will be issued in principal amounts of £100,000 and higher integral multiples of £1,000 up to a maximum of £199,000 but will in no circumstances be issued to Noteholders who hold Notes in the relevant clearing system in amounts that are less than £100,000.

If definitive Notes are issued, Noteholders should be aware that definitive Notes which have a denomination that is not an integral multiple of £100,000 may be illiquid and difficult to trade.

8. Risks related to the market generally

8.1 *The secondary market generally*

The Notes have no established trading market when issued, and one may never develop. If a market does develop it may not be liquid. In addition, the Notes will be unrated on issue, and the Issuer does not expect to seek a credit rating for the Notes at any time, which may limit the liquidity of the Notes in the secondary market. Investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market and/or which are rated. Illiquidity may have a severely adverse effect on the market value of the Notes.

If the Issuer's financial condition deteriorates such that there is an increased risk that the Issuer may be wound-up or enter into administration, or if at any time there is any actual or anticipated deferral of interest or redemption in accordance with the Conditions, such circumstances can be expected to have a material adverse effect on the market price of the Notes. Investors in the Notes may find it difficult to sell their

Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such a sale, investors may lose some or substantially all of their investment in the Notes.

8.2 *Exchange rate risks and exchange controls*

The Issuer will pay principal and interest on Notes in sterling. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than sterling. These include the risk that exchange rates may significantly change (including changes due to devaluation of sterling or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to sterling would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency-equivalent value of the principal payable on the Notes and (3) the Investor's Currency-equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

8.3 *Interest rate risks*

Investment in the Notes, which bear a fixed rate of interest, involves the risk that subsequent increases in market interest rates may adversely affect the market value of them.

Terms and Conditions of the Notes

The following are the Terms and Conditions of the Notes, substantially as they will appear on the Notes in definitive form (if issued).

The £300,000,000 6.50 per cent. Fixed Rate Subordinated Notes due 2024 (the "**Notes**", which expression shall, unless the context otherwise requires, include any further notes issued pursuant to Condition 14 and forming a single series with the Notes) of Pension Insurance Corporation plc (the "**Issuer**") are constituted by a trust deed dated 3 July 2014 (the "**Trust Deed**") between the Issuer and Citicorp Trustee Company Limited (the "**Trustee**", which expression shall include all persons for the time being the trustee or trustees under the Trust Deed) as trustee for the holders of the Notes (the "**Noteholders**"). These terms and conditions (the "**Conditions**") include summaries of, and are subject to, the detailed provisions of the Trust Deed, which includes the forms of the Notes and Coupons referred to below. An Agency Agreement dated 3 July 2014 (the "**Agency Agreement**") has been entered into in relation to the Notes between the Issuer, the Trustee and Citibank, N.A., London Branch as principal paying agent. The principal paying agent and any other paying agent(s) for the time being appointed under the Agency Agreement are referred to below respectively as the "**Principal Paying Agent**" and the "**Paying Agents**" (which expression shall include the Principal Paying Agent). Copies of the Trust Deed and the Agency Agreement are available for inspection during usual business hours and upon reasonable notice at the principal office of the Trustee (presently at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, United Kingdom) and at the specified office of each of the Paying Agents.

The Noteholders and the holders of the interest coupons (the "**Coupons**") relating to the Notes (the "**Couponholders**") are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and are deemed to have notice of those provisions applicable to them of the Agency Agreement.

1. Form, Denomination and Title

The Notes are issued in bearer form, serially numbered, in denominations of £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000, each with Coupons attached on issue. No definitive Notes will be issued with a denomination below £100,000 or above £199,000.

Title to the Notes and the Coupons shall pass by delivery. Except as ordered by a court of competent jurisdiction or as required by law, the holder of any Note or Coupon shall be deemed to be and may be treated as its absolute owner for all purposes whether or not it is overdue and regardless of any notice of ownership, trust or an interest in it, any writing on it, or its theft or loss and no person shall be liable for so treating the holder.

2. Status

2.1 Ranking

The Notes and the Coupons relating to them constitute direct, unsecured and subordinated obligations of the Issuer and rank *pari passu* and without any preference among themselves. In the event of the winding-up of the Issuer (other than an Approved Winding-up) or the appointment of an administrator of the Issuer where the administrator has given notice that it intends to declare and distribute a dividend, the payment obligations of the Issuer under or arising from the Notes and the Coupons relating to them and the Trust Deed, including any Arrears of Interest and any damages awarded for breach of any obligations in respect of the Notes and the Coupons, shall be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors of the Issuer, but shall rank at least *pari passu* with all other subordinated obligations of the Issuer which constitute, or would but for any applicable limitation on the amount of such capital constitute, Lower Tier 2 Capital (issued prior to Solvency II Implementation) or Tier 2 Capital (issued on or after Solvency II Implementation) ("**Pari Passu Securities**") and shall rank in priority to the claims of holders of: (i) all obligations of the Issuer which constitute, or would but for any applicable limitation on the amount of such capital constitute, Upper Tier 2 Capital issued prior to Solvency II Implementation; (ii) all obligations of the Issuer which constitute, or would but for any applicable limitation on the amount of such capital constitute, Tier 1 Capital (including, without limitation, by virtue of the operation of any grandfathering provisions under any Relevant Rules); and (iii) all classes of share capital of the Issuer (together, the "**Junior Securities**").

2.2 Solvency Condition

Without prejudice to Condition 2.1 above, all payments under or arising from the Notes, the Coupons relating to them and the Trust Deed shall be conditional upon the Issuer being solvent at the time for payment by the Issuer, and no amount shall be payable under or arising from the Notes, the Coupons relating to them and the Trust Deed unless and until such time as the Issuer could make such payment and still be solvent immediately thereafter (the "**Solvency Condition**").

For the purposes of this Condition 2.2, the Issuer will be solvent if (i) it is able to pay its debts owed to Senior Creditors and Pari Passu Creditors as they fall due and (ii) its Assets exceed its Liabilities (other than Liabilities to persons who are Junior Creditors). A certificate as to solvency of the Issuer signed by two Directors or, if there is a winding-up or administration of the Issuer, the liquidator or, as the case may be, the administrator of the Issuer shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the holders of the Notes and the Coupons relating to them and all other interested parties as correct and sufficient evidence thereof and the Trustee shall be entitled to rely on such certificate without liability to any person.

2.3 Set-off, etc.

Subject to applicable law, no holder of the Notes and the Coupons relating to them may exercise, claim or plead any right of set-off, compensation or retention in respect of any amount owed to it by the Issuer arising under or in connection with the Notes and the Coupons relating to them and each holder of the Notes and the Coupons relating to them shall, by virtue of being the holder of any Note or Coupon, be deemed to have waived all such rights of set-off, compensation or retention. Notwithstanding the preceding sentence, if any of the amounts owing to any holder of the Notes or Coupons relating to them by the Issuer is discharged by set-off, such holder shall, unless such payment is prohibited by law, immediately pay an amount equal to the amount of such discharge to the Issuer or, in the event of its winding-up or administration, the liquidator or administrator, as appropriate of the Issuer for payment to the Senior Creditors in respect of amounts owing to them by the Issuer, and, until such time as payment is made, shall hold an amount equal to such amount in trust for the Issuer, or the liquidator or administrator, as appropriate of the Issuer (as the case may be), for payment to the Senior Creditors in respect of amounts owing to them by the Issuer and accordingly any such discharge shall be deemed not to have taken place.

As used in this Condition 2, the expression “**obligations**” includes any direct or indirect obligations of the Issuer and whether by way of guarantee, indemnity, other contractual support arrangement or otherwise and regardless of name or designation.

On a winding-up of the Issuer, there may be no surplus assets available to meet the claims of the Noteholders after the claims of the parties ranking senior to the Noteholders (as provided in Condition 2) have been satisfied.

3. Interest

3.1 Interest Rate and Interest Payment Dates

Subject to Condition 2.2 and Condition 4, each Note bears interest on its outstanding principal amount from (and including) the Issue Date at the rate of 6.50 per cent. per annum, payable annually in arrear on 3 July of each year, the first payment to be made on 3 July 2015 (each an “**Interest Payment Date**”). The first payment shall be in respect of the period from (and including) the Issue Date to (but excluding) 3 July 2015, and thereafter for each successive period from (and including) an Interest Payment Date to (but excluding) the next Interest Payment Date.

3.2 Interest Accrual

Each Note will cease to bear interest from (and including) its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment, in which event interest shall continue to accrue as provided in the Trust Deed.

3.3 Calculation of Interest

Where it is necessary to compute an amount of interest in respect of any Note, such interest shall be calculated on the basis of (a) the actual number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Issue Date) to (but excluding) the relevant payment date divided by (b) the actual number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Issue Date) to (but excluding) the next (or first) scheduled Interest Payment Date.

Interest shall be calculated per £1,000 in principal amount of the Notes (the “**Calculation Amount**”) by applying the rate of interest referred to in Condition 3.1 to such Calculation Amount, multiplying the resulting figure by the day count fraction described in the immediately preceding paragraph and rounding the resultant figure to two decimal places (with 0.005 being rounded up). The amount of interest payable in respect of a Note shall be calculated by multiplying the amount of interest per Calculation Amount determined as aforesaid by the specified denomination of such Note and dividing the resulting figure by £1,000.

4. Deferral of Payments

4.1 Mandatory Deferral of Interest

Payment of interest on the Notes will be mandatorily deferred on each Mandatory Interest Deferral Date. The Issuer shall notify the Trustee in writing and notify the Noteholders in accordance with Condition 15 no later than 5 Business Days prior to an Interest Payment Date (or as soon as reasonably practicable if a Regulatory Deficiency Interest Deferral Event occurs less than 5 Business Days prior to an Interest Payment Date) if a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or if a Regulatory Deficiency Interest Deferral Event would occur on the Interest Payment Date if payment of interest was made (provided that, for the avoidance of doubt, any delay in giving such notice shall not result in such interest becoming due and payable on the relevant Mandatory Interest Deferral Date).

A certificate signed by two Directors confirming that (a) a Regulatory Deficiency Interest Deferral Event has occurred and is continuing, or would occur if payment of interest on the Notes were to be made or (b) a Regulatory Deficiency Interest Deferral Event has ceased to occur and/or payment of interest on the Notes would not result in a Regulatory Deficiency Interest Deferral Event occurring, shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the holders of the Notes and the Coupons relating to them and all other interested parties as correct and sufficient evidence thereof and the Trustee shall be entitled to rely on such certificate without liability to any person.

Notwithstanding any other provision in these Conditions or in the Trust Deed, the deferral of any payment of interest on a Mandatory Interest Deferral Date in accordance with this Condition 4.1 or in accordance with Condition 2.2 will not constitute a default by the Issuer and will not give Noteholders or the Trustee any right to accelerate repayment of the Notes.

4.2 Arrears of Interest

Any interest in respect of the Notes not paid on an Interest Payment Date as a result of the obligation on the Issuer to defer pursuant to Condition 4.1 or due to the operation of the Solvency Condition contained in Condition 2.2, together with any other interest in respect of the Notes not paid on an earlier Interest Payment Date shall, so long as the same remains unpaid, constitute "**Arrears of Interest**". Arrears of Interest shall not themselves bear interest.

Any Arrears of Interest may (subject to Condition 2.2 and (to the extent then required by the Relevant Regulator or the Relevant Rules) to any notifications to, or consent or non-objection from, the Relevant Regulator), be paid in whole or in part at any time (provided that at such time a Regulatory Deficiency Interest Deferral Event is not subsisting and would not occur if payment of such Arrears of Interest was made) upon the expiry of not less than 14 days' notice to such effect given by the Issuer to the Trustee in writing and to the Noteholders in accordance with Condition 15, and in any event will become due and payable (subject, in the case of (a) and (c) below, to Condition 2.2 and (to the extent then required by the Relevant Regulator or the

Relevant Rules) any notifications to, or consent or non-objection from, the Relevant Regulator) in whole (and not in part) upon the earliest of the following dates:

(a) the next Interest Payment Date which is not a Mandatory Interest Deferral Date; or

(b) the date on which an order is made or a resolution is passed for the winding-up of the Issuer (other than an Approved Winding-up) or the date on which any administrator of the Issuer gives notice that it intends to declare and distribute a dividend; or

(c) the date fixed for any redemption or purchase of Notes by or on behalf of the Issuer or any of its Subsidiaries pursuant to Condition 5.

5. Redemption, Substitution, Variation, Purchase and Options

5.1 Redemption

(a) Subject to Condition 2.2, Condition 5.1(b) below and to compliance by the Issuer with regulatory rules including (to the extent then required by the Relevant Regulator or the Relevant Rules) on notification to, or consent or non-objection from, the Relevant Regulator, and provided that such redemption is permitted under the Relevant Rules applicable from time to time to the Issuer (on the basis that the Notes are intended to qualify as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions), unless previously redeemed or purchased and cancelled as provided below each Note shall be redeemed on the Maturity Date at its principal amount together with Arrears of Interest, if any, and any other interest accrued to (but excluding) the date of redemption in accordance with these Conditions.

(b) No Notes shall be redeemed on the Maturity Date pursuant to Condition 5.1(a) or prior to the Maturity Date pursuant to Condition 5.3 or Condition 5.4 if a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if redemption is made on, if Condition 5.1(a) applies, the Maturity Date or, if Condition 5.3 or Condition 5.4 applies, any date specified for redemption in accordance with such Conditions.

(c) If the Notes are not to be redeemed on the Maturity Date pursuant to Condition 5.1(a) or on any scheduled redemption date pursuant to Condition 5.3 or Condition 5.4 as a result of circumstances where:

(i) a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if the Notes were redeemed on such date;

(ii) the Solvency Condition would not be satisfied on such date and immediately after the redemption; or

(iii) the Relevant Regulator does not consent to the redemption (to the extent that consent is then required by the Relevant Regulator or the Relevant Rules) or the Relevant Regulator objects to the redemption or such redemption otherwise cannot be effected in compliance with the Relevant Rules on such date,

the Issuer shall notify the Trustee in writing and notify the Noteholders in accordance with Condition 15 no later than 5 Business Days prior to the Maturity Date or the date specified for redemption in accordance with Condition 5.3 or Condition 5.4, as applicable, (or as soon as reasonably practicable if the relevant circumstance requiring redemption to be deferred arises, or is determined, less than 5 Business Days prior to the relevant redemption date).

(d) If redemption of the Notes does not occur on the Maturity Date or, as appropriate, the date specified in the notice of redemption by the Issuer under Condition 5.3 or Condition 5.4 as a result of Condition 5.1(b) above or the Relevant Regulator does not consent to the redemption (to the extent that consent is then required by the Relevant Regulator or the Relevant Rules) or the Relevant Regulator objects to the redemption or such redemption otherwise cannot be effected in compliance with the Relevant Rules on such date, subject (in the case of (i) and (ii) below only) to Condition 2.2 and (to the extent then required by the Relevant Regulator or the Relevant Rules) to any notifications to, or consent or non-objection from, the Relevant Regulator, such Notes shall be redeemed at their principal amount together with Arrears of Interest, if any, and any other interest accrued to (but excluding) the date of redemption, upon the earliest of:

(i) (in the case of a failure to redeem due to the operation of Condition 5.1(b) only) the date falling 10 Business Days after the date the Regulatory Deficiency Redemption Deferral Event has ceased (unless, on such 10th Business Day, a further Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or redemption of the Notes on such date would result in a Regulatory Deficiency Redemption Deferral Event occurring, in which case the provisions of Condition 5.1(b), Condition 5.1(c) and this Condition 5.1(d) shall apply *mutatis mutandis* to determine the due date for redemption); or

(ii) the date falling 10 Business Days after the Relevant Regulator has agreed to the repayment or redemption of the Notes; or

(iii) the date on which an order is made or a resolution is passed for the winding-up of the Issuer (other than an Approved Winding-up) or the date on which any administrator of the Issuer gives notice that it intends to declare and distribute a dividend.

(e) If Condition 5.1(b) does not apply, but redemption of the Notes does not occur on the Maturity Date or, as appropriate, the date specified in the notice of redemption by the Issuer under Condition 5.3 or Condition 5.4 as a result of the Solvency Condition not being satisfied at such time and immediately after such payment, subject (to the extent then required by the Relevant Regulator or the Relevant Rules) to any notifications to, or consent or non-objection from, the Relevant Regulator, such Notes shall be redeemed at their principal amount together with accrued interest and any Arrears of Interest on the 10th Business Day immediately following the day that (i) the Issuer is solvent for the purposes of Condition 2.2 and (ii) redemption of the Notes would not result in the Issuer ceasing to be solvent for the purposes of Condition 2.2, provided that if on such Business Day specified for redemption a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing, or would occur if the Notes were to be redeemed, or if the Solvency Condition would not be satisfied on such date and immediately after the redemption, then the Notes shall not be redeemed on such date and Condition 2.2 and Condition 5.1(d) shall apply *mutatis mutandis* to determine the date of the redemption of the Notes.

(f) A certificate signed by two Directors confirming that (i) a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing, or would occur if redemption of the Notes were to be made or (ii) a Regulatory Deficiency Redemption Deferral Event has ceased to occur and/or redemption of the Notes would not result in a Regulatory Deficiency Redemption Deferral Event occurring, shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the holders of the Notes and the Coupons relating to them and all other interested parties as correct and sufficient evidence thereof and the Trustee shall be entitled to rely on such certificate without liability to any person.

(g) Notwithstanding any other provision in these Conditions or in the Trust Deed, the deferral of redemption of the Notes in accordance with Condition 2.2 or this Condition 5 will not constitute a default by the Issuer and will not give Noteholders or the Trustee any right to accelerate repayment of the Notes or take any other action under the Notes or the Trust Deed.

5.2 Conditions to Redemption, Substitution, Variation or Purchase

Any redemption, substitution, variation or purchase of the Notes is subject to the Issuer having complied with relevant legal or regulatory requirements including (to the extent then required by the Relevant Regulator or the Relevant Rules) rules on notification to, or consent or non-objection from, the Relevant Regulator and being in continued compliance with the Regulatory Capital Requirements applicable to it at the relevant time and, in the case of a redemption or purchase that is within five years of the Issue Date of the Notes, to such redemption or purchase being funded out of the proceeds of a new issuance of capital of at least the same quality as the Notes and being otherwise permitted under the Relevant Rules. If, on or after Solvency II Implementation, (on the basis that the Notes are intended to qualify as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions) Solvency II does not require a redemption or purchase that is within five years of the Issue Date of the Notes to be funded out of the proceeds of a new issuance of capital of at least the same quality as the Notes, such a redemption or purchase will not be required to be so funded but such a redemption or purchase will be subject to the Relevant Rules.

A certificate signed by two Directors confirming such compliance shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the holders of the Notes and the Coupons relating to them and all other interested parties as correct, conclusive and sufficient evidence thereof and the Trustee shall be entitled to rely on such certificate without liability to any person.

In the case of a redemption that is within five years of the Issue Date of the Notes, the Issuer shall deliver to the Trustee a certificate signed by two Directors stating that it would have been reasonable for the Issuer to conclude, judged at the time of the issue of the Notes, that the circumstance entitling the Issuer to exercise the right of redemption was unlikely to occur. Such certificate shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the holders of the Notes and the Coupons relating to them and all other interested parties as correct, conclusive and sufficient evidence thereof and the Trustee shall be entitled to rely on such certificate without liability to any person.

5.3 Redemption, Substitution or Variation Due to Taxation

If immediately prior to the giving of the notice referred to below:

(a) as a result of a change in or proposed change in, or amendment or proposed amendment to, the laws or regulations of the UK or any political subdivision or authority therein or thereof having the power to tax, including any treaty to which the UK is a party, or any change in the application or official interpretation of such laws, including a decision of any court or tribunal, or any interpretation or pronouncement by any relevant tax authority that provides for a position with respect to such laws or regulations that differs from the previously generally accepted position in relation to similar transactions (in respect of securities similar to the Notes and which are capable of constituting Lower Tier 2 Capital under the rules applicable at issuance) or which differs from any specific written confirmation given by a tax authority in respect of the Notes, which change or amendment becomes, or would become, effective, or in the case of a change or proposed change in law if such change is enacted (or, in the case of a proposed change, is expected to be enacted) by UK Act of Parliament or by Statutory Instrument, on or after the Issue Date of the Notes (each a "**Tax Law Change**"), in making any payments on the Notes, the Issuer has paid or will or would on the next payment date be required to pay Additional Amounts on the Notes and the Issuer cannot avoid the foregoing in connection with the Notes by taking measures reasonably available to it; or

(b) as a result of a Tax Law Change, in respect of the Issuer's obligation to make any payment of interest on the next following Interest Payment Date, (i) the Issuer would not be entitled to claim a deduction in respect of computing its taxation liabilities in the UK, or such entitlement is materially reduced; or (ii) the Issuer would not to any material extent be entitled to have such deduction set against the profits of companies with which it is grouped for applicable UK tax purposes (whether under the group relief system current as at the date of the Tax Law Change or any similar system or systems having like effect as may from time to time exist) and, in each such case, the Issuer cannot avoid the foregoing in connection with the Notes by taking measures reasonably available to it,

then the Issuer may:

(x) subject to Condition 2.2, Condition 5.1(b) and Condition 5.2 and having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 15, the Noteholders (which notice shall be irrevocable), redeem in accordance with these Conditions at any time all, but not some only, of the Notes at their principal amount, together with Arrears of Interest, if any, and any other interest accrued to (but excluding) the date of redemption in accordance with these Conditions; provided that, in the case of a Tax Law Change which is a proposed amendment or a proposed change only, no such notice of redemption shall be given earlier than 90 days prior to: (i) the earliest date on which the Issuer would be required to pay such Additional Amounts (in the case of a redemption pursuant to Condition 5.3(a)); or (ii) the first Interest Payment Date on which the eventuality set out in Condition 5.3(b)(i) or Condition 5.3(b)(ii), as applicable, would materialise (in the case of a redemption pursuant to Condition 5.3(b)), as applicable; or

(y) subject to Condition 5.2 (without any requirement for the consent or approval of the Noteholders or the Couponholders) and having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 15, the Noteholders (which notice shall be irrevocable), substitute at any time all (but not some only) of the Notes for, or vary the terms of the Notes so that they remain or become, Qualifying Dated Tier 2 Securities, and the Trustee shall (subject to the following provisions of this paragraph (y) and subject to the receipt by it of the certificates of the Directors referred to below and in the definition of Qualifying Dated Tier 2 Securities) agree to such substitution or variation. The Trustee shall use its reasonable endeavours to assist the Issuer in the substitution or variation of the Notes for or into Qualifying Dated Tier 2 Securities provided that the Trustee shall not be obliged to participate or assist in any such substitution or variation if the terms of the securities into which the Notes are to be substituted or are to be varied impose, in the Trustee's opinion, more onerous obligations upon it. If the Trustee does not so participate or assist as provided above, the Issuer may, subject as provided above, redeem the Notes as provided above.

Prior to the publication of any notice of redemption, substitution or variation pursuant to this Condition 5.3 the Issuer shall deliver to the Trustee (A) a certificate signed by two Directors stating that the relevant requirement or circumstance referred to in Condition 5.3(a) or Condition 5.3(b) applies and (B) an opinion from a nationally recognised law firm or other tax adviser in the UK experienced in such matters to the effect that the relevant requirement or circumstance referred to in Condition 5.3(a) or Condition 5.3(b) applies. Such certificate and opinion shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the holders of the Notes and the Coupons relating to them and all other interested parties as correct, conclusive and sufficient evidence thereof and the Trustee shall be entitled to rely on such certificate and opinion without liability to any person. Upon expiry of such notice the Issuer shall (subject to Condition 5.2 and, in the case of a redemption, to Condition 2.2, Condition 5.1(b), Condition 5.1(c) and Condition 5.1(d)) either redeem, vary or substitute the Notes, as the case may be.

In connection with any substitution or variation in accordance with this Condition 5.3, the Issuer shall comply with the rules of any stock exchange or other relevant authority on which the Notes are for the time being listed or admitted to trading.

5.4 Redemption, Substitution or Variation at the Option of the Issuer due to Capital Disqualification Event

If immediately prior to the giving of the notice referred to below a Capital Disqualification Event has occurred and is continuing, then:

(a) the Issuer may, subject to Condition 2.2, Condition 5.1(b) and Condition 5.2 and having given not less than 30 nor more than 60 days' notice to the Noteholders in accordance with Condition 15, the Trustee and the Principal Paying Agent (which notice shall be irrevocable), redeem in accordance with these Conditions all, but not some only, of the Notes at any time. The Notes will be redeemed at their principal amount, together with Arrears of Interest, if any, and any other interest accrued to (but excluding) the date of redemption in accordance with these Conditions; or

(b) the Issuer may, subject to Condition 5.2 (without any requirement for the consent or approval of the Noteholders or the Couponholders) and having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 15, the Noteholders (which notice shall be irrevocable), substitute at any time all (and not some only) of the Notes for, or vary the terms of the Notes so that they remain or become, Qualifying Dated Tier 2 Securities, and the Trustee shall (subject to the following provisions of this paragraph (b) and subject to the receipt by it of the certificates of the Directors of the Issuer referred to below and in the definition of Qualifying Dated Tier 2 Securities) agree to such substitution or variation. The Trustee shall use its reasonable endeavours to assist the Issuer in the substitution or variation of the Notes for or into Qualifying Dated Tier 2 Securities provided that the Trustee shall not be obliged to participate or assist in any such substitution or variation of the terms of the securities into which the Notes are to be substituted or are to be varied impose, in the Trustee's opinion, more onerous obligations upon it. If the Trustee does not so participate or assist as provided above, the Issuer may, subject as provided above, redeem the Notes as provided above.

Prior to the publication of any notice of redemption, substitution or variation pursuant to this Condition 5.4 the Issuer shall deliver to the Trustee a certificate signed by two Directors stating that a Capital Disqualification Event has occurred and is continuing as at the date of the certificate. Such certificate shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the holders of the Notes and the Coupons relating to them and all other interested parties as correct, conclusive and sufficient evidence thereof and the Trustee shall be entitled to rely on such certificate without liability to any person. Upon expiry of such notice the Issuer shall (subject to Condition 5.2 and, in the case of a redemption, to Condition 2.2, Condition 5.1(b), Condition 5.1(c) and Condition 5.1(d)) either redeem, vary or substitute the Notes, as the case may be.

In connection with any substitution or variation in accordance with this Condition 5.4, the Issuer shall comply with the rules of any stock exchange or other relevant authority on which the Notes are for the time being listed or admitted to trading.

5.5 Purchases

Subject to Conditions 2.2 and 5.2, the Issuer and any of its Subsidiaries may at any time purchase Notes (provided that all unmatured Coupons relating thereto are attached thereto or surrendered therewith) in the open market or otherwise at any price.

5.6 Cancellation

All Notes purchased by or on behalf of the Issuer or any of its Subsidiaries may (at the option of the Issuer or the relevant Subsidiary) be held, reissued, resold or surrendered for cancellation. Each Note surrendered for cancellation shall be surrendered together with all unmatured Coupons to the Principal Paying Agent. All Notes surrendered for cancellation, together with all Notes redeemed by the Issuer, shall be cancelled forthwith (together with all unmatured Coupons attached thereto or surrendered therewith). Any Notes so redeemed or surrendered for cancellation may not be reissued or resold and the obligations of the Issuer in respect of any such Notes and Coupons shall be discharged.

5.7 Trustee Not Obliged to Monitor

The Trustee shall not be under any duty to monitor whether any event or circumstance has happened or exists within this Condition 5 and will not be responsible to Noteholders for any loss arising from any failure by the Trustee to do so. Unless and until the Trustee has actual knowledge of the occurrence of any event or circumstance within this Condition 5, it shall be entitled to assume that no such event or circumstance exists.

6. Payments

6.1 Method of Payment

Payments of principal and interest (including, without limitation, Arrears of Interest) will be made against presentation and surrender of Notes or the appropriate Coupons (as the case may be) at the specified office of any of the Paying Agents except that payments of interest in respect of any period not ending on an Interest Payment Date will only be made against presentation and either surrender or endorsement (as appropriate) of the relevant Notes. Such payments will be made, at the option of the payee, by a pounds sterling cheque drawn on, or by transfer to a pounds sterling account maintained by the payee with, a bank in London.

Each Note shall be presented for payment together with all relative unmatured Coupons, failing which the full amount of any relative missing unmatured Coupon (or, in the case of payment not being made in full, that proportion of the full amount of the missing unmatured Coupon which the amount so paid bears to the total amount due) will be deducted from the amount due for payment. Each amount so deducted will be paid in the manner mentioned above against presentation and surrender (or, in the case of part payment only, endorsement) of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date in respect of the relevant Note (whether or not the relevant Coupon would otherwise have become void pursuant to Condition 8). If any Note is presented for redemption without all unmatured Coupons appertaining to it, redemption shall be made only against the provision of such indemnity as the Issuer may require.

6.2 Payments subject to Fiscal Laws

All payments will be subject in all cases to (a) any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 7 and (b) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the U.S. Internal Revenue Code of 1986 (the "**Code**") or otherwise imposed pursuant to Sections 1471 through 1474 of the Code, any regulations or agreements thereunder, any official interpretations thereof, or (without prejudice to the provisions of Condition 7) any law implementing an intergovernmental approach thereto.

6.3 Appointment of Agents

The Principal Paying Agent initially appointed by the Issuer and its specified office are listed below. Subject as provided in the Agency Agreement, the Principal Paying Agent and the Paying Agents act solely as agents of the Issuer and do not assume any obligation or relationship of agency or trust for or with any Noteholder or Couponholder. The Issuer reserves the right at any time with the approval of the Trustee to vary or terminate the appointment of the Principal Paying Agent or any other Paying Agent and to appoint additional or other Paying Agents, provided that the Issuer shall at all times maintain (a) a Principal Paying Agent, (b) a Paying Agent having a specified office in a European Union Member State that will not be obliged to withhold or deduct tax whether pursuant to Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such directive, any agreement between the European Union and any jurisdiction providing for equivalent measures or otherwise (so long as there is such a Member State) and (c) a Paying Agent having specified offices in London so long as the Notes are admitted to the Official List of the UK Listing Authority and admitted to trading on the London Stock Exchange's EEA Regulated Market. Notice of any such change or any change of any specified office shall promptly be given to the Noteholders in accordance with Condition 15.

6.4 Non-Business Days

If any date for payment in respect of any Note or Coupon is not a Business Day, the holder shall not be entitled to payment until the next following Business Day nor to any interest or other sum in respect of such postponed payment. In these Conditions, "**Business Day**" means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for business:

(a) (in the case of this Condition 6) in the place where such Note or Coupon is presented for payment; or

(b) in any other case, in London.

7. Taxation

All payments of principal and interest by or on behalf of the Issuer in respect of the Notes and the Coupons shall be made free and clear of, and without withholding or deduction for or on account of, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the UK or any authority therein or thereof having power to tax, unless such withholding or deduction is required by law. In that event, the Issuer shall pay such additional amounts as shall result in receipt by the Noteholders and Couponholders of such amounts as would have been received by them had no such withholding or deduction been required by law to be made ("**Additional Amounts**"), except that no such Additional Amounts shall be payable with respect to any Note or Coupon:

(a) *Other connection*: presented for payment by or on behalf of, a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Note or Coupon by reason of his having some connection with the UK other than the mere holding of the Note or Coupon; or

(b) *Lawful avoidance of withholding*: presented for payment by or on behalf of, a holder who could lawfully avoid (but has not so avoided) such deduction or withholding by complying or procuring that any person who is associated or connected with the holder for the purposes of any tax complies with any statutory requirements or by making or procuring that any such person makes a declaration of non residence or other similar claim for exemption to any tax authority in the place where the relevant Note or Coupon is presented for payment; or

(c) *Presentation more than 30 days after the Relevant Date*: presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder of it would have been entitled to such additional amounts on presenting it for payment on the thirtieth day; or

(d) *Payment to individuals*: where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such directive or any agreement between the European Union and any jurisdiction providing for equivalent measures; or

(e) *Payment by another Paying Agent*: presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note or Coupon to another Paying Agent in a Member State of the European Union (provided that there is such a Paying Agent appointed at the relevant time).

As used in these Conditions, "**Relevant Date**" in respect of any Note or Coupon means the date on which payment in respect of it first becomes due or (if any amount of the money payable is improperly withheld or refused) the date on which payment in full of the amount outstanding is made or (if earlier) the date seven days after that on which notice is duly given to the Noteholders that, upon further presentation of the Note or Coupon being made in accordance with the Conditions, such payment will be made, provided that payment is in fact made upon such presentation. References in these Conditions to principal and/or interest shall be deemed to include any Additional Amounts that may be payable under this Condition or any undertaking given in addition to or in substitution for it under the Trust Deed.

8. Prescription

Claims against the Issuer for payment in respect of the Notes and Coupons shall be prescribed and become void unless made within 10 years (in the case of principal) or five years (in the case of interest including, without limitation, Arrears of Interest) from the appropriate Relevant Date in respect of them.

9. Events of Default and Enforcement

9.1 Rights to institute and/or prove in a winding-up

Notwithstanding any of the provisions below in this Condition 9, the right to institute winding-up proceedings is limited to circumstances where payment has become due and is not duly paid. Pursuant to Condition 2.2, no principal, interest or any other amount will be due on the relevant payment date if the Solvency Condition is not satisfied, at the time of and immediately after any such payment. In the case of any payment of interest in respect of the Notes, such payment will be deferred and will not be due if Condition 4.1 applies and in the case of payment of principal, such payment will be deferred and will not be due if Condition 5.1(b) applies or the Relevant Regulator does not consent to the redemption (to the extent that consent is then required by the Relevant Regulator or the Relevant Rules), the Relevant Regulator objects to the redemption or such redemption otherwise cannot be effected in compliance with the Relevant Rules on such date.

If default is made for a period of 14 days or more in the payment of any interest (including, without limitation, Arrears of Interest) or principal due in respect of the Notes or any of them, the Trustee in its discretion may, and if so requested by Noteholders of at least one quarter in principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution shall (subject in each case to Condition 9.4) institute proceedings for the winding-up of the Issuer and/or prove in the winding-up or administration of the Issuer and/or claim in the liquidation of the Issuer for such payment, but may take no further or other action to enforce, prove or claim for any such payment. No payment in respect of the Notes, the Coupons or the Trust Deed may be made by the Issuer pursuant to Condition 9.1, nor will the Trustee accept the same, otherwise than during or after a winding-up of the Issuer or after an administrator of the Issuer has given notice that it intends to declare and distribute a dividend, unless the Issuer has given prior written notice (with a copy to the Trustee) to, and received consent or non-objection from, the Relevant Regulator, which the Issuer shall confirm in writing to the Trustee.

9.2 Amount payable on winding-up or administration

If an order is made by the competent court or resolution passed for the winding-up of the Issuer, (other than an Approved Winding-up) or an administrator of the Issuer gives notice that it intends to declare and distribute a dividend, the Trustee at its discretion may, and if so requested by Noteholders of at least one quarter in principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution shall (subject in each case to Condition 9.4), give notice to the Issuer (or, as applicable, the administrator or liquidator) that the Notes are, and they shall accordingly forthwith become, immediately due and repayable at the amount equal to their principal amount together with Arrears of Interest, if any, and any other accrued and unpaid interest, and the claim in respect thereof will be subject to the subordination provided for in Condition 2.1.

In addition, any other amounts in respect of the Notes or the Coupons (including any damages awarded for breach of any obligations under these Conditions or the Trust Deed) in respect of which the Solvency Condition was not satisfied on the date upon which the same would otherwise have become due and payable ("**Solvency Claims**") will be payable by the Issuer in a winding-up of the Issuer, and the claim in respect thereof will be subject to the subordination provided for in Condition 2.1. A Solvency Claim shall not bear interest.

9.3 Enforcement

Without prejudice to Condition 9.1 or Condition 9.2 above, the Trustee may at its discretion and without further notice institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Trust Deed, the Notes or the Coupons (other than any payment obligation of the Issuer under or arising from the Notes, the Coupons or the Trust Deed including, without limitation, payment of any principal or interest (including, without limitation, Arrears of Interest) in respect of the Notes or the Coupons and any damages awarded for breach of any obligations) and in no event shall the Issuer, by virtue of the institution of any such proceedings, be obliged to pay any sum or sums (in cash or otherwise) sooner than the same would otherwise have been payable by it. Nothing in this Condition 9.3 shall, subject to Condition 9.1, prevent the Trustee instituting proceedings for the winding-up of the Issuer, proving in any winding-up of the Issuer and/or claiming in any liquidation of the Issuer in respect of any payment obligations of the Issuer arising from the Notes, the Coupons or the Trust Deed (including without limitation, payment of any principal or interest (including, without limitation, Arrears of Interest) in respect of the Notes or the Coupons and any damages awarded for any breach of any obligations).

9.4 Entitlement of the Trustee

The Trustee shall not be bound to take any of the actions referred to in Condition 9.1, Condition 9.2 or Condition 9.3 above to enforce the obligations of the Issuer under the Trust Deed, the Notes or the Coupons unless (a) it shall have been so directed by an Extraordinary Resolution of the Noteholders or so requested in writing by the holders of at least one-quarter in principal amount of the Notes then outstanding and (b) it shall have been indemnified and/or secured and/or prefunded to its satisfaction.

9.5 Right of Noteholders

No Noteholder or Couponholder shall be entitled to proceed directly against the Issuer or to institute proceedings for the winding-up or claim in the liquidation of the Issuer or to prove in such winding-up unless the Trustee, having become so bound to proceed or being able to prove in such winding-up or claim in such winding-up, fails to do so within a reasonable period and such failure shall be continuing, in which case the Noteholder or Couponholder shall have only such rights against the Issuer as those which the Trustee is entitled to exercise as set out in this Condition 9.

9.6 Extent of Noteholders' remedy

No remedy against the Issuer, other than as referred to in this Condition 9, shall be available to the Trustee or the Noteholders or Couponholders, whether for the recovery of amounts owing in respect of the Notes or under the Trust Deed or in respect of any breach by the Issuer of any of its other obligations under or in respect of the Notes, Coupons or under the Trust Deed.

10. Meetings of Noteholders, Modification, Waiver and Substitution

10.1 Meetings of Noteholders

The Trust Deed contains provisions for convening meetings of Noteholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of any of these Conditions or any provisions of the Trust Deed. Such a meeting may be convened by Noteholders holding not less than 10 per cent. in principal amount of the Notes for the time being outstanding. The quorum for any meeting convened to consider an Extraordinary Resolution shall be one or more persons holding or representing a clear majority in principal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons holding or representing Noteholders whatever the principal amount of the Notes held or represented, unless the business of such meeting includes consideration of proposals, *inter alia* (a) to amend the dates of maturity or redemption of the Notes or any date for payment of interest or Arrears of Interest on the Notes, (b) to reduce or cancel the principal amount of the Notes, (c) to reduce the rate or rates of interest or Arrears of Interest in respect of the Notes or to vary the method or basis of calculating the rate or rates or amount of interest or the basis for calculating any interest Amount in respect of the Notes, (d) to vary the currency or currencies of payment or denomination of the Notes, (e) to take any steps that as specified hereon may only be taken following approval by an Extraordinary Resolution to which the special quorum provisions apply, (f) to modify the provisions concerning the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, or (g) to modify Condition 2, in which case the necessary quorum shall be one or more persons holding or representing not less than two-thirds, or at any adjourned meeting not less than one-third, in principal amount of the Notes for the time being outstanding.

The agreement or approval of the Noteholders shall not be required in the case of any variation of these Conditions and/or the Trust Deed made in the circumstances described in Condition 5.3 or Condition 5.4 in connection with the substitution or variation of the Notes so that they remain or become Qualifying Dated Tier 2 Securities, and to which the Trustee has agreed pursuant to the relevant provisions of Condition 5.3 or Condition 5.4, as the case may be. Any Extraordinary Resolution duly passed shall be binding on Noteholders (whether or not they were present at the meeting at which such resolution was passed) and on all Couponholders.

10.2 Modification of the Trust Deed or the Agency Agreement

The Trustee may agree, without the consent of the Noteholders or Couponholders, to (a) any modification of any of these Conditions and the provisions of the Trust Deed or the Agency Agreement that is in the opinion of the Trustee of a formal, minor or technical nature or is made to correct a manifest error, and (b) any other modification (except as mentioned in the Trust Deed), and any waiver or authorisation of any breach or proposed breach, of any of these Conditions and the provisions of the Trust Deed or the Agency Agreement that is in the opinion of the Trustee not materially prejudicial to the interests of the Noteholders.

Any such modification, authorisation or waiver shall be binding on the Noteholders and the Couponholders and, if the Trustee so requires, such modification shall be notified to the Noteholders as soon as practicable thereafter.

10.3 Notice to the Relevant Regulator

No modification to these Conditions or any other provisions of the Trust Deed shall become effective unless (to the extent then required by the Relevant Regulator or the Relevant Rules) the Issuer shall have given at least one month's prior written notice to, and received consent or no objection from, the Relevant Regulator (or such other period of notice as the Relevant Regulator may from time to time require or accept).

10.4 Substitution

The Trustee may agree with the Issuer, without the consent of the Noteholders or the Couponholders, to the substitution on a subordinated basis equivalent to that referred to in Condition 2 of any person or persons incorporated in any country in the world (the "**Substitute Obligor**") in place of the Issuer (or any previous Substitute Obligor under this Condition) as a new principal debtor under the Trust Deed, the Notes and the Coupons provided that:

(a) a trust deed is executed or some other form of undertaking is given by the Substitute Obligor in form and manner satisfactory to the Trustee, agreeing to be bound by the terms of the Trust Deed, the Notes and the Coupons, with any consequential amendments which the Trustee may deem appropriate, as fully as if the Substitute Obligor had been named in the Trust Deed and on the Notes and the Coupons, as the principal debtor in place of the Issuer (or of any previous Substitute Obligor, as the case may be);

(b) (unless the successor in business (as defined in the Trust Deed) of the Issuer is the Substitute Obligor) the obligations of the Substitute Obligor under the Trust Deed, the Notes and the Coupons are guaranteed by the Issuer (or the successor in business of the Issuer) on a subordinated basis equivalent to that referred to in Condition 2 and in the Trust Deed and in a form and manner satisfactory to the Trustee, and provided further that the obligations of such guarantor shall be subject to a solvency condition equivalent to that set out in Condition 2.2, such guarantor shall not exercise rights of subrogation or contribution against the Substitute Obligor without the consent of the Trustee and the only event of default applying to such guarantor shall be an event of default equivalent to that set out in Condition 9.1.

(c) the directors of the Substitute Obligor or other officers acceptable to the Trustee certify that the Substitute Obligor is solvent at the time at which the said substitution is proposed to be effected (and the Trustee may rely absolutely on such certification without liability to any person and shall not be bound to have regard to the financial condition, profits or prospects of the Substitute Obligor or to compare the same with those of the Issuer);

(d) (without prejudice to the rights of reliance of the Trustee under Condition 10.4(c) above) the Trustee is satisfied that the said substitution is not materially prejudicial to the interests of the Noteholders;

(e) (without prejudice to the generality of Condition 10.4(a) above) the Trustee may in the event of such substitution agree, without the consent of the Noteholders or Couponholders, to a change in the law governing the Trust Deed and/or the Notes and/or the Coupons, provided that such change would not in the opinion of the Trustee be materially prejudicial to the interests of the Noteholders;

(f) if the Substitute Obligor is, or becomes, subject generally to the taxing jurisdiction of a territory or any authority of or in that territory with power to tax (the "**Substituted Territory**") other than the territory or any such authority to the taxing jurisdiction of which the Issuer is subject generally (the "**Issuer's Territory**"), the Substitute Obligor will (unless the Trustee otherwise agrees) give to the Trustee an undertaking satisfactory to the Trustee in terms corresponding to Condition 7 with the substitution for the references in that Condition and in Condition 5.3 to the Issuer's Territory of references to the Substituted Territory whereupon the Trust Deed, the Notes and the Coupons will be read accordingly; and

(g) the Issuer and the Substitute Obligor comply with such other requirements as are reasonable in the interests of the Noteholders, as the Trustee may direct.

Any substitution pursuant to this Condition 10 shall be subject (to the extent then required by the Relevant Regulator or the Relevant Rules) to any notifications to, or consent or non-objection from, the Relevant Regulator.

11. Entitlement of the Trustee

In connection with any exercise of its functions (including but not limited to those referred to in Condition 10), the Trustee shall have regard to the interests of the Noteholders as a class and the Trustee shall not have regard to the consequences of such exercise for individual Noteholders or Couponholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory. In connection with any such exercise as aforesaid, no Noteholder or Couponholder shall be entitled to claim, whether from the Issuer, the Substitute Obligor or the Trustee or any other person, any indemnification or payment in respect of any tax consequence of any such substitution or any such exercise upon any individual Noteholders or Couponholders except to the extent already provided in

Condition 7 and/or any undertaking given in addition thereto or in substitution therefor pursuant to the Trust Deed.

12. Indemnification of the Trustee

The Trust Deed contains provisions for the provision of indemnification, security and prefunding to the Trustee and for its relief from responsibility, including provisions relieving it from taking any action unless indemnified, secured or prefunded to its satisfaction. The Trustee is entitled to enter into business transactions with the Issuer and any entity related to the Issuer without accounting for any profit.

13. Replacement of Notes and Coupons

If a Note or Coupon is lost, stolen, mutilated, defaced or destroyed, it may be replaced, subject to applicable laws, regulations and stock exchange or other relevant authority regulations, at the specified office of the Principal Paying Agent or such other Paying Agent as the case may be, as may from time to time be designated by the Issuer for the purpose and notice of whose designation is given to Noteholders, in each case on payment by the claimant of the fees and costs incurred in connection therewith and on such terms as to evidence, security and indemnity (which may provide, inter alia, that if the allegedly lost, stolen or destroyed Note or Coupon is subsequently presented for payment or, as the case may be, for exchange for further Coupons, there shall be paid to the Issuer on demand the amount payable by the Issuer in respect of such Notes, Coupons or further Coupons) and otherwise as the Issuer may require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

14. Further Issues

The Issuer may from time to time without the consent of the Noteholders or Couponholders create and issue further securities either having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest on them) and so that such further issue shall be consolidated and form a single series with the outstanding securities of any series (including the Notes) or upon such terms as the Issuer may determine at the time of their issue. References in these Conditions to the Notes include (unless the context requires otherwise) any other securities issued pursuant to this Condition and forming a single series with the Notes. Any further securities forming a single series with the outstanding securities of any series (including the Notes) constituted by the Trust Deed or any deed supplemental to it shall, and any other securities may (with the consent of the Trustee), be constituted by the Trust Deed. The Trust Deed contains provisions for convening a single meeting of the Noteholders and the holders of securities of other series where the Trustee so decides.

15. Notices

Notices to Noteholders shall be valid if published in a daily newspaper of general circulation in London (which is expected to be the *Financial Times*). If in the opinion of the Trustee any such publication is not practicable, notice shall be validly given if published in another leading daily English language newspaper with general circulation in Europe. Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made, as provided above.

Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the Noteholders in accordance with this Condition.

16. Contracts (Rights of Third Parties) Act 1999

No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

17. Definitions

As used herein:

"**Additional Amounts**" has the meaning given to it in Condition 7;

"**Approved Winding-up**" means a solvent winding-up of the Issuer solely for the purposes of a reconstruction or amalgamation or the substitution in place of the Issuer of a successor in business of the Issuer, the terms of which reconstruction, amalgamation or substitution (i) have previously been approved in writing by the Trustee or by an Extraordinary Resolution and (ii) do not provide that the Notes shall thereby become payable;

"**Arrears of Interest**" has the meaning given to it in Condition 4;

"**Assets**" means the unconsolidated gross assets of the Issuer, as shown in the latest published audited balance sheet of the Issuer, but adjusted for subsequent events, all in such manner as the Directors may determine;

"**Business Day**" has the meaning given to it in Condition 6.4;

"**Capital Disqualification Event**" is deemed to have occurred if as a result of the implementation of Solvency II or any change to (or change to the interpretation by any court or authority entitled to do so of) the Relevant Rules, the Directive or (following its implementation) Solvency II:

(i) the entire principal amount of the Notes is fully excluded from counting; or

(ii) in the circumstances where such capability derives only from transitional or grandfathering provisions under the Directive, Solvency II or the Relevant Rules, as appropriate, less than 100 per cent. of the principal amount of the Notes outstanding at such time is capable of counting,

as Tier 2 Capital for the purposes of the Issuer or all or any part of the Group (which part includes the Issuer and at least one other member of the Group), whether on a solo, group or consolidated basis, except (in either case) where such non-qualification is only as a result of any applicable limitation on the amount of such capital (other than a limitation derived from transitional or grandfathering provisions as set out in (ii) above);

“**Directive**” means Directive 98/78/EC of the European Union as amended (from time to time);

“**Directors**” means the directors of the Issuer;

“**EEA Regulated Market**” means a market as defined by Article 4.1 (14) of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments, as amended;

“**European Economic Area**” or “**EEA**” means the countries comprising the European Union together with Norway, Liechtenstein and Iceland;

“**Extraordinary Resolution**” has the meaning given in the Trust Deed;

“**FSMA**” means the UK Financial Services and Markets Act 2000, as amended from time to time;

“**Group**” means, at any time, the Group Holding Company and its Subsidiaries at such time;

“**Group Holding Company**” means the ultimate insurance holding company of the Issuer that is subject to consolidated supervision by an EEA regulatory authority for the purposes of the Directive or, following Solvency II Implementation, the Solvency II Directive (such ultimate insurance holding company being, as at the Issue Date, Pension Holding Company (UK) 1 Limited);

“**Group Supervisor**” means the regulatory authority exercising group supervision over the Group in accordance with the Solvency II Directive;

“**insurance holding company**” has the meaning given to it in the Solvency II Directive;

“**insurance undertaking**” has the meaning given to it in the Solvency II Directive;

“**Interest Payment Date**” has the meaning given to it in Condition 3.1;

“**Issue Date**” means 3 July 2014, being the date of the initial issue of the Notes;

“**Junior Creditors**” means creditors of the Issuer whose claims rank, or are expressed to rank junior to, the claims of the Noteholders, including (without limitation) holders of Junior Securities;

“**Junior Securities**” has the meaning given to it in Condition 2.1;

“**Liabilities**” means the unconsolidated gross liabilities of the Issuer, as shown in the latest published audited balance sheet of the Issuer, but adjusted for contingent liabilities and for subsequent events, all in such manner as the Directors may determine;

“**Lower Tier 2 Capital**” has the meaning given to it for the purposes of the Relevant Rules and shall following the implementation of Solvency II or any other change in law or any Relevant Rules such that Lower Tier 2 Capital ceases to be a separately recognised tier of capital resources, be deemed to be a reference to Tier 2 Capital;

"**Mandatory Interest Deferral Date**" means each Interest Payment Date in respect of which a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date;

"**Maturity Date**" means 3 July 2024;

"**Minimum Capital Requirement**" means the Minimum Capital Requirement or the group Minimum Capital Requirement (as applicable) referred to in Solvency II or the Relevant Rules;

"**Pari Passu Creditors**" means creditors of the Issuer whose claims rank, or are expressed to rank, *pari passu* with the claims of the Noteholders, including (without limitation) holders of Pari Passu Securities;

"**Pari Passu Securities**" has the meaning given to it in Condition 2.1;

"**pounds sterling**" or "**£**" means the lawful currency of the UK;

"**Qualifying Dated Tier 2 Securities**" means securities issued directly by the Issuer or indirectly and guaranteed by the Issuer (such guarantee to rank on a subordinated basis equivalent to that referred to in Condition 2 and in the Trust Deed) that:

(i) have terms not materially less favourable to a holder than the terms of the Notes, as reasonably determined by the Issuer in consultation with an independent investment bank of international standing;

(ii) (subject to (i) above) contain terms which comply with the then current requirements of the Relevant Regulator in relation to Lower Tier 2 Capital (prior to Solvency II Implementation) or Tier 2 Capital (on or after Solvency II Implementation); and

(iii) are listed or admitted to trading on the EEA Regulated Market of the London Stock Exchange or such other stock exchange as is a Recognised Stock Exchange at that time as selected by the Issuer and approved by the Trustee,

and provided that a certification to the effect of (i) and (ii) above, signed by two Directors, shall have been delivered to the Trustee (upon which the Trustee shall be entitled to rely without liability to any person) prior to the issue of the relevant securities;

"**Recognised Stock Exchange**" means a recognised stock exchange as defined in section 1005 of the Income Tax Act 2007 as the same may be amended from time to time and any provision. statute or statutory instrument replacing the same from time to time;

"**Regulatory Capital Requirements**" means any applicable capital resources requirement or applicable overall financial adequacy rule (or equivalent) required by the Relevant Regulator, as any such requirement or rule is in force from time to time;

"**Regulatory Deficiency Interest Deferral Event**" means any event (including, without limitation, any event which causes any Solvency Capital Requirement or Minimum Capital Requirement applicable to the Issuer, all or part of the Group (which part includes the Issuer and at least one other member of the Group) or any insurance undertaking within the Group to be breached and such breach is an event) which under Solvency II and/or under the Relevant Rules means that the Issuer must defer payment of interest (or, if applicable, Arrears of Interest) in respect of the Notes (in order that the Notes qualify, and/or on the basis that the Notes are intended to qualify, as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions);

"**Regulatory Deficiency Redemption Deferral Event**" means any event (including, without limitation, any event which causes any Solvency Capital Requirement or Minimum Capital Requirement applicable to the Issuer, all or part of the Group (which part includes the Issuer and at least one other member of the Group) or any insurance undertaking within the Group to be breached and such breach is an event) which under Solvency II and/or under the Relevant Rules means that the Issuer must defer or suspend repayment or redemption of the Notes (in order that the Notes qualify, and/or on the basis that the Notes are intended to qualify, as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions);

"**Relevant Date**" has the meaning given to it in Condition 7;

"**Relevant Regulator**" means the UK Regulator or, if the UK Regulator at any time ceases to be the Group Supervisor or the Supplementary Supervisor, such other regulator as becomes the Group Supervisor for the purposes of Solvency II or the Supplementary Supervisor for the purposes of the Directive (as applicable);

"**Relevant Rules**" means any legislation, rules or regulations (whether having the force of law or otherwise) in the jurisdiction of the Relevant Regulator, implementing the Directive or, as applicable, Solvency II and includes any relevant prudential rules for insurers applied by the Relevant Regulator and any amendment, supplement or replacement of either thereof from time to time relating to the characteristics, features or criteria of own funds or capital resources;

"**Senior Creditors**" means (a) creditors of the Issuer who are unsubordinated creditors of the Issuer including all policyholders of the Issuer (for the avoidance of doubt, the claims of policyholders shall include all amounts to which policyholders are entitled under applicable legislation or rules relating to the winding-up of insurance companies to reflect any right to receive or expectation of receiving benefits which policyholders may have) and (b) other creditors of the Issuer whose claims are, or are expressed to be, subordinated to the claims of other creditors of the Issuer (other than those whose claims are in respect of instruments or obligations which constitute, or would but for any applicable limitation on the amount of any such capital, constitute (i) Tier 1 Capital, (ii) Upper Tier 2 Capital issued prior to Solvency II Implementation or Lower Tier 2 Capital issued prior to Solvency II Implementation or (iii) Tier 2 Capital issued on or after Solvency II Implementation, or whose claims otherwise rank, or are expressed to rank, *pari passu* with, or junior to, the claims of the Noteholders);

"**Solvency Capital Requirement**" means the Solvency Capital Requirement or the group Solvency Capital Requirement (as applicable) referred to in, or any other capital requirement howsoever described in, Solvency II or the Relevant Rules;

"**Solvency II**" means the Solvency II Directive and any additional measures adopted to give effect to the Solvency II Directive (for the avoidance of doubt, whether implemented by way of a regulation, a directive or otherwise);

"**Solvency II Directive**" means Directive 2009/138/EC of the European Union of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) and which must be transposed by Member States of the European Economic Area pursuant to Article 309 of Directive 2009/138/EC;

"**Solvency II Implementation**" means the date from which legislation, rules or other measures implementing Solvency II in the UK (or, if the UK Regulator ceases to be the Supplementary Supervisor or ceases to be the Group Supervisor, in the jurisdiction of such replacement Supplementary Supervisor or of the replacement Group Supervisor, as applicable) are applied to the Issuer;

"**Subsidiary**" has the meaning given to it in section 1159 of the Companies Act 2006 (as amended from time to time);

"**Supplementary Supervisor**" means the regulatory authority exercising supplementary supervision over the Group in accordance with the Directive;

"**Tax Event**" means an event of the type described in Condition 5.3(a) or 5.3(b);

"**Tax Law Change**" has the meaning given to it in Condition 5.3(a);

"**Tier 1 Capital**" has the meaning given to it for the purposes of the Relevant Rules;

"**Tier 2 Capital**" has the meaning given to it for the purposes of the Relevant Rules;

"**UK Listing Authority**" means the UK Financial Conduct Authority in its capacity as the UK listing authority for the purposes of FSMA and, as applicable, any successor authority when acting as the UK competent listing authority for the purposes of Part VI (Official Listing) of FSMA or otherwise;

"**UK Regulator**" means the UK Prudential Regulation Authority or any successor UK regulatory authority having prudential supervisory responsibilities with respect to the Issuer and/or the Group;

"**United Kingdom**" or "**UK**" means the United Kingdom of Great Britain and Northern Ireland; and

"**Upper Tier 2 Capital**" has the meaning given to it for the purposes of the Relevant Rules.

18. Governing Law

The Trust Deed, the Notes and the Coupons and any non-contractual obligations arising out of or in connection with the Trust Deed, the Notes and the Coupons are governed by, and shall be construed in accordance with, English law.

Overview of the Notes while in Global Form

*The Notes will be represented initially by a single temporary global Note in bearer form, without interest coupons (the "**Temporary Global Note**") which will be issued in CGN form. The Temporary Global Note will be deposited with a Common Depositary for Euroclear and Clearstream, Luxembourg on or about the Issue Date. The Temporary Global Note will be exchangeable on or after 12 August 2014 for a permanent global Note in bearer form, without interest coupons, (the "**Permanent Global Note**" and, together with the Temporary Global Note, the "**Global Notes**") upon certification as to non-U.S. beneficial ownership in the form set out in the Temporary Global Note. The Global Notes will be exchangeable for definitive Notes with Coupons attached only in the limited circumstances specified therein (the "**Definitive Notes**").*

Notes and Coupons will bear the following legend: "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in sections 165(j) and 1287(a) of the Internal Revenue Code.".

Each Accountholder (as defined below) must look solely to the relevant Clearing System (as defined below) (as the case may be) for his share of each payment made by the Issuer to the bearer of such Global Note and in relation to certain other rights arising under the Global Notes, subject to and in accordance with the respective rules and procedures of the relevant Clearing System. Such persons shall have no claim directly against the Issuer in respect of payments due on the Notes for so long as the Notes are represented by such Global Note and such obligations of the Issuer will be discharged by payment to or to the order of the bearer of such Global Note in respect of each amount so paid.

The Global Notes contain provisions which apply to the Notes while they are in global form, some of which modify the effect of the terms and conditions of the Notes set out in this Prospectus. The following is a summary of certain of those provisions.

1. Nominal Amount and Exchange

Upon the initial deposit of the Global Notes with the Common Depositary, Euroclear or Clearstream, Luxembourg will credit each subscriber with a nominal amount of Notes equal to the nominal amount thereof for which it has subscribed and paid.

The Permanent Global Note will be exchangeable in whole but not in part (free of charge to the holder) for Definitive Notes only if:

(a) an Event of Default (as set out in the Trust Deed) has occurred; or

(b) Euroclear and Clearstream, Luxembourg are both closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or both announce an intention permanently to cease business or do in fact do so and no Alternative Clearing System is available; or

(c) the Issuer would suffer a disadvantage as a result of a change in laws or regulations (taxation or otherwise) of the United Kingdom or as a result of a change in the practice of any relevant Clearing System which would not be suffered were the Notes in definitive form and a certificate to such effect signed by two Directors of the Issuer is given to the Trustee.

Thereupon (in the case of (a) and (b) above) the holder of the Permanent Global Note, acting on the instructions of one or more of the Accountholders (as defined below) or the Trustee, may give notice to the Issuer and (in the case of (c) above) the Issuer may give notice to the Trustee and the Noteholders, of its intention to exchange the Permanent Global Note for Definitive Notes on or after the Exchange Date (as defined below).

On or after the Exchange Date the holder of the Permanent Global Note may or, in the case of (c) above, shall surrender the Permanent Global Note to or to the order of the Principal Paying Agent. In exchange for the Permanent Global Note the Issuer will deliver (free of charge to the bearer), or procure the delivery of, an equal aggregate principal amount of Definitive Notes (having attached to them all Coupons in respect of interest which has not already been paid on the Permanent Global Note), security printed in accordance with any applicable legal, listing authority and stock exchange requirements and in or substantially in the form set out in the Trust Deed. On exchange of the Permanent Global Note, the Issuer will procure that it is cancelled and, if the holder so requests, returned to the holder together with any relevant Definitive Notes.

In the event that a Global Note is exchanged for Definitive Notes, such Definitive Notes shall be issued in minimum denominations of £100,000 and higher integral multiples of £1,000 up to a maximum of £199,000, but will in no circumstances be issued to Noteholders who hold Notes in the relevant Clearing System in amounts that are less than £100,000.

In this Prospectus, "**Exchange Date**" means a day specified in the notice requiring exchange falling not less than 60 days after that on which such notice is given and being a day on which banks are open for general business in the place in which the specified office of the Principal Paying Agent is located and, except in the case of exchange pursuant to (b) or (c) above, in the place in which the relevant Clearing System is located.

2. Payments

On and after 12 August 2014, no payment will be made on the Temporary Global Note unless exchange for an interest in the Permanent Global Note is improperly withheld or refused. Payments of principal and interest in respect of Notes represented by a Global Note will be made to its holder. All payments will be made against presentation for endorsement and, if no further payment falls to be made in respect of the Notes, surrender of that Global Note to or to the order of the Principal Paying Agent or such other Paying Agent as shall have been notified to the Noteholders for such purpose. A record of each payment so made will be endorsed on each Global Note, which endorsement will be *prima facie* evidence that such payment has been made in respect of the Notes and will discharge the Issuer's obligations in respect thereof.

Any failure to make the relevant entries shall not affect such discharge. Payment on the Permanent Global Note falling due after the Exchange Date, unless exchange of the Permanent Global Note for definitive Notes is improperly withheld or refused by or on behalf of the Issuer. Payments of interest on the Temporary Global Note (if permitted by the first sentence of this paragraph) will be made only upon certification as to non-U.S. beneficial ownership unless such certification has already been made.

3. Calculation of interest

Notwithstanding the provisions of the final paragraph of Condition 3.3, for so long as all of the Notes are represented by a Global Note, interest shall be calculated on the aggregate principal amount of the Notes represented by such Global Note (and not per £1,000 in principal amount), but otherwise shall be calculated in accordance with Condition 3.

4. Notices

For so long as all of the Notes are represented by one or both of the Global Notes and such Global Note(s) is/are held in one or more relevant Clearing Systems, notices to Noteholders may be given by delivery of the relevant notice to such relevant Clearing System(s) for communication to the relevant Accountholders (or otherwise in such manner as the Trustee, the Principal Paying Agent and the relevant Clearing System(s) may approve for this purpose) rather than by publication as required by Condition 15 provided that, so long as the Notes are admitted to listing or trading on any stock exchange, the requirements of such stock exchange have been complied with. Any such notice shall be deemed to have been given to the Noteholders on the day which is one business day, being a day on which banks are generally open, in Brussels and Luxembourg, after the date on which such notice is delivered to the relevant Clearing System as aforesaid.

5. Accountholders

For so long as all of the Notes are represented by one or both of the Global Notes and such Global Note(s) is/are held on behalf of one or more relevant Clearing Systems, each person (other than a relevant Clearing System) who is for the time being shown in the records of the relevant Clearing System(s) as the holder of a particular principal amount of such Notes (each an "**Accountholder**") (in which regard any certificate or other document issued by a relevant Clearing System as to the principal amount of such Notes standing to the account of any person shall, in the absence of manifest error, be conclusive and binding for all purposes) shall be treated as the holder of such principal amount of such Notes for all purposes (including but not limited to, for the purposes of any quorum requirements of, or the right to demand a poll at, meetings of the Noteholders) other than with respect to the payment of principal and interest on such principal amount of such Notes, the right to which shall be vested, as against the Issuer and the Trustee, solely in the bearer of the relevant Global Note in accordance with and subject to its terms and the terms of the Trust Deed. Each Accountholder must look solely to the relevant Clearing System for its share of each payment made to the bearer of the relevant Global Note subject to and in accordance with the respective rules and procedures of Euroclear and Clearstream, Luxembourg. Accountholders shall have no claim directly against the Issuer in respect of payments due on the Notes for so long as the Notes are represented by such Global Note, and such obligations of the Issuer will be discharged by payment to the bearer of such Global Note in respect of each amount so paid.

6. Prescription

Claims against the Issuer for payment in respect of principal and interest on the Notes represented by a Global Note will be prescribed after 10 years (in the case of principal) and five years (in the case of interest including, without limitation, Arrears of Interest) from the Relevant Date (as defined in Condition 7).

7. Cancellation

Cancellation of any Note represented by a Permanent Global Note that is required by the Conditions to be cancelled (other than upon its redemption) will be effected by endorsement by or on behalf of the Principal Paying Agent of the relevant Global Note of the reduction in the nominal amount of the relevant Global Note.

8. Authentication

Neither the Temporary Global Note nor the Permanent Global Note shall become valid or enforceable for any purpose unless and until it has been authenticated by or on behalf of the Principal Paying Agent.

9. Euroclear and Clearstream, Luxembourg

Notes represented by a Global Note are transferable in accordance with the rules and procedures for the time being of the relevant Clearing System(s).

References in the Global Notes to Euroclear and/or Clearstream, Luxembourg shall be deemed to include references to any other clearing system approved by the Trustee in which the Notes are held from time to time.

Business Description

Description of the Issuer

1. Overview

PIC was incorporated and registered as a private limited company in England and Wales on 13 February 2006 under the Companies Act 1985, with registered number 05706720. On 9 June 2014, PIC was re-registered as a public limited company. PIC is authorised by the PRA and regulated by the FCA and the PRA. PIC's principal activity is providing wholesale insurance annuity products to UK defined benefit occupational pension funds and their members, commonly referred to as "pension insurance".

The principal legislation under which PIC operates is the Companies Act 2006 and regulations made thereunder.

The registered office of PIC and the business address of each of its directors for matters concerning PIC's business is 14 Cornhill, London EC3V 3ND. The telephone number of the registered office is +44 (0)20 7105 2000.

The ultimate holding company of PIC is Pension Corporation Group Limited ("**PCG**"), which was incorporated in Guernsey in 2012. PCG and its subsidiaries are referred to herein as the "**PCG Group**". The PCG Group has two operating businesses: PIC, and PSIC, which provides reinsurance services to PIC from Guernsey. PIC has no subsidiaries.

2. History, Ownership and Management of the Issuer

PIC is a wholly-owned subsidiary of its ultimate holding company, PCG. PIC was incorporated in 2006, at which time it was authorised and regulated by the FSA. PIC wrote its first insurance business in 2008.

Until 9 October 2012, PIC was a wholly owned subsidiary of Cornhill Corporation Holdings LLP (formerly Pension Insurance Corporation Holdings LLP). On 9 October 2012, a reorganisation took place, which resulted in PIC becoming a wholly owned subsidiary of PCG.

The two principal shareholders of PCG are Reinet Fund SCA FIS ("**Reinet**") and J.C. Flowers Fund II ("**JCFlowers**") which had a 43.2 per cent. and a 25.1 per cent. stake (measured on a voting basis), respectively, as at 31 December 2013. As at 31 December 2013, the other institutional shareholders of PCG included Istithmar World (5.5 per cent.), RBS Group (5.1 per cent.), Swiss Re (5.1 per cent.), Och Ziff Capital (3.1 per cent.) and J.P. Morgan (2.8 per cent.) (each such stake measured on a voting basis). PCG also has a number of private individual shareholders.

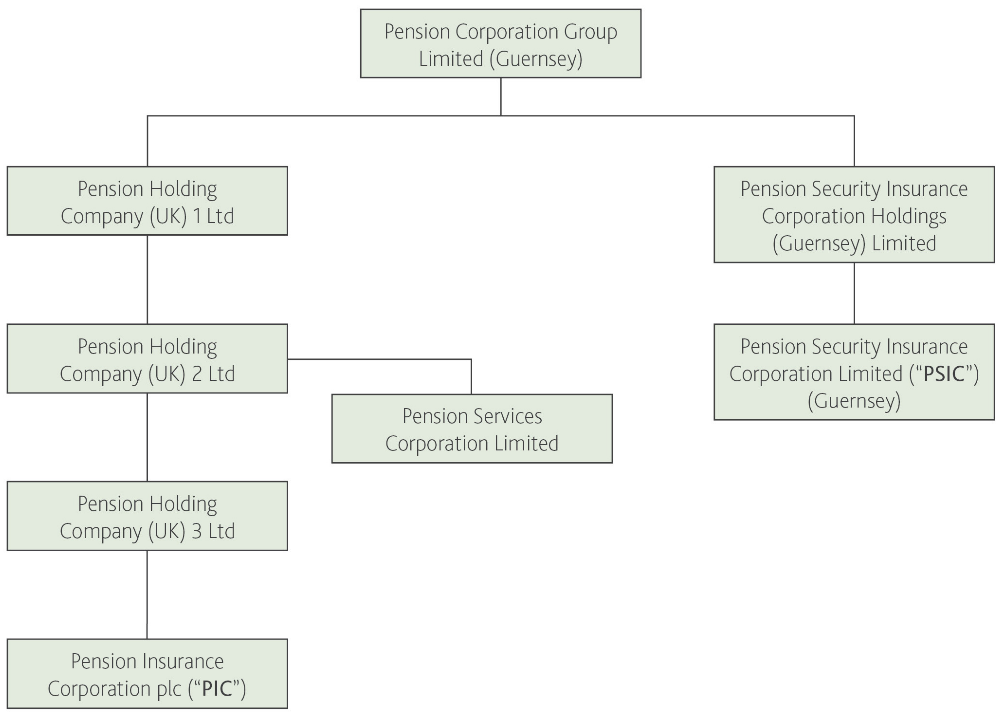
PCG is authorised and regulated by the Guernsey Financial Services Commission and is registered in Guernsey with the registration number 55358. Its registered office is Ogier House, St Julian's Avenue, St Peter Port, Guernsey.

Under the arrangements agreed by the principal shareholders of PCG, there are certain reserved matters in relation to PIC that require the prior approval of Reinet, either alone or together with JCFlowers (the "**Reserved Matters**"). These Reserved Matters include, but are not limited to, the entry into any significant transaction by PIC, any changes to the capital structure of PIC and certain material amendments to the articles of association of PIC.

PIC is managed by a board of directors (the "**Board**"), three of which are also directors of PCG. Please refer to *"Board of Directors"* below for further information about PIC's board and governance structure.

On 22 October 2012, agreement was reached between PCG and Reinet for Reinet to subscribe for up to £400m of new equity capital in PCG. At 31 December 2013, £325m of the £400m capital commitment had been drawn down by the PCG Group, with the significant majority of that capital having been transferred into PIC. The outstanding commitment of £75m was drawn down by the PCG Group from Reinet on 5 June 2014 in connection with the Total UK Pension Plan buy-in arrangement (as discussed further below).

3. Organisational Structure of the PCG Group



3.1 PCG Group Structure Chart

PIC is the main operating subsidiary in the PCG Group. PSIC is a Guernsey-authorised insurer which provides a small amount of internal reinsurance to PIC (approximately 3.2 per cent. of its gross insurance liabilities at the end of 2013). PSIC has provided reinsurance to PIC only.

Pension Services Corporation Limited is the PCG Group's services company, employing all employees within the PCG Group. PIC is dependent upon Pension Services Corporation Limited for the provision of services from its employees, directors and consultants. As at 31 December 2013, Pension Services Corporation Limited had 106 employees, excluding part-time employees and Board members.

3.2 PCG Group companies

Name of Company	***Percentage Owned by PCG[(1)]***	***Country of Incorporation[(2)]***	***Nature of Business***
Pension Corporation Group Limited	N/A	Guernsey	Holding company
Pension Insurance Corporation plc	100%	England and Wales	Pension insurance
Pension Holding Company (UK) 1 Limited	100%	England and Wales	Holding company
Pension Holding Company (UK) 2 Limited	100%	England and Wales	Holding company
Pension Holding Company (UK) 3 Limited	100%	England and Wales	Holding company
Pension Services Corporation Limited	100%	England and Wales	Service company
Pension Security Insurance Corporation Holdings (Guernsey) Limited	100%	Guernsey	Re-insurance holding company
Pension Security Insurance Corporation Limited	100%	Guernsey	Re-insurance company

[(1)] Each subsidiary has only one class of ordinary shares. PCG has both ordinary shares each of £1 nominal value and B shares each of 10p nominal value in issue.

[(2)] Each subsidiary operates mainly in its country of incorporation.

4. Pension Insurance Sector Overview

Pension insurance comprises the provision of wholesale insurance annuity products to UK defined benefit occupational pension funds and their members.

As at 31 March 2013, the full buy-out levels of the 6,150 UK defined benefit occupational pension funds that are eligible for entry into the UK Pension Protection Fund (the "**PPF**") was estimated to be as follows:

No. of members	***No. of funds***	***Market value of assets (£bn)***	***Insurance buy-out liabilities (£bn)***
2 to 999	4,948	111.3	182.5
1,000 – 4,999	803	168.8	284.1
5,000 – 9,999	191	136.7	219.6
Over 10,000	208	701.7	1,140.5
Total	6,150	1,118.5	1,826.7

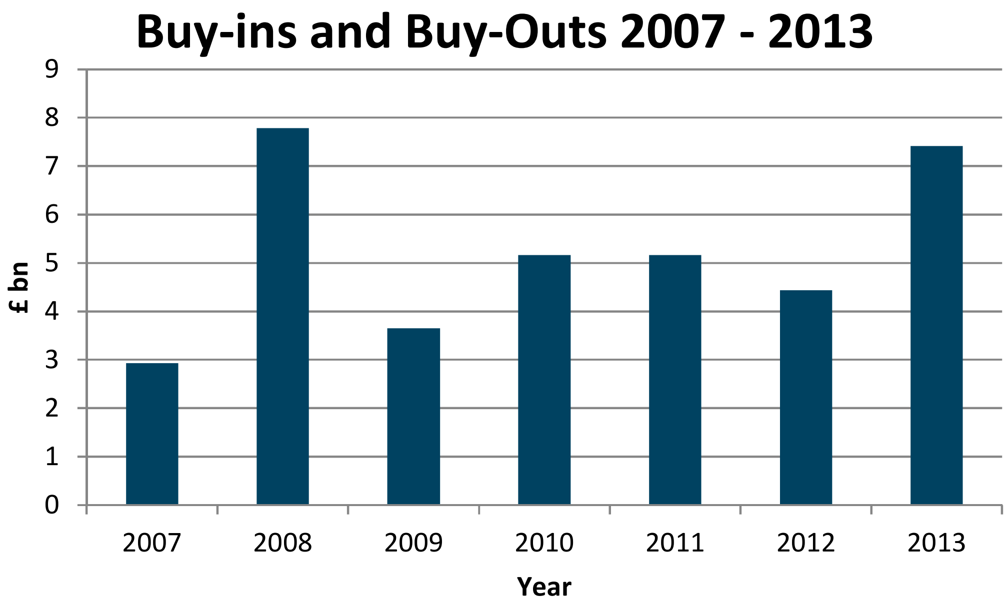
(Source: the PPF Purple Book, dated 5 November 2013 (the "**PPF Purple Book**").)

The PPF was established as a statutory fund under the provisions of the Pensions Act 2004 to pay compensation to members of eligible defined benefit occupational pension funds, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension fund to cover PPF levels of compensation.

The aggregate market value of the assets in such funds was estimated to be £1,133bn as at 31 December 2013[1]. The pension insurance sector has grown over the last six years, but still represents only a small proportion of the liabilities of the UK defined benefit occupational pension funds.

[1] Source: PPF 7800 Index

The following graph shows the total value of insurance buy-in and buy-out transactions between 2007 and 2013:



**Q4 2013 data have been provided for market participants apart from Prudential and Partnership Assurance. Source: LCP, Hymans Robertson and Company data.*

Key changes and trends which have influenced the buy-in and buy-out sector during the last ten years have included:

(i) the introduction of the Pensions Act, which significantly increased the regulatory requirements for defined benefit occupational pension funds, and in particular introduced a requirement that the pension fund sponsor must meet any deficit in the pension fund on the funding basis agreed between the trustees and the sponsor. This means that the sponsor must meet the cost of insuring the pension fund liabilities on a buy-out basis (and the pension fund must then enter into an insurance buy-in in respect of all such liabilities) if it wishes to remove the obligation to make any further deficit contributions;

(ii) changes to the UK accounting rules for pension fund liabilities, which increased the visibility of pension fund deficits and the costs to employers as set out in their financial statements;

(iii) a significant trend towards defined benefit occupational pension funds being closed to new entrants and subsequently frozen to the accrual of future benefits for existing fund members. The National Association of Pension Funds ("**NAPF**") Annual Survey 2013, published in January 2014, confirmed that in 2013, 53 per cent. of defined benefit occupational pension funds had been closed to new members and a further 35 per cent. of defined benefit occupational pension funds had been both closed to new members and had benefits frozen to future accrual; and

(iv) an increased industry focus on de-risking in pension fund asset and liability management. This is evidenced by the increasing proportion of pension fund assets held in gilts and fixed interest securities and the reducing proportion held in equities: in 2006, 28.3 per cent. of pension fund assets were invested in gilts and fixed interest securities, and by 2013 this percentage had increased to 44.8 per cent. By contrast, the proportion of pension fund assets held in equities reduced from 61.1 per cent. in 2006 to 35.1 per cent. in 2013. (Source: PPF Purple Book 2013.) De-risking strategies such as these more accurately match the profile of the assets of the pension fund with its liabilities and may then facilitate subsequent buy-in insurance transactions (with the ultimate aim of insuring all of the fund's liabilities in a subsequent buy-out transaction).

The UK pension insurance market has strong potential for future growth given the improvement in pension fund asset values and reduction in pension fund liabilities through 2013 (as evidenced by the PPF 7800 Index), coupled with ongoing deficit reduction contributions to funding costs of pension funds as agreed between the trustees and the corporate sponsor.

On 19 March 2014 the UK Government announced a set of reforms which are intended to allow individuals more choice over how they access their defined contribution pension savings. The reforms announced specifically did not affect pension benefits in defined benefit arrangements at the point of retirement. However, the UK Government has stated that it is open to various options, including extending such reforms to members of private sector defined benefit occupational pension funds and has requested views, as part of a consultation exercise, with submissions requested by 11 June 2014. The UK Government expects to publish the outcome of the consultation by 22 July 2014. It is not yet known whether the reforms, once finalised, will have an impact on the Issuer's business, results of operations or financial condition.

The main participants in the pension buy-in and buy-out sector include PIC, Aviva, Legal & General, Prudential and Rothesay Life.

5. Business of PIC

5.1 Business, Services and Products

PIC's principal activity is providing wholesale insurance annuity products to UK defined benefit occupational pension funds and their members. Pension insurance products are used by pension funds as a means of transferring risks and liabilities deriving from the promises made to their pension fund members to an insurance company. Pension insurance is also used as a means by which ultimate responsibility to pay the benefits promised is transferred to the insurance company through the issuance of an individual annuity insurance policy to the pension fund member.

PIC's strategy is to use its capital resources and expertise to provide long-term security for its policyholders and to generate target returns for its shareholders by writing wholesale pension insurance business for UK defined benefit pension funds.

PIC aims to deliver these objectives through:

- **a strong and sustainable pipeline of new business:** PIC provides tailored products to meet the specific requirements of each of its clients, dealing with complexity through innovation and flexibility, and offering price certainty where this is a requirement;

- **risk-adjusted asset performance:** PIC aims to source and acquire long-dated assets which provide investment returns over and above those needed to meet the liabilities assumed, whilst optimising the impact of those assets on capital requirements and reserve calculations;

- **hedging out unwanted risks:** PIC seeks to pass on inflation, interest rate and currency risk through hedging strategies, and to manage its longevity risk through the use of reinsurance;

- **a focus on administration efficiency and customer service levels:** PIC aims to provide policyholders with a high-quality service, adhering to the requirements and principles of Treating Customers Fairly, whilst building on its reputation in this key area; and

- **focused use of skills and resources:** PIC aims to be efficient in deploying resources to manage and operate its business, and uses services from outsourcing partners where it is efficient and cost effective to do so.

PIC originates new business through active engagement with, and marketing to, pension fund trustees and their advisers, as well as to the corporate sponsors of such funds. Specialist advisers in this field, appointed by trustees and corporate sponsors, play a key role in any evaluation or execution of a pension insurance solution and include advisers such as Aon Hewitt, Barnett Waddingham, Capita, Hymans Robertson, JLT, KPMG, Lane Clark & Peacock, Mercer, PwC, Towers Watson and Xafinity Consulting, with PIC maintaining strong relationships with these advisers.

Services and Products

A summary of PIC's two principal product categories is set out below.

Insurance Buy-Out: This is an insurance annuity policy purchased by the trustees of a pension fund in the name of the pension fund member. If a pension fund member has died and his, or her, beneficiaries, including spouse, children or other dependants, have a right to benefits from the pension fund ("**dependent beneficiaries**") then an annuity policy may also be purchased for such individuals. The members of the pension fund and dependent beneficiaries for whom insurance annuity policies have been purchased then become direct policyholders of the insurance company. The pension fund is then relieved of the obligations in respect of which annuity policies have been purchased. Where insurance annuity policies are purchased in respect of all of the members and dependent beneficiaries in respect of all of their benefit entitlements, known as a “full buy-out”, the pension fund can be wound up.

Operationally, an insurance buy-out is typically preceded by an insurance buy-in, pending detailed verification of benefits due to the pension fund members and the data held in respect of them.

Insurance Buy-In: This is an insurance annuity policy purchased by the trustees of a pension fund in respect of some or all of its members and dependent beneficiaries in respect of some or all of their benefit entitlements under the pension fund. A single annuity policy (the buy-in policy, often referred to as a bulk annuity) will be issued to the trustees of the pension fund in respect of all of the members and dependent beneficiaries covered. The buy-in policy is then held by the trustees alongside the other pension fund assets. The buy-in of a subset of the pension funds liabilities (e.g. covering in-payment pensioners only) is usually entered into as part of a phased strategy of the pension fund to reduce risk.

In this situation, the pension fund trust continues to exist and the trustees continue to be responsible for the payment of the pensions. The insurance company will pay the insured benefits to the pension fund which will then pay them to the pension fund members and dependent beneficiaries (although the trustees of the pension fund may ask the insurance company to make payments direct to the members and dependent beneficiaries on their behalf).

Summary of significant PIC buy-out and buy-in transactions

Date	***Size*** [(1)]	***Transaction Type***
June 2008	£450m	Pensioner buy-out
December 2008	£1,100m	Full buy-out
November 2009	£476m	Pensioner buy-in
May 2010	£313m	Full buy-out
July 2012	£300m	Pensioner buy-in
July 2013	£1,500m	Full buy-out
November 2013	£670m	Full buy-out
June 2014	£1,600m	Pensioner buy-in

(1) As stated in the transaction announcement.

5.2 Summary of Business Written by PIC

The tables below show the new business that PIC has written between 2008 and 2013 and the numbers of pension funds insured by PIC since its inception, the growth in assets and the changes in the expenses as a percentage of financial instruments. The total new business has been split between buy-in business (where the trustees buy an insurance policy from PIC to meet future benefits) and buy-out business (where the actual liability for paying pensions to individual members transfers to PIC and the members become PIC policyholders; the distinction between buy-in business and buy-out business is described in *"Business, Services and Products" above*. The business can further be broken down between large transactions, with premiums of £500m or more, and smaller transactions.

PIC – New Business Written, Assets and Expense Ratio	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
New business premiums in year (£m)	1,572	1,089	719	615	1,512	3,663
Number of pension funds insured	5	10	5	11	21	35
Number of pension funds insured since inception	5	15	20	31	52	87
Total Assets (£m)	2,326	3,859	5,092	6,409	8,703	13,495
Financial Investments (£m)	1,855	2,748	3,376	3,928	5,366	8,936
Expenses % of Financial Investments	1.03%	1.54%	1.22%	1.14%	1.07%	0.72%

Buy in / Buy Out – PIC New Business Premiums	**2011**	**2012**	**2013**
		(£m)	
Buy-In – New Business Premiums			
Greater than £500m	-	-	-
Less than £500m	312	773	761
Buy-In – Total	**312**	**773**	**761**
Buy-Out – New Business Premiums			
Greater than £500m	-	-	2,122
Less than £500m	303	739	780
Buy-Out Total	**303**	**739**	**2,902**
Total Premiums	**615**	**1,512**	**3,663**
Buy in / Buy Out – Number of Pension Funds Insured by PIC	**2011**	**2012**	**2013**
Buy-In – Number of Pension Funds Insured			
Greater than £500m	0	0	0
Less than £500m	2	8	17
Buy-In – Total	**2**	**8**	**17**
Buy-Out – Number of Pension Funds Insured			
Greater than £500m	0	0	2
Less than £500m	9	13	16
Buy-Out – Total	**9**	**13**	**18**
Total Number of Pension Funds Insured by PIC	**11**	**21**	**35**

5.3 Market position

PIC has established a significant presence in the buy-in and buy-out sector since it commenced writing business in Q2 2008, with a share of this sector between Q2 2008 and Q4 2013 of 29 per cent. In 2013, PIC's share of this sector was 49 per cent. (source: LCP, Hymans Robertson and company data). In addition, PIC has received numerous industry awards reflecting its success in product service and provision, including:

Provider	*Award*	*Year*
European Pensions	European Breakthrough Firm of the Year	2009
PIPA (FT Pensions Awards)	Buy-out/buy-in provider	2010
PIPA (FT Pensions Awards)	Buy-out/buy-in provider	2011
UK Pensions Awards	Risk Reduction Provider	2011
European Pensions Awards	Buy-out Firm of the Year	2011
Engaged Investor	Best Trustee Education Provider	2012
Engaged Investor	Best de-risking provider	2012
Engaged Investor	Best de-risking provider	2013
European Pensions Awards	Buy-out Firm of the Year	2013
PIPA (FT Pensions Awards)	De-risking Provider	2013
Insurance Risk Awards	Insurer of the Year	2013
Asset International's Chief Investment Officer (AiCIO)	Pension Risk Transfer / Swaps	2014
PIPA (FT Pensions Awards)	De-risking Provider	2014

5.4 PIC – Approach to Pricing

PIC seeks to generate profit by charging a premium for the liabilities and risks it assumes. The premium charged is greater than the value of assets which are expected to be needed to meet the projected claims and expenses. The balance equates to the profit margin in the premium that is expected to accrue to PIC over time and is reflected in the new business contribution to Embedded Value. Therefore, each new business transaction increases the amount of PIC profits expected in the future.

When pricing new business, PIC calculates the premium required such that the profit margin in that premium is expected to result in its target internal rate of return (or "**IRR**") on capital employed being met.

New business transactions typically require additional capital resources to be held in addition to the premium received. These capital resources are then expected to be released over time.

5.5 Underwriting of New Business

PIC undertakes a full programme of both assessing and underwriting the risks associated with new business transactions and then managing these risks once they are on PIC's balance sheet, with all new business transactions being reviewed and approved by the Origination Committee. The approach is designed to ensure that:

(a) the nature and profile of the business written meets management's criteria and objectives and is in line with PIC's business model;

(b) the liabilities and risks of the business written are fully understood and appropriately priced; and

(c) the profits anticipated when a transaction is priced are delivered within an acceptable range, which will depend on how the actual experienced outcomes of the risks insured differ over the duration of the transaction from those assumed for pricing purposes.

Market risk (i.e. the risk that asset markets will not perform in line with expectations) for a new insurance transaction is assessed according to the assets in which the premium will be invested. The appropriate assets into which new business premiums are to be invested are kept under regular review (typically weekly or more frequently depending on market movements). In determining the appropriate asset mix, PIC considers, among other things, the yield, risk, hedging and dealing costs, and duration for which the assets will be held.

Underwriting of longevity risk and other demographic risks (such as the existence and age of an eligible spouse) is carried out by a specialist team within PIC. This team makes an assessment of the insurance risk based on a number of sources, including pension fund-specific experience data and information supplied from bodies such as the Office for National Statistics ("**ONS**") and the Continuous Mortality Investigation ("**CMI**"). The CMI is a subsidiary body of the Institute and Faculty of Actuaries.

This underwriting is supplemented by an annual review of PIC's longevity and expense experience as a further check on the assumptions made.

5.6 Reserving

PIC holds technical reserves calculated on actuarial bases to ensure it has sufficient funds available to pay its technical liabilities when they fall due. The liability on a Solvency (Pillar 1) basis is set using assumptions which reflect the best estimate at the time, adjusted to include a prudent margin for risk and adverse deviation.

Longevity assumptions, including both the current base level of longevity and the assumptions for future longevity improvements, are based on standard industry tables, scheme specific factors and PIC's own experience.

The assumptions used for investment returns are based on the risk-adjusted current market yields of the assets held to back the liabilities. The assumptions used for expenses reflect PIC's budget and expected future experience.

The methodology and assumptions used to calculate the technical reserves are proposed by the Actuarial Function Holder (being a Fellow of the Institute and Faculty of

Actuaries appointed by PIC to advise on actuarial issues in accordance with UK insurance regulations), and are reviewed and approved by PIC's Board.

5.7 Asset and Liability Management

The Board reviews and sets key parameters for the investment of PIC's assets. These parameters include setting a Value at Risk limit as well as inflation risk, interest rate risk and currency risk exposures and various asset class limits. PIC's in-house investment team (the "**ALM team**") determines the investment strategy within those parameters and executes the strategy through the allocation of assets to externally managed specialist funds and through direct investments. Oversight of the ALM team is carried out by the Asset and Liability Management Committee of the Board.

The asset strategy aims to source and acquire long-dated fixed income assets which provide investment returns that meet or exceed those assumed for pricing purposes. PIC utilises the services of external asset managers such as Henderson Global Investors, Schroders and M&G, as appropriate, who in total managed 75.0 per cent. of PIC's total investment assets as at 31 December 2013, and 74.5 per cent. as at 31 December 2012. With effect from May 2014, PIC began to manage directly its portfolio of UK Gilts, supranational bonds and hedging instruments which represented 22.4 per cent. of PIC's total investment assets as at 31 December 2013.

PIC is exposed to inflation, interest rate and currency risk through its holdings of fixed interest securities and other investments, and through its liabilities. PIC seeks to hedge these risks as far as practicable in order to protect its balance sheet against adverse movements. The hedging programme uses a range of instruments comprising gilts (including index-linked gilts) and inflation rate, interest rate and currency derivatives. PIC reviews its hedging profiles on a frequent basis and rebalances its hedging arrangements accordingly.

PIC's Solvency (Pillar 1) liabilities had an average duration of 13.7 years, net of reinsurance, as at 31 December 2013.

Asset portfolio mix

PIC's investment assets as at 31 December 2013 and 31 December 2012 are set out in the table below:

Investment Assets

As at 31 December 2013 (£m)	AAA	AA	A	BBB	BB	Unrated	Total
Government securities (1)	103	2,526	-	53	-	-	**2,682**
Corporate securities (2)	576	262	1,550	2,048	25	409	**4,870**
Mortgage backed and other asset backed securities	19	141	118	143	4	12	**437**
Collateralised loan obligations	-	4	42	68	21	32	**167**
Collateralised derivative assets (3)	-	302	2,596	-	-	-	**2,898**
Receivables and other financial assets	19	9	21	37	1	97	**184**
Deposits with credit Institutions	-	-	94	-	-	-	**94**
Investment properties						93	**93**
Participation in investment schemes						686	**686**
Total investment assets	717	3,244	4,421	2,349	51	1,329	**12,111**

As at 31 December 2012 (£m)	AAA	AA	A	BBB	BB	Unrated	Total
Government securities (1)	1,112	55	2	49	-	-	**1,218**
Corporate securities (2)	675	395	864	1,016	35	144	**3,129**
Mortgage backed and other asset backed securities	112	83	81	89	2	10	**377**
Collateralised loan obligations	-	-	43	39	14	36	**132**
Collateralised derivative assets (3)	-	199	1,833	-	-	16	**2,048**
Receivables and other financial assets	22	5	13	21	1	84	**146**
Deposits with credit institutions	-	11	48	-	-	(1)	**58**
Investment properties						87	**87**
Participation in investment schemes						453	**453**
Total investment assets	1,921	748	2,884	1,214	52	829	**7,648**

(1) Government securities are government bonds, government backed securities and supranational securities.
(2) Corporate Securities includes exposures to financial institutions through both covered and non-covered bonds. Covered bonds exposure at 31 December 2013 was £533m (£601m at 31 December 2012). Non-covered bonds exposure at 31 December 2013 was £746m (£463m at 31 December 2012) of which £283m at 31 December 2013 (£189m at 31 December 2012) related to subordinated issues. Of the unrated Corporate Securities £357m at 31 December 2013 and £64m at 31 December 2012 relate to private transactions with unrated counterparties. This includes investments in PFI projects, social housing and solar parks.

(3) Derivative assets are gross figures and are offset by £3,033m of derivative liabilities for the year ended 31 December 2013 (as compared with £1,788m for the year ended 31 December 2012). Although these derivative assets are unrated, the ultimate issuing party's rating is used. The credit ratings used are Bloomberg Composite. In instances where such a rating does not exist, an S&P rating or a Moody's rating is used. The net positions with each institution are fully collateralised.

As at 31 December 2013, the largest exposure to a non UK government counterparty was 3.1 per cent. of Total Investment Assets less Government Securities.

Investment Operations

The Investment Operations team is separately managed and works with the ALM team to execute investment decisions, and manage, monitor and report on the asset portfolio. The Investment Operations team is also responsible for managing PIC's relationship with, and service delivery from, its two outsourcing partners, JP Morgan and Northern Trust for custody and investment services.

Default Experience

Over the period from 1 January 2009 to 31 December 2013, PIC experienced actual defaults at an average rate equivalent to 0.03 per cent. per annum of the value of the financial investments held.

As at 31 December 2013, the allowance for potential defaults in the Solvency Pillar 1 valuation was 0.50 per cent. per annum of the assets backing the policy liabilities.

5.8 Reinsurance

In order to reduce its exposure to certain demographic and other insurance related risks, PIC enters into reinsurance contracts with third party reinsurance companies, where it is considered appropriate and economic to do so.

Currently, PIC aims to reinsure between 60 and 70 per cent. of its longevity risk exposure, although the actual level of reinsurance varies from time to time as reinsurance arrangements are generally completed after the writing of the new business. As at 31 December 2013, PIC had reinsured around 60 per cent. of its total longevity exposure, with further reinsurance coverage the subject of negotiation with a range of counterparties.

The reinsurance that PIC has arranged to date takes two forms: longevity swap reinsurance and quota share reinsurance. Under the former, PIC has entered into a number of reinsurance contracts under which it has committed to pay the reinsurer a schedule of fixed payments based on the expected survivorship at the outset of the relevant underlying policyholders. In return, the reinsurer undertakes to reimburse the corresponding payments based on actual, realised survivorship. Importantly, these payments are not subject to a monetary cap and are payable for an unlimited term. The net effect is to eliminate the impact of uncertainty in future longevity experience in respect of the benefits insured. As part of these arrangements, a separate reinsurance fee is payable by PIC to the reinsurer.

The reinsurers with which PIC currently has longevity swap reinsurance contracts are Hannover Rück SE, Munich Re Company (UK Life Branch), Pacific Life Re Limited and RGA Global Reinsurance Company Limited.

In addition, PIC has entered into a number of tail-risk quota share arrangements with Berkshire Hathaway Life Insurance Company of Nebraska, a US-regulated insurer. Under these contracts, benefit payments due to underlying policyholders after a fixed period (subject to certain treaty-specific limits) are covered by the reinsurer in return for payment of an initial one-off premium. The net effect of these arrangements is to reduce significantly the uncertainty for PIC associated with long-term asset returns and long-term improvements in longevity for the relevant underlying policyholders.

PIC has also entered into a quota share reinsurance agreement with PSIC, covering a proportion of the policyholder benefit payments of the underlying business reinsured. This proportion varies between 40 per cent. and 50 per cent. for certain discrete blocks of underlying business. In total, the liabilities reinsured with PSIC represented around 3.2 per cent. of PIC's gross insurance liabilities as at the end of 2013. PIC has not placed any reinsurance with PSIC since 2010.

Each of the reinsurance arrangements referred to above, other than those with PSIC, is subject to the periodic posting of collateral or other security arrangements. This is structured so as to reduce PIC's exposure to default by the reinsurer.

The reinsurance arrangements with PSIC are subject to a security structure whereby the majority of PSIC's assets are held in a custody account in PIC's favour, should PSIC's solvency fall below certain levels.

All new reinsurance transactions are reviewed and approved by the Origination Committee of the Board.

5.9 Risk Management

PIC has a comprehensive risk management framework overseen by the Board and by the Risk Committee of the Board. The risk management framework is reinforced through the PIC Risk Function, the Chief Risk Officer and a management risk committee.

The risks faced by PIC are outlined in PIC's risk policies; in particular, market risk, insurance risk, operational risk, expense risk and counterparty risk. 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.

5.10 Administration

The administration of the issuance of new insurance policies and servicing of existing policyholders is an important function within PIC's operations.

PIC has an experienced in-house administration team. This team is supported by the services of two key administration outsourcing partners based in the UK: Mercer and Ensign (formerly, Merchant Navy Pension Fund Administration). These outsource partners provide PIC with dedicated specialist resources and the flexibility to vary administration servicing capacity in line with the flow of PIC's new business and the needs of its customers. PIC takes full responsibility for the services that its outsource partners provide to its customers and works closely with them to ensure that the service levels stipulated by PIC are met.

As at 31 December 2013, PIC was responsible for paying the pensions of 96,600 individuals and has 37,000 current individual policies in issue, in respect of 36 pension funds. The remaining pension funds that are insured are either in the transition process, which includes the verification of scheme data and finalisation of liabilities prior to individual policies being issued by PIC, or are buy-ins under which the policy is issued to the fund trustee, rather than to individuals.

PIC aims to have effective and high-quality communication with its policyholders and has established a dedicated UK-based helpline for its customers, which includes a free call-back facility if requested by the customer. PIC also maintains a dedicated section of its website for the provision of online services to its policyholders. In addition, PIC holds regular forums around the UK to which policyholders are invited to learn more about PIC and to discuss relevant issues.

The service quality which PIC provides to its policyholders is closely managed and monitored by PIC and its outsource partners to ensure that it not only fulfils its regulatory obligation to treat its customers fairly, but also to verify its service levels.

PIC has also been awarded Platinum status by the Plain English Campaign, in recognition of the clarity of its customer documentation.

6. Financial Information as at (or for the years ended) 31 December 2011, 2012 and 2013

6.1 Statement of Comprehensive Income (IFRS) (£m)

	2011	2012	2013
Revenue			
Gross Premiums Written	615	1,512	3,663
Outward Reinsurance Premiums	(27)	(153)	(323)
Net Premium Revenue Earned	**588**	**1,359**	**3,340**
Investment Return	534	434	74
Total Revenue (net of Reinsurance Premiums)	**1,122**	**1,793**	**3,414**
Expenses			
Claims Paid – Gross	(220)	(236)	(349)
Reinsurers' share of claims paid	14	16	19
	(206)	**(220)**	**(330)**
Increase in insurance liabilities - gross	(1,040)	(1,578)	(3,223)
Increase in reinsurers' share of insurance liabilities	181	247	317
	(859)	**(1,331)**	**(2,906)**
Acquisition Expenses	(21)	(29)	(37)
Other Operating expenses	(24)	(29)	(27)
	(45)	**(58)**	**(64)**
Total Claims and Expenses	**(1,110)**	**(1,609)**	**(3,300)**
Profit before taxation	12	184	114
Income tax charge	(4)	(44)	(27)
Profit for the year	**8**	**140**	**87**
Other comprehensive income	-	-	-
Total Comprehensive Income	**8**	**140**	**87**

6.2 Statement of Operating Profit (IFRS) for the years ended 31 December 2012 and 2013

Operating Profit (£m)	**2012**	**2013**
Return earned on insurance book	43	48
Return earned on surplus assets	23	32
Underlying operating profit	**66**	**80**
New business operating profit	68	(11)
Other changes to in-force business	3	(8)
Operating profit before taxation	**137**	**61**
Non-operating profit before taxation	**47**	**53**
IFRS profit before taxation	**184**	**114**

Operating profit is split into the following items:

(A) Underlying Operating Profit – represents:

(i) the return earned on insurance book – this is the release of investment and demographic margins, based on long-term operating assumptions and any additional expenses attributable to the insurance book; and

(ii) the return earned on the surplus assets – this is the return on the IFRS capital based on the long term operating assumptions.

(B) New Business Operating Profit – represents the IFRS profit earned on new business (including new reinsurance) at the commencement of the contract, expenses attributable to the new business activities and any adjustments to contracts as they occur, as well as the profits arising from the net release of IFRS reserves due to reinsurance contracts less any premiums, deal specific fees and any other reinsurance fees; and

(C) Other Changes to the In-force Business – represents changes in the variance between actual and expected demographic experience used in the IFRS liabilities.

Non-Operating Profit represents items which are considered to be:

(A) outside of direct management control, such as investment market movements; or

(B) of a one-off or of an exceptional nature which are not expected to recur.

Items which are treated as non-operating are:

(A) Short-Term Fluctuations in Investment Return – represents the variance between the actual investment return earned in the period and the long term operating assumptions;

(B) Model and Assumption Changes – which reflect changes that are one-off or of an exceptional nature which are not expected to recur; and

(C) Non-Recurring Expenses – which are treated as exceptional and non-recurring items such as Solvency II costs.

Underlying operating profit rose in 2013 to £80m compared to £66m in 2012. This reflects:

(A) the spread earned on the insurance book rose from £43m in 2012 to £48m in 2013, reflecting the growth in the overall portfolio during 2013, offset by a narrowing of spreads earned during the year; and

(B) the spread earned on surplus assets rose from £23m in 2012 to £32m in 2013, reflecting the growth in surplus assets during 2013.

Operating profit before tax fell in 2013 to £61m compared to £137m in 2012. Within this:

(A) New Business Operating Profit was £(11m) in 2013; compared to £68m in 2012; this reflects individual terms of new business and reinsurance entered into during each year; and

(B) Other Changes to the In-force Business have fallen in 2013 to £(8m), from £3m in 2012. This principally represents the annual short-term variance which arises each year in the levels of actual claims made, compared to the long term assumption used in the Company's reserving policy.

6.3 Embedded Value

Embedded Value or "**EV**" has been prepared in accordance with the European Embedded Value Principles issued in May 2004 by the European CFO Forum, as supplemented by the Additional Guidance on European Embedded Value Disclosures issued in October 2005 (together the "**EEV Principles**").

EV is an estimate of the realistic value of the in-force business of a life insurer. It is typically made up of the following components:

(A) Embedded Value = Adjusted Net Worth + Value of In-force Business – Cost of Capital.

(B) The Adjusted Net Worth ("**ANW**") is the sum of the Free Surplus and Required Capital, where:

(i) "Free Surplus" is equal to the unencumbered monies that could be withdrawn by shareholders. In practice, this money is retained in the company to support new business; and

(ii) "Required Capital" is the amount of capital required to be held by PIC which cannot be distributed due to regulatory capital requirements. This represents management's estimate of the "target" capital to be held to support the business in adverse circumstances, rather than the minimum regulatory capital requirement.

(C) The Value of In-force Business ("**VIF**") is the value of future after-tax profits to emerge on the business already written, discounted at the risk discount rate ("**RDR**"). The profits arise from a combination of the release over time of the prudential margins built in to the Pillar 1 (statutory) reserves in excess of the best-estimate cost of the liabilities in the future and future investment returns. For pension insurers, a significant proportion of the VIF typically arises because the expected investment returns are significantly higher than are allowed to be taken account of in calculating the policyholder liabilities.

(D) The Cost of Capital ("**CoC**") is included to allow for the fact that the Required Capital is not immediately available for distribution to shareholders, and therefore a discount is applied to represent the frictional cost of holding this capital. In effect, this is the opportunity cost of not being able to invest such capital freely to maximise shareholder returns.

The EV does not include any assessment of the value of future new business (i.e. the franchise value of PIC).

The allowance for risk in the EV is contained in four main areas of the calculation:

(i) the margin for non-market risks in the RDR, which represents an allowance for the non-hedgeable risk of the business. In accordance with the EEV Principles, the RDR is set as a risk margin over the risk-free (swaps) curve. An equivalent flat RDR has been shown below for comparative purposes; this is the flat RDR which would give the same embedded value result as that calculated using the margin shown over swaps;

(ii) the allowance for credit defaults within the earned rate (i.e. the investment return assumed in relation to the assets held to back the future policy liabilities) and the reinvestment rate assumed on the proceeds of asset cashflows in excess of liability payments which need to be reinvested to meet longer term liabilities;

(iii) the allowance for the frictional cost of holding required capital; and

(iv) the allowance for the cost of financial options and guarantees, which in the case of PIC relates to the limited price indexation ("**LPI**") caps and floors that apply to the inflationary escalation of certain annuity benefits.

The key assumptions used to derive points (i) to (iii) above are set out in the table below.

Embedded Value – Key Assumptions	**2011**	**2012**	**2013**
Margin over swaps (bps):			
- Risk discount rate	451	450	425
- Expected return	170	144	118
- Reinvestment rate	123	115	103
- Solvency (Pillar 1) liquidity premium	90	70	63
Default allowance within expected return (bps)	12	15	17
Risk discount rate as an equivalent flat rate	7.1%	6.8%	7.4%
Cost of capital	2.8%	3.0%	3.2%

The time value of the cost of the LPI benefits is allowed for explicitly within the actuarial reserves, hence the projected after-tax profits in the calculation of the VIF are net of this time value. Therefore, the value of options and guarantees is allowed for implicitly within the VIF calculation and is not disclosed separately within the EV.

Embedded Value as at 31 December 2011, 2012 and 2013	2011	2012	2013
		(£m)	
Free Surplus	176	272	342
Required Capital	253	371	556
Adjusted Net Worth	429	643	898
Value of in-force business before tax	344	401	626
Allowance for tax on shareholders' profits	(87)	(104)	(117)
Value of in-force business after tax	**257**	**297**	**509**
EV before cost of capital	**686**	**940**	**1,407**
Cost of Capital	(67)	(110)	(181)
EV Net of Cost of Capital	**619**	**830**	**1,226**

The PIC EV increased from £619m as at 31 December 2011 to £830m as at 31 December 2012 and £1,226m as at 31 December 2013. This was primarily due to:

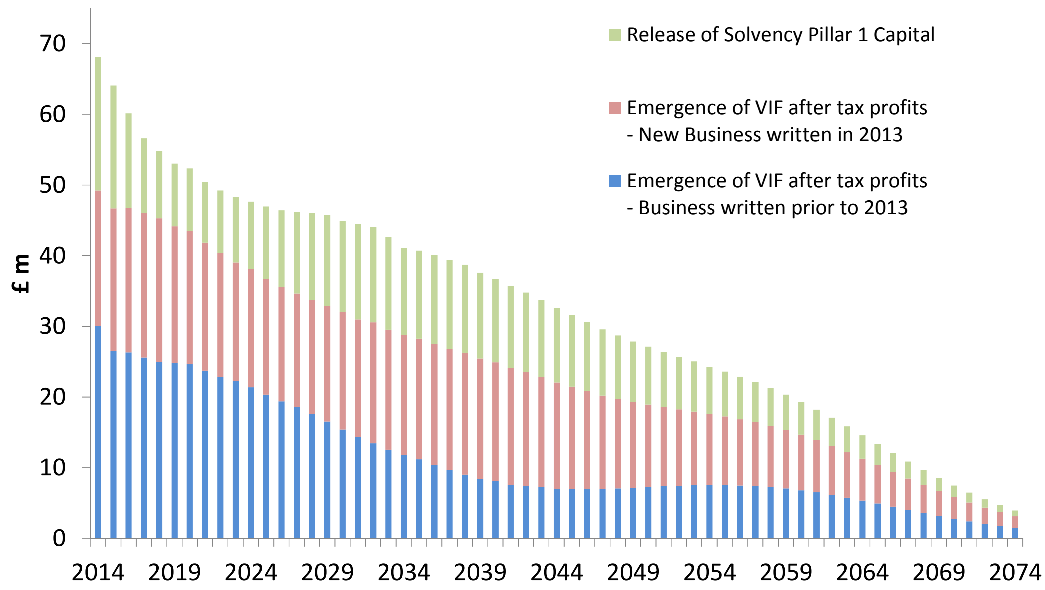
- new business after tax and before the cost of capital increasing to £166m in the year to 31 December 2012 and £331m in the year to 31 December 2013;

- capital contributions from PIC's shareholder of £84m in 2012 and £224m in 2013; and

- other variations reflecting changes to PIC's existing business, investment variances and assumptions and the cost of capital.

The graph below shows the undiscounted after-tax profits which contribute to the VIF, reflecting margins in PIC's reserves that are expected to emerge in the year from business written prior to 2013 and new business written in 2013, together with the release of the Solvency (Pillar 1) capital which supports this business.

Expected total future cash flow generation on business written as at 31 December 2013



Over the following ten years (from 1 January 2014 to 31 December 2023), the expected emergence of VIF after tax profits is:

- £252m for business written prior to 2013; and
- £191m for New Business written in 2013.

The expected release of Solvency – Pillar 1 Capital is £114m over the same period.

6.4 Movement in Embedded Value

The following table shows the movement in Embedded Value for the years ended 31 December 2012 and 2013, respectively.

£m	**2012**	**2013**
EV at start of period	**619**	**830**
New business contribution	166	331
Existing business contribution [(1)]	9	(47)
Other [(2)]	(5)	(41)
Change in EV pre-cost of capital and capital investment	**170**	**243**
Change in cost of capital	(43)	(71)
Capital investment	84	224
EV at end of period	**830**	**1,226**

[(1)] *Existing Business Contribution comprises:*

- *expected returns on the net assets and the unwind of the VIF;*
- *demographic and expense experience variances;*
- *the impact of new reinsurance transactions; and*
- *modelling and assumption changes*

[(2)] *Other comprises:*

- *investment experience variances in the year; and*
- *the impact of changes in future investment return assumptions*

The following table shows the Embedded Value New Business Margin for the years ended 31 December 2012 and 2013, respectively.

Embedded Value New Business Margin (£m)	**2011**	**2012**	**2013**
New business contribution	75	166	331
Gross premiums written	615	1,512	3,663
Embedded Value new business margin	**12.2%**	**11.0%**	**9.0%**

6.5 Solvency and Capital position

PIC is authorised by the PRA and regulated by the FCA and the PRA. Its capital requirements are prescribed by PRA rules which implement certain EU insurance directives and provide additional standards applicable to the UK. These rules are explained in detail in *"Regulatory Overview"* below.

The PRA prescribes two regulatory capital requirements:

- Solvency (Pillar 1) which specifies the capital requirements an entity is required to hold based on EU minimum requirements; and

- Solvency (Pillar 2) which requires the entity to define its capital requirements based on a 99.5 per cent. confidence interval over a one-year time frame that the value of assets exceed the value of liabilities.

PIC has set internal targets to manage both its Solvency (Pillar 1) and Solvency (Pillar 2) capital positions. These set a buffer over and above the regulatory minima so that PIC can continue its operations despite market volatility.

PIC's publicly disclosed Solvency (Pillar 1) position over the past three years is set out below:

PIC's Solvency (Pillar 1) Capital	**2011**	**2012**	**2013**
		(£m unless otherwise stated)	
Available Capital Resources (*a*)	341	595	898
Capital Requirements (*b*)	180	238	361
Surplus (*a*) – (*b*)	161	357	537
Capital Ratio (*a*) / (*b*)	**190%**	**251%**	**249%**

On 4 June 2014, PIC entered into a pensioner buy-in arrangement with the Trustee of the Total UK Pension Plan which covered £1.6bn of pensioner liabilities and simultaneously transacted a longevity swap reinsurance arrangement covering the majority of the longevity risk taken on. The transaction was supported by drawing down the remaining £75m capital commitment from Reinet into PCG, with a corresponding increase in financial resources of £72m. The net impact of these transactions was to increase both the Pillar 1 available capital resources and the Pillar 1 capital requirement. Had these transactions occurred in the 2013 financial year, the Solvency Pillar 1 Capital Ratio would have reduced to 214%.

It is the Board's view that, on an economic capital basis, at 31 December 2013 PIC had in excess of £400m capital surplus.

7. Key Sensitivities – Solvency Position and Embedded Value

The table below sets out the impact as at 31 December 2013 on the Solvency (Pillar 1) capital position and the Embedded Value for instantaneous key market risk movements and changes in assumptions for long-term insurance contracts.

Solvency (Pillar 1)	**Base**	**Interest rates +50bps**	**Interest rates -50bps**	**Interest rates +175bps**	**Interest rates -175bps**
Available Capital Resources	898	895	901	859	928
Capital Requirements	361	342	382	305	442
Surplus	537	553	519	554	486
Solvency Cover	**249%**	**262%**	**236%**	**282%**	**210%**
Change in Solvency Cover		13%	(13)%	33%	(39)%

Solvency (Pillar 1)	**Inflation rates +50bps**	**Inflation rates -50bps**	**Inflation rates +125bps**	**Inflation rates -125bps**	**Base mortality (1)**
Available Capital Resources	905	906	1,019	876	889
Capital Requirements	374	348	395	330	361
Surplus	531	558	624	546	528
Solvency Cover	**242%**	**260%**	**258%**	**265%**	**246%**
Change in Solvency Cover	(7)%	11%	9%	16%	(3)%

Solvency (Pillar 1)		**Mortality improvements (2)**	**Maintenance expenses increase by 15%**	**Credit spreads +25bps**	**Credit spreads +300bps**
Available Capital Resources		879	875	849	706
Capital Requirements		362	362	357	310
		517	513	492	396
Solvency Cover		**243%**	**242%**	**238%**	**228%**
Change in Solvency Cover		(6)%	(7)%	(11)%	(21)%

(1) Base Mortality sensitivity is based on a 1% decrease in the base mortality tables
(2) Mortality improvement sensitivity is based on a 0.1% increase in annual mortality improvement rates.

Embedded Value	Base	Interest rates +50bps	Interest rates -50bps	Interest rates +175bps	Interest rates -175bps
Free surplus	342	360	322	375	293
Required capital	556	535	579	484	635
Adjusted Net Worth	898	895	901	859	928
VIF	509	471	552	394	689
EV before cost of capital	1,407	1,366	1,453	1,253	1,617
Cost of capital	(181)	(170)	(193)	(145)	(228)
EV after cost of capital	**1,226**	**1,196**	**1,260**	**1,108**	**1,389**
Change as % of EV		(2)%	3%	(10)%	13%

Embedded Value	Inflation rates +50bps	Inflation rates -50bps	Inflation +125bps	Inflation rates -125bps	Base mortality (1)
Free surplus	353	347	478	315	332
Required capital	552	559	541	561	557
Adjusted Net Worth	905	906	1,019	876	889
VIF	538	481	585	444	509
EV before cost of capital	1,443	1,387	1,604	1,320	1,398
Cost of capital	(183)	(178)	(187)	(174)	(181)
EV after cost of capital	**1,260**	**1,209**	**1,417**	**1,146**	**1,217**
Change as % of EV	3 %	(1)%	16 %	(7)%	(1)%

Embedded Value	Mortality improvements (2)	Maintenance expenses increase by 15%	Credit spreads +25bps	Credit spreads +300bps
Free surplus	324	323	290	297
Required capital	555	552	559	409
Adjusted Net Worth	879	875	849	706
VIF	511	512	543	626
EV before cost of capital	1,390	1,387	1,392	1,332
Cost of capital	(181)	(182)	(181)	(142)
EV after cost of capital	**1,209**	**1,205**	**1,211**	**1,190**
Change as % of EV	(1)%	(2)%	(1)%	(3)%

(1) Base Mortality sensitivity is based on a 1% decrease in the base mortality tables
(2) Mortality improvement sensitivity is based on a 0.1% increase in annual mortality improvement rates.

8. Dividend Policy

PIC does not have a formal dividend policy. PIC has not paid a dividend to date and its current policy is not to pay dividends, but rather to reinvest surplus capital generated by PIC's business and operations in order to support new business growth.

9. Board of Directors

9.1 The Board

PIC's Board of directors is composed as follows:

Sir Mark Weinberg, Chairman, Non-Executive Director

Sir Mark Weinberg is President and co-founder of St James's Place Wealth Management Group, as well as being founder of Abbey Life Assurance and co-founder of Hambro Life (Allied Dunbar). Sir Mark is Chairman of the Origination Committee.

John Coomber, Chief Executive Officer, Executive Director

John Coomber is a former Group CEO and former Director of Swiss Re. Aside from being a director of PIC, John is also Chairman of MH(GB) Limited and Chairman of ClimateWise. John is a member of the Origination Committee. John has given notice to the Board of PIC that he intends to retire as CEO of PIC in the two years from June, 2014.

Rob Sewell, Chief Financial Officer, Executive Director

Rob Sewell is a former CEO of National Westminster Life Assurance and a former Finance Director of Legal & General UK. He is a Fellow of the Institute of Chartered Accountants in England & Wales. Rob is a member of the Origination Committee.

Tracy Blackwell, Executive Director

Tracy Blackwell is the former Head of Risk Management for Goldman Sachs Asset Management in Europe and Asia. Tracy is a member of the Origination Committee. Tracy is a Non-Executive Director of United Trust Bank Limited.

Tim Hanford, Non-Executive Director

Tim Hanford is a Partner of J.C.Flowers & Co UK LLP and a former board director of J. Henry Schroder & Co. Limited. Tim currently sits on the board of each of OneSavings Bank plc, Compagnie Européenne de Prévoyance, Castle Trust Capital plc, JCSB Investtradebank and Shelbourne Syndicate Services Limited. Tim is Chairman of the Risk Committee and a member of each of the Nomination and Remuneration Committee and the Audit Committee.

Harriet Maunsell, Non-Executive Director

Harriet Maunsell is the former Chairperson of the Occupational Pensions Regulatory Authority and the former Deputy Director of the Occupational Pensions Board. Harriet is a member of the Audit Committee and the Origination Committee.

Chris McKechnie, Non-Executive Director

Chris McKechnie is the former head of Principal Investments at Swiss Re. Chris is Chairman of the Asset and Liability Management Committee and a member of the Origination Committee.

Eloy Michotte, Non-Executive Director

Eloy Michotte is an Executive Director of Reinet Investments Manager SA and Reinet Fund Manager SA, and Head of Corporate Finance for Compagnie Financière Richemont SA. Eloy also serves on the boards of a number of companies in which Reinet Fund S.C.A. F.I.S. and Compagnie Financière Richemont SA hold interests. Eloy is a member of each of the Asset and Liability Management Committee, the Audit Committee and the Nomination and Remuneration Committee.

Nicholas Parker, Non-Executive Director

Nick Parker is the former head of project finance and privatisations at PwC for the EMEA region. Aside from being a non-executive director of PIC, Nick is also a Director and Chairman of The Wastepack Group Limited. Nick is Chairman of the Audit Committee and a member of the Nomination and Remuneration Committee and the Risk Committee.

Bill Winters, Non-Executive Director

Bill Winters is the former Co-CEO of JP Morgan Investment Bank and founder of Renshaw Bay. Bill is a member of the boards of the International Rescue Committee and the Young Vic Theatre. Bill is Chairman of the Nomination and Remuneration Committee and a member of each of the Asset and Liability Management Committee and the Risk Committee.

9.2 Board Committees

Asset and Liability Management Committee

The Asset and Liability Management Committee oversees the management of all aspects of investment policy and strategy for PIC and provides oversight of the operation of PIC's investment portfolios within an established strategy and risk framework.

Audit Committee

The Audit Committee has primary responsibility for the appointment and management of the external auditors and the annual audit, the appointment and overview of the internal audit function, systems of governance and compliance, systems of internal controls including those financial and information technology, and review of financial statements and related accounting policies and judgements.

Nomination and Remuneration Committee

The Nomination and Remuneration Committee reviews the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board and makes recommendations to the Board with regard to any changes. It also determines and agrees with the Board the framework or broad policy for the remuneration and recruitment of the company's chairman, non-executive directors, chief executive, the executive directors and such other members of the executive management as it is designated to consider.

Origination Committee

The Origination Committee approves the terms for quotations for and execution of new business transactions and assesses and approves acceptance of the related liabilities. It also approves the terms of all reinsurance arrangements.

Risk Committee

The Risk Committee provides oversight and advice to the Board with regard to PIC's current and likely risk exposures; risk tolerances and appetite; risk measurement; risk management performance; and its risk policies and procedures and risk controls. The Risk Committee recommends the risk policy to the Board and reports to the Board on the effectiveness of the risk controls.

10. Conflicts of Interest

The PIC directors below are also shareholders, or shareholder representatives, in respect of PCG:

- Tracy Blackwell;
- John Coomber;
- Tim Hanford;
- Eloy Michotte;
- Nicholas Parker;
- Rob Sewell;
- Sir Mark Weinberg; and
- Bill Winters.

Chris McKechnie has certain contractual financial arrangements with the PCG Group which relate to the advisory services he is providing to PIC in connection with the issue of the Notes.

Each of Tim Hanford and Eloy Michotte are directors of PIC and directors of PCG. Tim and Eloy were appointed to these directorships as representatives of PIC Holdings (Cayman) Limited and Reinet PC Investments (Jersey) Limited (respectively). These companies are affiliated with J.C. Flowers Fund II and Reinet Fund SCA FIS (respectively), each of which are significant shareholders in PCG. From time to time, circumstances may arise in which the duties of Tim and/or Eloy as directors of PIC may conflict with their interests as the representatives of shareholders in PCG.

Tim Hanford is also Partner of J.C. Flowers & Co UK LLP, which has an indirect investment in Pensions First (a potential competitor of PIC).

Sir Mark Weinberg, John Coomber, Tracey Blackwell, Nicholas Parker, Rob Sewell and Bill Winters are all directors of PIC and shareholders in PCG. From time to time, circumstances may arise in which the duties of each of these individuals as directors of PIC may conflict with their interests as shareholders in PCG.

Save for any conflicts which may arise by virtue of the foregoing, there are no other conflicts of interest between the duties of the PIC directors to PIC and their private interests or other duties. PIC has appropriate procedures in place to identify and manage any conflicts of interest should they arise.

Regulatory Overview

Introduction

The Issuer's insurance business is subject to the UK regulatory framework, established under FSMA. The Issuer is an insurer authorised by the PRA and regulated by both the PRA (as regards prudential and organisational requirements) and the FCA (as regards conduct of business requirements).

As a company carrying on insurance business in the UK, the Issuer is subject to detailed regulatory requirements, including the requirements to be authorised to carry on insurance business and to comply with comprehensive prudential and conduct of business rules. This section provides an overview of the key features of the regulatory regime for companies carrying on insurance business in the UK, as it applies to the Issuer.

Dual regulation by the PRA and the FCA

Prior to 1 April 2013, insurance companies in the UK were authorised and regulated by the FSA (the predecessor to the FCA and the PRA). The FSA has now been abolished and its responsibilities reallocated in modified form between two new regulatory authorities, the FCA and the PRA. As a result, insurance companies in the UK are dual-regulated, which means that they are authorised, prudentially regulated and supervised by the PRA, and regulated for conduct of business purposes by the FCA.

The PRA is a subsidiary of the Bank of England, and is responsible for the micro-prudential regulation of insurance companies, banks and certain large investment firms. The PRA's primary purpose and objective is to promote financial stability. It also has a specific "insurance objective" of contributing to the securing of an appropriate degree of protection for those who are or may become policyholders of PRA-authorised insurers.

The FCA regulates the conduct of every authorised firm. Its "operational objectives" are to protect and enhance confidence in the UK financial system by protecting consumers, enhancing the integrity of financial markets and promoting effective competition in the interests of consumers. The FCA also has a "strategic objective" of ensuring that relevant markets function well.

The Financial Policy Committee, a new body that operates within the Bank of England, is responsible for the macro-prudential regulation of the entire financial services sector.

As an authorised insurance company, the Issuer is required to comply with the provisions of FSMA, and the rules made by the PRA and the FCA under FSMA. These rules are set out in the PRA Handbook (including the PRA Rulebook) and the FCA Handbook, respectively. They include: the Principles for Businesses; the Senior Management, Systems and Controls Sourcebook ("**SYSC**"); prudential rules contained in the General Prudential Sourcebook ("**GENPRU**"), the Prudential Sourcebook for Insurers ("**INSPRU**"), and the Interim Prudential Sourcebook for Insurers ("**IPRU** (**INS**)"); and conduct of business rules contained in the Conduct of Business Sourcebook ("**COBS**") and the Insurance: Conduct of Business Sourcebook ("**ICOBS**").

The PRA and the FCA have extensive powers to supervise and intervene in the affairs of the firms they are responsible for regulating, for example, if they consider it appropriate in order to protect policyholders against the risk that the firm may be unable to meet its liabilities as they fall due, that the threshold conditions (see further below) may cease to be met, that the firm or its parent has failed to comply with obligations under the relevant legislation or rules, that the firm has furnished them with misleading or inaccurate information or that there has been substantial departure from any proposal or forecast submitted to the relevant regulator.

FSMA, the FCA Handbook, the PRA Handbook and secondary legislation made under FSMA are used to implement the requirements contained in a number of EU Directives (applicable throughout the European Economic Area ("**EEA**")) relating to financial services and to insurance business in particular.

Permission to carry on insurance business in the UK

Under section 19 of FSMA, it is unlawful to effect or carry out contracts of insurance in the UK (i.e. carry on the business of an insurer) without permission to do so from the PRA under Part 4A of FSMA (a "**Part 4A Permission**"). The FCA must also consent to the granting of the permission.

In order to grant a Part 4A Permission, the PRA, with input from the FCA where appropriate, must determine that the applicant meets the requirements of FSMA, including certain "threshold conditions". The threshold conditions are the minimum conditions which must be satisfied (both at the time of authorisation, and on an ongoing basis) in order for a firm to gain and continue to have permission to carry on the relevant regulated activities under FSMA. Dual-regulated firms must meet both the PRA and the FCA threshold conditions. These relate to matters including the applicant's legal form, whether the applicant has adequate resources (both financial and non-financial) to carry on its business and whether, having regard to all the circumstances (including whether the applicant's affairs are conducted soundly and prudently), the applicant is a fit and proper person to conduct the relevant regulated activities.

The Part 4A Permission contains a description of the activities that an authorised firm is permitted to carry on. When granting a Part 4A Permission, the PRA may impose such limitations and requirements as it considers appropriate.

Once authorised, in addition to continuing to meet the threshold conditions, firms must comply with the high-level Principles for Businesses, as well as other rules in the PRA Handbook and the FCA Handbook, as introduced below.

The PRA and FCA Handbooks

The FCA's approach to regulation and the standards it requires firms to maintain are set out in the FCA Handbook. Similarly, the PRA Handbook sets out the PRA's rules, which focus on prudential matters. The PRA has started to move away from the legacy material adopted from the FSA, towards a PRA Rulebook, and firms are currently required to refer to both the PRA Handbook and the PRA Rulebook while this transition is underway.

The PRA Handbook and the FCA Handbook comprise a number of sourcebooks which set out the rules which apply to dual-regulated firms and provide the core ongoing requirements for PRA-authorised firms.

The Principles for Businesses

PRA-authorised insurance companies are subject to certain overarching principles issued by the PRA and the FCA, the so-called “Principles for Businesses”. These principles are intended to ensure fairness and integrity in the provision of financial services in the United Kingdom and contain the fundamental obligations of insurance firms. The emphasis and reliance on these principles by the PRA and the FCA has marked a move to more judgment based regulation in recent years.

The PRA is currently consulting on a proposal to replace the Principles with “Fundamental Rules”. The proposal includes a specific Fundamental Rule relating to the preparation for resolution (orderly winding-up) and there is to be an increased focus on the effectiveness of the risk management frameworks of PRA-authorised firms.

Prudential Standards

It is a fundamental requirement of the PRA’s prudential rules that firms maintain adequate financial resources. This requirement and the obligation for a firm to carry out a risk-based assessment of its own capital requirements are contained in GENPRU. Provisions containing the requirement to manage risks in general and details relating to management of particular types of risk are set out in INSPRU and in SYSC.

GENPRU covers the overall requirement to have capital resources in excess of a firm’s capital resources requirement and sets out what constitutes capital resources and how different firms should calculate their capital requirement. It sets out the main categories of prudential risk against which a firm’s assessment of risk should be made. However, a firm’s own assessment should be appropriate to its size and the nature and complexity of its business. The categories of prudential risk include insurance risk, credit risk, market risk, liquidity risk, operational risk and certain other types of risk (for example, interest rate risk).

The rules in INSPRU apply specifically to insurers and contain further provisions on managing risk and calculating an insurer’s cover for insurance liabilities (and capital requirements for the business as a whole), including provisions relating to admissibility of assets to cover an insurer’s technical provisions and limits on counterparty and asset exposures. INSPRU also contains restrictions which limit the activities of the insurer to insurance business and activities directly arising from that business.

IPRU(INS) sets out certain residual prudential and notification requirements for insurers, and predominantly consists of financial reporting requirements.

The rules in SYSC aim to encourage senior managers and directors to take appropriate practical responsibility for the firm’s affairs. They elaborate on the Principles for Businesses and require a firm’s senior managers to ensure that, among other things:

(i) the firm’s employees have suitable skills, knowledge and expertise;

(ii) the firm has in place appropriate risk management systems and controls; and

(iii) the firm has in place appropriate compliance, record keeping and audit systems.

The Approved Persons regime

The regulatory approach of the PRA and the FCA is to place personal responsibility on individuals who are able to exercise significant influence over an authorised firm, including an insurer. In particular, an authorised insurer is required to obtain approval for any individual who carries on a specific "controlled function", such as, for example, executive or non-executive directors and persons responsible for risk management, internal audit or compliance. The relevant approval must be obtained from the PRA or, in relation to certain controlled functions, the FCA. These individuals are known as "**Approved Persons**" and must comply with a set of principles which contain many of the same features as the Principles for Businesses referred to above.

The PRA (or the FCA, as the case may be) will only approve an individual to undertake a controlled function if that individual is assessed to be a fit and proper person. In particular, the PRA (or, where relevant, the FCA) must be satisfied as to the person's honesty, integrity and reputation, competence and capability for the role that person is to assume in the firm, and their financial soundness.

In September 2010, the FSA published a policy statement that provided for changes to the Approved Persons regime, particularly to break up a number of existing controlled functions into more specific functions and to create a new controlled function relevant to an unregulated parent entity of an authorised firm. These changes have not, however, been implemented as yet and the timing for their implementation remains uncertain. Alongside these changes, there are a number of ongoing initiatives, both at UK and EU level, that are likely to result in the FCA and PRA making significant changes to the regime in the next few years.

Conduct of Business requirements

The FCA regulates, through COBS and ICOBS, the distribution and sale of insurance products. COBS applies where such insurance products have an investment element, such as pension policies, and ICOBS applies to non-investment insurance products.

The scope and range of the obligations imposed on an authorised firm under COBS and ICOBS vary according to the scope of the firm's business and the nature of its clients. Many of the provisions only apply to insurers that deal directly with retail customers or to transactions with retail customers. Broadly, the rules in COBS and ICOBS require firms to provide clients with information about the firm, meet certain standards of product disclosure, assess suitability when advising on certain products, report appropriately to clients and provide certain protections in relation to client assets.

These sourcebooks implement the Insurance Mediation Directive in the UK, which is currently under review by the European legislative bodies. One key aim of the review is to ensure a level playing field for all sellers of insurance products in the EU, including direct sales by insurers.

Treating Customers Fairly

The FSA instituted a Treating Customers Fairly initiative, which derives from the requirement in the Principles for Businesses that all regulated firms treat their customers fairly, and is an important example of a principles-based approach to regulation. This now a key focus of the FCA. The emphasis of this initiative is on achieving fair outcomes for customers.

The FCA has wide-ranging powers to take enforcement action against both firms and individuals (for example, against senior management if it considers that they have failed in their responsibilities) for breach of the TCF principle, including where it finds that a firm's systems or actions cause actual or potential consumer detriment.

Change of control of insurance companies

Section 178 of FSMA requires any person who intends to acquire or increase its "control" over a UK authorised insurance company to notify the PRA of its decision and to receive approval from the PRA before becoming a "controller" or increasing its interest in such a firm to or above certain thresholds.

The PRA must, within 60 working days from the date on which it receives a notification (provided it has received all the necessary information) either approve, or notify the applicant that it does not approve, the acquisition of or increase in control. In reaching its decision, the PRA is required to consult with the FCA and the FCA may require the PRA to reject the application or impose conditions on the approval of the application in certain circumstances.

The PRA must also be notified when the transaction which results in the change of control takes place. No prior approval for reducing control below one of the thresholds referred to below is needed, although notification must still be given to the PRA of the relevant transaction.

A proposed "controller" for the purposes of the controller regime is any natural or legal person or such persons "acting in concert" who has or have taken a decision to acquire or increase, directly or indirectly, a holding above a certain level in, broadly, a UK authorised firm (including a UK insurance company).

Broadly, "control" over a UK authorised insurer is acquired if the acquirer:

(i) holds 10 per cent. or more of the shares or voting rights in that company or in its parent undertaking; or

(ii) is able to exercise significant influence over the management of the firm by virtue of the acquirer's shares or voting power in the company or its parent undertaking.

Increases in control of an insurance company require the prior consent of the PRA where they reach thresholds of 20, 30 and 50 per cent. of the shares or voting power in the regulated firm or its parent undertaking.

Breach of the requirements to notify the PRA of a decision to acquire or increase control or to obtain approval before effecting the transaction in question is a criminal offence attracting potentially unlimited fines, and other offences exist for breaches of the provisions of the change of control regime described above.

Consumer complaints and compensation

Insurance companies, along with other regulated firms and certain other unregulated businesses, fall under the compulsory jurisdiction of the Financial Ombudsman Service ("FOS"), which is a body established under FSMA. Authorised firms are required to have adequate complaints handling procedures in place but, where these are exhausted and the complaint or dispute has not been resolved, the FOS provides for dispute resolution in respect of certain categories of customer complaints brought by individuals and small business customers. Insurance firms covered by the FOS are required to pay levies and case fees, which provides the funding for the FOS.

The Financial Services Compensation Scheme ("**FSCS**"), established under FSMA, seeks to protect policyholders when a UK authorised insurer is unable or unlikely to be able to meet its financial obligations to policyholders. The FSCS provides compensation to certain categories of customer who suffer loss as a consequence of the failure by a regulated firm to meet its liabilities arising from claims made in connection with regulated activities. The FSCS is funded by way of levies imposed on all of its participating financial services firms, including the Issuer.

Regulatory capital

Rules in force in the UK (in large part implementing EU insurance directives) require insurance companies to maintain capital resources equal to, or in excess of, their applicable capital resources requirement ("**CRR**"). Detailed rules define how to calculate the CRR and what constitutes capital for these purposes.

Under the rules in GENPRU, for an insurer only carrying on long-term insurance business (and which has no with-profits liabilities), the CRR is equal to the minimum capital requirement ("**MCR**"). The MCR for an insurer such as the Issuer is the higher of:

(i) the base CRR for long-term insurance business applicable to that firm; and

(ii) the sum of the long-term insurance capital requirement and the resilience capital requirement.

The base CRR is a euro-dominated amount specified at an EU level which differs for various classes of insurer. The long-term insurance capital requirement is the amount of capital resources an insurer must hold, calculated by reference to the capital at risk in respect of specified insurance business risks. The resilience capital requirement is an additional UK requirement which requires capital to be set aside against the potential effects of market risk.

Insurance companies are required to file with the PRA an annual return comprising audited accounts and other prescribed documents within three months of the end of the relevant financial year, if the deposit is made electronically, and otherwise within two months and 15 days of the end of the relevant financial year.

These returns are required to be prepared in accordance with the valuation rules in INSPRU and GENPRU and the reporting rules in IPRU(INS).

Assets and investments count towards capital adequacy requirements only if they are admissible assets capable of being valued in accordance with the rules in GENPRU. Inadmissible assets are deducted from capital resource calculations. Assets are also required to be deducted from capital resources to the extent that they exceed certain requirements in INSPRU as to counterparty and asset exposure limits. These limits are intended to prevent insurance companies from incurring a significant exposure to any one counterparty (including a group of companies) or one asset type.

Rules in the PRA Handbook and INSPRU also require a firm to calculate its capital requirements through its own risk assessment (known as an “individual capital assessment” or “ICA”). If the PRA disagrees with a firm’s ICA, it may draw up its own Individual Capital Guidance (“ICG”) for the firm, which it will provide on a confidential basis. Ultimately the PRA may, subject to satisfying certain conditions, impose ICG as a requirement on the scope of the firm’s permissions, resulting in that ICG becoming mandatory for the firm. The results of this assessment are not published.

EU Member States are required to provide group supervision for any insurance company which is part of a group comprising of at least one other insurance company (including where one of these companies is a non-member country insurance undertaking). This requirement is derived from the EU Insurance Groups Directive. The PRA implements this requirement by imposing a group capital resources requirement on a consolidated basis.

Supervision and enforcement

Supervision

The PRA has wide powers to supervise, and intervene in, the affairs of an insurance company under FSMA. It can, for instance, require firms to provide particular information or documents to it, require the production of a report by a “skilled person” appointed by the PRA or formally investigate a firm.

The nature and extent of the PRA’s supervisory relationship with a firm depends on how much of a risk the PRA considers it could pose to its statutory objectives. The PRA assigns firms to one of five “impact categories”, based on its overall assessment of a firms’ systemic importance, its proximity to failure, the context in which the firm operates and a bespoke selection of activities which PRA supervisors deploy as they judge necessary.

The FCA’s supervisory approach is built around three pillars. Pillar 1 is Proactive Firm Supervision (also referred to as the Firm Systematic Framework) which is designed to be a forward-looking assessment of a firm’s conduct risk. Pillar 2 is Event Driven Work where the FCA reacts to what is actually happening at the firm. Pillar 3 relates to Products and Issues, where the FCA carries out thematic reviews and market studies across a particular sector or sectors, which are becoming more common.

Enforcement

The PRA and the FCA have powers to take a range of enforcement action, including the ability to sanction companies and individuals carrying out controlled functions within them. Most notably, enforcement action may include restrictions on undertaking new business, public censure, restitution, fines and, ultimately, revocation of permission to carry on regulated activities or of an approved person’s status. The PRA (and, where relevant, the FCA) can also vary or revoke the permissions of an authorised firm that has not engaged in regulated activities for 12 months, or that fails to meet the threshold conditions.

In addition to the above, the FCA has the power to impose sanctions on an authorised person who is found to have committed market abuse and it has the power to institute criminal proceedings for offences under: (i) FSMA or any statutory instruments made under it (with the exception of certain provisions for which the PRA is the relevant regulator); (ii) the insider dealing provisions of the Criminal Justice Act 1993; and (ii) certain provisions contained in anti-money laundering and counter-terrorist financing legislation.

Money laundering and financial crime

The FCA has a duty to consider the importance of minimising the risk of the firms it regulates being used for financial crime. It therefore looks at measures a firm takes to monitor, detect, and prevent financial crime. This includes measures in respect of money laundering, terrorist financing, data security, bribery and corruption, fraud and sanctions breaches.

Data protection

The DPA came into force on 1 March 2000 and regulates in the UK the manner in which living individuals' personal data is obtained, maintained and used. Personal data includes all information relating to an individual by which he or she can be identified, and does not need to be private (and so would include, for example, a name or an address). The DPA covers both hard copy and electronic data and sets out a series of rules and requirements which must be adhered to by any party deemed to be controlling or processing such personal data. The Issuer is required to comply with the DPA and any breach could give rise to criminal or civil liability and other enforcement action by the Information Commissioner's Office, the body responsible for enforcement of the DPA.

European regulatory environment

The regulatory framework applicable to insurers in the UK is derived to a certain extent from EU directives. These directives are implemented into national legislation within each EU Member State. Member States may not pass implementing legislation that fails to meet the minimum standards, but may impose legal requirements that go beyond the minimum standards, unless the directive is a "maximum harmonisation" directive.

Of particular relevance to the Issuer's insurance business are the EU Life and Non-Life Insurance Directives (the "**EU Insurance Directives**"), which establish a framework for the regulation of insurance business in the EU, extending to the EEA. The EU Insurance Directives provide that an authorisation to carry on insurance business granted by the relevant regulator in an EEA Member State where the insurer is incorporated or has its head office is valid for the entire EEA. This "passporting" right may be exercised in accordance with certain terms depending upon, among other things, whether the insurer intends to establish a branch in another EEA Member State or simply provide cross-border services into that state.

Generally, the EU Insurance Directives provide that prudential regulation of an insurance company is a matter for the home state regulator, whereas conduct of business regulation will be subject to the jurisdiction of the regulator in the state into which the insurance business is being passported.

Recent and future developments

Solvency II

The existing solvency regime applicable to the EU insurance sector is over 30 years old. Financial markets have clearly developed significantly during this period.

The EU has for a number of years been developing proposals for the revision of the EU solvency framework applicable to insurers. The intention of the reform is to codify and harmonise prudential regulation for insurers, and apply more consistent risk sensitive standards to insurers' capital requirements. This new framework, as set out in Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance ("**Solvency II**") will, with effect from 1 January 2016, replace the current EU regulatory framework for the prudential supervision of insurance and reinsurance companies.

Solvency II adopts a three pillar approach to prudential regulation:

(i) Pillar 1 relates to minimum capital requirements, covering technical provisions, the Solvency Capital Requirement ("**SCR**") and MCR, rules on market consistent valuation, investment of assets and the use of internal models to calculate the SCR;

(ii) Pillar 2 covers risk management, governance requirements, supervisory review and the Own Risk and Solvency Assessment of an insurer ("**ORSA**"); and

(iii) Pillar 3 covers public and supervisory reporting and disclosure.

A key aspect of Solvency II is the focus on a supervisory review at the level of the individual legal entity. Insurance companies will be encouraged to improve their risk management processes and will be allowed to make use of internal economic capital models to calculate capital requirements, subject to regulatory approval. In addition, Solvency II will require firms to develop and embed an effective risk management system as a fundamental part of running the firm.

The new regime will require firms to disclose a considerably greater level of qualitative and quantitative information than under current rules, both to their own supervisor through Regular Supervisory Reporting ("**RSR**") and to the market through the publication of a Solvency and Financial Condition Report ("**SFCR**"). This is intended to increase transparency, allowing easier comparison across the industry and enabling supervisors to identify sooner if firms are heading for financial difficulty. In turn, increased transparency is intended to drive market discipline, arising from the reaction of ratings agencies and the capital markets to firms' performance.

The Solvency II Directive was formally adopted by the European Council in November 2009, setting out a framework which will be supplemented by further and more detailed technical implementing measures drafted by the European Commission. Member States are required to implement Solvency II by 31 March 2015 and firms must comply with the new regime from 1 January 2016.

Solvency II will be amended by Omnibus II, the agreed text of which was formally adopted by the European Council in March 2014. Omnibus II will introduce a number of changes to Solvency II, designed to reflect the revised EU financial services supervisory framework (in particular, the replacement of the Committee of European Insurance and Occupational Pensions Supervisors with EIOPA from 1 January 2011) and align it with the legislative process introduced by the Lisbon Treaty.

Omnibus II will define the scope of EIOPA's powers in the context of the Solvency II regime, including its powers to resolve disagreements between national supervisors and to act as a coordinator in "emergency situations". The proposed amendments also define the areas in which EIOPA may issue binding technical standards and set out an expanded role for EIOPA in monitoring compliance by Member States.

The Solvency II "Level 1" Directive will be implemented by means of both "Level 2" measures, including delegated acts and binding technical standards, and "Level 3" guidance, including non-binding supervisory standards, recommendations and guidelines. These further implementing measures are currently in the process of being developed. It is anticipated that the draft Level 2 delegated acts, which are expected to take the form of an EU Regulation, will be published later this year. Further, EIOPA has published its first sets of draft implementing technical standards and draft Level 3 guidelines for consultation, and has published a timeline indicating that it intends to consult on and finalise the implementing technical standards and guidelines required under Solvency II throughout the remainder of 2014 and the first half of 2015.

PIC complies with regulatory standards and continues to monitor the development of Solvency II specifications and the implications for its business.

Taxation

United Kingdom Taxation

The comments below, which are of a general nature and are based on the Issuer's understanding of current United Kingdom law and HM Revenue & Customs published practice, describe only the United Kingdom withholding tax treatment of payments in respect of the Notes. They are not exhaustive. They do not deal with any other United Kingdom taxation implications of acquiring, holding or disposing of Notes. Prospective holders of Notes who are in any doubt as to their tax position or who may be subject to tax in a jurisdiction other than the United Kingdom are strongly advised to consult their own professional advisers.

The Notes issued will constitute "quoted Eurobonds" provided they are and continue to be listed on a recognised stock exchange, within the meaning of Section 1005 Income Tax Act 2007. The London Stock Exchange is a recognised stock exchange for these purposes. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List by the United Kingdom Listing Authority and are admitted to trading on the regulated market of the London Stock Exchange. Whilst the Notes are and continue to be quoted Eurobonds, payments of interest by the Issuer on the Notes may be made without withholding or deduction for or on account of United Kingdom income tax.

Interest on the Notes may also be paid without withholding or deduction for or on account of tax where, at the time the payment is made, the Issuer reasonably believes (and any person by or through whom interest on the Notes is paid reasonably believes) that the beneficial owner of the interest is within the charge to United Kingdom corporation tax as regards the payment of interest, provided HM Revenue & Customs has not given a direction that the interest should be paid under deduction of tax.

In other cases, absent any other relief or exemption (such as a direction by HM Revenue & Customs that interest may be paid without withholding or deduction for or on account of tax to a specified Noteholder following an application by that Noteholder under an applicable double tax treaty), an amount must generally be withheld on account of income tax at the basic rate (currently 20 per cent.) from payments of interest on the Notes.

Where Notes are issued at an issue price of less than 100 per cent. of their principal amount, any payments in respect of the accrued discount element on any such Notes should not be subject to any withholding or deduction for or on account of income tax.

Noteholders may wish to note that certain information (including the name and address of the recipient or the beneficial owner of the payments under the Notes) may be obtained by, or be required to be reported to, HM Revenue & Customs. Information may be required to be provided by the registered holder of the Notes, persons who effect or are a party to a transaction in the Notes on behalf of others, registrars and administrators of such transactions, persons who make or receive or are entitled to receive payments derived from the Notes and persons by or through whom interest and payments treated as interest are paid or credited. Any information so reported or obtained may, in certain circumstances, be exchanged by HM Revenue & Customs with the tax authorities of other jurisdictions.

EU Savings Directive

Under the Savings Directive, each Member State of the European Union is required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State.

Amendments to the Savings Directive adopted by the Council of the European Union on 24 March 2014 will expand the circumstances in which payments which indirectly benefit an individual resident in another Member State must be reported, including where the payment is made to, or secured for, certain trusts or certain other legal arrangements. The amendments will also expand the range of payments covered by the Savings Directive, in particular to include additional types of income payable on securities. Member States are required to apply these new requirements from 1 January 2017.

For a transitional period, Luxembourg and Austria are instead required, unless during such period those countries elect otherwise, to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). Once the amendments referred to above are implemented, investors should be aware that withholding in the relevant Member State(s) may occur in a wider range of circumstances than at present. In April 2013, the Luxembourg Government announced its intention to abolish the withholding system with effect from 1 January 2015, in favour of automatic information exchange under the Savings Directive.

A number of other non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland).

Subscription and Sale

Pursuant to a Subscription Agreement dated 1 July 2014 (the "**Subscription Agreement**"), Morgan Stanley & Co. International plc and The Royal Bank of Scotland plc (together the "**Joint Lead Managers**" or the "**Managers**" and each, a "**Manager**") have agreed with the Issuer, subject to the satisfaction of certain conditions, to subscribe for the Notes at the issue price of 99.107 per cent. of their principal amount less commissions. The Managers are entitled to terminate and to be released and discharged from their obligations under the Subscription Agreement in certain circumstances prior to payment to the Issuer.

United States

The Notes have not been and will not be registered under the Securities Act and may not be offered, sold or delivered within the United States or to, or for the account or benefit of U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

The Notes are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a U.S. person, except in certain transactions permitted by U.S. Treasury regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986 and regulations thereunder.

Each Manager has agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver the Notes, (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the Issue Date, within the United States or to, or for the account or benefit of, U.S. persons, and it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

United Kingdom

Each Manager has represented warranted and agreed that: (i) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA would not, if the Issuer was not an authorised person, apply to the Issuer; and (ii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to such Notes in, from or otherwise involving the United Kingdom.

General

No action has been or will be taken by the Issuer or any of the Managers that would permit a public offering of the Notes or possession or distribution of this document or other offering material relating to the Notes in any jurisdiction where, or in any circumstances in which, action for these purposes is required. This document does not constitute an offer and may not be used for the purposes of any offer or solicitation in or from any jurisdiction where such an offer or solicitation is not authorised.

Neither the Issuer nor the Managers represent that the Notes may at any time lawfully be sold in or from any jurisdiction in compliance with any applicable registration requirements or pursuant to an exemption available thereunder or assumes any responsibility for facilitating such sales.

General Information

(1) The net proceeds of the issue will be used by the Issuer for general corporate purposes.

(2) The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg with a Common Code of 108398337 and an ISIN Code of XS1083983376.

(3) The address of Euroclear is Euroclear Bank SA/NV, 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L-1855 Luxembourg.

(4) The yield of the Notes is 6.625 per cent., on an annual basis. The yield is calculated as at the Issue Date on the basis of the issue price and the interest rate of 6.50 per cent. per annum. It is not an indication of future yield.

(5) The Issuer estimates that the amount of expenses related to the admission to trading of the Notes will be up to £4,200.

(6) It is expected that the applications for the Notes to be admitted to the Official List of the UKLA and to trading on the London Stock Exchange's regulated market will be granted on or about 3 July 2014 (subject only to the issue of the Temporary Global Note) and that such admission will become effective, and that dealings in the Notes on the London Stock Exchange will commence, on or about 4 July 2014.

(7) The Issuer has obtained all necessary consents, approvals and authorisations in connection with the issue and performance of the Notes. The issue of the Notes was authorised by a resolution of the board of directors of the Issuer passed on 21 May 2014 and a committee of the board of directors of the Issuer passed on 3 June 2014.

(8) The Trust Deed provides that the Trustee may rely on certificates or reports from any auditors or other parties in accordance with the provisions of the Trust Deed whether or not any such certificate or report or engagement letter or other document in connection therewith contains any limit on the liability of such auditors or such other party.

(9) There has been no significant change in the financial or trading position of the Issuer since 31 December 2013 (the date of the Issuer's most recent financial statements), nor has there has been any material adverse change in the prospects of the Issuer since 31 December 2013.

(10) There are no, nor have there been any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) which may have, or have had during the period of 12 months prior to the date of this document, a significant effect on the financial position or profitability of the Issuer.

(11) The Prospectus will also be available for inspection on the website of the Regulatory News Service operated by the London Stock Exchange at http://www.londonstockexchange.com/exchange/news/market-news/market-news-home.html.

(12) Copies of the annual report and audited consolidated financial statements of the Issuer for the years ended 31 December 2012 and 2013 and copies of this Prospectus, the Trust Deed and the Agency Agreement and the constitutional documents of the Issuer will be available for inspection at the specified offices of each of the Paying Agents (as defined in the Conditions) during normal business hours, so long as any of the Notes is outstanding.

(13) KPMG Audit Plc, Registered Auditors with the Institute of Chartered Accountants in England and Wales, have audited, and rendered an unqualified audit report on, in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and International Financial Reporting Standards, the consolidated financial statements of the Issuer, for the two years ended 31 December 2012 and 31 December 2013. KPMG Audit Plc has no material interest in the Issuer.

(14) There are no material contracts entered into other than in the ordinary course of the Issuer's business which could result in the Issuer being under an obligation or entitlement that is material to the Issuer's ability to meet its obligations to Noteholders in respect of the Notes.

(15) The Issuer does not intend to provide any post-issuance information in relation to the Notes.

(16) Certain of the Managers and their affiliates have engaged, and may in the future engage in investment banking and/or commercial banking transactions with, and may perform services for the Issuer and its affiliates in the ordinary course of business.

Financial Information

Registered Number 05706720

Pension Insurance Corporation Limited

Annual Report and Financial Statements
For the year ended 31 December 2013

Pension Insurance Corporation Limited

Incorporated and registered in England & Wales. Registered Number 05706720

Registered Office: The registered office of the Company is 14 Cornhill, London EC3V 3ND.

Contents	**Page**

The directors present their strategic report, annual report and the audited financial statements for Pension Insurance Corporation Limited ("PIC", or "the Company") registered number 05706720, for the year ended 31 December 2013.

Principal activity

The principal activity of PIC is providing insurance annuity products to UK defined benefit occupational pension funds and their members ("Pension Insurance").

Business Review

Background

The Company is authorised to write long term insurance business by the Prudential Regulation Authority ("PRA"). Pension Insurance products are utilised by pension funds as a means of transferring risks and liabilities deriving from the benefit promises made to pension fund members to an insurance company. Insurance is also used as a means by which the ultimate responsibility to pay the benefits promised is transferred to the insurance company through the issuance of an individual annuity insurance policy to the pension fund member.

The Company also takes a lead role in developing and directing the pensions market through pension trustee training events, publishing regular papers on the pensions market and information on how to address certain key issues for the commercial and the public sector such as managing pension costs and risk inherent in pension schemes. It has an active thought leadership programme in dealing with Government, corporate sponsors and pension trustees and working with them on pension solutions in the public and private sectors.

Trading during the year

The Company made a pre-tax profit in the year ended 31 December 2013 of £114m *(2012: £184m)*. The main contributory factors to the Company's profitability were the net favourable impact of investment market conditions on asset and liability valuations and longevity reinsurance treaties entered into during the year offset by the impact of new business written in the year. More details of how these factors have affected the financial results are set out in Notes 2 and 9.

During the year PIC wrote a further 35 *(2012:20)* new schemes with a total premium value of £3.7bn *(2012: £1.5bn)*.

By the end of 2013 PIC had total financial assets under management of £8.8bn (including net derivative assets), compared to £5.6bn at the end of 2012. The increase of £3.2bn was principally due to the new business premiums received as well as the effect of reinsurance contracts and market movements during the year.

PIC concluded one quota share and two longevity swap reinsurance transactions during the year which covered longevity risk on c.£1.5bn of insurance liabilities. At 31 December 2013 60% of PIC's total longevity exposure on a statutory solvency basis was reinsured to third party, investment grade reinsurer counterparties *(2012: 65%)*.

The Company is now responsible for paying the pensions of 96,600 individuals *(2012: 64,000)*. Payment of annuities grew by 40% in 2013 to £291m *(2012: £208m)* as a result of new business written during the year. Total pension amounts paid were £349m *(2012: £236m)*, an increase of 48% as the growth in annuities was exceeded by a growth in lump sum payments and transfers out compared to the previous year.

At the end of 2013 PIC has 37,000 current individual policies in issue, in respect of 36 schemes, up from 35,400 in respect of 25 schemes a year ago. The remaining schemes are either in the transition process, which includes the verification of scheme data and finalisation of liabilities prior to individual policies being issued by PIC, or are buy ins under which no individual policies are issued. The growth in the number of policies in issue is also affected by reductions due to leavers, transfers and deaths.

The directors remain positive about both the Company's own financial position and the growth potential of its market and the Company's ability to participate in that growth.

Business Review (continued)

Solvency

The Company has complied with the regulatory capital requirements under Pillar 1 as set out in the relevant PRA rules (see note 16) throughout the year and continues to do so. In addition, based on the Company's Individual Capital Assessment, it is the directors' view that the Company has held capital comfortably in excess of its Pillar 2 requirements during the same period.

The Company's statutory solvency ratio at 31 December 2013 was 249% *(2012: 251%)* and it had net assets which were £537m *(2012: £357m)* in excess of statutory requirements.

Solvency II

The European Union ("EU") is developing a new solvency framework for insurance companies, referred to as Solvency II. The Solvency II Directive was formally approved by the Economic and Financial Affairs Council in November 2009. The new approach is based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements.

An update to the Directive known as OMNIBUS II will be voted on in March 2014 and will, amongst other things, set the implementation date to 1 January 2016.

The Company has continually assessed the developing requirements of Solvency II and maintained an implementation programme, under direct oversight of the Board, to ensure that the Company is well-placed to achieve compliance with the new solvency regime. This includes compliance with the regulatory Interim Guidelines, under which the Company will submit Solvency II based reporting to the PRA covering 2014 and 2015 data.

Material Contracts

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

Strategy

The Company has continued with its strategy of seeking pension insurance business across all segments including the corporate and public sectors and insurer to insurer business. This strategy has been executed by identifying opportunities which meet PIC's internal criteria for proceeding with an insurance transaction and which the trustees of the pension scheme will find attractive and beneficial to members.

The escalating financial cost to pension schemes and their sponsors of pension provision, arising from volatility in asset performance, increases in life expectancy and the need to match assets more closely with liabilities (in order to comply with ever more stringent accounting and funding regime standards) have driven corporate sponsors to look increasingly at the benefit of transferring the risks associated with their defined benefit pension funds to the security of an insurance company regulated by the PRA, such as PIC.

Accordingly the size of PIC's potential market continues to increase and is influenced by the perceived affordability and benefits of the insurance offered. The directors believe that, as the market matures and pension insurance becomes more commonplace, these solutions will continue to be perceived as increasingly affordable and necessary.

Key Performance Indicators

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

Measures of assets & liabilities	**As at 31 December 2013**	As at 31 December 2012
Regulatory surplus		
Statutory surplus	**£537m**	£357m
Statutory solvency ratio	**249%**	251%
Embedded value (PCG)	**£1,290m**	£890m
Measures of income & expenditure		
New business (gross of reinsurance)		
Premiums written	**£3,663m**	£1,512m
Cost base		
Acquisition expenses	**£37m**	£29m
Other management expenses	**£9m**	£16m

Embedded value has been prepared in accordance with the European Embedded Value ("EEV") Principles issued in May 2004 by the European CFO Forum, as supplemented by the Additional Guidance on EEV Disclosures issued in October 2005.

Principal risks and uncertainties

The principal risks affecting the Company's business and its strategy for managing those risks are set out in detail in Note 13 to the financial statements.

On behalf of the Board

14 Cornhill
London
EC3V 3ND

John Coomber
Chief Executive

13 March 2014

Directors' report for the year ended 31 December 2013

Directors and their interests

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

Sir Mark Weinberg	Chairman	Non- Executive
John Coomber	Chief Executive	Executive
Tracy Blackwell		Executive
Rob Sewell		Executive
Tim Hanford		Non- Executive
Harriet Maunsell		Non- Executive
Chris McKechnie		Non- Executive
Eloy Michotte		Non- Executive
Nicholas Parker		Non- Executive
Bill Winters		Non- Executive

None of the directors who held office at the end of the financial year had any disclosable interest in the shares of the Company.

Issue of shares

The Company issued 50m £1 ordinary shares at par on 7 May 2013 and 174m £1 ordinary shares at par on 8 July 2013. Both issues were fully paid and wholly subscribed by Pension Holding Company 3 Limited, the immediate parent company, for cash consideration.

Dividends

The directors do not recommend a dividend for the year *(2012: nil).*

Creditors policy

The Company's policy in relation to its suppliers is to set the terms of payment at 30 days and to abide by those terms, provided that it is satisfied that the supplier has provided the goods or services in accordance with the agreed terms and conditions. Where specific terms and conditions have been agreed which vary from the Company's standard payment terms, it accepts responsibility to comply with them.

Political and charitable contributions

The Company made no charitable donations during the year *(2012: nil)*. The Company made no political contributions during the year *(2012: 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 PCG 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.

Disclosure of Information to Auditors

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 Company's auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditor

KPMG Audit Plc has instigated an orderly wind down of business. The Board has decided to recommend KPMG LLP to be appointed as auditors and a resolution concerning their appointment will be presented to a forthcoming Board meeting.

On behalf of the Board

14 Cornhill
London
EC3V 3ND

John Coomber
Chief Executive

13 March 2014

Statement of Directors' responsibilities in respect of the strategic report, 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 financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards (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 company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company 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.

Report of KPMG Audit Plc to the members of Pension Insurance Corporation Limited

Independent auditor's report to the members of Pension Insurance Corporation Limited

We have audited the financial statements of Pension Insurance Corporation Limited for the year ended 31 December 2013 set out on pages 11 to 50. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Report of KPMG Audit Plc to the members of Pension Insurance Corporation Limited

Independent auditor's report to the members of Pension Insurance Corporation Limited

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

M Wilson

Mostyn Wilson **(Senior Statutory Auditor)**
for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants

KPMG Audit Plc
15 Canada Square,
London,
E14 5GL

13 March 2014

Pension Insurance Corporation Limited

Statement of comprehensive income
for the year ended 31 December 2013

	Note	**Year ended 31 December 2013** £m	**£m**	Year ended 31 December 2012 £m	£m
Revenue					
Gross premiums written		**3,663**		1,512	
Outward reinsurance premiums	*9(f)*	**(323)**		(153)	
Net premium revenue earned			**3,340**		1,359
Investment return	*2*		**74**		434
Total revenue (net of reinsurance premiums)			**3,414**		1,793
Expenses					
Claims paid – gross		**(349)**		(236)	
Reinsurers' share of claims paid	*9(f)*	**19**		16	
			(330)		(220)
Increase in insurance liabilities – gross		**(3,223)**		(1,578)	
Increase in reinsurers' share of insurance liabilities	*9(f)*	**317**		247	
			(2,906)		(1,331)
Acquisition expenses	*3*	**(37)**		(29)	
Other operating expenses	*4*	**(27)**		(29)	
			(64)		(58)
Total claims and expenses			**(3,300)**		(1,609)
Profit before taxation			**114**		184
Income tax charge	*7*		**(27)**		(44)
Profit for the year			**87**		140
Other comprehensive income			**-**		-
Total comprehensive income			**87**		140

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 15 to 50 form an integral part of these financial statements.

Statement of changes in equity

for the year ended 31 December 2013

31 December 2013	**Share Capital £m**	**Other Reserves £m**	**Retained Profit £m**	**Total £m**
At beginning of year	**401**	**60**	**174**	**635**
Total comprehensive income for the year	**-**	**-**	**87**	**87**
Share capital issued for cash consideration	**224**	**-**	**-**	**224**
At end of year	**625**	**60**	**261**	**946**

31 December 2012	Share Capital £m	Other Reserves £m	Retained Profit £m	Total £m
At beginning of year	325	60	34	419
Total comprehensive income for the year	-	-	140	140
Share capital issued for cash consideration	76	-	-	76
At end of year	401	60	174	635

The accounting policies and notes on pages 15 to 50 form an integral part of these financial statements.

Pension Insurance Corporation Limited

Statement of financial position
as at 31 December 2013

	Note	31 December 2013 £m	31 December 2013 £m	31 December 2012 £m	31 December 2012 £m
Assets					
Investment properties	*8*		**93**		87
Reinsurers' share of insurance liabilities	*9*		**1,356**		1,039
Receivables and other financial assets	*11*		**184**		146
Prepayments			**28**		17
Financial investments	*11*		**8,936**		5,366
Derivative assets	*12*		**2,898**		2,048
Cash and cash equivalents	*11*		**-**		-
Total Assets			**13,495**		8,703
Equity					
Share capital	*14*	**625**		401	
Other reserves	*15*	**60**		60	
Retained profit	*15*	**261**		174	
Total Equity			**946**		635
Liabilities					
Gross insurance liabilities	*9*	**9,437**		6,214	
Deferred tax liability	*10*	**7**		9	
Derivative liabilities	*12*	**3,033**		1,788	
Insurance and other payables	*11*	**47**		14	
Current taxation		**12**		27	
Accruals	*11*	**13**		16	
Total Liabilities			**12,549**		8,068
Total Equity and Liabilities			**13,495**		8,703

The accounting policies and notes on pages 15 to 50 form an integral part of these financial statements.

The financial statements were approved by the directors on 13 March 2014 and were signed on its behalf by:

Rob Sewell
Director

Pension Insurance Corporation Limited

Statement of cash flows
for the year ended 31 December 2013

	Note	**Year ended 31 December 2013**		Year ended 31 December 2012	
		£m	**£m**	£m	£m
Cash flows from operating activities					
Profit for the year			**87**		140
Comprising:					
Interest income	*2*		**208**		140
Other operating activities (net)			**(94)**		44
Income tax	*7*		**(27)**		(44)
Adjustments for non-cash movements:					
Movement in accrued interest		**(27)**		(26)	
Revaluation of investment properties	*8*	**(6)**		(3)	
Movement in tax provisions		**27**		44	
			(6)		15
Changes in operating assets and liabilities					
Increase in receivables and other financial assets		**(10)**		(63)	
Increase in financial investments including derivative assets		**(4,420)**		(1,952)	
Increase in prepayments		**(11)**		(3)	
Increase in reinsurers' share of insurance liabilities		**(317)**		(247)	
Increase in insurance liabilities		**3,223**		1,578	
Increase in financial liabilities including derivative liabilities		**1,245**		492	
Increase/(decrease) in insurance and other payables		**31**		(22)	
(Decrease)/increase in accruals		**(2)**		4	
			(261)		(213)
Cash outflow from operating activities			**(180)**		(58)
Cash inflow from financing activities					
Proceeds from issue of share capital			**224**		76
Taxation					
Taxation paid			**(44)**		(18)
Net increase in cash and cash equivalents			**-**		-
Cash and cash equivalents at beginning of year			**-**		-
Cash and cash equivalents at end of year			**-**		-

The accounting policies and notes on pages 15 to 50 form an integral part of these financial statements.

1. Accounting policies

(a) Basis of preparation

The financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU") and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements also comply with the Statement of Recommended Practice on Accounting for Insurance Business (issued by the Association of British Insurers in December 2005, as amended in 2006) in so far as these requirements do not contradict IFRS requirements.

These financial statements have been presented in millions of British Pounds (£m) unless otherwise stated. Prior years' financial statements were presented in millions of British Pounds with one decimal place. Comparative figures have been rounded to conform to the current year's presentation.

The Company has applied all IFRSs and interpretations adopted by the EU at 31 December 2013. It has not adopted the following standards which are not yet mandatory.

Implementation of IFRS 10 – Consolidated Financial Statements – effective for accounting periods beginning on or after 1 January 2014. Amendment to IAS 27- Separate Financial Statements

Implementation of IFRS 11 – Joint Arrangements – effective for accounting periods beginning on or after 1 January 2014. Amendment to IAS 28 Investments in Associates and Joint Ventures

Implementation of IFRS 12 – Disclosure of Interests in Other Entities – effective for accounting periods beginning on or after 1 January 2014.

Amendment to IFRS 9 – Financial Instruments – Classification and Measurement – effective for accounting periods beginning on or after 1 January 2015

Amendment to IAS 32 – Financial Instruments: Presentation – effective for accounting periods beginning on or after 1 January 2014.

Amendment to IAS 36 – Impairment of Assets – effective for accounting periods beginning on or after 1 January 2014.

The Company believes the adoption of the above Accounting Standards will not materially impact the results of the Company.

In 2013 the Company has implemented the following IFRS and amendments, which are now mandatory;

Implementation of IFRS 13 – Fair Value Measurement – effective for accounting periods beginning on or after 1 January 2013.

Amendment to IAS 1 – Presentation of Financial Statements – effective for accounting periods beginning on or after 1 July 2012.

Amendment to IAS 19 – Employee Benefits – effective for accounting periods beginning on or after 1 January 2013.

There is no material effect on the results of the Company arising from these implementations.

(b) Recognition and derecognition of financial instruments

A financial instrument is recognised if the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Company's contractual rights to the cash flows from the financial assets expire, or if either the Company 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 the date of trading. Financial liabilities are derecognised when the Company's obligations specified in the contract expire or are discharged or cancelled.

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 Company has classified all its policyholder contracts as insurance contracts.

(d) Premiums

Premiums are received in consideration for taking on pension scheme liabilities. They are recognised and valued on the day risk is accepted. Retrospective adjustments to premiums may be required following work performed during the transition of a scheme prior to completion of a full buy-out. Such adjustments are recognised and valued at the date they become payable or receivable by the Company.

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 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 sale proceeds and the 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.

1. Accounting policies (continued)

(h) 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 Company 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.

(i) Investment properties

Investments in freehold properties not for occupation by the Company 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 and considered when estimating fair value.

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

(j) Financial instruments

All financial assets and financial liabilities with the exception of short term assets and liabilities and cash and cash equivalents are classified at fair value through profit or loss.

Financial instruments at fair value through profit or loss 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 11.

(k) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the Statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

1. Accounting policies (continued)

(l) Assets pledged as collateral

The Company 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, continues to be recognised in the Statement of financial position within the appropriate asset classification as the Company retains all rights relating to these assets. If the Company 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 Company acquires the rights relating to the economic risks and rewards relating to these assets. Where such assets are recognised the Company recognises a corresponding liability for the repayment in financial liabilities.

(m) 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.

(n) Foreign currencies

The functional currency of the Company is pounds sterling. The Company has chosen to present its financial statements in this currency.

Assets and liabilities denominated mainly in a foreign currency are translated into the functional currency at the foreign exchange rate ruling at the end of the financial year. All revenue and expense items are reflected in the Statement of comprehensive income at the rate effective at the date the transaction took place.

(o) 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.

(p) 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 scheme members on a timely basis.

1. Accounting policies (continued)

(q) Loans and receivables

Loans and receivables are either designated at fair value on inception, or are measured at fair value less transaction costs at initial recognition and subsequently measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate method.

The amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. Any resulting impairment loss is recorded in the Statement of comprehensive income. The amount of the impairment loss is the differences between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the Statement of comprehensive income to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

(r) Impairment of assets

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.

(s) Insurance liabilities

Insurance liabilities are determined by the Company's internal actuarial department, using methods and assumptions approved by the directors having regard to the advice of the Company's Actuarial Function Holder, and using recognised actuarial methods consistent with the principles laid down in Directive 2002/83/EC. The liabilities are calculated initially on a statutory solvency basis to comply with the reporting requirements under the Financial Services and Markets Act 2000. The liabilities are then modified to remove certain contingency and other reserves required under the regulations set out in INSPRU, the Prudential Sourcebook for Insurers issued by the Prudential Regulation Authority ("PRA"), which are not required to be recognised as insurance liabilities under IFRS 4.

Insurance liabilities comprise the discounted present value of future obligations to current policyholders, increased to take due account of future investment expenses and future administration expenses 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 9. These bases have been derived having regard to recent UK general population mortality experience, the demographic profile of the Company's in-force business and the Company's own internal mortality experience, and include an appropriate 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 makes allowance for the risk, including credit risk, associated with these assets. The calculation of the valuation rate of interest complies with the relevant PRA regulations (INSPRU 1.2.33R and INSPRU 3.1) adjusted for any modifications agreed with the PRA, or its predecessor the Financial Services Authority ("FSA") in respect of the Company's application of these regulations.

1. Accounting policies (continued)

(t) 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 Company 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 Company has two types of quota share reinsurance arrangements. The first type is a quota share agreement with Pension Security Insurance Corporation Limited ("PSIC"), a fellow subsidiary of PCG, covering all policyholder benefit payments for a proportion of the business reinsured. This proportion varies between 40% and 50% 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 Company has also entered into a number of longevity reinsurance contracts with 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 Company. Separately, there is also an insurance fee on each of these contracts for which the Company is liable. Settlement of the contract is on a net basis and amounts receivable from or payable to reinsurers are included in the appropriate heading under either "receivables and other financial assets" or "insurance and other payables".

Fees paid in respect of longevity reinsurance contracts are included under outward reinsurance premiums.

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

(u) Critical accounting policies, estimates and judgements

Included in the financial statements are certain critical accounting judgements as described below;

Insurance Liabilities

The Company is exposed to longevity risk, namely the risk that annuitant policyholders live longer than expected. In order to calculate the associated amount of insurance liabilities and the reinsurers' share of these liabilities, the Company makes assumptions relating to the incidence of deaths for each year of the duration of the insurance contracts. These assumptions are reconsidered annually and are based on standard mortality tables including an allowance for future longevity improvements and are adjusted to reflect the anticipated experience for each of the schemes acquired.

The Company has reinsured a proportion of its longevity risk through the use of reinsurance contracts. The anticipated effect of these contracts is reflected as an asset within the Statement of financial position.

The carrying value of insurance liabilities net of reinsurance at the end of the financial year is £8.1bn *(2012: £5.2bn*). The assumptions used to establish insurance contract liabilities and appropriate sensitivities relating to variations in these assumptions are disclosed in Note 9.

Notes to the financial statements for the year ended 31 December 2013 (continued)

1. Accounting policies (continued)

(u) Critical accounting policies, estimates and judgements (continued)

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.

2. Investment return

	Year ended 31 December 2013		Year ended 31 December 2012	
	£m	**£m**	£m	£m
Interest income on cash deposits	**5**		1	
Income from debt securities	**199**		135	
Income from loans secured by mortgage	**4**		4	
Interest income		**208**		140
Rental income	**5**		5	
Income from other investments				
- Investment schemes	**1**		1	
- Other asset backed securities	**9**		9	
- Other investments	**13**		14	
		28		29
Total investment income		**236**		169
Realised gains on investments	**440**		190	
Realised losses on investments	**(76)**		(97)	
Net realised gains		**364**		93
Unrealised gains on investments	**165**		312	
Unrealised losses on investments	**(691)**		(140)	
Net unrealised gains		**(526)**		172
Investment return		**74**		434

3. Acquisition expenses

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Acquisition expenses	**37**	29

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

4. Other operating expenses

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Investment charges and related expenses	**18**	13
Other expenses	**9**	16
	27	29

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

The auditor's remuneration relating to the audit of these financial statements was £158,924 *(2012: £154,316)*.

In addition the auditors received £27,281 *(2012: £34,646)* for other services pursuant to such legislation.

Charges for other services relating to taxation were £142,608 *(2012: £122,000)* and charges for all other services provided were £68,643 *(2012: £550,201).*

6. Directors remuneration, employee costs and headcount

PSC was the main provider of management, staff, IT and office services to the Company, under a defined service agreement, throughout the year.

The Company employs no staff directly as all staff were provided by PSC during the year.

The costs of directors and employees of the Company for the year were as follows;

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Wages and salaries	**14**	13
Social security costs	**2**	1
Other pension costs	**-**	-
	16	14

The Company has ten directors who served during the year *(2012: thirteen)*. All of the directors were employed by or contracted by the Company's service providers. The total remuneration received by the directors for their services, was £3m *(2012: £2m)*.

The amount of remuneration received by the highest paid director was £1m *(2012: £1m)*. These amounts relate solely to the services provided by the directors to the Company and do not include any payments due for services provided with regard to other group entities.

Two directors had money paid to money purchase pension schemes *(2012: nil)*. No directors, including the highest paid director, were eligible for shares or share options in the Company under a long term incentive scheme *(2012: nil)*. No directors exercised options in the Company during the year *(2012: nil)*.

7. Income tax

The Company's tax charge for the year is:

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Current taxation		
Income tax payable for the current year	**28**	44
Prior year under/(over) provision	**1**	(2)
Total current tax	**29**	42
Deferred taxation		
Recognition of deferred tax liability on temporary timing differences	**-**	3
Tax transitional adjustment	**(1)**	-
Effect of change in tax rates	**(1)**	(1)
Total deferred tax	**(2)**	2
Income tax charge	**27**	44

7. Income tax (continued)

The current tax charge for the period is higher *(2012:lower)* than the standard rate of corporation tax in the United Kingdom of 23.25% *(2012: 24.5%)*. The differences are explained below:

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Reconciliation of total income to the applicable tax rate		
Profit before taxation	**114**	**184**
Income tax at 23.25% *(2012:24.5%)*	**26**	**45**
Effects of:		
Expenses not deductible for tax purposes	**1**	**1**
Prior year under/(over) provision	**1**	**(1)**
Effect of change in tax rates	**(1)**	**(1)**
Income tax charge	**27**	**44**

Factors that may affect future tax charges

A new tax regime commenced in January 2013 which changed the calculation of taxable profits of insurance companies. The main change in the new regime is that the tax payable is based upon IFRS profits rather than those disclosed in the annual returns to the PRA. This generally results in higher taxable profits as certain reserves required to calculate solvency under the PRA rules are not permitted under IFRS.

The Company has incorporated the effects of the enacted legislation in calculating its deferred tax liability at 31 December 2013.

Following the 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 10 years. Consequently the Company has recognised a deferred tax liability at 31 December 2013 of £7m *(2012: £9m)* in respect of these timing differences which total £37m *(2012: £41m).*

The deferred tax liability has been calculated using the enacted tax rates at which the temporary timing differences are expected to reverse. The rates used by the Company in the calculation at 31 December 2013 are:

21% - effective from 6 April 2014, and
20% - effective from 6 April 2015

The rate used at 31 December 2012 was 23%.

The Company has no other timing differences or tax losses carried forward at 31 December 2013 which may give rise to reduced tax charges in future periods *(2012:nil).*

8. Investment property

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
At beginning of year	**87**	84
Revaluation during the year	**6**	3
At end of year	**93**	87

The Company holds 99.9% of the issued units in eight Guernsey registered property unit trusts ("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.

Rental income received in relation to these properties is shown within investment return in Note 2.

9. 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 Company's liabilities in relation to future policyholders' benefits are:

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Future policyholders' benefits		
Gross	**9,437**	6,214
Reinsurance	**(1,356)**	(1,039)
Net	**8,081**	5,175

The gross insurance liabilities shown above are stated in accordance with the Company's accounting policies as set out in Note 1. The figures exclude reserves which are required for the calculation of statutory solvency under the PRA rules but which are considered unlikely to occur 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. They also include £306m *(2012: £317m)* of liabilities which are reinsured under a quota share agreement with PSIC.

9. Insurance contracts and related insurance liabilities (continued)

a) Terms and conditions of insurance contracts

The Company'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 and/or dependants on the death of the main member.

The Company'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 "buy-out" 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 below.

b) Principal assumptions used in the preparation of insurance liabilities

Mortality assumptions

The base mortality assumptions as at 31 December 2013 inherent in the projected cash flows used in the valuation of insurance contract liabilities are set with reference to the following mortality tables published by the Continuous Mortality Investigation (a research body owned by the Institute and Faculty of Actuaries in the UK) ("CMI"):

- S1PMA, S1PFA & S1DFA
- PCMA00 & PCFA00
- PCML00 & PCFL00
- PNML00 & PNFL00

The above tables are the same as those used in preparing the mortality assumptions for the previous year.

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.

An allowance for future mortality improvements from 31 December 2013 has been made by applying a separate set of reduction factors to mortality rates relating to future calendar years for each gender.

The 2012 CMI mortality improvement table has been used in preparing these assumptions.

9. Insurance contracts and related insurance liabilities (continued)

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

Valuation rate of interest ("VRI")

The Company has applied the requirements of INSPRU 1.2.33R in calculating the VRI. Within the calculation it has applied a direction made by the FSA in May 2010, on the application of the Company, under section 148 of the Financial Services and Markets Act 2000. The effect of the direction is to modify the provisions of INSPRU 3.1.35R and IPRU(INS) Appendix 9.3 so that the Company can use a more appropriate rate of interest based on the yields on all of the assets backing its liabilities taken in combination.

The VRI is adjusted to reflect the risk, including credit risk, associated with the assets held to match liabilities. The regulatory requirements set out in INSPRU 3.1 state that the VRI should be set at 97.5% of the risk-adjusted yield on the assets backing the liabilities, with a further reduction for reinvestment risk. The rate calculated in accordance with these rules as at 31 December 2013 for PIC was 3.90% for index-linked liabilities and 3.86% for non-linked liabilities, giving an effective combined rate of 3.89% *(2012: 3.34%)*.

Inflation

Assumptions for expected future Retail Price Index ("RPI") inflation are based on a curve derived from market prices of inflation-linked swap contracts. For Limited Price Index ("LPI") 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, project costs, 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. No allowances are included for expenses incurred by the Company in relation to the generation of new business.

9. Insurance contracts and related insurance liabilities (continued)

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 reason for the increase is the new business written in the year. In addition, a rise in interest rates combined with a reduction in credit spreads has led to an increase in the VRI and hence to a decrease in the value of the insurance liabilities.

The movement between the insurance liabilities at the beginning and the end of year is explained as follows:

2013	**Gross £m**	**Reinsurance £m**	**Net £m**
At beginning of year	**6,214**	**(1,039)**	**5,175**
Increase in liability from new premiums	**3,681**	**(357)**	**3,324**
Reduction in liability from claims	**(340)**	**12**	**(328)**
Changes in economic assumptions	**(236)**	**21**	**(215)**
Changes in non-economic assumptions	**42**	**4**	**46**
Other movements (including net investment return)	**76**	**3**	**79**
At end of year	**9,437**	**(1,356)**	**8,081**

2012	Gross £m	Reinsurance £m	Net £m
At beginning of year	4,636	(791)	3,845
Increase in liability from new premiums	1,418	(177)	1,241
Reduction in liability from claims	(237)	16	(221)
Changes in economic assumptions	313	(47)	266
Changes in non-economic assumptions	44	(42)	2
Other movements (including net investment return)	40	2	42
At end of year	6,214	(1,039)	5,175

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:

Economic assumptions

The primary economic assumption changes during the year are in respect of the VRI and the assumptions for future rates of inflation. As explained above, the VRI is the rate at which future cash flows are discounted in determining liabilities, so an increase in VRI will decrease the present value of future liabilities. The assumed future inflation rate has a direct impact on both inflation-linked liability cash flows and future expenses, and therefore an increase in inflation will increase the value of future liabilities.

Non-economic assumptions

There have been a number of changes to the non-economic assumptions over the year, including updated per-policy and investment management expense assumptions and changes to the assumptions for base-level mortality and future longevity improvements.

9. Insurance contracts and related insurance liabilities (continued)

d) Analysis of expected maturity of 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	**33**	**172**	**683**	**1,961**	**2,849**
Reinsurance	**(4)**	**(21)**	**(73)**	**(710)**	**(808)**
As at 31 December 2013	**29**	**151**	**610**	**1,251**	**2,041**
Annuities in payment					
Gross	**388**	**1,460**	**2,637**	**2,103**	**6,588**
Reinsurance	**(5)**	**(34)**	**(136)**	**(373)**	**(548)**
As at 31 December 2013	**383**	**1,426**	**2,501**	**1,730**	**6,040**

	Within one year £m	In 1 -5 years £m	In 5 -15 years £m	Over 15 years £m	Total £m
Deferred annuities					
Gross	16	94	381	1,085	1,576
Reinsurance	(2)	(13)	(55)	(415)	(485)
As at 31 December 2012	14	81	326	670	1,091
Annuities in payment					
Gross	252	974	1,904	1,508	4,638
Reinsurance	(7)	(37)	(140)	(370)	(554)
As at 31 December 2012	245	937	1,764	1,138	4,084

9. Insurance contracts and related insurance liabilities (continued)

e) Sensitivity analysis

In accordance with IFRS 4 and IFRS 7 "*Financial Instruments"* the directors have considered the effect on profit or loss and equity at 31 December 2013 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	
	Increase of 50bps £m	Fall of 50bps £m	Increase of 50bps £m	Fall of 50bps £m
Movement in assets	(510)	571	311	(279)
Movement in liabilities	506	(567)	(303)	290
Tax effect	1	(1)	(2)	(3)
Movement in profit and equity	(3)	3	6	8

	Base Mortality (see below) £m	Mortality Improvements (see below) £m	Expenses (see below) £m	Credit spreads Increase of 25bps £m
Movement in assets	-	-	-	(142)
Movement in liabilities	(12)	(25)	(30)	78
Tax effect	3	6	7	15
Movement in profit and equity	(9)	(19)	(23)	(49)

Parameters for longevity and renewal expense sensitivities

The base mortality sensitivity is based on a 1% decrease in the base mortality rates.

The mortality improvements sensitivity is based on a 0.1% increase in annual mortality improvement rates.

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 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 Company's use of derivatives is designed to ensure that its exposure to market risk is hedged.
- There is no significant currency risk on the Company's business and the associated sensitivity analysis has therefore not been shown.

9. Insurance contracts and related insurance liabilities (continued)

f) Reinsurance results

The effect of reinsurance contracts entered into by the Company on profit before taxation is as follows:

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Outward reinsurance premiums	**(323)**	(153)
Reinsurers' share of claims paid	**19**	16
Changes in reinsurers' share of insurance liabilities	**317**	247
Net effect of reinsurance contracts on profit before taxation	**13**	110

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:

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Amounts payable in respect of insurance fees	**10**	8
Current year premiums payable in respect of quota share arrangements	**313**	145
Outward reinsurance premiums	**323**	153

10. Deferred tax

At 31 December 2013 the Company's deferred tax balances calculated in accordance with IAS 12 *"Income Taxes"* were as follows:

	Asset £m	**Liability £m**	**Total £m**
31 December 2013			
Tax transitional adjustment	**-**	**(7)**	**(7)**
31 December 2012			
Tax transitional adjustment	-	(9)	(9)

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

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
At beginning of year	**(9)**	(7)
Recognition of deferred tax liability on temporary timing differences	**-**	(3)
Effect of tax transitional adjustment	**1**	-
Effect of change in tax rates	**1**	1
At end of year	**(7)**	(9)

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 tax transitional adjustment arose following the introductuion of a new tax regime that commenced in January 2013 which changed the calculation of taxable profits of insurance companies (see note 7). The Company has no timing differences or tax losses carried forward at 31 December 2013 *(2012: nil)* which may give rise to reduced tax charges in future periods.

11. Financial assets and financial liabilities

All of the Company'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.

	31 December 2013		31 December 2012	
Financial Assets	**Fair value through profit and loss**	**Amortised cost**	Fair value through profit and loss	Amortised cost
	£m	**£m**	£m	£m
Financial investments				
Debt securities	**7,552**		4,347	
Mortgage backed and other asset backed securities	**437**		377	
Deposits with credit institutions	**94**		57	
Participation in investment schemes	**686**		453	
Collateralised loan obligations	**167**		132	
Total financial investments	**8,936**	**-**	5,366	-
Derivative assets	**2,898**		2,048	
Loans and receivables and other financial assets				
Debtors arising out of direct insurance operations		**55**		67
Other debtors		**35**		12
Accrued interest		**94**		67
Total receivables and other financial assets		**184**		146
Total Financial Assets	**11,834**	**184**	7,414	146
Financial Liabilities				
Derivative liabilities	**3,033**		1,788	
Creditors arising out of reinsurance operations		**3**		2
Other creditors		**44**		12
Insurance and other payables		**47**		14
Accruals		**13**		16
Total Financial Liabilities	**3,033**	**60**	1,788	30

Included within receivables and other financial assets are amounts totalling £18m *(2012: £48m)* 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.

11. Financial assets and financial liabilities (continued)

Other loans

As at 31 December 2012 the Company held a loan investment in Co-Investment Limited, a limited company incorporated in Guernsey, with a face value of £29m. The loan accrued interest at 0.6% above LIBOR and had a maturity date of 16 December 2013.

Following a valuation exercise based on information made available to PIC during 2012 regarding the trading performance of the assets underpinning the loan, the directors assessed its fair value at 31 December 2012 to be £nil and recognised a charge of £29m related to the impairment of this loan in the Statement of comprehensive income.

Included in the terms of the loan were provisions for all rights to be transferred from PIC to Pension Holding Company (UK) 3 Limited ("PHC3"), the immediate parent company, should Co-Investment Limited not repay the loan before the maturity date. As the loan remained unpaid on maturity, the Company passed all rights under the terms of the loan to PHC3 on 20 December 2013 in return for a loan note valued at £1.

As a result of the transfer of rights on maturity to PHC3, the Company has recognised a £29m realised loss in the year and reversed the £29m unrealised impairment recognised in 2012.

Other debtors

Other debtors includes three inter group loans made by PIC to PHC3 totalling £5m.

The first loan has no fixed maturity date and is repayable on demand by either party. Interest is payable on this loan at 2% above LIBOR. The balance outstanding at 31 December 2013 was £74,600 *(2012: £77,800).*

The second loan is for £5m, is non-interest bearing and has no fixed maturity date. The directors have considered the specific circumstances surrounding the value of this loan and have determined that the fair value at 31 December 2013 is £nil *(2012: £5m*). An unrealised impairment of £5m is included in the Statement of comprehensive income.

The third loan has a value of £1 and was provided on 20 December 2013 as consideration for the transfer of the loan investment in Co-Investment Limited. It has no fixed maturity date and is repayable at the discretion of PHC3. Interest is payable on this loan at 2.5% above LIBOR calculated quarterly.

11. Financial assets and financial liabilities (continued)

Deposits with credit institutions

Deposits with credit institutions include £10m *(2012: £10m)* in two bank accounts 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 Munchener Ruckversicherungsgesellschaft ("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.

The Company 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

At 31 December 2013 the Company has included £279m *(2012: £88m)* of financial assets which have been pledged as security under the terms of derivative contracts. The Company 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.

Measurement of financial assets and liabilities

The Company's financial assets and liabilities have been valued using the following methods in accordance with IAS 39 *"Financial Instruments"*.

The fair values of quoted investments are based on their bid market prices. For unlisted securities and all other financial assets for which there is no active market, the Company 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. These include infrastructure and other loans in respect of capital projects for which there is no active market. These investments have been included in Level 3 within the fair value hierarchy.

11. Financial assets and financial liabilities (continued)

Measurement of financial assets and liabilities (continued)

b) Derivatives

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. The fair value of foreign exchange forward contracts, futures and swaps are based on market prices, where available. Derivative contracts may not be readily tradeable and consequently most of the derivative contracts (other than swaps) have been classified as Level 2 assets within the fair value hierarchy.

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. Where the market is illiquid or inactive so that market prices do not provide an accurate indication of fair value, the data inputs to the discounted cash flows may be drawn from historic trends or other appropriate information sources. At 31 December 2013 the Company has used the historic volatility in the RPI to derive the implied future volatility in the pricing of its LPI swaps as if the market in those swaps were liquid. Given the valuation methodology indicated all swaps assets are included at Level 3 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.

c) Mortgage backed and other asset backed securities

The fair value of mortgage backed and other asset backed securities is determined by reference to their listed market price. The assets are not expected to be disposed of within 12 months of the end of the financial year. 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.

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.

e) Other loans

The value of other loans is based on their amortised cost adjusted for any impairment in value. In determining the value at the Statement of financial position date, the directors consider the specific circumstances surrounding the value of each loan on an individual basis.

f) Collateralised loan obligations

The fair value of collateralised loan obligations ("CLOs") is calculated using discounted cash flow techniques on a mark to model basis. As the market for CLOs is illiquid and each individual note is unique in respect of its cash flow and risk profile, the parameters of the valuation model are based on data inputs drawn from a number of sources including monthly reports from the trustee of each CLO, the capital structure and risk profile of each note, market data such as interest rate curves and recently traded prices of the comparable CLO transactions. Given the valuation methodology indicated all CLO assets are included at Level 3 within the fair value hierarchy.

11. Financial assets and financial liabilities (continued)

Measurement of fair value

The following table analyses the Company's financial investments according to the basis of measurement required by IFRS 7:

31 December 2013	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Debt securities	**2,682**	**4,254**	**616**	**7,552**
Mortgage backed and other asset backed securities	**-**	**437**	**-**	**437**
Deposits with credit institutions	**94**	**-**	**-**	**94**
Participation in investment schemes	**355**	**331**	**-**	**686**
Collateralised loan obligations	**-**	**-**	**167**	**167**
Financial investments	**3,131**	**5,022**	**783**	**8,936**
Derivative assets	**24**	**2,837**	**37**	**2,898**
Financial assets	**3,155**	**7,859**	**820**	**11,834**
Derivative liabilities	**-**	**(3,020)**	**(13)**	**(3,033)**

31 December 2012	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Debt securities	1,218	2,929	200	4,347
Mortgage backed and other asset backed securities	-	377	-	377
Deposits with credit institutions	57	-	-	57
Participation in investment schemes	81	372	-	453
Collateralised loan obligations	-	-	132	132
Financial investments	1,356	3,678	332	5,366
Derivative assets	2	1,996	50	2,048
	1,358	5,674	382	7,414
Derivative liabilities	(1)	(1,787)	-	(1,788)

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.

There were no assets held at 1 January and 31 December 2013 that were reclassified during the year *(2012: none)*. All movements relate to acquisitions and disposals, realised and unrealised gains.

Notes to the financial statements for the year ended 31 December 2013 (continued)

11. Financial assets and financial liabilities (continued)

Measurement of fair value (continued)

Movements relating to Level 3 assets during the reporting period are analysed as follows:

Year ended 31 December 2013	**Swaps £m**	**CLOs £m**	**Debt Securities £m**	**Total £m**
Opening balance	**50**	**132**	**200**	**382**
Unrealised gains	**14**	**27**	**24**	**65**
Unrealised losses	**(25)**	**(4)**	**(12)**	**(41)**
Acquisitions in year	**-**	**42**	**405**	**447**
Disposals in year	**(15)**	**(30)**	**(1)**	**(46)**
Closing balance	**24**	**167**	**616**	**807**

Year ended 31 December 2012	Other loans £m	Swaps £m	CLOs £m	Debt Securities £m	Total £m
Opening balance	115	59	88	22	284
Unrealised gains	-	-	19	13	32
Unrealised losses	(29)	(9)	(2)	-	(40)
Acquisitions in year	-	-	40	165	205
Disposals in year	(86)	-	(13)	-	(99)
Closing balance	-	50	132	200	382

Swap assets are stated net of swap liabilities in the above table.

11. Financial assets and financial liabilities (continued)

Measurement of fair value (continued)

The investment return within the Statement of comprehensive income includes the following income and investment gains and losses relating to Level 3 assets:

Year ended 31 December 2013	**Swaps**	**CLOs**	**Debt Securities**	**Total**
	£m	**£m**	**£m**	**£m**
Interest income	**-**	**-**	**-**	**-**
Income from debt securities	**-**	**-**	**8**	**8**
Income from other investments	**-**	**5**	**-**	**5**
Realised gains	**-**	**4**	**-**	**4**
Relaised losses	**(20)**	**-**	**-**	**(20)**
Unrealised gains	**14**	**27**	**24**	**65**
Unrealized losses	**(25)**	**(4)**	**(12)**	**(41)**
Investment return on Level 3 assets	**(31)**	**32**	**20**	**21**

Year ended 31 December 2012	Other loans	Swaps	CLOs	Debt Securities	Total
	£m	£m	£m	£m	£m
Interest income	-	-	1	1	2
Income from debt securities	-	-	-	3	3
Income from other investments	-	-	4	-	4
Realised gains	-	-	-	-	-
Realised losses	(73)	-	(2)	-	(75)
Unrealised gains	-	-	19	13	32
Unrealised losses	(29)	(9)	(2)	-	(40)
Investment return on Level 3 assets	(102)	(9)	20	17	(74)

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.

11. Financial assets and financial liabilities (continued)

Measurement of fair value (continued)

The following table shows the effect on the fair value of Level 3 financial assets from changes in unobservable inputs to a reasonable alternative for the valuation assumptions.

2013	**Main assumptions**	**Sensitivity**	**Current fair value £m**	**Increase in fair value £m**	**Decrease in fair value £m**
Swaps	Volatilities	+/- 100bps Interest Rate	**24**	**1**	**(1)**
CLOs	Interest rates and cashflows	+/- 100bps Interest Rate	**167**	**5**	**(10)**
Debt securities	Interest rates	+/- 50bps Interest Rate	**616**	**30**	**(28)**
			807	**36**	**(39)**

2012	Main assumptions	Sensitivity	Current fair value £m	Increase in fair value £m	Decrease in fair value £m
Swaps	Volatilities	+/- 100bps Interest Rate	50	1	(1)
CLOs	Interest rates and cashflows	+/- 100bps Interest Rate	132	8	(11)
Debt securities	Interest rates	+/- 50bps Interest Rate	200	11	(12)
			382	20	(24)

12. Derivative financial instruments

The Company 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 Company against the adverse effects of inflation over a period of time, while the Company 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 2013		31 December 2012	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Interest rate swaps	**561**	**(788)**	747	(506)
Inflation swaps	**149**	**(111)**	133	(145)
Credit default swaps	**3**	**-**	-	(1)
Currency swaps	**1**	**(2)**	5	-
Total return swaps	**-**	**-**	16	-
Foreign exchange forward contracts	**2,160**	**(2,132)**	1,144	(1,135)
Futures	**24**	**-**	3	(1)
Total derivative position	**2,898**	**(3,033)**	2,048	(1,788)

13. Risk management

As a provider of insurance solutions to defined benefit pension schemes, the Company's business involves the acceptance and management of risk to achieve its strategic objectives.

The principal risk factors which affect the Company'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 Company's business and mainly arises from exposure to longevity in respect of annuity payments. Regulatory risk stems principally from the risk of changed solvency requirements including those arising from the still evolving Solvency II regulations, but also in the way the Company's regulators, the Prudential Regulatory Authority and the Financial Conduct Authority, deal with the Company. The main reputational risks relate to the need to maintain a good reputation with trustees of pension schemes and their advisors in order to attract new business, and with its own policyholders through treating its customers fairly.

The directors have overall responsibility for the management of the exposure to these risks. They are supported through formal committees of the Board including the Asset Liability Management Committee, Audit Committee, Origination 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 managing reputational risk.

The management and control of the Company's risks is a significant focus area for the Board, as an uncontrolled and unmanaged development in various risks may affect the Company's performance and capital adequacy. The Company 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 longevity risk, interest rate risk and inflation risk, which carry little reward for the Company. Such risks are managed and mitigated to the extent that it is cost effective to do so.

The Company uses derivatives for the purpose of efficient portfolio management or to reduce risk in aspects of the Company'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 Company uses 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 tactically control credit risk.

The Company monitors its exposure to risks through regular reviews of its portfolios of assets and liabilities and their underlying characteristics. Consequently the directors have chosen not to apply hedge accounting to the Company's derivatives

13. Risk management (continued)

a) Market risk

The Company 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 Company 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 Company 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 Company's policy is that after hedging, no more than 5% of the asset portfolio is exposed to currency fluctuations.

The Company 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 Company 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. Where appropriate the management of these alternative exposures is delegated to specialist fund managers, in line with well-defined investment management mandates. In all cases the Company ensures regular oversight of the investment management activities, and maintains detailed risk models for all investment types, fully incorporating analysis of alternative investments in its risk and capital assessment.

b) Credit risk

Credit risk is the risk of loss due to the default of another party in performing its financial obligations to the Company. The Company is primarily exposed to credit risk through its investment in debt securities and cash deposits within both the long term business fund and shareholder fund.

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 Company manages exposure to credit risk by placing limits on exposures to individual counterparties as well as groups of counterparties with the same characteristics. 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.

13. Risk management (continued)

b) Credit risk (continued)

The following table sets out the credit risk exposure and ratings of financial assets which are susceptible to credit risk. The ratings used are Bloomberg Composite except in instances where such a rating does not exist, in which case an S&P rating has been used. The remaining unrated assets are not classified by either rating agency.

31 December 2013	**AAA £m**	**AA £m**	**A £m**	**BBB £m**	**BB £m**	**Unrated £m**	**Total £m**
Loans and debt securities							
Debt securities	**625**	**2,528**	**1,420**	**2,041**	**25**	**913**	**7,552**
Mortgage backed and other asset backed securities	**18**	**140**	**113**	**143**	**4**	**19**	**437**
Collateralised loan obligations	**-**	**4**	**42**	**68**	**21**	**32**	**167**
	643	**2,672**	**1,575**	**2,252**	**50**	**964**	**8,156**
Other assets							
Collateralised derivative assets	**-**	**-**	**-**	**-**	**-**	**2,898**	**2,898**
Participation in investment schemes	**-**	**-**	**-**	**-**	**-**	**686**	**686**
Receivables and other financial assets	**19**	**9**	**21**	**37**	**1**	**97**	**184**
Deposits with credit institutions	**-**	**-**	**94**	**-**	**-**	**-**	**94**
	19	**9**	**115**	**37**	**1**	**3,681**	**3,862**

31 December 2012	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Total £m
Loans and debt securities							
Debt securities	1,770	318	855	1,065	31	308	4,347
Mortgage backed and other asset backed securities	112	83	81	86	2	13	377
Collateralised loan obligations	-	-	43	39	14	36	132
	1,882	401	979	1,190	47	357	4,856
Other assets							
Collateralised derivative assets	-	-	-	-	-	2,048	2,048
Participation in investment schemes	-	-	-	-	-	453	453
Receivables and other financial assets	22	5	13	21	1	84	146
Deposits with credit institutions	-	11	48	-	-	(1)	58
	22	16	61	21	1	2,584	2,705

13. Risk management (continued)

b) Credit risk (continued)

Although the instruments themselves are unrated, the ultimate issuing party for most collateralised derivative assets do have a credit rating. Applying the issuer rating to the assets held at 31 December 2013 produces the following split:

31 December 2013	**AAA £m**	**AA £m**	**A £m**	**BBB £m**	**BB £m**	**Unrated £m**	**Total £m**
Collateralised derivative assets	**-**	**302**	**2,596**	**-**	**-**	**-**	**2,898**

31 December 2012	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Total £m
Collateralised derivative assets	-	199	1,833	-	-	16	2,048

Eurozone exposure

At 31 December 2013 the Company holds a number of loans and debt securities issued by the central governments of countries within the Eurozone and EU institutions backed by European sovereign treaties. In accordance with the Company's accounting policy all these investments are classified at fair value through profit and loss and marked to market. The fair value and credit rating of the assets held by the Company is:

Loans and debt securities *Counterparty*	**Fair value 31 December 2013 £m**	**Principal amount 31 December 2013 £m**	**Credit rating 31 December 2013**
Italy	**53**	**57**	**BBB+**
European Investment Bank	**15**	**14**	**AAA**
European Bank for Reconstruction and Development	**5**	**4**	**AAA**
	73	**75**	

Loans and debt securities *Counterparty*	Fair value 31 December 2012 £m	Principal amount 31 December 2012 £m	Credit rating 31 December 2012
Italy	51	57	BBB
France	42	32	AA+
European Investment Bank	31	25	AAA
European Bank for Reconstruction and Development	6	4	AAA
	130	118	

There have been no changes in credit rating since the Statement of financial position date.

13. Risk management (continued)

b) Credit risk (continued)

Eurozone exposure (continued)

These assets are included with regular stress testing undertaken by the Company which assesses the impact of a number of scenarios on the Company's solvency position.

Reinsurance counterparties

The Company has reinsurance contracts in place with five external reinsurers with an exposure of £1,040m at 31 December 2013 *(2012: £722m)*. 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 2013 and 31 December 2012.

Impaired assets

The Company did not have any impaired or past due date assets at 31 December 2013 *(2012: nil)*.

c) Liquidity risk

Liquidity risk is the risk that the Company, although solvent, either does not have sufficient financial resources available to it in order to meet its obligations when they fall due, or can secure them only at excessive cost. The Company's ALM framework is designed to ensure that sufficient cash is available from the investment portfolio to support the anticipated pension annuity payments as they fall due. In addition to holding liquid financial assets within the long term business fund, liquidity risk is managed through modelling detailed forecasts of annuity payments, ensuring counterparties for cash deposits are highly rated and regular monitoring of the overall liquidity position.

The following table sets out the contractual maturity analysis of financial liabilities.

31 December 2013	**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	**3**	**-**	**-**	**-**	**3**
Other creditors	**44**	**-**	**-**	**-**	**44**
Accruals	**13**	**-**	**-**	**-**	**13**
Derivative liabilities	**2,140**	**42**	**220**	**631**	**3,033**
	2,200	**42**	**220**	**631**	**3,093**

31 December 2012	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	2	-	-	-	2
Other creditors	12	-	-	-	12
Accruals	14	-	-	-	14
Derivative liabilities	1,170	38	162	418	1,788
	1,198	38	162	418	1,816

Amounts due to group undertakings are included within other creditors. At 31 December 2013 £19m was payable to PSC *(2012; £4m.)* This amount is expected to be paid in the next financial year.

13. Risk management (continued)

d) Specific insurance risk

Longevity risk is the risk that mortality experience of the Company's policyholders is less favourable than assumed, thus requiring pensions to be paid for a longer period than anticipated resulting in a higher than expected cost to the Company.

In order to help minimise this risk and also volatility arising through future longevity experience, PIC adopts an active approach to reinsuring these risks. This policy is founded on a principle of efficient capital management and operates within targets set by the Board. 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 Company has committed to pay the reinsurer a fixed line of cashflows for each relevant scheme. The reinsurer undertakes to reimburse the actual cost of claims to the Company. Separately, there is also an insurance fee for which the Company is liable. Settlement of the contract is on a net basis. These contracts also transfer the contingent longevity risk relating to any spouses of relevant policyholders.

Longevity reinsurance via the transfer of assets

This currently provides longevity cover in respect of certain policyholders whose pensions are not yet in-payment. Under such contracts, in return for a premium, the reinsurer agrees to reimburse the actual cost of future claims to the Company in respect of an agreed set of policyholders. These contracts also transfer the contingent risks relating to spouses of relevant policyholders.

The Company 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 on a scheme by scheme basis but with appropriate variation and granularity for individual members within that scheme. Individual variations are subject to a number of factors including, but not limited to, an individual's gender, age and pension amount.

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. These assumptions currently only differ according to gender. They are 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 portfolio, the Company also considers the following risks:

Risk arising from a specific insurance contract

The Company 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 Company prepares information based upon a series of possible market conditions. The results of this exercise are then considered with regard to the effect on the current portfolio.

13. Risk management (continued)

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 Company'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 Company has significant outsourcing arrangements of pension payrolls 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 external occurrences.

14. Share capital

The allotted, called up and fully paid share capital of the Company is:

	31 December 2013 £m	31 December 2012 £m
Allotted, called up and fully paid		
625,304,196 *(2012: 401,304,196)* ordinary shares of £1 each	**625**	401

The Company issued 50,000,000 fully paid £1 ordinary shares at par for cash consideration on 7 May 2013 and 174,000,000 fully paid £1 ordinary shares at par for cash consideration on 8 July 2013.

15. Reserves

	2013		2012	
	Other reserves £m	**Retained profit £m**	Other reserves £m	Retained profit £m
At beginning of year	**60**	**174**	60	34
Total comprehensive income	**-**	**87**	-	140
At end of year	**60**	**261**	60	174

16. 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. Full details of the Company's capital resources are given in the Statement of Changes in Equity.

The Company's statutory solvency ratio at 31 December 2013 was 249% (2012: 251%) and it had net assets which were £537m (2012: £357m) in excess of statutory requirements. The Company has complied with the regulatory capital requirements under Pillar 1 as set out in the relevant PRA rules throughout the year.

The Company'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 the Company'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.

The Company currently has sufficient capital available to meet all its present capital requirements and does not utilise debt capital, financial reinsurance or securitisation.

The Company is required to hold sufficient capital at all times to meet the PRA's capital requirements and it manages its capital so as to ensure compliance. The capital requirement is calculated on the statutory basis, which is based on EU Directives. For all regulated insurance business, account is also taken of the Individual Capital Assessment which considers certain business risks not reflected in the statutory basis.

The Company reviews its capital resources formally at least monthly and has complied with all externally and internally imposed capital requirements during the year. It remains the intention of management to ensure that there is adequate capital to exceed the Company's regulatory requirements. This is managed through the Company's internal policy of maintaining capital at a level which exceeds the higher of its internal capital requirement and the relevant regulatory capital requirement plus a specified margin.

16. Capital resources (continued)

The following table analyses the Company's capital resources between those held within the long term insurance business fund ("LTIBF") and other capital resources. The total available capital resources indicates the capital that is available to meet the regulatory capital requirements of the business.

31 December 2013	**UK Non-participating**	**Life Business Shareholders funds**	**Total Life Business**
	£000	**£000**	**£000**
Interests held outside LTIBF	**-**	**554**	**554**
Interests held in LTIBF	**392**	**-**	**392**
Total Shareholders' Interests	**392**	**554**	**946**
Adjustments onto regulatory basis:			
Adjustments for statutory solvency	**(48)**	**-**	**(48)**
	344	**554**	**898**
Other qualifying capital	**-**	**-**	**-**
Total available capital resources	**344**	**554**	**898**

31 December 2012	UK Non-participating	Life Business Shareholders funds	Total Life Business
	£m	£m	£m
Interests held outside LTIBF	-	516	516
Interests held in LTIBF	120	-	120
Total Shareholders' Interests	120	516	636
Adjustments onto regulatory basis:			
Adjustments for statutory solvency	(41)	-	(41)
	79	516	595
Other qualifying capital	-	-	-
Total available capital resources	79	516	595

17. Related party transactions

As at 31 December 2013 the directors regarded Pension Corporation Group Limited ("PCG"), a limited company incorporated in Guernsey, as the Company's ultimate parent and controlling party.

The group controlled by PCG includes seven other companies which the directors consider to be related parties by virtue of their common control.

The Company had transactions with three of its fellow subsidiaries of PCG as follows:

a) Transactions with PSIC

The Company did not cede any insurance premiums to PSIC during the year *(2012:nil)*. No commissions were due *(2012: nil)* and recovery of claims totalling £12m *(2012; £11m*), were due under the terms of the reinsurance contract in place with PSIC. At 31 December 2013 the outstanding balance in claims due from PSIC was £6m *(2012: £6m).*

b) Transactions with PSC

PSC is the main provider of management, staff, IT, office services and contracted director services to the Company. Total charges for the period to 31 December 2013 were £45m *(2012: £7m)*. At 31 December 2013 the amount due to PSC relating to the services provided was £19m *(2012: £4m).*

c) Transactions with PHC3

On 20 December 2013 the Company transferred all of its rights accruing under the terms of a loan to Co-Investment Limited to PHC3 in return for a loan note valued at £1 issued by that company. The fair value of this loan at the date of transfer was £nil (see note 11). The loan note issued by PHC3 is repayable by the borrower at its discretion and attracts interest at a rate 2.5% above LIBOR calculated quarterly. The amount outstanding at 31 December 2013 was £1.

On 3 October 2012 the Company novated a loan of £5m, from Pension Insurance Corporation Holdings LLP ("PICH"), to PHC3 in return for a loan note issued by that company. This loan note is non-interest bearing and full or partial repayment may be made, at any time, at the discretion of the borrower. The prospective repayment of this loan has been considered by the Directors and subsequently the loan has been impaired to £nil value at 31 December 2013 *(2012; £5m).*

On 14 May 2012 the Company acquired an £80,000 loan facility from PICH. The facility was provided to PHC3 for the purpose of funding its investment in the GPUTs. The loan is repayable on demand from the Company or at the discretion of the borrower with an interest rate of 2% above LIBOR calculated quarterly. The amount outstanding at 31 December 2013 was £74,558 *(2012; £77,800).*

18. Parent company and ultimate controlling party

The Company is a wholly owned subsidiary of PHC3, which is incorporated in England and Wales.

The directors regard PCG a limited company incorporated in Guernsey as the ultimate parent and controlling party. PCG is the largest and smallest group of which the Company is a member and for which group financial statements are prepared. The consolidated financial statements of PCG are available to the public and may be obtained from Ogier House, St Julian's Avenue, St Peter Port, Guernsey GY1 1WA.

Registered Number 05706720

Pension Insurance Corporation Limited

Annual Report and Financial Statements
For the year ended 31 December 2012

Pension Insurance Corporation Limited

Incorporated and registered in England & Wales. Registered Number 05706720

Registered Office: The registered office of the Company is 14 Cornhill, London EC3V 3ND.

Contents	**Page**

The directors present their annual report and the audited financial statements for Pension Insurance Corporation Limited, registered number 05706720, (the "Company" or "PIC") for the year ended 31 December 2012.

Principal activity

The principal activity of the Company is the provision of insurance solutions to pension annuity portfolios.

Business Review

Background

The Company is authorised to write long term insurance business by the Financial Services Authority ("FSA"). Its principal product is the provision of pension insurance and annuities to individuals, corporate pension schemes and other insurance companies through innovative and bespoke risk management solutions.

In return for receipt of an insurance premium, PIC issues an insurance policy that provides annuity payments to pensioners. The premium received by PIC is usually received from a pension scheme. Typically, the pension scheme is providing benefits to its members as part of a defined benefit pension plan. The pension scheme trustees will purchase an insurance policy from PIC either as part of an overall risk mitigation programme, or to pass the scheme's liabilities fully to PIC. By so doing, the pension scheme will benefit from the enhanced protection that is offered by an insurance policy.

The Company also takes a lead role in developing and directing the pensions market through pension trustee training events, publishing regular papers on the pensions market and information on how to address certain key issues for the commercial and the public sector such as managing pension costs and risk inherent in pension schemes. It has an active thought leadership programme in dealing with Government, corporate sponsors and pension trustees and working with them on pension solutions in the public and private sectors.

Group Reorganisation and Fundraising

Until 9 October 2012 the Company was a wholly owned subsidiary of Cornhill Corporation Holdings LLP (formerly Pension Insurance Corporation Holdings LLP) ("PICH"). On 9 October a group reorganisation took place which resulted in the Company becoming a wholly owned subsidiary of Pension Corporation Group Limited ("PCG"), a limited company incorporated in Guernsey.

On 22 October 2012 agreement was reached between PCG and Reinet PC Investments (Jersey) Limited ("Reinet") for Reinet to subscribe for up to £400m of new equity capital. The purpose of this new equity capital is to support the Company's future growth plans and those of the Group headed by PCG ("the Group"). At 31 December 2012 £100m of the £400m commitment had been drawn down by PCG.

Trading during the year

The Company made a pre-tax profit in the year ended 31 December 2012 of £184.2m *(2011: £12.0m)*. The main contributory factors to the improvement in profitability were the returns from new business, changes in the overall investment mix, longevity reinsurance treaties entered into during the year and the impact of favourable investment conditions. More details of how these factors have affected the financial results are set out in Notes 2 and 9.

During the year PIC wrote a further 20 *(2011:11)* new schemes with a total premium value of £1.5bn *(2011: £0.6bn)*.

By the end of 2012 PIC had total financial assets under management of £5.6bn (including net derivative assets), compared to £4.3bn at the end of 2011. The increase of £1.3bn was principally due to the new business premiums received in the year.

Business Review ***(continued)***

Trading during the year (continued)

PIC concluded two quota share and two longevity swap reinsurance transactions during the year which covered longevity risk on c£1.0bn of insurance liabilities. At 31 December 2012 65% of PIC's total longevity exposure on a statutory solvency basis was reinsured to third party, investment grade reinsurer counterparties *(2011: 60%).*

The Company is now responsible for paying the pensions of 64,000 individuals *(2011: 53,000).* Payment of annuities grew by 20% in 2012 to £208.2m *(2011: £173.1m)* as a result of new business written during the year. Total pension amounts paid were £236.1m *(2011: £219.7m),* an increase of 7% as the growth in annuities was partially offset by a reduction in lump sum payments and transfers out compared to the previous year.

At the end of 2012 PIC had issued 35,400 individual policies in respect of 25 schemes, up from 32,900 in respect of 14 schemes a year ago. The remaining schemes are either in the transition process, which includes the verification of scheme data and finalisation of liabilities prior to individual policies being issued by PIC, or are buy ins under which no individual policies are issued.

The directors remain positive about both the Company's own financial position and the growth potential of its market and the Company's ability to participate in that growth.

Dividends

The directors do not recommend a dividend for the year *(2011: nil).*

Solvency

The Company has complied with the regulatory capital requirements under Pillar 1 as set out in the relevant FSA rules (see Note 9) throughout the year and continues to do so. In addition, based on the Company's Individual Capital Assessment, it is the directors' view that the Company has held capital comfortably in excess of its Pillar 2 requirements during the same period.

The Company's statutory solvency ratio at 31 December 2012 was 251% *(2011:190%)* and it had net assets which were £357m *(2011: £162m)* in excess of statutory requirements.

Solvency II

The European Union ("EU") is developing a new solvency framework for insurance companies, referred to as Solvency II. The Solvency II Directive was formally approved by the Economic and Financial Affairs Council in November 2009. The new approach is based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements.

The anticipated implementation date for the project has been rescheduled from 1 January 2014 until an unspecified date no earlier than January 2016. However the Company has continued to assess the high-level requirements of Solvency II under a revised timetable and an implementation programme, under direct oversight of the Board, remains in place.

The Company remains well placed to ensure full compliance with the new solvency regime.

Material Contracts

Cornhill Corporation LLP (formerly Pension Corporation LLP) ("PCLLP"), a UK limited liability partnership, provided management, staff, IT and office services to the Company under defined service agreements. On 1 October 2012 these agreements were novated to Pension Services Corporation Limited ("PSC"), a UK limited company that is a fellow subsidiary of PCG.

Shares issued

On 23 October 2012 PIC issued 75.7m £1 ordinary shares to Pension Holding Company (UK) 3 Limited ("PHC3"), the immediate parent company, for cash consideration.

Strategy

The Company has continued with its strategy of seeking pension insurance business across all segments including the corporate and public sectors and insurer to insurer business. This strategy has been executed by identifying opportunities which PIC believes meet its internal criteria for proceeding with an insurance transaction and which the trustees of the pension scheme will find attractive and beneficial to members.

The escalating financial cost to pension schemes and their sponsors of pension provision, arising from volatility in asset performance, increases in life expectancy and the need to match assets more closely with liabilities (in order to comply with ever more stringent accounting and funding regime standards) have driven corporate sponsors to look increasingly at the benefit of transferring the risks associated with their defined benefit pension funds to the security of an insurance company regulated by the FSA, such as PIC.

Accordingly the size of PIC's potential market continues to increase and is influenced by the perceived affordability and benefits of the insurance offered. PIC believes that, as the market matures and pension insurance becomes more commonplace, these solutions will continue to be perceived as increasingly affordable and necessary.

Key Performance Indicators

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

Measures of assets & liabilities	**As at 31 December 2012**	As at 31 December 2011
Regulatory surplus		
Statutory surplus	**£357m**	**£162m**
Statutory solvency ratio	**251%**	**190%**
Embedded value	**£890m**	**£671m**
Measures of income & expenditure		
New business (gross of reinsurance)		
Premiums written	**£1,512m**	**£615m**
Cost base		
Acquisition expenses	**£29m**	**£21m**
Other management expenses	**£16m**	**£12m**

Embedded value has been prepared in accordance with the European Embedded Value ("EEV") Principles issued in May 2004 by the European CFO Forum, as supplemented by the Additional Guidance on EEV Disclosures issued in October 2005.

Directors and their interests

The directors who served during the year were:

Sir Mark Weinberg	Chairman	Non- Executive	(appointed 22 October 2012)
Sir Martin Jacomb	Chairman	Non- Executive	(resigned 22 October 2012)
John Coomber	Chief Executive	Executive	
Tracy Blackwell		Executive	
Graham Cooper		Non- Executive	(resigned 22 October 2012)
Tim Hanford		Non- Executive	
Nicholas Parker		Non- Executive	
Bob Scott		Non- Executive	(resigned 22 October 2012)
Rob Sewell		Executive	
Harriet Maunsell		Non- Executive	(appointed 22 October 2012)
Chris McKechnie		Non- Executive	(appointed 22 October 2012)
Eloy Michotte		Non- Executive	(appointed 22 October 2012)
Bill Winters		Non- Executive	(appointed 22 October 2012)

None of the directors who held office at the end of the financial year had any disclosable interest in the shares of the Company.

Principal risks and uncertainties

The principal risks affecting the Company's business and its strategy for managing those risks are set out in detail in Note 13 to the financial statements.

Creditors policy

The Company's policy in relation to its suppliers is to set the terms of payment at 30 days and to abide by those terms, provided that it is satisfied that the supplier has provided the goods or services in accordance with the agreed terms and conditions. Where specific terms and conditions have been agreed which vary from the Company's standard payment terms, it accepts responsibility to comply with them.

Political and charitable contributions

The Company made no charitable donations during the year *(2011: nil)*. The Company made no political contributions during the year *(2011: 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 PCG 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.

Disclosure of Information to Auditors

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 Company's auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditor

In accordance with Section 487 of the Companies Act 2006, the auditor will be deemed to be re-appointed and KPMG Audit Plc will therefore continue in office.

On behalf of the Board

14 Cornhill
London
EC3V 3ND

John Coomber
Chief Executive

25 March 2013

Pension Insurance Corporation Limited

Statement of Directors’ responsibilities in respect of the Directors’ report and the financial statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with 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 Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company 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.

Report of KPMG Audit Plc to the members of Pension Insurance Corporation Limited

Independent auditor's report to the members of Pension Insurance Corporation Limited.

We have audited the financial statements of Pension Insurance Corporation Limited for the year ended 31 December 2012 set out on pages 11 to 50. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Report of KPMG Audit Plc to the members of Pension Insurance Corporation Limited

Independent auditor's report to the members of Pension Insurance Corporation Limited.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

M Wilson

Mostyn Wilson **(Senior Statutory Auditor)**
for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants

KPMG Audit Plc
15 Canada Square,
London,
E14 5GL

25 March 2013

Pension Insurance Corporation Limited

Statement of comprehensive income
for the year ended 31 December 2012

	Note	**Year ended 31 December 2012** £m	**£m**	Year ended 31 December 2011 £m	£m
Revenue					
Gross premiums written		**1,512.2**		614.9	
Outward reinsurance premiums	*9*	**(153.4)**		(26.6)	
Net premium revenue earned			**1,358.8**		588.3
Investment return	*2*		**433.9**		533.8
Total revenue (net of reinsurance premiums)			**1,792.7**		1,122.1
Expenses					
Claims paid – gross		**(236.1)**		(219.7)	
Reinsurers' share of claims paid		**15.9**		13.3	
			(220.2)		(206.4)
Increase in insurance liabilities – gross		**(1,578.2)**		(1,040.3)	
Increase in reinsurers' share of insurance liabilities		**247.4**		181.5	
			(1,330.8)		(858.8)
Acquisition expenses	*3*	**(28.6)**		(20.6)	
Other operating expenses	*4*	**(28.9)**		(24.3)	
			(57.5)		(44.9)
Total claims and expenses			**(1,608.5)**		(1,110.1)
Profit before taxation			**184.2**		12.0
Income tax charge	*7*		**(44.5)**		(3.9)
Profit for the year			**139.7**		8.1
Other comprehensive income			**-**		-
Total comprehensive income			**139.7**		8.1

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 15 to 50 form an integral part of these financial statements.

Pension Insurance Corporation Limited

Statement of changes in equity
for the year ended 31 December 2012

31 December 2012	**Share Capital £m**	**Other Reserves £m**	**Accumulated surplus £m**	**Total £m**
At beginning of year	**325.6**	**60.0**	**34.4**	**420.0**
Total comprehensive income for the year	**-**	**-**	**139.7**	**139.7**
Share capital issued for cash consideration	**75.7**	**-**	**-**	**75.7**
At end of year	**401.3**	**60.0**	**174.1**	**635.4**

31 December 2011	Share Capital £m	Other Reserves £m	Accumulated surplus/(deficit) £m	Total £m
At beginning of year	325.6	60.0	26.3	411.9
Total comprehensive income for the year	-	-	8.1	8.1
At end of year	325.6	60.0	34.4	420.0

The accounting policies and notes on pages 15 to 50 form an integral part of these financial statements.

Pension Insurance Corporation Limited

Statement of financial position
as at 31 December 2012

	Note	31 December 2012 £m	31 December 2012 £m	31 December 2011 £m	31 December 2011 £m
Assets					
Investment properties	*8*		**87.1**		84.5
Reinsurers' share of insurance liabilities	*9*		**1,038.8**		791.5
Receivables and other financial assets	*11*		**145.7**		56.8
Prepayments			**17.0**		13.5
Financial investments	*11*		**5,366.4**		3,928.3
Derivative assets	*12*		**2,047.9**		1,534.2
Cash and cash equivalents	*11*		**0.5**		0.5
Total Assets			**8,703.4**		6,409.3
Equity					
Share capital	*14*	**401.3**		325.6	
Other reserves	*15*	**60.0**		60.0	
Accumulated surplus	*15*	**174.1**		34.4	
Total Equity			**635.4**		420.0
Liabilities					
Gross insurance liabilities	*9*	**6,214.2**		4,636.1	
Deferred tax liability	*10*	**9.4**		7.6	
Derivative liabilities	*12*	**1,787.6**		1,295.1	
Insurance and other payables	*11*	**14.3**		37.0	
Current taxation		**27.1**		2.4	
Accruals	*11*	**15.4**		11.1	
Total Liabilities			**8,068.0**		5,989.3
Total Equity and Liabilities			**8,703.4**		6,409.3

The accounting policies and notes on pages 15 to 50 form an integral part of these financial statements.

The financial statements were approved by the directors on 25 March 2013 and were signed on its behalf by:

Rob Sewell
Director

Pension Insurance Corporation Limited

Statement of cash flows
for the year ended 31 December 2012

	Note	**Year ended 31 December 2012**		Year ended 31 December 2011	
		£m	**£m**	£m	£m
Cash flows from operating activities					
Profit for the year			**139.7**		8.1
Comprising:					
Interest income	*2*		**140.2**		110.2
Other operating activities (net)			**44.0**		(98.2)
Income tax	*7*		**(44.5)**		(3.9)
Adjustments for non-cash movements:					
Movement in accrued interest		**(26.0)**		(5.1)	
Movement in tax provisions		**44.5**		3.9	
			18.5		(1.2)
Changes in operating assets and liabilities					
Increase in receivables and other financial assets		**(63.0)**		(6.5)	
Increase in financial investments including derivative assets		**(1,951.8)**		(1,123.5)	
Increase in prepayments		**(3.4)**		(1.0)	
Increase in investment properties	*8*	**(2.6)**		(1.1)	
Increase in reinsurers' share of insurance liabilities		**(247.4)**		(181.5)	
Increase in insurance liabilities		**1,578.2**		1,040.4	
Increase financial liabilities including derivative liabilities		**492.4**		413.8	
Decrease in insurance and other payables		**(22.5)**		(146.7)	
Increase in accruals		**4.3**		1.5	
			(215.8)		(4.7)
Cash (outflow)/inflow from operating activities			**(57.6)**		2.2
Cash inflow from financing activities					
Proceeds from issue of share capital			**75.7**		-
Taxation					
Taxation paid			**(18.1)**		(4.6)
Net increase in cash and cash equivalents			**-**		(2.4)
Cash and cash equivalents at beginning of year			**0.5**		2.9
Cash and cash equivalents at end of year			**0.5**		0.5

The accounting policies and notes on pages 15 to 50 form an integral part of these financial statements.

Notes to the financial statements for the year ended 31 December 2012

1. Accounting policies

(a) Basis of preparation

The financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU") and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements also comply with the Statement of Recommended Practice on Accounting for Insurance Business (issued by the Association of British Insurers in December 2005, as amended in 2006) in so far as these requirements do not contradict IFRS requirements.

The Company has applied all IFRSs and interpretations adopted by the EU at 31 December 2012, with the exception of the following, which are not yet mandatory;

Implementation of IFRS 10 –Consolidated Financial Statements – effective for accounting periods beginning on or after 1 January 2014. Amendment to IAS 27- Separate Financial Statements

Implementation of IFRS 11 –Joint Arrangements – effective for accounting periods beginning on or after 1 January 2014. Amendment to IAS 28 Investments in Associates and Joint Ventures

Implementation of IFRS 12 –Disclosure of Interests in Other Entities – effective for accounting periods beginning on or after 1 January 2014.

Implementation of IFRS 13 – Fair value management – effective for accounting periods beginning on or after 1 January 2013

Amendment to IFRS 9 – Financial Instruments – Classification and Measurement – effective for accounting periods beginning on or after 1 January 2015

Amendment to IAS 1 – Presentation of financial statements – effective for accounting periods beginning on or after 1 July 2012

Amendment to IAS 19 –Employee benefits – effective for accounting periods beginning on or after 1 January 2013

The Company believes the adoption of the above Accounting Standards and amendments to existing standards will not materially impact the results of the Company.

(b) Recognition and derecognition of financial instruments

A financial instrument is recognised if the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Company's contractual rights to the cash flows from the financial assets expire, or if either the Company 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 Company's obligations specified in the contract expire or are discharged or cancelled.

(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 Company has classified all its policyholder contracts as insurance contracts.

1. Accounting policies (continued)

(d) Premiums

Premiums are received in consideration for taking on pension scheme liabilities. They are recognised and valued on the day risk is accepted. Retrospective adjustments to premiums may be required following work performed during the transition of a scheme prior to completion of a full buy-out. Such adjustments are recognised and valued at the date they become payable or receivable by the Company.

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 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) 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 Company 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.

1. Accounting policies (continued)

(i) Investment properties

Investments in freehold properties not for occupation by the Company 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 and considered when estimating fair value.

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

(j) Financial instruments

All financial assets and financial liabilities with the exception of loans, short term assets and liabilities and cash and cash equivalents are classified at fair value through profit or loss.

Financial instruments at fair value through profit or loss 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 11.

(k) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the Statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

(l) Assets pledged as collateral

The Company 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 the 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 Company retains all rights relating to these assets. If the Company 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 Company acquires the rights relating to the economic risks and rewards relating to these assets. Where such assets are recognised the Company recognises a corresponding liability for the repayment in financial liabilities.

1. Accounting policies (continued)

(m) 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.

(n) Foreign currencies

The functional currency of the Company is pounds sterling. The Company has chosen to present its financial statements in this currency.

Assets and liabilities denominated mainly in a foreign currency are translated into the functional currency at the foreign exchange rate ruling at the end of the financial year. All revenue and expense items are reflected in the Statement of comprehensive income at the rate effective at the date the transaction took place.

(o) 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.

(p) 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 scheme members on a timely basis.

(q) Loans and receivables

Loans and receivables are measured at fair value less transaction costs at initial recognition and subsequently measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate method.

The amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. Any resulting impairment loss is recorded in the income statement. The amount of the impairment loss is the differences between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

(r) Impairment of assets

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.

1. Accounting policies (continued)

(s) Insurance liabilities

Insurance liabilities are determined by the Company's internal actuarial department, using methods and assumptions approved by the directors having regard to the advice of the Company's Actuarial Function Holder, and using recognised actuarial methods consistent with the actuarial principles laid down in Directive 2002/83/EC. The liabilities are calculated initially on a statutory solvency basis to comply with the reporting requirements under the Financial Services and Markets Act 2000. The liabilities are then modified to remove certain contingency and other reserves required under the regulations set out in INSPRU (the Prudential Sourcebook for Insurers issued by the Financial Services Authority ("FSA") which are not required to be recognised as insurance liabilities under IFRS 4.

Insurance liabilities comprise the discounted 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 9. These bases have been derived having regard to recent UK general population mortality experience, the demographic profile of the Company's in-force business and the Company's own internal mortality experience, and include an appropriate 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 makes allowance for the risk, including credit risk, associated with these assets. The calculation of the valuation rate of interest complies with the relevant FSA regulations (INSPRU 1.2.33R and INSPRU 3.1) adjusted for any modifications agreed with the FSA in respect of the Company's application of these regulations.

(t) 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 Company 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 Company has two types of quota share reinsurance arrangements. The first type is a quota share agreement with Pension Security Insurance Corporation Limited ("PSIC"), a fellow subsidiary of PCG, covering all policyholder benefit payments for a proportion of the business reinsured. This proportion varies between 40% and 50% 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 Company has also entered into a number of longevity reinsurance contracts with 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 Company. Separately, there is also an insurance fee on each of these contracts for which the Company is liable. Settlement of the contract is on a net basis and amounts receivable from or payable to reinsurers are included in the appropriate heading under either "receivables and other financial assets" or "insurance and other payables".

1. Accounting policies (continued)

(t) Reinsurance

Fees paid in respect of longevity reinsurance contracts are included under outward reinsurance premiums.

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

(u) Critical accounting policies, estimates and judgements

Included in the financial statements are certain critical accounting judgements as described below;

Insurance Liabilities

The Company is exposed to longevity risk, namely the risk that annuitant policyholders live longer than expected. In order to calculate the associated amount of insurance liabilities and the reinsurers' share of these liabilities, the Company makes assumptions relating to the incidence of deaths for each year of the duration of the insurance contracts. These assumptions are reconsidered annually and are based on standard mortality tables including an allowance for future longevity improvements and are adjusted to reflect the anticipated experience for each of the schemes acquired.

The Company has reinsured a proportion of its longevity risk through the use of reinsurance contracts. The anticipated effect of these contracts is reflected as an asset within the Statement of financial position.

The carrying value of insurance liabilities net of reinsurance at the end of the financial year is £5.2bn *(2011: £3.8bn)*. The assumptions used to establish insurance contract liabilities and appropriate sensitivities relating to variations in these assumptions are disclosed in Note 9.

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.

Notes to the financial statements for the year ended 31 December 2012 (continued)

2. Investment return

	Year ended 31 December 2012		Year ended 31 December 2011	
	£m	**£m**	£m	£m
Interest income on cash deposits	**0.9**		3.8	
Income from debt securities	**135.3**		103.6	
Income from loans secured by mortgage	**4.0**		2.8	
Interest income		**140.2**		110.2
Dividend income	**-**		0.2	
Rental income	**5.3**		4.8	
Income from other investments				
- Collective investment schemes	**0.5**		1.0	
- Other asset backed securities	**8.5**		6.8	
- Other investments	**14.2**		1.5	
		28.5		14.3
Total investment income		**168.7**		124.5
Realised gains on investments	**189.7**		92.1	
Realised losses on investments	**(96.6)**		(63.1)	
Net realised gains		**93.1**		29.0
Unrealised gains on investments	**311.8**		426.3	
Unrealised losses on investments	**(139.7)**		(46.0)	
Net unrealised gains		**172.1**		380.3
Investment return		**433.9**		533.8

Notes to the financial statements for the year ended 31 December 2012 (continued)

3. Acquisition expenses

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Acquisition expenses	**28.6**	20.6

Acquisition expenses relate to direct and indirect costs incurred in the process of acquiring business. No deferral of acquisition expenses has been made as the amount of directly attributable acquisition costs that would qualify as deferrable is not considered to be material. Acquisition costs include an element of the wages and salaries of employees involved in the activity.

4. Other operating expenses

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Investment charges and related expenses	**12.9**	12.0
Other expenses	**16.0**	12.3
	28.9	24.3

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. The Company 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.

5. Auditor's remuneration

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Audit of these financial statements	**0.1**	0.1
Other services pursuant to such legislation	**0.1**	0.1
Other services relating to taxation	**0.1**	0.1
All other services	**0.5**	0.4
	0.8	0.7

6. Directors remuneration, staff costs and headcount

PCLLP was the main provider of management, staff, IT and office services to the Company under defined service agreements. On 1 October these agreements were novated to PSC.

The Company employs no staff directly as all staff were provided by PCLLP or PSC during the year.

The costs of directors and employees of the Company for the year were as follows;

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Wages and salaries	**12.3**	10.5
Social security costs	**1.3**	0.4
Other pension costs	**0.1**	0.1
	13.7	11.0

The Company has thirteen directors who served during the year *(2011: eight)*. All of the directors were employed by or contracted by the Company's service providers. The total remuneration received by the directors for their services, was £2.2m *(2011: £2.1m)*. The amount of remuneration received by the highest paid director was £0.7m *(2011: £0.6m)*. These amounts relate solely to the services provided by the directors to the Company and do not include any payments due for services provided with regard to other group entities.

No directors had money paid to money purchase pension schemes *(2011: nil)*. No directors, including the highest paid director, were eligible for shares or share options in the Company under a long term incentive scheme *(2011: nil)*. No directors exercised options in the Company during the year *(2011: nil)*.

7. Income tax

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Current taxation		
Income tax payable for the current year	**43.9**	4.0
Prior year (over)/under provision	**(1.1)**	0.4
Total current tax	**42.8**	4.4
Deferred taxation		
Recognition of deferred tax liability on temporary timing differences	**2.5**	0.1
Effect of change in tax rates	**(0.8)**	(0.6)
Total deferred tax	**1.7**	(0.5)
Income tax charge	**44.5**	3.9

7. Income tax (continued)

The current tax charge for the period is lower *(2011: higher)* than the standard rate of corporation tax in the United Kingdom of 24.5% *(2011: 26.5%)*. The differences are explained below:

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Reconciliation of total income to the applicable tax rate		
Profit before taxation	**184.2**	12.0
Income tax at 24.5% *(2011:26.5%)*	**45.1**	3.2
Effects of:		
Expenses not deductible for tax purposes	**1.3**	0.9
Prior year (over)/under provision	**(1.1)**	0.4
Effect of change in tax rates	**(0.8)**	(0.6)
Income tax charge	**44.5**	3.9

Factors that may affect future tax charges

The Company's tax charge is based on its profits disclosed in its annual returns to the FSA. These profits include certain provisions which are required for the calculation of statutory solvency but which are considered unlikely to crystallise and therefore are excluded from insurance liabilities in the accounts. As a result taxable profits have been lower than IFRS profits in each of the last four accounting periods.

A new tax regime commencing in January 2013 will change the calculation of taxable profits of insurance companies. The Company has incorporated the effects of the enacted legislation in calculating its deferred tax liability at 31 December 2012.

Following the change in the taxation regime for insurance companies the benefit of the differences between the IFRS and taxable profits will reverse over a period of 10 years. Consequently the Company has recognised a deferred tax liability at 31 December 2012 in respect of these timing differences which total £40.7m *(2011: £30.3m)* with a tax value of £9.4m *(2011: £7.6m)*.

A rate of 23% has been adopted in the calculation of the deferred tax liability which forms part of the Statement of financial position, being the rate at which the Company currently expect the timing differences to reverse based on the corporation tax rate effective from 6 April 2013.

The Company has no timing differences or tax losses carried forward at 31 December 2012 which may give rise to reduced tax charges in future periods *(2011:nil)*.

8. Investment property

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
At beginning of year	**84.5**	83.4
Revaluation during the year	**2.6**	1.1
At end of year	**87.1**	84.5

The Company holds 99.9% of the issued units in eight Guernsey registered property unit trusts ("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.

Income received in relation to these properties is shown within investment return in Note 2.

9. 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 Company's liabilities in relation to future policyholders' benefits are:

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Future policyholders' benefits		
Gross	**6,214.2**	4,636.1
Reinsurance	**(1,038.8)**	(791.5)
Net	**5,175.4**	3,844.6

The gross insurance liabilities shown above are stated in accordance with the Company's accounting policies as set out in Note 1. The figures exclude reserves which are required for the calculation of statutory solvency under the FSA rules but which are considered unlikely to occur 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. They also include £316.9m *(2011: £309.3m)* of liabilities which are reinsured under a quota share agreement with PSIC.

9. Insurance contracts and related insurance liabilities (continued)

a) Terms and conditions of insurance contracts

The Company'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 which can be applied. The insurance liabilities also include tax-free cash lump sums on vesting, and annuities payable to spouses on the death of the main member.

The Company's insurance contracts are a mixture of "buy-in" benefits, where the policyholder is the pension scheme and the insured liabilities cover defined benefits within the scheme, and "buy-out" benefits, 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 below.

b) Principal assumptions used in the preparation of insurance liabilities

Mortality assumptions

The base mortality assumptions as at 31 December 2012 inherent in the projected cash flows used in the valuation of insurance contract liabilities are set with reference to the following mortality tables published by the Continuous Mortality Investigation (a research body with strong links to the Institute and Faculty of Actuaries in the UK) ("CMI"):

- S1PMA & S1PFA & S1DFA
- PCMA00 & PCFA00
- PCML00 & PCFL00
- PNML00 & PNFL00

All of these tables, with the exception of S1DFA, are the same tables that were used in preparing the 2011 mortality assumptions.

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.

An allowance for future mortality improvements from 31 December 2012 has been made by applying a separate set of reduction factors to mortality rates relating to future calendar years for each gender.

The improvements applied are based on a standard model developed by the CMI.

9. Insurance contracts and related insurance liabilities (continued)

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

Valuation rate of interest ("VRI")

The Company has applied the requirements of INSPRU 1.2.33R in calculating the VRI. Within the calculation it has applied a direction made by the FSA in May 2010, on the application of the Company, under section 148 of the Financial Services and Markets Act 2000. The effect of the direction is to modify the provisions of INSPRU 3.1.35R and IPRU(INS) Appendix 9.3 so that the Company can use a more appropriate rate of interest based on the yields on all of the assets backing its liabilities taken in combination.

The VRI is adjusted to reflect the risk, including credit risk, associated with the assets held to match liabilities. The regulatory requirements set out in INSPRU 3.1 state that the VRI should be set at 97.5% of the risk-adjusted yield on the assets backing the liabilities; the rate calculated in accordance with these rules as at 31 December 2012 for PIC was 3.37% for index-linked liabilities and 3.25% for non-linked liabilities, giving an effective combined rate of 3.34% *(2011: 3.67%)*.

Inflation

Assumptions for expected future Retail Price Index ("RPI") inflation are based on a curve derived from market prices of inflation-linked swap contracts. For Limited Price Index ("LPI") 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, project costs, 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. No allowances are included for expenses incurred in relation to the generation of new business.

9. Insurance contracts and related insurance liabilities (continued)

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 reason for the increase is the new business written in the year. In addition, the falls in interest rates and credit spreads have led to a reduction in the VRI and hence to an increase in the insurance liabilities.

The movement between the insurance liabilities at the beginning and the end of year is explained as follows:

2012	**Gross £m**	**Reinsurance £m**	**Net £m**
At beginning of year	**4,636.1**	**(791.5)**	**3,844.6**
Increase in liability from new premiums	**1,417.7**	**(176.6)**	**1,241.1**
Reduction in liability from claims	**(236.7)**	**15.9**	**(220.8)**
Changes in economic assumptions	**312.7**	**(46.9)**	**265.8**
Changes in non-economic assumptions	**44.5**	**(42.0)**	**2.5**
Other movements (including net investment return)	**39.9**	**2.3**	**42.2**
At end of year	**6,214.2**	**(1,038.8)**	**5,175.4**

2011	Gross £m	Reinsurance £m	Net £m
At beginning of year	3,595.7	(609.9)	2,985.8
Increase in liability from new premiums	585.3	(33.0)	552.3
Reduction in liability from claims	(206.0)	15.4	(190.6)
Changes in economic assumptions	565.1	(114.0)	451.1
Changes in non-economic assumptions	19.9	(7.2)	12.7
Other movements (including net investment return)	76.1	(42.8)	33.3
At end of year	4,636.1	(791.5)	3,844.6

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:

Economic assumptions

The primary economic assumption changes during the year are in respect of the VRI and the assumptions for future rates of inflation. As explained above, the VRI is the rate at which future cash flows are discounted in determining liabilities, so a reduction in VRI will increase the present value of future liabilities. The assumed future inflation rate has a direct impact on both inflation-linked liability cash flows and future expenses, and therefore an increase in inflation will increase the value of future liabilities.

Non-economic assumptions

There have been a number of changes to the non-economic assumptions over the year, including:

- Updated per-policy and investment management expense assumptions
- Changes to the assumptions for base-level mortality and future longevity improvements

Pension Insurance Corporation Limited

Notes to the financial statements for the year ended 31 December 2012 (continued)

9. Insurance contracts and related insurance liabilities (continued)

d) Analysis of expected maturity of 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	**16.3**	**93.5**	**381.5**	**1,084.6**	**1,575.9**
Reinsurance	**(2.5)**	**(12.7)**	**(55.4)**	**(414.3)**	**(484.9)**
As at 31 December 2012	**13.8**	**80.8**	**326.1**	**670.3**	**1,091.0**
Annuities in payment					
Gross	**252.2**	**974.5**	**1,904.3**	**1,507.3**	**4,638.3**
Reinsurance	**(6.8)**	**(37.5)**	**(139.9)**	**(369.7)**	**(553.9)**
As at 31 December 2012	**245.4**	**937.0**	**1,764.4**	**1,137.6**	**4,084.4**

	Within one year £m	In 1 -5 years £m	In 5 -15 years £m	Over 15 years £m	Total £m
Deferred annuities					
Gross	17.5	70.8	287.4	849.0	1,224.7
Reinsurance	(4.0)	(16.4)	(60.0)	(309.0)	(389.4)
As at 31 December 2011	13.5	54.4	227.4	540.0	835.3
Annuities in payment					
Gross	195.8	737.2	1,385.6	1,092.9	3,411.5
Reinsurance	(7.1)	(33.4)	(110.0)	(251.6)	(402.1)
As at 31 December 2011	188.7	703.8	1,275.6	841.3	3,009.4

9. Insurance contracts and related insurance liabilities (continued)

e) Sensitivity analysis

In accordance with IFRS 4 and IFRS 7 "*Financial Instruments"* the directors have considered the effect on profit or loss and equity at 31 December 2012 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	
	Increase of 50bps £m	Fall of 50bps £m	Increase of 50bps £m	Fall of 50bps £m
Movement in assets	(354.8)	393.2	196.7	(177.4)
Movement in liabilities	314.6	(356.8)	(191.7)	180.4
Tax effect	9.8	(8.9)	(1.2)	(0.7)
Movement in profit and equity	(30.4)	27.5	3.8	2.3

	Longevity (see below) £m	Expenses (see below) £m	Credit spreads Increase of 25bps £m
Movement in assets	-	-	(90.4)
Movement in liabilities	(127.9)	(16.2)	48.4
Tax effect	31.3	4.0	10.3
Movement in profit and equity	(96.6)	(12.2)	(31.7)

Parameters for longevity and renewal expense sensitivities

The longevity sensitivity is based on a 7.5% decrease in the base mortality rates combined with a 0.5% increase in annual mortality improvement rates.

The renewal 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 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 Company's use of derivatives is designed to ensure that its exposure to market risk is hedged.
- There is no significant currency risk on the Company's business and the associated sensitivity analysis has therefore not been shown.

9. Insurance contracts and related insurance liabilities (continued)

f) Reinsurance results

The effect of reinsurance contracts entered into by the Company on profit before taxation is as follows:

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Outward reinsurance premiums	**(153.4)**	(26.6)
Reinsurers' share of claims paid	**15.9**	13.3
Changes in reinsurers' share of insurance liabilities	**247.4**	181.5
Net effect of reinsurance contracts on profit before taxation	**109.9**	168.2

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:

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Amounts payable in respect of insurance fees	**8.3**	5.3
Current year premiums payable in respect of quota share arrangements	**145.1**	34.8
Adjustments to prior year premiums in respect of quota share arrangements	**-**	(13.5)
Outward reinsurance premiums	**153.4**	26.6

The adjustment to prior year premiums figure reported for 2011 reflects the revaluation of a transaction completed in December 2010 but not settled until January 2011.

10. Deferred tax

At 31 December 2012 the Company's deferred tax balances calculated in accordance with IAS 12 *"Income Taxes"* were as follows:

	Asset £m	**Liability £m**	**Total £m**
31 December 2012			
Additional reserves	**-**	**(9.4)**	**(9.4)**
31 December 2011			
Additional reserves	-	(7.6)	(7.6)

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

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
At beginning of year	**(7.6)**	(8.2)
Recognition of deferred tax liability on temporary timing differences	**(2.6)**	-
Effect of change in tax rates	**0.8**	0.6
At end of year	**(9.4)**	(7.6)

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 Company has no timing differences or tax losses carried forward at 31 December 2012 *(2011: nil)* which may give rise to reduced tax charges in future periods.

11. Financial assets and financial liabilities

All of the Company'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.

	31 December 2012		31 December 2011	
Financial Assets	**Fair value through profit and loss**	**Amortised cost**	Fair value through profit and loss	Amortised cost
	£m	**£m**	£m	£m
Financial investments				
Debt securities	**4,346.5**		3,014.9	
Mortgage backed and other asset backed securities	**377.1**		267.4	
Deposits with credit institutions	**57.4**		74.1	
Participation in investment schemes	**453.0**		368.9	
Collateralised loan obligations	**132.4**		88.0	
Other loans	**-**	**-**	-	115.0
Total financial investments	**5,366.4**	**-**	3,813.3	115.0
Derivative assets	**2,047.9**		1,534.2	
Loans and receivables and other financial assets				
Debtors arising out of direct insurance operations		**66.9**		8.0
Other debtors		**12.3**		8.3
Accrued interest		**66.5**		40.5
Total receivables and other financial assets		**145.7**		56.8
Cash and cash equivalents		**0.5**		0.5
Total Financial Assets	**7,414.3**	**146.2**	5,347.5	172.3
Financial Liabilities				
Derivative liabilities	**1,787.6**		1,295.1	
Creditors arising out of reinsurance operations		**1.9**		36.7
Other creditors		**12.4**		0.3
Insurance and other payables		**14.3**		37.0
Accruals		**15.4**		11.1
Total Financial Liabilities	**1,787.6**	**29.7**	1,295.1	48.1

Included within receivables and other financial assets are amounts totalling £47.8m *(2011: £1.8m)* 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.

11. Financial assets and financial liabilities (continued)

Other loans

As at 31 December 2011 the Company held a loan investment with Tusk Investments LP Incorporated ("Tusk") valued at £110m. The loan accrued interest at 2.75% above LIBOR and had a maturity date of 16 December 2013. On 4 October 2012 Tusk novated this loan to Co-Investment Limited, a wholly owned subsidiary of Tusk, and the loan was then split into the following tranches:

Junior Loan: Face Value £68m, Interest 1% above LIBOR, Maturity date 16 December 2021.
Senior Loan: Face Value £29m, Interest 0.6% above LIBOR, Maturity date16 December 2013.

On 8 October 2012 PIC transferred the Junior tranche to PHC3 at its fair value of £8m and in return received a loan note of the same value from PHC3. On 23 October 2012 PHC3 repaid this loan note in full.

On 22 October Reinet subscribed for shares in PIC's ultimate parent company, PCG. As part of this subscription it was required that the terms of the Senior Loan be amended so that there would be a contractual obligation on PIC to transfer the loan outside of the Group if it were not repaid before the maturity date.

The directors of PIC have performed a valuation exercise of the Senior Loan based on information regarding the trading performance and other liabilities of the Tusk group made available to PIC during the year. The review concluded it was unlikely that any repayment would be received before the maturity date. This analysis together with PIC's contractual obligations to transfer the loan outside the Group on maturity has resulted in the fair value of the Senior Loan being assessed as nil at 31 December 2012.

PIC recognised a realised loss of £73m and an unrealised impairment of £29m in respect of these loans.

Other debtors

Other debtors includes two inter group loans made by PIC to PHC3 totalling £5.2m.

The first loan was acquired from PICH on 9 May 2012 at fair value of £0.1m. It has no fixed maturity date and is repayable on demand by either party. Interest is payable on this loan at 2% above LIBOR. The balance outstanding at 31 December 2012 was £0.1m.

The second loan was acquired in return for PIC transferring its receivable from PICH, the former parent company, of £5.1m to PHC3 on 3 October 2012 as part of the reorganisation of the loan relationships within the group headed by PCG. This loan is non-interest bearing, has no fixed maturity and the balance outstanding at 31 December 2012 was £5.1m.

11. Financial assets and financial liabilities (continued)

Deposits with credit institutions

Deposits with credit institutions include £10.3m *(2011: nil)* in two bank accounts 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 Munchener Ruckversicherungsgesellschaft ("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.

The Company 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

At 31 December 2012 the Company has included £88.0m *(2011: £45.0m)* of financial assets which have been pledged as security under the terms of derivative contracts. The Company 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.

Measurement of financial assets and liabilities

The Company's financial assets and liabilities have been valued using the following methods in accordance with IAS 39 *"Financial Instruments"*.

The fair values of quoted investments are based on their bid market prices. For unlisted securities and all other financial assets for which there is no active market, the Company 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. 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.

11. Financial assets and financial liabilities (continued)

Measurement of financial assets and liabilities (continued)

b) Derivatives

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured 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. Where the market is illiquid or inactive so that market prices do not provide an accurate indication of fair value, the data inputs to the discounted cash flows may be drawn from historic trends or other appropriate information sources. At 31 December 2012 the Company has used the historic volatility in the RPI to derive the implied future volatility in the pricing of its LPI swaps as if the market in those swaps were liquid.

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.

c) Mortgage backed and other asset backed securities

The fair value of mortgage backed and other asset backed securities is determined by reference to their listed market price. The assets are not expected to be recovered within 12 months of the end of the financial year.

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.

e) Other loans

The value of other loans is based on their amortised cost adjusted for any impairment in value. In determining the value at the Statement of financial position date, the directors consider the specific circumstances surrounding the value of each loan on an individual basis.

f) Collateralised loan obligations

The fair value of collateralised loan obligations ("CLOs") is calculated using discounted cash flow techniques on a mark to model basis. As the market for CLOs is illiquid and each individual note is unique in respect of its cash flow and risk profile, the parameters of the valuation model are based on data inputs drawn from a number of sources including monthly reports from the trustee of each CLO, the capital structure and risk profile of each note, market data such as interest rate curves and recently traded prices of the comparable CLO transactions.

11. Financial assets and financial liabilities (continued)

Measurement of fair value

The following table analyses the Company's financial investments according to the basis of measurement required by IFRS 7.

31 December 2012	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Debt securities	**1,217.7**	**2,928.5**	**200.3**	**4,346.5**
Mortgage backed and other asset backed securities	**-**	**377.1**	**-**	**377.1**
Deposits with credit institutions	**57.4**	**-**	**-**	**57.4**
Participation in investment schemes	**80.9**	**372.1**	**-**	**453.0**
Collateralised loan obligations	**-**	**-**	**132.4**	**132.4**
Financial investments	**1,358.0**	**3,677.7**	**332.7**	**5,366.4**
Derivative assets	**2.5**	**1,995.8**	**49.6**	**2,047.9**
Financial assets	**1,358.5**	**5,673.5**	**382.3**	**7,414.3**
Derivative liabilities	**(0.7)**	**(1,786.9)**	**-**	**(1,787.6)**

31 December 2011	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Debt securities	1,382.6	1,610.1	22.2	3,014.9
Mortgage backed and other asset backed securities	-	267.4	-	267.4
Deposits with credit institutions	74.1	-	-	74.1
Participation in investment schemes	68.3	300.6	-	368.9
Collateralised loan obligations	-	-	88.0	88.0
Other loans	-	-	115.0	115.0
Financial investments	1,525.0	2,178.1	225.2	3,928.3
Derivative assets	0.1	1,475.7	58.4	1,534.2
	1,525.1	3,653.8	283.6	5,462.5
Derivative liabilities	(4.8)	(1,290.3)	-	(1,295.1)

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.

There were no assets held at 1 January and 31 December 2012 that were reclassified during the year. All movements relate to acquisitions and disposals, realised and unrealised gains.

11. Financial assets and financial liabilities (continued)

Measurement of fair value (continued)

Movements relating to Level 3 assets during the reporting period are analysed as follows:

Year ended 31 December 2012	**Other loans £m**	**Swaps £m**	**CLOs £m**	**Debt Securities £m**	**Total £m**
Opening balance	**115.0**	**58.4**	**88.0**	**22.2**	**283.6**
Realised and unrealised gains/(losses)	**(102.0)**	**(8.8)**	**15.5**	**13.5**	**(81.8)**
Acquisitions in year	**-**	**-**	**40.2**	**165.0**	**205.2**
Disposals in year	**(13.0)**	**-**	**(11.3)**	**(0.4)**	**(24.7)**
Closing balance	**-**	**49.6**	**132.4**	**200.3**	**382.3**

Year ended 31 December 2011	Other loans £m	Swaps £m	CLOs £m	Debt Securities £m	Total £m
Opening balance	119.5	26.3	-	-	145.8
Realised and unrealised gains/(losses)	-	32.1	(11.9)	-	20.2
Acquisitions in year	-	-	99.9	22.2	122.1
Disposals in year	(4.5)	-	-	-	(4.5)
Closing balance	115.0	58.4	88.0	22.2	283.6

Debt securities valued as mark to model include infrastructure and other loans in respect of capital projects for which there is no active market.

The investment return within the Statement of comprehensive income includes the following income and investment gains and losses relating to Level 3 assets:

Year ended 31 December 2012	**Other loans £m**	**Swaps £m**	**CLOs £m**	**Debt Securities £m**	**Total £m**
Interest income	**-**	**-**	**0.5**	**0.6**	**1.1**
Income from debt securities	**-**	**-**	**-**	**2.5**	**2.5**
Income from other investments	**-**	**0.3**	**4.1**	**-**	**4.4**
Net realised gains/(losses)	**(73.0)**	**0.5**	**(0.3)**	**0.1**	**(72.7)**
Net unrealised gains/(losses)	**(29.0)**	**(9.3)**	**15.8**	**13.4**	**(9.1)**
Investment return on Level 3 assets	**(102.0)**	**(8.5)**	**20.1**	**16.6**	**(73.8)**

11. Financial assets and financial liabilities (continued)

Measurement of fair value (continued)

Year ended 31 December 2011	Other loans £m	Swaps £m	CLOs £m	Debt Securities £m	Total £m
Interest income	3.4	-	0.8	-	4.2
Income from other investments	-	0.2	3.3	-	3.5
Net realised gains/(losses)	-	0.2	(0.1)	-	0.1
Net unrealised gains/(losses)	-	31.7	(11.8)	-	19.9
Investment return on Level 3 assets	3.4	32.1	(7.8)	-	27.7

12. Derivative financial instruments

The Company 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 Company against the adverse effects of inflation over a period of time while the Company 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 2012		31 December 2011	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Interest rate swaps	**746.9**	**(506.1)**	613.6	(428.3)
Inflation swaps	**132.5**	**(145.3)**	99.3	(64.1)
Credit default swaps	**-**	**(0.7)**	1.0	-
Currency swaps	**5.5**	**-**	2.1	(0.7)
Total return swaps	**16.5**	**-**	17.1	-
Foreign exchange forward contracts	**1,144.0**	**(1,134.9)**	801.0	(797.2)
Futures	**2.5**	**(0.6)**	0.1	(4.8)
Total derivative position	**2,047.9**	**(1,787.6)**	1,534.2	(1,295.1)

13. Risk management

As a provider of insurance solutions to defined benefit pension schemes, the Company's business involves the acceptance and management of risk to achieve its strategic objectives.

The principal risk factors which affect the Company'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 Company's business and mainly arises from exposure to longevity in respect of annuity payments. Regulatory risk stems principally from the risk of changed solvency requirements including those arising from the still evolving Solvency II regulations, but also in the way the regulator deals with the Company e.g. through the splitting of the FSA into Prudential Regulatory Authority and Financial Conduct Authority. The main reputation risks relate to the need to maintain a good reputation with trustees of pension schemes and their advisors in order to attract new business and with its own policyholders through treating its customers fairly.

The directors have overall responsibility for the management of the exposure to these risks. They are supported through formal committees of the Board including the Asset Liability Management Committee, Audit Committee, Origination 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 reputation risk.

The management and control of the Company's risks is a significant focus area for the Board as an uncontrolled and unmanaged development in various risks may affect the Company's performance and capital adequacy. The Company 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 longevity risk, interest rate risk and inflation risk, which carry little reward for the Company. Such risks are managed and mitigated to the extent that it is cost effective to do so.

The Company uses derivatives for the purpose of efficient portfolio management or to reduce risk in aspects of the Company'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 Company uses 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 tactically control credit risk.

The Company monitors its exposure to risks through regular reviews of its portfolios of assets and liabilities and their underlying characteristics. Consequently the directors have chosen not to apply hedge accounting to the Company's derivatives.

13. Risk management (continued)

a) *Market risk*

The Company 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 Company 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 Company 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 Company's policy is that after hedging, no more than 5% of the asset portfolio is exposed to currency fluctuations.

The Company 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 Company 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. Where appropriate the management of these alternative exposures is delegated to specialist fund managers, in line with well-defined investment management mandates. In all cases the Company ensures regular oversight of the investment management activities, and maintains detailed risk models for all investment types, fully incorporating analysis of alternative investments in its risk and capital assessment

b) *Credit risk*

Credit risk is the risk of loss due to the default of another party in performing its financial obligations to the Company. The Company is primarily exposed to credit risk through its investment in debt securities and cash deposits within both the long term business fund and shareholder fund.

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 Company manages exposure to credit risk by placing limits on exposures to individual counterparties as well as groups of counterparties with the same characteristics. 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.

Pension Insurance Corporation Limited

Notes to the financial statements for the year ended 31 December 2012 (continued)

13. Risk management (continued)

b) *Credit risk (continued)*

The following table sets out the credit risk exposure and ratings of financial assets which are susceptible to credit risk. The ratings used are Bloomberg Composite except in instances where such a rating does not exist, in which case an S&P rating has been used. The remaining unrated assets are not classified by either rating agency.

31 December 2012	**AAA £m**	**AA £m**	**A £m**	**BBB £m**	**BB £m**	**Unrated £m**	**Total £m**
Loans and debt securities							
Debt securities	**1,769.7**	**318.4**	**855.0**	**1,064.7**	**31.2**	**307.5**	**4,346.5**
Mortgage backed and other asset backed securities	**111.9**	**83.1**	**81.2**	**85.7**	**1.7**	**13.5**	**377.1**
Collateralised loan obligations	**-**	**-**	**43.3**	**39.3**	**13.8**	**36.0**	**132.4**
	1,881.6	**401.5**	**979.5**	**1,189.7**	**46.7**	**357.0**	**4,856.0**
Other assets							
Collateralised derivative assets	**-**	**-**	**-**	**-**	**-**	**2,047.9**	**2,047.9**
Participation in investment schemes	**-**	**-**	**-**	**-**	**-**	**453.0**	**453.0**
Receivables and other financial assets	**22.5**	**4.5**	**13.3**	**20.9**	**1.0**	**83.5**	**145.7**
Deposits with credit institutions	-	**10.3**	**47.9**	-	-	**(0.8)**	**57.4**
Cash and cash equivalents	**-**	**0.5**	**-**	**-**	**-**	**-**	**0.5**
	22.5	**15.3**	**61.2**	**20.9**	**1.0**	**2,583.6**	**2,704.5**

31 December 2011	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Total £m
Loans and debt securities							
Debt securities	1,483.2	272.7	678.7	497.5	16.2	66.6	3,014.9
Mortgage backed and other asset backed securities	80.5	58.7	99.1	20.2	2.3	6.7	267.5
Collateralised loan obligations	-	-	22.8	33.9	3.4	27.9	88.0
Other loans	-	-	-	-	-	115.0	115.0
	1,563.7	331.4	800.6	551.6	21.9	216.2	3,485.4
Other assets							
Collateralised derivative assets	-	-	-	-	-	1,534.3	1,534.3
Participation in investment schemes	-	-	-	-	-	368.9	368.9
Receivables and other financial assets	5.0	4.2	11.3	12.0	0.3	24.0	56.8
Deposits with credit institutions	-	-	-	-	-	74.1	74.1
Cash and cash equivalents	-	-	0.5	-	-	-	0.5
	5.0	4.2	11.8	12.0	0.3	2,001.3	2,034.6

13. Risk management (continued)

b) Credit risk (continued)

Although the instruments themselves are unrated, the ultimate issuing party for most collateralised derivative assets do have a credit rating. Applying the issuer rating to the assets held at 31 December 2012 produces the following split:

31 December 2012	**AAA £m**	**AA £m**	**A £m**	**BBB £m**	**BB £m**	**Unrated £m**	**Total £m**
Collateralised derivative assets	**-**	**198.9**	**1,833.2**	**-**	**-**	**15.8**	**2,047.9**

31 December 2011	AAA £m	AA £m	A £m	BBB £m	BB £m	Unrated £m	Total £m
Collateralised derivative assets	-	237.5	1,282.0	-	-	14.7	1,534.2

Eurozone exposure

At 31 December 2012 the Company holds a number of loans and debt securities issued by the central governments of countries within the Eurozone and EU institutions backed by European sovereign treaties. In accordance with the Company's accounting policy all these investments are classified at fair value through profit and loss and marked to market. The fair value and credit rating of the assets held by the Company is:

Loans and debt securities ***Counterparty***	**Fair value 31 December 2012 £m**	**Principal amount 31 December 2012 £m**	**Credit rating 31 December 2012**
Italy	**50.6**	**56.9**	**BBB**
France	**43.5**	**32.0**	**AA+**
European Investment Bank	**30.5**	**24.9**	**AAA**
European Bank for Reconstruction and Development	**5.6**	**4.0**	**AAA**
	130.2	**117.8**	

Loans and debt securities *Counterparty*	Fair value 31 December 2011 £m	Principal amount 31 December 2011 £m	Credit rating 31 December 2011
Italy	40.4	68.4	A-
France	35.6	36.7	AAA
European Investment Bank	45.0	37.9	AAA
European Bank for Reconstruction and Development	5.4	3.0	AAA
	126.4	146.0	

There have been no changes in credit rating since the Statement of financial position date.

13. Risk management (continued)

b) Credit risk (continued)

Eurozone exposure (continued)

These assets are included with regular stress testing undertaken by the Company which assesses the impact of a number of scenarios on the Company's solvency position.

Reinsurance counterparties

The Company has reinsurance contracts in place with five external reinsurer's with an exposure of £722m at 31 December 2012. 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 31 December 2012.

Impaired assets

The Company did not have any impaired or past due date assets at 31 December 2012.

c) Liquidity risk

Liquidity risk is the risk that the Company, although solvent, either does not have sufficient financial resources available to it in order to meet its obligations when they fall due, or can secure them only at excessive cost. The Company's ALM framework is designed to ensure that sufficient cash is available from the investment portfolio to support the anticipated pension annuity payments as they fall due. In addition to holding liquid financial assets within the long term business fund, liquidity risk is managed through modelling detailed forecasts of annuity payments, ensuring counterparties for cash deposits are highly rated and regular monitoring of the overall liquidity position.

The following table sets out the contractual maturity analysis of financial liabilities.

31 December 2012	**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	**1.9**	**-**	**-**	-	**1.9**
Other creditors	**12.5**	**-**	**-**	-	**12.5**
Accruals	**15.3**	**-**	**-**	-	**15.3**
Derivative liabilities	**1,169.6**	**38.2**	**162.4**	**417.4**	**1,787.6**
	1,199.3	**38.2**	**162.4**	**417.4**	**1,817.3**

31 December 2011	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	36.7	-	-	-	36.7
Other creditors	0.2				0.2
Accruals	11.1	-	-	-	11.1
Derivative liabilities	831.7	21.1	87.0	355.4	1,295.2
	879.7	21.1	87.0	355.4	1,343.2

Amounts due to group undertakings are included within Other creditors. At 31 December 2012 £3.7m was payable to PSC. This amount is expected to be paid in the next financial year. There were no amounts due to group undertakings at 31 December 2011.

13. Risk management (continued)

d) Specific insurance risk

Longevity risk is the risk that mortality experience of the Company's policyholders is less favourable than assumed, thus requiring pensions to be paid for a longer period than anticipated resulting in a higher than expected cost to the Company.

In order to help minimise this risk and also volatility arising through future longevity experience, PIC adopts an active approach to reinsuring these risks. This policy is founded on a principle of efficient capital management and operates within targets set by the Board. 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 Company has committed to pay the reinsurer a fixed line of cashflows for each relevant scheme. The reinsurer undertakes to reimburse the actual cost of claims to the Company. Separately, there is also an insurance fee for which the Company is liable. Settlement of the contract is on a net basis. These contracts also transfer the contingent longevity risk relating to any spouses of relevant policyholders.

Longevity reinsurance via the transfer of assets

This currently provides longevity cover in respect of certain policyholders whose pensions are not yet in-payment. Under such contracts, in return for a premium, the reinsurer agrees to reimburse the actual cost of future claims to the Company in respect of an agreed set of policyholders. These contracts also transfer the contingent risks relating to spouses of relevant policyholders.

The Company 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 on a scheme by scheme basis but with appropriate variation and granularity for individual members within that scheme. Individual variations are subject to a number of factors including, but not limited to, an individual's gender, age and pension amount.

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. These assumptions currently only differ according to gender. They are 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 portfolio, the Company also considers the following risks:

Risk arising from a specific insurance contract

The Company 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 Company prepares information based upon a series of possible market conditions. The results of this exercise are then considered with regard to the effect on the current portfolio.

13. Risk management (continued)

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 Company'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, a continuous training programme, segregation of duties and whistle-blowing policies.

The Company has significant outsourcing arrangements of pension payrolls 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 external occurrences.

14. Share capital

The allotted, called up and fully paid share capital of the Company is:

	31 December 2012 £m	31 December 2011 £m
Allotted, called up and fully paid		
401,304,196 *(2011: 325,583,561)* ordinary shares of £1 each	**401.3**	325.6

The Company issued 75,720,635 £1 ordinary shares fully paid for cash consideration on 23 October 2012.

15. Reserves

	Other reserves £m	**Accumulated surplus £m**
At beginning of year	**60.0**	**34.4**
Total comprehensive income	**-**	**139.7**
At end of year	**60.0**	**174.1**

16. Contingent liability

The Company incurred a potential obligation to pay £5.5m to Henderson Global Investors Limited in performance related management fees based on investment performance to September 2009. Both parties agreed that this potential obligation would be settled by PIC investing seed capital into a number of Henderson investment funds at its own discretion.

As at December 2012 the potential liability had reduced to £1.5m as a result of PIC's investment in various Henderson funds which continue to be held by the Company.

17. 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. Full details of the Company's capital resources are given in the Statement of Changes in Equity.

The Company'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 the Company'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.

The Company currently has sufficient capital available to meet all its present capital requirements and does not utilise debt capital, financial reinsurance or securitisation.

The Company is required to hold sufficient capital at all times to meet the FSA's capital requirements and it manages its capital so as to ensure compliance. The capital requirement is calculated on the statutory basis, which is based on EU Directives. For all regulated insurance business, account is also taken of the Individual Capital Assessment which considers certain business risks not reflected in the statutory basis.

The Company reviews its capital resources formally at least monthly and has complied with all externally and internally imposed capital requirements during the year. It remains the intention of management to ensure that there is adequate capital to exceed the Company's regulatory requirements. This is managed through the Company's internal policy of maintaining capital at a level which exceeds the higher of its internal capital requirement and the relevant regulatory capital requirement plus a specified margin.

17. Capital resources (continued)

The following table analyses the Company's capital resources between those held within the long term insurance business fund ("LTIBF") and other capital resources. The total available capital resources indicates the capital that is available to meet the regulatory capital requirements of the business.

31 December 2012	**UK Non-participating**	**Life Business Shareholders funds**	**Total Life Business**
	£000	**£000**	**£000**
Shareholders Other Interests outside LTIBF	**-**	**515.8**	**515.8**
Shareholders Other Interests held in LTIBF	**119.6**	**-**	**119.6**
Total Shareholders Other Interests	**119.6**	**515.8**	**635.4**
Adjustments onto regulatory basis:			
Other adjustments for statutory solvency	**(40.7)**	**-**	**(40.7)**
	78.9	**515.8**	**594.7**
Other qualifying capital	**-**	**-**	**-**
Total available capital resources	**78.9**	**515.8**	**594.7**

31 December 2011	UK Non-participating	Life Business Shareholders funds	Total Life Business
	£m	£m	£m
Shareholders Other Interests outside LTIBF	-	274.2	274.2
Shareholders Other Interests held in LTIBF	145.8	-	145.8
Total Shareholders Other Interests	145.8	274.2	420.0
Adjustments onto regulatory basis:			
Other adjustments for statutory solvency	(30.6)	-	(30.6)
	115.2	274.2	389.4
Other qualifying capital	-	-	-
Total available capital resources	115.2	274.2	389.4

18. Related party transactions

During October 2012 a group reorganisation was undertaken, the result of which was to replace PICH as the Company's ultimate parent with PCG.

On 1 October 2012 PCLLP was replaced as the Company's main service provider by PSC.

a) Transactions with PICH

Prior to the reorganisation, the Company provided a £10.0m unsecured loan facility to PICH.

The amount drawn down under this facility at 1 January 2012 was £5.0m. The repayment date was 31 December 2013 (or earlier at the discretion of the borrower) and with an interest rate of 2.5% above LIBOR. On 3 October 2012 the loan was transferred to PHC3 in return for a loan note issued by PHC3.

During the period prior to the transfer, the Company accrued interest of £0.1m which was added to the outstanding balance.

b) Transactions with PSIC

The Company did not cede any insurance premiums to PSIC during the year *(2011:nil)*. No commissions were due *(2011: nil)* and recovery of claims totalling £11.2m *(2011; £11.4m*), were due under the terms of the reinsurance contract in place with PSIC. At 31 December 2012 the outstanding balance in claims due from PSIC was £5.8m *(2011: £5.9m).*

c) Transactions with PCLLP

On 30 September 2012 the Company novated its agreement with PCLLP to provide management, staff, IT and office services to PSC.

On the same date the Company forgave a receivable of £3.6m due from PCLLP as an advance against the payment for future services provided. The receivable has been classed as a prepayment in prior years and an amount of £1.8m was included in the comparative figures. Total charges for the services received in the period to 30 September 2012 were £22.4m (*2011: Full year £20.3m).*The remaining prepayment of £0.6m was transferred to PSC by PC LLP along with the other trading assets and liabilities of its business.

d) Transactions with PSC

On 1 October 2012 PSC became the provider of management, staff, IT, office services and contracted director services to the Company. Total charges for the period to 31 December 2012 were £7.3m *(2011; nil).* At 31 December 2012 the amount due to PSC relating to the services provided was £3.7m *(2011; nil).*

18. Related party transactions (continued)

e) Transactions with PHC3

On 3 October 2012 the Company novated a loan of £5.1m, from PICH, to PHC3 in return for a loan note issued by that company.

The loan note is non-interest bearing and full or partial repayment may be made, at any time, at the discretion of the borrower.

On 14 May 2012 the Company acquired an £80,000 loan facility from PICH. The facility was provided to PHC3 for the purpose of funding its investment in the GPUTs. The loan is repayable on demand from the Company or at the discretion of the borrower with an interest rate of 2% above LIBOR calculated quarterly. The amount outstanding at 31 December 2012 was £77,800.

19. Parent company and ultimate controlling party

The Company is a wholly owned subsidiary of Pension Holdings Company (UK) 3 Limited, which is incorporated in England and Wales.

The directors regard Pension Corporation Group Limited ("PCG") a limited company incorporated in Guernsey as the ultimate parent and controlling party. PCG is the largest and smallest group of which the Company is a member and for which group financial statements are prepared. The consolidated financial statements of PCG are available to the public and may be obtained from Western Suite, Ground Floor, Mill Court, La Charroterie, St Peter Port, Guernsey GY1 1EJ.

PRINCIPAL OFFICE OF THE ISSUER

Pension Insurance Corporation plc
14 Cornhill
London EC3V 3ND
United Kingdom

TRUSTEE

Citicorp Trustee Company Limited
Citigroup Centre
Canada Square
Canary Wharf
London E14 5LB
United Kingdom

PRINCIPAL PAYING AGENT

Citibank, N.A., London Branch
Citigroup Centre
Canada Square
Canary Wharf
London E14 5LB
United Kingdom

JOINT LEAD MANAGERS

Morgan Stanley & Co. International plc
25 Cabot Square
Canary Wharf
London E14 4QA
United Kingdom

The Royal Bank of Scotland plc
135 Bishopgate
London EC2M 3UR
United Kingdom

AUDITOR OF THE ISSUER

KPMG Audit Plc
15 Canada Square
London E14 5GL
United Kingdom

LEGAL ADVISERS

To the Issuer
Slaughter and May
One Bunhill Row
London EC1Y 8YY
United Kingdom

To the Managers and the Trustee
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom