PARTNERSHIP ASSURANCE GROUP PLC

(incorporated and registered in England and Wales with registered number 08419490)

£100,000,000 9.5 per cent.
Fixed Rate Guaranteed Subordinated Notes due 2025

having the benefit of a subordinated guarantee of

PARTNERSHIP LIFE ASSURANCE COMPANY LIMITED

(incorporated and registered in England and Wales with registered number 05465261)

Issue Price 100 per cent.

The £100,000,000 9.5 per cent. Fixed Rate Guaranteed Subordinated Notes due 2025 (the "**Subordinated Notes**") were issued by Partnership Assurance Group plc (the "**Issuer**" or "**Partnership**") on 24 March 2015 (the "**Issue Date**"). The Subordinated Notes constitute subordinated obligations of the Issuer. The Subordinated Notes bear interest from (and including) the Issue Date to (but excluding) 24 March 2025 (the "**Maturity Date**") at a rate of 9.5 per cent. per annum payable annually in arrear on 24 March in each year, as described in *Terms and Conditions of the Subordinated Notes - Interest*. All obligations of the Issuer to make payments in respect of the Subordinated Notes are guaranteed on a limited and subordinated basis by Partnership Life Assurance Company Limited (the "**Guarantor**") as more particularly described in "*Terms and Conditions of the Subordinated Notes – Status and Subordination of the Guarantee*".

Payments of interest on the Subordinated Notes by the Issuer will be mandatorily deferred on each Interest Payment Date (as defined in the Conditions) (i) in respect of which an Issuer Regulatory Deficiency Deferral Event (as defined in the Conditions) has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date or (ii) where payment of interest on that date would breach the provisions of Solvency II and/or the Relevant Rules which apply to Tier 2 Capital (each such term as defined in the Conditions), as more particularly described in "*Terms and Conditions of the Subordinated Notes—Deferral of Interest*". Any interest which is deferred (and not paid by the Guarantor) will, for so long as it remains unpaid, constitute "**Arrears of Interest**". Arrears of Interest will not themselves bear interest, and will be payable as provided in Condition 6 (*Deferral of Interest*). Payments in respect of the Subordinated Notes will be made without withholding or deduction for, or on account of, taxes of the United Kingdom, unless such withholding or deduction is required by law. If any such withholding or deduction is made, additional amounts may be payable by the Issuer or the Guarantor, subject to certain exceptions as are more fully described in "*Terms and Conditions of the Subordinated Notes—Taxation*".

The Subordinated Notes will (unless previously redeemed or purchased and cancelled) mature on the Maturity Date. Subject to certain pre-conditions including the satisfaction of the Regulatory Clearance Condition and continued compliance with the Relevant Rules, the Subordinated Notes may be redeemed, substituted or varied prior to such date (i) in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation or application thereof or (ii) following the occurrence of (or if the Issuer is satisfied that there will occur within six months) a Capital Disqualification Event (**provided that**, in the case of any redemption or purchase prior to the fifth anniversary of the Issue Date, the approval of the Prudential Regulation Authority (the "**PRA**") is required and the Subordinated Notes are exchanged for, or redeemed out of the proceeds of, a new issue of regulatory capital of the same or higher category of regulatory capital treatment (unless Solvency II is implemented without such requirements). The redemption of the Subordinated Notes on the Maturity Date or any other date fixed for the redemption of the Subordinated Notes shall be deferred in certain circumstances as set out in Condition 7 (*Redemption, Substitution, Variation and Purchase*). Payments on redemption by the Issuer will be subject to the Issuer Solvency Condition and Policyholder Requirement and to the Issuer Regulatory Deficiency Redemption Deferral Event (each such term as defined in the Conditions) having not occurred or occurring if the Subordinated Notes were to be redeemed.

Application has been made to the Financial Conduct Authority (the "**FCA**") under Part VI of the Financial Services and Markets Act 2000 (in such capacity, the "**UK Listing Authority**") for the Subordinated Notes to be admitted to the official list of the UK Listing Authority (the "**Official List**") and to the London Stock Exchange plc (the "**London Stock Exchange**") for such Subordinated Notes to be admitted to trading on the London Stock Exchange's Regulated Market (the "**Market**"). References in this Prospectus to the Subordinated Notes being "listed" (and all related references) shall mean that the Subordinated Notes have been admitted to the Official List and have been admitted to trading on the Market. The Market is a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments.

The denomination of the Subordinated Notes is £100,000 and integral multiples of £1,000 in excess thereof. The Subordinated Notes were issued in registered form and were represented upon issue by a registered global certificate which was registered in the name of a nominee for a common depositary for Clearstream Banking, *société anonyme* ("**Clearstream, Luxembourg**") and Euroclear Bank SA/NV ("**Euroclear**") on the Issue Date. Save in limited circumstances, Subordinated Notes in definitive form will not be issued in exchange for interests in the registered global certificate.

Prospective investors should have regard to the factors described under the section entitled "*Risk Factors*" in this Prospectus.

Prospectus dated 14 May 2015

This Prospectus comprises a prospectus for the purposes of Directive 2003/71/EC, as amended (the "**Prospectus Directive**") and for the purpose of giving information with regard to the Issuer, the Guarantor, the Issuer and its subsidiaries taken as a whole (the "**Group**"), and the Subordinated Notes which, according to the particular nature of the Issuer, the Guarantor and the Subordinated Notes, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Issuer and the Guarantor. Each of the Issuer and the Guarantor accepts responsibility for the information contained in this Prospectus. To the best of the knowledge and belief of each of the Issuer and the Guarantor (each of which has 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.

Words and expressions defined in the section entitled "*Terms and Conditions of the Subordinated Notes*" and not otherwise defined in this Prospectus shall have the same meanings when used in the remainder of this Prospectus.

This Prospectus does not constitute an offer of, or an invitation by or on behalf of the Issuer or the Guarantor to subscribe or purchase any of the Subordinated Notes. The distribution of this Prospectus and the offering of the Subordinated Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes are required by the Issuer, the Guarantor and BNY Mellon Corporate Trustee Services Limited (the "**Trustee**") to inform themselves about and to observe any such restrictions. For a description of further restrictions on offers and sales of the Subordinated Notes and distribution of this Prospectus, see the section entitled "*Purchase and Sale*" on page 108.

No person is authorised to give any information or to make any representation not contained in this Prospectus and any information or representation not so contained must not be relied upon as having been authorised by or on behalf of the Issuer, the Guarantor 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 or the Guarantor since the date hereof or the date upon which this Prospectus has been most recently amended or supplemented or that there has been no adverse change in the financial position of the Issuer or the Guarantor since the date hereof or the date upon which this Prospectus has been most recently amended or supplemented or that the information contained in it or any other information supplied in connection with the Subordinated 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.

To the fullest extent permitted by law, the Trustee does not accept any responsibility whatsoever for the contents of this Prospectus or for any other statement, made or purported to be made by the Trustee, or on its behalf, in connection with the Issuer, the Guarantor or the issue and offering of the Subordinated Notes. The Trustee accordingly disclaims all and any liability whether arising in tort or contract or otherwise (save as referred to above) which it might otherwise have in respect of this Prospectus or any such statement.

The Subordinated Notes have not been and will not be registered under the US Securities Act of 1933, as amended (the "**Securities Act**"). Subject to certain exceptions, the Subordinated Notes may not be offered, sold or delivered within the United States or to US persons. The Subordinated Notes have not been approved or disapproved by the U.S. Securities and Exchange Commission (the "**SEC**"), any state securities commission in the United States or any other US regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering of the Subordinated Notes or the accuracy or adequacy of this Prospectus. Any representation to the contrary is a criminal offence in the United States.

Unless otherwise specified or the context requires, references to "**sterling**", "**pounds sterling**" or "**pounds**" are to the lawful currency of the United Kingdom and all references to "**euro**" and "**€**" are to the currency introduced at the start of the Third Stage of European Economic and Monetary Union pursuant to the Treaty on the Functioning of the European Union ("**EU**"), as amended.

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OVERVIEW OF THE PRINCIPAL FEATURES OF THE SUBORDINATED NOTES

The following overview refers to certain provisions of the terms and conditions of the Subordinated Notes and the Trust Deed and is qualified by the more detailed information contained elsewhere in this Prospectus. Capitalised terms which are defined in the section entitled "Terms and Conditions of the Subordinated Notes" on page 31 shall have the same meaning when used in this overview.

Issuer:	Partnership Assurance Group plc
Guarantor:	Partnership Life Assurance Company Limited
Description of the Subordinated Notes:	£100,000,000 9.5 per cent. Fixed Rate Guaranteed Subordinated Notes due 2025
Trustee:	BNY Mellon Corporate Trustee Services Limited
Principal Paying Agent:	The Bank of New York Mellon, London Branch
Registrar and Transfer Agent:	The Bank of New York Mellon (Luxembourg) S.A.
Issue Date:	24 March 2015
Issue Price:	100 per cent.
Risk Factors:	There are certain factors that may affect the Issuer's ability to fulfil its obligations under the Subordinated Notes and the Guarantor's ability to fulfil its obligations under the Guarantee. In addition, there are certain factors which are material for the purpose of assessing the market risks associated with the Subordinated Notes and certain risks relating to the structure of the Subordinated Notes. These are set out in the section entitled "*Risk Factors*" on page 9.
Status and Subordination of the Subordinated Notes:	The Subordinated Notes constitute direct, unsecured and subordinated obligations of the Issuer which at all times rank *pari passu* without any preference among themselves. The rights and claims of the Noteholders against the Issuer are subordinated in an Issuer Winding-Up as described in Condition 2(b) (*Subordination*).
Issuer Solvency Condition and Policyholder Requirement:	Other than in the event of an Issuer Winding-Up as described in Condition 2(b) (*Subordination*) and without prejudice to Condition 10 (*Events of Default*), payment of all amounts by the Issuer under or arising from the Subordinated Notes and the Trust Deed will be mandatorily deferred unless: (i) the Issuer is solvent at the time for payment by the Issuer, and until such time as the Issuer could make such payment and still be solvent immediately thereafter, and (ii) if at any time (a) an order is made, or an effective resolution is passed, for the winding-up in England and Wales of a Group Regulated Entity, or (b) if an administrator of such Group Regulated Entity has been appointed and such administrator gives notice that it intends to declare and distribute a dividend or other distribution of assets, all obligations owed by such Group Regulated Entity to its policyholders have been satisfied in full or the procedure for such winding-up or, as the case may be, administration, as referred to in (a) or (b) above is no

longer continuing.

Status and Subordination of the Guarantee:

The Subordinated Notes are irrevocably guaranteed on a subordinated basis by the Guarantor. The rights and claims of Noteholders against the Guarantor are subordinated upon a Guarantor Winding-Up in accordance with Condition 3(c) (*Subordination*).

Guarantor Solvency Condition and Policyholder Requirement:

Other than in the event of a Guarantor Winding-Up and without prejudice to Condition 10 (*Events of Default*), all payments of all amounts by the Guarantor under or arising from the Guarantee will be mandatorily deferred unless (i) the Guarantor is solvent at the time for payment by the Guarantor, and unless and until such time as the Guarantor could make such payment and still be solvent immediately thereafter and (ii) if, at any time (a) an order is made, or an effective resolution is passed, for the winding-up in England and Wales of a Group Regulated Entity, (b) or if an administrator of such Group Regulated Entity (other than the Issuer) is appointed and such administrator gives notice that it intends to declare and distribute a dividend or other distribution of assets, all obligations owed by such Group Regulated Entity (other than the Issuer) to its policyholders have been satisfied in full, or the procedure for such winding-up or, as the case may be, administration, as referred to in (a) or (b) above, is no longer continuing.

For the purpose only of determining whether any Guaranteed Amount is from time to time due and payable by the Issuer for the purposes of the obligations of the Guarantor under the Guarantee, any amount of principal, interest and Arrears of Interest shall be deemed to be due and payable by the Issuer on the applicable date regardless of whether the Issuer Solvency Condition and Policyholder Requirement is satisfied or whether the Issuer has deferred payment of such amounts in accordance with the Conditions.

Guarantor Obligations upon an Issuer Winding-Up:

In the event of an Issuer Winding-Up, the Guarantor undertakes under the Guarantee to pay the Guaranteed Amounts on the basis that such amounts are and will be due for payment under the terms of the Subordinated Notes and the Trust Deed as if the Issuer Winding-Up had not occurred and provided that no amount shall be deemed due and payable by the Issuer for the purpose of the Guarantee if such amount only became due and payable by the Issuer under the terms of the Subordinated Notes as a result of the occurrence of such Issuer Winding-Up. In the event that any Issuer Recovered Amount is paid to the Noteholders (or the Trustee on their behalf) in the Issuer Winding-Up, such Issuer Recovered Amount will reduce the amounts payable by the Guarantor in respect of the Subordinated Notes and the Trust Deed (including the Guarantee).

Maturity Date:

Unless previously redeemed or purchased and cancelled, the Issuer will (subject as provided under "*Deferral of Redemption at Maturity Date*" below) redeem the

Subordinated Notes on 24 March, 2025 subject to satisfying the Conditions to Redemption.

The Subordinated Notes are not redeemable at the option of any Noteholder in any circumstances.

Redemption, variation or substitution upon a relevant tax law change or Capital Disqualification Event:

Subject to the Conditions to Redemption, the Issuer may, upon the occurrence of any change in applicable law or regulation or in the interpretation or application of such law or regulation which results in (i) a Tax Event (as such term is defined in the Conditions) in relation to the Subordinated Notes or (ii) a Capital Disqualification Event (as such term is defined in the Conditions) in relation to the Subordinated Notes, either (A) redeem the Subordinated Notes in whole (and not in part) at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption: or (B) at any time substitute all (but not some only) of the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Lower Tier 2 Capital (prior to Solvency II implementation) or Tier 2 Capital (under Solvency II).

Conditions to Redemption:

The "**Conditions to Redemption**" are fulfilled on any day with respect to a scheduled or proposed redemption or a purchase of the Subordinated Notes, if:

a) prior to the publication of any notice of redemption, variation or substitution pursuant to a Tax Event or a Capital Disqualification Event, two Authorised Signatories of the Issuer or, as the case may be, the Guarantor certify to the Trustee in writing that a Tax Event will apply on the next Interest Payment Date, and cannot be avoided by the Issuer or, as the case may be, the Guarantor, having taken reasonable measures available to it, and/or a Capital Disqualification Event has occurred and is continuing as at the date of the certificate or, as the case may be, will occur within a period of 6 months;

b) prior to the publication of any notice of redemption before the Maturity Date or any substitution, variation or purchase of the Subordinated Notes, the Issuer, or as the case may be, the Guarantor will be required to have complied with the Regulatory Clearance Condition and be in continued compliance with the Relevant Rules.

c) neither the Issuer nor the Guarantor shall redeem (or, as the case may be, pay any Guaranteed Amounts in respect of any redemption of) any Subordinated Notes or purchase any Subordinated Notes unless at the time of such redemption or purchase (A) it is in compliance with the Relevant Rules and (B) the Issuer Solvency Condition and Policyholder Requirement or, as the case may be, the Guarantor Solvency Condition and Policyholder Requirement is satisfied at the time of such payment or purchase and will be satisfied immediately thereafter;

d) in the event of a redemption or purchase of the Subordinated Notes prior to the fifth anniversary of the issue date of the Subordinated Notes, any such redemption or purchase must be in compliance with the Relevant Rules and the Subordinated Notes must be exchanged or converted into another Tier 2 instrument or the redemption or purchase must be funded out of the proceeds of issue of a new Tier 2 or Tier 1 instrument (if under Solvency II such exchange or conversion is required at the time in order for the Subordinated Notes to qualify, and on the basis that the Subordinated Notes are intended to qualify, as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions).

The deferral of redemption of the Subordinated Notes by or on behalf of the Issuer or, as the case may be, the Guarantor at any time when the Conditions to Redemption are not met will not constitute a default under the Subordinated Notes or the Trust Deed or for any other purpose and will not give the Trustee or the Noteholders any right to accelerate the Subordinated Notes or to take any enforcement action under the Subordinated Notes or the Trust Deed.

Interest: The Subordinated Notes bear interest from (and including) the Issue Date to (but excluding) the Maturity Date at a rate of 9.5 per cent. per annum payable annually in arrear on 24 March in each year, as described in Condition 5 (*Interest*).

Issuer Mandatory Deferral of Interest: Payment of interest on the Subordinated Notes by the Issuer will be mandatorily deferred on each Interest Payment Date (i) in respect of which an Issuer Regulatory Deficiency Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date or (ii) where payment of interest on that date would breach the provisions of Solvency II and/or the Relevant Rules which apply to Tier 2 Capital (each a "**Mandatory Interest Deferral Date**").

If a Mandatory Interest Deferral Date has occurred, interest which accrued during the period ending on but excluding such Interest Payment Date will not be due and payable on that Interest Payment Date, but shall constitute Arrears of Interest.

Any such failure to pay will not constitute a default or any breach of any obligation under the Subordinated Notes or the Trust Deed or for any other purpose and will not give the Trustee or the Noteholders any right to accelerate the Subordinated Notes or to take any enforcement action under the Subordinated Notes or the Trust Deed.

Guarantor Mandatory Deferral of Interest: Any Guaranteed Amounts in respect of interest which would otherwise become due and payable under the Guarantee on a date which is a Guarantor Mandatory Interest Deferral Date will be mandatorily deferred.

If a Guarantor Mandatory Interest Deferral Event has occurred, interest which would otherwise become due and payable under the Guarantee which accrued during the period ending on but excluding such Interest Payment Date will not be due and payable on that Interest Payment Date, but shall constitute Arrears of Interest.

Any such failure to pay will not constitute a default or any breach of any obligation under the Subordinated Notes, Guarantee or the Trust Deed or for any other purpose and will not give the Trustee or the Noteholders any right to accelerate the Subordinated Notes or to take any enforcement action under the Subordinated Notes or the Trust Deed (including the Guarantee).

Arrears of Interest: Any interest which is deferred by the Issuer and the Guarantor will, together with any other interest not paid on any earlier Interest Payment Dates, to the extent and so long as the same remains unpaid, constitute "**Arrears of Interest**". Arrears of Interest shall not themselves bear interest and will be payable by the Issuer as provided in Condition 6(e) (*Payment of Arrears of Interest by the Issuer*) or, as the case may be, by the Guarantor as provided in Condition 6(f) (*Payment of Arrears of Interest by the Guarantor*).

Additional Amounts: The Issuer or, as the case may be, the Guarantor will pay such additional amounts as may be necessary in order that the net payment received by each Noteholder in respect of the Subordinated Notes, after withholding or deduction for, or on account of, any taxes required by law in the United Kingdom upon payments made by or on behalf of the Issuer in respect of the Subordinated Notes or by or on behalf of the Guarantor under the Guarantee, will equal the amount which would have been received in the absence of any such withholding or deduction, subject to customary exceptions as set out in Condition 9 (*Taxation*).

Events of Default:

Issuer

If default is made by the Issuer for a period of 14 days or more in the payment of any interest or principal due in respect of the Subordinated Notes or any of them, or an Issuer Winding-Up occurs, the Trustee on behalf of the Noteholders may (and, subject to certain conditions, if so directed by the requisite majority of Noteholders shall) institute proceedings for the winding-up of the Issuer in England and Wales (but not elsewhere), and/or (as applicable) prove in the winding-up or administration of the Issuer and/or claim in the liquidation of the Issuer, but may take no further action to enforce, prove or claim for any payment by the Issuer in respect of the Subordinated Notes or the Trust Deed.

Upon the occurrence of an Issuer Winding-Up, the Trustee may (and, subject to certain conditions, if so directed by the requisite majority of the Noteholders, shall) give notice to the Issuer that the Subordinated Notes are, and they shall accordingly forthwith become, immediately due and payable by the Issuer at the amount equal to their principal amount together with any Arrears of Interest and any other accrued and unpaid interest, but the Guarantor's obligations with respect to payments under the Guarantee shall be as provided in Condition 3(e) (*Obligations of the Guarantor upon an Issuer Winding-up*).

Guarantor

If default is made by the Guarantor for a period of 14 days or more in the payment of any Guaranteed Amounts in respect of interest or principal due in respect of the Subordinated Notes or a Guarantor Winding-Up occurs, the Trustee on behalf of the Noteholders may (and, subject to certain conditions, if so directed by the requisite majority of Noteholders, shall) institute proceedings for the winding-up of the Guarantor in England and Wales (but not elsewhere), and/or (as applicable) prove in the winding-up or administration of the Guarantor and/or claim in the liquidation of the Guarantor, but may take no further action to enforce, prove or claim for any payment by the Guarantor in respect of the Subordinated Notes or the Trust Deed (including the Guarantee).

Upon the occurrence of a Guarantor Winding-Up, there shall be due and payable by the Guarantor an amount equal to the principal amount of the Subordinated Notes together with any Arrears of Interest and any other accrued and unpaid interest, but the Subordinated Notes shall not thereby become immediately due and repayable by the Issuer.

No amounts shall be due for payment by the Issuer under the Subordinated Notes or the Trust Deed or due for payment by the Guarantor under the Guarantee where payment of such amounts has been deferred by the Issuer and/or the Guarantor, as the case may be, in

accordance with the Conditions.

Substitution of the Issuer or Guarantor:	Subject to the Issuer having notified and received no objection from the PRA or obtaining prior approval and consent from the PRA, the Trustee may agree with the Issuer and the Guarantor (without the consent of the Noteholders) to: (i) the substitution of the Guarantor in place of the Issuer as principal debtor under the Trust Deed and the Subordinated Notes; (ii) subject to the Subordinated Notes remaining unconditionally and irrevocably guaranteed on a subordinated basis, by the Guarantor, to the substitution of the Issuer by any member of the Insurance Group as principal debtor under the Trust Deed and the Subordinated Notes; or (iii) the substitution of (A) a successor in business to the Guarantor or (B) a Subsidiary of the Guarantor, in each case in place of the Guarantor.
Meetings of Noteholders:	The Conditions contain 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 relevant majority.
Form:	The Subordinated Notes were issued in registered form and were represented upon issue by a registered global certificate (the "**Global Note Certificate**") which was registered in the name of a nominee for a common depositary for Clearstream Banking *société anonyme*, Luxembourg ("**Clearstream, Luxembourg**") and Euroclear Bank S.A./N.V. ("**Euroclear**"), on the Issue Date. Save in limited circumstances, Subordinated Notes in definitive form will not be issued in exchange for interests in the Global Note Certificate. See "*Summary of Provisions relating to the Subordinated Notes while in Global Form*" for further details.
Denomination:	The denomination of the Subordinated Notes is £100,000 and higher integral multiples of £1,000 in excess thereof.
Listing and Admission to Trading:	Application has been made to the FCA under Part VI of FSMA for the Subordinated Notes to be admitted to the Official List and to the London Stock Exchange for such Subordinated Notes to be admitted to trading on the Market.
Rating:	The Subordinated Notes are not rated.
Governing Law:	The Subordinated Notes and the Trust Deed (including the Guarantee), and any non-contractual obligations arising out of or in connection with the Subordinated

	Notes or the Trust Deed (including the Guarantee), are governed by, and construed in accordance with, English law.
Selling Restrictions:	Customary selling restrictions in the United States and the United Kingdom.
Use of Proceeds:	The net proceeds of the issue of the Subordinated Notes are being used by the Issuer to fund the general business and commercial activities of the Group and to strengthen further its capital base.
Clearing System:	Clearstream, Luxembourg and Euroclear
ISIN:	XS1207688919
Common Code:	120768891

RISK FACTORS

Each of the Issuer and the Guarantor believes that the following factors may affect its ability to fulfil its obligations under the Subordinated Notes. All of these factors are contingencies which may or may not occur and neither the Issuer nor the Guarantor is in a position to express a view on the likelihood of any such contingency occurring.

In addition, factors which the Issuer and the Guarantor believe may be material for the purpose of assessing the market risks associated with the Subordinated Notes are described below.

Each of the Issuer and the Guarantor believes that the factors described below represent the principal risks inherent in investing in the Subordinated Notes, but the inability of the Issuer or the Guarantor to pay interest, principal or other amounts on or in connection with the Subordinated Notes may occur for other reasons, and neither the Issuer nor the Guarantor represents that the statements below regarding the risks of holding the Subordinated Notes are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Prospectus (including any documents incorporated by reference herein) and reach their own views prior to making any investment decision.

Capitalised terms which are defined in "Terms and Conditions of the Subordinated Notes" have the same meaning when used herein.

1. Risks relating to the Group's business and industry

Insurance Risk

The Group may suffer adverse experience compared with the actuarial assumptions used in pricing products, establishing reserves and reporting business results.

The Group's results depend on whether the actual timing of deaths and investment income experience, in terms of income and timing of cash flows, is consistent with the assumptions and pricing models it has used in underwriting and setting prices for individually underwritten annuities ("**IUAs**") and equity release mortgages it has written. These assumptions are based on a variety of factors which include historical data, estimates or individual expert judgments in respect of known or potential future changes, and statistical projections of what the Group believes will be the costs and cash flows of its assets and liabilities.

Although the Group monitors its actual experience against the actuarial assumptions it has used and refines its long-term assumptions in light of experience and the nature of the risks underlying its business it is not possible to determine precisely the amounts which the Group will ultimately pay to meet its annuity liabilities or to determine precisely the return on, or the maturity of, its equity release mortgages. Amounts payable under the Group's products will vary from actuarial estimates, particularly as the liabilities under the IUAs written by the Group will continue well into the future, and the income and timing of cash flows from the equity release mortgages which it provides may not materialise within the projected timeframe.

The following paragraphs summarise the risks relating to pricing of IUAs, equity release mortgages and protection policies arising from adverse experience against actuarial assumptions. The consequences of any could have a material adverse effect on the Group's business, results of operations and/or financial condition.

Annuities

The accurate pricing of the Group's annuity products is dependent on a detailed understanding of the impact on prospective customers' longevity of the various lifestyle and medical factors which are relevant to the customer. The Group utilises detailed underwriting manuals (which constitute part of the Group's experience, underwriting processes, methods and systems to interpret the Group's medical and mortality data (the "**Proprietary IP**")), experienced underwriters, analysis of past experience and the reinsurance of a substantial proportion of its annuity portfolio in order to manage the risk of any pricing inaccuracies. In addition to lives for which IUAs, are available, the Group underwrites healthy lives which do not qualify for an IUA as part of its core product offering. The Issuer believes that the Group's Proprietary IP enables it to understand better the mortality of healthy lives by assessing the impact of removing impaired

lives from the overall population mortality. There is a risk that historical data contained in the Proprietary IP may not be indicative of future longevity trends and could lead to inaccurate assumptions in respect of any of its annuities. Inaccurate estimation of the impact on longevity of relevant lifestyle and medical factors and, accordingly, mispricing of the Group's annuity products could have a material adverse effect on the Group's business, results of operations and/or financial condition.

The Group is particularly focused on changes in future expected levels of annuitant mortality (i.e. longevity risk). The Group seeks to mitigate its longevity risks through a systematic underwriting process, which selects lives with shorter anticipated lifespans than the current average in the markets in which the Group operates, reinsurance arrangements which transfer a portion of longevity risk and limited investment risk to third party reinsurers, and regular reviews of experience. However, there is a risk that lifespans may be longer than those assumed. This could occur due to a number of factors, including inaccuracies in the Group's Proprietary IP, failure of the Group to properly analyse the Proprietary IP, medical advances and inaccurate reporting of medical conditions by applicants. If this were to occur, the Group's business, results of operations and/or financial condition could be materially adversely affected. While the Issuer currently believes that the reserves that have been established for the Group's annuity business are sufficiently conservative to meet policy commitments, due to the uncertainties associated with such reserves, and in particular, the risk of future mortality improvements occurring at a faster rate than expected, there can be no assurance that this will continue to be the case, in which case the need to establish additional reserves could have a material adverse effect on the Group's financial condition.

The Group evaluates its liabilities at least annually, using the assumptions underlying such liabilities compared to actual mortality experience. If actual mortality experience is different from the underlying assumptions, it may be necessary to increase reserves in anticipation of longer lifespans and to set aside additional capital. Such adverse developments could materially adversely affect the Group's business, results of operations and/or financial condition.

Equity Release

The pricing of equity release mortgages, one of the asset classes which the Group invests in to match the liabilities arising from the sale of its retirement annuities, requires actuarial expertise. Actuarial expertise is required in the case of fixed lifetime mortgages because the amount repayable (including accrued interest) is fixed at the outset, and accordingly is a function of both the implied interest rate charged to the customer and the customer's anticipated mortality. In the case of all lifetime mortgages, the effect of mortality on the expected timing and amount of return on a lifetime mortgage, including the impact of the no negative equity guarantee, requires considerable actuarial expertise. In particular, there is a risk that a sustained fall in property values, on which lifetime mortgages are secured, and/or improving mortality, could expose the Group to costs relating to the no-negative equity guarantee provided on its lifetime mortgages. A general increase in longevity could expose the Group to the risk of cashflow mismatches between its lifetime mortgages and its annuity liabilities, as a result of expected equity release payments not becoming available at the expected time, in which case the need to establish additional reserves could have a material adverse effect on the Group's financial condition.

The assumptions used by the Group in pricing its equity release mortgages, including expected levels of the rates of early termination for lifetime mortgages by customers, reflect recent past and other relevant experience for these products. If actual levels of future policy termination rates are significantly higher than assumed, or if the mortality assumptions used in pricing fixed lifetime mortgages or the no-negative equity guarantee prove to be incorrect, the Group's business, results of operations and/or financial condition could be materially adversely affected.

If competitors or new entrants to the market introduce a competing equity release mortgage which does not include a no negative equity guarantee feature and therefore carries a reduced interest rate, this may negatively affect demand for equity release mortgages including the no negative equity guarantee. Under the current Equity Release Council ("**ERC**") rules, in order to be an ERC approved equity release product, a loan needs to come with a no negative equity guarantee.

Non-Standard Life Protection

Partnership also writes a limited amount of non-standard life protection business for individuals who have an impairment. Protection products pay out a pre-determined amount on death of the policyholder in exchange for regular premium payments over the life of the policy. Although the Group reinsures a

portion of the mortality and investment risk of its protection business, if the assumptions the Group makes in pricing its protection products prove to be inaccurate and insured individuals die sooner than expected, this could result in an exposure for payment on the policy which, to the extent they are not reinsured, could have a material adverse effect on the Group's business, results of operations and/or financial position.

Reinsurance may not be available, affordable or adequate to protect the Group against losses.

As part of its overall risk mitigation and capital management strategy, the Group purchases reinsurance from a number of reinsurance providers to cover a significant proportion of its longevity risk (the risk of annuitants living longer than expected), mortality risk in respect of its protection products (the risk of policyholders not living as long as expected) and for a proportion of its investment risk (the risk associated with performance of the Group's associated investment assets). For the year ended 31 December 2014, the Group reinsured approximately 65 per cent. of its new business longevity risk, 72 per cent. of its new business mortality risk on protection products and none of its new business investment risk (i.e. from new policies sold rather than products previously sold), excluding reinsurance of most of the investment risk for smoker annuities and protection policies. Market conditions beyond the Group's control determine the availability and cost of appropriate reinsurance and the receipt of future reinsurance recoveries as well as the financial strength of reinsurers. The market for reinsurance can be cyclical and exposed to substantial losses, which may adversely affect reinsurance pricing and availability, or its terms and conditions. Similarly, risk appetite among reinsurers may change, resulting in changes in price or their willingness to reinsure certain risks in the future. Additionally, a change in regulation could affect the availability or price of reinsurance. Any significant changes in reinsurance pricing may result in the Group being forced to incur additional expenses for reinsurance, writing less business, having to obtain reinsurance on less favourable terms or not being able to or choosing not to obtain reinsurance thereby exposing the Group to increased retained risk and capital requirements. Any of these could have a material adverse effect on the Group's business, financial condition and result of operations.

While the Group has not previously been impacted by a default by a reinsurer, and while the Group takes measures to limit the effects of a default through the use of collateralised arrangements, a default by a reinsurer to which the Group has material exposure could expose the Group to significant losses and therefore have a material adverse effect on its business, results of operations and/or financial position.

The Group's intellectual property, in particular its extensive database of mortality data, is crucial to the Group's operations and the Group is exposed to the risk of its theft, loss, deterioration, corruption and to competitors developing their own accurate mortality data over time.

The most significant portion of the Group's Proprietary IP comprises its mortality data, which has been developed over the past 20 years and which is continually updated. The Issuer believes that this mortality data enables the Group to reserve, and hence price its products, more accurately than it could without such data and to secure reinsurance agreements on attractive terms. Any theft of this data by an employee or competitor or another third party, or loss or corruption of the data, for example, as a result of systems failure, or the deterioration of the relevance of the data set over time as a result of medical advances or changes in longevity trends generally, could impair the Group's ability to price its products accurately and obtain reinsurance on attractive terms. In addition, competitors have assembled their own sets of mortality data and, over time, could begin to price across the spectrum of annuities at an increased level of accuracy, which could serve to devalue the Group's Proprietary IP. Any of the above could have a material adverse effect on the Group's business, results of operations and/or financial position.

2. Investment risk

An investment mismatch may arise between the liabilities of the Group in respect of its insurance products and the investment assets held to support those liabilities.

Under the Group's current investment management policies, for the year ended 31 December 2014 approximately 74 per cent. of the assets backing the Group's policyholder liabilities are held in fixed-income securities and cash and the remainder is invested in equity release mortgages with a small initial investment in commercial real estate mortgages. The Group continues to review opportunities to diversify its investments further. A mismatch between assets and liabilities in relation to annuities written by the

Group could arise where the cashflows of the investments are not well matched in timing, quantum or currency to the expected annuity liability payments.

In the event of materially adverse market conditions, there is a risk that liabilities may exceed the value of the Group's assets due to asset values falling or the Group may not be able to purchase sufficient assets at appropriate yields within an acceptable risk appetite to match liabilities. This may require the Group to take certain actions to protect policyholders, including actions to preserve or raise capital. If the Group needed to raise additional capital from outside the Group, it might be unable to do so due to factors outside its control, such as market conditions, or it might find that its ability to raise such capital on favourable terms was impaired, which could result in it having to pay increased servicing or other costs for such capital. Any inability to take the actions required to preserve its capital position could result in intervention by the PRA, the FCA or other regulators. In addition, a mismatch may occur as a result of the Group's investment in equity release lifetime mortgages and callable bonds (i.e. those that can be redeemed by the issuer prior to maturity) if people live longer than expected so that mortgages are not redeemed as expected, or callable bonds are not called as expected, and market conditions make it difficult to sell other assets to meet liabilities. Any of the foregoing events could have a material adverse effect on the Group's business, results of operations and/or financial condition.

The value of the Group's equity release and commercial mortgage assets is subject to fluctuations in housing and commercial property market values and the timing of the payment of interest or repayment of capital.

The value of the Group's equity release assets, which the Group invests in to match the liabilities arising from the sale of its retirement annuities, depends in part on the state of the UK housing market by affecting the value of the equity against which customers can obtain, or have already obtained, a lifetime mortgage. A decline in the UK housing market could have an adverse effect on the Group's equity release business, through a combination of: (i) reducing demand for equity release mortgages both by reducing consumers' propensity to borrow and by reducing the amount they are able to borrow as a function of the Group's "loan-to-value" limits; and (ii) increasing the exposure of the Group under the no negative equity guarantee provided to equity release customers, which would result in a lower-than-expected return on loans where the value realised on the sale of a customer's collateral is less than the principal and interest otherwise outstanding on such loan. Any of these eventualities could have a material adverse effect on the Group's business, results of operations and/or financial position.

The Group also has an investment management agreement in place with N M Rothschild & Sons Limited to invest £150 million in commercial mortgages, further diversifying the Group's investment portfolio. The value of the Group's commercial mortgage assets, and the security for these assets, is subject to fluctuations in the value of underlying assets and rent paid on those properties, and negative fluctuations may have a material adverse effect on the Group's business, results of operations and/or financial position.

Changes in the financial markets may have a significant adverse effect on the value of the Group's investment portfolio.

The value of the Group's fixed-income investment portfolio is affected by changes in interest rates, changes in the credit ratings of the issuers of the securities and liquidity generally in the bond markets, which may affect returns on, and the market values of, fixed-income investments in the Group's investment portfolios. In addition, when the credit rating of an issuer of fixed-income securities falls, or the credit spread with respect to the issuer increases, the market value of the issuer's fixed-income securities may also decline. Changes in the value of the Group's investment portfolio can have a material adverse effect on the Group's results of operations and/or financial condition.

Whilst the Group seeks to reduce the impact of interest rate fluctuations on its annuity business by limiting interest rate exposure through product design (having a single premium paid at the beginning of a policy rather than a series of premium payments), sales processes (for example, limits on quote guarantees as described below), a matching policy on the purchase of bond assets and using the natural, albeit only partial, mortality hedge of the Group's equity release lifetime mortgages, as an investment to support its IUA liabilities, the Group's business can be adversely affected by sustained low interest rates as well as certain interest rate movements. In a sustained low interest environment, new annuity business volumes may be affected as alternative investment products may become relatively more attractive. In addition, the Group provides a quotation guarantee of 14 days, for retirement and care products to receive

acceptance of the quote and a further 14 days for retirement products and a further 28 days for care products to receive the premium, during which it will adhere to quotations given for annuities. Separately, there is a regulatory "cooling off" period of 30 days during which the policyholder is able to cancel (which commences from the date of policyholder acceptance of the quote) in respect of new annuity business. These periods, if not hedged, could expose the Group to short term risks in respect of interest rate or market fluctuations, which could be unmatched by any investment until the end of the 28 or 42 day period and matched by investments during the cooling off period.

Any decline in the value of the Group's investment portfolio as a result of these factors or otherwise could have a material adverse effect on its business, results of operations and/or financial condition. To reduce the impact of falling interest rates on its Balance Sheet, the Group has purchased a series of one year swaptions.

The Group is exposed to the risk that the assets it invests in may default.

At 31 December 2014, approximately 74 per cent. of the Group's assets held within the investment portfolio are fixed-income securities and cash. Accordingly, the Group is exposed to default risk with respect to these securities. The Group seeks to offset this risk by investing in investment grade securities and government obligations, which at 31 December 2014 account for all of the Group's fixed-income securities. Nevertheless, the Group's business could suffer significant losses due to defaults on fixed-income investments or defaults on interest payments. Any losses from such defaults could have a material adverse effect on the Group's business, results of operations and/or financial position.

3. Regulatory, Legal and Political Risk

Changes in government policies, laws, regulations or their enforcement and interpretation could adversely affect the Group.

Changes in government policy, legislation or regulatory interpretation or enforcement (at a national and/or EU level) applying to any of the markets in which the Group operates may be applied retrospectively, and have in the past adversely impacted and may in the future adversely impact the Group's underlying profitability, its product range, distribution channels, capital requirements and, consequently, results and financing requirements.

In the March 2014 UK Budget, pension reforms were announced giving customers complete flexibility as to how to access their pension savings from April 2015. The announcement and implementation of the pension reforms have caused significant market disruption. The Issuer believes that this has resulted in a large number of customers deferring their decision as to how to utilise their pension savings, which in turn has impacted on the UK annuity market. In October 2014, proposals made by the UK Treasury to allow pension schemes to pay out lump sums from members' savings were confirmed. These proposals enable customers to make multiple withdrawals from their fund and receive up to 25 per cent. tax-free. In addition, further changes were announced at the same time enabling customers to transfer any unused defined contribution pension to any nominated beneficiary when they die, either tax free (if death occurs before age 75) or at the beneficiary's marginal tax rate, rather than paying the 55 per cent. tax charge which previously applied to pensions transferred at death. This tax change also applies from 6 April 2015 to joint life or guaranteed annuities where the principal annuitant dies before age 75. The reforms have been implemented in April 2015 and it is likely that the current market uncertainty will continue in 2015. Over the longer term, the consequences of the reforms are not clear. There may be an increased number of customers exercising their Open Market Option ("**OMO**") and more innovative products coming to market now that the regulatory framework and HMRC rules are clearer. Given the increased flexibility and the removal of the requirement for customers to secure a minimum income, fewer customers may purchase annuities, which would have an adverse effect on the Group's business, results of operations and/or financial position.

The FCA has the power to intervene to ban new products, place limits on profit margins and review insurance distribution models, which could impact the Group's ability to sell certain products and/or reduce the Group's expected profitability, or may involve significant liabilities in relation to historical business underwritten by the Group and/or the industry as a whole. Changes in the enforcement of laws, regulations or government policies as a result of political developments, worsening economic conditions or, in certain cases, introduction of government austerity measures, or otherwise, could result in an increase in the frequency or quantum of fines or other adverse government intervention, and, in turn,

reputational and other adverse impacts to the Group's business, such as censure by the regulators. The Group may also face increased compliance or compensation costs due to such changes to financial services legislation or regulation, for example, the recent strengthening of accountability for senior individuals in the banking and the insurance sector. Any such changes could have a material adverse effect on the Group's business, results of operations and/or financial position.

The Group may be negatively impacted by the FCA's review of its rules in the pension and retirement area.

In February 2014, the FCA published the findings of their thematic review of annuities. The results indicated that certain parts of the annuities market were not working well for some customers and that eight out of ten customers who purchased their annuity from their existing provider could get a better deal on the open market. As a result, the FCA stated that they would undertake a competition market study into retirement income. In December 2014 the FCA published the provisional findings and proposed remedies in relation to their retirement income market study. In summary, the FCA's provisional findings concluded that competition in the retirement income market is not working well for consumers and that many consumers are missing out on a higher income by not shopping around. The FCA consulted on the proposed remedies, recommendations and actions and published their final findings, confirming the provisional findings in March 2015. Additionally, from April 2015 all consumers have become entitled to free, impartial guidance at retirement, provided by independent organisations rather than pensions schemes or providers (the "Pension wise service"). The next phase of the FCA's work on annuity comparisons and the replacement of wake up packs will take place as part of a wider review of the FCA's rules in the pensions and retirement area in summer 2015.

The new regulatory framework around the Pension wise service.

As part of the pension reforms announced in March 2014, the FCA has been given responsibility for setting and monitoring the standards for delivery of the Pension wise service. In February 2015, the FCA published its policy statement in relation to the requirements for pension providers to determine whether customers have received advice or guidance prior to accessing their pensions. The FCA has published rules requiring providers to direct customers to the Pension wise service. Additionally, providers are required to ask customers relevant questions to determine whether risk factors are present, for example the customer's state of health, and then provide appropriate risk warnings.

Ensuring compliance with capital adequacy requirements and with a number of other regulations relating to the Group's operations, solvency and reporting bases could have a material adverse impact on the Group's business.

The Group and its regulated subsidiaries are each required to maintain a minimum margin of solvency capital in excess of the value of their liabilities to comply with a number of regulatory requirements relating to the Group's and such subsidiaries' solvency and reporting bases. These regulatory requirements apply to individual regulated subsidiaries on a stand-alone basis and in respect of the Group as a whole and apply to different levels within the Group and on different bases. The amount of regulatory and economic capital required also depends on the level of risk facing the insurance and other subsidiaries in the Group, and as such correlates to economic market cycles. The Guarantor 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. The Group's capital position can be adversely affected by a number of factors, in particular, factors that erode the Group's capital resources and which could impact the quantum of risk to which the Group is exposed. In addition, any event which erodes current profitability and is expected to reduce future profitability and/or make profitability more volatile could impact the Group's capital position, which in turn could have a negative effect on the Group's results of operations.

In the event that regulatory capital requirements are, or may be, breached, the PRA is likely to require the Group or any of its regulated subsidiaries to take remedial action, which could possibly include measures to restore the Group's or the individual subsidiary's capital and solvency positions to levels acceptable to the PRA, for the purposes of ensuring that the financial resources necessary to meet obligations to policyholders are maintained. In addition, due to adverse changes in the specific current or potential future risk profile of the Group's individual businesses, either the Group could decide to hold higher surplus above regulatory capital or the PRA could decide to increase the regulatory capital requirements of the Group or any of its regulated subsidiaries.

If the Group is unable to meet applicable regulatory capital requirements in any of its regulated subsidiaries, it would have to take measures to protect its capital and solvency position, which might include redeploying existing capital from elsewhere in the Group, increasing prices, reducing the volume of or types of business underwritten, increasing reinsurance coverage, altering its investment strategy, or divesting parts of its business, any of which may be difficult or costly or result in a significant loss, particularly in cases where such measures are required to be undertaken quickly. If the regulatory capital requirements are not met, the Group could lose key licences and hence be forced to cease some of its insurance and/or business operations. In circumstances where regulatory capital requirements are not met, the Issuer would not be allowed to pay dividends or interest payments on the Subordinated Notes, and the Group may be limited in its ability to draw upon the resources of, or satisfy intra-group arrangements with respect to its regulated subsidiaries. If the Issuer is required to take any of the foregoing measures, the Group's business, results of operations and/or financial position could be materially adversely affected.

The European Union is currently in the process of introducing a new regime, Solvency II, governing solvency requirements, technical reserves and other requirements for insurance companies, the effect of which is uncertain.

The European Union is in the process of developing and implementing a new regime in relation to solvency requirements and other matters, affecting the financial strength of insurers and reinsurers within each Member State ("**Solvency II**"). It is intended that the new regime for insurers and reinsurers domiciled in the European Union will apply more consistent risk sensitive standards to capital requirements, bringing European insurance regulation more closely in line with banking and securities regulation with a view to avoiding regulatory arbitrage, aligning regulatory capital with economic capital, and enhancing public disclosure and transparency.

In addition to new capital requirements and procedures, the Solvency II regime will also require changes to business operations, including the organisation of internal processes, the roles and responsibilities among certain key officers and external reporting obligations. The significant changes to the presentation of financial information for insurers on a Solvency II basis may also pose increased risk of misinterpretation by the market, third parties, stakeholders and consumers. While the overall intentions and process for implementing Solvency II have been outlined, the future landscape of EU solvency regulation is still evolving, and the interpretation of the rules is still being developed.

The European Parliament and Council of the European Union approved the directive containing the framework principles of Solvency II on 22 April 2009 and 10 November 2009, respectively. From 1 April 2015 Member States are required to commence implementation of the new rules, with the regime becoming binding on insurers and reinsurers within each Member State from 1 January 2016. Solvency II was amended by Directive 2014/51/EU ("**Omnibus II**"), which is designed to reflect the revised EU financial services supervisory framework.

Given the uncertainty surrounding the precise requirements of Solvency II, there can be no assurance that the Group will not need to strengthen its solvency capital position, change the details of its reporting, amend the form of its capital resources, change investment policy or modify its business operations and processes when Solvency II comes into force, which could result in negative publicity for the Group and other adverse impacts to the Group's business, such as reduced sales volumes and contractual difficulties. Compliance with Solvency II could also lead to higher expenses than those currently required to run the business, which could reduce the profitability of the Group and its ability to pay dividends. In such circumstances, the Group's business, results of operations and/or financial position could be materially adversely affected.

In addition, to the extent that the regulatory capital requirement under Solvency II is higher than that required currently, there is a risk that the Group may need to raise additional capital, resulting in further exposure to the risks relating to capital requirements described above in "*Ensuring compliance with capital adequacy requirements and with a number of other regulations relating to the Group's operations, solvency and reporting bases could have a material adverse impact on the Group's business*". If Solvency II leads to any of the above issues, this could have a material adverse effect on the Group's business, results of operations and/or financial position.

The Group and its products are subject to extensive regulatory supervision and legislation, including requirements to maintain certain licences, permissions and/or authorisations.

The Group is subject to detailed and comprehensive government regulation and legislation. Regulatory agencies have broad powers over many aspects of the insurance business, including marketing and selling practices, product development and structures, data and records management, systems and controls, capital requirements, permitted investments and imposing restrictions on the future growth of business. Government regulators are concerned primarily with financial stability and the protection of policyholders and third-party claimants rather than the Group's shareholders or creditors and have been giving increasing attention to consumer protection issues and the overall fairness of insurance products.

In order to conduct its business, the Group must obtain and maintain certain licences, permissions and authorisations (such as permission from the FCA and PRA to conduct insurance activities in the United Kingdom under Part 4A of the FSMA) and must comply with relevant rules and regulations. Failure to comply with the promulgated regulations, applicable insurance laws and public approvals and policies may lead to legal or regulatory disciplinary action, the imposition of fines or the revocation of licences, permissions or authorisations, which could have a material adverse impact on the Group's continued conduct of business.

The Group may be subject to measures imposed by the PRA in furtherance of its regulatory objectives. The PRA's two statutory objectives are to promote the safety and soundness of the firms it regulates and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders.

The Group may be subject to measures imposed by the FCA in furtherance of its regulatory objectives. The FCA's strategic objective is to protect and enhance confidence in the UK financial system. Its operational objectives include consumer protection, protecting the integrity of the UK financial system and promoting effective competition in the interest of consumers. The Group is also subject to competition and consumer protection laws enforced by the Competition and Markets Authority and the European Competition Commission, such as laws relating to consumer credit as well as price fixing, collusion and other anti-competitive behaviour in the UK.

Regulatory action, whether arising from EU, UK or other local laws and regulations, against a member of the Group or a determination that the Group has failed to comply with applicable regulation, including, without limitation, any of the examples discussed herein, could result in fines and losses as well as adverse publicity for, or negative perceptions regarding, the Group. This in turn could have an adverse effect on the Group's business, results of operations and/or financial position, or otherwise divert management's attention from the day-to-day management of the business, potentially impacting its ongoing or future performance.

Changes to EU IFRS generally or specifically for insurance companies may materially adversely affect the reporting of the Group's financial results.

Changes to EU IFRS for insurance companies have been proposed in recent years and further changes may be proposed in the future. The International Accounting Standards Board has published proposals in its IFRS 4 Insurance Contracts Phase II for Insurers Exposure Draft ("**Phase II**") that would introduce significant changes to the statutory reporting of insurance entities that prepare financial statements according to EU IFRS. The accounting proposals, which are not expected to become effective before 2018, will change the presentation and measurement of insurance contracts, including the effect of technical reserves and reinsurance on the value of insurance contracts. It is uncertain whether and how the proposals in the Phase II exposure draft will affect the Group should they become definitive standards. Current proposals under Phase II may have an adverse effect on the manner in which the Group reports provisions and therefore identifies and reports revenues and costs and could also have an effect on the Group's financial performance through changes affecting the calculation of taxation. These and any other changes to EU IFRS that may be proposed in the future, whether or not specifically targeted at insurance companies, could materially adversely affect the Group's reported results of operations and its financial position.

The Group is exposed to counterparty risk, particularly in relation to other financial institutions including reinsurers.

The Group is exposed to counterparty risk in relation to third parties in a number of ways, including but not limited to its cash holdings, through reinsurance counterparties, derivative counterparties, policyholders, brokers, care homes, distribution partners and other supplier contracts, as well as financial institutions holding its cash deposits. The Group has arrangements in place with its reinsurers whereby over 95 per cent. of its reinsurance liability is either deposited back to the Group or held by a third party in a trust arrangement.

The Group's business could suffer if the Group's counterparties fail to honour their obligations. Any losses from counterparties' failure to honour obligations and payments could have a material adverse effect on the Group's business, results of operations and/or financial position.

In the global financial system, financial institutions are interdependent, including with respect to reinsurers. The interdependence of financial institutions means that the failure of a sufficiently large and influential financial institution or other major counterparty, for whatever reason, could materially disrupt markets and could lead to a chain of defaults by counterparties. This risk, known as "systemic risk", could adversely impact the Group in many ways, some of which may be unpredictable, and may also adversely impact future sales, as a result of reduced confidence in the insurance industry or difficulties encountered in clearing premiums and payments through the banking system, or result in the Group not being able to recover amounts to which it is entitled under its reinsurance policies. The Issuer believes that, despite increased focus by regulators with respect to systemic risk, this risk remains part of the financial system and dislocations caused by the interdependence of financial market participants could materially adversely affect its business, results of operations and/or financial position.

*The proposed financial transactions tax ("**FTT**")*

The European Commission has published a proposal for a Directive for a common FTT in certain participating Member States.

The proposed FTT has very broad scope and could apply to certain dealings in financial instruments (including secondary market transactions).

The FTT could apply to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in financial instruments where at least one party is a financial institution, and either (i) at least one party is established or deemed to be established in a participating Member State or (ii) the financial instruments are issued in a participating Member State.

The proposed Directive remains subject to negotiation between the participating Member States and may be the subject of legal challenge. It may therefore be altered prior to any implementation, the timing of which remains unclear, although it has been indicated that first steps are intended to be implemented at the latest on 1 January 2016. On current proposals, the first steps will tax transactions in equity securities and certain derivatives. However, it remains a possibility that the FTT will be extended to cover other assets in the future, including debt securities such as those that form part of the Group's investment portfolio. While it is difficult to predict the impact of the FTT, if implemented the proposed FTT could have an adverse effect on the value of the Group's investment portfolio and/or on the ability of the Group to manage its investment portfolio, which could have a material adverse effect on the Group's business, results of operations and/or financial position.

Further, the proposed FTT could have an adverse effect on the value of the investment portfolios of the Group's reinsurers and/or on the ability of those reinsurers to manage their investment portfolios. This could adversely impact on the Group's reinsurance costs, which could in turn have a material adverse effect on the Group's business, results of operations and/or financial position.

4. Distribution risks

*The Group places substantial reliance on intermediaries, in particular financial advisers ("**FAs**"), FA networks and corporate partner organisations in the United Kingdom, to sell and distribute its products.*

The Group sells its products through intermediary distribution channels, such as FAs, FA networks, corporate partners (i.e. life insurance companies and pension providers), banks and employee benefit consultants ("**EBCs**").

The Group's relationships with its intermediaries could be terminated or disrupted as a result of a variety of events, including breach of contract, disagreement between the Group and its partners and counterparty insolvency. The terms and conditions of the Group's agreements with partners are also subject to change from time to time, and the Group may be unable to renew its agreements with partners on similar terms, or at all and could subsequently be unable to secure agreements with new distribution partners. Termination or non-renewal of, or any other material change to, the Group's relationships with its distribution partners could adversely affect the sale of its products and its growth opportunities in the UK. Termination of distribution relationships can also result in disputes over the dissolution or final settlement of distribution agreements, which can potentially lead to litigation. In addition, the Group could be required to fulfil the obligations of its agreements with distribution partners in the event of the termination of a relationship. Distribution agreements may include various requirements on the Group, and the Group may have to pay significant fines or damages under the arrangements if it fails to fulfil these obligations. Any of the foregoing events could have a material adverse effect on the Group's business, results of operations and/or financial position.

The Issuer considers that the number of FAs who have demonstrated a proactive approach to advising on equity release products and sales of annuity contracts to fund long-term care needs (immediate needs annuities, or "**INAs**") has, to date, been limited. The Issuer believes this is as a result of the relative complexity of the issues required to be considered when advising on such products and the perceived reputational risks to FAs, such as claims of potential mis-selling or provision of improper investment advice. Moreover, sales of INAs require FAs to have specific qualifications to advise on such products, and as such, the level of advice given on these products in the UK is constrained. Continuing reluctance in the FA community to actively market equity release products and INAs could constrain the future growth in sales of these products by the Group, which could in turn have a material adverse effect on the Group's business, results of operations and/or financial condition.

The impact on the intermediary market, as a result of the FCA's Retail Distribution Review ("**RDR**") has settled in the last 18 months. The changes from the RDR are intended to enhance customer confidence in the retail investment market by improving clarity of products and service provided to customers, raising the professional standards of advisers and reducing potential conflicts of interest. In January 2014, the FCA issued finalised guidance with regard to service or distribution agreements between providers and advisory firms. This outlined activity and payments that would be regarded by the FCA as breach of the Conduct of Business rules and Principle 8 (conflicts of interest), clarifying the FCA's interpretation of the current rules. There is a risk of the FCA's interpretation of its rules changing from time to time and a consequent risk of regulatory censure if there is non-compliance with that interpretation of the rules.

Failure of customers to access the Pension wise service or to take advantage of, or failure of FAs to advise their customers of, the OMO in the UK could have a material adverse effect on the Group's operations.

Sales of IUAs are dependent, in part, on the availability of advice to consumers. However, the Issuer believes that not all FAs and other intermediaries have as yet taken full advantage of the potential to offer their customers annuities or IUAs through the OMO available in the United Kingdom, which allows an individual to use pension savings from any pension fund to purchase an annuity from any annuity provider and effectively enables an individual to choose the best available retirement product from all providers. Should FAs fail to advise customers to take advantage of the OMO or fail to advise customers who so qualify to purchase an IUA, this could adversely affect the IUA market and, accordingly, materially adversely affect the Group's business, results of operations and/or financial condition.

In addition, following the pension reforms announced in March 2014, the Group's ability to grow its IUA business is dependent in part on improving customer awareness of the benefits of an annuity purchase when considered alongside alternative at-retirement propositions, including cash withdrawals. The

introduction of the Pension wise service as part of the pension reforms in April 2015 will now be an added factor in determining whether a customer will seek advice, decide to “self-select” their retirement solutions or indeed move from their existing provider at all. Given the increased choice and flexibility that customers are likely to have post-April 2015, the importance of customers receiving appropriate guidance or advice will increase. There is a risk that if only a small proportion of customers take-up the offer of guidance, and/or the guidance is ineffective, that these changes may result in more customers defaulting to staying with their existing pension providers and not considering other providers. This, in turn, may result in fewer customers purchasing the Group’s products.

The Group faces competition from other insurance companies and alternative at-retirement propositions.

The Group faces or may face significant competition (current and future) from domestic insurers, international insurance groups and other financial institutions (in any such case whether established or new entrants to the market or start-up operations), which offer or may in the future offer retirement solutions and products. Following the implementation of the pension reforms in April 2015, which are intended to introduce greater choice and flexibility for customers, the Group’s products are likely to need to compete with a wider range of alternative at-retirement propositions, including drawdown products, investment solutions, immediate or staged cash withdrawals and additional new retirement products which may be developed.

If the Group is unable or is perceived to be unable to compete effectively within its core markets or products, its competitive position may be adversely affected. In particular, competitive pressures may, among other things, compel the Group to offer higher annuity rates to customers, which may adversely affect its operating margins, underwriting results and capital requirements, any of which could constrain growth or otherwise have a material adverse effect on its business, results of operations and/or financial position.

The Group is exposed to further changes in the competitive landscape including new products developed in response to the pension reforms and increased competition from other distribution channels, in particular the development of channels/models to allow customers to purchase products without a personal recommendation or with simplified advice, the long-term implications of which are not yet fully understood.

The Group’s operations have historically focussed on the provision of IUAs and equity release mortgages in the UK, with the substantial majority of its sales being IUAs. Following the implementation of the pension reforms and the launch of the Pension wise service in April 2015, the Group’s products are likely to need to compete with a wider range of alternative at-retirement propositions in the UK, including drawdown product, investment solutions, immediate and staged cash withdrawals, alternative income generating investments such as buy-to-let property and new retirement products which may be developed. Therefore, the Group’s future success may depend on its ability to develop and market new products or enter new geographical markets successfully, while avoiding any potential damage to its reputation as a result of diversification of its product portfolio or geographical coverage. Should the Group prove to be unable to diversify its product portfolio or geographical coverage successfully, such failure could have a material adverse effect on the Group’s business, results of operations and/or financial condition.

Advances in technology have led, and will continue to lead, to changes in the distribution channels firms are using to sell at-retirement products. It is anticipated that some customers may purchase products without advice from a FA. It will be important that the supporting information, outlining the key factors which customers need to consider, is supplied to support customers in making complex decisions. Customers’ propensity to purchase at-retirement products without advice is currently unclear. In addition, the regulatory framework in relation to simplified advice or guidance lacks clarity. The FCA recently published its guidance consultation, GC 14/03, in relation to the boundaries and barriers to market development, attempting to address this issue. This lack of clarity may constrain development of non-advised or simplified advice models and may impact on the Group’s ability to distribute its products to end customers.

The Group is exposed to the risk of damage to its brand, the brands of its distribution partners, its reputation and a decline in customer confidence in the Group or its products.

The Group’s success and results are influenced by the financial strength and reputation of the Group and its brand. The Group and its brand are vulnerable to adverse market perception as the Group operates in

an industry where integrity, customer trust and confidence are paramount. The Group relies on its brand, FA networks, such as Sesame Bankhall Group, Openwork, 360 Services and SimplyBiz, and its distribution partner brands, such as B&CE, Royal London and Standard Life. The Group is exposed to the risk that litigation (for example, with relation to mis-selling claims by customers against the Group or its distribution partners), employee misconduct, operational failures, the outcome of regulatory or other investigations or actions, press speculation and negative publicity, amongst others, whether or not founded, could damage its brand or reputation. The Group's reputation could also be harmed if products or services sold by the Group (or by any of its distribution partners or intermediaries on behalf of the Group) do not perform as expected (whether or not the expectations are well founded) or customers' expectations for the products change.

Negative publicity could result, for instance, from an allegation or determination that the Group has failed to comply with regulatory or legislative requirements, from failure in business continuity or performance of the Group's information technology systems, loss of customer data or confidential information, fraudulent activities, unsatisfactory service and support levels or insufficient transparency or disclosure of information. Negative publicity adversely affecting the Group's brand or its reputation could also result from misconduct or malpractice by outsourcing partners, intermediaries, business promoters or other third parties linked to the Group (such as distributors and suppliers). In addition, to the extent that negative publicity or reputational damage regarding the Group adversely impacts one of the Group's partners, either in terms of reputational damage or sales of its products, the Group may be liable for contractually based fines or damages payments to such parties.

Any damage to the Group's brand or reputation could cause existing customers, partners or intermediaries to withdraw their business from the Group and potential customers, partners or intermediaries to be reluctant, or elect not to, do business with the Group. Such damage to the Group's brand or reputation could cause disproportionate damage to the Group's business, even if the negative publicity is factually inaccurate or unfounded. Furthermore, negative publicity could result in greater regulatory scrutiny and influence market or rating agencies' perception of the Group. The occurrence of any of these events could have a material adverse effect on the Group's business, results of operations and/or financial position.

Changes in lifestyle, medicine, technology, regulation or taxation could reduce demand for the Group's products.

The Group is exposed to changes in the behaviour of its customers and the markets in which it sells its insurance products. For example, changes in lifestyle or medicine could significantly alter customers' actual or perceived need for annuity products. In addition, further changes to regulation or taxation may make alternative at-retirement propositions more attractive to customers than annuities. Changes in technology could also give rise to new types of entrants into the insurance and/or insurance sales markets, or the development of new distribution channels requiring further adaptation of the Group's business and operations. Additionally, declines in the financial markets, for instance equity markets, can reduce the value of a customer's pension funds available to purchase an annuity, which could influence the decision to purchase an annuity. Moreover, declines in annuity yields could make the purchase of annuities unattractive and inhibit market growth. Such changes could result in reduced demand for the Group's products and/or require the Group to expend significant energy, resources and capital to change its product offering, build new risk and pricing models, modify and renew its operating and IT systems and/or retrain or hire new people. Such changes could have a material adverse effect on the Group's business, results of operations and/or financial position.

5. Operational Risks

The Group could be materially adversely affected by an inability to attract and retain, or obtain FCA or PRA approval for, qualified personnel.

The FCA and PRA have the power to regulate individuals with significant influence over the key functions of an insurance business, such as governance, finance, audit and management functions. The FCA and PRA may not approve individuals for such functions unless it is satisfied that they have appropriate qualifications and/or experience and are fit and proper to perform those functions, and may withdraw its approval for individuals whom it deems no longer fit and proper to perform those functions. The Senior Insurance Managers Regime final rules are due to be published soon with the majority of the proposals coming into effect on 1 January 2016, in line with Solvency II. Fewer senior insurance managers ("**SIMs**") will require pre-approval by the PRA or FCA and prescribed responsibilities will be

allocated between SIMs. Additionally, broader conduct standards to which SIMs will have to adhere have been drafted.

The Group's inability to attract and retain, or obtain FCA or PRA approval for, directors and highly skilled personnel, and to retain, motivate and train its staff effectively could adversely affect its competitive position, which could in turn result in a material adverse effect to its business, results of operations and/or financial position.

The Group is exposed to fraud risks.

The Group is vulnerable to internal and external fraud from a variety of sources such as employees, suppliers, intermediaries, customers and other third parties. This includes both policy (i.e. application-related) fraud and claims fraud. Although the Group employs fraud detection processes to help monitor and combat fraud, the Group is at risk from customers or FAs or other distribution partners or employees or outsourced service providers, who misrepresent or fail to provide full disclosure of the risks or over-disclose medical or lifestyle risk factors before policies are purchased and from a range of other fraud-related exposures, such as the fraudulent use of Group-related confidential information. These risks are higher in periods of financial stress and include payment security risks.

Additionally, the Group experiences risk from employees and staff members who fail to follow or circumvent procedures designed to prevent fraudulent activities. The occurrence or persistence of fraud in any aspect of the Group's business could damage its reputation and brands as well as its financial standing, and could have a material adverse effect on its business, results of operations and/or financial position.

The Group's operations support complex transactions and are highly dependent on the proper functioning of information technology and communication systems.

The Group relies heavily on its operational processes and on information technology and communication systems ("**IT**") to conduct its business, including the pricing and sale of its products, measuring and monitoring its underwriting liabilities, processing claims, assessing acceptable levels of risk exposure, setting required levels of provisions and capital, producing financial and management reports on a timely basis and maintaining customer service and accurate records. These processes and systems may not operate as expected, may not fulfil their intended purpose or may be damaged or interrupted by increases in usage, human error, unauthorised access, natural hazards or disasters or similarly disruptive events. Any failure of the Group's IT and communications systems and/or third-party infrastructure on which the Group relies could lead to significant costs and disruptions that could adversely affect the Group's business, results of operations and/or financial position as well as harm the Group's reputation and/or attract increased regulatory scrutiny.

If the Group were to introduce new products beyond its current offering, it may be required to develop new operational processes and information systems or to ensure current systems are adequate to support these products. Development of new systems or the expansion of current systems may require experience and resources beyond those the Group currently possesses. Failure to properly support new products with necessary resources could lead to significant costs or the failure of new product offerings.

While the Group does have in place disaster recovery and business continuity contingency plans, the occurrence of a serious disaster resulting in interruptions, delays, the loss or corruption of data, particularly its collection of mortality data, or the cessation of the availability of systems, could have a material adverse impact on the Group's business, results of operations and/or financial position.

The Group is dependent on the use of third-party investment managers, policy administrators and IT software and service providers.

Certain of the Group's functions are outsourced to third parties but remain critical to the Group's business, such as its investment management and the day-to-day administration of the Group's outstanding annuities and equity release mortgages. In addition, the Group is dependent on the use of certain third-party software and data service providers in order to conduct its business, particularly for financial and management reporting and customer relationship management. The Group is reliant in part on the continued performance, accuracy, compliance and security of such service providers and/or software and has limited back-up systems or procedures in place in the event of any failure of such

service providers and/or software. If the contractual arrangements with any third-party providers are terminated, the Group may not find an alternative outsource provider or supplier for the services, on a timely basis, on equivalent terms or without significant expense or at all, in which case the Group would need to handle such services in-house, which could involve potential additional costs and delays.

Any reduction in third-party product quality or any failure by a third party to comply with internal, contractual, regulatory or other requirements, including requirements with respect to the handling of customer data, could cause a material disruption to or adverse financial and/or reputational impact on the Group's business. Any of these events could have a material adverse effect on the Group's business, results of operations and/or financial position.

Failure to adequately maintain and protect customer and employee information could have a material adverse effect on the Group.

The Group collects and processes personal data (including name, address, age, medical details, bank and credit card details and other personal data) from its customers, third-party claimants, business contacts and employees as part of the operation of its business, and therefore it must comply with data protection and privacy laws and industry standards in the United Kingdom. Those laws and standards impose certain requirements on the Group in respect of the collection, use, processing and storage of such personal information. For example, under UK and EU data protection laws and regulations, when collecting personal data, certain information must be provided to the individual whose data is being collected. This information includes the identity of the data controller, the purpose for which the data is being collected and any other relevant information relating to the processing. There is a risk that data collected by the Group and its appointed third parties is not processed in accordance with notifications made to, or obligations imposed by, data subjects, regulators, or other counterparties or applicable law. The General Data Protection Regulation, due to be approved in late 2015, is designed to harmonise the current data protection laws across the EU member states. It will outline the legal requirements, which will then need to be applied by individual member states. The detailed legislation when finalised will require review to establish the impact on the Group and may increase the burden of data protection on insurers and the Group. Failure to operate effective data collection controls could potentially lead to regulatory censure, fines, reputational and financial costs as well as result in potential inaccurate rating of risks or overpayment of claims.

In addition, the Group is exposed to the risk that the personal data it controls could be wrongfully accessed and/or used, whether by employees or other third parties, or otherwise lost or disclosed or processed in breach of data protection regulations. If the Group or any of the third-party service providers on which it relies fail to process, store or protect such personal data in a secure manner or if any such theft or loss of personal data were otherwise to occur, the Group could face liability under data protection laws. This could also result in damage to the Group's brand and reputation as well as the loss of new or repeat business, any of which could have a material adverse effect on the Group's business, results of operations and/or financial position.

The amounts the Group reserves for administrative and other expenses when it sells its products could prove to be inadequate.

The Group allocates reserves when it sells products, not only for the expected annuity payments under the products, but also for administrative and other expenses in connection with the products. The Group also allocates reserves to cover the cost of closing to new business. If the Group's assumptions with respect to the reserves for these expenses prove to be inaccurate, as a result of increased administration costs, regulatory requirements or otherwise, its reserves might not prove adequate, which could have a material adverse effect on the Group's business, results of operations and/or financial position.

6. Other Risks

Downgrades of or the revocation of the Group's financial strength rating could affect its standing in the market, result in a loss of business and reduce earnings.

Partnership Life Assurance Company Limited ("**PLACL**") has been assigned an insurer financial strength rating of "B-strong" by the actuarial consulting firm AKG, as last confirmed in September 2014. PLACL's insurer financial strength rating is subject to periodic review by, and may be revised downward or revoked at the sole discretion of, AKG.

Downgrade or revocation could have a negative impact on the Group's public reputation and competitive position in the market, especially in relation to its distribution arrangements and commercial business where partners or customers may not be willing or permitted to place their insurance with a lower rated insurer, which could result in reduced business volumes and income. The occurrence of any of the above could have a material adverse effect on the Group's business, results of operations and/or financial position.

Changes in taxation laws may negatively impact the Group and/or decisions of customers.

Changes in corporate and other tax rules could have both a prospective and retrospective impact on the Group's business, results of operations or financial position. In general, changes to, or in the interpretation of, existing tax laws, or amendments to existing tax rates (corporate or personal), or the introduction of new tax legislation may materially adversely affect the Group's business, results of operations and/or financial position, either directly or indirectly or as a result of changes in the insurance purchasing decisions of customers. Changes to legislation that specifically governs the taxation of insurance companies might adversely affect the Group's business. While changes in taxation laws may affect the insurance sector as a whole, changes may be particularly detrimental to certain operators or certain products in the industry. The relative impact on the Group will depend on the areas impacted by the changes, the mix of business within the Group's portfolio and other relevant circumstances at the time of the change. Changes in UK national insurance contributions and the welfare system, including the level and age qualification for the state pension, may affect customers' demand for the Group's products.

The Cinven Funds retain a significant interest in and continue to exert substantial influence over the Issuer and their interests may differ from or conflict with those of other shareholders.

The Cinven Funds continue to own beneficially approximately 51.9 per cent. of the issued ordinary share capital of the Issuer. As a result, the Cinven Funds possess sufficient voting power to have a significant influence over all matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions. The interests of the Cinven Funds may not always be aligned with those of other security holders of the Issuer. In particular, the Cinven Funds may hold interests in, or may make acquisitions of or investments in, other businesses that may be, or may become, competitors of the Group.

Applicable insurance laws may make it difficult to effect a change of control of the Issuer.

In the United Kingdom, the prior approval of the PRA under Part XII of the Financial Services and Markets Act 2000, as amended ("**FSMA**") is required of any person proposing to acquire control of a UK PRA regulated firm, including an authorised insurance company. A person is also regarded as acquiring control over the UK authorised person if that person exercises significant influence over the management of the UK authorised person or its parent. For these purposes, a person is deemed to acquire control over a UK authorised person (including an insurance company) if such person holds, or is entitled to exercise or control the exercise of, ten per cent. or more of the voting power at any general meeting of the UK authorised person or of the parent undertaking of the UK authorised person. An acquisition of the beneficial ownership of ten per cent. or more of the Ordinary Shares of the Issuer would need to be notified to the PRA and its approval obtained, even though there may have been no change in the legal ownership of the Ordinary Shares of the Issuer. Similarly, if a person who is already a controller of a UK authorised person proposes to increase its control in excess of certain thresholds set out in Section 181 of the FSMA, such person will also require the prior approval of the PRA. The PRA has a period of three months from the date of notification of the proposed change of control to approve or refuse such proposed change of control.

These laws (and laws having similar effect in other jurisdictions) may discourage potential acquisition proposals and may delay, deter or prevent a change of control of the Issuer, including through transactions, and in particular unsolicited transactions, that some or all of the Shareholders might consider to be desirable.

7. Risks relating to the Subordinated Notes

The Subordinated Notes have features which entail particular risks for potential investors.

Redemption prior to the Maturity Date

The scheduled Maturity Date of the Subordinated Notes is 24 March 2025 and, although the Issuer may redeem or purchase the Subordinated Notes in certain circumstances described herein prior to that date, it is under no obligation to do so. In addition, the Noteholders have no right to call for the redemption of the Subordinated Notes. Therefore, prospective investors should be aware that they may be required to bear the financial risks associated with a long-term investment in the Subordinated Notes.

The Subordinated Notes may, subject as provided in Condition 7 (*Redemption, Substitution, Variation and Purchase*), at the option of the Issuer, be redeemed in whole (but not in part) before the Maturity Date at their principal amount, together with any Arrears of Interest and any other accrued but unpaid interest to (but excluding) the date of redemption, (i) in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation or application thereof, or (ii) following the occurrence of (or if the Issuer is satisfied that there will occur within six months) a Capital Disqualification Event (**provided that**, in the case of any redemption prior to the fifth anniversary of the Issue Date, the approval of the PRA is required and the Subordinated Notes are exchanged for, or redeemed out of the proceeds of, a new issue of regulatory capital of the same or higher category of regulatory capital treatment (unless Solvency II is implemented without such requirement).

In relation to a Capital Disqualification Event, it should be noted that the Solvency II framework for insurance companies (outlined in the "*Regulation of the Issuer*") will take effect from 1 January 2016. This will, amongst other things, set out features which any instruments (including subordinated notes) must have in order to qualify as regulatory capital. These features may be different and/or more onerous than those currently applicable to insurance companies in the United Kingdom and contained in the Subordinated Notes. Moreover the Solvency II framework may itself be amended, supplemented or replaced by a new insurance regulatory framework prior to the date upon which all the Subordinated Notes have been redeemed. Accordingly, there is a risk that after the issue of the Subordinated Notes, a Capital Disqualification Event may occur which would entitle the Issuer, with the consent (or non-objection) of the PRA if then required by the PRA, to redeem the Subordinated Notes early at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest.

An investor may not be able to reinvest the redemption proceeds at an effective interest rate which is as high as the interest rate on the Subordinated 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.

The Issuer's obligations under the Subordinated Notes are subordinated

The Issuer's obligations under the Subordinated Notes constitute direct, unsecured and subordinated obligations of the Issuer and rank *pari passu* and without any preference among themselves. In the event of (i) the Issuer being wound up or (ii) an administrator of the Issuer being appointed and such administrator giving notice that it intends to declare and distribute a dividend or other distribution of assets, the payment obligations of the Issuer under the Subordinated Notes will be subordinated to the claims of all Senior Creditors of the Issuer.

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

The Guarantor's obligations under the Guarantee are subordinated

The Guarantor's obligations under the Guarantee constitute direct, unsecured and subordinated obligations of the Guarantor. In the event of (i) the Guarantor being wound up or (ii) an administrator of the Guarantor being appointed and such administrator giving notice that it intends to declare and distribute a dividend or other distribution of assets, the payment obligations of the Guarantor under the Guarantee will be subordinated to the claims of all Senior Creditors of the Guarantor.

There is a significant risk that an investor in the Subordinated Notes will lose all or some of its investment should the Guarantor become insolvent.

Interest payments under the Subordinated Notes must be deferred in certain circumstances

The Issuer is required to defer any payment of interest on the Subordinated Notes on each Interest Payment Date (i) in the event that it cannot make such payment in compliance with the Issuer Solvency Condition and Policyholder Requirement or (ii) in respect of which an Issuer Regulatory Deficiency Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date or (iii) where payment of interest on that date would breach the provisions of Solvency II and/or the Relevant Rules which apply to Tier 2 Capital.

The Guarantor is required to defer any payment of Guaranteed Amounts in respect of interest on the Subordinated Notes on any date (i) in the event that it cannot make such payment in compliance with the Guarantor Solvency Condition and Policyholder Requirement or (ii) in respect of which a Guarantor Regulatory Deficiency Deferral Event has occurred and is continuing or would occur if payment of any Guaranteed Amounts in respect of interest was made on such date or (iii) where payment of any Guaranteed Amounts in respect of interest on that date would breach the provisions of Solvency II and/or the Relevant Rules which apply to Tier 2 Capital.

The deferral of interest (or Guaranteed Amounts in respect of interest) as described above will not constitute a default under the Subordinated Notes or the Guarantee for any purpose. Any interest so deferred shall, for so long as the same remains unpaid, constitute Arrears of Interest. Arrears of Interest do not themselves bear interest. Arrears of Interest may, subject to certain conditions, be paid by the Issuer or the Guarantor at any time upon notice to Noteholders, but in any event shall be payable, subject to satisfaction of the Issuer Solvency Condition (in respect of payment by the Issuer) or the Guarantor Solvency Condition (in respect of payment by the Guarantor), (i) by the Issuer on the earliest to occur of (a) the next Interest Payment Date which is not a Mandatory Interest Deferral Date on which payment of interest in respect of the Subordinated Notes is made or is required to be made (other than a voluntary payment by the Issuer of any Arrears of Interest), (b) the date on which an Issuer Winding-Up occurs or (c) the date fixed for redemption or purchase of the Subordinated Notes (subject to any deferral of such redemption date pursuant to a Regulatory Deficiency Deferral Event) pursuant to Condition 7 (*Redemption, Substitution, Variation and Purchase*), (ii) by the Guarantor on the earliest to occur of (a) the next Interest Payment Date which is not a Guarantor Mandatory Interest Deferral Date on which payment of Guaranteed Amounts in respect of interest is made or is required to be made (other than a voluntary payment by the Guarantor of any Guaranteed Amount in respect of Arrears of Interest), (b) the date on which a Guarantor Winding-Up occurs or (c) the date fixed for redemption or purchase of the Subordinated Notes (subject to any deferral of such redemption date pursuant to a Regulatory Deficiency Deferral Event) or, as the case may be, a Guarantor Regulatory Deficiency Deferral Event pursuant to Condition 7 (*Redemption, Substitution, Variation and Purchase*).

Any actual or anticipated deferral of interest payments will likely have an adverse effect on the market price of the Subordinated Notes. In addition, as a result of the interest deferral provision of the Subordinated Notes, the market price of the Subordinated Notes may be more volatile than the market prices of other debt securities on which interest accrues that are not subject to such deferral and may be more sensitive generally to adverse changes in the Issuer's and the Guarantor's financial condition.

Redemption payments under the Subordinated Notes must, in certain circumstances, be deferred

Notwithstanding the expected maturity of the Subordinated Notes on the Maturity Date, the Issuer must defer redemption of the Subordinated Notes on the Maturity Date, or on any other date set for redemption of the Subordinated Notes pursuant to Condition 7(f) (*Redemption, variation or substitution for taxation reasons*) or 7(a) (*Scheduled redemption*) if the preconditions as set out in 7(k) (*Preconditions to redemption, variation, substitution and purchases*) are not met.

In addition, the Guarantor must defer the payment of any Guaranteed Amounts in connection with the redemption of the Subordinated Notes (i) in the event that it cannot make such payment in compliance with the Guarantor Solvency Condition and Policyholder Requirement or (ii) a Guarantor Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if such payments were made by the Guarantor on such date.

Any such deferral of redemption of the Subordinated Notes or the payment of Guaranteed Amounts in respect of redemption of the Subordinated Notes will not constitute a default under the Subordinated Notes or the Guarantee for any purpose. Where redemption of the Subordinated Notes is deferred, subject to certain conditions, (i) the Subordinated Notes will be redeemed by the Issuer on the earliest of (a) the date falling 10 Business Days following cessation of the Issuer Regulatory Deficiency Redemption Deferral Date, (b) the date falling 10 Business Days after the PRA has agreed to the repayment or redemption of the Subordinated Notes or (c) the date on which an Issuer Winding-Up occurs, or (ii) the Guarantor will pay Guaranteed Amounts in respect of redemption by the Issuer of the Subordinated Notes on the earliest of (a) the date falling 10 Business Days following cessation of the Guarantor Regulatory Deficiency Redemption Deferral Date, (b) the date falling 10 Business Days after the PRA has agreed to the payment of such amounts by the Guarantor or (c) the date on which a Guarantor Winding-Up occurs.

Any actual or anticipated deferral of redemption of the Subordinated Notes will likely have an adverse effect on the market price of the Subordinated Notes. In addition, as a result of the redemption deferral provision of the Subordinated Notes, including with respect to deferring redemption on the scheduled Maturity Date, the market price of the Subordinated Notes may be more volatile than the market prices of other debt securities without such deferral feature, including dated securities where redemption on the scheduled maturity date cannot be deferred, and the Subordinated Notes may accordingly be more sensitive generally to adverse changes in the Issuer's and the Guarantor's financial condition.

Modifications and waivers

The Conditions and the Trust Deed contain 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 Conditions and the Trust Deed also provide that, subject to the prior consent of the PRA being obtained (so long as such consent is required), the Trustee may, without the consent of Noteholders, agree to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the Conditions or any of the provisions of the Trust Deed in the circumstances described in Condition 14 (*Meetings of Noteholders; Modification and Waiver*).

Substitution of obligors

The Conditions provide that the Trustee may, without the consent of the Noteholders, agree to the substitution of (i) the Guarantor in place of the Issuer as principal debtor under the Trust Deed and the Subordinated Notes; (ii) the Issuer by any member of the Group as principal debtor under the Trust Deed and the Subordinated Notes; or (iii) a successor in business to the Guarantor or a subsidiary of the Guarantor in place of the Guarantor. Such substitution will be subject to prior approval of the PRA.

No limitation on issuing senior or pari passu securities

There is no restriction on the amount of securities which the Issuer or the Guarantor may issue or guarantee, which securities or guarantees rank senior to, or *pari passu* with, the Subordinated Notes or the Guarantee (as applicable). The issue or guarantee of any such securities may reduce the amount recoverable by Noteholders on a winding-up of the Issuer or the Guarantor, as the case may be and/or may increase the likelihood of a deferral of interest payments under the Subordinated Notes. Accordingly, in the winding-up of the Issuer and/or the Guarantor and after payment of the claims of their respective senior ranking creditors, there may not be a sufficient amount to satisfy the amounts owing to the Noteholders.

Restricted remedy for non-payment when due

In accordance with the PRA's current requirements for tier 2 capital, the sole remedy against each of the Issuer and the Guarantor available to the Trustee or (where the Trustee has failed to proceed against the Issuer or the Guarantor as provided in the Conditions) any Noteholder for recovery of amounts which have become due in respect of the Subordinated Notes or the Guarantee will be the institution of proceedings for the winding-up of the Issuer or the Guarantor and/or proving in such winding-up or administration of the Issuer or the Guarantor and/or claiming in the liquidation of the Issuer or the Guarantor.

Non-payment by the Issuer of any amounts when due or the occurrence of any Issuer Winding-Up will not, of itself, render the Subordinated Notes immediately due and payable at their principal amount by the Guarantor, and conversely non-payment by the Guarantor of any amounts when due or the occurrence of a Guarantor Winding-Up will not, of itself, render the Subordinated Notes immediately due and payable at their principal amount by the Issuer. In circumstances where the Issuer fails to make a payment when due or an Issuer Winding-Up occurs but the Guarantor does not default in its obligations, the Guarantor will continue to service the Subordinated Notes (the principal amount of which may be reduced by amounts recovered in the winding-up, administration or liquidation of the Issuer in accordance with Condition 2(c) (*Issuer Recovered Amount*)) in place of the Issuer as if the Issuer default had not occurred, in accordance with Condition 3(e) (*Obligations of the Guarantor upon an Issuer Winding-Up*). Conversely, in circumstances where the Guarantor fails to make a payment when due or a Guarantor Winding-Up occurs but the Issuer does not default in its obligations, the Issuer will continue to service the Subordinated Notes (the principal amount of which may be reduced by amounts recovered in the winding-up, administration or liquidation of the Guarantor in accordance with Condition 3(d) (*Guarantor Recovered Amount*) as if the Guarantor default had not occurred, in accordance with Condition 3(c) (*Subordination*).

Variation or Substitution of the Subordinated Notes without Noteholder consent

Subject as provided in Condition 7 (*Redemption, Substitution, Variation and Purchase*), the Issuer may, at its option and without the consent or approval of the Noteholders, elect to substitute the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Lower Tier 2 Capital (prior to Solvency II implementation) or Tier 2 Capital (under Solvency II) (as the case may be) at any time in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation or application thereof, or following the occurrence of a Capital Disqualification Event.

Change of law

The Conditions are based on English law in effect as at the date of issue of the Subordinated 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 Subordinated Notes.

Integral multiples of £100,000

The Subordinated Notes are issued in the denomination of £100,000 and higher integral multiples of £1,000 thereafter and so it is possible that the Subordinated Notes may be traded in amounts in excess of £100,000 that are not integral multiples of £100,000 (or its equivalent). In such a case a Noteholder who, as a result of trading such amounts, holds a principal amount of less than £100,000 will not receive a definitive Note in respect of such holding (should definitive Subordinated Notes be printed) and would need to purchase a principal amount of Subordinated Notes such that it holds an amount equal to or greater than £100,000.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income (the "**Savings Directive**"), each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State; however, for a transitional period, Austria may instead apply a withholding system in relation to such payments, deducting tax at a rate of 35 per cent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

A number of non-EU countries and certain dependent or associated territories of certain Member States have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or

collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The Council of the European Union formally adopted a Council Directive amending the Savings Directive on 24 March 2014 (the "**Amending Directive**"). The Amending Directive broadens the scope of the requirements described above. Member States have until 1 January 2016 to adopt the national legislation necessary to comply with the Amending Directive. Under the changes, the Savings Directive will apply a "look through approach" to payments made via certain persons, entities or legal arrangements (including trusts and partnerships), where certain conditions are satisfied, where an individual resident in a Member State is regarded as the beneficial owner of the payment for the purposes of the Savings Directive. This approach may in some cases apply where the person, entity or arrangement is established or effectively managed outside of the European Union. The changes also broaden the definition of "interest payment" to cover income that is equivalent to interest.

However, the European Commission has proposed the repeal of the Savings Directive from 1 January 2017 in the case of Austria and from 1 January 2016 in the case of all other Member States (subject to on-going requirements to fulfil administrative obligations such as the reporting and exchange of information relating to, and accounting for withholding taxes on, payments made before those dates). This is to prevent overlap between the Savings Directive and a new automatic exchange of information regime to be implemented under Council Directive 2011/16/EU on Administrative Cooperation in the field of Taxation (as amended by Council Directive 2014/107/EU). The proposal also provides that, if it proceeds, Member States will not be required to apply the new requirements of the Amending Directive.

If a payment were to be made or collected through an EU 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 pursuant to the Savings Directive or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to such Directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. Furthermore, if the Amending Directive is implemented and takes effect in EU Member States, such withholding may occur in a wider range of circumstances than at present, as explained above.

The Issuer is required to maintain a Paying Agent with a specified office in an EU Member State that is not obliged to withhold or deduct tax pursuant to any law implementing the Savings Directive or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000, which may mitigate an element of this risk if the Noteholder is able to arrange for payment through such a Paying Agent. However, investors should choose their custodians and intermediaries with care, and provide each custodian and intermediary with any information that may be necessary to enable such persons to make payments free from withholding and in compliance with the Savings Directive, as amended.

Investors who are in any doubt as to their position should consult their professional advisers.

Risks relating to the US Foreign Account tax Compliance Withholding ("FATCA")

The United States has enacted rules, commonly referred to as FATCA, that generally impose a new reporting and withholding regime with respect to certain U.S. source payments (including interest and dividends), gross proceeds from the disposition of property that can produce U.S. source interest and dividends and certain payments made by entities that are classified as financial institutions under FATCA. The United States has entered into an intergovernmental agreement regarding the implementation of FATCA with the United Kingdom (the "**IGA**"). Under the IGA, as currently drafted, the Issuer does not expect payments made on or with respect to the Subordinated Notes to be subject to withholding under FATCA. However, significant aspects of when and how FATCA will apply remain unclear, and no assurance can be given that withholding under FATCA will not become relevant with respect to payments made on or with respect to the Subordinated Notes in the future. Prospective investors should consult their own tax advisors regarding the potential impact of FATCA.

8. Risks relating to the market generally

Set out below is a brief description of certain market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk.

The secondary market generally

The Subordinated Notes were purchased in their entirety by funds managed by Cinven on their date of issue. Consequently, although application has been made to admit the Subordinated Notes to trading on the Market, the Subordinated Notes have no established trading market and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Subordinated Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a severely adverse effect on the market value of the Subordinated Notes.

Fixed rate notes are exposed to specific market risks

The Subordinated Notes bear interest at a fixed rate. A holder of a security with a fixed interest rate is exposed to the risk that the price of such security falls as a result of changes in the current interest rate on the capital market (the "**Market Interest Rate**"). While the nominal rate of a security with a fixed interest rate is fixed for a specified period, the Market Interest Rate typically changes on a daily basis. As the Market Interest Rate changes, the price of such security is likely to change in the opposite direction. If the Market Interest Rate increases, the price of such security typically falls, until the yield of such security is approximately equal to the Market Interest Rate. If the Market Interest Rate falls, the price of a security with a fixed compensation rate typically increases, until the yield of such security is approximately equal to the Market Interest Rate. Investors should be aware that movements of the Market Interest Rate can adversely affect the price of the Subordinated Notes and can lead to losses for the Noteholders if they sell the Subordinated Notes.

Exchange rate risks and exchange controls

Payments of principal and interest on the Subordinated Notes will be made 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 Subordinated Notes, (2) the Investor's Currency equivalent value of the principal payable on the Subordinated Notes and (3) the Investor's Currency equivalent market value of the Subordinated 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.

Inflation risk

The value of future payments of interest and principal may be reduced as a result of inflation as the real rate of interest on an investment in the Subordinated Notes will be reduced at rising inflation rates and may be negative if the inflation rate rises above the nominal rate of interest on the Subordinated Notes.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to 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 (i) the Subordinated Notes are legal investments for it, (ii) the Subordinated Notes can be used as collateral for various types of borrowing and (iii) other restrictions apply to its purchase or pledge of the Subordinated Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Subordinated Notes under any applicable risk-based capital or similar rules.

Risk that investors will have to rely on the procedures of Euroclear and Clearstream, Luxembourg for transfer, payment and communication with the Issuer

The Subordinated Notes are represented by a Global Note Certificate (as defined in the Trust Deed). The Global Note Certificate has been deposited with a common depositary for, and registered in the name of the common nominee of, Euroclear and Clearstream, Luxembourg. Except in certain limited circumstances described in the Global Note Certificate, investors will not be entitled to receive definitive registered notes. Euroclear and Clearstream, Luxembourg will maintain records of the beneficial interests in the Global Note Certificate.

While the Subordinated Notes are represented by the Global Note Certificate, investors will be able to trade their beneficial interests only through Euroclear and Clearstream, Luxembourg. The Issuer will discharge its payment obligations under the Subordinated Notes by making payments to the common depositary for Euroclear and Clearstream, Luxembourg for distribution to their account holders. A holder of a beneficial interest in a Global Note Certificate must rely on the procedures of Euroclear or Clearstream, Luxembourg to receive payments under the Subordinated Notes. The Issuer has no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in the Global Note Certificate.

TERMS AND CONDITIONS OF THE SUBORDINATED NOTES

The following is the text of the terms and conditions of the Subordinated Notes which (subject to modification and except for the paragraphs in italics) are endorsed on the Certificates issued in respect of the Subordinated Notes:

The £100,000,000 9.5 per cent. Fixed Rate Guaranteed Subordinated Notes due 2025 (the "**Subordinated Notes**") of Partnership Assurance Group plc (the "**Issuer**") are constituted by, are subject to, and have the benefit of, a trust deed dated 24 March 2015 (as amended or supplemented from time to time, the "**Trust Deed**") between the Issuer, Partnership Life Assurance Company Limited (the "**Guarantor**") and BNY Mellon Corporate Trustee Services Limited as trustee (the "**Trustee**", which expression includes all persons for the time being trustee or trustees appointed under the Trust Deed) and are the subject of an agency agreement dated 24 March 2015 (as amended or supplemented from time to time, the "**Agency Agreement**") between the Issuer, the Guarantor, The Bank of New York Mellon (Luxembourg) S.A. as registrar (the "**Registrar**", which expression includes any successor registrar appointed from time to time in connection with the Subordinated Notes), The Bank of New York Mellon, London Branch as principal paying agent (the "**Principal Paying Agent**", which expression includes any successor principal paying agent appointed from time to time in connection with the Subordinated Notes), the transfer agent named therein (the "**Transfer Agent**", which expression includes any successor or additional transfer agents appointed from time to time in connection with the Subordinated Notes), the paying agents, if any, named therein (together with the Principal Paying Agent, the "**Paying Agents**", which expression includes any successor or additional paying agents appointed from time to time in connection with the Subordinated Notes), and the Trustee. References herein to the "**Agents**" are to the Registrar, the Principal Paying Agent, any other Paying Agents appointed from time to time under the Agency Agreement and the Transfer Agent and any reference to an "**Agent**" is to any one of them. Certain provisions of these Conditions are summaries of the Trust Deed and the Agency Agreement and subject to their detailed provisions. The Noteholders (as defined below) are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and those applicable to them in the Agency Agreement. Copies of the Trust Deed and the Agency Agreement are available for inspection and collection by Noteholders during normal business hours at the Specified Offices (as defined in the Agency Agreement) of each of the Agents, the initial Specified Offices of which are set out below.

1. Form and Denomination

The Subordinated Notes are in registered form in the denominations of £100,000 and integral multiples of £1,000 in excess thereof (each, an "**Authorised Denomination**").

2. Status of the Subordinated Notes

(a) ***Status***: The Subordinated Notes constitute direct, unsecured and subordinated obligations of the Issuer which will at all times rank *pari passu* without preference among themselves. The rights and claims of the Noteholders are subordinated as described in the Trust Deed and Condition 2(b) (*Subordination*).

(b) ***Subordination***: If:

(i) at any time an order is made, or an effective resolution is passed, for the winding-up in England and Wales of the Issuer (except, in any such case, a solvent winding-up solely for the purpose 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 (A) have previously been approved in writing by the Trustee or by an Extraordinary Resolution or which is effected in accordance with Condition 15 (*Substitution of the Issuer or the Guarantor*) and (B) do not provide that the Subordinated Notes or any amount in respect thereof shall thereby become payable); or

(ii) an administrator of the Issuer is appointed and such administrator gives notice that it intends to declare and distribute a dividend or other distribution of assets,

(the events in (i) and (ii) each being an "**Issuer Winding-Up**"), the rights and claims of the Trustee (on behalf of the Noteholders but not the rights and claims of the Trustee in its personal capacity under the Trust Deed) and the Noteholders against the Issuer in respect of or arising under the Subordinated Notes and the Trust Deed (including any damages awarded for breach of any obligations thereunder) will be subordinated to the claims of all Senior Creditors of the Issuer but shall rank: (A) *pari passu* with all claims of holders of all other subordinated obligations of the Issuer which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute, (i) Lower Tier 2 Capital of the Issuer at issue (issued prior to Solvency II Implementation) or (ii) Tier 2 Capital of the Issuer at issue (issued on or after Solvency II Implementation) and all obligations which rank, or are expressed to rank, *pari passu* therewith ("**Parity Securities of the Issuer**"); and (B) in priority to the claims of holders of (i) any subordinated obligations of the Issuer which rank or are expressed to rank junior to the Subordinated Notes, (ii) all obligations of the Issuer which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute (I) Upper Tier 2 Capital at issue (issued prior to Solvency II Implementation) or (II) Tier 1 Capital at issue and all obligations which rank, or are expressed to rank, *pari passu* therewith (together, the "**Junior Securities of the Issuer**").

Nothing in this Condition 2(b) shall affect or prejudice the payment of the costs, fees, charges, expenses, liabilities or remuneration of the Trustee under the Trust Deed or the rights and remedies of the Trustee in respect thereof.

(c) ***Issuer Recovered Amount***: In the event that any payment is made to the Trustee (other than payments made to the Trustee acting on its own account under the Trust Deed) and/or the Noteholders in respect of the claims arising under the terms of the Subordinated Notes and the Trust Deed by the liquidator or the administrator (as applicable) of the Issuer after the occurrence of an Issuer Winding-Up (any such amount paid, the "**Issuer Recovered Amount**"), any Issuer Recovered Amount shall reduce the amounts payable by the Guarantor under the Guarantee in the following manner:

(i) the Issuer Interest Portion of an Issuer Recovered Amount shall reduce any obligation of the Guarantor to make payment in respect of accrued interest and Arrears of Interest under the Guarantee by an amount equal to the Issuer Interest Portion with effect from (and including) the Issuer Recovered Amount Payment Date; and

(ii) the Issuer Non-Interest Portion of an Issuer Recovered Amount shall reduce any obligation of the Guarantor to make payment in respect of principal of the Subordinated Notes under the Guarantee by an amount equal to the Issuer Non-Interest Portion with effect from (and including) the Issuer Recovered Amount Payment Date, and accordingly interest shall only accrue on and be payable in respect of such reduced principal amount of the Subordinated Notes from (and including) the Issuer Recovered Amount Payment Date.

(d) ***Issuer Solvency Condition and Policyholder Requirement***: Other than in the event of an Issuer Winding-Up and without prejudice to Condition 10 (*Events of default*), payments of all amounts by the Issuer under or arising from the Subordinated Notes and the Trust Deed (other than payments made to the Trustee in its personal capacity under the Trust Deed) will be mandatorily deferred unless:

(i) the Issuer is solvent at the time for payment by the Issuer and unless and until such time as the Issuer could make such payment and still be solvent immediately thereafter; and

(ii) if, at any time (a) an order is made, or an effective resolution is passed, for the winding-up in England and Wales of a Group Regulated Entity or (b) an administrator of such Group Regulated Entity is appointed and such administrator gives notice that it intends to declare and distribute a dividend or other distribution of assets, all obligations owed by such Group Regulated Entity to its policyholders have been satisfied in full or the procedure for such winding-up or, as the case may be, administration, as referred to in (a) or (b) of this sub-paragraph is no longer continuing,

(the "**Issuer Solvency Condition and Policyholder Requirement**").

For the purposes of this Condition 2(d), the Issuer will be solvent if (i) it is able to pay its debts owed to Senior Creditors of the Issuer and Parity Creditors of the Issuer as they fall due and (ii) its total Assets exceed its total Issuer Liabilities (other than Issuer Liabilities owed to persons who are Junior Creditors of the Issuer). A certificate as to the solvency of the Issuer signed by two Authorised Signatories of the Issuer or, if there is a winding-up or administration of the Issuer, by two authorised signatories of the liquidator or, as the case may be, the administrator of the Issuer shall be treated and accepted by the Issuer, the Guarantor, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(e) ***Set-off***: By acceptance of the Subordinated Notes, each Noteholder and the Trustee on behalf of the Noteholders will, subject to applicable law, be deemed to have waived any right of set-off or counterclaim that such Noteholder might otherwise have against the Issuer in respect of or arising under the Subordinated Notes whether prior to or in liquidation, winding-up or administration. Notwithstanding the preceding sentence, if any of the rights and claims of any Noteholder in respect of or arising under the Subordinated Notes are discharged by set-off, such Noteholder will, unless prohibited by applicable law, hold a sum equal to such amount on trust for the Issuer or, if applicable, the liquidator, trustee, receiver or administrator in the Issuer's bankruptcy, winding-up or administration. Accordingly, such discharge will be deemed not to have taken place.

3. Guarantee

(a) ***Status***: The Guarantor has, in the Trust Deed, (subject as provided in clause 5.9 (*Subordination*) and clause 9 (*Enforcement*) of the Trust Deed and Conditions 2(c) (*Issuer Recovered Amount*), 3(a) (*Status*), 3(c) (*Subordination*), 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*), 6(b) (*Guarantor Mandatory Deferral of Guaranteed Amounts in respect of Interest*) and 7(c) (*Guarantor Deferral of redemption date*)) irrevocably guaranteed to the Trustee payment of all principal, interest and other sums from time to time which are (or are deemed under Condition 3(b) (*Due and Payable*) to be) due and payable by the Issuer in respect of the Subordinated Notes and all other monies due and payable by the Issuer in respect of or under or pursuant to the Trust Deed ("**Guaranteed Amounts**") as and when the same become due and payable, whether at maturity, upon early redemption, upon acceleration or otherwise, according to the terms of the Trust Deed and the Subordinated Notes. The obligations of the Guarantor under such Guarantee (the "**Guarantee**") constitute direct, unsecured and subordinated obligations of the Guarantor.

(b) ***Due and Payable***: For the purpose only of determining whether any Guaranteed Amount is from time to time due and payable by the Issuer for the purposes of the obligations of the Guarantor under the Guarantee, any amount of principal, interest and Arrears of Interest shall be deemed to be due and payable by the Issuer on the Applicable Date regardless of whether the Issuer Solvency Condition and Policyholder Requirement under Condition 2(d) (*Issuer Solvency Condition and Policyholder Requirement*) is satisfied or any of Conditions 6(a) (*Issuer Mandatory Deferral of Interest*), 7(b) (*Issuer Deferral of redemption date*) and 7(l) (*Preconditions to redemption, variation, substitution and purchases*) apply, provided that, if any such

amount is paid by the Guarantor under the Guarantee, such payment by the Guarantor shall be treated (to the extent of the amount paid) as satisfying the Trustee and any Noteholder's right to payment of any such amount under the Trust Deed and the Subordinated Notes.

For the purposes of this Condition 3(b), "**Applicable Date**" means the date on which any amount of principal, interest and/or Arrears of Interest (i) becomes due and payable by the Issuer or (ii) would have become due and payable by the Issuer had the Issuer not deferred payment of the same in accordance with these Conditions.

(c) ***Subordination***: If:

(i) at any time an order is made, or an effective resolution is passed, for the winding-up in England and Wales of the Guarantor (except, in any such case, a solvent winding-up solely for the purpose of a reconstruction or amalgamation or the substitution in place of the Guarantor of a successor in business of the Guarantor, the terms of which reconstruction, amalgamation or substitution (A) have previously been approved in writing by the Trustee or by an Extraordinary Resolution or which is effected in accordance with Condition 15 (*Substitution of the Issuer or the Guarantor*) and (B) do not provide that the Subordinated Notes or any amount in respect thereof (including under the Guarantee) shall thereby become payable); or

(ii) an administrator of the Guarantor is appointed and such administrator gives notice that it intends to declare and distribute a dividend or other distribution of assets,

(the events in (i) and (ii) each being a "**Guarantor Winding-Up**"), the rights and claims of the Trustee (on behalf of the Noteholders but not the rights and claims of the Trustee in its personal capacity under the Trust Deed) and the Noteholders against the Guarantor in respect of or arising under the Subordinated Notes and the Trust Deed (including the Guarantee) (including any damages awarded for breach of any obligations thereunder) will be subordinated to the claims of all Senior Creditors of the Guarantor but shall rank: (A) *pari passu* with all claims of holders of all other subordinated obligations of the Guarantor which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Guarantor in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute (i) Lower Tier 2 Capital of the Guarantor at issue (issued prior to Solvency II Implementation) or (ii) Tier 2 Capital of the Guarantor at issue (issued on or after Solvency II Implementation) and all obligations which rank, or are expressed to rank, *pari passu* therewith ("**Parity Securities of the Guarantor**"); and (B) in priority to the claims of holders of (i) any subordinated obligations of the Guarantor which rank or are expressed to rank junior to the Guarantee and (ii) all obligations of the Guarantor which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Guarantor in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute (I) Upper Tier 2 Capital at issue (issued prior to Solvency II Implementation) or (II) Tier 1 Capital at issue all obligations which rank, or are expressed to rank, *pari passu* therewith (together, the "**Junior Securities of the Guarantor**").

Nothing in this Condition 3(c) shall affect or prejudice the payment of the costs, fees, charges, expenses, liabilities or remuneration of the Trustee under the Trust Deed or the rights and remedies of the Trustee in respect thereof.

(d) ***Guarantor Recovered Amount***: In the event that any payment is made to the Trustee (other than payments made to the Trustee acting on its own account under the Trust Deed) and/or the Noteholders in respect of the claims under the terms of the Subordinated Notes and the Trust Deed (including the Guarantee) by the liquidator or administrator (as applicable) of the Guarantor (any such amount paid, the "**Guarantor**

Recovered Amount"), any Guarantor Recovered Amount shall reduce the amounts payable by the Issuer under the terms of the Subordinated Notes and the Trust Deed in the following manner:

(i) the Guarantor Interest Portion of a Guarantor Recovered Amount shall reduce any obligation of the Issuer to make payment in respect of accrued interest and Arrears of Interest under the Subordinated Notes and the Trust Deed by an amount equal to the Guarantor Interest Portion with effect from (and including) the Guaranteed Recovered Amount Payment Date; and

(ii) the Guarantor Non-Interest Portion of a Guarantor Recovered Amount shall reduce any obligation of the Issuer to make payment in respect of principal of the Subordinated Notes under the Subordinated Notes and the Trust Deed by an amount equal to the Guarantor Non-Interest Portion with effect from (and including) the Guarantor Recovered Amount Payment Date, and accordingly interest shall only accrue on and be payable in respect of such reduced principal amount of the Subordinated Notes from (and including) the Guarantor Recovered Amount Payment Date.

(e) ***Obligations of the Guarantor upon an Issuer Winding-up***: In the event of an Issuer Winding-Up, the Guarantor undertakes under the Guarantee to pay the Guaranteed Amounts on the basis that such amounts are and will be due for payment under the terms of the Subordinated Notes and the Trust Deed as if the Issuer Winding-Up had not occurred and provided that no amount shall be deemed due and payable by the Issuer for the purpose of the Guarantee if such amount only became due and payable by the Issuer under the terms of the Subordinated Notes as a result of the occurrence of such Issuer Winding-Up. In the event that any Issuer Recovered Amount is paid to the Noteholders (or the Trustee on their behalf) in the Issuer Winding-Up, such Issuer Recovered Amount will reduce the amounts payable by the Guarantor in respect of the Subordinated Notes and the Trust Deed (including the Guarantee) to the extent and in the manner provided in Condition 2(c) (*Issuer Recovered Amount*).

In addition, the Guarantor shall have the rights and benefits of all the provisions applicable to the Issuer in the Conditions and the Trust Deed including, without limitation, the Issuer's ability to redeem, vary, substitute or purchase the Subordinated Notes in the circumstances set out in Conditions 7(f) (*Redemption, variation or substitution for taxation reasons*) and 7(g) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) and, accordingly, in such circumstances all references in these Conditions and the Trust Deed to the Issuer shall, to the extent necessary to confer such rights and/or benefits, be construed as references to the Guarantor.

(f) ***Guarantor Solvency Condition and Policyholder Requirement***: Other than in the event of a Guarantor Winding-Up and without prejudice to Condition 10 (*Events of default*), payments of all amounts by the Guarantor under or arising from the Guarantee will be mandatorily deferred unless:

(i) the Guarantor is solvent at the time for payment by the Guarantor and unless and until such time as the Guarantor could make such payment and still be solvent immediately thereafter; and

(ii) if, at any time (a) an order is made, or an effective resolution is passed, for the winding-up in England and Wales of a Group Regulated Entity or (b) an administrator of such Group Regulated Entity (other than the Issuer) is appointed and such administrator gives notice that it intends to declare and distribute a dividend or other distribution of assets, all obligations owed by such Group Regulated Entity (other than the Issuer) to its policyholders have been satisfied in full or the procedure for such winding-up or, as the case may be, administration, as referred to in (a) or (b) of this sub-paragraph is no longer continuing,

(the "**Guarantor Solvency Condition and Policyholder Requirement**").

For the purposes of this Condition 3(f), the Guarantor will be solvent if (i) it is able to pay its debts owed to Senior Creditors of the Guarantor and Parity Creditors of the Guarantor as they fall due and (ii) its total Assets exceed its total Guarantor Liabilities (other than Guarantor Liabilities to persons who are Junior Creditors of the Guarantor). A certificate as to the solvency of the Guarantor signed by two Authorised Signatories of the Guarantor or, if there is a winding-up or administration of the Guarantor, by two authorised signatories of the liquidator or, as the case may be, the administrator of the Guarantor shall be treated and accepted by the Issuer, the Guarantor, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(g) ***Set-off***: By acceptance of the Subordinated Notes, each Noteholder and the Trustee, on behalf of each Noteholder, will, subject to applicable law, be deemed to have waived any right of set-off or counterclaim that such Noteholder might otherwise have against the Guarantor in respect of or arising under the Subordinated Notes or the Guarantee whether prior to or in liquidation, winding-up or administration. Notwithstanding the preceding sentence, if any of the rights and claims of any Noteholder in respect of or arising under the Subordinated Notes or the Guarantee are discharged by set-off, such Noteholder will, unless prohibited by applicable law, hold a sum equal to such amount on trust for the Guarantor or, if applicable, the liquidator, trustee, receiver or administrator in the Guarantor's bankruptcy, winding-up or administration. Accordingly, such discharge will be deemed not to have taken place.

4. Register, Title and Transfers

(a) ***Register***: The Registrar will maintain a register (the "**Register**") in respect of the Subordinated Notes in accordance with the provisions of the Agency Agreement. In these Conditions, the "**Holder**" of a Subordinated Note means the person in whose name such Subordinated Note is for the time being registered in the Register (or, in the case of a joint holding, the first named thereof) and "**Noteholder**" shall be construed accordingly. A certificate (each, a "**Note Certificate**") will be issued to each Noteholder in respect of its registered holding. Each Note Certificate will be numbered serially with an identifying number which will be recorded on the relevant Note Certificate and in the Register.

(b) ***Title***: The Holder of each Subordinated Note shall (except as otherwise required by law) be treated as the absolute owner of such Subordinated Note for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing on the Note Certificate relating thereto (other than the endorsed form of transfer) or any notice of any previous loss or theft of such Note Certificate) and no person shall be liable for so treating such Holder. No person shall have any right to enforce any term or condition of the Subordinated Notes or the Trust Deed under the Contracts (Rights of Third Parties) Act 1999 (except to the extent, if any, that the Trust Deed expressly provides for such act to apply).

(c) ***Transfers***: Subject to Conditions 4(f) (*Closed periods*) and 4(g) (*Regulations concerning transfers and registration*) below, a Subordinated Note may be transferred upon surrender of the relevant Note Certificate, with the endorsed form of transfer duly completed, at the Specified Office of the Registrar or any Transfer Agent, together with such evidence as the Registrar or (as the case may be) such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the individuals who have executed the form of transfer; *provided*, *however*, *that* a Subordinated Note may not be transferred unless the principal amount of Subordinated Notes transferred and (where not all of the Subordinated Notes held by a Holder are being transferred) the principal amount of the balance of Subordinated Notes not transferred are Authorised Denominations. Where not all the Subordinated Notes represented by the surrendered Note Certificate are the subject of the transfer, a new Note Certificate in respect of the balance of the Subordinated Notes will be issued to the transferor.

(d) ***Registration and delivery of Note Certificates***: Within five business days of the surrender of a Note Certificate in accordance with Condition 4(c) (*Transfers*) above, the Registrar will register the transfer in question and deliver a new Note Certificate of a like principal amount to the Subordinated Notes transferred to each relevant Holder at its Specified Office or (as the case may be) the Specified Office of any Transfer Agent or (at the request and risk of any such relevant Holder) by uninsured first class mail (airmail if overseas) to the address specified for the purpose by such relevant Holder. In this paragraph, "**business day**" means a day on which commercial banks are open for general business (including dealings in foreign currencies) in the city where the Registrar or (as the case may be) the relevant Transfer Agent has its Specified Office.

(e) ***No charge***: The transfer of a Subordinated Note will be effected without charge by or on behalf of the Issuer, the Registrar or any Transfer Agent but against such indemnity as the Registrar or (as the case may be) such Transfer Agent may require in respect of any tax or other duty of whatsoever nature which may be levied or imposed in connection with such transfer.

(f) ***Closed periods***: Noteholders may not require transfers to be registered during the period of 15 days ending on the due date for any payment of principal or interest in respect of the Subordinated Notes or during the period following delivery of a notice of a voluntary payment of Arrears of Interest in accordance with Condition 6(e) (*Payment of Arrears of Interest by the Issuer*), Condition 6(f) (*Payment of Arrears of Interest by the Guarantor*) and Condition 16 (*Notices*) and ending on the date referred to in such notice as having been fixed for such payment of Arrears of Interest.

(g) ***Regulations concerning transfers and registration***: All transfers of Subordinated Notes and entries on the Register are subject to the detailed regulations concerning the transfer of Subordinated Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Trustee and the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests in writing a copy of such regulations.

5. Interest

(a) ***Interest***: The Subordinated Notes bear interest from 24 March 2015 (the "**Issue Date**") at the Interest Rate in accordance with the provisions of this Condition 5. Subject to Conditions 2(d) (*Issuer Solvency Condition and Policyholder Requirement*), 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*) and 6 (*Deferral of Interest*), interest shall be payable annually in arrear on 24 March in each year (each, an "**Interest Payment Date**"), in each case as provided in this Condition 5 and in accordance with Condition 8 (*Payments*).

(b) ***Interest Accrual***: Each Subordinated Note will cease to bear interest from (and including) the due date for redemption (which due date shall, in the case of deferral of a redemption date due to the Issuer Solvency Condition and Policyholder Requirement or Guarantor Solvency Condition and Policyholder Requirement not being satisfied and/or in accordance with Condition 7(b) (*Issuer Deferral of redemption date*) or Condition 7(c) (*Guarantor Deferral of redemption date*), be the latest date to which redemption of the Subordinated Notes is so deferred) unless, upon due presentation, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at such rate (both before and after judgment) until (and including) whichever is the earlier of (i) the day on which all sums due in respect of such Subordinated Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Subordinated Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

(c) ***Interest Rate***: For each Interest Period, the Subordinated Notes bear interest at the rate of 9.5 per cent. per annum (the "**Interest Rate**"). Accordingly, the amount of interest which will, subject to Conditions 2(d) (*Issuer Solvency Condition and Policyholder*

Requirement), 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*) and 6 (*Deferral of Interest*), be payable on each Interest Payment Date will be £95 per Calculation Amount.

Where it is necessary to compute an amount of interest in respect of any Subordinated Note, such amount of interest shall be calculated on the basis of 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 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 Subordinated Notes (the "**Calculation Amount**") by applying the relevant Interest Rate referred to in this Condition 5(c) 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).

(d) ***Principal Paying Agent***: So long as any of the Subordinated Notes remains outstanding, the Issuer will maintain a Principal Paying Agent. The Issuer may, with the prior written approval of the Trustee, from time to time replace the Principal Paying Agent with another leading financial institution in London. If the Principal Paying Agent is unable or unwilling to continue to act as the Principal Paying Agent, the Issuer and Guarantor shall forthwith appoint another financial institution in London approved in writing by the Trustee to act as such in its place.

6. Deferral of Interest

(a) ***Issuer Mandatory Deferral of Interest***: Payment of interest on the Subordinated Notes by the Issuer will be mandatorily deferred on each Mandatory Interest Deferral Date. The Issuer shall notify the Noteholders, the Trustee and the Principal Paying Agent of any Mandatory Interest Deferral Date in accordance with Condition 6(g) (*Notice of Deferral*) (*provided that* failure to make such notification shall not oblige the Issuer to make payment of such interest, or cause the same to become due and payable, on such date).

A certificate signed by two Authorised Signatories confirming that (i) a Mandatory Interest Deferral Event has occurred and is continuing, or would occur if payment of interest on the Subordinated Notes were to be made or (ii) a Mandatory Interest Deferral Event has ceased to occur and/or payment of interest on the Subordinated Notes would not result in a Mandatory Interest Deferral Event occurring, shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(b) ***Guarantor Mandatory Deferral of Guaranteed Amounts in respect of Interest***: Payment of any Guaranteed Amounts in respect of interest which would otherwise become due and payable under the Guarantee will be mandatorily deferred on each Guarantor Mandatory Interest Deferral Date. The Guarantor shall notify the Noteholders, the Trustee and the Principal Paying Agent of any Guarantor Mandatory Interest Deferral Date in accordance with Condition 6(g) (*Notice of Deferral*) (*provided that* failure to make such notification shall not oblige the Guarantor to make payment of such Guaranteed Amounts, or cause the same to become due and payable, on such date).

A certificate signed by two Authorised Signatories confirming that (i) a Mandatory Interest Deferral Event has occurred and is continuing, or would occur if payment of interest on the Subordinated Notes were to be made or (ii) a Mandatory Interest Deferral Event has ceased to occur and/or payment of interest on the Subordinated Notes would not result in a Mandatory Interest Deferral Event occurring, shall, in the

absence of manifest error, be treated and accepted by the Issuer, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(c) ***No default***: Notwithstanding any other provision in these Conditions or in the Trust Deed, neither:

(i) the deferral by the Issuer of any payment of interest (i) on a Mandatory Interest Deferral Date in accordance with Condition 6(a) (*Issuer Mandatory Deferral of Interest*) or (ii) as a result of the non-satisfaction of the Issuer Solvency Condition and Policyholder Requirement in accordance with Condition 2(d) (*Issuer Solvency Condition and Policyholder Requirement*); nor

(ii) the deferral by the Guarantor of any payment of Guaranteed Amounts in respect of interest (i) on a Guarantor Mandatory Interest Deferral Date in accordance with Condition 6(b) (*Guarantor Mandatory Deferral of Guaranteed Amounts in respect of Interest*) or (ii) as a result of the non-satisfaction of the Guarantor Solvency Condition and Policyholder Requirement in accordance with Condition 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*),

will constitute a default by the Issuer or the Guarantor and will not give Noteholders or the Trustee any right to accelerate repayment of the Subordinated Notes or take any enforcement action under the Subordinated Notes or the Trust Deed (including the Guarantee).

(d) ***Arrears of Interest***: Any interest on the Subordinated Notes not paid on an Interest Payment Date as a result of:

(i) the obligation of the Issuer to defer such payment of interest pursuant to Condition 6(a) (*Issuer Mandatory Deferral of Interest*) or, for the avoidance of doubt, the non-satisfaction of the Issuer Solvency Condition and Policyholder Requirement described in Condition 2(d) (*Issuer Solvency Condition and Policyholder Requirement*); and

(ii) the obligation of the Guarantor to defer payment of Guaranteed Amounts in respect of such interest pursuant to Condition 6(b) (*Guarantor Mandatory Deferral of Guaranteed Amounts in respect of Interest*) or, for the avoidance of doubt, the non-satisfaction of the Guarantor Solvency Condition and Policyholder Requirement described in Condition 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*),

shall (without double counting), together with any other interest not paid on any earlier Interest Payment Dates, to the extent and so long as the same remains unpaid, constitute "**Arrears of Interest**". Arrears of Interest shall not themselves bear interest.

(e) ***Payment of Arrears of Interest by the Issuer***: Any Arrears of Interest may (subject to Condition 2(d) (*Issuer Solvency Condition and Policyholder Requirement*) and to the satisfaction of the Regulatory Clearance Condition) be paid by the Issuer in whole or in part at any time upon the expiry of not less than 14 days' notice to such effect given by the Issuer to the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 16 (*Notices*) and in any event will become due and payable by the Issuer (subject, in the case of (i) and (iii) below, to Condition 2(d) (*Issuer Solvency Condition and Policyholder Requirement*) and to the satisfaction of the Regulatory Clearance Condition) in whole (and not in part) upon the earliest of the following dates:

(i) the next Interest Payment Date which is not a Mandatory Interest Deferral Date on which payment of interest in respect of the Subordinated Notes is made or is required to be made (other than a voluntary payment by the Issuer of any Arrears of Interest); or

(ii) the date on which an Issuer Winding-Up occurs; or

(iii) the date fixed for any redemption, substitution or purchase of the Subordinated Notes pursuant to Condition 7 (*Redemption, Substitution, Variation and Purchase*) (subject to any deferral of such redemption date pursuant to Condition 7(b) (*Issuer Deferral of redemption date*) or Condition 10 (*Events of default*)).

(f) ***Payment of Arrears of Interest by the Guarantor***: Any Arrears of Interest may (subject to Condition 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*) and to the satisfaction of the Regulatory Clearance Condition) be paid by the Guarantor in whole or in part at any time upon the expiry of not less than 14 days' notice to such effect given by the Guarantor to the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 16 (*Notices*) and in any event will become due and payable by the Guarantor (subject, in the case of (i) and (iii) below, to Condition 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*) and to the satisfaction of the Regulatory Clearance Condition) in whole (and not in part) upon the earliest of the following dates:

(i) the next Interest Payment Date which is not a Guarantor Mandatory Interest Deferral Date on which payment of Guaranteed Amounts in respect of interest in respect of the Subordinated Notes is made or is required to be made (other than a voluntary payment by the Guarantor of any Guaranteed Amount in respect of Arrears of Interest); or

(ii) the date on which a Guarantor Winding-Up occurs; or

(iii) the date fixed for any redemption, substitution or purchase of the Subordinated Notes by the Issuer pursuant to Condition 7 (*Redemption, Substitution, Variation and Purchase*) (subject to any deferral by the Guarantor of payments of Guaranteed Amounts in connection with a redemption or purchase of the Subordinated Notes pursuant to Condition 7(c) (*Guarantor Deferral of redemption date*) or Condition 10 (*Events of default*)).

(g) ***Notice of Deferral***:

(i) The Issuer shall notify the Trustee, the Principal Paying Agent and the Noteholders in writing in accordance with Condition 16 (*Notices*) not less than 5 Business Days prior to an Interest Payment Date:

(A) if that Interest Payment Date is a Mandatory Interest Deferral Date, specifying that interest will not be paid because a Mandatory Interest Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date, *provided that* if a Mandatory Interest Deferral Event occurs less than 5 Business Days prior to an Interest Payment Date, the Issuer shall give notice of the interest deferral in accordance with Condition 16 (*Notices*) as soon as reasonably practicable following the occurrence of such event; or

(B) if payment of interest is to be deferred on that Interest Payment Date only as a result of the non-satisfaction of the Issuer Solvency Condition and Policyholder Requirement and specifying the same, *provided that* if the Issuer becomes aware of such non-satisfaction of the Issuer Solvency Condition and Policyholder Requirement less than five Business Days prior to an Interest Payment Date, the Issuer shall give notice of the interest deferral in accordance with Condition 16 (*Notices*) as soon as reasonably practicable following it becoming so aware.

(ii) The Guarantor shall notify the Trustee, the Principal Paying Agent and the Noteholders in writing in accordance with Condition 16 (*Notices*) not less than 5 Business Days prior to an Interest Payment Date in respect of which Guaranteed Amounts in respect of interest are scheduled to be paid:

(A) if that Interest Payment Date is a Guarantor Mandatory Interest Deferral Date, specifying that relevant Guaranteed Amounts will not be paid because a Mandatory Interest Deferral Event has occurred and is continuing or would occur if payment of relevant Guaranteed Amounts was made on such Interest Payment Date, *provided that* if a Mandatory Interest Deferral Event occurs less than 5 Business Days prior to such Interest Payment Date, the Guarantor shall give notice of the interest deferral in accordance with Condition 16 (*Notices*) as soon as reasonably practicable following the occurrence of such event; or

(B) if payment of interest is to be deferred on that Interest Payment Date only as a result of the non-satisfaction of the Guarantor Solvency Condition and Policyholder Requirement and specifying the same, *provided that* if the Guarantor becomes aware of such non-satisfaction of the Guarantor Solvency Condition and Policyholder Requirement less than five Business Days prior to an Interest Payment Date, the Guarantor shall give notice of the interest deferral in accordance with Condition 16 (*Notices*) as soon as reasonably practicable following it becoming so aware.

7. Redemption, Substitution, Variation and Purchase

(a) ***Scheduled redemption***: Subject to Condition 7(b) (*Issuer Deferral of redemption date*) and Condition 7(l) (*Preconditions to redemption, variation, substitution and purchases*), unless previously redeemed, or purchased and cancelled, the Subordinated Notes will be redeemed at their principal amount on the Maturity Date together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the Maturity Date in accordance with the terms of Condition 8 (*Payments*).

(b) ***Issuer Deferral of redemption date***:

(i) No Subordinated Notes shall be redeemed on the Maturity Date by the Issuer pursuant to Condition 7(a) (*Scheduled redemption*) or prior to the Maturity Date pursuant to Condition 7(e) (*Redemption at the option of the Issuer*), Condition 7(f) (*Redemption,variation or substitution for taxation reasons*) or Condition 7(g) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) if an Issuer Regulatory Deficiency Deferral Event has occurred and is continuing or would occur if redemption is made pursuant to this Condition 7.

(ii) The Issuer shall notify the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 16 (*Notices*) no later than 5 Business Days prior to any date set for redemption of the Subordinated Notes if such redemption is to be deferred in accordance with this Condition 7(b), *provided that* if an Issuer Regulatory Deficiency Deferral Event occurs less than 5 Business Days prior to the date set for redemption, the Issuer shall give notice of such deferral in accordance with Condition 16 (*Notices*) as soon as reasonably practicable following the occurrence of such event or the date on which such event would occur if redemption is made pursuant to this Condition 7.

(iii) If redemption of the Subordinated Notes does not occur on the Maturity Date or, as appropriate, the date specified in the notice of redemption by the Issuer under Condition 7(f) (*Redemption, variation or substitution for taxation reasons*) or Condition 7(g) (*Redemption, substitution or variation at the option*

of the Issuer due to a Capital Disqualification Event) as a result of Condition 7(b)(i) (*Issuer Deferral of redemption date*) above, the Issuer shall (subject to satisfaction of the Regulatory Clearance Condition) redeem such Subordinated Notes at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest upon the earliest of:

(1) subject to receipt of the certificate detailed in Condition 7(b)(iv) below, the date falling 10 Business Days after the date the Issuer Regulatory Deficiency Deferral Event has ceased (unless on such 10th Business Day a further Issuer Regulatory Deficiency Deferral Event has occurred and is continuing or redemption of the Subordinated Notes on such date would result in an Issuer Regulatory Deficiency Deferral Event occurring, in which case the provisions of Condition 7(b)(i) and this Condition 7(b)(iii) will apply *mutatis mutandis* to determine the due date for redemption of the Subordinated Notes); or

(2) the date falling 10 Business Days after the PRA has agreed to the repayment or redemption of the Subordinated Notes; or

(3) the date on which an Issuer Winding-Up occurs.

The Issuer shall notify the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 16 (*Notices*) no later than 5 Business Days prior to any date set for redemption pursuant to Conditions 7(b)(iii)(1) and 7(b)(iii)(2) above.

(iv) A certificate signed by two Authorised Signatories of the Issuer confirming that (A) an Issuer Regulatory Deficiency Deferral Event has occurred and is continuing, or would occur if redemption of the Subordinated Notes pursuant to this Condition 7 were to be made or (B) an Issuer Regulatory Deficiency Deferral Event has ceased to occur and/or redemption of the Subordinated Notes would not result in an Issuer Regulatory Deficiency Deferral Event occurring, shall, in the absence of manifest error, be treated and accepted by the Guarantor, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(v) Notwithstanding any other provision in these Conditions or in the Trust Deed, the deferral of redemption of the Subordinated Notes in accordance with this Condition 7(b) will not constitute a default by the Issuer and will not give Noteholders or the Trustee any right to accelerate the Subordinated Notes or take any enforcement action under the Subordinated Notes or the Trust Deed.

(c) ***Guarantor Deferral of redemption date***:

(i) The obligations of the Guarantor under the Guarantee to make payment of Guaranteed Amounts in respect of principal, interest or any other amount in relation to the redemption of the Subordinated Notes shall be mandatorily deferred if a Guarantor Regulatory Deficiency Deferral Event has occurred and is continuing or would occur if redemption is made pursuant to this Condition 7.

(ii) The Guarantor shall notify the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 16 (*Notices*) no later than 5 Business Days after the date on which the Guarantor becomes aware of its obligation to make payment of Guaranteed Amounts in respect of principal, interest or any other amount in relation to the redemption of the Subordinated Notes and if a Guarantor Regulatory Deficiency Deferral Event has occurred and is continuing or would occur if such payment was made.

(iii) If the obligations of the Guarantor under the Guarantee to make payment in relation to the redemption of the Subordinated Notes are mandatorily deferred in accordance with Condition 7(c)(i) (subject to satisfaction of the Regulatory Clearance Condition), such payment will (to the extent that the relevant amounts have not at such time already been paid by or otherwise recovered from the Issuer) become due and payable by the Guarantor (subject to satisfaction of the Regulatory Clearance Condition) in whole (and not in part) upon the earliest of:

(1) subject to receipt of the certificate detailed in Condition 7(c)(v) below the date falling 10 Business Days after the date the Guarantor Regulatory Deficiency Deferral Event has ceased (unless on such 10th Business Day a further Guarantor Regulatory Deficiency Deferral Event has occurred and is continuing or payment under the Guarantee in relation to the redemption of the Subordinated Notes on such date would result in a Guarantor Regulatory Deficiency Deferral Event occurring, in which case the provisions of Condition 7(c)(i) and this Condition 7(c)(iii) will apply *mutatis mutandis* to determine the due date for redemption of the Subordinated Notes); or

(2) the date falling 10 Business Days after the PRA has agreed to the payment by the Guarantor of Guaranteed Amounts in connection with redemption of the Subordinated Notes by the Issuer; or

(3) the date on which a Guarantor Winding-Up occurs.

The Guarantor shall notify the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 16 (*Notices*) no later than 5 Business Days prior to any date set for redemption pursuant to Conditions 7(c)(iii)(1) and 7(c)(iii)(2) above.

(iv) If Condition 7(c)(i) does not apply, but the obligations of the Guarantor under the Guarantee to make payment of any Guaranteed Amounts in relation to redemption of the Subordinated Notes are mandatorily deferred as a result of the Guarantor Solvency Condition and Policyholder Requirement not being satisfied at such time, subject to satisfaction of the Regulatory Clearance Condition, such obligations shall be payable on the 10th Business Day immediately following the day that (A) the Guarantor is solvent for the purposes of Condition 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*) and (B) the payment of such Guaranteed Amounts would not result in the Guarantor ceasing to be solvent for the purposes of Condition 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*), *provided that* if on such Business Day specified for redemption the Guarantor Solvency Condition and Policyholder Requirement is not satisfied, then such obligations shall not be paid on such date and Condition 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*) shall apply *mutatis mutandis* to determine the due date for payment of such amount.

(v) A certificate signed by two Authorised Signatories of the Guarantor confirming that (A) a Guarantor Regulatory Deficiency Deferral Event has occurred pursuant to this Condition 7 and is continuing, or would occur if redemption of the Subordinated Notes were to be made or (B) a Guarantor Regulatory Deficiency Deferral Event has ceased to occur and/or payment under the Guarantee in relation to the redemption of the Subordinated Notes would not result in a Guarantor Regulatory Deficiency Deferral Event occurring, shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

(d) Notwithstanding any other provision in these Conditions or in the Trust Deed, the deferral of redemption of the Subordinated Notes in accordance with Condition 7(b) (*Issuer Deferral of redemption date*) or Condition 7(c) (*Guarantor Deferral of redemption date*) (as the case may be) will not constitute a default by the Issuer or the Guarantor and will not give Noteholders or the Trustee any right to accelerate the Subordinated Notes or take any enforcement action under the Subordinated Notes or the Trust Deed.

(e) ***Redemption at the option of the Issuer***: subject to Condition 7(b) (*Issuer Deferral of redemption date*) and Condition 7(l) (*Preconditions to redemption, variation, substitution and purchases*) the Issuer may, having given:

(i) not less than 15 nor more than 30 days' notice to Noteholders in accordance with Condition 16 (*Notices*) (which notice shall be irrevocable and shall specify the date fixed for redemption); and

(ii) notice to the Principal Paying Agent and the Trustee not less than five days before the giving of the notice referred to in (i) in accordance with clause 7.8 (*Notices to Noteholders*) of the Trust Deed,

redeem all (but not some only) of the Subordinated Notes, on the First Optional Call Date or on any following Interest Payment Date at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption.

(f) ***Redemption, variation or substitution for taxation reasons***: Subject to Conditions 7(b) (*Issuer Deferral of redemption date*), 7(c) (*Guarantor Deferral of redemption date*), 7(k) (*Trustee role on redemption, variation or substitution*: *Trustee not obliged to monitor*), and 7(l) (*Preconditions to redemption, variation, substitution and purchases*) if immediately before the giving of the notice referred to below:

(i) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction, or any change in the application or official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after the Issue Date, on the next Interest Payment Date either (a) the Issuer would be required to pay additional amounts as provided or referred to in Condition 9 (*Taxation*); or (b) the Guarantor would be unable for reasons outside its control to procure payment by the Issuer and in making payment itself would be required to pay such additional amounts; or (c) the payment of interest (or any Guaranteed Amounts in respect of interest) would be treated as a "distribution" for United Kingdom tax purposes or the Issuer or the Guarantor, as the case may be, would otherwise not be able to claim a tax deduction (for United Kingdom tax purposes) for interest payable on the Subordinated Notes (or any Guaranteed Amounts in respect of interest); or (d) in respect of the payment of interest (or any Guaranteed Amounts in respect of interest), the Issuer or the Guarantor, as the case may be, would not to any material extent be entitled to have any attributable loss or non-trading deficit 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 Issue Date or any similar system or systems having like effect as may from time to time exist) (each a "**Tax Event**"); and

(ii) the effect of the foregoing cannot be avoided by the Issuer or, as the case may be, the Guarantor taking reasonable measures available to it, the Issuer may at its option (without any requirement for the consent or approval of the Noteholders) 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 16 (*Notices*), the Noteholders (which notice shall be irrevocable), either:

(1) redeem all of the Subordinated Notes, but not some only, at any time at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption, *provided that* no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which (a) with respect to (i)(a) and (i)(b) the Issuer or, as the case may be, the Guarantor would be obliged to pay such additional amounts; (b) with respect to (i)(c) above, the payment of interest (or Guaranteed Amounts in respect of interest) would be so treated as a "distribution" or the Issuer or, as the case may be, the Guarantor would otherwise not be able to claim a tax deduction as provided in paragraph (i)(c) above; or (c) with respect to (i)(d), the Issuer or, as the case may be, the Guarantor would not to any material extent be entitled to have the loss or non-trading deficit set against the profits as provided in (i)(d) above, in each case were a payment in respect of the Subordinated Notes then due; or

(2) substitute at any time all (but not some only) of the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Lower Tier 2 Capital (prior to Solvency II Implementation) or Tier 2 Capital (under Solvency II), and the Trustee shall (subject to both Condition 7(k) (*Trustee role on redemption, variation or substitution*: *Trustee not obliged to monitor*) and the receipt by it of the certificates of the Authorised Signatories referred to in Condition 7(l) (*Preconditions to redemption, variation, substitution and purchases*) agree to such substitution or variation.

Upon expiry of such notice the Issuer shall either redeem, vary or substitute the Subordinated Notes, as the case may be.

(g) ***Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event***:

(i) Subject to Conditions 7(b)(i) (*Issuer Deferral of redemption date*), 7(k) (*Trustee role on redemption, variation or substitution*: *Trustee not obliged to monitor*) and 7(l) (*Preconditions to redemption, variation, substitution and purchases*), if a Capital Disqualification Event has occurred and is continuing, or as a result of any change in, or amendment to, or any change in the application or official interpretation of, any applicable law, regulation or other official publication, the same will occur within a period of six months, then the Issuer may, having given not less than 30 nor more than 60 days' notice to the Noteholders (in accordance with Condition 16 (*Notices*)), the Trustee and the Principal Paying Agent, which notice must be given during the Notice Period and shall be irrevocable, either:

(1) as soon as reasonably practicable redeem all (but not some only) of the Subordinated Notes at their principal amount, together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption; or

(2) at any time substitute all (and not some only) of the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Lower Tier 2 Capital (prior to Solvency II Implementation) or Tier 2 Capital (under Solvency II), and the Trustee shall (subject to both Condition 7(k) (*Trustee role on redemption, variation or substitution*: *Trustee not obliged to monitor*) and the receipt by it of the certificates of the Authorised Signatories referred to in Condition 7(l) (*Preconditions to redemption, variation, substitution and purchases*) agree to such substitution or variation.

Upon expiry of such notice the Issuer shall either redeem, vary or substitute the Subordinated Notes, as the case may be.

(ii) For the purposes of this Condition 7(g), "**Notice Period**" means the period commencing on the date on which the relevant Capital Disqualification Event first occurs (or, as applicable, the date on which the Issuer certifies to the Trustee that the same will occur within a period of six months) and ending on (and including) the thirtieth calendar day following satisfaction of the Regulatory Clearance Condition in respect of the redemption, substitution or variation which is the subject of the notice to which the Notice Period relates.

(h) ***No other redemption***: The Issuer shall not be entitled to redeem the Subordinated Notes otherwise than as provided in Conditions 7(a) (*Scheduled redemption*) to 7(g) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) (inclusive).

(i) ***Purchase***: The Issuer or any of its Subsidiaries may at any time purchase Subordinated Notes in the open market or otherwise and at any price subject to Condition 7(l) (*Preconditions to redemption, variation, substitution and purchases*). All Subordinated Notes purchased by or on behalf of the Issuer or any Subsidiary may be held, reissued, resold or, at the option of the Issuer and the relevant purchaser, surrendered for cancellation to the Principal Paying Agent.

(j) ***Cancellation***: All Subordinated Notes redeemed or substituted by the Issuer pursuant to this Condition 7, and all Subordinated Notes purchased and surrendered for cancellation pursuant to Condition 7(i) (*Purchase*), will forthwith be cancelled. Any Subordinated Notes so surrendered for cancellation may not be reissued or resold and the obligations of the Issuer in respect of any such Subordinated Notes shall be discharged.

(k) ***Trustee role on redemption, variation or substitution*: *Trustee not obliged to monitor***: The Trustee shall (at the expense of the Issuer) use its reasonable endeavours to co-operate with the Issuer (including, but not limited to, entering into such documents or deeds as may be necessary) to give effect to substitution or variation of the Subordinated Notes for or into Lower Tier 2 Capital (prior to Solvency II Implementation) or Tier 2 Capital (under Solvency II) pursuant to Conditions 7(f) (*Redemption, variation or substitution for taxation reasons*) or 7(g) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) above, provided that the Trustee shall not be obliged to co-operate in or agree to any such substitution or variation of the terms referred to in this Condition 7 if the securities into which the Subordinated Notes are to be substituted or are to be varied or such substitution or variation imposes, in the Trustee's opinion, more onerous obligations or duties upon it or exposes it to liabilities or reduces its protections. If the Trustee does not so co-operate or agree as provided above, the Issuer may, subject as provided above, redeem the Subordinated Notes as provided above.

The Trustee shall not be under any duty to monitor whether any event or circumstance has happened or exists for the purposes of this Condition 7 and will not be responsible to Noteholders for any loss arising from any failure by it to do so. Unless and until the Trustee has been notified in accordance with this Condition 7 of the occurrence of any event or circumstance within this Condition 7, it shall be entitled to assume that no such event or circumstance exists.

(l) ***Preconditions to redemption, variation, substitution and purchases***:

(i) Prior to the publication of any notice of redemption, variation or substitution pursuant to Condition 7(e) (*Redemption at the option of the Issuer*), Condition 7(f) (*Redemption, variation or substitution for taxation reasons*) or Condition 7(g) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*), the Issuer shall deliver to the Trustee a certificate signed by two Authorised Signatories stating that, as the case may be:

(1) the requirement referred to in Condition 7(f)(i) (*Redemption, variation or substitution for taxation reasons*) above will apply on the next Interest Payment Date and cannot be avoided by the Issuer or, as the case may be, the Guarantor taking reasonable measures available to it and the Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of Condition 7(f) (*Redemption, variation or substitution for taxation reasons*), in which event it shall be conclusive and binding on the Noteholders; or

(2) a Capital Disqualification Event has occurred and is continuing as at the date of the certificate or, as the case may be, will occur within a period of six months.

(ii) Prior to the publication of any notice of redemption before the Maturity Date or any substitution, variation or purchase of the Subordinated Notes, the Issuer or, as the case may be, the Guarantor will be required to have complied with the Regulatory Clearance Condition and be in continued compliance with the Relevant Rules. A certificate from any two Authorised Signatories of the Issuer or the Guarantor (as the case may be) to the Trustee confirming such compliance shall, in the absence of manifest error, be treated and accepted by the Issuer, the Guarantor, the Trustee, the Noteholders and all other interested parties as conclusive evidence of such compliance, shall be binding on all such persons and the Trustee shall be entitled to rely absolutely on such certification without liability to any person.

(iii) Neither the Issuer nor the Guarantor shall redeem (or, as the case may be, pay any Guaranteed Amounts in respect of any redemption of) any Subordinated Notes or purchase any Subordinated Notes unless at the time of such redemption or purchase (A) it is in compliance with the Relevant Rules and (B) the Issuer Solvency Condition and Policyholder Requirement or the Guarantor Solvency Condition and Policyholder Requirement, as the case may be, is satisfied at the time of such payment or purchase and will be satisfied immediately thereafter.

(iv) In the event of a redemption or purchase of the Subordinated Notes prior to the fifth anniversary of the Issue Date, any such redemption or purchase must be in compliance with the Relevant Rules and the Subordinated Notes must be exchanged or converted into another Tier 2 instrument or the redemption or purchase must be funded out of the proceeds of issue of regulatory capital of the same or higher quality as the Subordinated Notes. To the extent required by the Relevant Rules at the time, the approval of the PRA must be obtained. A certificate from any two Authorised Signatories of the Issuer or the Guarantor (as the case may be) to the Trustee confirming such compliance shall, in the absence of manifest error, be treated and accepted by the Issuer, the Guarantor, the Trustee, the Noteholders and all other interested parties as conclusive evidence of such compliance, shall be binding on all such persons and the Trustee shall be entitled to rely absolutely on such certification without liability to any person.

(m) ***Compliance with stock exchange rules***: In connection with any substitution or variation of the Subordinated Notes in accordance with Condition 7(f) (*Redemption, variation or substitution for taxation reasons*) or Condition 7(g) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*), the Issuer and the Guarantor shall comply with the rules of any stock exchange or other relevant authority on which the Subordinated Notes are for the time being listed or admitted to trading, and (for so long as the Subordinated Notes are listed on the Official List and admitted to trading on the London Stock Exchange's Main Market) shall publish a supplement in connection therewith if the Issuer and/or the Guarantor is required to do so in order to comply with Section 87G of FSMA.

(n) ***Notices Final***: Upon the expiry of any notice of redemption as is referred to in Condition 7(f) (*Redemption, variation or substitution for taxation reasons*) or Condition 7(g) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) above, the Issuer shall be bound to redeem the Subordinated Notes to which the notice refers in accordance with the terms of the relevant Condition.

8. Payments

(a) ***Principal***: Payments of principal shall be made upon application by a Holder of a Subordinated Note to the Specified Office of the Principal Paying Agent not later than the fifteenth day before the due date for any such payment, by transfer to a Sterling account maintained by or on behalf of the payee with a bank in London and (in the case of redemption) upon surrender (or, in the case of part payment only, endorsement) of the relevant Note Certificates at the Specified Office of the Principal Paying Agent.

(b) ***Interest***: Payments of interest shall be made upon application by a Holder of a Subordinated Note to the Specified Office of the Principal Paying Agent not later than the fifteenth day before the due date for any such payment, by transfer to a Sterling account maintained by or on behalf of the payee with a bank in London and (in the case of interest payable on redemption) upon surrender (or, in the case of part payment only, endorsement) of the relevant Note Certificates at the Specified Office of the Principal Paying Agent.

(c) ***Payments subject to fiscal laws***: Payments will be subject in all cases to (i) any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 9 (*Taxation*) and (ii) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the US 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 9 (*Taxation*)) any law implementing an intergovernmental approach thereto.

(d) ***Payments on business days***: Where payment is to be made by transfer to a Sterling account, payment instructions (for value the due date, or, if the due date is not a business day, for value the next succeeding business day) will be initiated (i) (in the case of payments of principal and interest payable on redemption) on the later of the due date for payment and the day on which the relevant Note Certificate is surrendered (or, in the case of part payment only, endorsed) at the Specified Office of the Principal Paying Agent and (ii) (in the case of payments of interest payable other than on redemption) on the due date for payment. A Holder of a Subordinated Note shall not be entitled to any interest or other payment in respect of any delay in payment resulting from the due date for a payment not being a business day. In this paragraph, "**business day**" means any day on which banks are open for general business (including dealings in foreign currencies) in London and, in the case of surrender (or, in the case of part payment only, endorsement) of a Note Certificate, in the place in which the Note Certificate is surrendered (or, as the case may be, endorsed).

(e) ***Partial payments***: If the Principal Paying Agent makes a partial payment in respect of any Subordinated Note, the Issuer shall procure that the amount and date of such payment are noted on the Register and, in the case of partial payment upon presentation of a Note Certificate, that a statement indicating the amount and the date of such payment is endorsed on the relevant Note Certificate.

(f) ***Record date***: Each payment in respect of a Subordinated Note will be made to the person shown as the Holder in the Register at the opening of business in the place of the Registrar's Specified Office on the fifteenth day before the due date for such payment (the "**Record Date**").

(g) ***No commissions***: No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition 8.

(h) ***Agents***: The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer and the Guarantor (acting together) reserve the right, subject to the prior written approval of the Trustee, at any time to revoke the appointment of any Agent by not less than 30 days' notice to the relevant Agent and to appoint additional or successor Agents, *provided that* the Issuer will at all times maintain:

(i) a Principal Paying Agent;

(ii) an Agent (which may be the Principal Paying Agent) having a specified office in a European city;

(iii) a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; and

(iv) a Registrar.

Notice of any revocation, termination or appointment and of any changes in specified offices of any of the Agents will be given to the Noteholders promptly by the Issuer in accordance with Condition 16 (*Notices*).

9. Taxation

All payments of principal and interest in respect of the Subordinated Notes by or on behalf of the Issuer or the Guarantor shall be made free and clear of, and without withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the United Kingdom or any political subdivision thereof or any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges is required by law. In that event the Issuer or, as the case may be, the Guarantor shall pay such additional amounts as will result in receipt by the Noteholders after such withholding or deduction of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Subordinated Note:

(a) held by a Holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Subordinated Note by reason of its having some connection with the United Kingdom other than the mere holding of the Subordinated Note; or

(b) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26 – 27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, this Directive; or

(c) held by a Holder who would have been able to avoid such withholding or deduction by arranging to receive the relevant payment through another Paying Agent in a Member State of the European Union; or

(d) where (in the case of a payment of principal or interest) the relevant Note Certificate is surrendered for payment more than 30 days after the Relevant Date except to the extent that the relevant Holder would have been entitled to such additional amounts if it had surrendered the relevant Note Certificate on the last day of such period of 30 days.

For the avoidance of doubt, payments will be subject in all cases to any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the Code or otherwise imposed pursuant to Sections 1471 through 1474 of the Code, any regulations or agreements

thereunder, any official interpretations thereof, or any law implementing an intergovernmental approach thereto, as provided in Condition 8 (*Payments*). No additional amounts will be paid on the Subordinated Notes with respect to any such withholding or deduction.

In these Conditions, "**Relevant Date**" means whichever is the later of (1) the date on which the payment in question first becomes due and (2) if the full amount payable has not been received in London by the Principal Paying Agent or the Trustee on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders.

Any reference in these Conditions to principal or interest shall be deemed to include any additional amounts in respect of principal or interest (as the case may be) which may be payable under this Condition 9 or any undertaking given in addition to or in substitution of this Condition 9 pursuant to the Trust Deed.

If the Issuer or, as the case may be, the Guarantor becomes subject at any time to any taxing jurisdiction other than the United Kingdom references in Condition 7(f) (*Redemption, variation or substitution for taxation reasons*) and in this Condition 9 (*Taxation*) to the United Kingdom shall be construed as references to the United Kingdom and/or such other jurisdiction.

10. **Events of default**

(a) ***Rights to institute and/or prove in a winding-up of the Issuer***: The right to institute winding-up proceedings in respect of the Issuer is limited to circumstances where a relevant payment by the Issuer under the Subordinated Notes or the Trust Deed has become due and is not duly paid. No amount shall be due from the Issuer in circumstances where payment of such amount could not be made in compliance with the Issuer Solvency Condition and Policyholder Requirement or payment of such amount is deferred by the Issuer in accordance with Condition 6(a) (*Issuer Mandatory Deferral of Interest*) or Condition 7(b) (*Issuer Deferral of redemption date*).

If:

(i) default is made by the Issuer for a period of 14 days or more in the payment of any interest or principal due in respect of the Subordinated Notes or any of them; or

(ii) an Issuer Winding-Up occurs,

the Trustee at its discretion may, and if so requested in writing by Noteholders of at least one-fifth in principal amount of the Subordinated Notes then outstanding or if so directed by an Extraordinary Resolution shall (but in each case subject to it having been indemnified and/or secured and/or prefunded to its satisfaction):

(A) in the case of (i) above, institute proceedings or take any steps or actions for the winding-up of the Issuer in England and Wales (but not elsewhere) and prove in the winding-up; and/or

(B) in the case of (ii) above, prove in the winding-up or administration of the Issuer (whether in England and Wales or elsewhere) and/or claim in the liquidation of the Issuer (whether in England and Wales or elsewhere),

but (in either case) may take no further or other action to enforce, prove or claim for any payment by the Issuer in respect of the Subordinated Notes or the Trust Deed. No payment in respect of the Subordinated Notes or the Trust Deed may be made by the Issuer pursuant to this Condition 10(a), 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 no objection from, the PRA which the Issuer shall confirm in writing to the Trustee.

(b) ***Rights to institute and/or prove in a winding-up of the Guarantor***: The right to institute winding-up proceedings in respect of the Guarantor is limited to circumstances where a payment of Guaranteed Amounts in respect of principal, interest or other amount in respect of the Subordinated Notes by the Guarantor under the Guarantee has become due and is not duly paid. For the avoidance of doubt, no amount shall be due from the Guarantor in circumstances where payment of such amount could not be made in compliance with the Guarantor Solvency Condition and Policyholder Requirement or payment of such amount is deferred by the Guarantor in accordance with Condition 6(b) (*Guarantor Mandatory Deferral of Guaranteed Amounts in respect of Interest*) or Condition 7(c) (*Guarantor Deferral of redemption date*).

If:

(i) default is made by the Guarantor for a period of 14 days or more in the payment of any Guaranteed Amounts in respect of interest or principal due in respect of the Subordinated Notes or any of them; or

(ii) a Guarantor Winding-Up occurs,

the Trustee at its discretion may, and if so requested in writing by Noteholders of at least one-fifth in principal amount of the Subordinated Notes then outstanding or if so directed by an Extraordinary Resolution shall (but in each case subject to it having been indemnified and/or secured and/or prefunded to its satisfaction):

(A) in the case of (i) above, institute proceedings or take any steps or actions for the winding-up of the Guarantor in England and Wales (but not elsewhere) and prove in the winding-up; and/or

(B) in the case of (ii) above, prove in the winding-up or administration of the Guarantor (whether in England and Wales or elsewhere) and/or claim in the liquidation of the Guarantor (whether in England and Wales or elsewhere),

but (in either case) may take no further or other action to enforce, prove or claim for any payment by the Guarantor in respect of the Subordinated Notes or the Trust Deed (including the Guarantee). No payment in respect of the Subordinated Notes or the Trust Deed (including under the Guarantee) may be made by the Guarantor pursuant to this Condition 10(b), nor will the Trustee accept the same, otherwise than during or after a winding-up of the Guarantor or after an administrator of the Guarantor has given notice that it intends to declare and distribute a dividend, unless the Guarantor has given prior written notice (with a copy to the Trustee) to, and received no objection from, the PRA which the Guarantor shall confirm in writing to the Trustee.

(c) ***Amount payable on a winding-up or administration***:

(i) **Issuer Winding-Up**: Upon the occurrence of an Issuer Winding-Up (including, for the avoidance of doubt, a winding-up initiated pursuant to Condition 10(a) (*Rights to institute and/or prove in a winding-up of the Issuer*)), the Trustee at its discretion may, and if so requested by Noteholders of at least one-fifth in principal amount of the Subordinated Notes then outstanding or if so directed by an Extraordinary Resolution shall (but in each case subject to it having been indemnified and/or secured and/or prefunded to its satisfaction), give notice to the Issuer that the Subordinated Notes are, and they shall accordingly forthwith become, immediately due and payable at the amount equal to their principal amount together with any Arrears of Interest and any other accrued and unpaid interest. Claims against the Issuer in respect of such amounts will be subordinated in accordance with Condition 2(b) (*Subordination*). However, as regards the Guarantor's obligations to pay under the Guarantee upon the occurrence of an Issuer Winding-Up, Condition 3(e) (*Obligations of the Guarantor upon an Issuer Winding-Up*) shall apply.

(ii) **Guarantor Winding-Up**: Upon the occurrence of a Guarantor Winding-Up (including, for the avoidance of doubt, a winding-up initiated pursuant to Condition 10(b) (*Rights to institute and/or prove in a winding-up of the Guarantor*)), the Trustee at its discretion may, and if so requested by Noteholders of at least one-fifth in principal amount of the Subordinated Notes then outstanding or if so directed by an Extraordinary Resolution shall (but in each case subject to it having been indemnified and/or secured and/or prefunded to its satisfaction), give notice to the Guarantor that the Subordinated Notes are, and they shall accordingly forthwith become, immediately due and payable at the amount equal to their principal amount together with any Arrears of Interest and any other accrued and unpaid interest. Claims against the Guarantor in respect of such amounts will be subordinated in accordance with Condition 3(c) (*Subordination*).

In the event that any Guarantor Recovered Amount is paid to the Noteholders (or the Trustee on their behalf) in the Guarantor Winding-Up, such Guarantor Recovered Amount will to the extent of amounts recovered be treated as satisfying the amounts payable by the Issuer in respect of the Subordinated Notes and the Trust Deed to the extent and in the manner provided in Condition 3(d) (*Guarantor Recovered Amount*).

(iii) **Adjustment of claims following payment or recovery**: Any claim against the Issuer pursuant to Condition 10(c)(i) for amounts in respect of principal, interest and/or Arrears of Interest shall be treated as satisfied if, and to the extent that, any amounts in respect of the same are first paid by or recovered from the Guarantor (including, without limitation, any Guarantor Recovered Amount following a Guarantor Winding-Up). Any claim against the Guarantor pursuant to Condition 10(c)(ii) for amounts in respect of principal, interest and/or Arrears of Interest shall be reduced if, and to the extent that, any amounts in respect of the same are first paid by or recovered from the Issuer (including, without limitation, any Issuer Recovered Amount following an Issuer Winding-Up).

(d) ***Enforcement***: Without prejudice to Condition 10(a) (*Rights to institute and/or prove in a winding-up of the Issuer*), Condition 10(b) (*Rights to institute and/or prove in a winding-up of the Guarantor*) or Condition 10(c) (*Amount payable on a winding-up or administration*), the Trustee may at its discretion and without further notice institute such proceedings or take such steps or actions against the Issuer and/or the Guarantor or otherwise as it may think fit to recover any amounts due in respect of the Subordinated Notes which are unpaid or to enforce any of its rights under the Trust Deed or the Subordinated Notes (other than any payment obligation of the Issuer or the Guarantor under or arising from the Subordinated Notes or the Trust Deed (including the Guarantee), including any payment of damages awarded for breach of any obligations thereunder) but in no event shall the Issuer or the Guarantor, by virtue of the institution of any such proceedings or the taking of such steps or actions, 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 10(d) shall, however, prevent the Trustee:

(i) subject to Condition 10(a) (*Rights to institute and/or prove in a winding-up of the Issuer*), instituting proceedings for the winding-up of the Issuer in England and Wales and/or proving in any winding-up or administration of the Issuer (whether in England and Wales or elsewhere) and/or claiming in any liquidation of the Issuer (whether in England and Wales or elsewhere);

(ii) subject to Condition 10(b) (*Rights to institute and/or prove in a winding-up of the Guarantor*), instituting proceedings for the winding-up of the Guarantor in England and Wales and/or proving in any winding-up or administration of the Guarantor (whether in England and Wales or elsewhere) and/or claiming in any liquidation of the Guarantor (whether in England and Wales or elsewhere),

in each case where such payment obligation arises from the Subordinated Notes or the Trust Deed (including the Guarantee) (including, without limitation, payment of any principal, interest or Arrears of Interest in respect of the Subordinated Notes or any payment of damages awarded for breach of any obligations under the Subordinated Notes or the Trust Deed (including the Guarantee)).

(e) ***Entitlement of Trustee***: The Trustee shall not be bound to take any of the actions referred to in Conditions 10(a) (*Rights to institute and/or prove in a winding-up of the Issuer*), 10(b) (*Rights to institute and/or prove in a winding-up of the Guarantor*), 10(c) (*Amount payable on a winding-up or administration*) or 10(d) (*Enforcement*) above against the Issuer or the Guarantor (as the case may be) to enforce the terms of the Trust Deed, the Subordinated Notes or any other action under or pursuant to the Trust Deed (including the Guarantee) unless (i) it shall have been so directed by an Extraordinary Resolution of the Noteholders or requested in writing by the holders of at least one-fifth in principal amount of the Subordinated Notes then outstanding and (ii) it shall have been indemnified and/or secured and/or prefunded to its satisfaction.

(f) ***Right of Noteholders***: No Noteholder shall be entitled to proceed directly against the Issuer or the Guarantor or to institute proceedings for the winding-up or claim in the liquidation of the Issuer or the Guarantor or to prove in such winding-up unless the Trustee, having become so bound to proceed, fails to do so within a reasonable period and such failure shall be continuing, in which case the Noteholder shall have only such rights against the Issuer or the Guarantor (as the case may be) as those which the Trustee is entitled to exercise as set out in this Condition 10.

(g) ***Extent of Noteholders' remedy***: No remedy against the Issuer or the Guarantor other than as referred to in this Condition 10, shall be available to the Trustee or the Noteholders, whether for the recovery of amounts owing in respect of the Subordinated Notes or under the Trust Deed or in respect of any breach by the Issuer or the Guarantor of any of its other obligations under or in respect of the Subordinated Notes or under the Trust Deed.

11. Prescription

Claims for principal and interest on redemption shall become void unless the relevant Note Certificates are surrendered for payment within ten years (in the case of principal) and five years (in the case of interest) of the appropriate Relevant Date.

12. Replacement of Note Certificates

If any Note Certificate is mutilated or defaced or is alleged to have been lost, stolen or destroyed, it may be replaced at the Specified Office of the Replacement Agent, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer, the Guarantor and/or the Replacement Agent may reasonably require provided that such claimant has paid such costs and expenses as may be incurred in connection with such replacement. Mutilated or defaced Note Certificates must be surrendered before replacements will be issued.

13. Trustee and Agents

Under the Trust Deed, the Trustee is entitled to be indemnified and relieved from responsibility in certain circumstances and to be paid its costs and expenses in priority to the claims of the Noteholders. In addition, the Trustee is entitled to enter into business transactions with the Issuer and any entity relating to the Issuer without accounting for any profit.

In the exercise of its powers, trusts, authorities or discretions under these Conditions and the Trust Deed, the Trustee will have regard to the interests of the Noteholders as a class and will not be responsible for any consequence for individual Holders of Subordinated Notes as a result of such Holders being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, a particular territory.

In acting under the Agency Agreement and in connection with the Subordinated Notes, the Agents act solely as agents of the Issuer and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders.

The initial Agents and their initial Specified Offices are listed below. The Issuer reserves the right (with the prior approval of the Trustee) at any time to vary or terminate the appointment of any Agent and to appoint a successor registrar or principal paying agent and additional or successor paying agents and transfer agents; *provided, however, that* the Issuer shall at all times maintain (a) a principal paying agent and a registrar, (b) a Paying Agent in an EU member state that will not be obliged to withhold or deduct tax pursuant to any law implementing European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive and (c) an agent (which may be the Principal Paying Agent) having a specified office in a European city.

Notice of any change in any of the Agents or in their Specified Offices shall promptly be given to the Noteholders.

14. **Meetings of Noteholders; Modification and Waiver**

(a) ***Meetings of Noteholders***: Except as provided herein, any modification to these Conditions or any provisions of the Trust Deed will require the Issuer giving at least one month's prior written notice to, and receiving no objection from, the PRA (or such shorter period of notice as the PRA may accept and so long as there is a requirement to give such notice).

The Trust Deed contains provisions for convening meetings of Noteholders to consider matters relating to the Subordinated Notes, including the modification of any provision of these Conditions or the Trust Deed. Any such modification may be made if sanctioned by an Extraordinary Resolution. Such a meeting may be convened by the Issuer or by the Trustee and shall be convened by the Trustee upon the request in writing of Noteholders holding not less than one-tenth of the aggregate principal amount of the outstanding Subordinated Notes (subject to the Trustee being indemnified and/or secured and/or prefunded to its satisfaction). The quorum at any meeting convened to vote on an Extraordinary Resolution will be two or more voters holding or representing one more than half of the aggregate principal amount of the outstanding Subordinated Notes or, at any adjourned meeting, two or more persons being or representing Noteholders whatever the principal amount of the Subordinated Notes held or represented; *provided*, *however*, *that* certain proposals (including any proposal: (i) to change any date fixed for payment of principal or interest in respect of the Subordinated Notes, to reduce the amount of principal or interest payable on any date in respect of the Subordinated Notes, to alter the method of calculating the amount of any payment in respect of the Subordinated Notes or the date for any such payment, (ii) to amend the provisions of clauses 4 (*Subordination*) and 5.9 (*Subordination*) of the Trust Deed and Conditions 2(b) (*Subordination*) and 3(c) (*Subordination*); (iii) to effect the exchange, conversion or substitution of the Subordinated Notes for, or the conversion of the Subordinated Notes into, shares, bonds or other obligations or securities of the Issuer, the Guarantor or any other person or body corporate formed or to be formed (other than as permitted under clause 8.3 (*Substitution*) of the Trust Deed); (iv) to change the currency in which amounts due in respect of the Subordinated Notes are payable; (v) to change the quorum requirements relating any meeting or the majority required to pass an Extraordinary Resolution; (vi) to modify any provision of the guarantee of the Subordinated Notes (other than as permitted under clause 8.3 (*Substitution*) of the Trust Deed; and (vii) to amend the definition of Reserved Matter (each, a "**Reserved Matter**")) may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more persons holding or representing not less than three-quarters or, at any adjourned meeting, one quarter of the aggregate principal amount of the outstanding Subordinated Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not.

In addition, a resolution in writing signed by or on behalf of holders of 75 per cent. in principal amount of the Subordinated Notes which are for the time being outstanding will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

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 required to be made in connection with the substitution or variation of the Subordinated Notes pursuant to Condition 7(f) (*Redemption, variation or substitution for taxation reasons*) or Condition 7(g) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) or any consequential amendments to these Conditions and/or the Trust Deed approved by the Trustee in connection with a substitution of the Issuer pursuant to Condition 15 (*Substitution of the Issuer or the Guarantor*).

(b) ***Modification and waiver***: The Trustee may from time to time and at any time, without the consent or sanction of the Noteholders, agree to (i) any modification of the Subordinated Notes or the Trust Deed (other than in respect of a Reserved Matter) which, in the opinion of the Trustee it may be proper to make provided the Trustee is of the opinion that such modification will not be materially prejudicial to the interests of Noteholders, and (ii) any modification of the Subordinated Notes or the Trust Deed which is, in the opinion of the Trustee, of a formal, minor or technical nature or is to correct a manifest error. In addition, the Trustee may, without the consent or sanction of the Noteholders, authorise or waive or determine that any Event of Default, proposed breach or breach of the Subordinated Notes or the Trust Deed shall not be treated as such for the purposes of the Trust Deed if, in the opinion of the Trustee, the interests of the Noteholders will not be materially prejudiced thereby. However, no such modification may be made unless the PRA has been given prior notice of such modification in accordance with the Relevant Rules (as applicable) and PRA has not objected.

Any such authorisation, waiver or modification shall be notified to the Noteholders as soon as practicable thereafter.

(c) ***Trustee to have regard to interests of Noteholders as a class***: In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution of obligor), the Trustee shall have regard to the general interests of the Noteholders as a class but shall not have regard to any interests arising from circumstances particular to individual Noteholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Noteholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer, the Trustee or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders except to the extent already provided for in Condition 8 (*Payments*) and/or any undertaking given in addition to, or in substitution for, Condition 8 (*Payments*) pursuant to the Trust Deed.

15. Substitution of the Issuer or the Guarantor

Subject to the Issuer giving at least one month's prior written notice to, and receiving no objection from, the PRA or obtaining prior approval and consent from the PRA in respect thereof, the Trustee may agree with the Issuer and the Guarantor, without the consent of the Noteholders:

(a) to the substitution of the Guarantor in place of the Issuer as principal debtor under the Trust Deed and the Subordinated Notes;

(b) subject to the Subordinated Notes remaining unconditionally and irrevocably guaranteed on a subordinated basis in accordance with Condition 3 (*Guarantee*), by the Guarantor, to the substitution of the Issuer by any member of the Insurance Group as principal debtor under the Trust Deed and the Subordinated Notes; or

(c) to the substitution of (A) a successor in business to the Guarantor or (B) a Subsidiary of the Guarantor, in each case in place of the Guarantor,

(each such substitute issuer or, where applicable, guarantor being hereinafter referred to as the "**Substituted Obligor**") *provided that* in each case:

(i) a trust deed or some other form of undertaking, supported by one or more legal opinions, is executed by the Substituted Obligor in a form and manner satisfactory to the Trustee, agreeing to be bound by the terms of the Trust Deed and the Conditions, with any consequential amendments which the Trustee may deem appropriate, as fully as if the Substituted Obligor has been named in the Trust Deed and the Subordinated Notes, as the principal debtor in place of the Issuer, or where applicable, as a guarantor of in place of the Guarantor (or any previous Substituted Obligor, as the case may be);

(ii) the Substituted Obligor confirms to the Trustee in one or more legal opinions addressed to the Trustee and the Issuer in a form approved by and provided to the Trustee that (i) it has obtained all necessary governmental and regulatory approvals and consents necessary for its assumptions of the duties and liabilities as Substituted Obligor under the Trust Deed and the Conditions in place of the Issuer or the Guarantor (as applicable) or, as the case may be, any previous Substituted Obligor and (ii) such approvals and consents are at the time of substitution in full force and effect, and the Trustee shall be entitled to rely absolutely on such legal opinions without liability to any person;

(iii) two directors (or other officers acceptable to the Trustee) of the Substituted Obligor certify that the Substituted Obligor is solvent at the time at which the substitution is proposed to be in effect, and immediately thereafter, and the Trustee shall be entitled to 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 Substituted Obligor or to compare the same with those of the Issuer or (as the case may be) the Guarantor or (as the case may be) any previous Substituted Obligor;

(iv) (without prejudice to the generality of the foregoing) the Trustee may, in the event of such substitution agree, without the consent of the Noteholders, to a change in the law governing the Trust Deed and/or the Subordinated Notes if in the opinion of the Trustee such change would not be materially prejudicial to the interests of the Noteholders;

(v) if the Substituted 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 or in addition to the territory, the taxing jurisdiction of which (or to any such authority of or in which) the Issuer or (as the case may be) the Guarantor (or any previous Substituted Obligor) is subject generally (the "**Original Territory**"), the Substituted Obligor will (unless the Trustee otherwise agrees) give to the Trustee an undertaking in form and manner satisfactory to the Trustee in terms corresponding to Condition 9 (*Taxation*) with the substitution for or addition to the references in that Condition and in Condition 7(f) (*Redemption, variation or substitution for taxation reasons*) to the Original Territory of references to the Substituted Territory whereupon the Trust Deed and the Subordinated Notes will be read accordingly;

(vi) the Issuer, the Guarantor and the Substituted Obligor comply with such other requirements as the Trustee may direct in the interests of the Noteholders;

(vii) in the case of a full substitution of the Issuer pursuant to Condition 15 (*Substitution of the Issuer or the Guarantor*) above only, if the Subordinated Notes are rated (where such rating was assigned at the request of the Issuer) by one or more credit rating agencies of international standing immediately prior to such substitution, the Subordinated Notes shall continue to be rated by each such rating agency immediately following such substitution, and the credit ratings assigned to the Subordinated Notes by each such rating agency immediately following such substitution will be no less than those assigned to the Subordinated Notes immediately prior thereto; and

(viii) without prejudice to the rights and reliance of the Trustee under paragraphs (ii) and (iii) above, the Trustee shall be satisfied that the interests of the Noteholders will not be materially prejudiced by the substitution proposed pursuant to Condition 15 (*Substitution of the Issuer or the Guarantor*).

16. **Notices**

Notices to the Noteholders will be sent to them by first class mail (or its equivalent) or (if posted to an overseas address) by airmail at their respective addresses on the Register. In addition, so long as the Subordinated Notes are listed on the London Stock Exchange, the Issuer shall ensure that notices are duly given or published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Subordinated Notes are for the time being listed. Any notice shall be deemed to have been given on the second day after the date of mailing or the date of publication or, if so published more than once or on different dates, the date of the first publication.

17. **Governing Law**

The Subordinated Notes and the Trust Deed (including the Guarantee) and any non-contractual obligations arising out of or in connection with the Subordinated Notes and the Trust Deed (including the Guarantee) are governed by English law.

18. **Defined Terms**

In these Conditions:

"**Arrears of Interest**" has the meaning given in Condition 6(d) (*Arrears of Interest*);

"**Assets**" means the unconsolidated gross assets of the Issuer or the Guarantor (as the case may be) as shown in the latest published audited balance sheet of the Issuer or the Guarantor (as the case may be), but adjusted for contingencies and subsequent events, all in such manner as the Directors may determine;

"**Authorised Denomination**" has the meaning given in Condition 1 (*Form and Denomination*);

"**Authorised Signatory**" means:

(i) in relation to the Issuer, any director or any other person or persons notified to the Trustee by any director as being an Authorised Signatory pursuant to sub-clause 7.17 (*Authorised Signatories*) of the Trust Deed; and

(ii) in relation to the Guarantor, any director of the Guarantor or any other person or persons notified to the Trustee by any director of the Guarantor as being an Authorised Signatory pursuant to sub-clause 7.17 (*Authorised Signatories*) of the Trust Deed;

"**Business Day**" means: (i) except for the purposes of Conditions 4 (*Register, Title and Transfers*) and 8(d) (*Payments on business days*), a day (other than a Saturday, Sunday or public holiday) on which commercial banks and foreign exchange markets are open for general business in London; (ii) for the purposes of Condition 4 (*Register, Title and Transfers*), a day on which commercial banks are open for general business (including dealings in foreign currencies) in the city where the relevant Agent has its Specified Office; and (iii) for the purpose of Condition 8(d) (*Payments on business days*), has the meaning specified therein;

"**Calculation Amount**" has the meaning given in Condition 5(c) (*Interest Rate*);

"**Capital Disqualification Event**" is deemed to have occurred if, as a result of any replacement of or change to (or change to the interpretation by any court or authority entitled to do so of) Solvency II or the Relevant Rules or following the implementation of Solvency II, the Subordinated Notes are no longer capable of counting in full either as:

(i) cover for capital requirements or treated as own funds (however such terms might be described in Solvency II or the Relevant Rules) applicable to the Issuer, the Insurance Group or any member of the Insurance Group whether on a sole, group or consolidated basis; or

(ii) at least Tier 2 Capital for the purposes of the Issuer, the Insurance Group or any member of the Insurance Group whether on a solo, group or consolidated basis;

except where in the case of either (i) or (ii) above such non-qualification is only as a result of any applicable limitation on the amount of such capital;

"**Directors**" means the directors of the Issuer or, as the case may be, the Guarantor from time to time;

"**Extraordinary Resolution**" has the meaning given in the Trust Deed;

"**FCA**" means the Financial Conduct Authority, acting in consultation with or with the consent of the PRA where required under the Relevant Rules, or such successor or other authority having primary supervisory authority with respect to conduct of business matters in relation to the Issuer and/or the Insurance Group and/or (as applicable) its capacity as the relevant authority under Part 6 of FSMA with respect to the Official List;

"**First Optional Call Date"** means 24 March 2020;

"**FSMA**" means the Financial Services and Markets Act 2000 (as amended or re-enacted from time to time including pursuant to the Financial Services Act 2012);

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

"**Group Regulated Entity**" means any member of the Insurance Group;

"**Guarantee"** has the meaning given in Condition 3(a);

"**Guaranteed Amounts**" has the meaning given in Condition 3(a);

"**Guarantor**" has the meaning given in the preamble to these Conditions;

"**Guarantor Interest Portion**" means, in respect of a Guarantor Recovered Amount, an amount equal to such Guarantor Recovered Amount multiplied by a fraction the numerator of which is the Total Guarantor Interest Amount and the denominator of which is the aggregate of the Total Guarantor Interest Amount and the principal amount of the Subordinated Notes outstanding as at the date of the Guarantor Winding-up;

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

"**Guarantor Mandatory Interest Deferral Date**" means each Interest Payment Date (i) in respect of which a Guarantor Regulatory Deficiency Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date or (ii) where payment of any Guaranteed Amounts in respect of interest on that date would breach the provisions of Solvency II and/or the Relevant Rules which apply to Tier 2 Capital;

"**Guarantor Non-Interest Portion**" means the Guarantor Recovered Amount less the Guarantor Interest Portion;

"**Guarantor Recovered Amount**" has the meaning given in Condition 3(d);

"**Guarantor Recovered Amount Payment Date**" means in respect of any Guarantor Recovered Amount, the date on which such Guarantor Recovered Amount is paid by the liquidator or administrator (as applicable) of the Guarantor to the Noteholders (or the Trustee on their behalf);

"**Guarantor Regulatory Deficiency Deferral Event**" means any event which (including without limitation, any event which causes the Solvency Capital Requirement or Minimum Capital Requirement, if higher, applicable to the Guarantor, the Insurance Group or any member of the Insurance Group to be breached and such breach is or would be an event which) under Solvency II and/or under the Relevant Rules would require the Guarantor to, defer payment in respect of any Guaranteed Amounts (on the basis that the Subordinated Notes are intended to qualify as Lower Tier 2 Capital (prior to Solvency II Implementation) and as Tier 2 Capital (following Solvency II Implementation and without the operation of any grandfathering provisions)) and the PRA have not waived the requirements (to the extent it has the authority to do so); (ii) such payment could not be made in compliance with the Guarantor Solvency Condition and Policyholder Requirement; or (iii) the PRA has notified the Guarantor in writing that it has determined in accordance with the Relevant Rules at such time that the Guarantor must defer a payment in respect of the Subordinated Notes;

"**Guarantor Solvency Condition and Policyholder Requirement**" has the meaning given in Condition 3(f) (*Guarantor Solvency Condition and Policyholder Requirement*);

"**Guarantor Winding-Up**" has the meaning given to it in Condition 3(c) (*Subordination*);

"**Holder**" has the meaning given in Condition 4(a) (*Register*);

"**Interest Payment Date**" has the meaning given in Condition 5(a) (*Interest*);

"**Interest Period**" means a period from (and including) one Interest Payment Date (or in the case of the first Interest Period only, the Issue Date) up to (but excluding) the next following Interest Payment Date;

"**Interest Rate**" has the meaning given in Condition 5(c) (*Interest Rate*);

"**Insurance Group**" means, at any time, the Group Holding Company and its subsidiaries at such time;

"**Issue Date**" has the meaning given in Condition 5(a) (*Interest*);

"**Issuer Interest Portion**" means, in respect of an Issuer Recovered Amount, an amount equal to such Issuer Recovered Amount multiplied by a fraction the numerator of which is the Total Issuer Interest Amount and the denominator of which is the aggregate of the Total Issuer Interest Amount and the principal amount of the Subordinated Notes outstanding as at the date of the Issuer Winding-Up;

"**Issuer 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;

"**Issuer Non-Interest Portion**" means the Issuer Recovered Amount less the Issuer Interest Portion;

"**Issuer Recovered Amount**" has the meaning given in Condition 2(c) (*Issuer Recovered Amount*);

"**Issuer Recovered Amount Payment Date**" means, in respect of any Issuer Recovered Amount, the date on which such Issuer Recovered Amount is paid by the liquidator or administrator (as applicable) of the Issuer to the Noteholders (or the Trustee on their behalf);

"**Issuer Regulatory Deficiency Deferral Event**" means (i) any event which (including, without limitation, any event which causes the Solvency Capital Requirement or Minimum Capital Requirements, if higher, applicable to the Issuer, the Insurance Group or any member of the Insurance Group to be breached and such breach is or would be an event which) under Solvency II and/or under the Relevant Rules would require the Issuer to defer a payment in respect of the Subordinated Notes (on the basis that the Subordinated Notes are intended to qualify as Lower Tier 2 Capital (prior to Solvency II Implementation) and as Tier 2 Capital (following Solvency II Implementation and without the operation of any grandfathering provisions)) and the PRA have not waived the requirement to defer the payment under the Subordinated Notes (to the extent it has the authority to do so); or (ii) such payment could not be made in compliance with the Issuer Solvency Condition and Policyholder Requirement; or (iii) the PRA has notified the Issuer in writing that it has determined in accordance with the Relevant Rules at such time that the Issuer must defer a payment in respect of the Subordinated Notes;

"**Issuer Solvency Condition and Policyholder Requirement**" has the meaning given in Condition 2(d) (*Issuer Solvency Condition and Policyholder Requirement*);

"**Issuer Winding-Up**" has the meaning given in Condition 2(b) (*Subordination*);

"**Junior Creditors of the Guarantor**" means creditors of the Guarantor whose claims rank, or are expressed to rank junior to, the claims of the Noteholders including holders of Junior Securities of the Guarantor;

"**Junior Creditors of the Issuer**" means creditors of the Issuer whose claims rank, or are expressed to rank junior to, the claims of the Noteholders, including holders of Junior Securities of the Issuer;

"**Junior Securities of the Guarantor**" has the meaning given in Condition 3(c) (*Subordination*);

"**Junior Securities of the Issuer**" has the meaning given to it in Condition 2(b) (*Subordination*);

"**London Stock Exchange**" means the London Stock Exchange plc;

"**Lower Tier 2 Capital**" has the meaning given by the PRA from time to time 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 recognised tier of capital resources, be deemed to be a reference to any Tier 2 Capital;

"**Mandatory Interest Deferral Date**" means each Interest Payment Date (i) in respect of which an Issuer Regulatory Deficiency Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date or (ii) where payment of interest on that date would breach the provisions of Solvency II and/or the Relevant Rules which apply to Tier 2 Capital;

"**Mandatory Interest Deferral Event**" means an event causing a Mandatory Interest Deferral Date or a Guarantor Mandatory Interest Deferral Date, as the case may be, to occur;

"**Maturity Date**" means 24 March 2025;

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

"**Note Certificate**" has the meaning given in Condition 4(a) (*Register*);

"**Noteholder**" has the meaning given in Condition 4(a) (*Register*);

"**Official List**" means the official list of the UK Listing Authority maintained pursuant to Section 74 of FSMA;

"**Original Territory**" has the meaning given in Condition 15 (*Substitution of Issuer or the Guarantor*);

"**Parity Creditors of the Guarantor**" means creditors of the Guarantor whose claims rank, or are expressed to rank, *pari passu* with the claims of the Noteholders, including holders of Parity Securities of the Guarantor;

"**Parity Creditors of the Issuer**" means creditors of the Issuer whose claims rank, or are expressed to rank, *pari passu* with the claims of the Noteholders, including holders of Parity Securities of the Issuer;

"**Parity Securities of the Guarantor**" has the meaning given to it in Condition 3(c) (*Subordination*);

"**Parity Securities of the Issuer**" has the meaning given to it in Condition 2(b) (*Subordination*);

"**PRA**" means the Prudential Regulation Authority, acting in consultation with or with the consent of the FCA where required under the Relevant Rules, or such successor or other authority having primary supervisory authority with respect to prudential matters in relation to the Issuer, the Guarantor and/or the Insurance Group;

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

"**Record Date**" has the meaning given in Condition 8(f) (*Record Date*);

"**Register**" has the meaning given in Condition 4(a) (*Register*);

"**Regulatory Clearance Condition**" means, in respect of any proposed act on the part of the Issuer or the Guarantor, the PRA having consented to, or having been given due notification of and having not within any applicable time-frame objected to, such act (in any case only if and to the extent required by the PRA or any applicable rule of the PRA at the relevant time);

"**Related Undertaking**" means in relation to any person, (i) any subsidiary undertaking or parent undertaking of that person or (ii) any subsidiary undertaking of any such parent undertaking;

"**Relevant Date**" has the meaning given in Condition 9 (*Taxation*);

"**Relevant Jurisdiction**" means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer or the Guarantor becomes subject in respect of payments made by it of principal and interest (including Arrears of Interest) on the Subordinated Notes or the Guaranteed Amounts in respect thereof;

"**Relevant Rules**" means any legislation, rules or regulations (whether having the force of law or otherwise) applicable in the United Kingdom from time to time and applying to the Issuer, the Guarantor or any insurance or reinsurance undertaking within the Insurance Group from time to time relating to the characteristics, features or criteria of own funds or capital resources and the requirement to retain capital resources in excess of a prescribed capital resources requirement and, for the avoidance of doubt and without limitation to the foregoing, includes any legislation, rules or regulations relating to such matters which are supplementary or extraneous to the obligations imposed on Member States by Solvency I or the Solvency II Directive;

"**Reserved Matter**" has the meaning given in Condition 14(a) (*Meetings of Noteholders*);

"**Senior Creditors of the Guarantor**" means:

(a) any policyholders or beneficiaries of the Guarantor (and, for the avoidance of doubt, the claims of Senior Creditors of the Guarantor who are policyholders shall include all amounts to which any such policyholder would be entitled in its capacity as

policyholder under any applicable legislation or rules relating to a winding-up of insurance companies to reflect any right to receive, or expectation of receiving, policyholder benefits which policyholders may have);

(b) creditors of the Guarantor (other than policyholders) who are unsubordinated creditors of the Guarantor; and

(c) other creditors of the Guarantor whose claims are, or are expressed to be, subordinated to the claims of other creditors of the Guarantor (other than those whose claims constitute (or relate to a guarantee or other like or similar undertaking or arrangement given by the Guarantor in respect of any obligation of any other person which constitute), or would but for any applicable limitation on the amount of any such capital constitute, in each case at issue, Tier 1 Capital, Upper Tier 2 Capital (issued prior to Solvency II Implementation), Lower Tier 2 Capital (issued prior to Solvency II Implementation), or 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);

"**Senior Creditors of the Issuer**" means:

(a) creditors of the Issuer who are unsubordinated creditors of the Issuer; 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 constitute (or relate to a guarantee or other like or similar undertaking or arrangement given by the Issuer in respect of any obligation of any other person which constitute), or would but for any applicable limitation on the amount of any such capital constitute, in each case at Issue, Tier 1 Capital, Upper Tier 2 Capital (issued prior to Solvency II Implementation), Lower Tier 2 Capital (issued prior to Solvency II Implementation), or 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 I**" means the directives adopted by the Parliament and Council of the European Union relating to the taking-up and pursuit of insurance business within the European Union (excluding the Solvency II Directive) and including, without limitation, Directive 73/239/EEC of the European Union (as amended) and Directive 98/78/EC of the European Union (as amended) on the supplementary supervision of insurance undertakings in an insurance group;

"**Solvency II**" means the Solvency II Directive and any implementing measures adopted pursuant to the Solvency II Directive (for the avoidance of doubt, whether implemented by way of regulation or by further directives or otherwise);

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

"**Solvency II Implementation**" means the implementation by the PRA of Solvency II or any other change in law or any Relevant Rules if such implementation or other change in law results in Upper Tier 2 Capital and Lower Tier 2 Capital ceasing to be recognised as distinct tiers of capital (or, if later, the coming into effect of the same with respect to the Issuer, the Guarantor and/or Insurance Group);

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

"**Sterling**" means the lawful currency of the United Kingdom;

Subsidiary" means a subsidiary or subsidiary undertaking of the Issuer whose affairs are for the time being required to be fully consolidated in the consolidated accounts of the Issuer;

"**Substituted Obligor**" has the meaning given in Condition 15 (*Substitution of the Issuer or the Guarantor*);

"**Substituted Territory**" has the meaning given in Condition 15 (*Substitution of the Issuer or the Guarantor*);

"**Tax Event**" has the meaning given to such term in Condition 7(f) (*Redemption, variation or substitution for taxation reasons*);

"**Tier 1 Capital**" has the meaning given to it by the PRA from time to time;

"**Tier 2 Capital**" has the meaning given to it by the PRA from time to time;

"**Total Guarantor Interest Amount**" means the aggregate of (i) interest accrued (but unpaid) on the Subordinated Notes from the last Interest Payment Date preceding the Guarantor Winding-Up to the date of the Guarantor Winding-Up and (ii) Arrears of Interest;

"**Total Issuer Interest Amount**" means the aggregate of (i) interest accrued (but unpaid) on the Subordinated Notes from the last Interest Payment Date preceding the Issuer Winding-Up to the date of the Issuer Winding-Up and (ii) Arrears of Interest; and

"**Upper Tier 2 Capital**" has the meaning given to it by the PRA from time to time.

SUMMARY OF PROVISIONS RELATING TO THE SUBORDINATED NOTES WHILE IN GLOBAL FORM

1. Initial Issue of Certificates

The Global Note Certificate was registered in the name of a nominee for a common depositary for Euroclear and Clearstream, Luxembourg and was delivered on the Issue Date.

Upon the registration of the Global Note Certificate in the name of a nominee for Euroclear and Clearstream, Luxembourg and delivery of the Global Note Certificate to the Common Depositary, Euroclear or Clearstream, Luxembourg credited each subscriber with a nominal amount of Subordinated Notes equal to the nominal amount thereof for which it has subscribed and paid.

2. Relationship of Accountholders with Clearing Systems

Each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or any other clearing system ("**Alternative Clearing System**") as the holder of a Subordinated Note represented by the Global Note Certificate must look solely to Euroclear, Clearstream, Luxembourg or any such Alternative Clearing System (as the case may be) for his share of each payment made by the Issuer or the Guarantor (as the case may be) to the holder of the Global Note Certificate and in relation to all other rights arising under the Global Note Certificate, subject to and in accordance with the respective rules and procedures of Euroclear, Clearstream, Luxembourg, or such Alternative Clearing System (as the case may be). Such persons shall have no claim directly against the Issuer or the Guarantor in respect of payments due on the Subordinated Notes for so long as the Subordinated Notes are represented by the Global Note Certificate and such obligations of the Issuer and the Guarantor will be discharged by payment to the registered holder of the Global Note Certificate in respect of each amount so paid.

3. Exchange for Individual Note Certificates

The Global Note Certificate will be exchangeable in whole (but not in part) for duly authenticated and completed individual note certificates if any of the following events occurs:

(i) the relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention to permanently cease business; or

(ii) any of the circumstances described in Condition 10 (*Events of default*) of the Subordinated Notes occurs.

4. Amendment to Conditions

The Global Note Certificate contains provisions that apply to the Subordinated Notes that it represents, some of which modify the effect of the terms and conditions of the Subordinated Notes set out in this Prospectus. The following is a summary of certain of those provisions:

4.1 *Payments*

All payments in respect of Subordinated Notes represented by a Global Note Certificate will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the Clearing System Business Day immediately prior to the date for payment, where Clearing System Business Day means Monday to Friday (inclusive) except 25 December and 1 January.

4.2 *Meetings*

For the purposes of any meeting of Noteholders, a single Voter appointed in relation to the Subordinated Notes represented by the Global Note Certificate shall (unless the Global Note Certificate represents only one Subordinated Note) be treated as two Voters for the purposes of any quorum requirements of a meeting of Noteholders and as being entitled on a poll to one vote in respect of each £1 in aggregate face amount of the outstanding Subordinated Notes represented or held by him.

4.3 ***Trustee's Powers***

In considering the interests of Noteholders while the Global Note Certificate is held on behalf of, or registered in the name of any nominee for, a clearing system, the Trustee may have regard to any information provided to it by such clearing system or its operator as to the identity (either individually or by category) of its accountholders with entitlements to the Global Note Certificate and may consider such interests as if such accountholders were the holders of the Subordinated Notes represented by the Global Note Certificate.

4.4 ***Notices***

Notwithstanding Condition 16 (*Notices*), while all the Subordinated Notes are represented by a Global Note Certificate held on behalf of, or registered in the name of a nominee for, a clearing system, notices to Noteholders may be given by delivery of the relevant notice to any such clearing system, and in any case, such notices shall be deemed to have been given to the Noteholders in accordance with Condition 16 (*Notices*) on the date of delivery to any such clearing system, except that, for so long as such Subordinated Notes are admitted to trading on the London Stock Exchange and it is a requirement of applicable law or regulations, such notices shall be published according to such applicable law or regulations.

INDUSTRY OVERVIEW

The following information relating to the annuity industry has been provided for background purposes only. The information has been extracted from a variety of sources released by public and private organisations. The information has been accurately reproduced and, as far as the Issuer is aware and is able to ascertain from information published by such sources, no facts have been omitted which would render the reproduced information inaccurate or misleading.

1. THE UK PENSION MARKET — INTRODUCTION

Individuals in the UK may rely on a number of sources from which to draw income during retirement; however, income is commonly provided by a pension plan. Pension plans, or schemes, are usually identified either as defined benefit ("**DB**") or defined contribution ("**DC**") schemes. DB schemes, which are generally funded by employers, provide individuals with a pre-determined monthly income at retirement based on their earnings history, tenure and age, which is payable by the trustee of the pension scheme during the individuals' retirement years. In contrast, for a DC scheme, an employer and/or an individual makes a specified but flexible contribution to a pension fund, which is invested for the individual's benefit.

In the March 2014 UK Budget, pension reforms were announced giving customers complete flexibility as to how to access their pension savings from April 2015. In October 2014, proposals made by the UK Treasury to allow pension schemes to pay out lump sums from members' savings were confirmed. These changes enable customers to make multiple withdrawals from their fund and receive up to 25 per cent. tax-free. The reforms were implemented on 6 April 2015 and it is likely that the current market uncertainty will continue through 2015. Further changes enable customers to transfer any unused defined contribution pension to any nominated beneficiary when they die, either tax free (if death occurs before age 75) or at the beneficiary's marginal tax rate, rather than paying the 55 per cent. tax charge which previously applied to pensions transferred at death. This tax change also applies from 6 April 2015 to joint life or guaranteed annuities where the principal annuitant dies before age 75. In addition the FCA introduced 'Additional Protection' for customers, which requires pension providers to ask customers about key aspects of their circumstances that relate to the retirement income choice they are making. At retirement, individuals now have access to the Pension wise service, providing free and impartial guidance on their retirement income options.

Prior to the reforms, individuals in DC schemes effectively had the option to purchase one of two at-retirement products: annuities or income drawdown plans. In 2014, annuities accounted for approximately 73 per cent. of total at-retirement market premiums in the UK, while income drawdown accounted for the other 27 per cent. (source: ABI). Annuities are insurance contracts that pay out a regular amount of guaranteed income (or, in the case of with-profits or unit-linked annuities, amounts based on bonus declarations or the value of underlying assets) to insured individuals, either for a fixed duration or, more commonly, until the insured's death. Annuities are generally purchased using an individual's pension assets but can also be purchased from non-pension assets. Income drawdown plans provide no income guarantees: the individual leaves his or her pension savings invested and periodically withdraws cash directly from the invested pension assets. Given that income received from drawdown plans is uncertain, such plans were previously typically not deemed suitable by advisers for the majority of UK retirees and usually only recommended by FAs to those with significant pension sums.

The immediate impact of the reforms announced in 2014 was a significant reduction in the number of individuals purchasing an annuity, driven partly, the Issuer believes, by a material increase in the number of individuals deferring accessing their pension savings until there was further clarity. This is borne out by the market data which shows that in the 9 months post budget to 31 December 2014 sales of individual annuities fell by £4.2 billion, while sales of drawdown products increased by £0.7 billion (source: ABI), suggesting £3.5 billion of funds remain with customers who deferred accessing their pension savings. The level of retirement saving in the form of assets contained within DC schemes is unaffected and the long term outlook and structural drivers of growth in this area, as set out below, are unchanged by the UK Budget announcement. The potential impact of the proposed reforms on the annuity market is set out in below in "*The UK Annuity Market—Overview*".

At present, the majority of corporate pension assets reside in DB schemes; however, in recent years, there has been a shift from DB scheme membership to DC scheme membership (in the form of group personal

pensions) as DB schemes close to new members. This shift is expected to continue, so that DC and DB assets represent equal proportions by 2019, with DC schemes representing an estimated 96 per cent. of total pension assets under management by 2030 (source: Oliver Wyman).

Various factors have driven this trend, including DB scheme members living longer, the introduction of mark-to-market accounting by corporate sponsors to reflect DB scheme liabilities, sustained periods of adverse market conditions which have increased DB funding gaps and increased DB scheme regulation, all of which have made opening or maintaining such schemes less attractive and more costly for companies. In the private sector, the rate of closure to new members and closure to existing members of DB schemes has accelerated in recent years to such an extent that, as at the end of 2014, 13 per cent. of private sector DB schemes in the UK were open to new members and 32 per cent. were not accruing further benefits and were in run-off (source: Pension Protection Fund/The Pensions Regulator). The UK Government has also promoted greater access to and use of DC schemes, including stakeholder pensions, in order to increase pension saving penetration to assist in mitigating the pensions savings gap as described below under "*The UK Annuity Market—Overview*". In 2012, the UK Government further encouraged pension savings into DC pension funds through the introduction of "auto-enrolment", requiring all employers over a certain size (with phased introduction for smaller employers) to enrol all employees into a DC pension savings plan, unless the employees actively request non-participation. Increasing pressure on corporate employers to disclose their DB pension funding deficits has also driven the move to enrol new employees in DC schemes.

2. THE UK ANNUITY MARKET — OVERVIEW

2.1 Individual Annuities

The total market for annuities and income drawdown products was £9.5 billion in 2014. The total "at-retirement" market is forecast to grow at circa 13 per cent. compound annual growth rate over the next few years, reaching £29 billion in premiums by 2020, with the market growth underpinned by the following structural growth drivers:

- The move from DB to DC schemes, which will drive the requirement for individuals to provide for their own retirement needs via the purchase of an annuity, an income drawdown solution, a combination of these, or utilising alternative at-retirement propositions.
- The UK population is living longer, with the number of people in the population who are aged 65 and over forecast to grow from an estimated 11.4 million as at 2014 to 19.2 million in 2041 (source: ONS). The UK Government is progressively seeking to reduce reliance on state-funded pensions by implementing plans such as increasing the age at which an individual is entitled to receive a state pension and promoting personal retirement saving through schemes such as the National Employment Savings Trust ("**NEST**"), participation in which is expected to grow substantially over the next decade (source: Oliver Wyman).
- The significant pension funding gap (which represents the difference between the income needed to live comfortably in retirement and the actual income individuals can currently expect from existing savings levels) in the UK (estimated at approximately £318 billion per annum as of 2010 (source: Aviva)) and government encouragement for individuals to save for retirement, should act as a catalyst for retirement savings growth.
- Finally, the size of the at-retirement market is also driven by growth in employment income, contribution changes and investment returns on accumulated pension assets.

In 2014, annuities represented a significant proportion of the at-retirement market in the UK, accounting for £6.9 billion in premiums in 2014 (on a single premium equivalent ("SPE") basis representing 73 per cent. of total DC retirement funds placed with ABI members (source: ABI). The March 2014 UK Budget announcement in relation to reforms of pension taxation had an immediate impact in reducing the size of the annuity market in 2014. There is a wide range of views on the eventual impact of the reforms on the size of the annuity market and there remains a high degree of uncertainty as to the long term impact of these reforms on customer behaviour and market development. Fitch expects annuity sales to stabilise in

2016 at 50 per cent. to 70 per cent. of the pre-budget level of £12 billion per year (source: Fitch "Annuity Market In Flux"). The Issuer believes that a significant number of customers have deferred their retirement decision until after the pension taxation changes were implemented in April 2015. This was driven, in part, by the widespread disruption to the distribution networks as advisers digested the implications of the various changes for their advice to clients.

An independent study published in January 2015 by the International Centre for Longevity – UK showed that 70% of retirees rank an income guaranteed for life as the most important consideration in retirement planning. This is consistent with Partnership's own consumer research conducted following the UK Budget announcement which found that 64 per cent. of customers rank a guaranteed income for life as the most important attribute for their retirement income. The Issuer believes that the structural growth in the "at-retirement" market set out above and the ongoing customer need for a guaranteed income for life should encourage a significant proportion of customers to continue to elect to secure part of their retirement income using an annuity product rather than choosing to rely solely on income drawdown, which typically involves drawing down on pension assets for an uncertain period of time, or cash withdrawal options.

In its response to the consultation on Freedom and Choice in Pensions, HM Treasury states that: "The government is clear that annuities will remain the right choice for many at some point during their retirement, and believes that many people will still value the security of an annuity." The FCA's published findings in relation to the retirement income market study conclude that while there is a common perception among consumers that annuities offer poor value, "the right annuity purchased on the open market offers good value for money relative to alternative drawdown strategies and may therefore be a good option for those with low risk appetites."

Following the pension taxation changes implemented in April 2015, the market for annuities will depend on a number of factors, including: the level of take up of the Pension wise service, the content and effectiveness of the Pension wise service and the additional protection, the impact of both of these on the number of customers shopping around, the accessibility and affordability of advice for customers, the importance placed by customers and advisers on the guaranteed income for life offered by annuities and the attractiveness of the alternative retirement income products or cash withdrawal options that will be available to customers.

2.1.1 Annuity Product Segmentation

Annuity products offered in the UK are generally divided into two broad segments based on the level and type of underwriting undertaken: standard and individually underwritten. Of the £6.9 billion annuity premiums written in the UK in the year to 31 December 2014, 68 per cent. were written as standard products and 32 per cent. were written as individually underwritten products (source: ABI).

Standard products offer a uniform level of annuity income payable to individuals, without reference to their individual state of health and differentiation typically only by reference to factors such as age, postcode and premium size. In the third quarter of 2014, 17 providers sold annuity products in the UK market, of which seven operated in the standard segment only: the top 5 providers of standard annuity products held a combined 70 per cent. share of new business premiums in the third quarter of 2014 (source: ABI). Given the limited use of personal health information to drive pricing, and the general availability of average life expectancy tables, the standard annuity segment is commoditised.

By contrast, IUAs offer annuitants with lifestyle or medical factors, such as cancer, heart conditions, high stroke risk, multiple sclerosis, circulatory and respiratory illnesses and diabetes, which are expected to result in shorter life expectancy, annuity rates which are superior to standard annuity rates. The degree of annuity rate enhancement offered depends on an assessment of each individual's life expectancy, with higher rates typically extended to individuals with lower life expectancies. Given this model, insurers operating in the individually underwritten segment require significant medical and lifestyle information prior to quotation and an understanding of the likely impact of such information on life expectancy. As such, the ability to capture and analyse medical and lifestyle underwriting data is a key competitive differentiator in the IUA market. In the IUA segment, Partnership held a 16 per cent. share of new business premiums in the third quarter of 2014 and the top five providers held a 77 per cent. share over the same period (source: ABI). IUA providers in the UK include Partnership, Just Retirement, LV and Aviva.

In its 2014 publication "The Future of the UK Life Industry" Oliver Wyman's analysis is that the changes in the market post April 2015 will result in the annuity market becoming wholly underwritten over time.

2.1.2 IUA Market Outlook

In previous years, the IUA segment has achieved faster growth than the standard annuities segment. The IUA segment increased in size from £0.8 billion (or approximately 8 per cent. of the UK annuities market) in 2006 to £3.8 billion (approximately 32 per cent.) in 2013 (source: ABI). For 2014, the size of the IUA segment was £2.2 billion, representing 32 per cent. of the UK annuities market (which includes sales from both the pre-UK Budget announcement and post-UK Budget periods) (source: ABI). The increase pre-UK Budget, which is over and above the growth achieved in the annuity market in general, has been due to people exercising their OMO, an increasing proportion of individuals that seek and qualify for a IUA and the generally higher annuity rates available for medically underwritten annuities. For example, on average in 2014, Partnership's medically underwritten annuities provided 19 per cent. more income to customers than a standard annuity.

As a result of the widespread market disruption caused by the 2014 UK Budget announcement, in the 9 months post budget to 31 December 2014 sales of individual annuities fell by £4.2 billion as customers deferred making a retirement income decision until the new rules were implemented in April 2015. The current market disruption and uncertainty makes it impossible to determine with any degree of accuracy, how customer and advisor behaviour will change post 6 April 2015 and how that will translate into IUA market growth in future.

However, once the new regime is established, the Issuer expects growth to return to the IUA market due to:

- the structural growth expected in the "at-retirement" market;
- the customer desire, and often need, to achieve a guaranteed income for life;
- the higher rates typically offered by IUAs compared to standard annuities; and,
- assuming the Pension wise service and additional protections are effective, an increased propensity for customers to shop-around.

The proportion of OMO customers choosing a IUA held up well in the initial aftermath of the March 2014 UK Budget announcement, with 63 per cent. of OMO customers choosing a IUA in the third quarter of 2014 (source: ABI). This compares with 52 per cent. of OMO customers who chose a IUA in the first quarter of 2014, before the UK Budget announcement (source: ABI).

2.2 DB De-risking/Bulk Annuities

2.2.1 Partnership's DB proposition

There are significant legacy defined benefit liabilities across UK pension schemes. These remain a significant and long-term challenge for corporate sponsors and have led to an increasing focus on active deficit and risk reduction management strategies. The core product that Partnership currently offers in this market is a bulk annuity that can be utilised so as to result in a number of different defined benefit de-risking propositions for pension schemes. The market for defined benefit de-risking has been active for many years and is unaffected by the proposed pension reforms.

Bulk annuities are used to effect a "buy-out" or "buy-in" of some or all of a pension scheme's liabilities. This involves the insurer issuing a bulk annuity policy to match the pension scheme's obligations to its members. Bulk annuities provide an equivalent guaranteed retirement income to pension scheme members whilst removing or reducing exposure to pension risk and uncertainty for the corporate sponsor and the pension scheme trustees. A bulk annuity policy is either held by the trustees of the pension scheme or assigned to the pension scheme members in which case they become individual annuitants of the insurer.

2.2.2 DB market outlook

In 2014, there were in excess of £13 billion worth of DB pension liabilities placed with UK insurance companies, which represents only a small proportion of the £1,700 billion of buy-out liabilities currently held by UK companies (source: TPR Purple Book 2014). It is projected that the overall DB market will increase to £20 billion per annum by 2020 (source: KPMG) and that around £100 billion of de-risking transactions will take place over the next five years (source: Oliver Wyman). The pension reforms could lead to growth in de-risking of defined benefit pension schemes; more deferred pensioners transferring out (as anticipated) will improve funding and accelerate many schemes' de-risking strategies.

The Issuer estimates that there are approximately 5,000 smaller DB schemes (with up to £100 million liabilities) with total liabilities of £170 billion at the end of 2014, which represents its core target market. In 2014, the Issuer estimates that within this core market 158 de-risking transactions were undertaken with the premium paid for risk transfer of £2.4 billion. Of the 2013 sales of deals less than £100 million, only 3 per cent. were medically underwritten. By 2014, this figure had grown to over 10% (source: TPR Purple Book 2014 and Partnership analysis)

In 2013 there were eleven transactions of £100 million or greater in size. The application of medical underwriting can equally apply in this market segment, demonstrated by Partnership's £206 million transaction with the Taylor Wimpey Pension Scheme in December 2014.

The Issuer believes that the outlook for future de-risking activity is strong, with scope for increased penetration of medically underwritten de-risking transactions, supported by certain EBCs setting up their own in house services to collect data from DB members to support medical underwriting. It is expected that the transition to medically underwritten DB deals will be faster than in the retail market due to several factors:

- medical underwriting is already established in the retail market and therefore no proof of concept is required;
- DB pension schemes are sophisticated, informed and highly advised buyers;
- trustees have to access EBCs who provide advice; and,
- The Issuer expects other insurers to enter the market, which will be viewed as a vote of confidence by EBCs, helping to accelerate the transition to medically underwritten approaches.

The Issuer began to develop the medically underwritten DB market in 2012 and completed the first medically underwritten DB transaction in 2012. Increasing numbers of trustees are recognising the better value medical underwriting can deliver, as demonstrated by the increase in sales since 2013.

3. THE UK CARE MARKET

Immediate needs annuities ("**INAs**") constitute a distinct segment within the annuity market and are not affected by the recent pension reforms. An INA offers a guaranteed fixed-income income paid directly to a registered care provider for the life of the insured, in exchange for an up-front lump sum premium, and, under current rules, is tax free so long as the income is paid directly to the registered care provider. INAs are available to individuals entering care facilities or receiving domiciliary support. As such, INAs provide a form of longevity insurance to the individual against the costs of receiving care from policy inception until death.

The provision of INAs is currently split between three active market participants, led by Partnership.

The Issuer believes that there is considerable structural growth potential in the UK INA market. The population aged 80 and over is projected to grow from 3.0 million in mid-2012 to 6.7 million by mid-2037, more than doubling over 25 years. By mid-2087 the projections suggest there will be 15.6 million people aged 80 and over (source: ONS). In 2013, there were an estimated 426,000 residential care residents in the UK, with 44 per cent. of such individuals paying all care costs personally, while a further 13 per cent. of individuals paid some contribution toward care costs (source: Laing & Buisson). It is

estimated that nearly 40 per cent. of self-funders in residential care would benefit from an existing financial product to protect their assets (source: PSSRU).

Partnership is actively engaged with central government and local authorities in order to raise education around the availability of INAs and promote their benefits to customers.

On 14 May 2014, the Care Act (the "**Act**") received Royal Assent. The Act seeks to increase public awareness about the need to make provision for the costs of care. The Act includes provision for a state funded deferred payment arrangement launched from April 2015. These arrangements are only available to individuals with non-housing assets of less than £23,250 and therefore the impact on the market of INAs is likely to be limited. The Act makes provisions for local authorities to establish and maintain a service for providing people with information and advice on how to access independent financial advice on matters relevant to care and support needs. The government has also announced a public awareness campaign to raise public awareness of care funding requirements and sources of advice. Both MPs and Peers have raised concerns that this does not go far enough, and have emphasised the need for local authorities to facilitate access, where appropriate, to regulated financial advice for self-funders. Government ministers acknowledged that this advice will be important for a number of people paying for all or some of their care, and this is therefore set to be addressed in the statutory regulation and guidance that will accompany the Act.

The Act provides for a cap on personal care costs set at £72,000 with effect from April 2016. Only personal care costs, and only at a rate that a local authority would typically pay, will go towards calculation of the cap. Individuals' general living expenses, any care costs above the local authority rate and any costs of additional or more extensive services will not count towards the cap. The cap is only relevant to individuals who meet eligibility criteria based on need which will be set by the UK Government. The needs assessment categorises individual care needs into four categories: substantial, severe, moderate or low. It is likely that funding will only be available for needs categorised as "substantial". The average weekly cost of care in the south east is £646 for residential care and £887 for nursing care, and the average for the UK as a whole is £550 for residential care and £728 for nursing care (source: Laing & Buisson). The average local authority rate across England is approximately £500 per week (source: Laing & Buisson). This £500 per week will be reduced by about £230 per week, being the proposed fixed costs of "general living expenses" set by the UK Government. This leaves £270 to contribute towards the cap. As a result, on average, it would take over four years of care to reach the cap. All costs prior to reaching the cap would be payable by the individual. Having reached the cap the general living expenses and the costs above the local authority rate remain the responsibility of the individual until they either die or deplete their assets. Therefore, the Issuer does not believe that the impact on the Group's business will be material.

4. THE US CARE MARKET — OVERVIEW

As discussed further in section 3.1 of the "*Description of the Issuer and Guarantor"*, Partnership has identified a significant opportunity in the US for an immediate needs care annuity.

There is a wide spectrum of long-term care provision in the US, including:

- Independent Living Facilities, where care recipients do not require assistance with daily activities;
- Assisted Living Facilities for care recipients who are not able to live independently, but may need personal care or assistance with meal preparation;
- Skilled Nursing Facilities which are staffed 24 hours a day by medical staff for those with chronic conditions requiring long-term care or those needing a shorter-term acute recovery period after hospitalisation; and
- Home Health Care, where caregivers are hired to provide care in the home.

It is estimated that there are approximately 3.5 million long-term care recipients in the US at any one time. Each year, there are a further 850,000 new entrants to Assisted Living Facilities, Skilled Nursing

Facilities and Home Health Care settings, self-funding approximately $45 billion per annum on care provision (source: Towers Watson). Government funding provides for initial care via Medicare and Medicaid schemes, but duration and means-tested limitations apply and eligibility and services covered vary from state to state, resulting in this large residual self-funding market. US demographics support an increase in the number of individuals who may require these facilities; the 5.5 million people over the age of 85 in the US in 2010 is projected to grow to 8.7 million in 2030 and 19 million in 2050 (source: 2010 US census).

For those who plan early enough, pre-funded long-term care insurance products are available. However, applicants must be able to pass underwriting criteria to determine that they are healthy when purchasing the policy. Many insurers have withdrawn from the market and products have undergone significant re-pricing due to initial assumptions overestimating investment returns and lapse rates, resulting in insufficient premium levels. As a result, US insurers participating in this market have had to strengthen reserves and de-scope the benefits on new products to improve profitability.

Options are limited for those at the point of need who do not have a pre-funded long-term care insurance product.

5. DISTRIBUTION OF ANNUITY PRODUCTS

Partnership does not provide advice to customers on any of its products and distributes its products mainly via intermediaries, including FAs, EBCs and corporate partner relationships.

Intermediated distribution employs either a “whole of market” model, in which the adviser recommends the most suitable product available across the whole market, or a “restricted” model, where advisers recommend products from a panel of selected product providers. FAs can belong to national or regional networks or can trade individually, and whereas some FAs offer a broad range of financial products to customers, others specialise in specific products, such as annuities. EBCs provide services to employers and pension fund trustees on employment-related issues, including longevity de-risking solutions. Partnership’s corporate partner relationships provide it with marketing access to the customer base of other pension product providers, in return for a share of the economics resulting from any sales of Partnership’s IUA products. EBCs and corporate partner distribution channels allow annuity providers to access a market segment not traditionally served by FAs. In 2014, 44 per cent. of annuity purchases were non-intermediated (source: ABI) and the Issuer believes that EBCs, corporate partners and banks will play a key role in increasing customer access to advice in the future.

The majority of OMO at-retirement pension annuities continue to be sold through FAs given the large number of products available and the importance of the decision-making process for customers (source: ABI). The role of FAs is expected to remain significant given the choices likely to be presented to customers as a result of the recent pension reforms. Consolidation of FAs into networks is expected to continue, and the number of “new breed” specialist annuity FAs is expected to increase, reflecting the ability of these specialist FAs to market to customers but it is likely that they will diversify their business models to capture advised and non-advised sales.

While the long term impact of the recent pension reforms is unclear, it is possible that the availability of the Pension wise service to all customers at retirement will lead to an increased number of customers buying at-retirement products directly, either through non-advised or simplified advice channels.

5.1 Distribution of INAs

Historically most INAs have been sold via specialist FAs because of the high level of adviser knowledge required to sell these products. However, more recently the growing awareness of the potential benefits of INAs amongst customers and advisers has led to increased distribution of these products by traditional FAs, which have made significant investment in adviser training and education. The Issuer expects the number of distributors and the breadth of the distribution platform to increase over time as customer interest in INAs continues to increase.

6. IMPACT OF DIRECT REGULATION ON THE UK ANNUITY MARKET

Regulation remains significant within the annuities market and in December 2014, the FCA published the provisional findings and proposed remedies in relation to its retirement income market study. In summary, the FCA's provisional findings concluded that competition in the retirement income market is not working well for consumers and that many consumers are missing out on a higher income by not shopping around. The FCA consulted on the proposed remedies, recommendations and actions and published their final findings, confirming the provisional findings in March 2015. Additionally, from April 2015 all consumers have become entitled to free, impartial guidance at retirement, provided by independent organisations rather than pensions schemes or providers (the "Pension wise service"). The next phase of the FCA's work on annuity comparisons and the replacement of wake up packs will take place as part of a wider review of the FCA's rules in the pensions and retirement area in summer 2015.

Further FCA rules have been developed to implement and monitor the Pension wise service. In addition the FCA has implemented rules placing a requirement on pension providers to give appropriate retirement risk warnings to customers accessing their pension savings, which will impact existing pension and annuity providers.

One of the FCA's objectives under the Financial Services and Markets Act 2012 is to promote effective competition. From April 2015 the FCA also takes on the full suite of concurrent competition powers providing the FCA with the authority to investigate and enforce using the Enterprise Act and the Competition Act. This is expected to result in the FCA continuing to focus on competition issues in relation to products and markets, as seen with the market study on retirement income.

The FCA Risk Outlook issued in March 2015 identified a number of forward-looking areas of focus, including a review of retirement income products and how these are distributed, in particular since the implementation of the retail distribution review ("**RDR**"). Distributors have adapted their business models and distribution strategies with some evidence of an increase in non-advised sales. This has raised concern that some customers may find it more difficult to get financial advice. Therefore, the FCA will also focus on technology innovation and the potential for an increase in non-advised sales.

The FCA published their Business Plan and Risk Outlook in April 2015. The Plan identifies seven forward looking areas of risk which FCA believes could pose risks to consumer protection, market integrity, and competition. The first six areas of FCA risk focus have been "rolled over" from the FCA's 2014 Risk Outlook and include Pensions, retirement income products and distribution methods delivering poor consumer outcomes (all of which are described as being of significant interest). The final and additional point relates to the importance of firms' systems and controls in preventing financial crime, which replaces concerns over house price growth from last year (although FCA notes that it will continue to monitor it closely).

The FCA has developed the FSA's Treating Customers Fairly initiative further with regard to the conduct risk outlook. This is a more holistic approach to delivering good outcomes for customers. The Group has a core objective to ensure it delivers good value products to customers.

The FCA and PRA have jointly published their consultation on the new senior insurance managers regime. Additional regulatory obligations on the Group in relation to individuals holding key functions or with significant influence are expected to come into effect from 1 January 2016, concurrently with Solvency II requirements.

7. THE UK EQUITY RELEASE MARKET

An equity release, or lifetime, mortgage is a mortgage designed for individuals in or near retirement who wish to realise some of the equity value of their home. The loan is secured on the mortgagor's home and accrues regular interest, but payments of interest and the repayment of principal are not due until the death of the mortgagor.

The equity release market in the UK expanded in 2014 with total advances increasing from £1.07 billion in 2013 to £1.4 billion in 2014, an increase of 31 per cent. (source: Equity Release Council).

Partnership focuses on the provision of equity release mortgages with relatively short expected terms, either by originating loans with individuals with shortened life expectancies or by acquiring existing books of older equity release mortgages from third party originators. Partnership uses equity release mortgages as an asset class to match the liabilities arising from the sale of retirement annuities.

In April 2014, the FCA took formal responsibility for regulating the consumer credit market. Due to the volume of firms that will require authorisation the FCA has provided interim permission to relevant firms, including the Group. Full consumer credit permission will be applied for in the third quarter of 2015 in line with the timeline set by the FCA.

DESCRIPTION OF THE ISSUER AND THE GUARANTOR

1. INTRODUCTION

Partnership is a leading provider of individually underwritten and care annuities in the UK, offering better rates to individuals who suffer from shortened life expectancy by utilising an IP-led, capital-efficient business model.

Partnership's IUA products are priced using its proprietary medical and mortality data which has been collected over 20 years, as well as the experience, underwriting processes, methods and systems to interpret and apply such data (the "**Proprietary IP**"). The Issuer believes that this data and Partnership's ability to use it to price its products competitively and profitably represent the critical components of Partnership's competitive advantage. Partnership applies its Proprietary IP to estimate future mortality rates of individuals with reduced life expectancy compared to those of healthy individuals. With this information, Partnership is typically able to offer a higher annuity to customers with medical or lifestyle issues than a standard annuity provider can achieve.

The Proprietary IP dates back to Partnership's predecessor, the Pension Annuity Friendly Society ("**PAFS**"), which began collecting detailed medical and mortality data on its customers and quote-seekers in 1995. Partnership acquired PAFS in 2005 and with it this database, which it considered to be unique in the UK annuity marketplace at the time.

Since then, Partnership has continued to gather further detailed medical and mortality data on its customers and quote seekers; for each applicant, Partnership asks up to 250 questions relating to factors likely to influence life expectancy compared to 5 questions for typical standard annuity providers. As this data set has grown, Partnership has increased the sophistication with which it determines its pricing, increasing the granularity of the life expectancy assessment. Today, Partnership's Proprietary IP represents a medical and mortality database which the Issuer believes enables it to estimate and price the effect of certain medical and lifestyle conditions upon an individual's life expectancy with greater accuracy than other annuity providers, standard or non-standard.

The Group uses reinsurance to reduce its regulatory capital requirements, improve pricing competitiveness and improve the quality of its earnings by reducing the potential volatility of a significant component of its profits. In addition, because Partnership's Proprietary IP reduces the Group's reliance on its reinsurance partners for technical input, the Issuer believes that Partnership is able to secure more attractive economic terms for its reinsurance arrangements than its competitors.

The Group's use of the Proprietary IP and reinsurance enables higher margins and a more capital efficient model than it would otherwise achieve. As a result, the Issuer expects the Group to produce day-one EU IFRS profits and to be capital generative on its new business before allowing for overheads.

Partnership's products are typically sold to customers by intermediaries. Partnership has implemented a multi-channel distribution strategy and has strong relationships with its key partners which have supported its growth in recent years. The Issuer believes that the strength of Partnership's distribution relationships and the willingness of networks to engage with it are testament to the strength of its commitment to offer a better deal for its customers.

In March 2014, pension reforms were announced in the UK Budget effectively giving customers complete flexibility as to how to access their pension savings from 6 April 2015. In October 2014 the Treasury announced changes to allow pension schemes to pay out lump sums from members' savings, also effective from 6 April 2015. These changes enable customers to make multiple withdrawals from their fund and receive up to 25 per cent. tax-free. In addition, further changes were announced at the same time enabling customers to transfer any unused defined contribution pension to any nominated beneficiary when they die, either tax free (if death occurs before age 75) or at the beneficiary's marginal tax rate, rather than paying the 55 per cent. tax charge which previously applied to pensions transferred at death. This tax change also applies from 6 April 2015 to joint life or guaranteed annuities where the principal annuitant dies before age 75. These announcements created significant market disruption and the Issuer believes that this has resulted in a large number of customers deferring their decision as to how to utilise their pension savings, which in turn has impacted on the UK annuity market. These changes were implemented on 6 April 2015 and it is likely that the current market uncertainty will continue

through 2015 and the Issuer believes that a significant recovery in sales is unlikely to begin before the second half of 2015.

Over the longer term, the consequences of the proposed reforms are not clear. There may be an increased number of customers exercising their Open Market Option ("**OMO**") if customers take advantage of the Pension wise service and the content of the guidance is meaningful and effective. There may also be more innovative products coming to market as the regulatory framework and HMRC rules become clearer. Given the increased flexibility and the removal of the requirement for customers to secure a minimum income at any level, fewer customers may purchase annuities in the future.

Partnership is based in London and Redhill and, as at 31 December 2014, had 427 employees. The Issuer is led by its CEO Steve Groves, a qualified actuary who has led the day-to-day operations of the Group since 2006, initially as Managing Director and since 2008 as CEO, and has 20 years of experience in the life insurance industry. The Group is authorised and regulated in the UK by the FCA and PRA.

Partnership is a public limited company of infinite duration domiciled in England and Wales. Partnership was incorporated and registered in England and Wales on 26 February 2013 as a public company limited with the name Partnership Assurance Group plc and with the registered number 08419490. The principal legislation under which the Issuer operates is the Companies Act 2006.

Partnership's registered office and principal place of business is at 5th Floor, 110 Bishopsgate, London EC2N 4AY. The telephone number of Partnership is +44 (0)845 108 7240.

The Guarantor, Partnership Life Assurance Company Limited, is a wholly owned subsidiary of the Issuer and is a regulated insurance company. The Guarantor was incorporated on 26 May 2005, following which it acquired the assets and liabilities of PAFS, a pioneer of impaired annuities since its foundation in 1995. The Guarantor's registered number is 05465261. The principal legislation under which the Guarantor operates is the Companies Act 2006.

The Guarantor's registered office and principal place of business is at 5th Floor, 110 Bishopsgate, London EC2N 4AY. The telephone number of the Guarantor is +44 (0)845 108 7240.

2. HISTORY AND DEVELOPMENT

Partnership was established following the acquisition of the business of PAFS in September 2005 by Partnership, funded by Phoenix Equity Partners and management. Launched in 1995 and structured as a mutual society run for the benefit of its members, PAFS was the first provider of impaired annuities for those entering retirement in the UK. PAFS's business model was focussed on the collection and analysis of medical and underwriting data on each life for which an annuity was written. When it was acquired, the business already held a significant competitive advantage derived from a database containing 10 years of proprietary medical, underwriting and mortality data. Partnership's current CEO, Steve Groves, was CFO at the time of the formation of Partnership.

Since the acquisition of PAFS, Partnership has continued to focus on maintaining and improving its Proprietary IP via the continued collection and analysis of medical and mortality data from customers and quote-seekers. Partnership has also continued to improve its Proprietary IP via the use of external medical consultants who provide input on the latest medical developments and advances in treatments.

In August 2008, Partnership was acquired from Phoenix Equity Partners by the Cinven Funds. Under the ownership of the Cinven Funds, Partnership has further enhanced its business model and operational platform via a number of key initiatives, including strengthening its senior management team, launching new enhanced products, strengthening its distribution channels, restructuring its reinsurance arrangements and investing in its Proprietary IP and underwriting systems.

In June 2013 Partnership was admitted to a premium listing on the London Stock Exchange and undertook an initial public offering of shares.

Immediately prior to listing, a group reconstruction was undertaken whereby Partnership Assurance Group plc became the top holding company in the Group, replacing the previous top holding company, PAG Holdings Limited.

As a result of the market disruption following the 2014 UK Budget announcement, Partnership implemented cost management proposals targeted at maintaining technical and product development expertise.

On 3 March 2015 the Group announced an agreement to issue a £100m subordinated bond to funds managed by Cinven Capital Management ('Cinven'), its majority shareholder. Following this announcement, the Subordinated Notes were issued on 24 March 2015 by the Issuer, and were purchased in their entirety by funds managed by Cinven.

3. FUTURE DEVELOPMENTS

3.1 International

Partnership has identified a significant opportunity in the US for an immediate needs care annuity, similar to Partnership's existing UK care product.

Partnership has evaluated its intellectual property and the results confirm the validity of the dataset for application to the US market.

Partnership believes that a reinsurance arrangement with a US partner is likely to provide an attractive risk/reward balance and speed to launch. It is expected that this structure will allow the key strengths of Partnership (e.g. product development, leverageable intellectual property and pricing) and a US partner (e.g. brand, distribution network, infrastructure to support regulatory compliance) to be combined.

Partnership's discussions with US partners are progressing and further updates will be provided in due course.

3.2 Retirement account

The reforms announced in the 2014 UK Budget will allow a wider range of products to be developed to meet the demands of the UK at-retirement market. The Issuer expects that the currently polarised options of an annuity or a drawdown contract will be blurred and that new 'retirement-account' products will be developed offering the benefits of a guaranteed income for life to secure a basic living standard, as well as the flexibility of a drawdown contract for any remaining savings. Partnership is using its unique dataset and its innovative product development expertise to develop products to meet anticipated customer demands, following the implementation of the new regulations on 6 April 2015.

3.3 Secondary market for annuities

On 18 March 2015 a consultation was announced in the UK Budget on proposals to create a secondary market in annuities in 2016, allowing existing annuity policyholders to assign the right to their annuity income to a third party in exchange for a lump sum or alternative retirement product.

The Issuer believes that the idea in principle is broadly positive for both consumers and Partnership. The ability to assign annuity income combined with the existing guaranteed income for life may make annuities more attractive to prudent savers.

The detail and impact of the proposals is still uncertain and subject to consultation and legislation.

4 CURRENT TRADING

4.1 Sales and lead indicators

The Issuer believes that structural growth drivers of the at-retirement market remain intact and that there is a positive long-term outlook for the individually underwritten annuity market supported by the Financial Conduct Authority's Additional Protection for consumers and the Pension wise guidance service.

In the near term, the Issuer believes that disruption to Partnership's core individually underwritten annuity market is expected to continue. Deferrals have increased during early 2015 as the April 2015 implementation date for pension taxation changes approached.

Given the typical two month lead time from quote to conversion, an increase in individual annuity sales is expected by the Issuer to be gradual and is unlikely to begin before the second half of 2015.

4.2 Costs and capital

After the March 2014 UK Budget, the Issuer took immediate action to realign its cost base to the level required to support lower sales of individual annuities. The cost reductions were less extensive than implied by the size of annuity market reduction, but were targeted so that the Issuer could maintain its technical and product development expertise to allow new initiatives to be pursued and to be ready for the return to growth. A reduction of £21 million versus the planned £101 million 2015 cost base was targeted. 2014 operating expenses were reduced to £78 million compared with £84m in 2013 and the Issuer is now targeting £5 million of additional savings resulting in targeted operating expenses of £75 million in 2015, representing a £26 million reduction against the planned 2015 cost base.

The economic capital surplus at 31 December 2014, proforma for the impact of the £100 million Subordinated Notes issued on 24 March 2015, was £232 million, representing coverage of 159 per cent. (excluding impact of bond: £132 million surplus, coverage of 134 per cent.). The Partnership Board continues to maintain a target minimum coverage ratio of 125 per cent. in normal conditions. There has been no change to Partnership's pricing discipline, which seeks to ensure each policy covers its own capital requirement. However, given the subdued volumes of new business post the March 2014 UK Budget and the current cost base, the economic capital coverage ratio is expected to trend down over time.

Partnership has in place a Solvency II programme designed to ensure the group meets the requirements of the Solvency II regulations, when they go live on 1 January 2016. Based on the Group's current interpretation of the draft Solvency II regulations, the Group expects to remain well capitalised under Solvency II and that the standard formula basis would be favourable relative to its economic capital basis. Elements of the regulations remain in draft form or are not yet available and there remains uncertainty in the interpretation of key elements of the regulations. The final rules, and how regulators choose to apply these rules may impact the ultimate position under Solvency II.

5. MANAGEMENT

Directors of the Issuer

The following is a list of directors of the Issuer as at the date of this Prospectus. The business address of each of the directors referred to below is 5th Floor, 110 Bishopsgate, London EC2N 4AY.

Name	Position at the Issuer
Paul Bishop ACA	Independent Non-Executive Director
Peter Catterall	Non-Executive Director
Ian Cormack	Senior Independent Non-Executive Director
Douglas Ferrans FFA	Independent Non-Executive Director
Dr Chris Gibson-Smith	Independent Non-Executive Chairman
Steve Groves FIA	Chief Executive Officer
Dr Ian Owen FIA	Non-Executive Director
David Richardson FIA	Chief Financial Officer
Clare Spottiswoode	Independent Non-Executive Director
Dr Richard Ward	Independent Non-Executive Director
Simon Waugh	Independent Non-Executive Director

Peter Catterall is a partner of Cinven which controls 51.9 per cent. of the voting rights in the Issuer.

Save as set out in the paragraph above, no director of the Issuer has any actual or potential conflicts of interest between any of his or her duties to the Issuer and his or her private interests and/or other duties.

Directors of the Guarantor

The following is a list of directors of the Guarantor as at the date of this Prospectus. The business address of each of the directors referred to below is at 5th Floor, 110 Bishopsgate, London EC2N 4AY.

Name	Position at the Guarantor
Paul Bishop ACA	Independent Non-Executive Director
Andrew Chamberlain FIA	Actuarial Function Holder
Ian Cormack	Senior Independent Non-Executive Director
Mark Dearsley ACA	Managing Director, International
Douglas Ferrans FFA	Independent Non-Executive Director
Chris Gibson-Smith	Independent Non-Executive Chairman
Steve Groves FIA	Chief Executive Officer
Jane Kennedy	Chief Operating Officer
Andrew Megson	Managing Director, Retirement
Dr Ian Owen FIA	Non-Executive Director
Kathryn Purves	Chief Risk Officer
Clare Spottiswoode	Independent Non-Executive Director
David Richardson FIA	Chief Financial Officer
Dr Richard Ward	Independent Non-Executive Director
Simon Waugh	Independent Non-Executive Director

No director of the Guarantor has any actual or potential conflicts of interest between any of his or her duties to the Guarantor and his or her private interests and/or other duties.

6. BUSINESS DESCRIPTION

The following description sets out the Group's operations, detailing Proprietary IP, products, distribution channels for the Group's offerings, pricing and underwriting of the Group's policies, reinsurance of the Group's products, investment management and risk management.

6.1 Proprietary IP

The design and pricing of the Group's products are based upon its set of proprietary medical and mortality data and research which was first established in 1995 and has been continually updated and developed with additional research and data collected since that time. The Issuer believes that the depth of this data and the Group's ability to translate it into the annuity underwriting systems used to drive its day-to-day annuity pricing activities together represent the Group's key competitive advantage.

For an annuitant, the rate offered by an annuity provider represents the value of the total payment received by the annuitant annually in exchange for the annuitant's payment of an up-front lump-sum premium. For a provider of IUAs, the key factor determining the pricing which can be offered to a customer is the life expectancy of the annuitant. The shorter life expectancy of a non-standard annuitant leads to a smaller number of expected payments with each payment being higher, and a shorter term on the product sold which makes the expected investment return generated over the life of the policy a smaller component of pricing than in the case of standard annuities. Consequently, the accuracy of a provider's mortality assumptions, produced from its Proprietary IP, is an important determinant of the accuracy of its pricing, the quality of its earnings and the strength of its balance sheet.

Through its acquisition of PAFS, Partnership first established underwriting tables and associated mortality tables in 1995 based on medical research, statistical analysis and expert opinion. The underwriting experience and mortality data obtained over the last 20 years have enabled Partnership to use this data to continue to enhance its underwriting systems and processes and so compete for new business. These underwriting systems integrate the medical and mortality data sets to price annuities on a case-by-case basis. Because Partnership's price quotation takes into account about 250 rating factors per life, Partnership is typically able to offer higher annuity rates to those with reduced longevity with a high degree of confidence.

As PAFS, Partnership's original strategy was to underwrite severely impaired lives with very short life expectancies. Over time Partnership used its advanced understanding of severely impaired life longevity to make underwriting decisions for lives with marginally less severe impairments, and so expanded its underwriting proposition from severely impaired lives through to mild impairments, gaining additional mortality data as it grew. Partnership also expanded into underwriting based on lifestyle factors, such as smoking, on the basis of external research and the methodology and processes which it had developed in underwriting severely impaired lives.

In addition, using its Proprietary IP which allows an estimate of the life expectancy of lives with lifestyle and medical risk factors, the Issuer believes Partnership has also been able to more accurately assess the mortality curves that are appropriate for healthy lives based on an assessment of the comparison of impaired life expectancies against the average life expectancy of the overall population. Using this information, Partnership has developed an innovative approach to pricing joint-life annuity policies where one life has reduced life expectancy and one life is "healthy". Using this data, Partnership is also able to provide DB annuity buy-in and buy-out solutions to pension scheme trustees where certain members and their spouses are both healthy (rather than requiring at least one of the member or spouse to have reduced life expectancy).

Partnership therefore benefits from an understanding of the whole spectrum of lifestyle and medical risk factors and their impact on life expectancy.

The key features of Partnership's medical and mortality data set can be summarised as follows:

- It is proprietary in nature and securely held within the Group. Access to Partnership's Proprietary IP is tightly controlled and, in particular, there is a strict separation of duties and information access between the underwriting and pricing teams. Only a very limited number of individuals in the research and development team have access to the full Proprietary IP. In circumstances where Partnership is obliged to disclose certain underwriting information to its reinsurance partners, disclosure is highly restricted and is generally limited to information on a pooled rather than individual case basis. Reinsurers are also required to enter into non-disclosure and, in some cases, exclusivity agreements.

- It has been accumulated over a significant length of time. The 20 year period of time over which the data set has been collected adds to its statistical credibility and narrows the range of underwriting estimates. Partnership issued over 108,000 IUA and Care policies over this 20 year period.

- It contains a large number of rating factor data points for each individual case. The questionnaires which annuitants are required to complete in order to receive a quote or purchase a standard annuity are standardised across the UK life insurance industry and are broadly based upon five questions to be answered. In the year ended 31 December 2014, Partnership collected on average (excluding care annuities and products sold via its PA Lite process) approximately 250 data points for each life, as well as taking into account additional information, such as medical reports and general practitioner assessments, provided by applicants, on each life insured before performing an assessment of life expectancy. These data points can be generalised to create a large number of potential medical and lifestyle factors to evaluate when profiling a potential customer. This process is intended to increase the Group's understanding of each customer and to improve the accuracy of its longevity assumptions.

- It can be updated on an accelerated basis. The non-standard profile of the individuals purchasing the products, shortens the duration between policy provision and an annuitant's death, and results in higher levels of mortality experience for the Group as compared to a standard annuity provider. For the year ended 31 December 2014, based on the Proprietary IP, the average life expectancy for a typical Partnership customer purchasing an IUA was 31 per cent. lower than the average life expectancy for a healthy individual of the same age (source: Partnership calculations). As a result, Partnership is able to update its mortality assumptions on a more frequent basis to create a richer data set. For the six months ended 30 June 2014, the Group's mortality rate for its annuity

holders was approximately 195 deaths per month and as of 30 June 2014 has had over 13,000 annuitant deaths since 1995.

Partnership reviews its mortality data set and pricing models, at least on an annual basis with periodic reviews throughout the year, to optimise the statistical credibility of the information underlying its longevity pricing assumptions through the following means:

- The Group compares actual deaths with expected deaths and investigates variances. In so doing, Partnership incorporates new mortality data into its database and adjusts rating factors in its pricing models and underwriting systems and processes to reflect the latest available data.

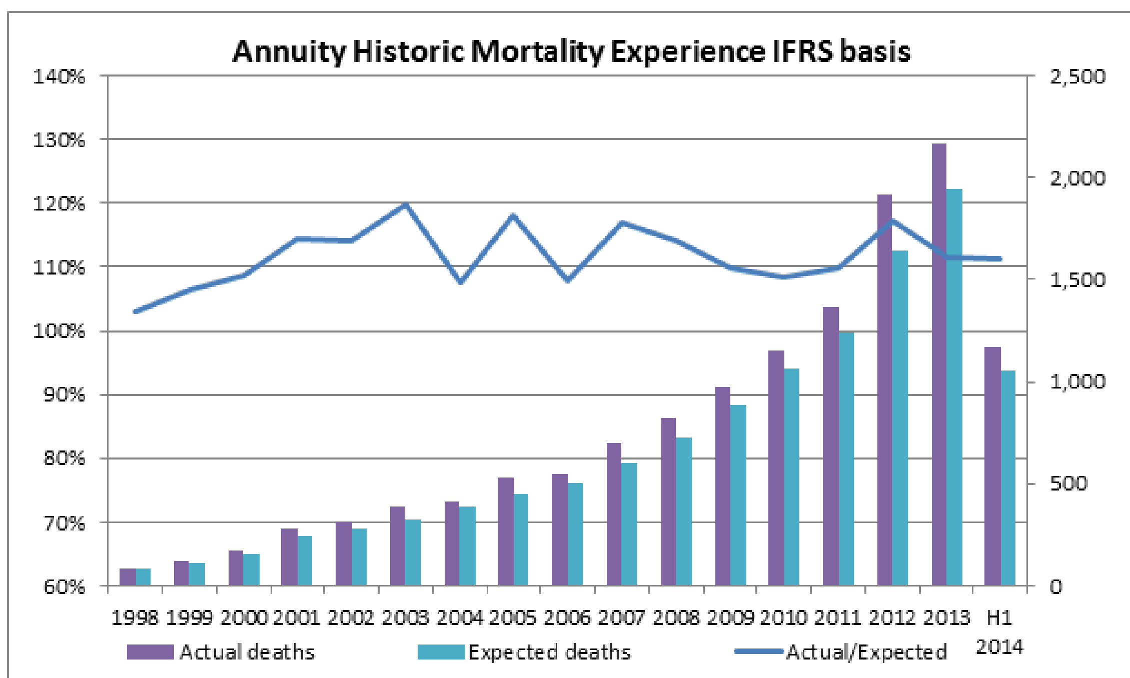
- Advanced statistical methods are used to perform analysis of the risk factors and the experience analysis to improve further the calibration of the underwriting systems and mortality tables.

- Partnership consults with 4 medical officers (all qualified doctors) and other consultants to incorporate new diagnostic methods and medical treatments. Partnership conducts research on certain conditions where material gains in treatments may be possible. This research is conducted in-house by Partnership's chief underwriter and Partnership's research and development department as well as being conducted on Partnership's behalf by external experts.

- Partnership closely monitors its competitive position in terms of quote conversions for each medical condition group and level of impairment. Where Partnership observes that its conversion ratios are significantly different from those of its competitors, Partnership will investigate the reasons for the difference.

Partnership's Proprietary IP is reviewed by its external professional advisers as part of the year-end process. Partnership's reinsurance partners conduct due diligence on the Group's Proprietary IP before entering into reinsurance agreements and during the term of those agreements. In addition, the PRA reviews the reserves which Partnership sets to support its annuity risks as part of a regular process to assess the minimum levels of regulatory capital which Partnership is obliged to hold.

The chart below presents Mortality experience for calendar years 1998 to 2013 inclusive and the first six months of 2014. Expected deaths as determined by mortality assumptions used for the IFRS valuation at 31 December 2013. The chart includes all annuity products sold by the Group (including IUA and INA). The experience presented is for first lives only.



According to the Issuer's estimates, in a hypothetical run-off scenario existing in-force business would generate an increase in free surplus totalling approximately £145 million between 2015 and 2019 and a further amount totalling approximately £135 million between 2020 and 2024 from the emergence of surplus and the release of capital requirements. The issuer also estimates that in 2025, assuming no more new business written and taking into account the surplus expected to emerge over the run-off of the business, approximately £400 million of capital would be released over time as the in-force business matures.

6.2 Customer proposition and products

As set out in "*Industry Overview*", prior to the reforms announced in March 2014 which were implemented in April 2015, the UK at-retirement market comprised two key products, annuities and income draw-down. Annuity products can be defined as 'standard', and underwritten based on a limited number of rating factors (predominantly age and postcode), or individually underwritten based on a greater number of rating factors (and in effect on an appraisal of the customer's medical health). IUAs cater for a spectrum of impairments ranging from light to severe and, because the pricing methodology takes into account a number of factors which determine longevity, typically offer higher regular annuity payments than standard products. Partnership sells IUAs and focuses particularly on the more impaired end of the medical spectrum. Partnership also sells a small number of standard annuity products in those cases where it is the exclusive provider of annuities to a distributor.

Partnership's annuity products are purchased by customers either to provide a guaranteed income (retirement annuities) or to meet the costs of long-term care (care annuities). Partnership also sells limited volumes of non-standard protection products to customers with impaired lives.

In the March 2014 UK Budget, pension reforms were announced giving customers complete flexibility on how to access their pension savings from April 2015.

In October 2014, proposals made by the Treasury to allow pension schemes to pay out lump sums from members' savings were confirmed. These changes enable customers to make multiple withdrawals from their fund and receive up to 25 per cent. tax-free. In addition, further changes were announced at the same time enabling customers to transfer any unused defined contribution pension to any nominated beneficiary when they die, either tax free (if death occurs before age 75) or at the beneficiary's marginal tax rate, rather than paying the 55 per cent. tax charge which previously applied to pensions transferred at death. These tax changes applied from 6 April 2015 to joint life or guaranteed annuities where the principal annuitant dies before age 75.

Whilst it has not been compulsory for people to annuitise their pension savings since 2010, the reforms may increase the number of people shopping around but potentially decrease the number of annuities purchased and increase the proportion of people taking income directly from their pension savings, either via drawdown or cash withdrawals.

Partnership's commitment to doing the best for its customers and meeting their retirement income needs has not altered, nor has its customers' need to manage their retirement assets through a highly uncertain future lifetime. Partnership's response to the changes is based around Partnership's view of the Group's core competencies, which is intended to deliver a stronger and more diversified business over time. This includes extending the defined benefit de-risking proposition, developing new products to meet the expected ongoing customer need for longevity insurance and progressing opportunities to leverage its unique dataset internationally.

6.2.1 Retirement annuities

6.2.1.1 Individually underwritten annuities

IUAs sold by Partnership are designed for customers with a reduced life expectancy, where longevity has been reduced as a result of diseases such as cancer or other medical conditions, and also for customers with lifestyle conditions which typically indicate a propensity for future medical conditions to develop, such as high blood pressure, obesity or high cholesterol, who smoke or have previously smoked, or who have any combination of these factors. Income rates on Partnership's IUAs exceed income rates on standard products. Income rates for customers where longevity has been reduced as a result of medical conditions are typically higher than rates for customers with lifestyle conditions compared to customers of the same age. A typical customer with a medical condition purchasing a Partnership IUA would have a life expectancy 31 per cent. below the average life expectancy of a healthy individual of the same age and with a £61,000 premium with which to purchase the annuity. A typical customer with a lifestyle condition purchasing a Partnership IUA would have a life expectancy 8 per cent. below the average life expectancy of a healthy individual of the same age and with a £65,000 premium with which to purchase the annuity.

6.2.1.2 DB De-risking/Bulk annuities

The market for bulk annuities has been active for over 25 years, as corporate sponsors and trustees focus on active deficit and risk reduction management strategies for these legacy schemes. Bulk annuities provide a guaranteed retirement income to pension scheme members, whilst removing or reducing exposure to pension risk and uncertainty for the corporate sponsor and the pension scheme trustees.

Until 2012, when Partnership first started to develop the medically underwritten market, the DB insurance market relied on proxies such as pension amount and postcode in order to assess life expectancy. By contrast Partnership uses health and well-being information collected directly from a subset of members in order to medically underwrite each transaction.

Bulk annuities have been unaffected by the pension reforms and market commentators predict significant growth in this market. It is projected that the overall DB market will increase to over £20 billion per annum by 2020 (source: KPMG Bulk Annuity Market Insight Report).

By bringing Partnership's high data approach to the defined benefit market, Partnership is able to use its expertise and unique proprietary intellectual property in medical underwriting to price the longevity risk of pensioners within defined benefit schemes more accurately, often resulting in more attractive prices for trustees.

Partnership was the first company to offer this proposition to the UK defined benefit market in 2012 and wrote £84 million and £247 million of medically underwritten bulk annuities in 2013 and 2014 respectively.

Partnership's core market is pension schemes with liabilities under £100 million, as these schemes are typically not large enough for traditional low data pricing to accurately reflect their risk profile. There are approximately 5,000 schemes in this sector of the market, representing an estimated £180 billion of liabilities.

Beyond Partnership's core market, pension schemes larger than £100 million can benefit from medical underwriting via Partnership's 'top-slicing' and 'selective risk removal' propositions, which transfer the risk for a specific population of scheme members, rather than the whole scheme. This allows trustees to insure those pensioners with the largest liabilities, and hence the highest concentration of risk, or to selectively remove risks within the scheme, for example, purchasing a bulk annuity to cover pensioners who retire early due to ill health. Partnership can therefore bring the benefits of medical underwriting to the entire spectrum of DB pension scheme sizes.

Defined benefit sales in 2014 totalled £247 million single premium equivalent ("**SPE**").

6.2.2 Care annuities

Partnership's INA products are designed to provide a guaranteed level of income for customers who are entering residential care or who are receiving domiciliary care. In contrast to retirement annuities, where payments are made from Partnership to the annuitant, INAs are structured so that payments are made by Partnership directly to the care provider, usually on a monthly basis, for the rest of the customer's life. This results in tax-free payments being made to the care provider on the customer's behalf. Payments can begin immediately or can be deferred for a period as indicated by the customer. There is a money-back guarantee in the event of early death: a 100 per cent. return of premium in the event of a death within one month of sale of the policy, a 50 per cent. return in the case of a death within three months, and a 25 per cent. return in the case of a death within six months. In addition, a customer can further protect up to 75 per cent. of his or her premium payment for an additional premium. INA sales in 2014 totalled £76 million.

6.2.3 Non-standard protection

Partnership also writes a limited amount of non-standard life protection business for individuals who have an impairment. Protection products pay out a pre-determined amount on death of the policyholder in exchange for regular premium payments over the life of the policy. Whilst not a large component of Partnership's business, the non-standard life protection market is attractive to Partnership because it serves an important customer need and also provides regulatory capital diversification benefits to Partnership. Non-standard protection sales in 2014 totalled £3 million SPE.

6.3 Distribution

6.3.1 Sales process

Partnership distributes its products primarily through intermediated channels, comprising FAs, EBCs, banks and other corporate partners. Partnership's distribution strategy has been designed to support and grow its distribution partner relationships to provide an effective route to market for Partnership's products as well as to increase customer awareness regarding the benefits of non-standard products.

Partnership requires information on each customer's medical status prior to offering an annuity price quote. Partnership has developed two processes by which this data can be captured in order to offer an annuity price and to access the broadest pool of retirees. First, Partnership captures data provided in industry-standard medical questionnaires, provided by Partnership's distribution partners on behalf of customers. This process requires customers to provide detailed information relating to current and historical medical and lifestyle conditions. Partnership supplements this patient disclosure with a range of other data gathering exercises on a sample basis, including in-house examination of a patient's general practitioner medical notes and, in the case of smoker annuities, home visits by qualified nurses. Partnership also carries out physical examinations in certain cases after going on-risk to further verify the data. Second, Partnership has developed its short-form questionnaire sales process called PA Lite in order to provide quotes to customers who are unable or unwilling to complete full medical questionnaires. Having captured between 5 and 10 medical data points using the PA Lite form, Partnership is then able to use those data points and its Proprietary IP to price an annuity. The PA Lite process was originally designed to capture business which Partnership would not otherwise obtain due to small sizes of the customers' pension funds and the minimal benefit of filling out a full questionnaire, but increasingly the process is useful for total pension income exchange (TPIE) exercises and for initial triaging of customers by new breed specialist FAs, which could in turn lead to a full assessment of a customer's life expectancy or to provision of a quote on the basis of the PA Lite process.

6.3.2 Distribution of retirement products

Partnership's distribution approach for its at-retirement annuity products has been designed to:

- Cultivate a diverse set of distribution channels;
- Focus on expected beneficiaries of the RDR;
- Develop and maintain long-term relationships with the Group's most productive distribution partners; and,
- Develop and maintain relationships with professional bodies (for example the Personal Finance Society).

For the years ended 31 December 2012, 2013 and 2014, at least 80 per cent. of Partnership's retirement annuities were distributed via the FA channel. Whilst FAs remain a key channel for Partnership, Partnership has diversified its distribution activities in order to access new pools of demand from retirees. Partnership's distribution strategy is currently structured as follows:

- For retirees actively exercising OMO, Partnership operates through a network of FAs, across specialist and general financial advisers. Recently a new set of specialist annuity FAs has emerged with a view to taking advantage of the growth in the IUA market. These specialist FAs seek to offer strong process and marketing-oriented capabilities in order to triage customers based on level of impairment.
- For retirees who do not actively exercise OMO and purchase an annuity through their incumbent pension provider, Partnership has put in place arrangements with a number of UK life assurance companies and pension providers to offer IUAs where the corporate partner is unable or unwilling to provide a quote. These arrangements provide access to vesting pension customers who may not otherwise take advantage of OMO.
- For retirees who are part of employer DB schemes, Partnership works with EBCs to offer TPIE and buy-outs or buy-ins of small and mid-sized DB schemes as de-risking processes for scheme participants, trustees and corporates. Through these services, Partnership offers its annuity products to retirees who would not otherwise require a pension product with a guaranteed income.

The table below sets out Partnership's 2013 and 2014 individual annuity SPE by distribution channel.

	FY14 % of SPE	FY13 % of SPE
FAs	86%	84%
Corporate partners	10%	13%
EBCs	4%	3%
Total	**100%**	**100%**

6.3.2.1 FAs

The FA channel is key to Partnership's distribution activities. IUAs represent an important purchase for retirees and are well-suited to the advisory channel.

Partnership has increased its presence in the FA segment via a number of initiatives:

- A highly analytical approach to the use of sales data analysis to assist the Group in quote-chasing to secure sales. Partnership tracks the performance of FAs and FA networks in terms of FAs quoting, number of quotes, quote-to-sale conversion ratios, pipeline activity and completed sales;

- The implementation of marketing services agreements with key FA networks. These agreements typically provide Partnership with the right to market its products to each organisation's advisers, significantly increasing the familiarisation of advisers with Partnership's products;

- The use of web portals, such as Iress and iPipeline, which are integrated quotation systems that link Partnership to an FA's IT systems and offer indicative quotes based on FA input; and

- The implementation of a program of FA education on the benefits of IUAs to customers.

FAs were previously remunerated through a commission payment from the product provider. However, as a result of the RDR, commissions can only be paid in the case of a non-advised sale, a model operated by a number of specialist FAs such as Hargreaves Lansdown and Age Partnership. Other than in these situations, FAs are now generally remunerated through payment by the customer of an agreed fee, which, for the sale of an annuity, can be deducted from the customer's pension fund. As a result, there is little practical difference between commission-based and fee-based FA remuneration for the customer.

FA sales information is gathered by Partnership based on Partnership's own record of product sales and through available industry data from third party systems, which collate total sales data by product for each broker firm.

6.3.2.2 Corporate Partners

Partnership's corporate partner distribution strategy is designed to capture annuity business to which the Group would not otherwise have access because the retiree has chosen not to exercise OMO or is not accessing advice through the FA channel.

In 2014, approximately 45 per cent. of retirees exercised the OMO (source: ABI). A significant number of retirees therefore currently purchase an annuity from their vesting pension provider. Partnership's arrangements with corporate partners are designed to provide Partnership with access to vesting customers who might not otherwise take advantage of the OMO. Partnership's corporate partners include B&CE, Standard Life and Wesleyan.

6.3.2.3 DB De-Risking

Partnership does not provide advice to scheme trustees. The advisory component of the transfer is provided by a scheme trustee's EBC (individual members do not receive advice in connection with a DB de-risking transfer).

During 2014, Partnership strengthened and extended its DB proposition to offer trustees a greater range of de-risking options, including "top-slicing" (see "*DB De-risking/Bulk Annuities*"). Partnership's traction in this nascent market is beginning to grow, as demonstrated by the growth of DB premiums from £84million in 2013 to £247million in 2014, and being spread across 12 different Employee Benefit Consultants ("**EBCs**") reflecting both the increasing recognition of medical underwriting in defined benefit de-risking and the stronger and broader relationships with EBCs.

6.3.3 Distribution of care products

Partnership's distribution strategy for the care annuity market recognises that only a small proportion of those needing long-term care receive any form of financial advice (source: Oliver Wyman, 2008). However, the Issuer believes that awareness of the benefits of care annuities is increasingly being appreciated by customers and specialist advisers due to the effects of an ageing demographic and the rising costs of residential and domiciliary care.

Care annuities are a specialist product requiring a high level of adviser knowledge and were historically distributed principally through specialist advisers. However, a growing awareness of the potential benefits of care annuities is leading to more care annuities being distributed by traditional FAs. An increasing number of traditional FAs are now able to provide advice on care annuities and Partnership works with these advisers to streamline sales processes and increase adviser and customer awareness.

Partnership also works with central government and local authorities to establish a process for raising education on the availability of annuities for those entering residential care and promoting their potential benefits, especially for individuals whose personal financial circumstances do not entitle them to state funding for residential or domiciliary care. The Issuer expects the benefits of local authority links to increase with a "hard" referral model being pursued with local authorities, which involves individuals who must fund care privately being referred directly to specific specialist FAs, as opposed to a "soft" referral model, with the individual simply being given a list of FAs to contact.

As part of its effort to raise awareness of care annuities, Partnership has set up the not-for-profit information website www.payingforcare.org. The website acts as an independent source of advice for those considering how to fund long-term care, provides direct links to specialist FAs who advise on care annuities and offers users a care funding cost "widget", which demonstrates the potential cost of receiving residential care and consequently encourages visitors to seek more detailed financial advice. Partnership is currently working with other potential sources of customer interest in order to attract additional traffic to the site and, ultimately, to specialist care annuity advisers, including residential care home groups, charities and other social groups with an applicable member base.

6.3.4 Distribution of protection products

Partnership distributes its protection product through two key channels:

- Partnership distributes its products through a range of specialist FAs who are experienced in sourcing protection products for customers with impaired lives.

- Partnership also has exclusive agreements with a number of leading protection providers to offer its products to customers with impaired lives, including Bright Grey and Legal & General. In circumstances where the partner is unable or unwilling to provide a quote because of the customer's impairment, the partner will refer the case to Partnership in order to secure a quote. This process allows the partner to fulfil its 'Treating Customers Fairly' obligations. Partnership does not provide advice to those individuals referred.

6.4 Pricing and underwriting

6.4.1 Pricing approach

Partnership sets its product margins with the aim of ensuring that new business written in a period is capital generative before allowing for overheads.

Pricing decisions are ultimately the responsibility of the Pricing Committees, subject to operating guidelines, targets and certain parameters set by the Board, which are staffed by senior members of Partnership's management team.

The Pricing Committees delegate day-to-day pricing operations to Partnership's two pricing teams, led by qualified actuaries. The technical pricing team is responsible for setting the minimum technical price for an annuity given the prevailing investment yields and the level of medical impairment and the capital requirements of the individual case. The pricing analytics team is responsible for setting the commercial margin over the minimum technical price in order to meet the Group's margin and sales volume targets, taking into account competitive and market dynamics.

Annuity pricing quotes provided to customers are guaranteed for a limited period only, typically 14 and 28 days for retirement and care policies, respectively, for the customer to accept the quote and a total of 28 and 42 days for retirement and care policies, respectively, for the customer to pay the premium, beyond which Partnership has the ability to cancel or re-price the quote.

6.4.2 Underwriting approach

Partnership has developed and owns its underwriting manuals and systems and all underwriting is performed in-house with a small number of complex cases reviewed by its medical officers. Partnership's underwriting team comprises a technical underwriting function, which is responsible for developing and maintaining Partnership's underwriting manuals, including automated underwriting engines, and ensuring compliance with those manuals, and an operational underwriting function, which takes the day-to-day assessment of life expectancy decisions on a case-by-case basis.

The assessment of life expectancy is performed by assessing the medical conditions and other risk factors for each life and then calculating an adjustment to the healthy life expectancy. The healthy life expectancy tables are set by the research and development team and are based on the most recent outlook for healthy lives using both the current mortality rates and the view on future mortality improvements.

In order to assist senior underwriters to calculate the appropriate reduction to the life expectancy, a set of underwriting manuals have been created for the main medical and lifestyle conditions considered. These include heart conditions, diabetes, cancers and respiratory diseases. These manuals have been translated into an automated system which allows the underwriter to make a consistent and accurate reduction in life expectancy in line with Partnership's previous experience, whilst also preserving the underwriter's ability to reach a final decision using additional adjustment if deemed necessary.

Partnership's underwriting systems are used only by those with the relevant underwriting authority within the operational underwriting function and technical underwriting team. Underwriting authority levels are strictly controlled and monitored.

6.4.2.1 Fully underwritten retirement annuities

For fully underwritten annuities underwriters perform an assessment of life expectancy on an individual basis using data from the industry-standard common quotation request form and supplied by the customer's intermediary. For more complex and/or large cases, a general practitioner report is obtained prior to a binding quotation being issued. General practitioner reports are typically obtained for between 5-10 per cent. of cases quoted. In certain cases for a partially random and partially criteria-based sample of policies, a general practitioner report is obtained following issuance of the policy. This sample will generally involve approximately 30 to 40 per cent. of non-smoker policies. In these situations, the underwriting team will perform an assessment of life expectancy for each life for a second time, using the information from the general practitioner's medical report and the policyholder's common quotation request form data. This process allows Partnership to assess the quality of policyholder disclosure. Adjustments may be made to the policyholder's annuity payments if the policyholder has deliberately over or under-disclosed medical information. In addition, where there are trends of over or under disclosure, Partnership reflects any required adjustments either in the underwriting systems or to the mortality tables. Partnership monitors policyholder mortality and reviews its Proprietary IP at least annually in order to improve the quality of Partnership's future life expectancy predictions.

For lifestyle annuities covering smoker conditions, Partnership requires policyholders to accept a visit from a qualified nurse after the policyholder accepts the quote but before the policy goes on-risk. The nurse carries out a smoker-verification test and asks a number of other connected and medical questions. A voluntary health assessment is also performed where the retiree consents to it. The questions and answers from the nurse visits are recorded on Partnership's systems for audit and future analysis. Where the applicant fails one or more of the tests, the applicant has the option of taking a reduced annuity with Partnership or seeking an annuity from another provider.

6.4.2.2 PA Lite

The PA Lite process for performing the assessment of life expectancy for annuities makes use of a short-form questionnaire covering the most common medical conditions. Partnership has calibrated a set of life expectancy assessment decisions to this short-form question set and derived appropriate mortality assumptions. The PA Lite underwriting process is not used where competitor quotations will be derived from the full common quotation request form, ensuring that Partnership is not placed at a competitive disadvantage. In order to check the accuracy of information submitted in quotation requests, Partnership performs, on a random sample basis, verification of the information by obtaining a general practitioner's report. Where Partnership can prove that a customer has deliberately included false information in a quotation request, Partnership has the ability to make adjustments to the annuity payments. Where a customer's pension fund exceeds £100,000, Partnership requests a full general practitioner report on the customer.

6.4.2.3 Automated full underwriting process

Partnership has automated the process of performing the assessment of life expectancy for the majority of fully underwritten cases both to produce quotes directly from an annuity FA on-line portal (such as Avelo) after input of the policyholder medical information and quotation details by the FA and for paper based common quotation request form business. For the paper based applications the automated process speeds up the initial stage of performing the assessment of life expectancy whilst also allowing the underwriters to make manual adjustments based on specifics of each case. The process with part automation and part manual override allows Partnership to perform assessments of life expectancy for a larger number of cases than would be possible if a fully manual process existed, whilst maintaining discipline over the process.

6.5 Reinsurance

Transferring a proportion of longevity risk to its reinsurance partners is a strategic component of the Group's underwriting model which reduces the volatility of future profits, improves pricing competitiveness and improves returns on capital. These arrangements have the following features:

- Longevity risk transfer reduces the impact on Partnership's profits of any deviations in mortality experience. As a result, the use of reinsurers reduces the volatility of Partnership's earnings arising from this risk.

- Partnership is able to limit the amount of underwriting risk retained after reinsurance, allowing it to increase capital efficiency. Approximately 65 per cent. of Partnership's in force longevity risk is reinsured as at 31 December 2014, reducing Partnership's exposure to the risk that customers live longer than expected. Partnership continues to retain investment risk. These arrangements reduce the amount of capital which Partnership is obliged to set aside as reserves to support future annuity payments, which results in a smaller and more efficient balance sheet for Partnership's shareholders.

- Partnership is able to leverage its Proprietary IP by using its own underwriting systems and mortality tables. The Group provides its reinsurer partners with restricted access to this information in support of basis development, due diligence and audit, enabling it to secure cost effective reinsurance. It also allows the Group to engage reinsurers on an exclusive basis in return for restricted access to risks underwritten using its Proprietary IP, which the Issuer believes improves the Group's competitive position in the market.

- As Partnership's customers have shorter life expectancies, Partnership's exposure to medical breakthroughs which could impact on its in-book profit margins is reduced. Reinsuring the business passes on most longevity risk to reinsurers. Partnership uses a medical tracking service which highlights research which may impact longevity developments to provide an early warning indicator of changes in life expectancies.

- Partnership manages its reinsurance counterparty credit exposure by utilising global reinsurers who are all currently rated A or above (Standard&Poor's or equivalent). In addition, credit risk is mitigated via collateral arrangements. The uncollateralised credit exposure to each reinsurer is matched by either assets deposited back as collateral to Partnership or deposited in trust for the benefit of Partnership. Partnership becomes the legal owner of the collateral assets on default of a reinsurer under these arrangements.

- The use of reinsurance ensures third party due diligence and validation of Partnership's Proprietary IP. Each reinsurer's due diligence process includes an analysis of the quality of Partnership's Proprietary IP and the accuracy of Partnership's reserving of insurance liabilities.

Partnership's reinsurance strategy has been designed to deliver these key features within a stable, long-term set of arrangements.

6.5.1 Overview of Reinsurance Arrangements

Partnership's approach is to build long-term relationships with its reinsurance partners. This allows Partnership to optimise its reinsurance pricing from a capital and risk perspective. The table below lists, for business written from 2010 to the date of this Prospectus, Partnership's reinsurance partners by treaty along with the percentage of longevity and investment risk assumed by the reinsurers under the treaties.

Reinsurer	Treaty coverage	Longevity risk assumed by reinsurer	Investment risk assumed by reinsurer[(1)]
Hannover Re	Care (since July 2009)	42.5%	—
Hannover Re	Retirement – medically impaired (July 2009 to June 2011)	85.0%	—
Hannover Re	Retirement – medically impaired (July 2011 to March 2012)	70.0%	—
Pacific Life Re	Retirement – medically impaired (April 2012 to December 2013)	70.0%	—
Pacific Life Re	Retirement – medically impaired (December 2013 to May 2014)	70.0%	—
Pacific Life Re	Retirement – medically impaired (since May 2014)	50.0%	—
Pacific Life Re	Retirement – lifestyle (December 2008 to November 2012)	80.0%	—
Pacific Life Re	Retirement – lifestyle (since November 2012)	70.0%	—
Pacific Life Re	Retirement – smoker (since February 2008)	85.0%	85.0%
Gen Re	Protection (since February 2009)	65.0%	65.0%

(1) Investment risk represents the risks relating to the investment of proceeds for the sale of annuities, including, for example, default risk, interest rate risk and foreign currency risk.

Partnership has negotiated an exclusivity arrangement with Pacific Life Re which contractually restricts the ability of Pacific Life Re to reinsure annuities for Partnership's competitors with respect to IUAs for which full life expectancy assessments are performed.

Partnership's ability to negotiate economically attractive reinsurance terms is driven by the following key factors:

- Reinsurers are able to access a pool of IUA risks which have been underwritten by Partnership on the basis of its proprietary underwriting, mortality database and

Proprietary IP. Reinsurers are therefore able to act as capacity providers, with minimal technical and operational investment. The Issuer believes that this is reflected in the pricing terms which reinsurers are prepared to offer to Partnership;

- The longevity exposure provided by Partnership's annuity portfolio naturally hedges a proportion of certain mortality risks present in reinsurers' protection books, as the reinsurer's risk of early death on protection business offsets the annuity provider's risk of longer lifespans on annuity business. This risk diversification effect may reduce the capital requirements of Partnership's reinsurance partners, which the Issuer believes is reflected in the pricing terms which reinsurers are prepared to offer to Partnership; and

- Reinsurers typically have a lower cost of capital than primary insurers. Partnership is able to take advantage of this cost of capital synergy when it negotiates pricing with its reinsurance partners.

Partnership has put in place collateral arrangements, in the form of fixed-income investment assets such as government and corporate bonds, in order to reduce individual counterparty risk.

6.6 Investment management

Partnership's investment portfolio is held in fixed-income securities, commercial mortgages, cash and equity release assets, which are all subject to strict risk tolerance limits. Partnership's objective is to invest in capital efficient assets that provide a high risk-adjusted yield (which is used to determine the rate at which insurance and other financial liabilities are discounted) and are within the Issuer's risk appetite. Partnership's investment strategy is to invest in a mix of assets in order to achieve these objectives and to match the cash flow and duration of its annuity liabilities. As at 31 December 2014, Partnership's total investment portfolio amounted to £4.9 billion and consisted of approximately 73 per cent. approved securities and corporate bonds, approximately 25 per cent. equity release mortgages, approximately 1 per cent. commercial mortgages and approximately 1 per cent. cash.

6.6.1 Fixed-income investments

The fixed-income investment policy is set by the Board and based on advice from the Chief Investment Officer and the Investment Committee. The day-to-day implementation of this policy is outsourced to Insight Investment Management (Global) Limited ("**Insight Investment Management**") under an investment management agreement which specifies strict portfolio allocation and risk limits, including interest rate, credit and concentration limits.

6.6.2 Fixed-income risk limits

Insight Investment Management is required to keep Partnership's fixed-income portfolio within the following limits as a percentage of fixed income and equity release assets:

- Less than:
    - 61 per cent. in bonds rated A or below;
    - 27 per cent. in bonds rated BBB or below;
    - 49 per cent. in financial bonds;
    - 37 per cent. in bank bonds;
    - 2.4 per cent. per issuer;
    - 1.6 per cent. for issuers rated A or lower per issuer; or
    - 1.2 per cent. for issuers rated BBB or lower per issuer.

- Duration limited to +/- 0.5 year of supplied target
- Open foreign exchange positions limited to +/- £1,500,000 per sub-portfolio.

The investment limits can be relaxed on approval from the Board if required to support the Group's investment strategy.

As at 31 December 2014, investments were as allotted as follows:15 per cent. in AAA rated bonds, 7 per cent. in AA rated bonds, 26 per cent. in A rated bonds and 26 per cent. in BBB rated bonds. By sector, 37 per cent. of the total asset portfolio was held in financial bonds of which bank bonds were 24 per cent. of the portfolio, excluding AAA rated covered bonds. Non-financial sector bonds made up 34 per cent. of the fund.

As at 31 December 2014, the value of fixed-income investments was £3.6 billion. The top 10 exposures accounted for 26 per cent. of the fixed-income and equity release assets with the largest single exposure to EIB bonds (11 per cent.).

As at 31 December 2014, the average modified duration of Partnership's fixed-income assets was about 6.6 years.

6.6.3 Fixed-income strategy

Within the above limits, Partnership seeks to align Insight Investment Management's investment decisions with Partnership's objectives through a 'buy-and-maintain-plus' strategy, the implementation of which involves close work with Insight Investment Management. The strategy comprises of three elements.

1. Insight Investment Management are instructed to buy investment grade bonds on the expectation that they are held to maturity and which both have a high risk-adjusted yield and are capital efficient.
2. Insight Investment Management are asked to sell holdings of bonds that are expected to underperform due to an increasing likelihood either of a default or of a credit downgrade and to reinvest the proceeds in better value, alternative bonds. Other than these factors, Insight Investment Management are asked to disregard short and medium term general and issuer-specific credit spread widening.
3. Insight Investment Management are asked to enhance returns by pursuing value-enhancing transactions such as the sale of holdings of bonds that have become over-valued and reinvest the proceeds in bonds that are under-valued. They will also look to position assets to benefit from interest rate, inter-market and sector positions which offer high potential risk-adjusted returns.

The performance of the bond portfolio with respect to Partnership's liabilities is closely monitored by the investment team, executive committees and investment committee. In particular, the impact of market rates on IFRS profits and available Pillar II capital are reviewed bi-weekly with more detailed analysis conducted every month. There is also a weekly update call with Insight Investment Management.

It should be noted that the Board does not consider the value of Partnership's bond portfolio on its own to be a key financial performance indicator. The Board also does not consider unrealised gains and losses on the Group's investment portfolio to provide insight into Group performance, as any negative or positive valuation movement will generally be reversed by equal and offsetting movements over the life of the bond, provided that experienced defaults are less than actuarial assumptions. Nevertheless, an increase in credit spreads over a prolonged period can adversely impact both the Group's profits and the Group's available capital.

The Board believes that this investment strategy allows the Group to focus on its core competency of annuity provision, whilst retaining full control over investment management decisions.

Insight Investment manages £363bn ($565bn) as at 31 December 2014 across fixed income, liability-driven investment, absolute return, cash management, multi-asset, specialist equity and currency

strategies. Insight Investment is owned by BNY Mellon. Insight Investment's assets under management are represented by the value of cash securities and other economic exposure managed for clients. The assets under management figure represents the combined assets under management of Insight Investment Management (Global) Limited and Pareto Investment Management Limited, which became part of the Insight group on 1 January 2013.

6.6.4 Equity release assets

Whilst the core of Partnership's investment portfolio comprises government and corporate bonds, Partnership also invests in equity release, or lifetime, mortgage assets. In this respect, Partnership originates and purchases equity release mortgages with shorter expected duration for homeowners with medical conditions or for older homeowners (in the case of new loans). Partnership also makes loans secured on equity release mortgages with shorter expected durations for older homeowners (in the case of purchases of existing loan portfolios). Partnership offers equity release lifetime mortgages where the loan is secured against a property, interest is accrued and added to the outstanding principal amount and the mortgagor has the right to stay in the property rent-free for the rest of his or her life. Partnership has also lent money to companies secured on residential property assets owned via portfolios of home reversions. As at 31 December 2014, equity release assets represented approximately 25 per cent. of the Group's investment portfolio.

Partnership's equity release activities are designed primarily to diversify its investment portfolio and also enhance its risk-adjusted yields. As such, the Board regards Partnership's equity release activities as an investment decision, rather than a customer-driven activity.

Equity release investment is synergistic with Partnership's annuity business and its investment characteristics are attractive for annuity writers. Specifically:

- Equity release mortgages are long-term and have a fixed interest rate, providing a good duration match for annuity liabilities. For Partnership, the relatively short term nature of its annuity liabilities means that flow investments are made in shorter duration mortgages such as impaired-life mortgages or mortgages for older homeowners.

- Equity release mortgages currently offer higher risk-adjusted yields than the alternative government and corporate bond investments. The risk-adjusted returns contribute to the rate used to discount insurance and other financial liabilities.

- Investment in equity release mortgages provides an element of asset diversification to Partnership's investment portfolio through exposure to property risk rather than credit risk, which reduces the Group's overall capital requirements.

The equity release asset class is particularly useful to support Partnership's longer duration lifestyle annuities, where demand for longer duration corporate or government bonds from insurance companies and pension funds is significant.

Partnership's equity release portfolio as at 31 December 2014 had an average loan-to-value ratio of 43 per cent. and an average duration of 12.6 years. Partnership has been able to enter the equity release market by leveraging the Proprietary IP developed from its core annuity business. Partnership is able to use this Proprietary IP to assess the expected term of the equity release mortgages marketed to individuals with impairment or lifestyle conditions and consequently offer these customers a higher loan-to-value product at a given agreed interest rate than standard providers. For equity release mortgages the lives are subject to the same assessment of life expectancy as annuities assessed using Partnership's PA Lite process. Partnership can generally offer a higher loan-to-value ratio to customers who are older and more impaired than it would be able to offer younger or less impaired customers.

Partnership's equity release mortgages contain a no-negative-equity guarantee, in-line with the requirements of the Equity Release Council. As a result, if the property sale proceeds are insufficient to repay the loan then a no-negative-equity guarantee restricts the amount of repayment to the sales proceeds net of sale expenses.

6.6.4.1 Origination of equity release mortgages

Partnership originates non-standard equity release assets on a ‘flow’ and ‘bulk’ basis.

6.6.4.1.1 Flow origination

Partnership originates its flow business via Partnership-branded equity release mortgages which are distributed through FAs. Partnership provides the equity release mortgage to the customer, with equity release mortgage administration and processing outsourced to Stonehaven. Partnership also originates equity release mortgages under purchasing agreements with a number of providers of equity release mortgages in the UK. Under the terms of these agreements, Partnership is able to acquire, on pre-agreed terms, equity release mortgages which the equity release providers have originated using a pre-set funding line provided by Partnership. The legal title for the equity release mortgage remains with the equity release providers, with Partnership acquiring the beneficial interest in the loan. For equity release assets originated through Partnership-branded equity release mortgages distributed by FAs or under Partnership’s distribution agreements Partnership performs a medical assessment of life expectancy similar to the PA Lite process on a case-by-case basis, as it does for its IUA products.

6.6.4.1.2 Bulk origination

Partnership also acquires existing books of equity release mortgages and makes loans secured on portfolios of home reversions. Previous bulk purchase transactions have included deals with Hodge Bank, Milton Homes, New Life, Dunfermline Building Society (in administration), Grainger plc, Manchester Building Society and Yorkshire Building Society. For equity release assets acquired using bulk origination, Partnership conducts due diligence on the individual properties within the portfolio but does not perform any individual medical assessment of life expectancy.

To the extent that Partnership undertakes a greater size or number of equity release block deals than it has in the past, this could potentially change the balance of the investment portfolio. There is not a fixed target allocation to equity release mortgages and the allocation will depend, among other things, on the relative attractiveness of it as an asset class and flow volumes in the market. In line with its stated equity release strategy, the Group is currently pursuing a number of block deals in the market (including several deals of significant scale) and generally seeks to take advantage of attractive block deals opportunistically. If successfully completed, such deals may increase the overall allocation of the investment portfolio to equity release. However, there can be no assurance that any of these transactions will be completed.

6.6.5 Other asset classes

Partnership’s investment approach in respect of other asset classes is to seek out investments which provide enhanced risk adjusted return, are economic and capital efficient. This can be a result of asset illiquidity, which Partnership can take advantage of due to the illiquid and fixed nature of its liability portfolio.

Partnership has entered into an Investment Management Agreement with Rothschild to invest up to £175 million in commercial mortgages, further diversifying the investment portfolio. Partnership will benefit from Rothschild’s extensive experience of managing this asset class and Rothschild will co-invest alongside Partnership. As at 31 December 2014, Partnership’s investment in commercial mortgages was valued at £38 million and represented 1 per cent. of the Group’s investment portfolio.

Partnership is actively investigating other alternative assets, such as infrastructure debt, that can provide superior risk-adjusted returns for the benefit of shareholders or to match insurance liabilities.

6.7 Risk management

The Board has overall responsibility for the management of Partnership’s business risks. Partnership has a risk management framework in place comprising formal committees, a suite of formal policies, risk assessment processes and risk review functions. The framework is based on the concept of “three lines of defence” with first-line operating functions, second-line control functions and third-line review functions, including internal audit, designed to monitor and control total exposure to different risks within agreed risk tolerance and appetite levels.

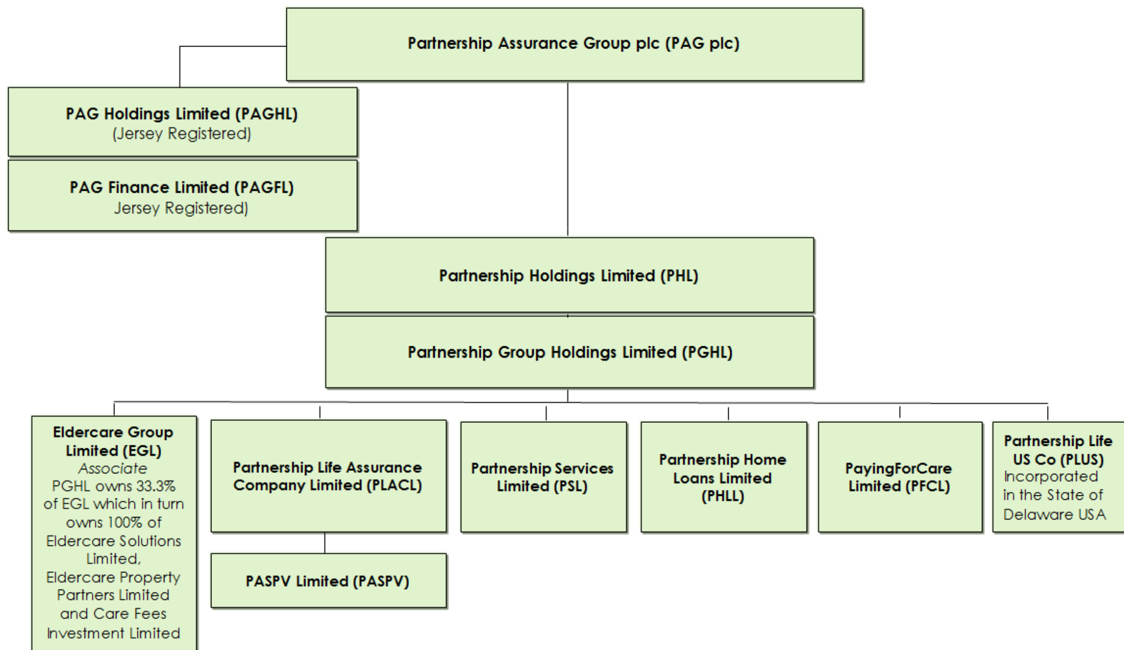
Partnership's risk committee is responsible for providing oversight and advice to the Board in relation to risk management systems, risk appetite, strategy and exposure, reviewing and approving risk assessment, reporting processes and promoting a risk awareness culture within the Group. The risk committee is chaired by an Independent Non-executive Director, Ian Cormack. In addition, Partnership has three executive risk committees tasked with overseeing the management of financial, operational risks and distribution respectively. The executive risk committees are chaired by the Chief Risk Officer and meet quarterly.

Partnership's risk management function works closely with the business to monitor risk issues, identify new and emerging risks and establish appropriate procedures to mitigate those risks. This enables the risk management function to assess the overall risk exposure and maintain a consolidated key risk profile that is reviewed quarterly by management and the executive risk committees and reported to the Board. Supporting risk profiles are maintained at executive sub-committee, operating board and individual department levels and each is subject to review by the risk management function.

Partnership maintains a consistent Group-wide process for the timely identification and assessment of the risks to which it is exposed. The risk assessment process extends to all activities including the evaluation of new and changed business activities and the management of outsourced environments. Risks are identified and assessed against Partnership's business objectives and risk appetite. All risks are assessed with and without the mitigating effect of existing controls. If existing controls do not reduce the risk to an acceptable level then additional management and operational procedures are identified and implemented. Clear criteria exist for the escalation of new or changed risks and the ongoing status of key risks is reported each quarter through the consolidated key risk profile.

7. GROUP STRUCTURE AND OWNERSHIP

The following chart presents the Group's organisational structure:



Each of the companies listed above are registered in England and Wales (unless otherwise stated) and their respective shareholdings are 100 per cent. (unless otherwise stated).

The Issuer is a holding company with no material assets other than the shares of its subsidiaries and therefore relies on the ability of its subsidiaries to generate cash.

8. PROPERTY

Partnership operates from two locations: London, which primarily houses professional staff including the finance, actuarial, investment management, risk management, legal, company secretarial, internal audit,

IT, change management and sales teams; and Redhill, which primarily serves as the service delivery centre and houses the quote processing, third party administrator oversight, HR and underwriting teams.

9. IT AND OPERATIONS

Partnership's information technology and operations strategy is designed to support the growth of the Group by providing scalability to its operations. While Partnership has outsourced a number of its operational and administrative functions where appropriate, such as investment management, customer medical assessments, the administration of annuity payments, premium collections for protection policies and the servicing of equity release mortgages, in those areas where Partnership's Proprietary IP and skilled employees are vital, such as in pricing, underwriting, relationship management, sales, finance and management, Partnership retains control over such operations in-house.

Partnership's Proprietary IP, including information about customer health conditions, mortality tables and calculation algorithms, is protected by means of strict segregation of duty protocols and access technology restrictions, such as passwords, firewalls, e-mail scanning, restricted USB and flash drive access and passkey entry to Partnership's data.

Partnership plans to increase investment in IT to support business growth, particularly in relation to customer service improvement, operational efficiency and meeting current and future regulatory requirements.

Scalability and information security remains high on Partnership's agenda and as such a number of initiatives are planned to make use of technology to further promote scalability and security.

In software development, work will continue on to the operational platform in a controlled manner without presenting negative business impacts.

10. EMPLOYEES

The implementation of cost management proposals announced on 23 June 2014 resulted in our headcount being reduced by 129 roles to 427 as at 31 December 2014, located at the Issuer's London and Redhill offices. The table below sets out the average number of employees of the Group for the years ended 31 December 2014, 2013 and 2012.

Year ended 31 December	Average number of employees
2014	517
2013	539
2012	418

Partnership recognises the importance of its people to the success of the business. Partnership employs highly experienced staff with robust industry knowledge along with a significant number of employees with advanced actuarial, product and medical underwriting qualifications or experience in the UK and the Issuer believes that Partnership's employees provide a key competitive advantage to the Group.

Partnership seeks to recruit and retain the highest possible calibre of staff by using a thorough recruitment process and a remuneration and reward structure designed to maximise retention of key skills and knowledge. In addition to industry benchmarked salaries and performance-related reward schemes, Partnership offers the opportunity for participation by select employees in the equity of the business, which the Issuer believes is the best way to reward ongoing commitment and build long-term success.

REGULATION OF THE ISSUER AND THE GROUP

The Group is subject to detailed and comprehensive legislation and regulation in respect of its operations. Regulatory agencies have broad administrative powers over many aspects of the insurance and equity release businesses, including marketing and selling practices, advertising, product development structures, data and records management, systems and controls, capital adequacy and permitted investments.

The Group is subject to regulation and supervision by the FCA and PRA in relation to the carrying on of its regulated activities in the United Kingdom. All of the Group's regulated entities are subject to capital requirements with a view to ensuring the protection of policyholders.

The following discussion considers the main features of the UK regulatory regimes for insurance business as it applies to the Group.

1. THE POWERS OF THE FCA AND PRA

In the United Kingdom, the Group's business is currently subject to primary regulation by the FCA and PRA, which have broad powers under the FSMA, including, among others, the authority to: grant and, in specific circumstances, to vary or cancel permissions; ensure that regulated firms treat customers fairly; investigate marketing, sales, claims and complaint handling practices; ensure that regulated firms have adequate risk management and control functions and require the maintenance of appropriate financial resources. One of the FCA and PRA's principal regulatory objectives in the context of the regulation of insurance companies is the protection of policyholders and third-party claimants, rather than shareholders or general creditors.

The PRA has powers to impose requirements on an insurance company (such as a requirement not to take on new business) if it is not satisfied that the company has met its capital adequacy requirement or does not meet the Threshold Conditions (as defined below in "*—Permission to carry on insurance business*").

The FCA may make enquiries or conduct inspections of the companies which it regulates regarding compliance with regulations governing the conduct and operation of business. Issues and disputes may arise from time to time in relation to the way an insurance product has been constructed, sold or administered, or in the way in which policyholders or customers have been treated, either at an individual firm level or across the insurance industry. In the United Kingdom, individual policyholder disputes of this nature are typically resolved by the Financial Ombudsman Service or by litigation. The FCA or PRA may intervene directly, however, where larger groups or matters of public policy are involved. There have been several industry-wide issues in recent years where the PRA's predecessor, the FSA, intervened directly, such as the sale of payment protection insurance.

The FCA and PRA have wide powers to supervise and intervene in the affairs of an insurance company, for example, if it considers that it is appropriate in order to protect policyholders or potential policyholders against the risk that the company may be unable to meet its liabilities as they fall due, that the Threshold Conditions may not be met, that the company or its parent has failed to comply with obligations under the relevant legislation, that the company has furnished misleading or inaccurate information or that there has been a substantial departure from any proposal or forecast submitted to the FCA or PRA. The FCA and PRA also have the power to take a range of informal and formal disciplinary or enforcement actions in relation to a breach by a firm of FSMA or the rules in the FCA or PRA's Handbooks, including private censure, public censure, restitution, fines or sanctions and the award of compensation. The PRA may also cancel or vary (including by imposing limitations on) a Part 4A Permission (as defined below in "*—Permission to carry on insurance business*") of an insurance company, including imposing restrictions on the ongoing operation of the insurance company's business or cancelling permission to write new policies, thereby putting the insurer into run-off.

2. PERMISSION TO CARRY ON INSURANCE BUSINESS

Under section 19 of the FSMA, it is unlawful to carry on insurance business in the United Kingdom without permission to do so from the PRA under Part 4A of the FSMA (a "**Part 4A Permission**").

The PRA, in deciding whether to grant a Part 4A Permission, is required to determine whether the applicant satisfies, and will continue to satisfy, the FSMA Threshold Conditions (the "**Threshold**

Conditions"). As part of this decision, the PRA will consider whether the applicant has appropriate resources and if the applicant is 'fit and proper' to be authorised (that is, whether it has established systems and controls to comply with regulatory standards and the PRA and FCA's Principles for Business, which cover matters such as: integrity; skill, due care and diligence; management and control; financial prudence; observance of the proper standards of market conduct; payment of due regard to customers' interests and treating customers fairly; communication with customers; management of conflicts of interest; a proper relationship of trust with customers; adequate protection for customers' assets when responsible for them; and dealing with regulators in an open and cooperative way). A Part 4A Permission will specify: (a) a description of the activities the firm can carry on, including any limitations to the scope of the permission; (b) the specified investments involved; and (c) if appropriate, any requirements imposed in relation to the Part 4A Permission.

Once authorised, an insurance company is required to continue to meet the Threshold Conditions and comply with the PRA's Principles for Business. The PRA may impose limitations and requirements relating to the operation of an insurance company and the carrying on by it of insurance business through its Part 4A Permissions.

3. SCREENING OF CONTROLLERS (INCLUDING SHAREHOLDERS)

Under section 178 of FSMA, if a person intends to acquire or increase its "control" of an insurance company, it must first notify the PRA. The PRA must then decide whether to approve the acquisition or increase of control within 60 working days' of receipt of this notice (assuming it has been provided with a complete application). The PRA will not approve any new controller or any increase of control without being satisfied that the controller is financially sound and suitable to be a controller of, or acquire increased control of, the insurance company. Acquiring control for the purposes of FSMA includes where a person first holds 10 per cent. or more of the shares or voting power in an insurance company or its parent undertaking. A person will be treated as increasing his or her control over an insurance company, and therefore require further approval from the PRA, if the level of his or her shareholding or entitlement to voting power increases from a holding below certain thresholds to a holding above them. The thresholds are 10 per cent., 20 per cent., 30 per cent. or 50 per cent. of shares or voting power.

When determining a person's level of control, that person's holding of shares or entitlement to voting power will be aggregated with the holdings or entitlements of any person with whom he or she is "acting in concert".

4. SCREENING OF CONTROLLED FUNCTION HOLDERS

Certain key functions in the operation of an insurance business ("controlled functions") may only be carried out by persons who are approved for such tasks by the PRA or FCA under the FSMA ("**Approved Persons**").

Under FSMA, the PRA and FCA have powers to regulate two types of individuals: those whose functions have a significant influence on the conduct of an authorised company's affairs and functions and those who deal with customers (or the property of customers).

The 'significant influence' controlled functions include governing functions such as being a director or non-executive director of an insurance company, finance functions, actuarial functions and significant management functions, such as insurance underwriting. The PRA or FCA will not grant Approved Person status to an individual unless it is satisfied that the individual has appropriate qualifications and/or experience and is fit and proper to perform those functions.

Approved Persons must comply with the PRA and FCA's Fit and Proper Test for Approved Persons and the Statements of Principle and Code of Practice for Approved Persons (each as set out in the respective chapters of the PRA or FCA Handbook as defined below in "*—Prudential requirements*" bearing such titles).

The Senior Insurance Managers Regime final rules are due to be published soon with the majority of the proposals coming into effect on 1 January 2016, in line with Solvency II. Fewer SIMs will require pre-approval by the PRA or FCA and prescribed responsibilities will be allocated between them. Additionally, broader conduct standards to which SIMs will have to adhere have been drafted.

5. PRUDENTIAL REQUIREMENTS

Detailed prudential rules applicable to carrying on insurance business are contained in the PRA's Handbook of Rules and Guidance (the "**PRA Handbook**"). The rules are set out in (i) its General Prudential Sourcebook ("**GENPRU**") and (ii) its Prudential Sourcebook for Insurers ("**INSPRU**"). The overall financial adequacy rule in GENPRU 1.2.26R requires an insurance company to maintain overall financial resources, including capital resources and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

5.1 Capital requirements

GENPRU 2.1.13R provides that an insurer must maintain at all times capital resources equal to or in excess of its capital resources requirement (referred to as the "**CRR**"). The CRR for an insurance company carrying on long-term (and not general) insurance business is equal to the minimum capital requirement ("**MCR**") (GENPRU 2.1.17R). The MCR for an insurance company only carrying on long-term insurance business is the higher of:

(i) the base capital resources requirement; and

(ii) the long-term insurance capital requirement plus the resilience capital requirement.

The resilience capital requirement is an additional capital requirement to reflect market risks in respect of assets held to cover insurance and other financial liabilities.

The base capital resources requirement is a euro-denominated amount specified in GENPRU 2.1.30R and the long-term insurance capital requirement is an amount determined by reference to a formula where the relevant inputs include the insurance company's mathematical reserves gross of reinsurance, the level of reinsured mathematical reserves, the death benefit sum at risk and reinsured death benefit sum at risk.

5.2 Individual Capital Assessment

In addition to the CRR, insurance companies carrying on long-term insurance business are required to calculate an Individual Capital Assessment ("**ICA**") under INSPRU 7. Pursuant to the ICA, insurance companies are required to conduct stress and scenario testing to determine the overall adequacy of their financial resources and make a reasonable assessment of the capital needs for their business overall in line with the overall financial adequacy rule in GENPRU 1.2.26R.

The ICA assists the PRA in providing Individual Capital Guidance ("**ICG**") to insurance companies on a confidential basis. The ICG is set with reference to the specific business and control risks faced by each individual company and takes account of the company's ICA and any areas of prudence or optimism within the assessment or elsewhere in the business.

6. REPORTING

Insurance companies are required to deposit 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 fifteen 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 the Interim Prudential Sourcebook for Insurers.

7. INVESTMENT OF CAPITAL AND RESERVES

Under INSPRU 1.1.20R, insurance companies carrying on long-term insurance business must hold admissible assets of a value at least equal to the amount of:

(i) the technical provisions that it is required to establish under INSPRU 1.1.12R, being, in essence, an estimate of the amount needed to cover expected insurance claims, adjusted for volatility and prudence; and

(ii) its other long-term insurance liabilities.

Assets and investments only count towards capital adequacy requirements if they are permitted to be counted in accordance with the rules. Assets are also required to be deducted from capital resources if they do not comply with the requirements in INSPRU 2 as to counterparty and asset exposure limits (although they may still be included in the calculation of a firm's realistic assets). These limits are intended to prevent companies from having too much exposure to either one counterparty (including a group of companies) or one asset type.

8. INSURANCE GROUP CAPITAL

The Directive on the Supplementary Supervision of Insurance Companies in an Insurance Group (1998/78/EC) (the "**Insurance Groups Directive**") as amended by the EU Directive on the Supplementary Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate (2002/87/EC) requires Member States to provide supervision for any insurance undertaking that is part of a group which includes at least one other insurance company, insurance holding company, reinsurance undertaking or non-member-country insurance undertaking. The relevant provisions governing group capital for UK insurers are primarily contained in Chapter 6 of INSPRU.

The Group is an insurance group for the purposes of the Insurance Groups Directive and is therefore subject to the supplementary supervisory requirements for insurance groups contained in that directive as implemented by the PRA as the regulator in the domicile of the Group's head office. The supplementary supervision of insurance groups encompasses such matters as intra-group transactions, group risk management processes and internal control processes and reporting and accounting procedures. In addition, in accordance with the Insurance Groups Directive, the PRA requires the calculation of group capital resources on a consolidated basis. The PRA requires that such group capital resources are equal to or in excess of the Group's capital resources requirement at the level of ultimate group parent within the EEA. The Group must also report on group capital resources at the level of the ultimate parent. It is not, however, required to match group capital resources with the group capital resources requirement at this higher level. These requirements apply at the same time as, and in addition to, the capital requirements which apply to PLACL on a solo basis.

9. CONDUCT OF BUSINESS REQUIREMENTS

The FCA's conduct of business requirements in relation to the distribution and sale of insurance products are contained in its Insurance Conduct of Business Sourcebook ("**ICOBS**") and its Conduct of Business Sourcebook ("**COBS**"). ICOBS applies to non-investment insurance products, including long-term non-investment insurance products such as mortgage protection insurance. COBS generally applies more stringent standards than ICOBS. COBS applies to insurance products with an investment element, such as mortgage endowments, pension policies and insurance bonds. These sourcebooks also implement the Insurance Mediation Directive (Directive 2002/92/EC) ("**IMD**") and extend the IMD to direct sales by insurers themselves. The FCA's conduct of business requirements with respect to the distribution and sale of mortgages are contained in the Mortgages and Home Finance Conduct of Business Sourcebook ("**MCOB**"), which applies to the Group's equity release assets.

Many of the provisions of these sourcebooks only apply to insurers or intermediaries who deal directly with retail customers, or are confined in their application to transactions with retail customers. Further, the rules require the product documentation to be fully compliant for retail sales.

10. COMPENSATION SCHEME

Insurance companies are subject to the Financial Services Compensation Scheme (the "**FSCS**"), which seeks to protect policyholders when a UK authorised firm is unable or is likely to be unable to meet its financial obligations. Most claims made in respect of insurance business will also be protected if the business was carried out from the UK or, in another EEA State, from a branch of an insurer authorised by the PRA. The FSCS is funded by levies on authorised UK firms. Generally, companies subject to the FSCS make provisions for their share of the levies. Such provisions are often based on estimates of a company's market participation in the relevant charging periods and the interest the FSCS will pay on the facilities provided by the UK Treasury in support of its obligations.

In relation to insurance business in particular, there are detailed provisions which govern the amount to be paid on a failure by the firm and policyholders will obtain only a percentage (usually 90 per cent.) of their

guaranteed benefits. The FSCS, on a failure of an insurer, is obligated to attempt to transfer the insurance business to another insurer before paying compensation.

11. ANTI-MONEY LAUNDERING, ANTI-TERRORISM AND SANCTIONS LAWS AND REGULATIONS

In addition to financial and insurance regulation, the Group must comply with anti-money laundering, anti-terrorism and sanctions laws and regulations. The Group is committed to working with international organisations, governments, law enforcement agencies, regulators and its industry peers to identify the threat of money laundering and close off channels in the financial system that money launderers, terrorists and other criminals may use.

Sanctions screening requires the Group to ensure it neither breaches legal and/or regulatory requirements nor suffers reputational damage by providing services to, or dealing directly or indirectly with persons, entities or countries who have been identified by the United Kingdom, United States, United Nations, European Union or other governmental, national and international bodies as subject to any form of restriction including financial sanctions or asset freezing orders.

12. REGULATORY DEVELOPMENTS

The new UK regulatory bodies have been established under the Financial Services Act 2012. The FCA also acquired an additional statutory duty to promote effective competition in the interests of consumers. Additionally, the FCA gained powers to regulate consumer credit activities which captures many firms in the insurance industry, including the Group.

12.1 Retirement reforms and the Pension wise service

In March 2014, the Government announced reforms which were implemented in April 2015, resulting in customers having greater choice and flexibility as to how to access their pension savings. To support this, the FCA has outlined the standards for the delivery partners of the Pension wise service and will also monitor the standards expected of these partners and the insurance industry. The Pension wise service does not replace financial advice. Pension providers are required from April 2015 to signpost consumers to the Pension wise service and outline certain risk warnings to their customers. The updated Conduct of Business handbook has come into effect from 6 April 2015 which applies to all regulated firms, but has a greater impact on pension providers.

12.2 Structure of the UK financial supervisory architecture

The Group's UK insurance subsidiaries are authorised and regulated by the PRA and regulated by the FCA. The two bodies are still embedding the interaction between each other over the regulation of the same legal entities. The Group is structured and resourced to manage both relationships in a co-ordinated approach.

The PRA is a subsidiary of the Bank of England with responsibility for promoting the stable and prudent operation of the financial system through the regulation of all deposit-taking institutions, insurers and investment banks. The PRA's general objective is promoting the safety and soundness of PRA authorised persons. In relation to insurers it also has an insurance objective of contributing to securing an appropriate degree of protection for those who are or may become policyholders.

The FCA is responsible for regulating conduct in retail and wholesale financial markets (including insurance) and the infrastructure that supports those markets. It has a consumer protection objective, an integrity objective and a competition objective.

The Act provides for specific additional powers for the PRA and the FCA, including:

(1) the ability for the FCA to intervene in order to ban financial products from sale or to ban a firm from selling a widely accepted product if it determines such firm's sale processes to be unacceptable; and

(2) the ability for the PRA to direct an unregulated UK holding company to take a particular action, or refrain from taking a particular action, and to censure or fine such company if it does not so comply.

12.3 The new EU solvency regime for insurance companies

The European Commission is continuing to develop a new prudential framework for insurance companies, known as "Solvency II", that will replace the existing life, non-life, reinsurance and insurance groups directives. The main aim of this framework is to ensure the financial stability of the insurance industry across the European Union and protect policyholders through establishing solvency requirements better matched to the true risks of the business. Solvency II adopts a three-pillar approach to prudential regulation which is similar to the "Basel II" approach which has already been adopted in the banking sector in Europe. These pillars are quantitative requirements (Pillar 1); qualitative requirements (Pillar 2); and supervisory and reporting disclosure (Pillar 3).

Although the Solvency II directive has similarities to the current UK regime set out in GENPRU and INSPRU in terms of its risk-based approach to the calculation of capital resources requirements and use of capital tiering, there are also many differences both in terms of substance and terminology.

A key aspect of Solvency II is the focus on a supervisory review at the level of the individual legal entity and the group. Insurers and groups will be allowed to make use of internal economic capital models to calculate capital requirements if the model has been approved by the regulator. In addition, Solvency II includes a requirement that firms develop and embed an effective risk management and internal audit system as a fundamental part of running the firm.

Solvency II is being developed in accordance with the Lamfalussy four-level process. The "Level 1" directive was formally approved by the European Parliament on 22 April 2009 and the final text was adopted by the European Council on 10 November 2009 and sets out a framework which will be supplemented by further and more detailed technical implementing measures at "Level 2". At "Level 3", standards and guidance will be agreed between national supervisors. At "Level 4", the European Commission will monitor compliance by Member States and take enforcement action as necessary. Proposed modifications to the Level 1 directive (set out in a legislative proposal from the European Commission in January 2011 referred to as the Omnibus II directive ("**Omnibus II**")) are likely to mean that, in addition, binding technical standards will be produced at "Level 2.5". The status of level 3 will be enhanced. National supervisors will be required to "comply or explain". From 1 April 2015 Member States are required to commence implementation of the new rules, with the regime becoming binding on insurers and reinsurers within each Member State from 1 January 2016.

Solvency II provides for the supervision of insurance groups and will impose a group-level capital requirement in relation to certain insurance groups, including the Group. Where entities in any insurance group are located in different Member States, the national supervisors of those entities will participate in a college of supervisors to supervise the group, with the PRA becoming the lead regulator for the Group as the regulator in the domicile of the Group's head office.

The Group's Solvency II programme is scheduled to meet implementation requirements and milestones. However, the implementation of this programme, and the ultimate changes required to the Group's capital, involve certain risks.

12.4 The European Insurance and Occupational Pensions Authority

The European Parliament has called for a strengthening of the European supervision framework to reduce the risk and severity of future financial crises. This has led to the creation of the European Insurance and Occupational Pensions Authority ("**EIOPA**"), which is a regulatory and supervisory authority which replaces the Committee of European Insurance and Occupational Pensions Supervisors. EIOPA is part of the European System of Financial Supervisors that comprises three supervisory authorities: one for the banking sector, one for the securities sector and EIOPA for the insurance and occupational pensions sector. Under Omnibus II, EIOPA will have extended powers to develop the detailed aspects of the Solvency II regime, to provide guidelines and recommendations to national supervisors and to resolve differences between national supervisors in the supervision of international insurance groups. The Group will seek to ensure that it is prepared for regulation under the EIOPA, however there are risks associated with the uncertainty in respect of how the EIOPA intends to apply its powers and whether the new authority will result in more intrusive and intensive regulation, adding additional burdens on the Group's resources.

12.5 UK Government Care and Support Bill and caps on care costs

On 14 May 2014, the Care Act (the "**Act**") received Royal Assent. The Act seeks to increase public awareness about the need to make provision for the costs of care. The Act includes provision for a state funded deferred payment arrangement launched in April 2015. These arrangements are only available to individuals with non-housing assets of less than £23,250 and therefore the impact on the market of INAs is likely to be limited. The Act makes provisions for local authorities to establish and maintain a service for providing people with information and advice on how to access independent financial advice on matters relevant to care and support needs. The government has also announced a public awareness campaign to raise public awareness of care funding requirements and sources of advice. Both MPs and Peers have raised concerns that this does not go far enough, and have emphasised the need for local authorities to facilitate access, where appropriate, to regulated financial advice for self-funders. Government ministers acknowledged that this advice will be important for a number of people paying for all or some of their care, and this is therefore set to be addressed in the statutory regulation and guidance that will accompany the Act.

The Act provides for a cap on personal care costs set at £72,000 with effect from April 2016. Only personal care costs, and only at a rate that a local authority would typically pay, will go towards calculation of the cap. Individuals' general living expenses, any care costs above the local authority rate and any costs of additional or more extensive services will not count towards the cap. The cap is only relevant to individuals who meet eligibility criteria based on need which will be set by the UK Government. The needs assessment categorises individual care needs into four categories: substantial, severe, moderate or low. It is likely that funding will only be available for needs categorised as "substantial".

12.6 UK insurance contract law

In 2006, the Law Commissions of England and Wales and the Scottish Law Commission (the "**Law Commissions**") began a programme for the review of English and Scottish insurance contract law. In December 2009 the Law Commissions published a joint report on consumer insurance law and a draft bill introducing changes which affect insurance customer obligations regarding their disclosure of pre-contractual information to insurers and the insurers' remedies where the consumers fail to do so. The main change introduced by the resulting legislation is to replace the duty of disclosure with a duty on consumers to take reasonable care to answer insurers' questions fully and accurately. This act, termed the Consumer Insurance (Disclosure and Representations) Act 2012 came into force on 6 April 2013. It is expected that it will bring the legal regime more in line with the PRA regime that applies to insurers and consumers and with the decisions of the Financial Ombudsman Service.

A consultation began in December 2011 regarding the post-contract regime applying to insurers and consumers with the expectation that this will lead to further legislation on such issues as a proposed duty of the insurers to pay claims promptly (breach of which would entitle the policyholder to damages) and the consequences which flow from fraudulent claims. The consultation closed in March 2012. A further consultation opened in June 2012 regarding the business insured's duty of disclosure and the law of warranties. The consultation closed in September 2012. The proposals and legislation remain under debate and are not fixed. Pressure may also develop from proposals under discussion in the European Union and in the context of a European initiative known as the Principles of European Insurance Contract Law, which, if they are taken forward, may increase protection for consumer and business insurance customers yet further.

USE OF PROCEEDS

The net proceeds of the issue of the Subordinated Notes are being used by the Issuer to fund the general business and commercial activities of the Group and to strengthen further its capital base.

The expenses in connection with the transaction are expected to amount to £374,000.

TAXATION

United Kingdom Taxation

The following is a summary of the United Kingdom withholding taxation treatment as at the date of this Prospectus in relation to payments of principal and interest in respect of the Subordinated Notes. It is based on current United Kingdom law as applied in England and Wales, and the published practice of Her Majesty's Revenue and Customs ("**HMRC**") (which may not be binding on HMRC), which may be subject to change, sometimes with retrospective effect. The comments do not deal with other United Kingdom tax aspects of acquiring, holding or disposing of the Subordinated Notes. The comments relate only to the position of persons who are absolute beneficial owners of the Subordinated Notes, hold such Subordinated Notes as investments and are not connected to the Issuer. The following is a general guide for information purposes and should be treated with appropriate caution. It is not intended as tax advice and it does not purport to describe all of the tax considerations that may be relevant to a prospective purchaser. Prospective Noteholders who are in any doubt as to their tax position should consult their professional advisers. Prospective Noteholders who may be liable to taxation in jurisdictions other than the United Kingdom in respect of their acquisition, holding or disposal of the Subordinated Notes are particularly advised to consult their professional advisers as to whether they are so liable (and if so under the laws of which jurisdictions), since the following comments relate only to certain United Kingdom taxation aspects of payments in respect of the Subordinated Notes and information sharing requirements.

The summary of the United Kingdom withholding tax position below assumes that there will be no substitution of the Issuer as Issuer pursuant to Condition 15 (*Substitution of the Issuer or the Guarantor*) of the Subordinated Notes or otherwise and does not consider the tax consequences of any such substitution(s).

UK Withholding Tax on UK Source Interest

The Subordinated Notes issued by the Issuer, which carry a right to interest, will constitute "quoted Eurobonds" within the meaning of section 987 of the Income Tax Act 2007 provided they are and continue to be listed on a recognised stock exchange within the meaning of section 1005 of the Income Tax Act 2007. Whilst the Subordinated Notes are and continue to be quoted Eurobonds, payments of interest on the Subordinated Notes may be made without withholding or deduction for or on account of United Kingdom income tax.

Securities will be "listed on a recognised stock exchange" for this purpose if they are admitted to trading on an exchange designated as a recognised stock exchange by an order made by the Commissioners for HMRC and either they are included in the United Kingdom official list (within the meaning of Part 6 of the Financial Services and Markets Act 2000) or they are officially listed, in accordance with provisions corresponding to those generally applicable in European Economic Area states, in a country outside the United Kingdom in which there is a recognised stock exchange.

The London Stock Exchange is a recognised stock exchange, and accordingly the Subordinated Notes will constitute quoted Eurobonds provided they are and continue to be included in the United Kingdom official list and admitted to trading on the Main Market of that Exchange.

Absent the availability of the exemption described above, interest on the Subordinated Notes may fall to be paid under deduction of United Kingdom income tax at the basic rate (currently 20 per cent.) subject to such relief as may be available following a direction from HMRC pursuant to the provisions of any applicable double taxation treaty, or to any other exemption which may apply.

Depending on the correct legal analysis of payments in respect of amounts due under the Subordinated Notes (other than repayment of amounts subscribed for the Subordinated Notes) made by the Guarantor as a matter of UK tax law, it is possible that such payments by the Guarantor would be subject to withholding on account of United Kingdom tax at the basic rate (currently 20 per cent.), subject to any claim which could be made under applicable double tax treaties or to any other exemption which may apply. Such payments by the Guarantor may not be eligible for the other exemptions described in respect of payments by the Issuer above. In particular, payments by the Guarantor may be subject to withholding or deduction notwithstanding the fact that the Subordinated Notes are and continue to be quoted Eurobonds.

Provision of Information

HMRC have powers to obtain information, including in relation to interest or payments treated as interest and payments derived from securities. This may include details of the beneficial owners of the Subordinated Notes (or the persons for whom the Subordinated Notes are held), details of the persons to whom payments derived from the Subordinated Notes are or may be paid and information in connection with transactions relating to the Subordinated Notes. Information may be obtained from a range of persons who effect or are party to such transactions on behalf of others, registrars and administrators of such transactions, the registered holders of the Subordinated Notes, persons who make, receive or are entitled to receive payments derived from the Subordinated Notes and persons by or through whom interest and payments treated as interest are paid or credited. Information obtained by HMRC may be provided to tax authorities in other countries.

Information may also be required to be reported in accordance with regulations made pursuant to the EU Savings Directive (see "*EU Savings Directive*" below).

Other Rules Relating to United Kingdom Withholding Tax

Where interest has been paid under deduction of United Kingdom income tax, Noteholders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

The references to "**interest**" in this section "*Taxation*" mean "interest" as understood in United Kingdom tax law. The statements in this section "*Taxation*" do not take any account of any different definitions of "interest" which may prevail under any other law or which may be created by the terms and conditions of the Subordinated Notes or any related documentation. Prospective Noteholders should seek their own professional advice as regards the withholding tax treatment of any payment on the Subordinated Notes which does not constitute "interest" or "principal" as those terms are understood under United Kingdom tax law. Payments of principal on redemption of the Subordinated Notes do not generally constitute "interest" as understood in United Kingdom tax law.

Other Tax Considerations

Stamp Duty and Stamp Duty Reserve Tax ("SDRT")

No UK stamp duty or SDRT is payable on the issue into a clearing system of debt securities that fall within the scope of Article 5(2)(b) of Council Directive 2008/7/EC (e.g., loan notes and corporate bonds), as, following recent litigation, HMRC have confirmed that they will no longer seek to apply the 1.5% stamp duty or SDRT charge on an issue of such securities into a clearance service or depository receipt system.

No UK stamp duty or SDRT is payable on dealings in debt securities within a clearing system where such dealings are effected in electronic book entry form and not by written instrument of transfer, except where the clearing system has elected to apply an alternative system of charge.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income (the "**Savings Directive**"), each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State; however, for a transitional period, Austria may instead apply a withholding system in relation to such payments, deducting tax at a rate of 35 per cent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

A number of non-EU countries and certain dependent or associated territories of certain Member States have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those

dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The Council of the European Union formally adopted a Council Directive amending the Savings Directive on 24 March 2014 (the "**Amending Directive**"). The Amending Directive broadens the scope of the requirements described above. Member States have until 1 January 2016 to adopt the national legislation necessary to comply with the Amending Directive. The changes made under the Amending Directive include extending the scope of the Savings Directive to payments made to, or collected for, certain other entities and legal arrangements. They also broaden the definition of "interest payment" to cover income that is equivalent to interest.

However, the European Commission has proposed the repeal of the Savings Directive from 1 January 2017 in the case of Austria and from 1 January 2016 in the case of all other Member States (subject to on-going requirements to fulfil administrative obligations such as the reporting and exchange of information relating to, and accounting for withholding taxes on, payments made before those dates). This is to prevent overlap between the Savings Directive and a new automatic exchange of information regime to be implemented under Council Directive 2011/16/EU on Administrative Cooperation in the field of Taxation (as amended by Council Directive 2014/107/EU). The proposal also provides that, if it proceeds, Member States will not be required to apply the new requirements of the Amending Directive.

Investors who are in any doubt as to their position should consult their professional advisers..

The proposed financial transactions tax ("FTT")

On 14 February 2013, the European Commission published a proposal (the "**Commission's Proposal**") for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "**participating Member States**").

The Commission's Proposal has very broad scope and could, if introduced, apply to certain dealings in the Subordinated Notes (including secondary market transactions) in certain circumstances.

Under the Commission's Proposal the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Subordinated Notes where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

Joint statements issued by participating Member States indicate an intention to implement the FTT by 1 January 2016.

However, the FTT proposal remains subject to negotiation between the participating Member States and the scope of any such tax is uncertain. Additional EU Member States may decide to participate.

Prospective holders of the Subordinated Notes are advised to seek their own professional advice in relation to the FTT.

PURCHASE AND SALE

Funds managed by Cinven have, pursuant to a Purchase Agreement dated 19 March 2015, purchased the Subordinated Notes at 100 per cent. of their principal amount, less an amount which the Issuer has agreed to pay to Cinven in respect of its fees and expenses.

The yield of the Subordinated Notes is 9.5 per cent. on an annual basis. The yield is calculated as at the date of this Prospectus on the basis of the issue price. It is not an indication of future yield.

So far as the Issuer is aware, no person involved in the offer of the Subordinated Notes has an interest material to the offer.

General

Neither the Issuer nor the Guarantor has made any representation that any action will be taken in any jurisdiction by the Issuer or the Guarantor that would permit a public offering of the Subordinated Notes, or possession or distribution of this Prospectus (in preliminary, proof or final form) or any other offering or publicity material relating to the Subordinated Notes, in any country or jurisdiction where action for that purpose is required.

United States

The Subordinated Notes have not been and will not be registered under the Securities Act and are subject to U.S. tax law requirements. Subject to certain exceptions, the Subordinated Notes may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons.

GENERAL INFORMATION

1. The listing of the Subordinated Notes on the Official List will be expressed as a percentage of their nominal amount (exclusive of accrued interest). It is expected that listing of the Subordinated Notes on the Official List and admission of the Subordinated Notes to trading on the Market will be granted on or around 19 May 2015. Prior to official listing and admission to trading, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. Transactions will normally be effected for delivery on the third working day after the day of the transaction. The total expenses relating to the admission to trading are estimated to be £2,975.

2. Each of the Issuer and the Guarantor has obtained all necessary consents, approvals and authorisations in the United Kingdom in connection with the issue and performance of the Subordinated Notes and the giving of the Guarantee. The issue of the Subordinated Notes was authorised by a written resolution of a sub-committee of the Board of Directors of the Issuer passed on 2 March 2015. The giving of the Guarantee by the Guarantor was authorised by a written resolution of a sub-committee the Board of Directors of the Guarantor passed on 2 March 2015.

3. There has been no material adverse change in the financial or trading position of the Issuer or the Group since 31 December 2014.

4. There has been no material adverse change in the financial or trading position of the Guarantor since 31 December 2014.

5. There has been no significant change in the financial or trading position of the Issuer or the Group since 31 December 2014.

6. There has been no significant change in the financial or trading position of the Guarantor since 31 December 2014.

7. The Issuer's audited consolidated financial statements for the year ended 31 December 2013 have been prepared as if the transaction which occurred on 12 June 2013, by which Partnership Assurance Group plc became the top holding company in the Group, had taken place at the beginning of the comparative period. Under the relevant accounting principles, the consolidated financial statements for the year ended 31 December 2013 have been prepared as if Partnership Assurance Group plc were the holding company of PAG Holdings Limited from 1 January 2012.

8. There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer or Guarantor are aware) with respect to any member of the Group during the 12 months preceding the date of this Prospectus which may have or has had in the recent past significant effects on the financial position or profitability of the Issuer, the Guarantor and/or the Group.

9. The Subordinated Notes have been accepted for clearance through the Euroclear and Clearstream, Luxembourg systems (which are the entities in charge of keeping the records) with a Common Code of 120768891. The International Securities Identification Number (ISIN) for the Subordinated Notes is XS1207688919.

   The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy L-1855 Luxembourg.

10. There are no material contracts (not being contracts entered into in the ordinary course of the Issuer's or Guarantor's business, which could result in any member of the Group being under an obligation or entitlement that is material to the Issuer's or Guarantor's ability to meet its obligations to Noteholders in respect of the Subordinated Notes being issued).

11. Where information in this Prospectus has been sourced from third parties, this information has been accurately reproduced and, as far as the Issuer is aware and is able to ascertain from the information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third-party information is identified where used.

12. For the period of 12 months starting on the date on which this Prospectus is made available to the public, copies of the following documents will be available, during usual business hours on any weekday (Saturdays and public holidays excepted), for inspection at the office of the Issuer, Partnership Assurance Group plc, 5th Floor, 110 Bishopsgate, London EC2N 4AY:

    (a) the Trust Deed (which includes the guarantee, the form of the Global Note Certificate and the Certificates);

    (b) the Agency Agreement;

    (c) the articles of association of each of the Issuer and the Guarantor;

    (d) the published annual report and audited consolidated annual accounts of the Issuer for the years ended 31 December 2013 and 31 December 2014;

    (e) the published annual report and audited consolidated annual accounts of the Guarantor for the years ended 31 December 2013 and 31 December 2014; and

    (f) a copy of this Prospectus together with any Supplement to this Prospectus or further Prospectus.

    This Prospectus will be published 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

13. Deloitte LLP, chartered accountants of 2 New Street Square, London EC4A 3BZ, United Kingdom audited without qualification the consolidated financial statements contained in the Annual Report and Accounts of the Issuer for the financial years ended 31 December 2014 and 2013.

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AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF PARTNERSHIP ASSURANCE GROUP PLC FOR THE YEAR ENDED 31 DECEMBER 2014

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF PARTNERSHIP ASSURANCE GROUP PLC

OPINION ON FINANCIAL STATEMENTS OF PARTNERSHIP ASSURANCE GROUP PLC

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2014 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise the consolidated statement of comprehensive income, the consolidated and Parent Company statements of financial position, the consolidated and Parent Company cash flow statements, the consolidated statement of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

GOING CONCERN

As required by the Listing Rules we have reviewed the Directors' statement that the Group is a going concern. We confirm that:

- we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and
- we have not identified any material uncertainties that may cast significant doubt on the Group's ability to continue as a going concern.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team:

<table>
<tr><th>RISK</th><th>HOW THE SCOPE OF OUR AUDIT RESPONDED TO THE RISK</th></tr>
<tr><td colspan="2">Insurance liabilities (£5,231m)</td></tr>
<tr><td>The Group predominantly writes enhanced annuities which it prices using its bespoke mortality data and internally generated intellectual property. The Group reserves for the future expected cost of these policies using complex actuarial models to project the insurance liabilities. These models are dependent on key assumptions made by management in respect of the following:
• projected cash flows – the expected payments on the portfolio based on assumptions as to the mortality of the policyholders based on their medical condition or lifestyle characteristics; and
• the valuation rate of interest based on the yield of the portfolio of assets that back the liabilities that is used to discount the expected cash flows, which also needs to reflect a deduction for the credit risk of the underlying assets.
Further detail on these principal assumptions can be found in note 20 to the financial statements.
The significance and inherent subjectivity of these assumptions means that we view this as an area of significant risk.</td><td>We used our actuarial specialist auditors to test the controls over the end-to-end reserving process, focussing on the controls over changes to the reserving model and changes to the underlying demographic and economic assumptions.
We performed detailed substantive testing on the data inputs to the model including checks on policy data via agreeing a sample back to original policyholder documentation and checks that all assumptions had been input to the model accurately. In addition, we test the Group's controls over the completeness of the data.
Management have updated their mortality basis for the largest policy group. We tested these assumptions, in addition to testing manual provisions, the closure reserve, reinsurance reserves, allowance for counterparty default risk, allowance for cash flow and currency mis-matching risk and statutory capital requirements. We used our actuarial specialist auditors to challenge management's assumptions by considering the Group's own experience, comparison to industry benchmarks and by testing compliance with regulations.
An assessment on the overall results was made by reviewing the analysis of change in reserves over the period under audit.</td></tr>
<tr><td colspan="2">Equity release assets (£1,212m)</td></tr>
<tr><td>The Group's investments include loans secured by residential mortgages (equity release assets). In Q4 2014 the Group completed one bulk purchase deal with a face value of £61m, bringing the total value of the equity release book to £1.2bn.
The fair value of the investment is dependent on the valuation of the underlying properties and the assumptions used in the fair value calculation, such as the property growth rate, property volatility, a revaluation index to revalue properties to the valuation date, swap rates, and mortality assumptions. Note 25b to the financial statements provides further detail as to the methodology used to calculate the fair value of these assets.
The subjectivity of the key assumptions, coupled with the significance of the bulk transaction, means that we view this as an area of significant risk.</td><td>We tested the new bulk transaction through reviewing the due diligence work performed by the Group, and then tested the whole portfolio by challenging the valuation basis put forward by management based on independent macroeconomic advice received. We also tested the underlying data used in the valuation of the equity release assets via agreement of a sample of loans back to original policy documentation.
We assessed the underlying portfolio of assets for indicators of impairment by segmenting the portfolio geographically and using applicable regional property valuation indices to check for signs of significant diminution in the value of underlying property.
Our actuarial specialist auditors assessed management's methodology and assumptions used to value the equity release assets via comparison to industry benchmarks, consultation with real estate specialists and consideration of whether the valuation was sensitive to the mortality assumption.</td></tr>
<tr><td colspan="2">Valuation of Goodwill and intangible assets (£129m)</td></tr>
<tr><td>The Group holds a significant amount of goodwill</td><td>Management's methodology for its impairment</td></tr>
</table>

RISK	**HOW THE SCOPE OF OUR AUDIT RESPONDED TO THE RISK**
on its statement of financial position, in addition to intangible assets representing intellectual property. Further detail can be found in notes 10 and 11 to the financial statements. Goodwill and intangible assets have been identified as a significant risk area due to the uncertainties following the Chancellor's Budget announcement in March 2014 surrounding rules on the use of pensions. A key parameter within the goodwill and intangible assets valuation is current and projected new business sales, which have become more uncertain given the regulatory changes. There is also judgement over the allocation of assets and liabilities to the in-force and new business cash-generating units (see note 10 to the financial statements for further detail). This in turn affects the carrying value within the impairment assessment.	assessment has been reviewed, comparing it to the requirements of IAS 36 and checking for consistency with the prior year approach. Our procedures then included: • obtaining management's business plan and considering the methodology behind its production, as well as challenging the assumptions on which it is based. This included challenging management's market projections and scrutinising the underlying analysis for evidence of bias; • challenging whether all relevant assets and liabilities had been allocated to the new business cash-generating unit; and • engaging our valuation specialists to recalculate the discount rate used and verify the inputs to the impairment calculation, which is based on the capital asset pricing model, in conjunction with challenging the sophistication of management's assessment by checking that key parameters are supported by the most up-todate information.
Defined benefit transactions (£247m)	
Individually underwritten bulk annuities are becoming an increasingly important source of revenue for the Group, representing 32% of the Group's gross written premium for 2014, including a single premium of £206m. The significance of the individual transactions means that we see this as an area of significant risk.	We have substantively tested 100% of the contracts written by tracing the premiums to signed quotations and agreeing the consideration received to bank accounts or custodian confirmations as appropriate.

Last year the risk relating to Defined Benefit transactions concerned the model used to calculate the reserves for Defined Benefit business, which does not form part of the risk this year because the model has become embedded into the established reporting process.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

OUR APPLICATION OF MATERIALITY

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Group to be £4.5m (2013: £4.2m), which is below 1% of net written premiums. We consider a turnover based measure to be the most suitable benchmark at this stage in Partnership Assurance Group plc's development as it drives one of the Group's key performance indicators and is a figure on which the users of the financial statements focus.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £86,000 (2013: £84,000), as well as differences below that threshold that, in our view,

warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

AN OVERVIEW OF THE SCOPE OF OUR AUDIT

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Our Group audit has covered entities representing 100% of the Group's net assets, 100% of the Group's revenue and 100% of the Group's profit before tax (2013: 100% of net assets, revenue and profit before tax). The result of the Group is predominantly driven by a single trading company, Partnership Life Assurance Company Limited. All of the Group entities audited are based in the same location and were audited by the Group audit team and the Group engagement partner.

Our audit work was executed at levels of materiality applicable to each individual entity which were lower than Group materiality. Component materialities ranged from £0.03m to £4.28m (2013: £0.06m to £3.99m).

At the Parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- 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.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

Corporate Governance Statement

Under the Listing Rules we are also required to review the part of the Corporate Governance Statement relating to the Company's compliance with 10 provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

As explained more fully in the Directors' Responsibilities Statement, 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. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

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.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Paul Stephenson
BA ACA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
2 March 2015

AUDITED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2014

	Note	**2014**	2013
		£000's	*£000's*
Gross premiums written	1	**760,638**	1,159,562
Outward reinsurance premiums		**(307,959)**	(733,849)
Net premiums earned		**452,679**	425,713
Net investment income	3	**299,232**	137,762
Share of results of joint ventures and associates accounted for using the equity method	14	**(179)**	(162)
Profit on loss of control of subsidiary	13	**158**	—
Other income		**207**	219
Total income		**752,097**	563,532
Gross claims paid		**(390,570)**	(341,124)
Reinsurers' share of claims paid		**255,957**	225,277
Change in insurance liabilities:			
Gross amount		**(883,524)**	(624,290)
Reinsurers' share		**405,259**	428,197
Acquisition costs	4	**(4,997)**	(13,036)
Investment expenses and charges		**(14,352)**	(13,270)
Interest on external borrowings		—	(25,403)
Other operating expenses	5	**(95,803)**	(117,223)
Total claims and expenses		**(728,030)**	(480,871)
Profit from continuing operations before tax	5	**24,067**	82,661
Income tax charge from continuing operations	7	**(5,213)**	(23,240)
Profit for the year from continuing operations		**18,854**	59,421
Profit/(loss) attributable to:			
- Owners of the Parent		**18,852**	59,465
- Non-controlling interest		**2**	(44)
Profit for the period		**18,854**	59,421
Basic earnings per ordinary share	8	**£0.05**	£0.17
Diluted earnings per ordinary share	8	**£0.05**	£0.17

The notes are an integral part of these financial statements.

AUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2014

		Attributable to Owners of the Parent								
	Note	**Share Capital *£000's***	**Share Premium *£000's***	**Capital Redemption Reserve *£000's***	**Merger Reserve *£000's***	**Shares held by Employee Benefit Trust *£000's***	**Retained profit *£000's***	**Total *£000's***	**Non-controlling interest *£000's***	**Total *£000's***
At 1 January 2013		36	182	3,297	-	(33)	78,901	82,383	(22)	82,361
PAGH shares exchanged for ordinary shares		28,250	(182)	(3,297)	(24,521)	(250)	-	-	-	-
Loan notes exchanged for ordinary shares		8,462	317,288	-	-	-	-	325,750	-	325,750
Share issued/ bought for cash		3,252	121,993	-	-	(46)	526	125,725	-	125,725
Share issue costs		-	(4,032)	-	-	-	-	(4,032)	-	(4,032)
Share-based payments	19	-	-	-	-	271	9,053	9,324	-	9,324
Profit for the year		-	-	-	-	-	59,465	59,465	(44)	59,421
At 31 December 2013		40,000	435,249	-	(24,521)	(58)	147,945	598,615	(66)	598,549
At 1 January 2014		**40,000**	**435,249**	**-**	**(24,521)**	**(58)**	**147,945**	**598,615**	**(66)**	**598,549**
Share-based payments	19	**-**	**-**	**-**	**-**	**(78)**	**1,301**	**1,223**	**-**	**1,223**
Disposal of subsidiary		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**64**	**64**
Dividends paid		**-**	**-**	**-**	**-**	**-**	**(14,000)**	**(14,000)**	**-**	**(14,000)**
Profit for the year		**-**	**-**	**-**	**-**	**-**	**18,852**	**18,852**	**2**	**18,852**
At 31 December 2014		**40,000**	**435,249**	**-**	**(24,521)**	**(136)**	**154,098**	**604,690**	**-**	**604,690**

The notes are an integral part of these financial statements.

AUDITED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

<u>As at 31 December 2014</u>

	Note	**2014**	Restated 2013
		£000's	*£000's*
Assets			
Property, plant and equipment	9	12,557	15,459
Goodwill	10	126,207	126,207
Other intangible assets	11	15,219	16,401
Financial assets	12	4,910,904	4,010,269
Investment in joint ventures and associates	14	233	206
Reinsurance assets	20	3,246,008	2,840,749
Insurance and other receivables	15	39,167	79,633
Prepayments and accrued income	16	3,615	10,991
Deferred tax asset	17	519	424
Cash and cash equivalents	18	87,251	112,741
Total assets		**8,441,680**	7,213,080
Equity			
Share capital	31	40,000	40,000
Share premium	31	435,249	435,249
Merger reserve		(24,521)	(24,521)
Shares held by Employee Benefit Trust	31	(136)	(58)
Retained profit		154,098	147,945
Total equity attributable to owners of the Parent		**604,690**	598,615
Non-controlling interest		-	(66)
Total equity		**604,690**	598,549
Liabilities			
Insurance liabilities	20	5,231,112	4,347,588
Insurance and other payables	21	29,527	34,004
Financial liabilities	22	2,571,288	2,214,741
Current tax liabilities	23	3,735	18,198
Deferred tax liability	17	1,328	-
Total liabilities		**7,836,990**	6,614,531
Total equity and liabilities		**8,441,680**	7,213,080

The notes are an integral part of these financial statements.

AUDITED CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2014

	Note	**2014** *£000's*	2013 *£000's*
Cash generated from/(used in) operations	26	**11,664**	(56,851)
Corporation tax paid		**(19,705)**	(17,000)
Net cash used in operating activities		**(8,041)**	(73,851)
Cash flows from investing activities:			
Purchase of property, plant and equipment	9	**(1,308)**	(13,657)
Purchase of other intangible assets	11	**(2,093)**	(7,696)
Investment in associate		**(48)**	—
Disposal of subsidiary		—	—
Net cash used in investing activities		**(3,449)**	(21,353)
Cash flows from financing activities:			
Proceeds from issuance of share capital	31	—	121,693
Repayment of loan notes		—	(7,656)
Repayment of bank loan		—	(70,000)
Dividends paid to shareholders		**(14,000)**	—
Interest payable on external borrowings		—	(2,365)
Net cash (used in)/from financing activities		**(14,000)**	41,672
Net (decrease)/increase in cash and cash equivalents		**(25,490)**	(53,532)
Cash and cash equivalents brought forward		**112,741**	166,273
Cash and cash equivalents carried forward	18	**87,251**	112,741

Cash flows related to the sale and purchase of financial investments are included in operating cash flows as they are associated with the origination of insurance contracts and payment of insurance claims.

The notes are an integral part of these financial statements.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2014

1 SEGMENTAL ANALYSIS

The operating segments reflect the level within the Group at which key strategic and resource allocation decisions are made and the way in which operating performance is reported internally to the chief operating decision makers in the Group, being the Group Board.

Information is provided to the Board which identifies operating profit segmented between: that achieved on new business written in the period; that which derives from in-force policies; and that relating to the long-term expected return on surplus assets. This split forms the reportable operating segments in accordance with IFRS 8 *"Operating Segments"*.

New business revenue is reported as Single Premium Equivalent (SPE), being the actual single premium plus 10 times the annual regular premium for new contracts written during the year. These revenue measures are monitored by the Board separately for each core target market.

a) Segmental analysis of profit

The table below shows operating profit for each year, together with a reconciliation to profit before tax:

For the year ended 31 December	**2014** ***£000's***	2013 *£000's*
New business operating profit	**38,962**	85,678
In-force operating profit	**8,477**	34,278
Long-term expected return on surplus assets	**16,328**	11,435
Operating profit	**63,767**	131,391
Investment variances	**(23,491)**	8,643
Non-recurring expenditure	**(16,348)**	(30,769)
Other	**139**	(1,201)
Interest on borrowings	—	(25,403)
Profit from continuing operations before tax	**24,067**	82,661

Investment variances reflect:

a) the difference between actual performance on investment assets (e.g. cash, gilts, corporate bonds, loans secured by residential mortgages and loans secured by commercial mortgages) over the reporting period and the investment yield allowed for in the calculation of in-force liabilities at the start of the reporting period;

b) the difference between the yield on investment assets allowed for in the calculation of new business profits and the actual investment performance including differences arising from investing at different yields and asset allocations than those expected when pricing new business;

c) the difference between actual performance on investment assets and long-term assumed return on surplus assets; and

d) the impact of changes in the best-estimate credit default allowance made against the Group's invested assets.

Non-recurring expenditure primarily relates to:

- £2.0m of Solvency II related costs (2013: £4.1m);
- £2.3m of costs incurred in developing scalable and flexible DB architecture (2013: £nil);
- £3.5m of implementation costs in respect of cost management actions, new initiatives, product development and other items (2013: £1.1m).

In addition, non-recurring non cash items were recognised, comprising £6.0m impairment of sales infrastructure in and a further £2.5m of IT development costs, which are being amortised over a 5 year period (2013: £nil).

2013 non-recurring expenditure also included £15.8m expenses in respect of the Group's restructure and IPO and £9.8m in respect of the Group's staff share option which vested as a result of the IPO.

Other gains/(losses) relate to the Group's interest in distribution subsidiaries and holding company expenses.

The profit measure used by the Board to monitor performance is operating profit before tax, analysed between new business operating profit, in-force operating profit and the long-term expected return on surplus assets.

- New business operating profit is profit generated from new business completed in the period, calculated using actuarial assumptions applicable at the time the new business was written, and utilising a discount rate based upon investment yields on investment assets (e.g. cash, gilts, corporate bonds, loans secured by residential mortgages and loans secured by commercial mortgages) used to generate the annuity quotation, net of expenses allocated against new business.

- In-force operating profit is generated from the actual experience measured against the assumed experience in the actuarial basis. The actuarial basis includes a number of assumptions, the most material of which are mortality levels, levels of default on investments, expense levels (to maintain the business in-force), levels of inflation, and lapse rates (for regular premium business). In-force operating profit also includes the effect recognised in the IFRS profit arising from changes to the reported value of insurance (and associated financial) liabilities resulting from changes to the actuarial assumptions, valuation methods, or underlying data, made subsequent to the point of sale.

- Return on surplus assets is the long-term, risk-adjusted, expected return on investments that are surplus to those investments that are used to back insurance liabilities. The long-term expected return is derived from applying an average expected yield appropriate to the category of surplus assets held, and is adjusted for the best-estimate expected level of defaults on those investments. The risk-adjusted annual yields applied to surplus assets during the period were:

For the year ended 31 December	**2014** *% p.a.*	2013 *% p.a.*
Cash	**0.5**	0.5
Gilts	**3.0**	3.0
Corporate bonds	**4.5**	4.5
Commodity trade finance	**10.0**	10.0
Loans secured by residential mortgages	**6.0**	n/a

b) Segmental analysis of new business revenue by target market

For the year ended 31 December	**2014** *£000's*	2013 *£000's*
Individual retirement annuities	**465,840**	1,076,693
Defined benefit buy-in/buy-out annuities	**246,573**	82,923
Individual care annuities	**75,741**	65,854
Individual protection policies	**3,083**	3,389
Total SPE	**791,237**	1,228,859

c) Reconciliation of new business revenue by target market to gross premiums written

Premiums are recognised in the accounting period in which an insurance contract commences, gross of any commission paid. Premiums which have been received and for which no contract is yet in-force are classified as payables arising from insurance contracts and are included within insurance and other payables in the consolidated statement of financial position. Where a contract has been issued but premiums have not yet been received, a debtor arising out of direct insurance operations is recognised for the expected premiums due. Reinsurance premiums and recoveries are accounted for in the accounting period in accordance with the contractual terms of the reinsurance treaties. Premiums exclude any taxes or duties based on premiums.

New business revenue by target market reconciles to gross premiums written as follows:

For the year ended 31 December	**2014** *£000's*	2013 *£000's*
Total single premium equivalent	**791,237**	1,228,859
Adjustment in respect of regular premium business	**135**	(5)
Change in premiums receivable – not included in SPE	**(30,734)**	(69,335)
Reinsurance premiums received	**—**	43
Gross premiums written	**760,638**	1,159,562

Premiums are written at the point an insurance contract comes into force. For management purposes SPE is recorded when all funds have been received from the policyholder. Amounts due from policyholders for premiums not yet received is shown in note 15.

d) Product revenue information

The following table illustrates revenue by product as required by IFRS 8 *"Operating Segments"*. All revenues from external customers are predominantly derived from business originated in the UK, and as such no geographical information is disclosed.

The Board considers the Group's external customers to be the individual policyholders. As such, the Group is not reliant on any individual customer.

An analysis of gross premiums written by product is set out below:

For the year ended 31 December	**2014** *£000's*	2013 *£000's*
Individual retirement annuities	**435,106**	1,007,359
Defined benefit buy-in/buy-out annuities	**246,573**	82,923
Individual care annuities	**75,864**	65,979
Individual protection policies	**3,095**	3,258
Other	**—**	43
Total gross premiums written	**760,638**	1,159,562

2 BASIS OF PREPARATION AND NEW AND REVISED STANDARDS CONTINUED

Basis of preparation

Partnership Assurance Group (PAG) plc (the Company) was incorporated in the United Kingdom and registered in England and Wales on 26 February 2013 as a public company limited by shares. The Company's registered office address is 5th Floor, 110 Bishopsgate, London, EC2N 4AY.

The principal activity of the Company is that of a holding company. The Company and the entities controlled by the Company (its subsidiaries) are collectively "the Group".

Note 29 to the financial statements sets out the Group's policies and procedures for managing insurance and financial risk, and note 30 sets out how the Group manages its capital resources.

These financial statements comprise the consolidated annual financial statements of the Group and the individual annual financial statements of the Company made up to 31 December 2014.

The results of subsidiaries acquired or disposed of during the period are included from or up to the effective date of acquisition or disposal. Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. The Group has control over an entity if all of the following conditions are met: (a) the Group has power over an entity; (b) the Group is exposed to, or has rights, to variable returns from its involvement with the entity; (c) the Group has the ability to use its power over the entity to affect its own returns.

The presentation currency of the Group is sterling. Unless otherwise stated, the amounts shown in the consolidated financial statements are in thousands of pounds sterling (£'000).

The consolidated financial statements and those of the Company have been prepared and approved by the Directors in accordance with IFRS as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU), and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The Group has applied all IFRS standards and interpretations adopted by the EU effective for the year ended 31 December 2014.

The Directors have undertaken a going concern assessment in accordance with *"Going Concern and Liquidity Risk: Guidance for UK directors of UK Companies 2009"*, published by the Financial Reporting Council in October 2009 as described in the Directors' Report.

Significant accounting policies applied to the preparation of these financial statements are presented in the designated boxes within the notes to the financial statements, aligning disclosure of accounting policies to the item which is most directly relevant to the policy.

Adoption of new and revised standards

The Group has adopted the following new standards and changes to existing standards which are relevant to the Group's operations, and became effective for financial years beginning on or after 1 January 2014:

- **IFRS 10 Consolidated financial statements** – This standard sets out the requirements for the preparation and presentation of consolidated financial statements, requiring entities controlled by the Parent Company to be consolidated as subsidiaries. The standard changes the definition of "control" from that previously established in IFRS. As a result of the adoption of this standard the Group has changed its accounting policy for determining when the Group has control over an entity to the following: The Group has control over an entity if all of the following conditions are met: (a) the Group has power over an entity; (b) the Group is exposed to, or has rights, to variable returns from its involvement with the entity; (c) the Group has the ability to use its power over the entity to affect its own returns. Associated amendments to IAS 27 *Separate financial statements* have also been adopted. The application of IFRS 10, and associated amendments, has not resulted in any change in the entities which are determined to be subsidiaries of the Group. There is no impact on the financial statements in the current or comparative periods.

- **IFRS 11 Joint Arrangements** – This standard defines joint arrangements and related accounting principles. The standard established two types of joint arrangement – joint ventures and joint arrangements – based on how rights and obligations are shared by investors in the arrangements. Associated amendments to IAS 28 Investments in associates and joint ventures have also been adopted. The application of IFRS 11 has no impact on the financial statements in the current or comparative periods.

- **IFRS 12 Disclosures of interests in other entities** – IFRS 12 requires additional disclosures for investments in subsidiaries, joint arrangements, associates and structured entities. The new disclosures required by this standard are presented in note 13 and note 14.

- **IAS 32 Financial Instruments** – Presentation – An amendment to IAS 32 clarifies the requirements for offsetting financial assets and liabilities. The application of the amendment has no impact on the financial statements in the current or comparative periods.

- **IAS 36 Impairment of assets** – An amendment to IAS 36 which reduces the circumstances in which the recoverable amount of nonfinancial assets is required to be disclosed. The application of the amendment has no impact on the financial statements in the current or comparative periods.

- **IAS 39 Financial Instruments: Recognition and measurement** – An amendment to IAS 39 which clarifies the circumstances in which hedge accounting can be continued when derivatives are novated to a central counterparty. The application of the amendment has no impact on the financial statements in the current or comparative periods.

Other changes in accounting policy are:

- **Segmental analysis** – To reflect changes in the information provided to the Board, revenue attributable to Defined Benefit buy-in/buy out annuities is now presented separately from revenue attributable to Individual retirement annuities in the segmental analysis of revenue. Previously these

categories were presented together in a Retirement Annuity segment. Comparative information has been re-analysed accordingly.

Restatement of 2013 balance sheet

- **Presentation of accrued income arising from financial investments** – During the year the Group reviewed the presentation of accrued income arising from financial investments classified as fair value through profit and loss in the consolidated statement of financial position. It was concluded that presenting all components of the fair value of financial investments on the same line provides more clarity as to the Group's exposure to these investments and therefore provides more relevant and no less reliable information. As a result of this change in policy an amount of £65.8m (2013: £59.1m) was reclassified from Prepayments and accrued income to Financial Assets. This change in policy has no effect on profit for the current or prior period or earnings per share.
- **Payables and receivables arising from reinsurance contracts** – During the year the Group reviewed the presentation of balances due to and from the Group under reinsurance contracts. It was concluded that presenting financial liabilities due to reinsurers where assets are legally and physically deposited back to the Group separately from other payables and receivables under reinsurance contracts better reflects the Group's management of reinsurance balances and therefore provides more relevant and no less reliable information. As a result of this change in policy an amount of £21.5m (2013: £15.2m) was reclassified from financial liabilities to Insurance and other receivables. An amount of £3.2m (2013: £1.9m) was reclassified from financial liabilities to Insurance and other payables. This change in policy has no effect on profit for the current or prior period or earning per share.

The following new or revised or amended standards, in issue, were not yet effective, or in some cases not yet endorsed by the EU. The Group has not early adopted any of these standards.

Standard/ Interpretation	**Content/amendment**	**Applicable for annual financial periods beginning on or after**
IFRS 9	**Financial Instruments**	1 January 2018
	IFRS 9 will replace IAS 39: "*Financial Instruments – Recognition and Measurement*". The impact of the adoption of IFRS 9 on the Group will depend on the finalisation of the standard and the interaction of the requirements of IFRS 9 with the IASB's on-going insurance contracts accounting project. The standard has not yet been endorsed by the EU.	
IFRS 10, IFRS 11, and IAS 28	**Consolidated Financial Statements, Joint Arrangements, Investments in Associates and Joint Ventures**	1 January 2016
	Amendments regarding the sale of contribution of assets between an investor and its associate or joint venture and application of the consolidation exception. The amendments have not yet been endorsed by the EU.	
IFRS 14	**Regulatory Deferral Accounts**	1 January 2016
	The standard permits an entity which is a first-time adopter of IFRS to continue to account for "regulatory deferral account balances" in accordance with its previous GAAP. As the Group is not a first-time adopter of IFRS, the standard will have no impact on the Group. The standard has not yet been endorsed by the EU.	

Standard/ Interpretation	Content/amendment	Applicable for annual financial periods beginning on or after
IFRS 15	**Revenue from Contracts with Customers** IFRS 15 specifies how and when to recognise revenue, and requires additional disclosures. The standard provides a single, principles-based five-step model to be applied to contracts with customers. Insurance contracts and financial instruments are excluded from the scope of the standard. Therefore the amendments are not expected to have a material impact on the Group's profit before tax for the year or equity. The standard has not yet been endorsed by the EU.	1 January 2017
IAS 16	**Property, Plant and Equipment** Amendments regarding the clarification of acceptable methods of depreciation and amortisation and bringing bearer plants into the scope of IAS 16. The standard has not yet been endorsed by the EU.	1 January 2016
IAS 19	**Employee Benefits** Amendments clarify the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. The amendments have been endorsed by the EU.	1 July 2014
IAS 27	**Separate Financial Statements** Amendments reinstating the equity method as an accounting option for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements. The amendments have not yet been endorsed by the EU.	1 January 2016
IAS 38	**Intangible Assets** Amendments regarding the clarification of acceptable methods of depreciation and amortisation. The amendments have not yet been endorsed by the EU.	1 January 2016
IAS 41	**Agriculture** Amendments bringing bearer plants into the scope of IAS 16. The amendments have not yet been endorsed by the EU.	1 January 2016
IAS1	**Presentation of Financial Statements** Amendments that provide additional clarity and explanations on the application of materiality and the presentation of accounting policies and disclosures in financial statements. The amendments have not yet been endorsed by the EU.	1 January 2016
Annual Improvements 2010–2012	Amendments to a number of IFRS standards, clarifying guidance, wording or minor corrections. None of the proposed amendments are expected to have a material	1 July 2014

Standard/ Interpretation	Content/amendment	Applicable for annual financial periods beginning on or after
Cycle	impact on the Group's profit before tax for the year or equity. The amendments have been endorsed by the EU.	
Annual Improvements 2011–2013 Cycle	Amendments to a number of IFRS standards, clarifying guidance, wording or minor corrections. None of the proposed amendments are expected to have a material impact on the Group's profit before tax for the year or equity. The amendments have been endorsed by the EU.	1 July 2014
Annual Improvements 2012–2014 Cycle	Amendments to a number of IFRS standards, clarifying guidance, wording or minor corrections. None of the proposed amendments are expected to have a material impact on the Group's profit before tax for the year or equity. The amendments have not yet been endorsed by the EU.	1 January 2016

3 NET INVESTMENT INCOME

Investment income comprises interest received on financial investments, realised investment gains and losses and movements in unrealised gains and losses. Expenses and charges are included on an accruals basis.

Realised gains and losses on investments are calculated as the difference between net sales proceeds less costs of sale and original cost. Unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

For the year ended 31 December	**2014** *£000's*	2013 *£000's*
Interest receivable from financial assets	**152,519**	138,533
Interest payable on financial liabilities	**(81,065)**	(71,596)
Movement in fair value of financial assets	**365,915**	26,616
Movement in fair value of financial liabilities	**(176,573)**	17,382
Realised gains on financial assets	**95,158**	72,604
Realised losses on financial liabilities	**(56,723)**	(45,777)
Total net investment income	**299,232**	137,762

All financial assets and liabilities at 31 December 2014 are classified at fair value through profit and loss.

4 ACQUISITION COSTS

Acquisition costs comprise direct costs such as commissions and indirect costs of obtaining and processing new business. They are allocated to particular categories of business based on available information. Acquisition costs are not deferred as they are largely recovered at policy inception through profit margins.

For the year ended 31 December	2014 £000's	2013 £000's
Commission	**4,049**	11,435
Other acquisition expenses	**948**	1,601
Total acquisition costs	**4,997**	13,036

5 OTHER OPERATING EXPENSES

Profit from continuing operations before tax is stated after charging the following items:

For the year ended 31 December	Note	2014 £000's	2013 £000's
Staff costs, including Directors' remuneration	6	**40,760**	41,052
Depreciation of property, plant and equipment	9	**3,239**	1,843
Amortisation of intangible assets	11	**3,275**	1,997
Rental of leased premises		**3,220**	2,860
Other operating leases		**308**	419
Auditor remuneration		**704**	3,307
Share-based payment charges	19	**1,223**	9,324
Consultancy		**8,681**	11,507
Legal and professional fees		**5,288**	20,143
Marketing		**12,591**	11,591
Other (primarily office maintenance and supplies)		**16,515**	13,180
Total other operating expenses		**95,803**	117,223

Included in the expenses above are £78.1m (2013: £83.9m) of Operating expenses that are included in the derivation of the Operating profit. A further £16.3m (2013: £30.8m) are reported as non-Recurring expenditure and the balance of £1.4m (2013: £2.5m) are included within other non-operating items.

The analysis of the auditor's remuneration for the year is as follows:

Fees payable for the year ended 31 December were in respect of:	2014 £000's	2013 £000's
The audit of the PAG plc Annual Report and Accounts	**94**	85
The audit of other Group entities	**192**	336
Audit related assurance services	**172**	166
Taxation compliance services	**118**	44
All other assurance services	**128**	—
Corporate finance transactions relating to the IPO in June 2013	—	2,676
Auditor remuneration	**704**	3,307

6 STAFF COSTS

The aggregate staff costs, including Directors' remuneration in the year were:

For the year ended 31 December	2014 £000's	2013 £000's
Wages and salaries	**34,202**	33,839
Social security costs	**4,494**	5,528
Other pension costs	**2,064**	1,685
Total staff costs	**40,760**	41,052
The average number of persons employed during the year were:		
Administration and finance	**444**	430
Sales and marketing	**73**	109
Average number of employees	**517**	539

An analysis of Directors' remuneration is included in the Remuneration Report.

7 INCOME TAX

Income tax comprises current and deferred tax. Income tax is charged or credited to other comprehensive income if it relates to items that are charged or credited to other comprehensive income. Similarly,

income tax is charged or credited to equity if it relates to items that are credited or charged directly to equity. Otherwise income tax is recognised in the consolidated statement of comprehensive income.

Provision is made for taxation on taxable profits for the year, using tax rates enacted or substantially enacted at the balance sheet date together with adjustments to tax payable in respect of previous years.

Deferred tax is provided in full on temporary differences arising, which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on tax rates and laws enacted or substantively enacted at the balance sheet date. Temporary differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements except for differences arising from the initial recognition of goodwill and the initial recognition of assets and liabilities in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting nor taxable profit.

A deferred tax asset is recognised to the extent that it is regarded as more likely than not that it will be recovered. Deferred tax assets and liabilities are not discounted.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date. Deferred income tax assets and liabilities are offset only if: a legally enforceable right exists to set off current tax assets against current tax liabilities; the deferred income taxes relate to the same taxation authority; and that authority permits the Group to make a single net payment.

For the year ended 31 December	**2014** ***£000's***	2013 *£000's*
Current taxation:		
Tax charge for the year	**6,015**	23,112
Adjustment in respect of prior periods	**(2,035)**	394
	3,980	23,506
Deferred taxation:		
Tax credit for the year	**1,233**	(266)
Net taxation charge	**5,213**	23,240

The actual tax charge of the Group differs from the expected tax charge, computed by applying the average rate of UK corporation tax for the year of 21.5% (2013: 23.25%), as follows:

For the year ended 31 December	**2014** ***£000's***	2013 *£000's*
Profit before tax	**24,067**	82,661
Current taxation at 21.5% (2013: 23.25%)	**5,173**	19,216
Disallowable expenses	**51**	4,140
Adjustments in respect of prior periods	**(2,035)**	394
Adjustments to deferred tax in respect of prior periods	**1,903**	(315)
Rate change impact	**55**	15
Non-qualifying depreciation	**106**	66
Share-based payment charge on which deferred tax not recognised	**(40)**	(276)
Net taxation charge	**5,213**	23,240

Taxation was all from continuing operations in 2014 and 2013.

8 EARNINGS PER SHARE

Basic earnings per share is calculated using the earnings attributable to ordinary equity holders of the Parent, divided by the weighted average number of ordinary shares in issue during the period.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares, including share options and awards.

Diluted earnings per share amounts are calculated by dividing the profit attributable to ordinary equity holders of the Parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive ordinary shares into ordinary shares.

The calculation of the basic and diluted earnings per share from continuing operations is based on the following data:

For the year ended 31 December	**2014** *£000's*	2013 *£000's*
Profit for the year	**18,854**	59,421
Less non-controlling interests	**(2)**	44
Profit attributable to equity holders of the Parent	**18,852**	59,465
Effect of dilutive potential ordinary shares:		
Share options	**—**	—
Diluted profit attributable to equity holders of the Parent	**18,852**	59,465

Prior to 12 June 2013 the top holding company in the Group was PAG Holdings Limited (PAGH). All of PAGH's A, B and C shares (see note 31) were exchanged for PAG plc shares on 12 June 2013. For the purpose of the earnings per share calculation, the weighted average number of share shown below has been calculated as if the exchange of these PAGH shares had occurred at the beginning of the comparative period.

For the year ended 31 December	**2014** *Number of shares*	2013 *Number of shares*
Basic weighted average number of shares	**399,870,568**	346,138,910
Effect of dilutive potential ordinary shares:		
Share options	**2,780,521**	1,276,243
Diluted weighted average number of shares	**402,651,089**	347,415,153

The options granted by the PAGH trust in respect of the ESOP scheme have a dilutive effect, up to the date of the IPO when these options vested.

As detailed in note 19, the Group implemented a number of new employee share-based plans following admission on the London Stock Exchange. The Share Incentive Plan (SIP) has a dilutive effect.

It is our current intention that the Long Term Incentive Plan (LTIP) and the share element of the Deferred Share Bonus Plan (DBSP) be settled by fresh issues of shares as the awards vest. The weighted average number of shares calculation above has been derived on the assumption that the vesting of shares in respect of the LTIP and DSBP awards will be settled by a fresh issue of shares when the awards vest and hence will be dilutive.

9 PROPERTY, PLANT AND EQUIPMENT

Assets are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated to write off the cost of tangible assets over their estimated useful life on a straight-line basis. The principal rates used for this purpose are as follows:

Computer equipment	33%
Fixtures and fittings	10% to 20%
Office re-fit	10% to 50%

	Computer equipment *£000's*	**Fixtures and fittings** *£000's*	**Office refit costs** *£000's*	**Total** *£000's*
Cost at 1 January 2014	7,830	1,373	11,164	20,367
Additions	873	16	419	1,308
Disposals	(22)	(893)	(358)	(1,273)
At 31 December 2014	**8,681**	**496**	**11,225**	**20,402**
Accumulated depreciation at 1 January 2014	3,577	423	908	4,908
Charge for the year	2,037	31	1,171	3,239
Disposals	(22)	—	(280)	(302)
At 31 December 2014	**5,592**	**454**	**1,798**	**7,845**
Net book value:				
At 31 December 2013	4,253	950	10,256	15,459

At 31 December 2014	**3,089**	**42**	**9,427**	**12,557**

10 GOODWILL

Goodwill represents the excess of cost of acquisition over the fair value of the separable net assets of businesses acquired. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill is allocated to each of the cash generating units (CGU) that are expected to benefit from the combination. Goodwill is tested for impairment at least annually, or when circumstances or events indicate there may be uncertainty over this value. Impairment is determined by assessing the recoverable amount of each CGU to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognised. Any impairment is recognised immediately in the consolidated statement of comprehensive income and is not subsequently reversed.

	2014	2013
	£000's	*£000's*
At 1 January	**126,207**	126,207
At 31 December	**126,207**	126,207

The goodwill arose on acquisition of the PLACL operations and the value represented the potential of this business to generate value from future sales. Therefore the goodwill is allocated to the new business cash-generating unit, the scope of which is identical to the "new business" operating segment described in note 1.

The carrying value of goodwill has been tested for impairment at the balance sheet date.

The impairment test compares the carrying value of the new business cash generating unit (including goodwill and intangible assets) to its recoverable amount. The recoverable amount of the CGU is the higher of fair value less costs to sell and value in use. The Group uses an estimate of value in use is the primary measure of the recoverable amount. The future cash flows from the CGU are estimated as the expected future profits for the CGU set out in the Group's business plan as determined by management for a period of five years from the balance sheet date. These plans reflect management's best estimate of future profits based on both historical experience and expected growth rates for the CGU. The underlying assumptions of these projections include market size and growth, market share, profit margins, customer numbers and mortality.

Expected future profits for the CGU are discounted using a risk adjusted discount rate. The risk adjusted discount rate is a combination of a risk-free rate and an allowance for risk estimated with reference to observable rates and factors applied to business of similar size and nature. A rate of 13.1% (2013: 10.0%) has been applied to discount cash flows to a present value.

No impairment has been recognised in 2014 or 2013.

11 OTHER INTANGIBLE ASSETS

Other intangible assets comprise intellectual property and software development costs.

The intellectual property asset comprising specific mortality tables derived from data collected over an extended period and are deemed to have an indefinite life. Consequently no amortisation is charged against its carrying value.

Development costs that are directly attributable to the design and testing of identifiable software products, controlled by the Group, are recognised as intangible assets when it can be demonstrated that it is technically feasible to complete the product so that it is available for use and will generate probable future economic benefits. Software development costs have a finite useful life and are amortised using the straight-line method over three to five years.

Impairment review of other intangible assets

The carrying amounts of intangible assets with finite expected useful economic lives are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be

recoverable. A review for indicators of impairment is conducted annually. The carrying amounts of intangible assets with indefinite expected useful economic lives are tested for impairment at least annually, or when circumstances or events indicate there may be uncertainty over this value. An impairment loss is recognised in the Consolidated Statement of Comprehensive Income for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its net selling price (fair value less selling costs) and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit, or company of units, to which the asset belongs.

	2014	2013
	£000's	*£000's*
Intellectual property cost and carrying amount:		
At 1 January	**3,100**	3,100
At 31 December	**3,100**	3,100
Software development cost:		
At 1 January	**17,805**	11,750
Additions at cost	**2,093**	7,696
Assets written off	—	(1,641)
At 31 December	**19,898**	17,805
Software development accumulated amortisation:		
At 1 January	**4,504**	2,507
Charge for the year	**3,275**	1,997
At 31 December	**7,779**	4,504
Total intangible assets at 1 January	**16,401**	12,343
Total intangible assets at 31 December	**15,219**	16,401

The value of intellectual property has been determined based upon an estimate of the costs to employ adequately skilled individuals over an appropriate period of time to develop intellectual property of a similar nature sufficient to enable the Group to replicate the estimated future cash flows and profits deriving from that intellectual property.

The intellectual property is continually updated through the collection of further data, updated analyses, and conversion into new and more detailed underwriting manuals and mortality tables. For this reason, the intangible asset is deemed to have an indefinite life, and consequently, no amortisation is provided against the value of the intangible asset. The carrying value of the intangible asset is tested for impairment at each reporting date, and is allocated to the "new business" cash-generating unit, the scope of which is identical to the "new business" operating segment described in note 1. The method and assumptions used in this test are identical to those applied in the goodwill impairment test, as set out in note 10.

No impairment of intellectual property has been recognised in 2013 or 2014.

12 FINANCIAL ASSETS

Financial assets classification

The Group classifies its financial assets as financial investments, loans secured by residential mortgages, loans secured by commercial mortgages and derivative financial assets at fair value through profit and loss. The category of fair value through profit and loss has two sub-categories: those that meet the definition as being held for trading; and those that the Group chooses to designate as fair value. The fair value through profit and loss is selected as the Group's strategy is to manage its financial assets, as a portfolio, on a fair value basis.

Financial investments

Purchases and sales of debt securities and other fixed income securities are recognised on the trade date, which is the date that the Group commits to purchase or sell the assets, at their fair values. Transaction costs are expensed as incurred. These investments are derecognised when the contractual rights to receive

cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Debt securities and other fixed income securities are subsequently carried at fair value with changes in fair value included in the Consolidated Statement of Comprehensive Income in the period in which they arise.

The fair values of debt securities are based on quoted bid prices, or based on modelled prices (using observable market inputs) where quoted bid-prices are not available.

Commodity Trade Finance Investments, whether by way of a direct loan or an investment in a fund of such loans (CTF Investments), are carried at fair value on initial recognition and are recognised when the cash is advanced for the trade. CTF Investments are subsequently carried at fair value with changes in fair value included in the consolidated statement of comprehensive income in the period in which they arise. The fair value of these investments is not based on observable market data.

Loans secured by residential mortgages

Loans secured by residential mortgages are recognised when the cash is advanced to borrowers at their fair values. These loans are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Loans secured by residential mortgages are subsequently carried at fair value with changes in fair value included in the consolidated statement of comprehensive income in the period in which they arise.

The fair value of loans secured by residential mortgages is initially deemed to be the transaction price and subsequently marked to model. The underlying model follows the methodology used to establish transaction prices. It uses longevity assumptions to derive expected cash flows and the Black-Scholes option pricing methodology to establish the value of the "no negative equity guarantee" (NNEG) that is embedded in the product. The discount rates that are applied to cash flows to produce fair value are based on long dated swaps adjusted so that they would produce transaction date prices on the date of transaction.

Loans secured by commercial mortgages

Loans secured by commercial mortgages are recognised when the cash is advanced to borrowers at their fair values. These loans are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Loans secured by commercial mortgages are subsequently carried at fair value with changes in fair value included in the consolidated statement of comprehensive income in the period in which they arise.

The fair value of loans secured by commercial mortgages is initially deemed to be the transaction price and subsequently marked to model. The valuation model produces a series of projected future cash flows for each mortgage, based on a range of simulations of changes in property prices drawn from a distribution based on historic observed changes. Potential changes in property tenancy are also modelled in a range of simulations. The discount rates that are applied to cash flows to produce the fair value are based on long dated swaps adjusted so that they would produce transaction date prices on the date of the transaction.

Derivative financial instruments

The Group enters into a variety of derivative financial instruments to manage its exposure to interest rates, inflation, credit default and foreign exchange rate risk, including foreign exchange forward contracts, interest rate swaps, credit default swaps and inflations swaps.

Derivative contracts are traded either through an exchange or over-the-counter (OTC). OTC derivative contracts are individually negotiated between contracting parties and can include options, swaps, caps and floors.

Derivatives are initially recognised at fair value at the date that a derivative contract is entered into and are subsequently remeasured to fair value at each balance sheet date. The resulting gain or loss is recognised in the consolidated statement of comprehensive income. The fair values are obtained from quoted market prices or, if these are not available, by using standard valuation techniques based on discounted cash flow models or option pricing models. All derivatives are carried as assets when the fair value is positive and liabilities when the fair values are negative. Premiums paid for derivatives are recorded as an asset in the consolidated statement of financial position at the date of purchase representing their fair value at that date.

Financial assets: Fair value at 31 December	**2014** *£000's*	Restated[i] 2013 *£000's*
Financial investments	**3,584,820**	3,133,790
Loans secured by residential mortgages	**1,212,324**	840,066
Derivative assets	**75,892**	36,413
Loans secured by commercial mortgages	**37,868**	—
Total financial assets	**4,910,904**	4,010,269

i See note 2.

The methodology used to derive the fair values is set out in note 25.

Financial assets: Cost at 31 December	**2014** *£000's*	2013 *£000's*
Financial investments	**3,298,543**	2,991,196
Loans secured by residential mortgages at cost	**950,909**	796,788
Derivative assets	—	—
Loans secured by commercial mortgages at cost	**37,481**	—
Total financial assets	**4,286,933**	3,787,984

13 PRINCIPAL GROUP UNDERTAKINGS

Foreign currencies

Items included in the financial statement of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The functional currency of each of the Group's material entities is sterling. The consolidated financial statements are presented in sterling, which is the Group's presentation currency.

Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the end of the financial period. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in net investment income in the consolidated statement of comprehensive income.

Set out below are the principal subsidiary and associate undertakings of Partnership Assurance Group plc. All of the companies are incorporated in the United Kingdom and registered in England and Wales unless otherwise indicated. The shares held are voting ordinary equity shares. A full list of subsidiary and joint venture undertakings will be annexed to the Partnership Assurance Group plc annual return filed at Companies House.

Name:	**Principal activity**:	**Holding**
PAG Holdings Limited[i]	Holding company	100%
PAG Finance Limited[i]	Holding company	100%
Partnership Holdings Limited	Holding company	100%
Partnership Group Holdings Limited	Holding company	100%
Partnership Life Assurance Company Limited	Life assurance and pension annuities	100%
Partnership Home Loans Limited	Provision of lifetime mortgage products	100%
Partnership Services Limited	Service company	100%
Payingforcare Limited	Website	100%
PASPV Limited	Investment activity	100%
Partnership Life US Company[ii]	Management services	100%
Eldercare Group Limited[iii]	Independent financial advisers	33%

i Incorporated in Jersey (now dormant).
ii Incorporated in the USA.
iii Associate.

Partnership Assurance Group plc directly or indirectly holds 100% of the ordinary shares and voting rights in the entities listed above (with the exception of Eldercare Group Limited), therefore Partnership Assurance Group plc controls these entities as subsidiaries.

Eldercare Group Limited

On 6 February 2014 the Group's subsidiary, Eldercare Group Limited (Eldercare), entered into a transaction to acquire Care Fee Investment Limited, an independent financial adviser in exchange for the issue of ordinary shares. As part of the transaction the Group made a capital contribution to Eldercare of £48,345. As a result of this transaction the Group's holding in Eldercare represented a smaller proportion of the enlarged Eldercare group, decreasing to 33% of its ordinary shares. Eldercare therefore ceased to be a subsidiary and became an associate of the Group. The Group's interest in the associate was initially measured at £206,000, representing its fair value on the date of the transaction. As a result of the transaction a gain of £157,509 arose, representing the difference between the fair value of the Group's interest in the associate and the prior carrying value of the Group's share of the subsidiary, less the capital contribution and attributable costs.

Gateway Specialist Advice Services

During 2014 the Group completed a review of the operations of Gateway Specialist Advice Services Limited (Gateway), and wrote down to £nil the value of its joint venture investment in Gateway and wrote down to £nil the value of its loans to Gateway (see note 8). A £334,000 charge for the write down of the value of loans is included in Operating expenses and a £206,000 charge for the write down of the investment is included in Share of result of joint venture and associates accounted for using the equity method in the Statement of Comprehensive Income. On 29 August 2014 the Group disposed of its investment in Gateway to Sesame Limited for consideration of £1, resulting in a profit on disposal of £1 recognised in the Share of results in joint ventures and associates using the equity method in the Statement of Total Comprehensive Income.

Partnership Life Assurance Company Limited

The Group's regulated insurance entity, Partnership Life Assurance Company Limited, is subject to UK solvency requirements which may, in the event of a breach of those requirements, affect that entity's ability to transfer funds in the form of cash dividends to other entities in the Group. The net assets of Partnership Life Assurance Company Limited at the balance sheet date are £459.0m (2013: £415.5m). There are no protective rights of non-controlling interests which significantly restrict the Group's ability to access or use the assets and settle the liabilities of the Group.

14 INVESTMENT IN JOINT VENTURES AND ASSOCIATES ACCOUNTED FOR USING THE EQUITY METHOD

The Group uses the equity method to consolidate its investments in joint ventures and associates. Under the equity method of accounting the investment is initially recognised at fair value and adjusted thereafter for the post-acquisition change in the Group's share of net assets of the joint venture.

Associates	**2014**	2013
	£000's	*£000's*
At 1 January	—	—
Fair value on initial recognition	**206**	—
Share of profit from continuing operations	**27**	—
At 31 December	**233**	—

Joint ventures	**2014**	2013
	£000's	*£000's*
At 1 January	**206**	368
Impairment of joint venture	**(206)**	(162)
At 31 December	—	206

In the year the Group entered into a transaction that changed its holding in Eldercare from a subsidiary to an associate and also disposed of its joint venture investment in Gateway. Details of both of these transactions are included in note 13.

There were no profits or losses arising from discontinued operations in joint ventures or associates in 2014 or 2013. There were no items of other comprehensive income in joint ventures or associates in 2014 or 2013.

15 INSURANCE AND OTHER RECEIVABLES

Insurance and reinsurance debtors represent amounts receivable after commencement of the contract which has not been settled at the balance sheet date.

As at 31 December	**2014** *£000's*	Restated[i] 2013 £000s
Debtors arising out of insurance contracts[ii]	**11,135**	51,140
Debtors arising out of reinsurance contracts	**22,522**	24,196
Other debtors	**3,266**	4,008
Corporation tax receivable	**2,091**	—
Amounts due from associate	**153**	—
Amounts due from joint venture	—	289
Total insurance and other receivables	**39,167**	79,633

i See note 2.
ii Includes £9.7m in respect of premiums written for which funds have not yet been received from the policyholder (2013: £51.1m).

The Directors consider that the carrying value of insurance and other receivables in the balance sheet is a reasonable approximation of the fair value.

16 PREPAYMENTS AND ACCRUED INCOME

Interest accrued represents the balance receivable for interest income, calculated daily based on the contractual interest rates of the relevant instruments, recognised since the last interest payment date.

As at 31 December	**2014** *£000's*	Restated[i] 2013 £000s
Accrued interest	**32**	11
Prepayments	**3,583**	10,980
Total prepayments and accrued income	**3,615**	10,991

i See note 2.

17 DEFERRED TAX ASSET/LIABILITY

For the year ended 31 December	**2014** *£000's*	2013 *£000's*
At 1 January	**424**	158
(Debit)/credit to consolidated statement of comprehensive income	**(1,233)**	266
Deferred tax asset at 31 December	**519**	424
Deferred tax liability at 31 December	**(1,328)**	—

The deferred tax asset is recognised as a result of the difference between: the accumulated depreciation and the capital allowances claimed on property, plant and equipment and the accumulated share based payment charges and a more current estimation of the likely cost of schemes that have not yet vested based on a revaluation at the balance sheet date. The recoverability of deferred tax assets have been considered with regard to the future taxable profits expected in management plans. The deferred tax liability is recognised as a result of the difference between the accumulated amortisation and research and

development claims relating to software development costs. The UK corporation tax rate that is expected to be appropriate when each of these timing differences arise is 20% (2013: 20%).

18 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash in hand, deposits held on call with banks and other short-term highly liquid investments with original maturities of 90 days or less. Bank overdrafts are included in cash and cash equivalents for the purposes of the consolidated cash flow statement.

As at 31 December	**2014**	2013
	£000's	*£000's*
Short-term bank deposits	**56,159**	94,723
Cash at bank and in hand	**31,092**	18,018
Total cash and cash equivalents	**87,251**	112,741

19 SHARE-BASED PAYMENTS

Equity-settled share-based payments to employees and others providing services are measured at the fair value of the equity instruments at the grant date. The fair value excludes the effect of non-market-based vesting conditions. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest.

At each period end, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the consolidated statement of comprehensive income such that the cumulative expense reflects the revised estimate with a corresponding adjustment to equity.

Where the terms and conditions of options are modified before they vest, the increase in the fair value of those instruments, measured immediately before and after the modification, is also charged to the consolidated statement of comprehensive income over the remaining vesting period.

The share-based payment expense recognised for employee services receivable during the year is as follows:

For the year ended 31 December	**2014**	2013
	£000's	*£000's*
Employee Share Option Plan	—	8,378
Long Term Incentive Plan	**863**	432
Deferred Share Bonus Plan	**273**	374
Share Incentive Plan	**92**	65
Save As You Earn Plan	**(5)**	75
Total expense	**1,223**	9,324

i) Employee Share Option Plan (ESOP)

In 2009, the Group implemented an Employee Share Option Plan (ESOP) to retain and motivate its employees. Following admission on the London Stock Exchange on 12 June 2013, all the awards under the ESOP vested in full and were exercised immediately. There were no outstanding options under the ESOP as at 31 December 2014 or 31 December 2013.

ii) Long Term Incentive Plan (LTIP)

	2014	2013
	Number of Awards	*Number of Awards*
Outstanding at the beginning of the year	**1,280,414**	—
Granted during the year	**4,745,589**	1,294,740
Forfeited during the year	**(294,492)**	(14,326)
Outstanding at the end of the year	**5,731,511**	1,280,414

The Group made awards under the LTIP to Executive Directors and other senior executives in May 2014 (2014 LTIP) and June 2013 (2013 LTIP). The LTIP awards will be subject to the satisfaction of the following performance conditions which will determine the proportion (if any) of the LTIP award to vest at the end of the performance period.

50% of the 2013 LTIP awards are subject to a performance condition relating to the growth in the Group's operating profit over a performance period of three financial years. If operating profit for the financial year ending 31 December 2015 exceeds operating profit for the financial year ending 31 December 2012 by 33.1%, 10% of the 2013 LTIP award will vest. The maximum 50% will vest if operating profit for the financial year ending 31 December 2015 exceeds operating profit for the financial year ending 31 December 2012 by at least 64.3%. Payment will be on a sliding scale in between these points.

The remaining 50% of the 2013 LTIP awards and all of the 2014 LTIP will be subject to a condition measuring the Company's total shareholder return (TSR) performance relative to the constituent companies of the FTSE 250 index (excluding investment trusts, mining companies and oil and gas producers), over the period from admission to 31 December 2015, in respect of the 2013 LTIP, and over the period from 22 May 2014 to 22 May 2017 in respect of the 2014 LTIP. Vesting of 10% of the 2013 LTIP award and 20% of the 2014 LTIP award will occur for median performance and the maximum vesting (50% for the 2013 LTIP and 100% for the 2014 LTIP) at upper quartile performance or above, with the proportion vesting between these points calculated on a straight-line basis.

The awards are accounted for as equity-settled schemes. The fair value of these schemes is calculated at each award date based upon the number of shares expected to vest and the expense charge is recognised over the course of the vesting period.

A charge of £862,718 (2013: £431,848) has been recognised in the consolidated statement of comprehensive income with a corresponding increase in equity in the consolidated statement of financial position. The weighted average fair value of awards made in the year was £0.74.

The fair value of the award was measured with reference to the quoted share price of PAG plc at the measurement date. The performance condition relating to total shareholder return was incorporated into the measure of fair value through stochastic models incorporating the historical TSR volatility of the Group and other comparable listed entities. The performance condition relating to operating profit performance and other non-market vesting conditions are incorporated into the estimate of the total number of awards expected to vest. This expectation is reviewed and if necessary, revised at each reporting date.

During the period the Group reviewed the stochastic model used to incorporate the performance condition into the fair value of the LTIP awards. Resulting corrections to the working of the model resulted in an increase in the value of the 2013 LTIP award recognised. This correction has resulted in an increase in the charge recognised during the period of £194,000.

The weighted average exercise price of all awards under the LTIP is £nil.

iii) Deferred Share Bonus Plan (DSBP)

Effective from June 2013, one-third of the bonuses earned by Executive Directors and certain other senior executives in respect of the Company's annual bonus arrangements are deferred into shares in PAG plc. The remaining two-thirds of the awards will continue to be paid in cash. The share element of the bonus awards will vest on the third anniversary of the date of the determination of the bonus in respect of which they were granted.

The share element of these bonus awards are accounted for as equity-settled schemes. The fair value of these awards are calculated at each award date based on one-third of the estimated annual bonus payout and the expense charge is recognised over the course of the service period to which the bonus relates and the vesting period.

A charge of £272,545 (2013: £374,072) has been recognised in the consolidated statement of comprehensive income in respect of these schemes for the year to 31 December 2014 with a corresponding increase in equity in the consolidated statement of financial position. 946,134 awards were

made in the period. 46,606 awards were forfeit during the period and 899,528 awards were outstanding at the end of the period. The weighted average exercise price of the awards is £nil.

The weighted average fair value of awards made during the year was £1.25. The fair value of the award was measured with reference to the quoted share price of PAG plc at the measurement date. Non-market vesting conditions are incorporated into the estimate of the total number of awards expected to vest. This expectation is reviewed and, if necessary, revised at each reporting date.

iv) Share Incentive Plan (SIP)

	2014 *Number of Awards*	2013 *Number of Awards*
Outstanding at the beginning of the year	**119,340**	—
Granted during the year	**2,911**	131,300
Forfeited during the year	**(34,408)**	(11,960)
Outstanding at the end of the year	**87,843**	119,340

In 2013 the Company made a one-off award of £1,000 of free shares immediately after admission to all eligible employees under a new all-employee share plan, known as the Share Incentive Plan (SIP). These shares will be forfeited if the employees cease employment (except in "good leaver" circumstances) within the first three years from the date of the award. Awards made under this plan entitle these employees to:

- a conditional right to acquire shares in PAG plc at no cost;
- an option to acquire shares in PAG plc at no cost; or
- a right to receive a cash amount which relates to the value of certain number of notional ordinary shares.

These awards are accounted for as equity-settled schemes. The fair value of these schemes is calculated at each award date based upon the number of shares awarded multiplied by the share price at grant date and expensed over the vesting period. The weighted average exercise price of the awards is £nil.

A charge of £92,430 (2013: £65,277) has been recognised in the consolidated statement of comprehensive income in respect of this scheme for the year to 31 December 2014 with a corresponding increase in equity in the consolidated statement of financial position.

Further awards have been made in the year to 31 December 2014, reflecting additional shares to scheme participants on payment on dividends by the Group, subject to the same conditions as the original award. The weighted average fair value of awards made in the year was £1.31. The fair value of the award was measured with reference to the quoted share price of PAG plc at the measurement date. Non-market vesting conditions are incorporated into the estimate of the total number of awards expected to vest. The expectation is reviewed and, if necessary, revised at each reporting date.

v) Save As You Earn (SAYE) share option plan

	2014 *Number of Awards*	2013 *Number of Awards*	**2014** *Weighted average of exercise price £*	2013 *Weighted average of exercise price £*
Outstanding at the beginning of the year	**465,761**	—	**3.57**	0.00
Granted during the year	**1,536,051**	508,261	**0.94**	3.57
Forfeited during the year	**(441,250)**	(42,500)	**3.21**	3.57
Outstanding at the end of the year	**1,560,562**	465,761	**1.08**	3.57

In July 2013, the Group introduced a SAYE scheme. Under this plan, employees may elect to save up to £500 per month over a three- or five-year period. The amount of ordinary shares of PAG plc over which the option is granted will be determined at the grant date to reflect the amount that each employee has

agreed to save under the Share Save contract. Awards were granted under the scheme to member employees in July 2013 and November 2014.

A credit of £4,954 (2013 charge of £74,734) has been recognised in the Consolidated Statement of Comprehensive Income in respect of this scheme for the year to 31 December 2014 with a corresponding decrease in equity in the consolidated statement of financial position, reflecting an increase in the lapse assumption applied to the 2013 award as a result of lapse experience during the period exceeding previous expectations.

The fair value of the awards made in the year has been determined using a Black-Scholes valuation model. Key assumptions within this valuation model were: expected share price volatility (41.8%), expected dividend yield (1%), risk-free interest rate (1.7%), expected option life (three years and five years), exercise price (£0.94) and share price at the measurement date (£1.17).

20 INSURANCE LIABILITIES AND REINSURANCE ASSETS

Insurance liabilities

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event would cause an insurer to pay significant additional benefits 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.

The Group's long-term insurance contracts include annuities to fund retirement income, annuities to fund care fees (immediate needs and deferred), long-term care insurance and whole of life and term protection insurance. These contracts are expected to remain in force for an extended period of time, and insure events associated with human life.

One of the purposes of insurance is to enable policyholders to protect themselves against future uncertain events such as death or specific types of illness. Insurance companies accept the transfer of uncertainty from policyholders and seek to add value through the aggregation and management of these risks. As a consequence of this uncertainty, estimation techniques are employed by suitably qualified personnel in computing the levels of provisions held against such uncertainty.

The insurance liabilities, which are also referred to as the long-term business provision and policyholder reserves elsewhere in this report, are determined by the Partnership Board on the advice of the Group's Actuarial Function Holder on the modified statutory basis using recognised actuarial methods with due regard to the actuarial principles set out in the PRA's (formerly the FSA's) Insurance Prudential Sourcebook. In particular, a prospective gross premium valuation method has been adopted for major classes of business.

Although the process for the establishment of insurance liabilities follows specified rules and guidelines, the provisions that result from the process remain uncertain. As a consequence of this uncertainty, the eventual value of claims could vary from the amounts provided to cover future claims. The Group seeks to provide for appropriate levels of contract liabilities taking known facts and experiences into account but nevertheless such provisions remain uncertain.

The estimation process used in determining insurance liabilities involves projecting future annuity payments and the costs of maintaining the contracts. For non-annuity contracts, the long-term business provision is determined as the sum of the discounted value of future benefit payments and future administration expenses less the expected value of premiums payable under the contract. The key sensitivities are the assumed level of interest rates and the mortality experience.

At the balance sheet date, provision is made for all notified claims plus an estimate for those claims that have been incurred but not reported. The principal assumptions underlying the calculation of insurance liabilities are set out in note 20.

Reinsurance assets

Long-term business is ceded to reinsurers under contracts to transfer part or all of one or more of the following risks: mortality, morbidity, investment, persistency and expenses. The benefits to which the Group are entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets

consist of short-term balances due from reinsurers (classified within "Insurance and other receivables") as well as longer-term receivables that are dependent on the expected benefits arising under the related reinsured contracts.

Amounts recoverable from reinsurers are estimated in a consistent manner with insurance liabilities, and are classified as "Reinsurance assets".

Some contracts, which provide for the transfer of significant risk, are also structured to provide financing. When, under such contracts, financing components are to be repaid in future accounting periods, the amount outstanding under the contract at the balance sheet date are classified as "Payables arising from reinsurance contracts" and included within insurance and other payables in the consolidated statement of financial position.

If the reinsurance asset were impaired, the Group would adjust the carrying amount accordingly and recognise that impairment loss in the consolidated statement of comprehensive income. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Group may not receive all amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer.

Liability adequacy test

At the end of each reporting period, liability adequacy tests are performed to ensure the adequacy of the insurance liabilities. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from assets backing such liabilities, are used. Any deficiency is immediately charged to the consolidated statement of comprehensive income.

Claims

Maturity claims and annuities are charged against revenue when due for payment. Death claims and all other claims are accounted for when notified. Claims reinsurance recoveries are accounted for in the same period as the related claim. Where reinsurance treaties are recaptured, amounts received to compensate for the transfer of risk from the reinsurer are accounted for when received or, if earlier, on the date the treaty ceases to be included within the calculation of the reinsurers' share of long-term business provision.

As at 31 December	**2014** ***£000's***	2013 *£000's*
Long-term business provision	**5,231,112**	4,347,588
Reinsurers' share of long-term business provision	**(3,246,008)**	(2,840,749)
Net provision	**1,985,104**	1,506,839

a) Principal assumptions

The principal assumptions underlying the calculation of the long-term business provision are as follows:

		Mortality tables	**Valuation discount rates**
Medically underwritten annuity products	2014	Modified E&W Population Mortality with CMI 2013m (1.25%) and CMI 2013f (1.00%)	**3.53%**
	2013	Modified E&W Population Mortality with CMI 2012m (1.75%) and CMI 2012f (1.50%)	4.31%
Other annuity products	2014	Modified PCMA/PCFAOOu bespoke	**1.35%**
	2013	Modified PCMA/PCFA00u bespoke	1.70%
Term and whole of life products	2014	86.25% TM/TF00Select	**1.00%**
	2013	86.25% TM/TF00Select	1.44%

Valuation discount rate assumptions are set with regards to yields on supporting assets. An allowance for risk is included by making an explicit deduction from the yields on debt and other fixed income securities based on historical default experience and expected experience of each asset class. The allowance for

credit risk has been set at 42% (31 December 2013: 47%) of the spread on the yield of the corporate bonds over the yield on gilts.

The changes in the valuation discount rates at each period end reflect changes in yields on the supporting assets and changes made to the allowance for risk.

The mortality tables used have been adjusted to reflect additional mortality based on the proprietary data held by the Group developed from actual experience incurred. The valuation basis used to calculate the long-term business provisions includes an allowance for future expenses.

b) Movements

Movements in the carrying amount of insurance liabilities and reinsurance assets are explained as follows:

For the year ended 31 December 2014	**Gross** *£000's*	**Reinsurance** *£000's*	**Net** *£000's*
At 1 January 2014	**4,347,588**	**(2,840,749)**	**1,506,839**
Increase in liability from new business	**692,005**	**(266,845)**	**425,160**
Release of in-force liability	**(130,286)**	**87,709**	**(42,577)**
Release of liability due to recorded deaths	**(67,743)**	**31,799**	**(35,944)**
Economic changes	**332,956**	**(211,434)**	**121,522**
Non-economic changes	**912**	**—**	**912**
Other	**55,680**	**(46,488)**	**9,192**
At 31 December 2014	**5,231,112**	**(3,246,008)**	**1,985,104**

For the year ended 31 December 2013	Gross *£000's*	Reinsurance *£000's*	Net *£000's*
At 1 January 2013	3,723,298	(2,412,551)	1,310,747
Increase in liability from new business	1,038,011	(678,827)	359,184
Release of in-force liability	(111,110)	75,012	(36,098)
Release of liability due to recorded deaths	(69,967)	31,040	(38,927)
Economic changes	(209,299)	144,164	(65,135)
Non-economic changes	(25,847)	1,609	(24,238)
Other	2,502	(1,196)	1,306
At 31 December 2013	4,347,588	(2,840,749)	1,506,839

c) Analysis of expected maturity

The following table analyses insurance liabilities and reinsurance assets by duration.

	Expected cash flows (undiscounted)				
At 31 December 2014	**less than one year** *£000's*	**one to five years** *£000's*	**five to ten years** *£000's*	**more than ten years** *£000's*	**Carrying value (discounted)** *£000's*
Long-term business provision	**411,885**	**1,510,716**	**1,624,201**	**4,367,492**	**5,231,112**
Reinsurers' share of long-term business provision	**(258,539)**	**(966,479)**	**(1,053,161)**	**(2,699,933)**	**(3,246,008)**
Net	**153,346**	**544,237**	**571,040**	**1,667,559**	**1,985,104**

	Expected cash flows (undiscounted)				
At 31 December 2013	less than one year *£000's*	one to five years *£000's*	five to ten years *£000's*	more than ten years *£000's*	Carrying value (discounted) *£000's*
Long-term business provision	373,419	1,360,968	1,450,164	3,829,024	4,347,588
Reinsurers' share of long-term business provision	(241,692)	(903,711)	(985,311)	(2,544,018)	(2,840,749)
Net	131,727	457,257	464,853	1,285,066	1,506,839

d) Sensitivity analysis

Life insurance results are inherently uncertain due to actual experience being different to modelled assumptions. Sensitivity analysis is provided below to illustrate the impact of changes in key assumptions.

Sensitivity factor	Description of sensitivity factor applied
Interest rate and investment return	The impact of a change in the market interest rates by +/- 1% (e.g. if a current interest rate is 5%, the impact of an immediate change to 4% and 6% respectively). The test allows consistently for similar changes to investment returns and movements in the market backing fixed interest securities.
Credit spreads	The impact of credit spreads widening by 50bps with a corresponding pro-rated change to defaults.
Expenses	The impact of an increase in maintenance expenses by 10%.
Mortality rates	The impact of a decrease in mortality rates by 5%.
Property values	The impact of an immediate decrease in the value of properties by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the loans secured by residential mortgages and loans secured by commercial mortgages used to back the liabilities.
Voluntary redemptions	The impact of an increase in voluntary redemption rates on loans secured by residential mortgages by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the loans secured by residential mortgages that are used to back the liabilities.

The table below demonstrates the effect of a change in a key assumption whilst other assumptions remain unchanged. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results. The sensitivity analyses do not take into consideration that the Group's assets and liabilities are actively managed and may vary at the time that any actual market movement occurs.

	Increase/(decrease) in profit before tax	
Change in assumption:	**2014**	2013
	£000's	*£000's*
Interest rates +1%	**2,866**	2,954
Interest rates -1%	**(5,993)**	(3,308)
Credit spreads +0.5%	**(11,621)**	(10,917)
Expenses +10%	**(10,906)**	(9,962)
Mortality -5%	**(32,027)**	(22,140)
Property prices -10%	**(38,583)**	(25,313)
Voluntary redemptions +10%	**(6,412)**	(2,402)

21 INSURANCE AND OTHER PAYABLES

As at 31 December		Restated[i]
	2014	2013
	£000's	*£000's*
Payables arising from insurance contracts	**4,774**	9,639
Payables arising from reinsurance contracts	**3,159**	1,916
Other creditors and accruals	**21,594**	22,449
Total insurance and other payables	**29,527**	34,004

i See note 2.

The Directors consider that the carrying value of insurance and other payables in the balance sheet is a reasonable approximation of the fair value.

22 FINANCIAL LIABILITIES

As well as derivative financial liabilities, the Group carries financial liabilities where assets under specific reinsurance treaties are legally and physically deposited back to the Group by reinsurers. Financial liabilities are initially recognised at fair value on the same date that the value of underlying deposited assets is recognised and are subsequently remeasured at fair value at each balance sheet date. The resulting gain or loss is recognised in the consolidated statement of comprehensive income. The net gain or loss recognised incorporates any interest paid on the financial liability. Fair value is determined as the amount payable discounted from the first date that the amount is required to be paid.

A financial liability (including subordinated debt and external borrowings) is generally derecognised when the contract that gives rise to it, is settled, sold, cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange of modification is treated as a derecognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in the consolidated statement of comprehensive income.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into.

As at 31 December	**2014**	Restated[i] 2013
	£000's	*£000's*
Deposits from reinsurers	**2,491,795**	2,182,350
Derivative liabilities	**79,493**	32,391
Total financial liabilities	**2,571,288**	2,214,741

i See note 2.

Payables arising from reinsurance contracts at fair value through profit and loss are designated as such on initial recognition. Derivative liabilities are carried at fair value through profit and loss.

23 CURRENT TAX LIABILITIES

As at 31 December	**2014**	2013
	£000's	*£000's*
Corporation tax payable	—	13,633
Other taxes and social security costs	**3,735**	4,565
Total current tax liabilities	**3,735**	18,198

24 DERIVATIVE FINANCIAL INSTRUMENTS

The Group uses various derivative financial instruments to manage its exposure to interest rates, counterparty credit risk, inflation and foreign exchange risk, including foreign exchange forward contracts, interest rate swaps, credit default swaps and inflation swaps.

As at 31 December 2014	**Asset fair value**	**Liability fair value**	**Notional amount**
	£000's	***£000's***	***£000's***
Forward currency positions	**7,335**	**1,615**	**553,106**
Interest rate swaps	**66,651**	**62,030**	**1,119,400**
Inflation swaps	**309**	**15,848**	**414,646**
Credit default swaps	**1,597**	—	**38,104**
Total derivative financial instruments	**75,892**	**79,493**	**2,125,256**

As at 31 December 2013	Asset fair value *£000s*	Liability fair value *£000s*	Notional amount *£000s*
Forward currency positions	8,488	278	548,392
Interest rate swaps	24,847	31,271	1,242,924
Inflation swaps	3,078	842	162,135
Total derivative financial instruments	36,413	32,391	1,953,451

All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual Group entities and relevant counterparties in place under each of these master agreements.

At 31 December 2014, the Group had pledged £29.8m (2013: £10.1m) and held collateral of £19.0m (2013: £0.9m) in respect of outstanding over-the-counter derivative positions.

25 FINANCIAL INSTRUMENTS – FAIR VALUE METHODOLOGY

All financial instruments, with the exception of external borrowings, are classified at fair value through profit and loss. In accordance with IFRS 13 Fair Value Measurement, financial instruments at fair value have been classified into three categories:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); or

Level 3: Inputs for the assets or liabilities that are not based on observable market data (that is, unobservable inputs).

An analysis of financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below. All these financial assets and liabilities relate to recurring fair value measurements. There are no non-recurring fair value measurements as at 31 December 2014 and 31 December 2013.

At 31 December 2014	**Level 1** ***£000's***	**Level 2** ***£000's***	**Level 3** ***£000's***	**Total** ***£000's***
Financial investments (a)	**3,583,183**	**—**	**1,637**	**3,584,820**
Loans secured by residential mortgages (b)	**—**	**—**	**1,212,324**	**1,212,324**
Derivative assets (c)	**—**	**75,892**	**—**	**75,892**
Loans secured by commercial mortgages (d)	**—**	**—**	**37,868**	**37,868**
Total financial assets held at fair value	**3,583,183**	**75,892**	**1,251,829**	**4,910,904**
Deposits from reinsurers (e)	**—**	**—**	**2,491,795**	**2,491,795**
Derivative liabilities (c)	**—**	**79,493**	**—**	**79,493**
Total financial liabilities held at fair value	**—**	**79,493**	**2,491,795**	**2,571,288**

Restated[i] At 31 December 2013	Level 1 *£000's*	Level 2 *£000's*	Level 3 *£000's*	Total *£000's*
Financial investments (a)	3,122,222	—	11,568	3,133,790
Loans secured by residential mortgages (b)	—	—	840,066	840,066
Derivative assets (c)	—	36,413	—	36,413
Total financial assets held at fair value	3,122,222	36,413	851,634	4,010,269
Deposits from reinsurers (e)	—	—	2,182,350	2,182,350
Derivative liabilities (c)	—	32,391	—	32,391
Total financial liabilities held at fair value	—	32,391	2,182,350	2,214,741

i See note 2.

The Group's policy is to recognise transfers into and transfers out of Levels 1, 2 and 3 as of the date at which the consolidated statement of financial position is prepared.

There have been no transfers between Levels 1, 2 and 3 in 2014.

The table below reconciles the opening and closing recorded amount of level 3 financial liabilities and financial assets which are stated at fair value.

For the year ended 31 December 2014	**Deposits from reinsurers** *£000's*	**Loans secured by commercial mortgages** *£000's*	**CTF Investments** *£000's*	**Loans secured by residential mortgages** *£000's*
At 1 January 2014	**(2,182,350)**	**—**	**11,568**	**840,066**
Loans (received)/advanced	**(307,959)**	**37,481**	**6,321**	**232,519**
Total (losses)/gains in consolidated statement of comprehensive income	**(139,376)**	**263**	**(884)**	**185,634**
Redemptions made/(received)	**229,082**	**—**	**(16,386)**	**(51,273)**
(Interest payable accrued)/interest receivable accrued	**(91,192)**	**125**	**1,018**	**5,378**
At 31 December 2014	**(2,491,795)**	**37,869**	**1,637**	**1,212,324**

Restated[i] For the year ended 31 December 2013	Deposits from reinsurers *£000's*	Loans secured by commercial mortgages *£000's*	CTF Investments *£000's*	Loans secured by residential mortgages *£000's*
At 1 January 2013	(1,728,998)	—	—	478,097
Loans (received)/advanced	(733,849)	—	23,990	416,473
Total (losses)/gains in consolidated statement of comprehensive income	(155,522)	—	(3,135)	(25,695)
Redemptions made/(received)	514,878	—	(11,306)	(34,187)
(Interest payable accrued)/interest receivable accrued	(78,859)	—	2,019	5,378
At 31 December 2013	(2,182,350)	—	11,568	840,066

i See note 2.

The gains and losses are included within net investment income in the consolidated statement of comprehensive income.

The unrealised gains/(losses) in respect of payables arising out of reinsurance contracts, commodity trade finance investments, loans secured by residential mortgages and loans secured by commercial mortgages for the period to 31 December 2014 are £139.4m (2013: £155.5m), £0.9m (2013: £(1.1)m), £191.0m (2013: £(20.3)m) and £0.2m (2013: £nil) respectively. These unrealised gains and losses are included within net investment income in the Consolidated Statement of Comprehensive Income.

Level 3 sensitivity analysis

As at 31 December 2014	**Significant assumption**	**Current fair value** *£000's*	**Impact of alternative assumption** — **Increase in fair value** *£000's*	**Impact of alternative assumption** — **Decrease in fair value** *£000's*
Assets				
CTF Investments	Expected defaults	**1,637**	**289**	**(353)**
Loans secured by commercial mortgages	Discount rate	**37,868**	**2,744**	**(2,501)**
Loans secured by residential mortgages	Discount rate	**1,212,324**	**156,367**	**(132,186)**
Liabilities				
Deposits from reinsurers	Discount rate	**(2,491,795)**	**(220,538)**	**192,268**

Restated[i] At 31 December 2013	Significant assumption	Current fair value *£000's*	Increase in fair value *£000's*	Decrease in fair value *£000's*
Assets				
CTF Investments	Expected defaults	11,568	406	(584)
Loans secured by residential mortgages	Value of NNEG	840,066	100,863	(86,046)
Liabilities				
Deposits from reinsurers	Discount rate	(2,182,350)	(182,645)	161,733

i See note 2.

The impact of reasonably possible alternative assumptions are estimated by modelling alternative scenarios for the key assumptions for each valuation model.

a) Financial investments

All financial investments are designated at fair value through profit and loss. All financial investments excluding commodity trade finance are listed.

In assessing the fair value of the debt securities and other fixed income securities, the Directors have relied upon values provided by an independent third party which specialises in providing such values to companies. The third party provides prices based upon quoted market prices, or where not available, modelled prices using observable market inputs. At 31 December 2014 and 31 December 2013, 100% of the values provided were based on quoted market prices that are observable for the asset or liability.

Due to the short-term nature of the commodity trade finance (CTF) loans, the fair value of these instruments is estimated as the principal amount borrowed plus accrued interest from the date of acquisition, adjusted for incurred and expected defaults. These CTF loans are considered to be Level 3 within the valuation category prescribed by IFRS 13 as the inputs to the fair value calculation are not based on observable market data, and includes the Group's own assumptions.

The change in the fair value of Level 3 financial instruments from period to period is analysed into loans advanced, loans repaid/redemptions, and interest accrued, with the remaining balance representing fair value measurement gains and losses recognised in the statement of comprehensive income.

Interest rate: The interest rate used in estimating the fair value of the CTF Funds as at 31 December 2014 was nil% p.a. (31 December 2013: 12%).

b) Loans secured by residential mortgages

The fair value recognised in the financial statements for loans secured by residential mortgages is determined using a marked to model valuation technique where a significant proportion of inputs are not based on observable market data and so these assets are considered to be Level 3 within the valuation category prescribed by IFRS 13.

The valuation model discounts the expected future cash flows using an interest rate swap curve with an additional spread or yield factor minus the cost of the no-negative equity guarantee. The no-negative equity guarantee represents an embedded guarantee that the repayment of the loan cannot exceed the value of the property at the time of repayment.

Although such valuations are sensitive to various estimates, it is considered that only the discount rate and no-negative equity guarantee assumptions would have significant impact on the fair value.

Discount rate: Loans secured by mortgages are valued using the swap rate appropriate to the term of each contract with adjustment to reflect the credit and liquidity risk associated with such long dated contracts. The risk adjusted swap rate for the portfolio weighted by average value at 31 December 2014 was 5.05% (31 December 2013: 6.42%).

No-negative equity guarantee: The fair value of loans secured by residential mortgages takes into account an explicit provision in respect of the no-negative equity guarantee which is calculated using a variant of the Black-Scholes option pricing model. The key assumptions used to derive the value of the

no-negative equity guarantee include property growth, volatility and over-valuation. The property growth and volatility assumed at 31 December 2014 were 5.5% (31 December 2013: 5.5%) and 13% (31 December 2013: 13%) respectively. The over-valuation assumption used as at 31 December 2014 was 27.4% (31 December 2013: 22%). The value of the no-negative equity guarantee as at 31 December 2014 was £112.5m (31 December 2013: £67.3m).

The valuation technique that the Group uses to assess the fair value of loans secured by mortgages is consistent with that used to derive the prices applied at the initial transaction. As such, there is no difference between the fair value of loans secured by equity release mortgages at initial recognition and the amount that would have been determined at that date using the valuation technique.

c) Derivative assets and liabilities

The estimated fair value of derivative instruments reflects the estimated amount the Group would receive or pay in an arm's length transaction. All the derivatives held at 31 December 2014 and 31 December 2013 were purchased over-the-counter.

The Group's derivative assets and liabilities largely relate to forward currency positions, interest rate swaps and inflation swaps.

Forward currency positions: Forward currency exchange contracts are priced by independent third parties.

Interest rate swaps: The fair value of the interest rate swaps is derived using an interest rate swap pricing model, using a time series of historical LIBOR rates, an applicable zero coupon interest rate swap curve to derive future cash flows (forward curve) and an applicable zero coupon interest rate swap curve to discount future cash flows (discount curve) as inputs. The forward curve is used by the pricing model to determine the future LIBOR rates to be applied in the calculation of the floating leg cash flow(s). The discount curve is used to calculate the present value of the future cash flow(s) of both the fixed and floating legs of the swap and its composition is driven by the terms of the Credit Support Annex under which the swap is traded.

Inflation swaps: The fair value of the inflation swaps is derived using the inflation swap pricing model, using a time series of historical inflation index levels, a zero coupon swap inflation expectation curve, an inflation seasonality model and a zero coupon interest rate swap curve as inputs. The inflation swap pricing model generates a future cash flow for both the fixed and inflation legs of a swap for which a present value is determined using zero coupon interest rate swap curve.

The derivative assets and liabilities are presented on a gross basis in the consolidated statement of financial position. All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual Group entities and relevant counterparties in place under each of these master agreements.

d) Loans secured by commercial mortgages

The fair value recognised in the financial statements for loans secured by commercial mortgages is determined using a marked to model valuation technique where a significant proportion of inputs are not based on observable market data and so these assets are considered to be Level 3 within the valuation category prescribed by IFRS 13.

The valuation model produces a series of projected future cash flows for each mortgage, based on a range of simulations of changes in property prices drawn from a distribution based on historic observed changes. Potential changes in property tenancy (e.g. tenant default, exercise of break clause or non-renewal of lease) are also modelled in a range of simulations. Risk adjusted cash flows are calculated as the average across the range of simulations.

The risk adjusted cash flows are discounted using a swap curve with an additional spread. The additional spread is the increase in swap discount rates required so that the initial discounted risk adjusted cash flows equal the initial purchase price. This uplift is reviewed if there is evidence that market has moved materially.

The discount rate and changes in property prices and tenancy are the most significant assumptions applied in calculating the fair value of the loans.

Discount rate: Loans secured by commercial mortgages are valued using the swap rate appropriate to the term of each contract with adjustment to reflect the credit and liquidity risk associated with such long dated contracts. The risk adjusted swap rate for the portfolio weighted by average value at 31 December 2014 was 3.02%.

e) Deposits from reinsurers

The fair value recognised in the financial statements is determined using a marked to model valuation technique where not all inputs are based on observable market data and so these liabilities are considered to be Level 3 within the valuation category prescribed by IFRS 13.

The valuation model discounts the expected future cash flows using a discount rate derived from the assets hypothecated to back these liabilities at a product level.

As payables arising from reinsurance contracts do not have a single fixed maturity date it is not possible to determine an amount that would be contractually required to pay at maturity.

Discount rate: The key inputs to the derivation of the discount rate include market observable gross redemption yields, contractual investment expenses and an allowance for credit risk on a best estimate basis. The discount rates used as at 31 December 2014 for Individual retirement and Individual care annuities were 4.16% and 1.67% respectively (31 December 2013: 4.95% and 1.97% respectively).

26 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December	2014 £000's	Restated[i] 2013 £000's
Profit before income tax including discontinued operations	**24,067**	82,661
Fair value gains and interest accrued on financial assets	**(365,937)**	(32,028)
Fair value losses and interest accrued on financial liabilities	**257,638**	54,214
Depreciation of property, plant and equipment	**3,238**	1,843
Amortisation of intangible assets	**3,275**	1,997
Assets written off	**971**	1,684
Investment in associate – Eldercare	**(27)**	—
Profit on reclassification of subsidiary to associate	**(94)**	—
Share of loss of joint venture	**206**	162
Profit of subsidiary before disposal	**2**	—
Share-based payment charge	**1,223**	9,324
Amortisation of capitalised loan note debt issuance costs	—	2,519
Amortisation of capitalised bank loan debt issuance costs	—	1,765
Interest accrued on loan notes	—	19,125
Interest on bank loan	—	1,995
Net investment in financial assets	**(534,698)**	(764,815)
Net receipt of financial liabilities	**98,909**	340,612
Increase in reinsurance assets	**(405,259)**	(428,198)
Decrease in insurance and other receivables excluding Corporation Tax	**42,557**	61,916
Decrease/(increase) in prepayments and accrued income	**7,376**	(2,293)
Increase in insurance liabilities	**883,524**	624,290
Decrease in insurance and other payables	**(4,477)**	(34,462)
(Decrease)/increase in other taxes and social security payables	**(830)**	838
Cash generated from/(used in) operations	**11,664**	(56,851)

i See note 2.

27 EMPLOYEE BENEFITS

Pension scheme

Details of the amounts payable for the year are included in "Other pension costs", in note 6. No amounts are outstanding in respect of these contributions at the end of the year.

The Group is a Participating Employer for a money purchase group personal pension plan. The assets of the plan are held separately from those of the Group. The Group does not provide a final salary plan.

28 DEPOSITS RECEIVED FROM REINSURERS

Financial assets arising from the payment of reinsurance premiums, less the repayment of claims, to certain reinsurers in relation to specific treaties are legally and physically deposited back with the Group. Although the funds are managed by the Group (as the Group controls the investment of the asset), no future benefits accrue to the Group as any returns on the deposits are paid to reinsurers. Consequently the deposits are not recognised as assets of the Group and the investment income they produce does not accrue to the Group.

In addition, the Group has trust agreements with two reinsurers (2013: two) whereby the assets are held in trust in order to fully fund the reinsurers' obligations under the reinsurance treaty. As the Group has no control over these funds and does not accrue any future benefit these funds are not recognised as assets of the Group.

As at 31 December	**2014** ***£000's***	2013 *£000's*
Deposits managed by the Group	**269,630**	272,493
Deposits held in trust	**279,619**	241,699
Total deposits received from reinsurers	**549,249**	514,192

29 MANAGEMENT OF INSURANCE AND FINANCIAL RISK

The Group issues contracts that accept insurance risk in return for a premium. In addition the Group is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. In particular, the key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from contracts with policyholders. The most important components of this financial risk are interest rate risk, credit risk, property risk and liquidity risk. The Group is not exposed to any equity price risk and to currency risk only to an immaterial extent.

a) Insurance risk

a1) Underwriting, pricing and reserving risk

Underwriting and pricing risk is the risk that insurance contracts will be written that are not within the Board's risk appetite, or that the premium charged for that business is not adequate to cover the risks borne by the Group.

The accurate pricing of non-standard annuities is dependent on the Group's assessment of the impact on prospective customers' longevity of various medical and lifestyle factors and an estimate of future investment yields and credit default.

The actual timing of deaths and investment income experience may be inconsistent with the assumptions and pricing models used in underwriting and setting prices for its products.

Reserving risk is the risk that the reserves have been calculated incorrectly, or the assumptions used in the calculations are inappropriate.

As the Group's insurance business is targeted at people with conditions affecting their life expectancy, or people seeking to fund domiciliary or residential care, the underwriting risk is managed through the use of highly trained, and qualified underwriting staff, together with detailed underwriting manuals designed to cover a large range of medical conditions.

Partnership has developed its own proprietary underwriting manuals for retirement annuity business and those seeking care funding, based on industry standard mortality tables modified to take account of experience data recorded by Partnership.

The assumptions used in the reserving for future policyholder payments are set based on available market and experience data, on the advice of Partnership's Actuarial Function Holder. The assumptions are approved by the Board. The reserves are calculated using recognised actuarial methods with due regard to

the actuarial principles set out in the PRA's sourcebooks, including appropriate levels of prudential margin against future adverse experience.

a2) Specific insurance risk

Insurance risk on the Group's annuity contracts arises through longevity risk and through the risk that operating factors, such as administration expenses, are worse than expected. Insurance risk on the Group's protection policies arises through higher than expected mortality levels. The Group's longevity and mortality experience is monitored on a regular basis and compared to the underlying assumptions used to reserve for future insurance payments. The exposure to longevity and mortality risk is reduced through the use of reinsurance.

Expense risk is managed through regular assessment and quarterly reforecasting of expenses incurred against budgets.

b) Interest Rate Risk

Interest rate risk arises from open positions in fixed and variable rate stock issued by government and corporate bodies that are exposed to general and specific market movements. The Group is exposed to the market movements in interest rates to the extent that the asset value movement is different to the accompanying movement in the value of its insurance liabilities.

The difference between asset and liability movements can arise from both a change in the absolute level of interest rates, and from a change in the "spread" (that is the level of interest rates applying to an asset in excess of the risk-free interest rate).

The Group manages its interest rate risk within an asset liability management (ALM) framework that has been developed to achieve investment returns in excess of its obligations under insurance contracts. The principal technique of the ALM framework is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to policyholders.

The Group monitors interest rate risk by calculating the mean duration and cash flow profile of the investment portfolio and the liabilities. The mean duration is an indicator of the sensitivity of the assets and insurance liabilities to changes in current interest rates but is not sufficient in isolation. The mean duration of the liabilities is determined by means of projecting expected cash flows from the contracts using best estimates of mortality and voluntary terminations. No future discretionary supplemental benefits are assumed to accrue. The mean duration of the assets is calculated in a consistent manner. Any gap between the mean duration of the assets and the mean duration of the liabilities is minimised by means of buying and selling fixed interest securities of different durations or purchasing interest rate swap derivatives to alter the effective mean duration of the assets. Periodically the cash flow matching is reviewed and rebalanced.

At 31 December 2014, the mean duration of the assets including surplus assets was 8.3 years (2013: 7.5 years) measured with reference to a gross redemption yield and the mean duration of the liabilities (including both retirement and care liabilities) was at 9.6 years (2013: 8.9 years) measured with reference to the valuation interest rate.

The Group has reinsurance arrangements in place which provide for fixed payments to the reinsurer over future periods. In assessing the fair value of this liability, the Directors have used a discount rate derived from current market yields earned on assets held to fund the future cash outflows, adjusted for the risk of default on those assets. No further adjustment to the discount rate to reflect any risk of the Group defaulting on those payments to the reinsurer was deemed appropriate.

c) Credit risk

Market credit risk is the risk that the Group invests in assets that may default.

If an asset fails to repay either interest or capital, or that payment is significantly delayed, the Group may make losses and be unable to meet liabilities as they fall due.

The Group's Investment Management Guidelines set out maximum exposure to bonds issued by a single, or related group of, counterparty(/ies) and to credit ratings. The allowance made for issuer default in the Group's valuation is regularly monitored and kept up to date.

At 31 December 2014, £19.0m of collateral (2013: £0.9m) had been pledged to the Group to mitigate the credit risk exposure associated with the derivative assets held at that time.

Counterparty credit risk arises if another party fails to honour its obligations to the Group including failure to honour these obligations in a timely manner.

The Group's primary counterparty credit risk exposure arises from the inability of the reinsurers to meet their claim payment obligations.

The Group has arrangements with its reinsurers whereby most reinsurance premiums are either deposited back to the Group or held by a third party in a trust arrangement.

In addition, the Group's reinsurance policy is to seek to choose companies with a minimum "A" credit rating.

The following table analyses the credit exposure of the Group by type of asset and includes the credit risk arising out of reinsurance exposures, based on the credit ratings of the reinsurer, as published by Standard & Poors, or an equivalent rating from another recognised rating agency.

	Credit rating					
At 31 December 2014	**AAA**	**AA**	**A**	**BBB**	**Unrated**	**Total**
	£000's	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***
Financial investments	**815,605**	**234,771**	**1,251,104**	**1,280,870**	**2,470**	**3,584,820**
Derivative assets	—	—	—	—	**75,892**	**75,892**
Loans secured by residential mortgages	—	—	—	—	**1,212,324**	**1,212,324**
Loans secured by commercial mortgages	—	—	—	—	**37,868**	**37,868**
Reinsurance assets	—	**1,290,232**	**1,955,776**	—	—	**3,246,008**
Insurance and other receivables	—	**17,761**	**4,761**	—	**16,645**	**39,167**
Total	**815,605**	**1,542,764**	**3,211,641**	**1,280,870**	**1,345,199**	**8,196,079**

	Credit rating					
Restated[i] At 31 December 2013	AAA	AA	A	BBB	Unrated	Total
	£000's	*£000's*	*£000's*	*£000's*	*£000's*	*£000's*
Financial investments	611,062	260,620	1,193,352	1,057,189	11,568	3,133,790
Derivative assets	—	—	—	—	36,413	36,413
Loans secured by residential mortgages	—	—	—	—	840,066	840,066
Reinsurance assets	—	1,240,280	1,600,469	—	—	2,840,749
Insurance and other receivables	—	13,132	11,064	—	55,437	79,633
Total	611,062	1,514,032	2,804,885	1,057,189	943,484	6,930,651

i See note 2.

The following table presents an aging analysis of financial assets by payment due status:

No financial assets were past due at 31 December 2014.

		Past due but not impaired					
Restated[i] As at 31 December 2013	**Not past due**	**Less than 1 month**	**1-3 months**	**3-6 months**	**More than 6 months**	**Impaired**	**Total**
	£000's	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***
CTF investments	**7,094**	—	**742**	**3,732**	—	—	**11,568**
Loans secured by mortgages	**840,066**	—	—	—	—	—	**840,066**
Other financial assets	**6,079,017**	—	—	—	—	—	**6,079,017**

i See note 2.

d) Liquidity risk

Liquidity risk arises where cash flows from investments and from new premiums prove insufficient to meet our obligations to policyholders and other third parties as they fall due.

The Group's ALM framework ensures that cash flows are sufficient to meet both long- and short-term liabilities.

The Group maintains a minimum level of cash and highly liquid assets such that, in the extreme scenario of new business cash flows being insufficient to meet current obligations, those obligations can continue to be met.

In accordance with PRA regulations, the Group's assets are reviewed to ensure they are of sufficient amount and of an appropriate currency and term to ensure that the cash inflows from those assets will meet the expected cash outflows from the Group's insurance and other financial liabilities.

In the following table expected cash outflows for:

- net insurance liabilities have been modelled with reference to underlying mortality and longevity assumptions;
- payables arising from reinsurance include interest and payments due under the terms of reinsurance treaties; and
- derivative liabilities have been modelled with reference to the yield curves that existed at the balance sheet date and assumed to be held to maturity.

The following table includes insurance and financial liabilities that are exposed to liquidity risk.

At 31 December 2014	**Expected cash flows (undiscounted)**				
	less than one year	**one to five years**	**five to ten years**	**more than ten years**	**Carrying value (discounted)**
	£000's	***£000's***	***£000'***	***£000'***	***£000's***
Net insurance liabilities...............	**153,346**	**544,237**	**571,040**	**1,667,559**	**1,985,104**
Deposits received from reinsurers	**213,142**	**793,042**	**843,324**	**2,005,880**	**2,491,795**
Derivative liabilities....................	**13,523**	**37,602**	**10,603**	**34,097**	**79,493**
Total...	**380,011**	**1,374,881**	**1,424,967**	**3,707,536**	**4,556,392**

Restated[i] At 31 December 2013	Expected cash flows (undiscounted)				
	less than one year	one to five years	five to ten years	more than ten years	Carrying value (discounted)
	£000's	*£000's*	*£000'*	*£000'*	*£000's*
Net insurance liabilities...............	131,727	457,257	464,853	1,285,066	1,506,839
Deposits received from reinsurers	1,831,083	735,336	792,792	1,934,163	2,182,350
Derivative liabilities....................	584	10,252	14,381	15,596	32,391
Total...	1,963,394	1,202,845	1,272,026	3,234,825	3,721,580

The maximum exposure to credit risk is equal to the balance sheet value of debt instruments/derivatives.

e) Property risk

Property risk arises from the provision of a protected equity guarantee on the mortgages underlying the equity release assets purchased. The Group is exposed to the risk that property values do not rise sufficiently, or that the property is not maintained properly, to recover the full value of the loan made plus accrued interest.

The Group manages its purchase of loan assets to a level appropriate to its liability profile and ensures that the purchase prices of loan assets reflect a prudent assessment of future property price growth. Appropriate limits are applied to the "loan-to-value" ratio in order to limit the risk exposure to the Group. The Group seeks to avoid excess concentration of property holdings in any geographical area.

Property risk on commercial mortgages is the risk that property values decline or property tenancy changes such that the full value of the commercial mortgage loan is not recovered. The initial loan value is restricted to a maximum "loan-to-value" ratio that limits its exposure for the Group.

30 AVAILABLE CAPITAL RESOURCES

Economic capital is the principal risk-based capital measure used by the Board. Economic capital is based on the Board's view of the available capital and required capital calibrated to a 1 in 200 stress.

The Group's capital consists of equity attributable to equity holders of the Parent Company. For the purposes of regulatory capital requirements, certain assets are restricted, or are inadmissible.

The Group manages its capital to ensure that all of entities within the Group will be able to continue to operate as going concerns, remaining compliant with all regulatory capital requirements to which each is subject.

Partnership Life Assurance Company Limited (PLACL), the principal operating and only insurance company in the Group, is required to comply with minimum capital requirements calculated at the level of its EEA parent and ultimate Parent Company level as required by the PRA as set out in the Insurance Groups Directive, as well as its own single entity level as required by the PRA. PAG plc is both the EEA parent and ultimate Parent Company of PLACL.

The table below provides a reconciliation between the available capital resources of the PAG plc Group, measured under IFRS, and the surplus over regulatory capital requirement as is required to be measured under the Insurance Groups Directive. Any changes or release of capital from long-term funds is subject to there being an established surplus shown by an actuarial investigation.

As at 31 December	**2014** ***£000's***	2013 *£000's*
Total equity of PAG plc Group	**604,690**	598,549
Minority interest in equity for regulated business	**—**	(66)
Adjustments in respect of regulatory capital basis:		
Inadmissible intangible assets	**(15,219)**	(16,401)
Inadmissible goodwill	**(126,207)**	(126,207)
Inadmissible deferred tax asset	**(519)**	(424)
Equity and reserves related to non-regulated entities (excluded from regulatory capital calculation), adjusted for inadmissible assets already adjusted above	**3,042**	13,031
Total available capital resources (IGD basis)	**465,787**	468,482
Group minimum capital requirement (IGD basis)	**(224,127)**	(191,630)
Surplus over regulatory capital requirement	**241,660**	276,852

Movements in equity are shown in the Consolidated Statement of Changes in Equity.

Throughout the year, each regulated subsidiary has maintained capital resources in excess of the minimum required by the PRA regulations and the EU directives.

31 SHARE CAPITAL

The Group has issued ordinary shares which are classified as equity. Incremental external costs that are directly attributable to the issue of the ordinary shares are recognised in equity, net of tax.

As at 31 December 2014	**Number of shares**	**Share capital** ***£000's***	**Share premium** ***£000's***
The allotted and issued share capital of PAG plc:			
Shares subdivided into 500,000 ordinary shares of £0.10 each	**399,999,971**	**40,000**	**435,249**
As at 31 December 2014, ordinary shares of £0.10 each	**399,999,971**	**40,000**	**435,249**

As at 31 December 2013	Number of shares	Share capital *£000's*	Share premium *£000's*
The allotted and issued share capital of PAG plc:			
On incorporation, ordinary shares of £1.00 each	50,000	50	—
On 12 June 2013:			

Shares subdivided into 500,000 ordinary shares of £0.10 each	450,000	—	—
Exchange of the A and B loan notes	69,212,294	6,921	259,547
Exchange of C loan notes	15,397,726	1,540	57,742
Share for share exchange of A, B and C ordinary shares in PAGH for ordinary shares in PAG plc	282,358,446	28,236	—
New issue of shares as part of Global Offer	32,467,532	3,247	121,752
New ordinary shares issued to senior management	51,948	5	195
New ordinary shares issued to EBT	12,025	1	45
Share issue costs	—	—	(4,032)
As at 31 December 2013, ordinary shares of £0.10 each	399,999,971	40,000	435,249

The ordinary share entitles the holder to dividends declared by the Board which are not cumulative. The ordinary share entitles the holder to one vote for every share held.

Shares held by the employee trust

Where an employee trust acquires shares in the Company or obtains rights to purchase its shares, the consideration paid (including attributable transaction costs, net of tax) is shown as a deduction from the owners' equity. Gains and losses on sales of shares held by the employee trust are charged or credited to the own shares account in equity.

As at 31 December	**2014**	2013
	£000's	*£000's*
Employee benefit trust	**(136)**	(58)

32 OPERATING LEASE COMMITMENTS

The Group has annual commitments in respect of non-cancellable operating leases as follows:

As at 31 December	**2014**	2013
	£000's	*£000's*
Leases expiring not later than one year	**2,816**	3,645
Leases expiring between one and five years	**9,036**	11,671
Leases expiring in more than five years	**7,835**	9,453
Total lease commitments	**19,687**	24,769

33 RELATED PARTY TRANSACTIONS

Balances and transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

During the period, the Group entered into transactions, in the ordinary course of business, with other related parties. Transactions entered into and balances outstanding at the end of each reporting date are detailed below.

a) Remuneration of key management personnel

Key management personnel consist of the Directors of the Company. The key management personnel changed during the year 2014 reflecting the Group reorganisation. The remuneration of the Directors, who are the key management personnel of the Group, is set out below:

As at 31 December	**2014**	2013
	£000's	*£000's*
Short-term employee benefits	**2,850**	2,060
Post-employment benefits	**16**	55
Total	**2,866**	2,115

b) Directors' loans

A number of Directors who are defined as key management personnel of the Company held loans during the period. The loans owed to/by the Directors are detailed as follows:

As at 31 December	**2014**	2013
	£000's	*£000's*
Amounts owed by Directors:		
Loan advances	**302**	289
Loans owed by Directors	**302**	289

The terms of the B and Vendor loan notes are detailed in note 31 and, as set out in that note, were exchanged for ordinary shares in the Company as part of the IPO.

The loan advances to Directors accrue interest fixed at 4% per annum and are repayable in whole or in part at any time.

The amounts accruing (to)/from the Directors in respect of these loan notes are detailed below:

As at 31 December	**2014**	2013
	£000's	*£000's*
Interest accrued on B and Vendor loan notes	—	(663)
Interest accrued on Directors' loan advances	**12**	6
Total	**12**	(657)

c) Other related party transactions

During the year the Group entered into transactions with other entities controlled by Cinven Limited, associates and joint ventures as set out below. All transactions were on a commercial basis.

	2014	2013
	£000's	*£000's*
Costs paid to entities related to the ultimate parent controlling party	**122**	558
Group's share of losses of joint venture investment	**6**	—
Loans advanced to associate and fees on loans	**187**	—
Value of other related party transactions	**315**	558

Costs paid to entities related to the ultimate parent controlling party include management fees paid to Cinven Partnerships LLP for director services. The comparative cost in 2013 included expenses associated with the 2013 IPO. At 31 December 2014 there was no amount due or receivable from any entities related to the ultimate parent controlling party (2013: £nil).

The Group's share of losses of joint venture investment arose in Gateway prior to sale on 29 August 2014. Note 13 includes detail of loans from Gateway that were written off in 2014. At 31 December 2014 there was no amount due or receivable from Gateway (2013: £289,000).

Loans were advanced to the Group's associate, Eldercare, during the 2014. At 31 December 2014, Eldercare owed the Group £153,000. At 31 December 2013 Eldercare was not an associate of the Group.

d) Ultimate controlling party

As at 31 December 2014 a majority of the Company's ordinary shares are held by the partnerships comprising the Fourth Cinven Funds (the Cinven Funds), being funds managed and advised by Cinven Limited, a company incorporated in the United Kingdom. Accordingly, the Directors consider the Company's ultimate controlling party to be Cinven Limited, the manager and adviser to the Cinven Funds.

34 EVENTS AFTER THE BALANCE SHEET DATE

Dividend

Subsequent to 31 December 2014, the Directors proposed a final dividend for 2014 of 1.0 pence per ordinary share (2013: 3.0 pence), amounting to £4.0m (2013: £12m) in total. Subject to approval by shareholders at the AGM, the dividend will be paid on 29 May 2015 and will be accounted for as an appropriation of retained earnings in the year ending 31 December 2015.

Bond issue

On 2 March 2015 the Group entered into an agreement to issue a £100m bond to funds managed by Cinven Capital Management ('Cinven'), its majority shareholder. The bond is repayable after a 10 year term with possible redemption, at option of the Group, at the fifth anniversary or on any interest payment date thereafter, in each case subject to PRA consent. The bond has an annual interest rate of 9.5% payable annually in arrears from the issue date. The bond is a Tier 2 qualifying regulatory capital instrument under existing solvency regulations and Solvency II compliant following implementation of the Solvency II regime on 1 January 2016. The bond is issued by Partnership Assurance Group plc with a guarantee provided by Partnership Life Assurance Company Limited.

35 BASIS OF PREPARATION

The separate financial statements of Partnership Assurance Group plc (the Company) have been prepared on a going concern basis in accordance with the Companies Act 2006 applicable to companies reporting under IFRS, and accounting policies have been applied consistently. As permitted by that act, the separate financial statements have been prepared in accordance with IFRS which comprise standards and interpretations approved by either the International Accounting Standards Board or the IFRS Interpretations Committee or their predecessors, as adopted by the European Union (EU) as at 31 December 2013. The Company has taken advantage of the exemption in section 408 of the Companies Act 2006 not to present its own Income Statement and Statement of Comprehensive Income.

The financial statements have been prepared on the historical cost basis, except for the measurement of long-term employee benefits at present value of the obligation less fair value of any assets held to settle the obligation. The principal accounting policies adopted are the same as those set out in the Group's financial statement note disclosures. In addition, note 36 sets out the accounting policy in respect of investments in subsidiary undertakings.

36 INVESTMENT IN SUBSIDIARIES

Investments in subsidiaries are stated at cost less impairment in the Statement of Financial Position of the Company, as determined by the Company's Directors.

As at 31 December	**2014**	2013
	£000's	*£000's*
Investment in PAGH	28,286	28,286
Investment in Partnership Holdings Limited (PHL)	1,171,534	1,148,534
Investment in Partnership Services Limited (PSL)	**2,169**	946
Investment in subsidiaries	**1,201,989**	1,177,766

During the year the Company made a capital contribution of £23m in the form of a gift to the Company's subsidiary, PHL. The capital contribution is recognised as an increase in cost of investment in the subsidiary.

37 INSURANCE AND OTHER RECEIVABLES

As at 31 December	**2014**	2013
	£000's	*£000's*
Other debtors	29	—
Amounts due from other Group undertakings	**9,932**	25,514
Total insurance and other receivables	**9,961**	25,514

38 PREPAYMENTS AND ACCRUED INCOME

As at 31 December	**2014**	2013
	£000's	*£000's*
Accrued income	**4**	10
Total prepayments and accrued income	**4**	10

39 CASH AND CASH EQUIVALENTS

As at 31 December	2014	2013
	£000's	*£000's*
Short-term bank deposits	**10,846**	30,012
Cash at bank and in hand	**66**	2,548
Total cash and cash equivalents	**10,912**	32,560

40 INSURANCE AND OTHER PAYABLES

As at 31 December	2014	2013
	£000's	*£000's*
Amounts due to other Group undertakings	**58,219**	58,219
Total insurance and other payables	**58,219**	58,219

41 CURRENT TAX LIABILITIES

As at 31 December	2014	2013
	£000's	*£000's*
Income taxes	**46**	421
Total current tax liabilities	**46**	421

42 SHARE CAPITAL

Details of the Company's share capital and share premium are set out in note 33.

43 RELATED PARTY TRANSACTIONS

During the year the Company made a capital contribution of £23m to PHL in the form of a gift (note 36).

On 14 July 2014, the Company advanced a loan to its subsidiary, PSL. At 31 December 2014 the balance on that loan was £9.4m and is included in Amounts due from other Group undertakings (note 37). Interest is charged on that loan at 150 basis points over 6 months LIBOR. £155,800 of interest accrued to the Company on the loan in 2014.

The Company received no other interest or income, neither did it suffer costs incurred from any other Group entity during 2014. The Amounts due from other Group undertakings receivable, included in insurance and other payables, are not interest bearing.

The Amounts due to another Group undertaking (note 40) is a balance due to the Company's wholly owned dormant subsidiary, PAG Finance Limited, and is equal to the equity of that subsidiary.

Details of the remuneration of key management personnel is set out in note 32.

44 ULTIMATE PARENT UNDERTAKING

The Company's ultimate Parent undertakings are the partnerships comprising the Fourth Cinven Funds (the Cinven Funds), being funds managed and advised by Cinven Limited, a company incorporated in the United Kingdom. Accordingly, the Directors consider the Company's ultimate controlling party to be Cinven Limited, the manager and adviser to the Cinven Funds.

45 EVENTS AFTER THE BALANCE SHEET DATE

The events after the balance sheet date applicable to the Company are set out in note 34.

AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF PARTNERSHIP ASSURANCE GROUP PLC FOR THE YEAR ENDED 31 DECEMBER 2013

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF PARTNERSHIP ASSURANCE GROUP PLC

OPINION ON FINANCIAL STATEMENTS OF PARTNERSHIP ASSURANCE GROUP PLC

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2013 and of the Group's profit for the year then ended,
- the Group financial statements have been properly prepared in accordance with IFRS as adopted by the European Union,
- the Parent Company financial statements have been properly prepared in accordance with IFRS as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise the consolidated statement of comprehensive income, the consolidated and Parent Company statements of financial position, the consolidated and Parent Company cash flow statements, the consolidated and Parent Company statements of changes in equity and the related notes 1 to 46. The financial reporting framework that has been applied in their preparation is applicable law and IFRS as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

GOING CONCERN

As required by the Listing Rules we have reviewed the directors' statement that the Group is a going concern. We confirm that:

- we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and
- we have not identified any material uncertainties that may cast significant doubt on the Group's ability to continue as a going concern.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team

Insurance liabilities

RISK

The Group predominantly writes non-standard annuities which it prices using its bespoke mortality data and internally generated intellectual property. The Company reserves for the future expected cost of these policies using complex actuarial models to project the insurance liabilities. These models are dependent on key assumptions made by management in respect of the following:

- projected cash flows - the expected payments on the portfolio based on assumptions as to the mortality of the policyholders based on their medical condition or lifestyle characteristic; and
- the valuation rate of interest based on the yield of the portfolio of assets that back the liabilities that is used to discount the expected cash flows, which also needs to reflect a deduction for the credit risk of the underlying assets.

Further detail on these principal assumptions can be found in note 20 to the financial statements. The significance and inherent subjectivity of these assumptions means that we view this as an area of heightened risk.

HOW THE SCOPE OF OUR AUDIT RESPONDED TO THE RISK

We used our internal actuarial specialists to test the controls over the end-to-end reserving process, focusing on the controls over changes to the reserving model and changes to the underlying demographic and economic assumptions.

We performed detailed substantive testing on the data inputs to the model including checks on policy data via agreeing a sample back to original policyholder documentation and checks that all assumptions had been input to the model accurately.

Management has updated their mortality basis for the largest policy group and a new valuation rate of interest model has been implemented during the year. We tested these assumptions, in addition to testing manual provisions, reinsurance reserves, allowance for counterparty default risk, allowance for cash flow and currency mis-matching risk and statutory capital requirements. We used our internal actuarial specialists to challenge management's assumptions by considering the Group's own experience, comparison to industry benchmarks and by testing compliance with regulations.

An assessment on the overall results was made by reviewing the analysis of change in reserves over the period under audit.

Equity release asset transactions

RISK

The Group's investments include loans backed by a portfolio of equity release assets. In Q3 2013 the Group completed a large bulk purchase deal for a value of £218m, with a further deal completed in Q4 2013 for a value of £69m.

The fair value of the investment is dependent on the valuation of the underlying properties and the assumptions used in the fair value calculation, such as the property growth rate, property volatility, a revaluation index to revalue properties to the valuation date, swap rates, and mortality assumptions. Note 26b to the financial statements provides further detail as to the methodology for calculating the fair value of these assets.

The subjectivity of the key assumptions, coupled with the significance of the transactions, means that we view this as an area of risk.

HOW THE SCOPE OF OUR AUDIT RESPONDED TO THE RISK

We tested the new transactions through reviewing the due diligence work performed by the Group, challenging the valuation basis put forward by management based on independent macroeconomic advice received, and testing the underlying data used in the valuation of the equity release assets via agreement of a sample of loans back to original policy documentation.

We also assessed the underlying portfolio of assets for indicators of impairment via segmenting the portfolio geographically and using applicable regional property valuation indices to check for signs of significant diminution in the value of the underlying properties on which the loans are secured, as well as analysing the age of the loan book.

Our internal actuarial specialists challenged management's methodology and assumptions used to value the equity release assets via comparison to industry benchmarks, including whether the valuation was sensitive to the mortality assumption.

RISK	HOW THE SCOPE OF OUR AUDIT RESPONDED TO THE RISK
Defined benefit scheme buy-in and buy-out transactions	
The Group is further diversifying its business through insuring the risk on defined benefit schemes, focusing specifically on high value, impaired policies. A new model was introduced during the period to calculate the reserves for this liability. The lack of maturity around this model means that we view this as an area of risk.	Our internal actuarial specialists have reviewed the controls over, and management's testing of, the model and gained assurance that it is operating effectively with a framework of supporting controls. The assumptions underlying the model were challenged via comparison to industry benchmarks and by testing compliance with regulations.

The Audit Committee's consideration of these risks is set out herein.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

OUR APPLICATION OF MATERIALITY

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Group to be £4.2m, which is below 1% of net written premiums. We consider a turnover based measure to be the most suitable benchmark at this stage in Partnership Assurance Group plc's development as it drives one of the Group's key performance indicators and is a figure on which the users of the financial statements focus.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £84,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

AN OVERVIEW OF THE SCOPE OF OUR AUDIT

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level.

Our Group audit has covered entities representing 100% of the Group's net assets, 100% of the Group's revenue and 100% of the Group's profit before tax. The result of the Group is predominantly driven by a single trading company, Partnership Life Assurance Company Limited. All of the Group entities audited are based in the same location and were audited by the Group audit team and the Group engagement partner.

Our audit work was executed at levels of materiality applicable to each individual entity which were lower than Group materiality.

Further information on the Group and the recent restructure can be found in notes 13 and 32 to the Annual Report and Accounts.

At the Parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- 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.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

Directors' remuneration

We have nothing to report in respect of these matters.

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

Corporate Governance Statement

Under the Listing Rules we are also required to review the part of the Corporate Governance Statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

As explained more fully in the Directors' Responsibilities Statement, 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. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team, strategically focused second partner reviews and independent partner reviews.

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.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Alex Arterton
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
18 March 2014

AUDITED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2013

	Note	**2013** *£000's*	2012 *£000's*
Gross premiums written	1	**1,159,562**	1,468,008
Outward reinsurance premiums		**(733,849)**	(554,620)
Net premiums earned before restructure of reinsurance treaty		**425,713**	913,388
Reinsurance premium related to restructure of treaty		—	(495,803)
Net premiums earned		**425,713**	417,585
Net investment income	3	**137,762**	290,738
Share of results of joint venture	14	**(162)**	(40)
Other income		**219**	180
Total income		**563,532**	708,463
Gross claims paid		**(341,124)**	(273,655)
Reinsurers' share of claims paid		**225,277**	188,462
Recovery related to recapture of reinsurance treaty		—	99,748
Net claims (paid)/recovered		**(115,847)**	14,555
Change in insurance liabilities:			
Gross amount		**(624,290)**	(1,564,761)
Reinsurers' share not related to restructure and recapture		**428,197**	663,452
Reinsurers' share related to restructure and recapture	20	—	396,213
Net change in insurance liabilities		**(196,093)**	(505,096)
Acquisition costs	4	**(13,036)**	(34,566)
Investment expenses and charges		**(13,270)**	(8,178)
Interest on subordinated debt		—	(496)
Interest on external borrowings		**(25,403)**	(33,976)
Administrative and other expenses	5	**(117,223)**	(73,227)
Total expenses		**(168,931)**	(150,443)
Total claims, change in insurance liabilities and expenses		**(480,872)**	(640,984)
Profit from continuing operations before tax	5	**82,661**	67,479
Income tax charge from continuing operations	7	**(23,240)**	(17,245)
Profit for the year from continuing operations		**59,421**	50,234
Loss for the year from discontinued operations	7	—	(28)
Profit for the period		**59,421**	50,206
Profit/(loss) attributable to:			
- Owners of the Parent		**59,465**	50,193
- Non-controlling interest		**(44)**	13
Profit for the period		**59,421**	50,206
Basic earnings per ordinary share	8	**£0.17**	£0.18
Diluted earnings per ordinary share	8	**£0.17**	£0.18

AUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

<u>For the year ended 31 December 2013</u>

		Attributable to Owners of the Parent								
	Note	**Share Capital** *£000's*	**Share Premium** *£000's*	**Capital Redemption Reserve** *£000's*	**Merger Reserve** *£000's*	**Shares held by Employee Benefit Trust** *£000's*	**Retained profit** *£000's*	**Total** *£000's*	**Non-controlling interest** *£000's*	**Total** *£000's*
At 1 January 2013.....		**36**	**182**	**3,297**	**—**	**(33)**	**78,901**	**82,383**	**(22)**	**82,361**
PAGH shares exchanged for ordinary shares.....	33	**28,250**	**(182)**	**(3,297)**	**(24,521)**	**(250)**	**—**	**—**	**—**	**—**
Loan notes exchanged for ordinary shares.....	33	**8,462**	**317,288**	**—**	**—**	**—**	**—**	**325,750**	**—**	**325,750**
Shares issued for cash	33	**3,252**	**121,993**	**—**	**—**	**(46)**	**526**	**125,725**	**—**	**125,725**
Share issue costs.......		**—**	**(4,032)**	**—**	**—**	**—**	**—**	**(4,032)**	**—**	**(4,032)**
Share-based payments.............	19	**—**	**—**	**—**	**—**	**271**	**9,053**	**9,324**	**—**	**9,324**
Profit for the year......		**—**	**—**	**—**	**—**	**—**	**59,465**	**59,465**	**(44)**	**59,421**
At 31 December 2013.....................		**40,000**	**435,249**	**—**	**(24,521)**	**(58)**	**147,945**	**598,615**	**(66)**	**598,549**

		Attributable to Owners of the Parent								
	Note	Share Capital *£000's*	Share Premium *£000's*	Capital Redemption Reserve *£000's*	Merger Reserve *£000's*	Shares held by Employee Benefit Trust *£000's*	Retained profit *£000's*	Total *£000's*	Non-controlling interest *£000's*	Total *£000's*
			£000's	*£000's*	*£000's*	*£000's*	*£000's*	*£000's*	*£000's*	*£000's*
At 1 January 2012.....		3,330	182	—	—	(33)	27,208	30,687	(35)	30,652
Shares issued/ (bought back) for cash.....................	33	(3,294)	—	3,297	—	—	—	3	—	3
Share-based payments.............	19	—	—	—	—	—	1,500	1,500	—	1,500
Profit for the year......		—	—	—	—	—	50,193	50,193	13	50,206
At 31 December 2012		36	182	3,297	—	(33)	78,901	82,383	(22)	82,361

The notes are an integral part of these financial statements.

AUDITED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2013

	Note	**2013**	2012
		£000's	*£000's*
Assets			
Property, plant and equipment	9	**15,459**	3,688
Goodwill	10	**126,207**	126,207
Other intangible assets	11	**16,401**	12,343
Financial assets	12	**3,950,443**	3,159,001
Investment in joint ventures	14	**206**	368
Reinsurance assets	20	**2,840,749**	2,412,551
Insurance and other receivables	15	**64,476**	94,881
Prepayments and accrued income	16	**70,817**	63,123
Deferred tax assets	17	**424**	158
Cash and cash equivalents	18	**112,741**	166,273
Total assets		**7,197,923**	6,038,593
Equity			
Share capital	33	**40,000**	36
Share premium	33	**435,249**	182
Capital redemption reserve	33	**—**	3,297
Merger reserve	33	**(24,521)**	—
Shares held by Employee Benefit Trust	33	**(58)**	(33)
Retained profit		**147,945**	78,901
Total equity attributable to owners of the Parent		**598,615**	82,383
Non-controlling interest		**(66)**	(22)
Total equity		**598,549**	82,361
Liabilities			
Insurance liabilities	20	**4,347,588**	3,723,298
Insurance and other payables	21	**32,088**	62,948
Financial liabilities	22	**2,201,500**	1,778,765
External borrowings	23	**—**	380,367
Current tax liabilities	24	**18,198**	10,854
Total liabilities		**6,599,374**	5,956,232
Total equity and liabilities		**7,197,923**	6,038,593

The notes are an integral part of these financial statements.

AUDITED CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2013

	Note	**2013**	2012
		£000's	*£000's*
Cash (used in)/from operations	27	**(56,851)**	46,171
Corporation tax paid		**(17,000)**	(17,074)
Net cash (used in)/from operating activities		**(73,851)**	29,097
Cash flows from investing activities:			
Purchase of property, plant and equipment	9	**(13,657)**	(3,058)
Purchase of other intangible assets	11	**(7,696)**	(7,385)
Net cash used in investing activities		**(21,353)**	(10,443)
Cash flows from financing activities:			
Proceeds from issuance of share capital	33	**121,693**	3
Repayment of subordinated debt	23	—	(16,000)
Repayment of loan notes	23	**(7,656)**	—
(Repayment)/receipt of bank loan	23	**(70,000)**	50,000
Proceeds from issuance of bank loan	23	—	68,075
Interest on subordinated debt		—	(496)
Interest payable on external borrowings		**(2,365)**	(829)
Net cash from financing activities		**41,672**	100,753
Net (decrease)/increase in cash and cash equivalents		**(53,532)**	119,407
Cash and cash equivalents brought forward		**166,273**	46,866
Cash and cash equivalents carried forward	18	**112,741**	166,273

Cash flows related to the sale and purchase of financial investments are included in operating cash flows as they are associated with the origination of insurance contracts and payment of insurance claims.

The notes are an integral part of these financial statements.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

1 SEGMENTAL ANALYSIS

The operating segments reflect the level within the Group at which key strategic and resource allocation decisions are made and the way in which operating performance is reported internally to the chief operating decision makers in the Group, being the Board.

Information is provided to the Board, which identifies operating profit split between that achieved on new business written in the period, that which derives from in-force policies and that relating to the long-term expected return on surplus assets, and therefore this split forms the reportable operating segments in accordance with IFRS 8 "*Operating Segments*".

New business revenue is reported as Single Premium Equivalent (SPE), being the actual single premium plus ten times the annual regular premium for new contracts written during the year. These revenue measures are monitored by the Board separately for each core target market.

a) Segmental analysis of profit

The table below shows operating profit for each year, together with a reconciliation to profit before tax

For the year ended 31 December	**2013** ***£000's***	2012 *£000's*
New business operating profit	**85,678**	93,871
In-force operating profit	**34,278**	14,263
Long-term expected return on surplus assets	**11,435**	3,997
Operating profit	**131,391**	112,131
Investment variances	**8,643**	(3,289)
Non-recurring expenditure	**(30,769)**	(5,735)
Other	**(1,201)**	(1,156)
Interest on borrowings	**(25,403)**	(34,472)
Profit from continuing operations before tax	**82,661**	67,479

Investment variances reflect:

a) the difference between actual performance on investment assets (e.g. cash, gilts, corporate bonds and equity release) over the reporting period and the investment yield allowed for in the calculation of in-force liabilities at the start of the reporting period;

b) the difference between the yield on investment assets allowed for in the calculation of new business profits and the actual investment performance including differences arising from investing at different yields and asset allocations than those expected when pricing new business;

c) the difference between actual performance on investment assets and long-term assumed return on surplus assets; and

d) the impact of changes in the best-estimate credit default allowance made against the Group's invested assets.

Non-recurring expenditure comprises:

- £158m expenses in respect of the Group's restructuring and IPO (2012: £2.3m);
- £9.8m charge related to the Group's staff share option plan which vested in full as a result of the IPO (2012: £1.5m);
- £4.1m of costs relating to regulatory projects (Solvency II) and re-engineering of financial processes (2012: £1.9m); and

- £1.1m of other costs including redundancy, office relocation costs and other professional fees (2012: £nil).

Other losses relate to the Group's interest in distribution subsidiaries and holding company expenses.

The profit measure used by the Board to monitor performance is operating profit before tax, analysed between new business operating profit, n-force operating profit and the long-term expected return on surplus assets. Each component of operating profit is explained as

- New business operating profit is profit generated from new business completed in the period, calculated using actuarial assumptions applicable at the time the new business was written, and utilising a discount rate based upon investment yields on investment assets (e.g. cash, gilts, corporate bonds and loans secured by mortgages) used to generate the annuity quotation, net of expenses allocated against new business.

- In-force operating profit is generated from the actual experience measured against the assumed experience in the actuarial basis. The actuarial basis includes a number of assumptions, the most material of which are mortality levels, levels of default on investments, expense levels (to maintain the business in-force), levels of inflation, and lapse rates (for regular premium business). In-force operating profit also includes the effect recognised in the IFRS profit arising from changes to the reported value of insurance (and associated financial) liabilities resulting from changes to the actuarial assumptions, valuation methods, or underlying data, made subsequent to the point-of-sale.

- Return on surplus assets is the long-term, risk-adjusted, expected return on investments that are surplus to those investments that are used to back insurance liabilities. The long-term expected return is derived from applying an average expected yield appropriate to the category of surplus assets held, and is adjusted for the best-estimate expected level of defaults on those investments. The risk-adjusted annual yields applied to surplus assets during the period were

For the year ended 31 December	**2013** ***% p.a.***	2012 *% p.a.*
Cash	**0.5**	0.5
Gilts	**3.0**	3.0
Corporate bonds	**4.5**	4.5
Commodity trade finance	**10.0**	n/a

b) Segmental analysis of new business revenue by target market

For the year ended 31 December	**2013** ***£000's***	2012 *£000's*
Retirement	**1,159,616**	1,167,537
Care	**65,854**	94,362
Protection	**3,389**	2,738
Total single premium equivalent	**1,228,859**	1,264,637

c) Reconciliation of new business revenue by target market to gross premiums written

Premiums are recognised in the accounting period in which an insurance contract commences, gross of any commission paid. Single premium retirement policies commence at the point that the policyholder accepts a quote. Other policies commence on the date set out in the individual policy contracts. Premiums which have been received and for which no contract is yet in-force are classified as payables arising from insurance contracts and are included within insurance and other payables in the consolidated statement of financial position. Where a contract has been issued but premiums have not yet been received, a debtor arising out of direct insurance operations is recognised for the expected premiums due. Reinsurance premiums and recoveries are accounted for in the accounting period in accordance with the contractual terms of the reinsurance treaties. Premiums exclude any taxes or duties based on premiums.

New business revenue by target market reconciles to gross premiums as follows:

For the year ended 31 December	**2013** ***£000's***	2012 *£000's*
Total single premium equivalent	**1,228,859**	1,264,637
Adjustment in respect of regular premium business	**(5)**	—
Premiums received in respect of equity release longevity insurance	—	2,522
Premiums arising from change to contract terms in 2012	**(69,335)**	109,580
Reinsurance premiums received	**43**	91,269
Gross premiums written	**1,159,562**	1,468,008

Premiums are written at the point an insurance contract comes into force. In November 2012, the Group changed the terms of its offer to potential retirement policyholders such that an insurance contract would come into force at the point of their acceptance of the offered terms. Previously a contract only came into force when all funds had been received from the policyholder. For management purposes SPE continues to be recorded when all funds have been received from the policyholder. £109.6m of premium recognised in 2012 would otherwise have been recognised in 2013 and £40.3m of the premium recognised in 2013 would otherwise have been recognised in 2014 so that total premium recognised in 2013 was £69.3m lower than would otherwise have been recognised. This also gives rise to amounts due from policyholders for premiums not yet received, as shown in note 15.

d) Product revenue information

The following table illustrates revenue by product as required by IFRS 8 "*Operating Segments*". All revenues from external customers are derived from business originated in the UK, and as such no geographical information is disclosed.

The Board consider the Group's external customers to be the individual policyholders. As such, the Group is not reliant on any individual customer.

An analysis of gross premiums written by product is set out below:

For the year ended 31 December 2013	**2013** ***£000's***	2012 *£000's*
Retirement annuity	**1,090,282**	1,277,177
Care annuity	**65,979**	94,508
Protection life assurance	**3,258**	3,433
Other	**43**	92,950
Total gross premiums written	**1,159,562**	1,468,008

2 BASIS OF PREPARATION AND ADOPTION OF NEW AND REVISED STANDARDS

Basis of preparation

Partnership Assurance Group (PAG) plc (the "**Company**") was incorporated and registered in England and Wales on 26 February 2013 as a public company limited by shares. The Company's registered office address is 5th Floor, 110 Bishopsgate, London EC2N 4AY

The principal activity of the Company is that of a holding company. The Company and the entities controlled by the Company (its "**subsidiaries**") are collectively "**the Group**"

On incorporation, the share capital of the Company was £50,000 divided into 50,000 ordinary shares of 100 pence each. The 50,000 subscriber shares of 100 pence each were issued in consideration for an undertaking by funds managed or advised by Cinven Partners LLP (Cinven) to pay cash at par. On 12 June 2013, at admission on the London Stock Exchange, the 50,000 ordinary shares of 100 pence each were subdivided into 500,000 ordinary of 10 pence shares each.

During the year, prior to admission, the Company acquired a 100% shareholding in Partnership Assurance Group Holdings (PAGH) and completed a number of steps as part of a reorganisation of the Group. In addition, the Company also successfully completed the issue of new ordinary shares to raise

approximately £125m through its admission via a Premium Listing on the London Stock Exchange, (collectively, the "**Global Offer**"). Details of these transactions are detailed in note 32.

The Strategic Report outlines the activities, performance and future outlook of the Group. Note 30 to the financial statements sets out the Group's policies and procedures for managing insurance and financial risk, and note 31 sets out how the Group manages its capital resources.

These financial statements comprise the consolidated annual financial statements of the Group and the individual annual financial statements of the Company made up to 31 December 2013.

The results of subsidiaries acquired or disposed of during the period are included from or up to the effective date of acquisition or disposal. Non-controlling interest in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Control is achieved where the Group has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

The presentation currency of the Group is sterling. Unless otherwise stated, the amounts shown in the consolidated financial statements are in thousands of pounds sterling (*£'000*).

The consolidated financial statements and those of the Company have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU), and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The Group has applied all IFRS standards and interpretations adopted by the EU effective for the year ended 31 December 2013. These are the first annual consolidated financial statements of the Group and are prepared in accordance with IFRS adopted for use in the EU.

IFRS 1 "*First Time Adoption of International Financial Reporting Standards*" requires an explanation to be presented of how the transition to IFRS has affected the reported financial position and the financial performance of the Group. As these are the Group's first full year financial statements no transitional disclosures are necessary.

The Group in its current structure was formed on 12 June 2013 when the Company acquired PAGH from the Cinven funds, certain Directors, certain members of Senior Management and other individuals (see note 32). Whilst legally the Company is the acquirer and PAGH the acquiree, IFRS 3, "*Business Combinations*" requires consideration as to which entity's shareholder has majority control after the combination. The majority of shares in both entities are held by the Cinven Funds, but after the restructure the majority of the share holdings in the Company are owned by virtue of holdings that had existed in PAGH before they were swapped for share holdings in the Company. Given this, for the purposes of IFRS 3, PAGH is treated as the accounting acquirer and the Company as the accounting acquiree. At the point of the acquisition, the Company did not meet the test of being a business. As the accounting acquiree is not a business, the acquisition falls outside of the scope of IFRS 3. Accordingly, as permitted by IAS 8, "*Accounting Polices, Changes in Accounting Estimates and Errors*", in the absence of specific guidance in IFRS for entities involved in common control transactions, the group has elected to account for the acquisition as a group reconstruction as described under the UK GAAP accounting standard, Financial Reporting Standard 6, "*Acquisitions and Mergers*". The consolidated financial statements have been prepared as if the transaction that gave rise to the formation of the Group had taken place at the beginning of the comparative period. Under these principles, the consolidated financial statements have been prepared as if the Company were the holding company of PAGH from 1 January 2012, the date of the beginning of the comparative period.

The information for the year ended 31 December 2012 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. As the predecessor holding company of the Group, PAGH is a Jersey company. A copy of the statutory accounts for that year has not been delivered to the Registrar of Companies. Deloitte LLP (the "auditor") reported on those accounts: their report was unqualified, did not draw attention to any matters by way of emphasis and by virtue of the PAGH being a Jersey company, did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The Directors have undertaken a going concern assessment in accordance with "*Going Concern and Liquidity Risk Guidance for UK directors of UK Companies 2009*" published by the Financial Reporting Council in October 2009 as described in the Directors' Report.

Significant accounting policies applied to the preparation of these financial statements are presented in the notes below, aligning disclosure of accounting policies to the item which is most directly relevant to the policy.

Adoption of new and revised standards

The Group has adopted the following new standards and changes to existing standards which are relevant to the Group's operations, and became effective for financial years beginning on or after 1 January 2013

- **Amendments to IFRS 7** "***Offsetting Financial Assets and Financial Liabilities***" - these amendments require disclosure about rights to set-off financial instruments and related arrangements. These disclosures are set out in note 30.

- **IFRS 13** "***Fair Value Measurement***" - IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when the entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The standard is applied prospectively. The application of IFRS 13 has not materially impacted the fair value measurements carried out by the Group. IFRS 13 also requires specific disclosures on fair values which are set out in note 26.

- **Amendments to IAS 1** "***Presentation of Items of Other Comprehensive Income***" - the amendments to IAS 1 require items of other comprehensive income to be grouped by those items that will be reclassified subsequently to profit and loss and those that will never be reclassified, together with their associated income tax. During the period the Group had no items reported within Other Comprehensive Income, and therefore the adoption of this amendment has not affected these financial statements.

- **Amendments to IAS 12** "***Income Taxes***" - These amendments provide a presumption that recovery of the carrying amount of an asset measured using the fair value model in IAS 40 "Investment Property" will, normally, be through sale. The Group has held no investment property measured using the fair value model during the year, and therefore the adoption of this amendment has not affected these financial statements.

- **Annual Improvements 2009-2011 cycle** - Amendments to five standards, IFRS 1 "First Time Adoption" IAS 1 "Presentation of Financial Statements" IAS 16 "Property, Plant and Equipment" IAS 32, "Financial instruments - Presentation", and IAS 34, "Interim Financial Reporting". The amendments clarify existing guidance and have no impact on these financial statements.

The following new or revised or amended standards, in issue, were not yet effective, or in some cases not yet endorsed by the EU. The Group has not early adopted any of these standards.

Standard/ Interpretation	Content/amendment	Applicable for financial periods beginning on or after
IFRS 10	**Consolidated financial statements**	1 January 2014*
	IFRS 10 establishes a new definition of "control" to be applied when determining which entities must be consolidated. This definition is based on the concept of power, exposure or rights to variable returns and their linkage. This differs from the current definition in IAS 27 which is based on the power to determine financial and operating policies. The standard is not expected to have a material impact on the Group's profit before tax for the year or equity. The standard has been endorsed by the EU.	

Standard/ Interpretation	Content/amendment	Applicable for financial periods beginning on or after
IFRS 11	**Joint arrangements** IFRS 11 defines two types of joint arrangements - joint ventures and joint operations - based on how rights and obligations are shared by parties to the arrangements. The standard sets out the required accounting treatment for each type of joint arrangement. The standard is not expected to have a material impact on the Group's profit before tax for the year or equity. The standard has been endorsed by the EU.	1 January 2014*
IFRS 12	**Disclosures of interests in other entities** IFRS 12 requires additional disclosure for investments, in subsidiaries, joint arrangements, associates and structured entities. The standard is expected to have a significant impact on the level of disclosure in respect of subsidiaries and joint arrangements. The standard has been endorsed by the EU.	1 January 2014*
IAS 27	**Separate financial statements** Removes requirements superseded by IFRS 10. The standard has been endorsed by the EU.	1 January 2014*
IAS 28	**Associates and joint ventures** Amendment to bring joint ventures into the scope of IAS 28 and to require equity accounting for these entities. The amendment is not expected to have a significant impact on the Group financial statements. The amendment has been endorsed by the EU.	1 January 2014*
IFRS 10, IFRS 12 and IAS 27	**Investment Entities** Amendments to provide "investment entities" an exemption from the consolidation of particular subsidiaries. The Group is not an investment entity, as defined in the amendments, and therefore the amendment is not expected to have a significant impact on the Group financial statements. The amendment has been endorsed by the EU.	1 January 2014*
IAS 32	**Financial Instruments - Presentation** This amendment clarifies the requirements for offsetting financial assets and financial liabilities on the statement of financial position. The amendment is not expected to have significant implications for the Group financial statements. The amendment has been endorsed by the EU.	1 January 2014*
IAS 36	**Recoverable Amount Disclosures for Non-Financial Assets** Amendments which reduce the circumstances in which the recoverable amount of assets is required to be disclosed and clarification and amendments to the disclosures required. The amendment is not expected to	1 January 2014*

Standard/ Interpretation	Content/amendment	Applicable for financial periods beginning on or after
	have significant implications for the Group financial statements. The amendment has been endorsed by the EU.	
IAS 39	**Novation of Derivatives and Continuation of Hedge Accounting** Amendment to clarify the circumstances in which hedge accounting can be continued if derivatives are novated, to facilitate the novation of derivatives to a central counterparty. The amendment is not expected to have significant implications for the Group financial statements. The amendment has been endorsed by the EU.	1 January 2014*
IFRS 9	**Financial Instruments** IFRS 9 will replace IAS 39: "*Financial instruments – Recognition and Measurement*". The impact of the adoption of IFRS 9 on the Group will depend on the finalisation of the standard and the interaction of the requirements of IFRS 9 with the IASB's on-going insurance contracts accounting project. The standard has not yet been endorsed by the EU.	1 January 2018

* as adopted by the EU.

3 NET INVESTMENT INCOME

Investment income comprises interest received on financial investments, realised investment gains and losses and movements in unrealised gains and losses.

Expenses and charges are included on an accruals basis.

Realised gains and losses on investments are calculated as the difference between net sales proceeds less costs of sale and original cost. Unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

For the year ended 31 December	**2013** ***£000's***	2012 *£000's*
Interest receivable from financial assets	**138,533**	113,479
Interest payable from financial liabilities	**(71,596)**	(58,970)
Movement in fair value of financial assets	**26,616**	247,126
Movement in fair value of financial liabilities	**17,382**	(38,787)
Realised gains on financial assets	**72,604**	65,531
Realised losses on financial liabilities	**(45,777)**	(37,641)
Total net investment income	**137,762**	290,738

All financial assets and liabilities at 31 December 2013 are classified at fair value through profit and loss.

4 ACQUISITION EXPENSES

Acquisition expenses comprise direct costs such as commissions and indirect costs of obtaining and processing new business. They are allocated to particular categories of business based on available

information. Acquisition expenses are not deferred as they are largely recovered at inception through profit margins.

For the year ended 31 December	**2013** *£000's*	2012 *£000's*
Commission[i]	**11,435**	32,899
Other acquisition expenses	**1,601**	1,667
Total acquisition expenses	**13,036**	34,566

i The regulatory changes introduced by the Retail Distribution Review in December 2012 have prompted an increase in adviser fees paid directly by polio/holders to their financial advisers and a reduction in commission paid by the Group and reported in acquisition expenses.

5 ADMINISTRATIVE AND OTHER EXPENSES

Profit from continuing operations before tax is stated after charging the following items:

For the year ended 31 December	**2013** *£000's*	2012 *£000's*
Staff costs, including directors' remuneration	**41,052**	34,241
Share-based payments	**9,324**	1,500
Depreciation of property, plant and equipment	**1,843**	1,037
Amortisation of intangible assets	**1,997**	1,263
Rental of leased premises	**2,860**	950
Other operating leases	**419**	9
Auditor remuneration	**3,307**	1,424
Consultancy	**11,507**	12,613
Legal and professional fees	**20,143**	3,551
Marketing	**11,591**	9,883
Other (primarily office maintenance and supplies)	**13,180**	6,756
Total administrative and other expenses	**117,223**	73,227

The analysis of auditor's remuneration for the year is as follows:

Fees payable for the year ended 31 December were in respect of:	**2013** *£000's*	2012 *£000's*
Audit of the PAG plc Annual Report and Accounts	**85**	8
Audit of other Group entities	**336**	160
Audit related assurance services	**166**	72
Taxation compliance services	**44**	127
Corporate finance transactions relating to the IPO in June 2013	**2,676**	1,057
Auditor remuneration	**3,307**	1,424

6 STAFF COSTS

The aggregate staff costs, including Directors' remuneration in the year were:

For the year ended 31 December	**2013** *£000's*	2012 *£000's*
Wages and salaries	**33,839**	29,369
Social security costs	**5,528**	3,784
Other pension costs	**1,685**	1,088
Total staff costs	**41,052**	34,241
The average number of persons employed during the year were:		
Administration and finance	**430**	323
Sales and marketing	**109**	95
Average number of employees	**539**	418

An analysis of Directors' remuneration is included in the Remuneration Report.

7 INCOME TAX

Income tax comprises current and deferred tax. Income tax is charged or credited to other comprehensive income if it relates to items that are charged or credited to other comprehensive income. Similarly, income tax is charged or credited to equity if it relates to items that are credited or charged directly to equity. Otherwise income tax is recognised in the consolidated statement of comprehensive income.

Provision is made for taxation on taxable profits for the year, using tax rates enacted or substantially enacted at the balance sheet date together with adjustments to tax payable in respect of previous years.

Deferred tax is provided in full on temporary differences arising, which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on tax rates and laws enacted or substantively enacted at the balance sheet date. Temporary differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements except for differences arising from the initial recognition of goodwill and the initial recognition of assets and liabilities in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting nor taxable profit.

A deferred tax asset is recognised to the extent that it is regarded as more likely than not that it will be recovered. Deferred tax assets and liabilities are not discounted.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date. Deferred income tax assets and liabilities are offset, only if a legally enforceable right exists to set-off current tax assets against current tax liabilities, the deferred income taxes relate to the same taxation authority and that authority permits the Group to make a single net payment.

For the year ended 31 December	**Continuing operations 2013** *£000's*	Discontinued operations 2012 *£000's*	Continuing operations 2012 *£000's*
Current taxation:			
Tax charge for the year	**23,112**	—	17,555
Adjustment in respect of prior periods	**394**	—	(299)
	23,506	—	17,256
Deferred taxation:			
Tax credit for the year	**(266)**	—	(11)
Net taxation charge	**23,240**	—	17,245

The actual tax charge of the Group differs from the expected tax charge, computed by applying the average rate of UK corporation tax for the year of 23.25% (2012: 24.5%), as follows:

For the year ended 31 December	**Continuing operations 2013** *£000's*	Discontinued operations 2012 *£000's*	Continuing operations 2012 *£000's*
Profit/(loss) before tax	**82,661**	(28)	67,479
Current taxation at 23.25% (2012: 24.5%)	**19,216**	(7)	16,532
Prior period losses utilised in period	**(5)**	—	—
Disallowable expenses	**3,892**	7	970
Difference between depreciation and capital allowances for tax purposes	**(110)**	—	42
Expenses not deductible in determining taxable profit	**247**	—	
Share-based payments crystallised in the period	**(2,296)**	—	
Add back IFRS 2 share-based payment charge	**2,168**	—	—
Deferred taxation	**(266)**	—	
Adjustment in respect of prior periods	**394**	—	(299)
Net taxation charge	**23,240**	—	17,245

For the year ended 31 December	2013 £000's	2012 £000's
Unutilised tax losses	**44**	21,420
Unrecognised deferred tax assets	—	4,500

From 1 January 2013 insurers carrying on long-term insurance business in the UK are required to calculate taxable trading profits or losses by reference to the statutory accounts rather than their annual return to the Prudential Regulatory Authority. This change has little impact on the tax arrangements of the Group as it has treated all insurance profits as pension business (rather than Basic Life Assurance and General Annuity Business, 'BLAGAB', or any other tax category) in its corporation tax calculations since 2007.

Under this new regime, £14.1m of carried forward unutilised tax losses which arose in PLACL, the main life subsidiary of the Group, on BLAGAB business as a result of excess management expenses, cannot be utilised after 31 December 2013 since taxable BLAGAB profits will not arise. The remaining £7.3m of carried forward unutilised tax losses related to a Group entity which became dormant in 2013 so that future taxable profits will not arise. No deferred tax asset is recognised for any of these losses because the Group does not expect to be able to utilise them.

8 EARNINGS PER SHARE

Basic earnings per share is calculated using the earnings attributable to ordinary equity holders of the parent, divided by the weighted average number of ordinary shares in issue during the period.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares, including share options.

Diluted earnings per share amounts are calculated by dividing the profit attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

The calculation of the basic and diluted earnings per share from continuing operations is based on the following data:

For the year ended 31 December	2013 £000's	2012 £000's
Profit for the year	**59,421**	50,206
Less non-controlling interests	**44**	(13)
Profit attributable to equity holders of the Parent	**59,465**	50,193
Effect of dilutive potential ordinary shares:		
Share options	—	—
Diluted profit attributable to equity holders of the Parent	**59,465**	50,193

All of PAGH's A, B and C shares (see note 32) were exchanged for PAG plc shares on 12 June 2013. For the purpose of the earnings per share calculation, the weighted average number of share shown below has been calculated as if the exchange of these PAGH shares had occurred at the beginning of the comparative period.

For the year ended 31 December	2013 Number of shares	2012 Number of shares
Basic weighted average number of shares	**346,138,910**	279,527,196
Effect of dilutive potential ordinary shares:	—	—
Share options	**1,276,243**	2,133,025
Diluted weighted average number of shares	**347,415,153**	281,660,221

The options granted by the PAGH trust in respect of the ESOP scheme have a dilutive effect, up to the date of the IPO when these options vested.

As detailed in note 19, the Group implemented a number of new employee share-based plans following admission on the London Stock Exchange. The Share Incentive Plan (SIP) has a potential dilutive effect.

No decisions have been made as to the method of settlement of the Long Term Incentive Plan (LTIP) or the share element of the Deferred Share Bonus Plan (DSBP). The weighted average number of shares calculation above has been derived on the assumption that the vesting of shares in respect of the LTIP and DSBP awards will be settled with shares bought externally from the market and hence will not be dilutive.

9 PROPERTY, PLANT AND EQUIPMENT

Assets are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated to write off the cost of tangible assets over their estimated useful life on a straight-line basis. The principal rates used for this purpose are as follows:

For the year ended 31 December	**2013**	2012
Computer equipment	33%	33%
Fixtures and fittings	10% to 20%	20%
Office refit	10% to 50%	20% to 50%

The range of principal rates used changed during 2013 as new assets came into use.

	Computer equipment *£000's*	**Fixtures and fittings** *£000's*	**Office refit costs** *£000's*	**Total** *£000's*
Cost at 1 January 2013	4,586	473	2,906	7,965
Acquired at fair value:				
Additions at cost	3,244	900	9,513	13,657
Depreciated assets written off	—	—	(1,255)	(1,255)
At 31 December 2013	**7,830**	**1,373**	**11,164**	**20,367**
Accumulated depreciation at 1 January 2013	2,397	375	1,505	4,277
Charge for the year	1,180	48	615	1,843
Depreciated assets written off	—	—	(1,212)	(1,212)
At 31 December 2013	**3,577**	**423**	**908**	**4,908**
Net book value:				
At 31 December 2012	2,189	98	1,401	3,688
At 31 December 2013	**4,253**	**950**	**10,256**	**15,459**

10 GOODWILL

Goodwill represents the excess of cost of acquisition over the fair value of the separable net assets of businesses acquired. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill is allocated to each of the cash-generating units (CGU) that are expected to benefit from the combination. Goodwill is tested for impairment at least annually, or when circumstances or events indicate there may be uncertainty over this value. Impairment is determined by assessing the recoverable amount of each CGU to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognised. Any impairment is recognised immediately in the consolidated statement of comprehensive income and is not subsequently reversed.

	2013 *£000's*	2012 *£000's*
At 1 January	**126,207**	126,207
At 31 December	**126,207**	126,207

The goodwill arose on acquisition of the PLACL operations and the value represented the potential of this business to generate value from future sales. Therefore the goodwill is allocated to the new business cash generating unit, the scope of which is identical to the "new business" operating segment described in note 1.

The carrying value of goodwill has been tested for impairment at the balance sheet date. Value in use has been determined as the present value of expected future cash flows associated with new business. The cash flows used in this calculation are consistent with those monitored by management.

Expected future new business cash flows are based on financial plans approved by management, covering a period of three years from the balance sheet date. A rate of 10% has been applied to discount cash flows to a present value.

No impairment has been recognised in 2013 or 2012.

11 OTHER INTANGIBLE ASSETS

Other intangible assets comprise intellectual property and software development costs.

The intellectual property asset comprises of specific mortality tables derived from data collected over an extended period and are deemed to have an indefinite life. Consequently no amortisation is charged against its carrying value.

Development costs that are directly attributable to the design and testing of identifiable software products, controlled by the Group, are recognised as intangible assets when it can be demonstrated that it is technically feasible to complete the product so that it is available for use and will generate probable future economic benefits. Software development costs have a finite useful life and are amortised using the straight-line method over three to five years.

Impairment review of other intangible assets

The carrying amounts of intangible assets with finite expected useful economic lives are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. A review for indicators of impairment is conducted annually. The carrying amounts of intangible assets with indefinite expected useful economic lives are tested for impairment at least annually, or when circumstances or events indicate there may be uncertainty over this value. An impairment loss is recognised in the consolidated statement of comprehensive income for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its net selling price (fair value less selling costs) and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit, or company of units, to which the asset belongs.

	2013	2012
	£000's	*£000's*
Intellectual property cost and carrying amount:		
At 1 January	**3,100**	3,100
At 31 December	**3,100**	3,100
Software development cost:		
At 1 January	**11,750**	4,365
Additions at cost	**7,696**	7,385
Assets written off	**(1,641)**	—
At 31 December	**17,805**	11,750
Software development accumulated amortisation:		
At 1 January	**2,507**	1,244
Charge for the year	**1,997**	1,263
At 31 December	**4,504**	2,507
Total intangible assets at 1 January	**12,343**	6,221
Total intangible assets at 31 December	**16,401**	12,343

The value of intellectual property has been determined based upon an estimate of the costs to employ adequately skilled individuals over an appropriate period of time to develop intellectual property of a

similar nature sufficient to enable the Group to replicate the estimated future cash flows and profits deriving from that intellectual property.

The intellectual property is continually updated through the collection of further data, updated analyses, and conversion into new and more detailed underwriting manuals and mortality tables. For this reason, the intangible asset is deemed to have an indefinite life, and consequently, no amortisation is provided against the value of the intangible asset. The carrying value of the intangible asset is tested for impairment at each reporting date, and is allocated to the "new business" cash-generating unit, the scope of which is identical to the "new business" operating segment described in note 1. The method and assumptions used in this test are identical to those applied in the goodwill impairment test, as set out in note 10.

No impairment of intellectual property has been recognised in 2012 or 2013.

The amortisation period for software development costs is three to five years. During the year the intangible assets relating to software development were reviewed for impairment. As a result of this certain software assets were identified as no longer being expected to generate economic benefits for the Group. No other indicators of impairment existed in respect of software development costs as at the balance sheet date.

12 FINANCIAL ASSETS

Financial assets classification

The Group classifies its financial assets as financial investments, loans secured by mortgages and derivative financial assets at fair value through profit and loss. The category of fair value through profit and loss has two sub-categories: those that meet the definition as being held for trading; and those that the Group chooses to designate as fair value. The fair value through profit and loss is selected as the Group's strategy is to manage its financial assets, as a portfolio, on a fair value basis.

Financial investments

Purchases and sales of debt securities and other fixed income securities are recognised on the trade date, which is the date that the Group commits to purchase or sell the assets, at their fair values. Transaction costs are expensed as incurred. These investments are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Debt securities and other fixed income securities are subsequently carried at fair value with changes in fair value included in the consolidated statement of comprehensive income in the period in which they arise.

The fair values of debt securities are based on quoted bid prices, or based on modelled prices (using observable market inputs) where quoted bid-prices are not available.

Investments in Commodity Trade Finance loans are carried at fair value on initial recognition and are recognised when the cash is advanced for the trade. Commodity Trade Finance loans are subsequently carried at fair value with changes in fair value included in the consolidated statement of comprehensive income in the period in which they arise. The fair value of these investments is not based on observable market data.

Loans secured by mortgages

Loans secured by mortgages are recognised when the cash is advanced to borrowers at their fair values. These loans are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Loans secured by mortgages are subsequently carried at fair value with changes in fair value included in the consolidated statement of comprehensive income in the period in which they arise.

The fair value of loans secured by mortgages is initially deemed to be the transaction price and subsequently marked to model. The underlying model follows the methodology used to establish transaction prices. It uses longevity assumptions to derive expected cash flows and the Black-Scholes option pricing methodology to establish the value of the no-negative equity guarantee that is embedded in the product. The discount rates that are applied to cash flows to produce fair value are based on long dated swaps adjusted so that they would produce transaction date prices on the date of transaction.

Derivative financial instruments

The Group enters into a variety of derivative financial instruments to manage its exposure to interest rates, inflation, credit default and foreign exchange rate risk, including foreign exchange forward contracts, interest rate swaps, credit default swaps and inflation swaps.

Derivative contracts are traded either through an exchange or over-the-counter (OTC). OTC derivative contracts are individually negotiated between contracting parties and can include options, swaps, caps and floors.

Derivatives are initially recognised at fair value at the date that a derivative contract is entered into and are subsequently remeasured to fair value at each balance sheet date. The resulting gain or loss is recognised in the consolidated statement of comprehensive income. The fair values are obtained from quoted market prices or, if these are not available, by using standard valuation techniques based on discounted cash flow models or option pricing models. All derivatives are carried as assets when the fair value is positive and liabilities when the fair values are negative. Premiums paid for derivatives are recorded as an asset in the consolidated statement of financial position at the date of purchase representing their fair value at that date.

Fair value at 31 December	**2013** *£000's*	2012 *£000's*
Financial investments	**3,073,964**	2,645,997
Loans secured by mortgages	**840,066**	478,097
Derivative assets	**36,413**	34,907
Total financial assets	**3,950,443**	3,159,001

Cost at 31 December	**2013** *£000's*	2012 *£000's*
Financial investments	**2,991,196**	2,464,790
Loans secured by mortgages at cost	**796,788**	414,500
Derivative assets	**—**	—
Total financial assets	**3,787,984**	2,879,290

The methodology used to derive the fair values is set out in note 26.

13 PRINCIPAL GROUP UNDERTAKINGS

Foreign currencies

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The functional currency of each of the Group's material entities is sterling. The consolidated financial statements are presented in sterling, which is the Group's presentation currency.

Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the end of the financial period. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in net investment income in the consolidated statement of comprehensive income.

Set out below are the principal subsidiary and joint venture undertakings of Partnership Assurance Group plc. All of the companies are incorporated in England and Wales unless otherwise indicated. The shares held are voting ordinary equity shares. A full list of subsidiary and joint venture undertakings will be annexed to the Partnership Assurance Group plc annual return filed at Companies House.

Name:	**Principal activity**:	**Holding**
PAG Holdings Limited[i]	Holding company	100%
PAG Finance Limited[i]	Holding company	100%
Partnership Holdings Limited	Holding company	100%
Partnership Group Holdings Limited	Holding company	100%
Partnership Life Assurance Company Limited	Life assurance and pension annuities	100%
Partnership Home Loans Limited	Provision of Lifetime Mortgage products	100%
Partnership Services Limited	Service company	100%
Payingforcare Limited	Website company	100%
PASPV Limited	Investment activity	100%
Eldercare Group Limited	Independent financial advisers	51%
Gateway Specialist Advice Services Limited[ii]	Independent financial advisers	50%

i incorporated in Jersey
ii joint Venture

14 INVESTMENT IN JOINT VENTURES

The Group has chosen to take advantage of the option under IAS 31 to use the equity method to consolidate its investment in its joint venture. Under the equity method of accounting the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the Group's share of net assets of the joint venture.

	2013 *£000's*	2012 *£000's*
At 1 January	**368**	408
Share of losses in the year	**(162)**	(40)
At 31 December	**206**	368

Gateway Specialist Advice Services Limited

The investment in joint venture at 31 December 2013 relates entirely to the Group's investment in Gateway Specialist Advice Services Limited, an IFA business that provides specialist later-life financial advice.

Pension Annuity Limited

On 3 June 2011 the Group entered into a joint venture agreement with Digitalis Retail 1 Limited. As a result of this agreement, the Group acquired 49 shares in Pension Annuity Limited (the joint venture entity) representing 49% of its issued share capital, for a total consideration of £150,000.

On 9 March 2012, the Group acquired the remaining 51 shares in Pension Annuity Limited from Digitalis Retail 1 Limited for a total consideration of £30,000, at which time Pension Annuity Limited became a wholly owned subsidiary.

The operations of Pension Annuity Limited were discontinued during 2012 and on 29 January 2013, the Company was dissolved and removed from the register of companies.

15 INSURANCE AND OTHER RECEIVABLES

Insurance and reinsurance debtors represent amounts receivable after commencement of the contract which have not been settled at the balance sheet date.

As at 31 December	**2013** *£000's*	2012 *£000's*
Debtors arising out of insurance contracts[i]	**51,140**	85,153
Debtors arising out of reinsurance contracts	**9,039**	5,627
Other debtors[(i)]	**4,008**	3,879
Amounts due from joint venture	**289**	222
Total insurance and other receivables	**64,476**	94,881

i The 2013 balances are impacted relative to 2012 as they reflect the revised policy contract terms explained in note 1

The Directors consider that the carrying value in the balance sheet is a reasonable approximation of the fair value.

16 PREPAYMENTS AND ACCRUED INCOME

Interest accrued represents the balance receivable for interest income, calculated daily based on the contractual interest rates of the relevant instruments, recognised since the last interest payment date.

As at 31 December	**2013** *£000's*	2012 *£000's*
Accrued interest	**59,837**	54,425
Prepayments	**10,980**	8,698
Total prepayments and accrued income	**70,817**	63,123

17 DEFERRED TAX ASSETS

For the year ended 31 December	**2013** *£000's*	2012 *£000's*
At 1 January	**158**	147
Credit to consolidated statement of comprehensive income	**266**	11
At 31 December	**424**	158

Deferred tax is recognised as a result of the difference between the accumulated depreciation and the capital allowances granted in the annual corporation tax submission on property, plant and equipment using a UK corporation tax rate of 20%, which is appropriate for when the timing differences are expected to unwind (2012: 23%).

18 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash in hand, deposits held on call with banks and other short-term highly liquid investments with original maturities of 90 days or less. Bank overdrafts are included in cash and cash equivalents for the purposes of the consolidated cash flow statement.

As at 31 December	**2013** *£000's*	2012 *£000's*
Short-term bank deposits	**94,723**	151,529
Cash at bank and in hand	**18,018**	14,744
Total cash and cash equivalents	**112,741**	166,273

19 SHARE-BASED PAYMENTS

Equity-settled share-based payments to employees and others providing services are measured at the fair value of the equity instruments at the grant date. The fair value excludes the effect of non-market-based vesting conditions. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest.

At each period end, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the consolidated statement of comprehensive income such that the cumulative expense reflects the revised estimate with a corresponding adjustment to equity.

Where the terms and conditions of options are modified before they vest, the increase in the fair value of those instruments, measured immediately before and after the modification, is also charged to the consolidated statement of comprehensive income over the remaining vesting period.

The share-based payment expense recognised for employee services receivable during the year is as follows:

For the year ended 31 December	**2013** *£000's*	2012 *£000's*
Employee Share Option Plan	**8,378**	1,500
Long Term Incentive Plan	**432**	—
Deferred Share Bonus Plan	**374**	—
Share Incentive Plan	**65**	—
Save as you earn Plan	**75**	—
Total expense	**9,324**	1,500

i) Employee Share Option Plan (ESOP)

In 2009, the Group implemented an Employee Share Option Plan (ESOP) to retain and motivate its employees. Awards under this plan were in the form of options to acquire shares of PAGH, the top holding company of the Group at that point in time, for an exercise price equivalent to the market value of those shares at the grant date. The expense recognised in other operating expenses in the consolidated statement of comprehensive income for the period to 31 December 2013 is £8.4m (£6.9m net of tax) (31 December 2012: £1.5m). As shares awarded under the plan were unlisted at the grant date as their fair value could not be measured reliably, therefore the value, and expense, relating to this scheme was measured at its intrinsic value, remeasured at each reporting date.

For the year ended 31 December	**2013** *Number of share options*	2012 *Number of share options*
Outstanding at the beginning of the year	**23,953**	26,285
Granted during the year	**7,910**	—
Forfeited during the year	**—**	(2,332)
Exercised during the year	**(31,863)**	—
Outstanding at the end of the year	**—**	23,953

During the year the terms of the ESOP were modified such that the options to acquire shares of PAGH were exchanged for options to acquire shares in PAG plc of equal value at the date of the modification. No incremental fair value arose as a result of this modification.

Following admission on the London Stock Exchange, the awards under the ESOP vested in full and were exercised immediately. The settlement of these ESOPs was funded by the sale of 2,706,399 shares from the PAGH EBT.

The weighted average exercise price for the awards exercised in the year was £0.20. The share price at the date of exercise was £3.85.

There are no outstanding options under the ESOP as at 31 December 2013.

Following admission, the Group has implemented the following employee share-based payment plans;

ii) Long Term Incentive Plan (LTIP)

The Group made awards under the LTIP to Executive Directors and other senior executives in June 2013. The LTIP awards will be subject to the satisfaction of the following performance conditions which will determine the proportion (if any) of the LTIP award to vest at the end of the performance period.

50% of these LTIP awards are subject to a performance condition relating to the growth in the Group's operating profit over a performance period of three financial years. If operating profit for the financial year ending 31 December 2015 exceeds operating profit for the financial year ended 31 December 2012 by 33.1%, 10% of the LTIP award will vest. The maximum 50% will vest if operating profit for the financial year ending 31 December 2015 exceeds operating profit for the financial year ended 31 December 2012 by at least 64.3%. Payment will be on a sliding scale in between these points.

The remaining 50% of these LTIP awards will be subject to a condition measuring the Company's total shareholder return (TSR) performance relative to the constituent companies of the FTSE 250 index (excluding investment trusts, mining companies and oil and gas producers) over the period from admission to 31 December 2015. Vesting of 10% of the LTIP award will occur for median performance and the maximum 50% at upper quartile performance or above, with straight line vesting in between these points.

The awards are accounted for as equity-settled schemes. The total value of these schemes is measured at each award date based upon the number of shares expected to vest awarded and the expense charge is recognised over the course of the vesting period.

At 31 December 2013 there were 1,248,636 awards in issue and a charge of £431,848 has been recognised in the consolidated statement of comprehensive income with a corresponding increase in equity in the consolidated statement of financial position. The weighted average fair value of awards made during the year was £2.67.

The fair value of the award was measured with reference to the quoted share price of PAG plc at the measurement date. The performance condition relating to total shareholder return was incorporated into the measure of fair value through a stochastic model incorporating the historical TSR volatility of comparable listed entities.

The performance condition relating to operating profit over performance and other non-market vesting conditions are incorporated into the estimate of the total number of awards expected to vest. This expectation is reviewed and, if necessary, revised at each reporting date.

iii) Deferred Share Bonus Plan (DSBP)

Effective from June 2013, one-third of the bonuses earned by Executive Directors and certain other senior executives in respect of the Company's annual bonus arrangements are deferred into shares in PAG plc. The remaining two-thirds of the awards will continue to be paid in cash. The share element of the bonus awards will vest on the third anniversary of the date of the determination of the bonus in respect of which they were granted.

The share element of the bonus awards are accounted for as equity-settled schemes. The fair value of the awards are calculated at each aware date based on one-third of the estimated annual bonus payout and the expense charge is recognised over the course of the vesting period.

A charge of £374,072 has been recognised in the consolidated statement of comprehensive income in respect of these schemes for the year to 31 December 2013 with a corresponding increase in equity in the consolidated statement of financial position.

The weighted average fair value of awards made during the year was £3.85. The fair value of the award was measured with reference to the quoted share price of PAG plc at the measurement date. Non-market vesting conditions are incorporated into the estimate of the total number of awards expected to vest. This expectation is reviewed and, if necessary, revised at each reporting date.

iv) Share Incentive Plan (SIP)

The Company has made a one-off award of £1,000 of free shares immediately after admission to all eligible employees under a new all-employee share plan, known as the Share Incentive Plan (SIP). These shares will be forfeited if the employees cease employment (except in "good leaver" circumstances) within the first three years from the date of the award. Awards made under this plan entitle these employees to

- a conditional right to acquire shares in PAG plc at no cost;
- an option to acquire shares in PAG plc at no cost; or
- a right to receive a cash amount which relates to the value of certain number of notional ordinary shares.

These awards are accounted for as equity-settled schemes. The fair value of these schemes is calculated at each award date based upon the number of shares awarded multiplied by the share price at grant date and expensed over the vesting period.

A charge of £65,277 has been recognised in the consolidated statement of comprehensive income in respect of this scheme for the year to 31 December 2013 with a corresponding increase in equity in the consolidated statement of financial position.

The weighted average fair value of awards made during the year was £3.85. The fair value of the award was measured with reference to the quoted share price of PAG plc at the measurement date. Non-market vesting conditions are incorporated into the estimate of the total number of awards expected to vest. This expectation is reviewed and, if necessary, revised at each reporting date.

v) Save As You Earn (SAYE) share option plan

In July 2013, the Group introduced a SAYE scheme. Under this plan, employees may elect to save up to £2 50 per month over a three or five year period. The amount of ordinary shares of PAG plc over which the option is granted will be determined at the grant date to reflect the amount that each employee has agreed to save under the Share Save contract.

A charge of £74,734 has been recognised in the consolidated statement of comprehensive income in respect of this scheme for the year to 31 December 2013 with a corresponding increase in equity in the consolidated statement of financial position.

The weighted average fair value of the awards made during the year was £18,546. The fair value of the awards has been determined using a Black-Scholes valuation model.

Key assumptions within this valuation model were: expected share price volatility (43%), expected dividend yield (1%), risk-free interest rate (2%), expected option life (three years and five years), exercise price (£3.57), and share price at the measurement date (£4.45).

20 INSURANCE LIABILITIES AND REINSURANCE ASSETS

Insurance liabilities

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event would cause an insurer to pay significant additional benefits 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.

The Group's long-term insurance contracts include annuities to fund retirement income, annuities to fund care fees (immediate needs and deferred), long-term care insurance and whole of life and term protection insurance. These contracts are expected to remain in force for an extended period of time, and insure events associated with human life.

One of the purposes of insurance is to enable policyholders to protect themselves against future uncertain events such as death or specific types of illness. Insurance companies accept the transfer of uncertainty from policyholders and seek to add value through the aggregation and management of these risks. As a consequence of this uncertainty, estimation techniques are employed by suitably qualified personnel in computing the levels of provisions held against such uncertainty.

The insurance liabilities, which are also referred to as the long-term business provision and policyholder reserves elsewhere in this report, are determined by the Partnership Board on the advice of the Group's Actuarial Function Holder on the modified statutory basis using recognised actuarial methods with due regard to the actuarial principles set out in the PRA's (formerly the FSA's) Insurance Prudential Sourcebook. In particular, a prospective gross premium valuation method has been adopted for major classes of business.

Although the process for the establishment of insurance liabilities follows specified rules and guidelines, the provisions that result from the process remain uncertain. As a consequence of this uncertainty, the eventual value of claims could vary from the amounts provided to cover future claims. The Group seeks

to provide for appropriate levels of contract liabilities taking known facts and experiences into account but nevertheless such provisions remain uncertain.

The estimation process used in determining insurance liabilities involves projecting future annuity payments and the costs of maintaining the contracts. For non-annuity contracts, the long-term business provision is determined as the sum of the discounted value of future benefit payments and future administration expenses less the expected value of premiums payable under the contract. The key sensitivities are the assumed level of interest rates and the mortality experience.

At the balance sheet date, provision is made for all notified claims plus an estimate for those claims that have been incurred but not reported. The principal assumptions underlying the calculation of insurance liabilities are set out below.

Reinsurance assets

Long-term business is ceded to reinsurers under contracts to transfer part or all of one or more of the following risks: mortality, morbidity, investment, persistency and expenses. The benefits to which the Group are entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers (classified within “Insurance and other receivables”) as well as longer-term receivables that are dependent on the expected benefits arising under the related re-insured contracts.

Amounts recoverable from reinsurers are estimated in a consistent manner with insurance liabilities, and are classified as “reinsurance assets”.

Some contracts, which provide for the transfer of significant risk, are also structured to provide financing. When, under such contracts, financing components are to be repaid in future accounting periods, the amount outstanding under the contract at the balance sheet date are classified as “payables arising from reinsurance contracts” and included within insurance and other payables in the consolidated statement of financial position.

If the reinsurance asset were impaired, the Group would adjust the carrying amount accordingly and recognise that impairment loss in the consolidated statement of comprehensive income. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Group may not receive all amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer.

Liability adequacy test

At the end of each reporting period, liability adequacy tests are performed to ensure the adequacy of the insurance liabilities. In performing these tests, current best-estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from assets backing such liabilities, are used. Any deficiency is immediately charged to the consolidated statement of comprehensive income.

Claims

Maturity claims and annuities are charged against revenue when due for payment. Death claims and all other claims are accounted for when notified. Claims reinsurance recoveries are accounted for in the same period as the related claim. Where reinsurance treaties are recaptured, amounts received to compensate for the transfer of risk from the reinsurer are accounted for when received or, if earlier, on the date the treaty ceases to be included within the calculation of the reinsurers’ share of long-term business provision.

As at 31 December	**2013** ***£000’s***	2012 *£000’s*
Long-term business provision	**4,347,588**	3,723,298
Reinsurers’ share of long-term business provision	**(2,840,749)**	(2,412,551)
Net provision	**1,506,839**	1,310,747

a) Principal assumptions

The principal assumptions underlying the calculation of the long-term business provision are as follows:

		Mortality tables	**Valuation discount rates**
Medically underwritten annuity products	2013	Modified E&W Population Mortality with CMI 2012u (1.75%) and CMI 2012F (1.50%)	**4.31%**
	2012	Modified PML/PFL92 (U=2013) modified ave MC & LC floor 1.5%	3.76%
Other annuity products	2013	Modified PCMA/PCFA00u2014 p-spline	**1.70%**
	2012	Modified PCMA/PCFA00u2013 p-spline	2.26%
Term and whole of life products	2013	86.25% TM/TF00Select	**1.44%**
	2012	86.25% TM/TF00Select	1.07%

Valuation discount rate assumptions are set with regards to yields on supporting assets. An allowance for risk is included by making an explicit deduction from the yields on debt and other fixed income securities based on historical default experience and expected experience of each asset class. The allowance for credit risk has been set at 47% (2012: 37%) of the spread on the yield of the corporate bonds over the yield on gilts.

The changes in the valuation discount rates at each period end reflect changes in yields on the supporting assets and changes made to the allowance for risk.

The mortality tables used have been adjusted to reflect additional mortality based on the proprietary data held by the Group developed from actual experience incurred. The valuation basis used to calculate the long-term business provisions includes an allowance for future expenses.

b) Movements

Movements in the carrying amount of insurance liabilities and reinsurance assets are explained as follows:

For the year ended 31 December 2013	**Gross** *£000's*	**Reinsurance** *£000's*	**Net** *£000's*
At 1 January 2013	**3,723,298**	**(2,412,551)**	**1,310,747**
Increase in liability from new business	**1,038,011**	**(678,827)**	**359,184**
Release of in-force liability	**(111,110)**	**75,012**	**(36,098)**
Release of liability due to recorded deaths	**(69,967)**	**31,040**	**(38,927)**
Economic changes	**(209,299)**	**144,164**	**(65,135)**
Non-economic changes	**(25,847)**	**1,609**	**(24,238)**
Other	**2,502**	**(1,196)**	**1,306**
At 31 December 2013	**4,347,588**	**(2,840,749)**	**1,506,839**

For the year ended 31 December 2012	Gross *£000's*	Reinsurance *£000's*	Net *£000's*
At 1 January 2012	2,158,537	(1,352,886)	805,651
Increase in liability from new business	1,324,979	(532,265)	792,714
Release of in-force liability	(48,465)	30,083	(18,382)
Release of liability due to recorded deaths	(61,815)	36,098	(25,717)
Recapture and restructure of reinsurance treaties*	-	(396,213)	(396,213)
Economic changes	335,573	(200,464)	135,109
Non-economic changes	11,266	-	11,266
Other	3,223	3,096	6,319
At 31 December 2012	3,723,298	(2,412,551)	1,310,747

* The impact of the recapture and restructure of reinsurance treaties has been calculated as if both transactions occurred on 31 December 2012 before the impact of year end basis changes.

c) Analysis of expected maturity

The following table analyses insurance liabilities and reinsurance assets by duration.

	Expected cash flows (undiscounted)				
At 31 December 2013	**less than one year** *£000's*	**one to five years** *£000's*	**five to ten years** *£000's*	**more than ten years** *£000's*	**Carrying value (discounted)** *£000's*
Gross	**373,419**	**1,360,968**	**1,450,164**	**3,829,024**	**4,347,588**
Reinsurance..................	**(241,692)**	**(903,711)**	**(985,311)**	**(2,544,018)**	**(2,840,749)**
Net	**131,727**	**457,257**	**464,853**	**1,285,066**	**1,506,839**

	Expected cash flows (undiscounted)				
At 31 December 2012	less than one year *£000's*	one to five years *£000's*	five to ten years *£000's*	more than ten years *£000's*	Carrying value (discounted) *£000's*
Gross	300,885	1,080,196	1,122,562	2,998,611	3,723,298
Reinsurance..................	(191,170)	(711,459)	(767,756)	(2,028,997)	(2,412,551)
Net................................	109,715	368,737	354,806	969,614	1,310,747

d) Sensitivity analysis

Life insurance results are inherently uncertain due to actual experience being different to modelled assumptions. Sensitivity analysis is provided below to illustrate the impact of changes in key assumptions.

Sensitivity factor	**Description of sensitivity factor applied**
Interest rate & investment return	The impact of a change in the market interest rates by +/- 1% (e.g. if a current interest rate is 5%, the impact of an immediate change to 4% and 6% respectively). The test allows consistently for similar changes to investment returns and movements in the market backing fixed interest securities.
Credit spreads	The impact of credit spreads widening by 50bps with a corresponding pro-rated change to defaults.
Expenses	The impact of an increase in maintenance expenses by 10%.
Mortality rates	The impact of a decrease in mortality rates by 5%.
Property values	The impact of an immediate decrease in the value of properties by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the equity release assets used to back the liabilities.
Voluntary redemptions	The impact of an increase in voluntary redemption rates on equity release loans by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the equity release assets used to back the liabilities.

The table below demonstrates the effect of a change in a key assumption whilst other assumptions remain unchanged. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results. The sensitivity analyses do not take into consideration that the Group's assets and liabilities are actively managed and may vary at the time that any actual market movement occurs.

	Increase/(decrease) in profit before tax	
Change in assumption:	**2013**	2012
	£000's	*£000's*
Interest rates +1%	**2,954**	1,362
Interest rates -1%	**(3,308)**	(8,610)
Credit spreads +0.5%	**(10,917)**	(7,305)
Expenses +10%	**(9,962)**	(8,894)
Mortality -5%	**(22,140)**	(19,791)
Property prices -10%	**(25,313)**	(11,093)
Voluntary redemptions +10%	**(2,402)**	2,871

21 INSURANCE AND OTHER PAYABLES

As at 31 December	**2013**	2012
	£000's	*£000's*
Payables arising from insurance contracts	**9,639**	40,208
Other creditors and accruals	**22,449**	22,740
Total insurance and other payables	**32,088**	62,948

The Directors consider that the carrying value in the balance sheet is a reasonable approximation of the fair value.

22 FINANCIAL LIABILITIES

As well as derivative financial liabilities, the Group carries financial liabilities where assets under specific reinsurance treaties are legally and physically deposited back to the Group by reinsurers. Financial liabilities are classified as at fair value through profit and loss. As such, financial liabilities are initially recognised at fair value on the same date that the value of underlying deposited assets is recognised and are subsequently remeasured at fair value at each balance sheet date. The resulting gain or loss is recognised in the consolidated statement of comprehensive income. The net gain or loss recognised incorporates any interest paid on the financial liability. Fair value is determined as the amount payable discounted from the first date that the amount is required to be paid.

A financial liability (including subordinated debt and external borrowings) is generally derecognised when the contract that gives rise to it, is settled, sold, cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in the consolidated statement of comprehensive income.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into.

As at 31 December	**2013**	2012
	£000's	*£000's*
Payables arising from reinsurance contracts	**2,169,109**	1,728,998
Derivative liabilities	**32,391**	49,767
Total financial liabilities	**2,201,500**	1,778,765

Payables arising from reinsurance contracts at fair value through profit and loss are designated as such on initial recognition. Derivative liabilities are carried at fair value through profit and loss.

23 EXTERNAL BORROWINGS

External borrowings are recorded at the proceeds received, net of direct issue costs. Issue costs are capitalised and charged to the consolidated statement of comprehensive income over the life of the loan using the effective interest method. Interest payable is accounted for on an accruals basis in the consolidated statement of comprehensive income.

Gains and losses on the repurchase, settlement or otherwise cancellation of external borrowings are recognised respectively in the income and interest expenses and charges.

As at 31 December	**2013** ***£000's***	2012 *£000's*
Due in more than five years:		
Loan notes issued, repayable otherwise than by instalments (unsecured)	—	299,823
Less capitalised debt issuance costs on loan notes	—	(2,519)
Interest payable on loan notes	—	14,458
Due in one to five years:		
Bank loan	—	70,000
Less capitalised debt issuance costs on bank loan	—	(1,765)
Interest payable on bank loan	—	370
Total external borrowings	—	380,367

- A and B loan notes totalling £151,667,000 were issued by PAGF, a Group company, to the Fourth Cinven Fund and other third parties on 5 August 2008. The interest rate on these notes was 12% p.a. and was payable at six monthly intervals starting on 30 June 2009 at the discretion of the Group. In the event that interest payments were not made, the amounts due accrued interest at the same rate from the date payment was due. Additional loan notes totalling £6.9m were issued during the period (31 December 2012: £25.6m) in settlement of interest accrued.

- On 21 August 2012, C loan notes totalling £50m were issued by the Group to the Fourth Cinven Funds. The interest rate was fixed at 22% p.a. and was payable at six monthly intervals starting 30 June 2013. In the event that interest payments were not made, the amounts due began to accrue interest at the same rate from the date payment was due.

- Vendor loan notes totalling £5m were issued by the Group on 5 August 2008 in connection with the acquisition of the former Group by the Cinven funds. The interest rate was fixed at 9% p.a. and was payable at six monthly intervals starting 30 June 2009. In the event that interest payments were not made, the amounts due began to accrue interest at the same rate from the date payment was due.

- A bank loan of £70m was taken out on 21 August 2012. The bank loan carried a fixed interest rate at LIBOR plus 4% p.a. Debt issuance costs of £1,925,000 were capitalised, of which £1,491,000 was amortised in the period (2012: £160,000).

- As set out in note 32, as a result of the reorganisation steps undertaken before the admission of the Company to the London Stock Exchange, the A,B,C and Vendor loan notes, the bank loan and accrued interest were settled in the period.

The Group hedged its exposure to LIBOR, using an interest rate swap, whereby LIBOR payments were swapped for a fixed interest payment of 0.7% p.a. for two years from the date the loan was taken. Interest was payable at three monthly instalments, in advance, starting 21 November 2012. Effective 21 June 2013, this interest rate swap arrangement was terminated.

24 CURRENT TAX LIABILITIES

As at 31 December	2013	2012
	£000's	*£000's*
Income taxes	**13,633**	7,127
Other taxes and social security costs	**4,565**	3,727
Total current tax liabilities	**18,198**	10,854

25 DERIVATIVE FINANCIAL INSTRUMENTS

The Group uses various derivative financial instruments to manage its exposure to interest rates, counterparty credit risk, inflation and foreign exchange risk, including foreign exchange forward contracts, interest rate swaps, credit default swaps and inflation swaps.

As at 31 December 2013	Asset fair value	Liability fair value	Notional amount
	£000's	*£000's*	*£000's*
Forward currency positions	**8,488**	**278**	**548,392**
Interest rate swaps	**24,847**	**31,271**	**1,242,924**
Inflation swaps	**3,078**	**842**	**162,135**
Total derivative financial instruments	**36,413**	**32,391**	**1,953,451**

As at 31 December 2012	Asset fair value	Liability fair value	Notional amount
	£000s	*£000s*	*£000s*
Forward currency positions	860	2,957	372,062
Interest rate swaps	33,657	41,187	792,980
Inflation swaps	390	5,623	121,355
Total derivative financial instruments	34,907	49,767	1,286,397

All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc.) master agreements and the Group has collateral agreements between the individual Group entities and relevant counterparties in place under each of these market master agreements.

At 31 December 2013, the Group had pledged £10.1m (2012: £13.8m) and held collateral of £0.9m (2012: £0.5m) in respect of over-the-counter derivative transactions.

26 Financial instruments - fair value methodology

All financial instruments, with the exception of external borrowings are classified at fair value through profit and loss. In accordance with IFRS 13 Fair Value measurement, financial instruments at fair value have been classified into three categories.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities,

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and

Level 3: Inputs for the assets or liabilities that are not based on observable market data (that is, unobservable inputs).

An analysis of financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below. All these financial assets and liabilities relate to recurring fair value measurements. There are no non-recurring fair value measurements as at 31 December 2013 and 31 December 2012.

At 31 December 2013	**Level 1** *£000's*	**Level 2** *£000's*	**Level 3** *£000's*	**Total** *£000's*
Financial investments (a)	**3,063,140**	**—**	**10,824**	**3,073,964**
Loans secured by mortgages (b)	**—**	**—**	**840,066**	**840,066**
Derivative assets (c)	**—**	**36,413**	**—**	**36,413**
Total financial assets held at fair value	**3,063,140**	**36,413**	**850,890**	**3,950,443**
Payables arising from reinsurance contracts (d)	**—**	**—**	**2,169,109**	**2,169,109**
Derivative liabilities (c)	**—**	**32,391**	**—**	**32,391**
Total financial liabilities held at fair value	**—**	**32,391**	**2,169,109**	**2,201,500**

At 31 December 2012	Level 1 *£000's*	Level 2 *£000's*	Level 3 *£000's*	Total *£000's*
Financial investments (a)	2,645,997	—	—	2,645,997
Loans secured by mortgages (b)	—	—	478,097	478,097
Derivative assets (c)	—	34,907	—	34,907
Total financial assets held at fair value	2,645,997	34,907	478,097	3,159,001
Payables arising from reinsurance contracts (d)	—	—	1,728,998	1,728,998
Derivative liabilities (c)	—	49,767	—	49,767
Total financial liabilities held at fair value	—	49,767	1,728,998	1,778,765

The Group's policy is to recognise transfers into and transfers out of Levels 1, 2 and 3 as of the date at which the consolidated statement of financial position is prepared.

During 2012, all the financial investments, with the exception of Commodity Trade Finance (CTF) loans were reclassified from Level 2 to Level 1. Since the financial crisis in 2008, there has been a continual improvement in the level of liquidity in the fixed and variable rate securities markets, and having considered this during 2012, the Directors considered that the market is sufficiently active to allow classification of these financial investments as Level 1. There are no transfers between Levels 1, 2 and 3 during the period to 31 December 2013.

The table below reconciles the opening and closing recorded amount of Level 3 financial liabilities and financial assets which are stated at fair value.

For the year ended 31 December 2013	**Payables arising out of reinsurance contracts** *£000's*	**Commodity Trade Finance Loans** *£000's*	**Loans secured by mortgages** *£000's*
At 1 January 2013	**(1,728,998)**	**—**	**478,097**
Loans (received)/advanced	**(733,849)**	**23,990**	**416,473**
Total (losses)/gains in consolidated statement of comprehensive income excluding reinsurance restructure	**(155,522)**	**(3,135)**	**(25,695)**
Redemptions made/(received)	**528,119**	**(11,306)**	**(34,187)**
(Interest payable accrued)/interest receivable accrued	**(78,859)**	**1,275**	**5,378**
At 31 December 2013	**(2,169,109)**	**10,824**	**840,066**

For the year ended 31 December 2012	Payables arising out of reinsurance contracts *£000's*	Commodity Trade Finance Loans *£000's*	Loans secured by mortgages *£000's*
At 1 January 2012	(809,641)	—	316,729
Loans (received)/advanced	(1,050,424)	—	148,030
Total (losses)/gains in consolidated statement of comprehensive income excluding reinsurance restructure	(75,427)	—	7,246
Total gains in consolidated statement of comprehensive income from reinsurance restructure	35,186	—	—
Redemptions made/(received)	224,083	—	(13,847)
(Interest payable accrued)/interest receivable accrued	(52,775)	—	19,939
At 31 December 2012	(1,728,998)	—	478,097

The gains and losses are included within net investment income in the consolidated statement of comprehensive income.

The unrealised gains/(losses) in respect of payables arising out of reinsurance contracts, commodity trade finance loans and loans secured by mortgages for the period to 31 December 2013 are £105.6m, £118.3m and £(14.1)m respectively (31 December 2012: £(40.2)m, £nil and £27.2m respectively). These unrealised gains and losses are included within net investment income in the consolidated statement of comprehensive income.

Level 3 sensitivity analysis

As at 31 December 2013	**Reasonably possible alternative assumptions**	**Current fair value** *£000's*	**Increase in fair value** *£000's*	**Decrease in fair value** *£000's*
Assets				
Commodity trade finance loans..........	Expected defaults	**10,824**	**350**	**(528)**
Loans secured by mortgages	Discount rate, value of no-negative equity guarantee	**840,066**	**100,863**	**(86,046)**
Liabilities				
Payables arising out of reinsurance contracts..	Discount rate	**(2,169,109)**	**(182,645)**	**161,733**

The impacts of reasonably possible alternative assumptions are estimated by modelling alternative scenarios for the key assumptions for each valuation model.

a) Financial investments

All financial investments are designated at fair value through profit and loss. All financial investments excluding commodity trade finance are listed.

In assessing the fair value of the debt securities and other fixed income securities, the Directors have relied upon values provided by an independent third party which specialises in providing such values to companies. The third party provides prices based upon quoted market prices, or where not available, modelled prices using observable market inputs. At 31 December 2013 and 31 December 2012, 100% of the values provided were based on quoted market prices that are observable for the asset or liability.

Due to the short-term nature of the commodity trade finance (CTF) loans, the fair value of these instruments is estimated as the principal amount borrowed plus accrued interest from the date of acquisition, adjusted for incurred and expected defaults. These CTF loans are considered to be Level 3 within the valuation category prescribed by IFRS 13 as the inputs to the fair value calculation are not based on observable market data, and includes the Company's own assumptions.

The change in the fair value of Level 3 financial instruments from period to period is analysed into loans advanced, loans repaid/redemptions, and interest accrued, with the remaining balance representing fair value measurement gains and losses recognised in the statement of comprehensive income.

Interest rate: The interest rate used in estimating the fair value of the CTF loans as at 31 December 2013 was 12.0% p.a. (31 December 2012 not applicable).

b) Loans secured by mortgages

The fair value recognised in the financial statements for loans secured by mortgages is determined using a marked to model valuation technique where a significant proportion of inputs are not based on observable market data and so these assets are considered to be Level 3 within the valuation category prescribed by IFRS 13.

The valuation model discounts the expected future cash flows using an interest rate swap curve with an additional spread or yield factor minus the cost of the no-negative equity guarantee. The no-negative equity guarantee represents an embedded guarantee that the repayment of the loan cannot exceed the value of the property at the time of repayment.

Although such valuations are sensitive to various estimates, it is considered that only the discount rate and no-negative equity guarantee assumptions would have significant impact the fair value.

Discount rate: Loans secured by mortgages are valued using the swap rate appropriate to the term of each contract with adjustment to reflect the credit and liquidity risk associated with such long dated contracts. The risk adjusted swap rate for the portfolio weighted by average value at 31 December 2013 was 6.24% (31 December 2012: 5.89%).

No-negative equity guarantee: The fair value of loans secured by mortgages takes into account an explicit provision in respect of the no-negative equity guarantee which is calculated using a variant of the Black-Scholes option pricing model. The key assumptions used to derive the value of the no-negative equity guarantee include property growth, volatility and over-valuation. The property growth and volatility assumed at 31 December 2013 were 5.5% (31 December 2012: 5.5%) and 13% (31 December 2012: 13%) respectively. The over-valuation assumption used as at 31 December 2013 was 22% (31 December 2012: 17%). The value of the no-negative equity guarantee as at 31 December 2013 was £67.3m (31 December 2012: £27.6m).

The valuation technique that the Group uses to assess the fair value of loans secured by mortgages is consistent with that used to derive the prices applied at the initial transaction. As such, there is no difference between the fair value of loans secured by equity release mortgages at initial recognition and the amount that would have been determined at that date using the valuation technique.

c) Derivative assets and liabilities

The estimated fair value of derivative instruments reflects the estimated amount the Group would receive or pay in an arm’s length transaction. All the derivatives held at 31 December 2013 and 31 December 2012 were purchased over-the-counter.

The Group’s derivative assets and liabilities largely relate to forward currency positions, interest rate swaps and inflation swaps.

Forward currency positions: Forward currency exchange contracts are priced from independent third parties.

Interest rate swaps: The fair value of the interest rate swaps is derived using an interest rate swap pricing model, using a time series of historical LIBOR rates, an applicable zero coupon interest rate swap curve to derive future cash flows (“forward curve”) and an applicable zero coupon interest rate swap curve to discount future cash flows (“discount curve”) as inputs. The forward curve is used by the pricing model to determine the future LIBOR rates to be applied in the calculation of the floating leg cash flow(s). The discount curve is used to calculate the present value of the future cash flow(s) of both the fixed and floating legs of the swap and its composition is driven by the terms of the Credit Support Annex under which the swap is traded.

Inflation swaps: The fair value of the inflation swaps is derived using the inflation swap pricing model, using a time series of historical inflation index levels, a zero coupon swap inflation expectation curve, an inflation seasonality model and a zero coupon interest rate swap curve as inputs. The inflation swap pricing model generates a future cash flow for both the fixed and inflation legs of a swap for which a present value is determined using zero coupon interest rate swap curve.

The derivative assets and liabilities are presented on a gross basis in the consolidated statement of financial position. All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual Group entities and relevant counterparties in place under each of these market master agreements. As at 31 December 2013, the Group had pledged £10.1m (31 December 2012: £13.8m) and held collateral of £0.9m (31 December 2012: £0.5m) in respect of over-the-counter derivative transactions.

d) Payables arising from reinsurance contracts

The fair value recognised in the financial statements is determined using a marked to model valuation technique where not all inputs are based on observable market data and so these liabilities are considered to be Level 3 within the valuation category prescribed by IFRS 13.

The valuation model discounts the expected future cash flows using a discount rate, derived from the assets hypothecated to back these liabilities at a product level.

As payables arising from reinsurance contracts do not have a single fixed maturity date it is not possible to determine an amount that would be contractually required to pay at maturity.

Discount rate: The key inputs to the derivation of the discount rate include market observable gross redemption yields, contractual investment expenses and an allowance for credit risk on a best-estimate basis. The discount rate used as at 31 December 2013 for Retirement and Care was 4.95% and 1.97% respectively (31 December 2012: 4.53% and 2.45% respectively).

27 NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December	**2013**	2012
	£000's	*£000's*
Profit before income tax including discontinued operations	**82,661**	67,451
Non-cash movements in profit before income tax:		
Fair value gains and interest accrued on financial assets	**(32,028)**	(360,606)
Fair value losses and interest accrued on financial liabilities	**54,214**	97,758
Depreciation of property, plant and equipment	**1,843**	1,037
Amortisation of intangible assets	**1,997**	1,263
Assets written off	**1,684**	—
Interest accrued on subordinated debt	—	496
Share of loss of joint venture	**162**	40
Share-based payment charge	**9,324**	1,500
Amortisation of subordinated debt issuance costs	—	75
Amortisation of capitalised loan note debt issuance costs	**2,519**	97
Amortisation of capitalised bank loan debt issuance costs	**1,765**	160
Interest accrued on loan notes	**19,125**	32,519
Interest on bank loan	**1,995**	1,199
Net investment in financial assets	**(759,414)**	(1,048,017)
Net receipt of financial liabilities	**368,521**	837,424
Increase in reinsurance assets	**(428,198)**	(1,059,665)
Decrease/(Increase) in insurance and other receivables excluding corporation tax	**30,405**	(83,727)
Increase in prepayments and accrued income	**(7,694)**	(26,897)
Increase in insurance liabilities	**624,290**	1,564,761
(Decrease)/Increase in insurance and other payables	**(30,860)**	18,138
Increase in other taxes and social security payables	**838**	1,165
Cash (used in)/generated from operations	**(56,851)**	46,171

28 EMPLOYEE BENEFITS

Pension scheme

Details of the amounts payable for the year are included in "Other pension costs", in note 6. No amounts are outstanding in respect of these contributions at the end of the year.

The Group is a Participating Employer for a money purchase group personal pension plan. The assets of the plan are held separately from those of the Group. The Group does not provide a final salary plan.

29 DEPOSITS RECEIVED FROM REINSURERS

Financial assets arising from the payment of reinsurance premiums, less the repayment of claims, to certain reinsurers in relation to specific treaties are legally and physically deposited back with the Group. Although the funds are managed by the Group (as the Group controls the investment of the asset), no future benefits accrue to the Group as any returns on the deposits are paid to reinsurers. Consequently the deposits are not recognised as assets of the Group and the investment income they produce does not accrue to the Group.

In addition, the Group has trust agreements with two reinsurers (2012: two) whereby the assets are held in trust in order to fully fund the reinsurers' obligations under the reinsurance treaty. As the Group has no control over these funds and does not accrue any future benefit these funds are not recognised as assets of the Group.

As at 31 December	**2013** *£000's*	2012 *£000's*
Deposits managed by the Group	**272,493**	330,012
Deposits held in trust	**241,699**	192,781
Total deposits received from reinsurers	**514,192**	522,793

30 MANAGEMENT OF INSURANCE AND FINANCIAL RISK

The Group issues contracts that accept insurance risk in return for a premium. In addition the Group is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and insurance liabilities. In particular, the key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from contracts with policyholders. The most important components of this financial risk are interest rate risk and credit risk. The Group is not exposed to any equity price risk and to currency risk only to an immaterial extent.

a) Insurance risk

a1) Underwriting, pricing and reserving risk

Underwriting and pricing risk is the risk that inappropriate business will be written, or an inappropriate premium will be charged for that business. Reserving risk is the risk that the insurance liabilities have been calculated incorrectly, or the assumptions used in the calculations are incorrect.

As the Group's insurance business is specifically targeted at people with medical conditions affecting their life expectancy, or people seeking to fund domiciliary or residential care, the underwriting risk is managed through the use of highly trained, and qualified underwriting staff, together with tailored underwriting manuals designed to specifically cover a large array of medical conditions.

The Group has developed its own proprietary underwriting manuals for retirement annuity business and those seeking care funding, based on industry standard mortality tables modified to take account of experience data recorded by the Group and its predecessor organisations.

The assumptions used in the reserving for future policyholder payments are set based on available market and experience data, on the advice of the Actuarial Function Holder. The assumptions are approved by the Partnership Board. The insurance liabilities are calculated using recognised actuarial methods with due regard to the actuarial principles set out in the Prudential Regulation Authority's Prudential sourcebooks.

a2) Specific insurance risk

Insurance risk on the annuity contracts arises through longevity risk and through the risk that operating factors, such as administration expenses, are worse than expected. Insurance risk on the protection policies arises through higher than expected mortality levels. Longevity and mortality experience is monitored on a regular basis and compared to the underlying assumptions used to reserve for future insurance payments. The exposure to longevity and mortality risk is also reduced significantly through the use of reinsurance. Expense risk is managed through regular assessment of expenses incurred against budgets and overall impact on profitability of the insurance contracts.

a3) Concentration of insurance risk

The Group writes annuity contracts for the provision of retirement income or care fees and protection insurance contracts, primarily for individuals in the UK with one or more medical conditions or lifestyle factors that are likely to reduce their overall life expectancy. The Group's insurance risk is therefore concentrated on longevity and mortality risk. These risks are significantly reduced through the Group's use of external reinsurance arrangements.

b) Interest rate and other market risk

Interest rate risk arises from open positions in fixed and variable rate stock issued by government and corporate bodies that are exposed to general and specific market movements. The Group is exposed to the

market movements in interest rates to the extent that the asset value movement is different to the accompanying movement in the value of insurance liabilities.

The Group manages its interest rate risk within an asset liability management (ALM) framework that has been developed to achieve long-term investment returns in excess of its obligations under insurance and investment contracts. The principal technique of the Group's ALM framework is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to policyholders.

The Group monitors interest rate risk by calculating the mean duration and cash flow profile of the investment portfolio and the liabilities. The mean duration is an indicator of the sensitivity of the assets and insurance liabilities to changes in current interest rates but is not sufficient in isolation. The mean duration of the liabilities is determined by means of projecting expected cash flows from the contracts using best-estimates of mortality and voluntary terminations. No future discretionary supplemental benefits are assumed to accrue. The mean duration of the assets is calculated in a consistent manner. Any gap between the mean duration of the assets and the mean duration of the liabilities is minimised by means of buying and selling fixed interest securities of different durations or purchasing interest rate swap derivatives to alter the effective mean duration of the assets. Periodically the cash flow matching is reviewed and rebalanced.

At 31 December 2013, the mean duration of the assets was 7.5 years (2012: 7.7 years) measured with reference to a gross redemption yield and the mean duration of the liabilities was at 9.0 years (2012: 8.9 years) measured with reference to the valuation interest rate.

The Group has reinsurance arrangements in place which provide for fixed payments to the reinsurer over future periods. In assessing the fair value of this liability, the Directors have used a discount rate derived from current market yields earned on assets held to fund the future cash outflows, adjusted for the risk of default on those assets. No further adjustment to the discount rate to reflect any risk of the Group defaulting on those payments to the reinsurer was deemed appropriate.

c) Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Group is exposed to credit risk are exposure to:

- the issuer of corporate bonds;
- counterparties in derivative contracts;
- reinsurers in respect of their share of insurance liabilities; and
- reinsurers in respect of claims already paid.

The Group places limits on its exposures to a single counterparty, or groups of connected counterparties.

With respect to its investment in corporate bonds, the credit rating is derived from the Standard & Poor's, Moody and Fitch ratings for each individual stock, if two or more ratings are available the second highest rating is used otherwise the single available rating is used. The Group places limits on the exposure to bond issuers with different credit ratings. Credit default swaps are also used to manage exposure to single issuers. Current restrictions do not allow investment in any corporate bond with a rating below "BBB" (or equivalent). Where investments already held are subsequently downgraded, the Directors will review each holding to determine whether to retain that exposure.

At 31 December 2013, £0.5m of collateral (2012: £8.6m) had been pledged to the Group to mitigate the credit risk exposure associated with the derivative assets held at that time.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Group's liability as primary insurer, and consequently, if a reinsurer fails to pay a claim, the Group remains liable for the payment to the policyholder. As a result, the Group is exposed to credit risk in relation to the reinsurers' ability to fulfil its obligations to the Group. The creditworthiness of reinsurers is considered by reviewing their financial strength prior to finalisation of any contract and then subsequently at least on an annual basis.

We seek to place new business with reinsurers with a minimum credit rating of "A".

For certain reinsurance treaties, the reinsurers share of annuity insurance liabilities is backed by investments deposited back with the Group, or held in trust for the beneficial ownership of the Group. In this way, the Group's exposure to the credit risk relating to the reinsurer is significantly reduced. The investment risk on investments deposited back with the Group, or held in trust for the beneficial ownership of the Group, is borne by the reinsurers.

The following table analyses the credit exposure of the Group by type of asset and includes the credit risk arising out of reinsurance exposures, based on the credit ratings of the reinsurer, as published by Standard & Poor's, or an equivalent rating from another recognised rating agency.

	Credit rating					
At 31 December 2013	**AAA**	**AA**	**A**	**BBB**	**Below BBB/ Unrated**	**Total**
	£000's	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***
Financial investments	**601,351**	**257,263**	**1,170,898**	**1,033,628**	**10,824**	**3,073,964**
Derivative assets	—	—	—	—	**36,413**	**36,413**
Loans backed by mortgages	—	—	—	—	**840,066**	**840,066**
Reinsurance assets	—	**1,240,280**	**1,600,469**	—	—	**2,840,749**
Insurance and other receivables	—	**29**	**9,010**	—	**55,437**	**64,476**
Total	**601,351**	**1,497,572**	**2,780,377**	**1,033,628**	**942,740**	**6,855,668**

	Credit rating					
At 31 December 2012	AAA	AA	A	BBB	Below BBB/ Unrated	Total
	£000's	*£000's*	*£000's*	*£000's*	*£000's*	*£000's*
Financial investments	621,927	220,684	1,036,267	759,049	8,070	2,645,997
Derivative assets	—	—	—	—	34,907	34,907
Loans backed by mortgages	—	—	—	—	478,097	478,097
Reinsurance assets	—	1,353,220	1,059,331	—	—	2,412,551
Insurance and other receivables	—	—	5,627	—	89,254	94,881
Total	621,927	1,573,904	2,101,225	759,049	610,328	5,666,433

The following table presents an aging analysis of financial assets by payment due status:

		Past due but not impaired					
As at 31 December 2013	**Not past due**	**Less than 1 month**	**1-3 months**	**3-6 months**	**More than 6 months**	**Impaired**	**Total**
	£000's	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***
Commodity Trade Finance	**6,350**	—	**742**	**3,732**	—	—	**10,824**
Loans secured by mortgages	**840,066**	—	—	—	—	—	**840,066**
Other financial assets	**6,008,985**	—	—	—	—	—	**6,008,985**

No other financial assets were past due at 31 December 2012.

d) Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Partnership Board sets limits on the minimum amount of highly liquid assets to be available to meet such obligations.

Short-term cash requirements are monitored on a daily basis to ensure sufficient funds are available to meet immediate payments. The nature of the Group's business means that, in general, cash flows into the Group (through up-front premium payments) before annuity payments become due. Annuity payments are substantially fixed in nature, and consequently the cash requirements are not subject to excessive uncertainty.

In accordance with PRA (formerly the FSA) regulations, the Group's assets are reviewed to ensure they are of sufficient amount and of an appropriate currency and term to ensure that the cash inflows from those assets will meet the expected cash outflows from the Group's insurance and other financial liabilities.

In the following table expected cash outflows for:

- net insurance liabilities have been modelled with reference to underlying mortality and longevity assumptions;
- payables arising from reinsurance include interest and payments due under the terms of reinsurance treaties,
- derivative liabilities have been modelled with reference to the yield curves that existed at the balance sheet date and assumed to be held to maturity, and
- subordinated debt is assumed to be repaid in accordance with the terms set out in the loan agreement.

The following table includes insurance and financial liabilities that are exposed to liquidity risk.

At 31 December 2013	**Expected cash flows (undiscounted)**				
	less than one year	**one to five years**	**five to ten years**	**more than ten years**	**Carrying value (discounted)**
	£000's	***£000's***	***£000'***	***£000'***	***£000's***
Net insurance liabilities	**131,727**	**457,257**	**464,853**	**1,285,066**	**1,506,839**
Payables arising from reinsurance contracts	**1,831,083**	**735,336**	**792,792**	**1,934,163**	**2,169,109**
Derivative liabilities	**584**	**10,252**	**14,381**	**15,596**	**32,391**
Total	**1,963,394**	**1,202,845**	**1,272,026**	**3,234,825**	**3,708,339**

At 31 December 2012	Expected cash flows (undiscounted)				
	less than one year	one to five years	five to ten years	more than ten years	Carrying value (discounted)
	£000's	*£000's*	*£000's*	*£000's*	*£000's*
Net insurance liabilities	109,715	368,737	354,809	969,614	1,310,747
Payables arising from reinsurance contracts	114,153	576,795	619,048	1,496,027	1,728,998
External borrowings	—	—	—	365,539	365,539
Derivative liabilities	8,406	27,856	5,142	11,971	49,767
Total	232,274	973,388	978,999	2,843,151	3,455,051

The maximum exposure to credit risk is equal to the balance sheet value of debt instruments/ derivatives.

e) Property risk

Property risk is the risk that property values do not rise sufficiently to recover the full value of equity release loans made plus accrued interest. The initial loan value is restricted to a maximum "loan to value" ratio that limits the risk exposure for the Group.

Loans backed by mortgages represent little credit risk as the debt is ultimately repayable from the proceeds of the sale of the property on death of the policyholder or on their transfer to long-term care.

31 AVAILABLE CAPITAL RESOURCES

The Group manages its capital to ensure that entities within the Group will be able to continue to operate as going concerns, and to ensure that where a subsidiary is subject to regulatory capital requirements, that entity maintains an adequate capital surplus to ensure compliance with those requirements. The Group's capital consists of equity attributable to equity holders of the Parent Company. For the purposes of regulatory capital requirements, certain assets are restricted, or are inadmissible.

One subsidiary, Partnership Life Assurance Company Limited, is required to comply with minimum capital requirements calculated at the level of its EEA Parent Company level, as well as its own single entity level. It must also calculate its available capital at the ultimate Parent Company level, but as failure to cover the minimum capital requirement at this level has no consequence for the entity, or the Group, it is not a measure used to manage capital and hence is not disclosed in this note. The table below shows the available capital resources at the level of the EEA Parent Company as this is the number by which we assess the Group's capital adequacy. These capital requirements are determined in accordance with the PRA regulations and the EU directives, for insurance and other PRA regulated business. Any changes or

release of capital from long-term funds is subject to there being an established surplus shown by an actuarial investigation.

As at 31 December	**2013** *£000's*	2012 *£000's*
Total equity of EEA Parent Company	**598,549**	457,703
Minority interest in equity for regulated business	**(66)**	—
Adjustments in respect of regulatory capital basis:		
Inadmissible intangible assets	**(16,401)**	(12,343)
Inadmissible goodwill	**(126,207)**	(126,207)
Inadmissible deferred tax asset	**(424)**	(158)
Equity and reserves related to non-regulated entities (excluded from regulatory capital calculation), adjusted for inadmissible assets already adjusted above	**13,031**	9,157
Total available capital resources (regulatory basis)	**468,483**	328,152
Group minimum capital requirement (regulatory basis)	**(191,630)**	(163,213)
Surplus over regulatory capital requirement	**276,853**	164,939

Movements in equity are shown in the consolidated statement of changes in equity.

Throughout the year, each regulated subsidiary has maintained capital resources in excess of the minimum required by the PRA regulations and the EU directives.

32 REORGANISATION

As part of the "Global Offer" and admission of the Company to the London Stock Exchange on the 12 June 2013, the Group has undertaken certain reorganisation steps as detailed below.

Immediately prior to admission on 12 June 2013:

- the A and B loan notes, previously issued by PAG Finance Limited (PAGF), a Group company, together with accrued but unpaid interest, were exchanged on a pound-for-pound basis for the allotment and issue of 69,212,294 ordinary shares in the Company which had a value of £266.5m (note 33);
- the C loan notes, previously issued by PAGH, together with accrued but unpaid interest, were exchanged on a pound-for-pound basis for the allotment and issue of 15,397,726 ordinary shares in the Company which had a value of £59.3m (note 33); and
- the A, B, and C ordinary shares in PAGH were exchanged for the allotment and issue of 282,358,446 ordinary shares in the Company. A merger reserve of £(24.5)m arose on consolidation as a result of this share exchange to maintain parity of the consolidated net assets of the Group before and after these share exchanges.

As a result of the above steps the Company obtained control of PAGH and its subsidiaries. The accounting treatment of this is set out in note 2. Also as a result of the above steps Cinven Funds, certain Directors, certain members of Senior Management and other individuals hold ordinary shares in each case in proportion to the value of the shareholder instruments in the Group held by them immediately prior to the reorganisation.

Pursuant to the Global Offer and following admission on 12 June 2013:

- the Company issued 32,467,532 new ordinary shares raising gross proceeds of £125.0m;
- £7.7m of these proceeds were used to repay in full the Vendor loan notes (VLN), together with accrued unpaid interest (note 23);
- the remainder of these proceeds were used in part to fund transaction costs, to repay the £70m external borrowing facility on 21 August 2013 (note 23) and for general corporate purposes; and

- the Company also issued 51,948 new ordinary shares to certain of the independent non-executive Directors and 12,025 new ordinary shares to the employee benefit trust raising £246,000.

The transaction costs relating to the Global Offer in the six months period to 30 June 2013 amounted to £19.6m. £4.0m of these costs are directly associated with the issue of new shares and have therefore been set-off against the share premium associated with those shares. £3.8m of these costs have been paid during the period to 30 June 2013.

33 SHARE CAPITAL

The Group has issued ordinary shares which are classified as equity. Incremental external costs that are directly attributable to the issue of the ordinary shares are recognised in equity, net of tax.

On 12 June 2013, immediately prior to admission on the London Stock Exchange, the Company acquired a 100% shareholding in PAGH, the top holding company of the Group at that point in time.

The allocated and issued share capital of PAGH and PAG plc, the top holding companies of the Group as at 31 December 2012 and 31 December 2013 respectively are detailed below:

At 31 December 2012	**Share capital** *£000's*	**Share premium** *£000's*
The authorised share capital of the Company is:		
"A" ordinary shares of £0.01 each	25	–
"B" ordinary shares of £0.01 each	3	–
"C" ordinary shares of £0.01 each	5	182
"D" ordinary shares of £1 each	3	–
Total	36	182

In the year to 31 December 2012:

- 2,834 ordinary D shares of PAGH of £1 each were issued at par for cash;
- the A, B and C ordinary shares of PAGH were converted into new A, B and C ordinary shares of £0.01 each and new deferred shares of £0.99 each;
- PAGH repurchased the deferred (DEF) shares of £0.99 each, for a total consideration of £1; and
- a Capital Redemption Reserve of £3,296,860 was created on repurchase of the deferred shares.

As detailed in note 32, immediately prior to admission on 12 June 2013, all of the A, B and C ordinary shares in PAGH were transferred to the Company in exchange for the allotment and issue of ordinary shares in the Company of £0.10 each. This resulted in the creation of the Merger Reserve as a result of the Group electing to account for the acquisition of its 100% shareholding in PAGH as a Group reconstruction as described under the UK GAAP accounting standard, Financial Reporting Standard 6, "Acquisitions and Mergers" In addition, the Capital Redemption Reserve was transferred to this Merger Reserve as part of the same transaction.

As at 31 December 2013	**Number of shares**	**Share capital** *£000's*	**Share premium** *£000's*
The allotted and issued share capital of PAG plc:			
On incorporation, ordinary shares of £1.00 each	**50,000**	**50**	**—**
On 12 June 2013:			
Shares subdivided into 500,000 ordinary shares of £0.10 each	**450,000**	**—**	**—**
Exchange of the A and B loan notes	**69,212,294**	**6,921**	**259,547**
Exchange of C loan notes	**15,397,726**	**1,540**	**57,742**
Share for share exchange of A, B and C ordinary shares in PAGH for ordinary shares in PAG plc	**282,358,446**	**28,236**	**—**
New issue of shares as part of Global Offer	**32,467,532**	**3,247**	**121,752**
New ordinary shares issued to senior management	**51,948**	**5**	**195**
New ordinary shares issued to EBT	**12,025**	**1**	**45**
Share issue costs	**—**	**—**	**(4,032)**

As at 31 December 2013, ordinary shares of £0.10 each	**399,999,971**	**40,000**	**435,249**

The Company was incorporated on 26 February 2013 with an issued share capital of £50,000 divided into 50,000 ordinary shares of 100 pence each. On 12 June 2013, the 50,000 ordinary shares of 100 pence each were subdivided into 500,000 ordinary shares of 10 pence each. Immediately following the completion of the Global Offer, and as a result of a number of steps undertaken prior to admission described in note 32 below, the issued share capital of the Company was increased to £39,999,997, comprising 399,999,971 ordinary shares of 10 pence each, all of which will be fully paid or credited as fully paid.

The ordinary share entitles the holder to dividends declared by the Board which are not cumulative. The ordinary share entitles the holder to one vote for every share held.

Shares held by the employee trust

Where an employee trust acquires shares in the Company or obtains rights to purchase its shares, the consideration paid (including attributable transaction costs, net of tax) is shown as a deduction from the owners' equity. Gains and losses on sales of shares held by the employee trust are charged or credited to the own shares account in equity.

As at 31 December	**2013** ***£000's***	**2012** ***£000's***
Employee benefit trust	**(58)**	(33)

Prior to the Global Offer, the PAGH Employee Benefit trust (PAGH trust), which was established in 2008, and is a discretionary employee benefit trust, held shares to satisfy awards granted to employees of the Group.

As part of the Group restructuring prior to the Global Offer, the shares in PAGH held by the EBT were exchanged for £283,000 of ordinary shares in PAG plc. Following the admission of the Group onto the London Stock Exchange via a Premium Listing, £271,000 of these shares were sold to fund the vesting of the options under the Group's previous Employee Share Option Plan with the remainder of the shares transferred to a new employee benefit trust.

In addition, during the year, £46,000 of new shares were issued by the Company to the new employee benefit trust. The number of shares held by the new employee trust as at 31 December 2013 was 136,884 (31 December 2012: PAGH trust: 33,000).

34 OPERATING LEASE COMMITMENTS

The Group has annual commitments in respect of non-cancellable operating leases as follows:

As at 31 December	**2013** ***£000's***	**2012** ***£000's***
Leases expiring not later than one year	**3,645**	2,859
Leases expiring between one and five years	**11,671**	10,489
Leases expiring in more than five years	**9,453**	13,246
Total lease commitments	**24,769**	26,594

35 RELATED PARTY TRANSACTIONS

Balances and transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

During the period, the Group entered into transactions, in the ordinary course of business, with other related parties. Transactions entered into and balances outstanding at the end of each reporting date are detailed below.

a) Financing transactions

Prior to the Group reorganisation in 2013 and as described in note 32, the Fourth Cinven Fund was the ultimate shareholder of the Group.

The Group issued a number of loan notes to the Fourth Cinven Fund. These included the A, B and C loan notes. Details of these loan notes are described in note 12 above and the outstanding balances at the end of each reporting period are disclosed in the table below:

As at 31 December	**2013**	2012
	£000's	*£000's*
A and B loan notes	—	232,702
C loan notes	—	53,978
Total	—	286,680

During the year, as described in note 32 above, the A, B and C loan were transferred on a pound-for-pound basis to the Company in exchange for the allotment and issue of ordinary shares in the Company.

The amounts accruing to the Fourth Cinven Funds in respect of these loan notes are detailed below:

As at 31 December	**2013**	2012
	£000's	*£000's*
Interest accrued on loan notes	**18,629**	29,640
Monitoring fee payments	**216**	450
Total	**18,845**	30,090

The monitoring fee payments up to February 2013 include fees for two of the Group's non-executive Directors who are also employees of Cinven Capital Management.

In addition, as part of the IPO, ordinary shares in the Company were issued to Cinven and Directors as explained in note 32.

b) Remuneration of key management personnel

Key management personnel consist of the directors of the Company. The key management personnel changed during the year 2013 reflecting the Group reorganisation. The remuneration of the directors, who are the key management personnel of the Group, is set out below

As at 31 December	**2013**	2012
	£000's	*£000's*
Short-term employee benefits	**2,060**	2,129
Post-employment benefits	**55**	114
Share-based payments	—	—
Total	**2,115**	2,243

c) Directors' loans

A number of directors who are defined as key management personnel of the Company held loans during the period. The loans owed to/by the directors are detailed as follows

As at 31 December	**2013**	**2012**
	£000's	***£000's***
Amounts owed to directors:		
B loan notes	—	12,216
Vendor loan notes	—	878
Total	—	13,094
Amounts owed by directors:		
Loan advances	**289**	378
Total	**289**	378

The terms of the B and Vendor loan notes are detailed in note 32, and, as set out in that note, the loan notes were exchanged for ordinary shares in the Company as part of the IPO.

The loan advances to directors accrue interest fixed at 4% p.a. and are repayable in whole or in part at any time.

The amounts accruing to/from the directors in respect of these loan notes are detailed below:

As at 31 December	**2013** *£000's*	**2012** *£000's*
Interest accrued on B and Vendor loan notes	**663**	1,421
Interest accrued on Directors' loan advances	**6**	—
Total	**669**	1,421

d) Other related party transactions

During the year the Group entered into transactions with other entities controlled by Cinven Limited as set out below. All transactions were on a commercial basis.

As at 31 December	**2013** *£000's*	**2012** *£000's*
Transaction expense (services received)	**558**	—
Total	**558**	—

e) Ultimate controlling party

As at 31 December 2013 a majority of the Company's ordinary shares are held by the partnerships comprising the Fourth Cinven Funds (the "Cinven Funds"), being funds managed and advised by Cinven Limited, a company incorporated under the laws of England and Wales. Accordingly, the Directors consider the Company's ultimate controlling party to be Cinven Limited, the manager and adviser to the Cinven Funds.

36 Events after the balance sheet date

Dividend

Subsequent to 31 December 2013, the directors proposed a final dividend for 2013 of 3.0 pence per ordinary share (2012: nil), amounting to £12.0m (2012: nil) in total. Subject to approval by shareholders at the AGM, the dividend will be paid on 30 May 2014 and will be accounted for as an appropriation of retained earnings in the year ending 31 December 2014.

AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF PARTNERSHIP LIFE ASSURANCE COMPANY LIMITED FOR THE YEAR ENDED 31 DECEMBER 2014

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF PARTNERSHIP LIFE ASSURANCE COMPANY LIMITED

We have audited the Financial Statements of Partnership Life Assurance Company Limited for the year ended 31 December 2014 which comprise the Statement of Comprehensive Income, the Statement of Changes in Equity, the Statement of Financial Position, the Cash Flow Statement and the related notes 1 to 26. The financial reporting framework that has been applied in their preparation is applicable law and IFRS as adopted by the European Union.

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, 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

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatement or inconsistencies we consider the implications for our report.

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 2014 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; 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.

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.

Paul Stephenson
BA ACA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK
2 March 2015

AUDITED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2014

	Note	**2014**	2013
		£000's	*£000's*
Gross premiums written		760,638	1,159,561
Outward re-insurance premiums		(307,959)	(733,849)
Net premiums earned		452,679	425,712
Net investment income	2	299,040	136,207
Total income		751,719	561,919
Gross claims paid		(390,570)	(341,126)
Reinsurers' share		255,957	225,277
		(134,613)	(115,849)
Change in insurance liabilities:			
Gross amount	14	(883,524)	(624,290)
Reinsurers' share	14	405,259	428,197
		(478,265)	(196,093)
Acquisition costs		(4,038)	(11,508)
Investment expenses and charges		(14,201)	(12,737)
Other operating expenses		(96,971)	(91,348)
		(115,210)	(115,593)
Total claims and expenses		**(728,088)**	(427,535)
Profit before tax	3	**23,631**	134,384
Income tax expense	4	(3,178)	(23,001)
Profit for the year		**20,453**	111,383

The Company's results are from continuing operations.

The profit for each year is entirely attributable to equity.

The notes are an integral part of these Financial Statements.

AUDITED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2014

	Note	**Share capital** *£000's*	**Other reserves** *£000's*	**Retained Earnings** *£000's*	**Total** *£000's*
At 1 January 2013		137,190	-	191,931	329,121
Profit for the year		-	-	111,383	111,383
Dividends payable	5		-	(25,000)	(25,000)
At 31 December 2013		**137,190**	**-**	**278,314**	**415,504**
At 1 January 2014		137,190	-	278,314	415,504
Other reserves	13	-	23,000	-	23,000
Profit for the year		-	-	20,453	20,453
At 31 December 2014		**137,190**	**23,000**	**298,767**	**458,957**

The profit for each year is entirely attributable to equity.

The notes are an integral part of these Financial Statements.

AUDITED STATEMENT OF FINANCIAL POSITION

For the year ended 31 December 2014

	Note	**2014** *£000's*	Restated 2013 *£000's*
Assets			
Goodwill	6	1,332	1,332
Other intangible assets	7	1,000	1,000
Financial assets	9	4,909,267	3,998,702
Reinsurance assets	14	3,246,008	2,840,749
Insurance and other receivables	10	42,158	125,352
Prepayments and accrued income	11	28	-
Cash and cash equivalents	12	74,565	64,760
Total assets		8,274,358	7,031,895
Equity			
Share capital	13	137,190	137,190
Other reserves	13	23,000	-
Retained earnings		298,767	278,314
Total equity and reserves		**458,957**	415,504
Liabilities			
Insurance liabilities	14	5,231,112	4,347,588
Insurance and other payables	15	10,150	37,628
Financial liabilities	16	2,571,290	2,214,830
Current tax liabilities	17	2,849	16,345
Total liabilities		**7,815,401**	6,616,391
Total equity and liabilities		**8,274,358**	7,031,895

The notes are an integral part of these Financial Statements.

The financial statements of the Company were approved by the board of Directors and authorised for issue on 2 March 2015.

They were signed on its behalf by:

SJ Groves, FIA
Chief Executive Officer
Company Registered Number: 5465261

AUDITED CASH FLOW STATEMENT

For the year ended 31 December 2014

	Note	**2014**	2013
		£000's	*£000's*
Cash generated/ (used in) operations	20	**5,840**	(77,908)
Income taxes paid		(19,035)	(16,768)
Dividends payable to Company shareholder		-	25,000
Dividends settled via intercompany	5	-	(25,000)
Net cash used in operating activities		**(13,195)**	(94,676)
Cash flows from financing activities:			
Capital contribution		23,000	-
Net cash from financing activities		**23,000**	-
Net increase/ (decrease) in cash and cash equivalents		9,805	(94,676)
Cash and cash equivalents at beginning of year		64,760	159,436
Cash and cash equivalents at end of year	12	**74,565**	64,760

Cash flows related to the sale and purchase of financial investments are included in operating cash flows as they are associated with the origination of insurance contracts and payment of insurance claims.

The notes are an integral part of these Financial Statements.

NOTES TO THE FINANCIAL STATEMENTS

1 SIGNIFICANT ACCOUNTING POLICIES

General information

Partnership Life Assurance Company Limited ("the Company") underwrites life assurance and annuity business in the UK.

Note 22 to the Financial Statements sets out the Company's policies and procedures for managing insurance and financial risk, and note 23 sets out how the Company manages its capital resources. Having regard to the Company's financial position, its expected performance in the future, and having made appropriate enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Basis of preparation

These Financial Statements are prepared in accordance with IFRS adopted by the European Union as defined by IAS 1, and in accordance with the provisions of Sections 1165 (5) and 1165 (6) of the Companies Act 2006 and the special provisions relating to insurance companies of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008, Schedule 3.

The financial information has been prepared in accordance with applicable accounting standards and under the historical cost convention, modified to include the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss.

The Company is exempt from the requirement to prepare consolidated accounts under the provision of IAS27. The Company is a subsidiary undertaking of Partnership Assurance Group plc (PAG Plc) and its results are consolidated in the Financial Statements of that company (note 25).

Critical accounting judgements and key sources of estimation uncertainty

The preparation of financial information in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial information and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

Premiums

Premiums are recognised in the accounting period in which an insurance contract commences, gross of any commission paid. Premiums which have been received and for which no contract is yet in-force are classified as payables arising from insurance contracts and are included within insurance and other payables in the Statement of Financial Position. Where a contract has been issued but premiums have not yet been received, a debtor arising out of direct insurance operations is recognised for the expected premiums due. Reinsurance premiums and recoveries are accounted for in the accounting period in accordance with the contractual terms of the reinsurance treaties. Premiums exclude any taxes or duties based on premiums.

Claims

Maturity claims and annuities are charged against revenue when due for payment. Death claims and all other claims are accounted for when notified. Claims reinsurance recoveries are accounted for in the same period as the related claim. Where reinsurance treaties are commuted, amounts received to compensate for the transfer of risk from the reinsurer are accounted for when received or, if earlier, on the date the treaty ceases to be included within the calculation of the reinsurers' share of long term business provision.

Insurance liabilities

Insurance contracts are defined as those containing significant insurance risk if, and only if, and insured event would cause and insurer to pay significant additional benefits 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.

The Company's long-term insurance contracts include annuities to fund retirement income, annuities to fund care fees (immediate needs and deferred), long-term care insurance and whole of life and term protection insurance. These contracts are expected to remain in force for an extended period of time, and insure events associated with human life.

One of the purposes of insurance is to enable policyholders to protect themselves against future uncertain events such as death or specific types of illness. Insurance companies accept the transfer of uncertainty from policyholders and seek to add value through the aggregation and management of these risks. As a consequence of this uncertainty, estimation techniques are employed by suitably qualified personnel in computing the levels of provisions held against such uncertainty.

The insurance liabilities, which are also referred to as the long-term business provision and policyholder reserves elsewhere in this report, are determined by the Partnership Board on the advice of the Company's Actuarial Function Holder on the modified statutory basis using recognised actuarial methods with due regard to the actuarial principles set out in the PRA's (formerly the FSA's) Insurance Prudential Sourcebook. In particular, a prospective gross premium valuation method has been adopted for major classes of business.

Although the process for the establishment of insurance liabilities follows specified rules and guidelines, the provisions that result from the process remain uncertain. As a consequence of this uncertainty, the eventual value of claims could vary from the amounts provided to cover future claims. The Company seeks to provide for appropriate levels of contract liabilities taking known facts and experiences into account but nevertheless such provisions remain uncertain.

The estimation process used in determining insurance liabilities involves projecting future annuity payments and the costs of maintaining the contracts. For non-annuity contracts, the long-term business provision is determined as the sum of the discounted value of future benefit payments and future administration expenses less the expected value of premiums payable under the contract. The key sensitivities are the assumed level of interest rates and the mortality experience.

At the balance sheet date, provision is made for all notified claims plus an estimate for those claims that have been incurred but not reported. The principal assumptions underlying the calculation of insurance liabilities are set out in note 14.

Reinsurance assets

Long-term business is ceded to reinsurers under contracts to transfer part or all of one or more of the following risks: mortality, morbidity, investment, persistency and expenses. The benefits to which the Company are entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers (classified within "Insurance and other receivables") as well as longer term receivables that are dependent on the expected benefits arising under the related reinsured contracts.

Amounts recoverable from reinsurers are estimated in a consistent manner with insurance liabilities, and are classified as "Reinsurance assets".

Some contracts, which provide for the transfer of significant risk, are also structured to provide financing. When, under such contracts, financing components are to be repaid in future accounting periods, the amount outstanding under the contract at the balance sheet date are classified as "Payables arising from reinsurance contracts" and included within insurance and other payables in the Statement of Financial Position.

If the reinsurance asset were impaired, the Company would adjust the carrying amount accordingly and recognise that impairment loss in the Statement of Comprehensive Income. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Company may not receive all amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

Liability adequacy test

At the end of each reporting period, liability adequacy tests are performed to ensure the adequacy of the insurance liabilities. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from assets backing such liabilities, are used. Any deficiency is immediately charged to the Statement of Comprehensive Income.

Acquisition costs

Acquisition costs comprise direct costs such as commissions and indirect costs of obtaining and processing new business. They are allocated to particular categories of business based on available information. Acquisition costs are not deferred as they are largely recovered at inception through profit margins.

Investment income & expenses

Investment income comprises interest received on financial investments, realised investment gains and losses and movements in unrealised gains and losses.

Expenses and charges are included on an accruals basis.

Realised gains and losses on investments are calculated as the difference between net sales proceeds less costs of sale and original cost. Unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or if they have been previously valued their valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Goodwill

Goodwill represents the excess of cost of acquisition over the fair value of the separable net assets of businesses acquired. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill is allocated to each of the cash-generating units ("CGU") that are expected to benefit from the combination. Goodwill is tested for impairment at least annually, or when circumstances or events indicate there may be uncertainty over this value. Impairment is determined by assessing the recoverable amount of each CGU to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognised. Any impairment is recognised immediately in the Statement of Comprehensive Income and is not subsequently reversed.

Other intangible assets

Other intangible assets comprise intellectual property in the form of specific mortality tables derived from data collected over an extended period. The intangible asset is deemed to have an indefinite life and consequently no amortisation is charged against its carrying value.

Impairment of tangible and intangible assets excluding goodwill

The carrying amounts of tangible and intangible assets with finite expected useful economic lives are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, A review for indicators of impairment is conducted annually. The carrying amounts of intangible assets with indefinite expected useful economic lives are tested for impairment at least annually, or when circumstances or events indicate there may be uncertainty over this value. An impairment loss is recognised in the income statement for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its net selling price (fair value less selling costs) and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre¬tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit, or company of units, to which the asset belongs.

Investments in subsidiaries

Investments in subsidiaries are stated at cost less impairment, as determined by the Company's Directors.

Financial assets classification

The Company classifies its financial assets as financial investments, loans secured by residential mortgages, loans secured by commercial mortgages and derivative financial assets at fair value through profit and loss. The category of fair value through profit and loss has two sub-categories: those that meet the definition as being held for trading; and those that the Company chooses to designate as fair value. The fair value through profit and loss is selected as the Company's strategy is to manage its financial assets, as a portfolio, on a fair value basis

Financial investments

Purchases and sales of debt securities and other fixed income securities are recognised on the trade date, which is the date that the Company commits to purchase or sell the assets, at their fair values. Transaction costs are expensed as incurred. These investments are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Debt securities and other fixed income securities are subsequently carried at fair value with changes in fair value included in the Statement of Comprehensive Income in the period in which they arise.

The fair values of debt securities are based on quoted bid prices, or based on modelled prices (using observable market inputs) where quoted bid-prices are not available.

Loans secured by residential mortgages

Loans secured by residential mortgages are recognised when the cash is advanced to borrowers at their fair values. These loans are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Loans secured by residential mortgages are subsequently carried at fair value with changes in fair value included in the Statement of Comprehensive Income in the period in which they arise.

The fair value of loans secured by residential mortgages is initially deemed to be the transaction price and subsequently marked to model. The underlying model follows the methodology used to establish transaction prices. It uses longevity assumptions to derive expected cash flows and the Black Scholes option pricing methodology to establish the value of the no negative equity guarantee that is embedded in the product. The discount rates that are applied to cash flows to produce fair value are based on long dated swaps adjusted so that they would produce transaction date prices on the date of transaction.

Loans secured by commercial mortgages

Loans secured by commercial mortgages are recognised when the cash is advanced to borrowers at their fair values. These loans are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Loans secured by commercial mortgages are subsequently carried at fair value with changes in fair value included in the Consolidated Statement of Comprehensive Income in the period in which they arise.

The fair value of loans secured by commercial mortgages is initially deemed to be the transaction price and subsequently marked to model. The valuation model produces a series of projected future cash flows for each mortgage, based on a range of simulations of changes in property prices drawn from a distribution based on historic observed changes. Potential changes in property tenancy are also modelled in a range of simulations. The discount rates that are applied to cash flows to produce the fair value are based on long dated swaps adjusted so that they would produce transaction date prices on the date of the transaction.

Derivative financial instruments

The Company enters into a variety of derivative financial instruments to manage its exposure to interest rates, inflation, credit default and foreign exchange rate risk, including foreign exchange forward contracts, interest rate swaps, credit default swaps and inflation swaps.

Derivative contracts are traded either through an exchange or over-the-counter ("OTC"). OTC derivative contracts are individually negotiated between contracting parties and can include options, swaps, caps and floors.

Derivatives are initially recognised at fair value at the date that a derivative contract is entered into and are subsequently remeasured to fair value at each balance sheet date. The resulting gain or loss is recognised in the Statement of Comprehensive Income. The fair values are obtained from quoted market prices or, if these are not available, by using standard valuation techniques based on discounted cash flow models or option pricing models. All derivatives are carried as assets when the fair value is positive and liabilities when the fair values are negative. Premiums paid for derivatives are recorded as an asset on the balance sheet at the date of purchase representing their fair value at that date.

Insurance and other receivables

Insurance and reinsurance debtors represent amounts receivable after commencement of the contract which has not been settled at the balance sheet date.

Prepayments and accrued income

Interest accrued represents the balance receivable for interest income, calculated daily based on the contractual interest rates of the relevant instruments, recognised since the last interest payment date.

Financial liabilities

As well as derivative financial liabilities, the Company carries financial liabilities where assets under specific reinsurance treaties are legally and physically deposited back to the Company by reinsurers. Financial liabilities are initially recognised at fair value on the same date that the value of underlying deposited assets is recognised and are subsequently remeasured at fair value at each balance sheet date. The resulting gain or loss is recognised in the Statement of Comprehensive Income. The net gain or loss recognised incorporates any interest paid on the financial liability. Fair value is determined as the amount payable discounted from the first date that the amount is required to be paid.

A financial liability (including subordinated debt and external borrowings) is generally derecognised when the contract that gives rise to it, is settled, sold, cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange of modification is treated as a derecognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in the Statement of Comprehensive Income.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into.

Income tax

Income tax comprises current and deferred tax. Income tax is charged or credited to other comprehensive income if it relates to items that are charged or credited to other comprehensive income. Similarly, income tax is charged or credited to equity if it relates to items that are credited or charged directly to equity. Otherwise income tax is recognised in the Statement of Comprehensive Income.

Provision is made for taxation on taxable profits for the year, using tax rates enacted or substantially enacted at the balance sheet date together with adjustments to tax payable in respect of previous years.

Deferred tax is provided in full on temporary differences arising, which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply

when they crystallise based on tax rates and laws enacted or substantively enacted at the balance sheet date. Temporary differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements except for differences arising from the initial recognition of goodwill and the initial recognition of assets and liabilities in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting nor taxable profit.

A deferred tax asset is recognised to the extent that it is regarded as more likely than not that it will be recovered. Deferred tax assets and liabilities are not discounted.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date. Deferred income tax assets and liabilities are offset only if: a legally enforceable right exists to set off current tax assets against current tax liabilities; the deferred income taxes relate to the same taxation authority; and that authority permits the Company to make a single net payment.

Pension costs

All staff are employed by Partnership Services Limited, a fellow subsidiary undertaking of the parent undertaking. Partnership Services Limited operates money purchase company personal pension plans. The pension charge attributable to the Company is recharged from Partnership Services Limited and is expensed to the income statement as the charges arise.

Foreign currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the end of the financial period. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held on call with banks and other short term highly liquid investments with original maturities of 90 days or less. Bank overdrafts are included in cash and cash equivalents.

Operating segments

The Company is not required to include a segmental analysis as it is not a listed company with traded debt or equity. Segmental analysis for the Partnership Assurance Group is included in the financial statements of Partnership Assurance Group plc.

Adoption of new and revised standards

The Company has adopted the following new or revised standards that became effective (as adopted by the EU) as of 1 January 2014.

- IFRS 10 Consolidated financial statements - This standard sets out the requirements for the preparation and presentation of consolidated financial statements, requiring entities controlled by the parent company to be consolidated as subsidiaries. The standard changes the definition of “control” from that previously established in IFRS. As the Company does not prepare consolidated financial statements the application of IFRS 10 has no impact on the financial statements in the current or comparative periods.

- IFRS 11 Joint Arrangements - This standard defines joint arrangements and related accounting principles. The standard established two types of joint arrangement - joint ventures and joint arrangements - based on how rights and obligations are shared by investors in the arrangements. Associated amendments to IAS 28 Investments in associates and joint ventures have also been adopted. The application of IFRS 11 has no impact on the financial statements in the current or comparative periods.

- IFRS 12 Disclosures of interests in other entities - IFRS 12 requires additional disclosures for investments in subsidiaries, joint arrangements, associates and structured entities. The application of IFRS 12 has no impact on the financial statements in the current or comparative periods.

- IAS 32 Financial Instruments - Presentation - An amendment to IAS 32 clarifies the requirements for offsetting financial assets and liabilities. The application of the amendment has no impact on the financial statements in the current or comparative periods.

- IAS 36 Impairment of assets - An amendment to IAS 36 which reduces the circumstances in which the recoverable amount of non-financial assets is required to be disclosed. The application of the amendment has no impact on the financial statements in the current or comparative periods.

- IAS 39 Financial Instruments: Recognition and measurement - an amendment to IAS 39 which clarifies the circumstances in which hedge accounting can be continued when derivatives are novated to a central counterparty. The application of the amendment has no impact on the financial statements in the current or comparative periods.

Restatement of 2013 balance sheet

- **Presentation of accrued income arising from financial investments** - During the year the Company reviewed the presentation of accrued income arising from financial investments classified as fair value through profit and loss in the consolidated statement of financial position. It was concluded that presenting all components of the fair value of financial investments on the same line provides more clarity as to the Company's exposure to these investments and therefore provides more relevant and no less reliable information. As a result of this change in policy an amount of £65.8m (2013: £59.1m) was reclassified from Prepayments and accrued income to Financial Assets. This change in policy has no effect on profit for the current or prior period.

- **Payables and receivables arising from reinsurance contracts** - During the year the Company reviewed the presentation of balances due to and from the Company under reinsurance contracts. It was concluded that presenting financial liabilities due to reinsurers where assets are legally and physically deposited back to the Company separately from other payables and receivables under reinsurance contracts better reflects the Company's management of reinsurance balances and therefore provides more relevant and no less reliable information. As a result of this change in policy an amount of £21.5m (2013: £15.2m) was reclassified from financial liabilities to Insurance and other receivables. An amount of £3.2m (2013: £1.9m) was reclassified from financial liabilities to Insurance and other payables. This change in policy has no effect on profit for the current or prior period.

The following new or revised or amended standards, in issue, were not yet effective, or in some cases not yet endorsed by the EU. The Company has not early adopted any of these standards.

Standard/ Interpretation	**Content/amendment**	**Applicable for financial periods beginning on or after**
IFRS 9	**Financial Instruments**	1 January 2018
	IFRS 9 will replace IAS 39: "*Financial Instruments – Recognition and Measurement*". The impact of the adoption of IFRS 9 on the Company will depend on the finalisation of the standard and the interaction of the requirements of IFRS 9 with the IASB's on-going insurance contracts accounting project. The standard has not yet been endorsed by the EU.	
IFRS 10, IFRS 11, and IAS 28	**Consolidated Financial Statements, Joint Arrangements, Investments in Associates and Joint Ventures**	1 January 2016
	Amendments regarding the sale of contribution of	

Standard/ Interpretation	Content/amendment	Applicable for financial periods beginning on or after
	assets between an investor and its associate or joint venture and application of the consolidation exception. The amendments have not yet been endorsed by the EU.	
IFRS 14	**Regulatory Deferral Accounts** The standard permits an entity which is a first-time adopter of IFRS to continue to account for 'regulatory deferral account balances' in accordance with its previous GAAP. As the Company is not a first-time adopter of IFRS, the standard will have no impact on the Company. The standard has not yet been endorsed by the EU.	1 January 2016
IFRS 15	**Revenue from Contracts with Customers** IFRS 15 specifies how and when to recognise revenue, and requires additional disclosures. The standard provides a single, principles based five-step model to be applied to contracts with customers. Insurance contracts and financial instruments are excluded from the scope of the standard. Therefore the standard is not expected to have a material impact on the Company's profit before tax for the year or equity. The standard has not yet been endorsed by the EU.	1 January 2017
IAS 16	**Property, Plant and Equipment** Amendments regarding the clarification of acceptable methods of depreciation and amortisation and brining bearer plants into the scope of IAS 16. The amendments have not yet been endorsed by the EU.	1 January 2016
IAS 19	**Employee Benefits** Amendments clarify the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. The amendments have been endorsed by the EU.	1 July 2014
IAS 27	**Separate Financial Statements** Amendments reinstating the equity method as an accounting option for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements. The amendments have been endorsed by the EU.	1 January 2016
IAS 38	**Intangible Assets** Amendments regarding the clarification of acceptable methods of depreciation and amortisation. The amendments have not yet been endorsed by the EU.	1 January 2016

Standard/ Interpretation	Content/amendment	Applicable for financial periods beginning on or after
IAS 41	**Agriculture** Amendments bringing bearer plants into the scope of IAS 16. The amendments have not yet been endorsed by the EU.	1 January 2016
IAS1	**Presentation of financial statements** Amendments that provide additional clarity and explanation on the application of materiality and the presentation of accounting policies and disclosures in financial statements. The amendments have not yet been endorsed by the EU.	1 January 2016
Annual Improvements 2010-2012 Cycle	Amendments to a number of IFRS standards, clarifying guidance, wording or minor corrections, None of the proposed amendments are expected to have a material impact on the Company's profit before tax for the year or equity. The amendments have been endorsed by the EU.	1 July 2014
Annual Improvements 2011-2013 Cycle	Amendments to a number of IFRS standards, clarifying guidance, wording or minor corrections. None of the proposed amendments are expected to have a material impact on the Company's profit before tax for the year or equity. The amendments have been endorsed by the EU.	1 July 2014
Annual Improvements 2012-2014 cycle	Amendments to a number of IFRS standards, clarifying guidance, wording or minor corrections. None of the proposed amendments are expected to have a material impact on the Company's profit before tax for the year or equity. The amendments have been endorsed by the EU.	1 January 2016

2 NET INVESTMENT INCOME

	2014	2013
	£000's	*£000's*
Interest received from financial assets	152,699	138,850
Interest payable on financial liabilities	(81,065)	(71,597)
Movement in fair value of financial assets	368,362	24,377
Movement in fair value of financial liabilities	(176,573)	17,382
Realised gains on financial assets	92,339	72,972
Realised losses on financial liabilities	(56,722)	(45,777)
	299,040	136,207

All financial assets and liabilities are classified at fair value through profit and loss.

Movement in fair value of financial assets includes a £1.3m (2013: £1.8m) reduction to the value of a loan to a subsidiary undertaking. This loan has been impaired to reduce its carrying value to the expected recoverable amount.

3 PROFIT BEFORE TAX

All overheads are paid by Partnership Services Limited ("PSL"), a fellow subsidiary company, and recharged to the Company through a management charge. Included within the recharge was an amount of £186,281 (2013: £181,756) in respect of auditor's remuneration and £86,400 (2013: £82,800) paid to the Company's auditor in respect of non-audit services for the Company.

Details of directors' remuneration and other overheads charged to the Company are included in note 24.

The staff and Directors are remunerated as employees of PSL, which also bears all pension costs. Remuneration and pension costs are charged to the Company through the management charge.

4 INCOME TAX

	2014	2013
	£000's	*£000's*
Current taxation:		
Tax charge for the year	5,004	22,647
Adjustment in respect of prior years	(1,826)	354
Total tax charge for the year	3,178	23,001

The actual tax charge differs from the expected tax charge, computed by applying the average rate of UK corporation tax for the year of 21,5% (2013: 23.25%), as follows:

	2014	2013
	£000's	*£000's*
Profit before tax	23,631	134,384
Current taxation at 21.5% (2013: 23.25%)	5,080	31,237
Elimination of ineligible intragroup transactions	283	(9,020)
Adjustments in respect of prior periods	(1,826)	354
Surrender of tax losses (by)/ to other group companies	(359)	430
Income tax expense	**3,178**	23,001

5 DIVIDEND PAYABLE

The Directors do not recommend a payment of a dividend in 2014, On 13 December 2013 the Company declared and paid a dividend to Partnership Group Holdings Limited ("PGHL") totalling £25m, that was settled by intercompany account.

6 GOODWILL

	2014	2013
	£000's	*£000's*
Goodwill at cost:		
At start of year	1,332	1,332
At end of year	**1,332**	1,332

The carrying value of goodwill has been tested for impairment at the balance sheet date, Value in use has been determined as the present value of expected future cash flows associated with new business. The cash flows used in this calculation are consistent with those monitored by management.

Expected future new business cash flows are based on financial plans approved by management, covering a period of 5 years from the balance sheet date. A rate of 13.1% (2013: 10.0%) has been applied to discount cash flows to a present value.

No impairment has been recognised in 2014 or 2013.

7 OTHER INTANGIBLE ASSETS

	2014 £000's	2013 £000's
Intellectual property at cost:		
At start of year	1,000	1,000
At end of year	**1,000**	1,000

The value of intellectual property has been determined based upon an estimate of the costs to employ adequately skilled individuals over an appropriate period of time to develop intellectual property of a similar nature sufficient to enable the company to replicate the estimated future cash flows and profits deriving from that intellectual property.

The intellectual property is continually updated through the collection of further data, updated analyses, and conversion into new and more detailed underwriting manuals and mortality tables. For this reason, the intangible asset is deemed to have an indefinite life, and consequently, no amortisation is provided against the value of the intangible asset. The carrying value of the intangible asset is tested for impairment at each reporting date, and is allocated to the "new business" cash-generating unit, the scope of which is identical to the "new business" operating segment. The method and assumptions used in this test are identical to those applied in the goodwill impairment test, as set out in note 6.

No impairment of intellectual property has been recognised in 2014 or 2013.

8 INVESTMENT IN SUBSIDIARY

The Company owns all of the capital of PASPV Limited, PASPV Limited's principal activity is facilitating commodity trade finance, and started trading on in April 2013.

9 FINANCIAL ASSETS

Fair value at 31 December	2014 £000's	Restated[i] 2013 £000's
Financial investments	3,583,183	3,122,222
Loans secured by residential mortgages	1,212,323	840,066
Derivative assets (note 18)	75,892	36,414
Loan secured by commercial mortgages	37,869	-
Total financial assets	**4,909,267**	3,998,702

i See note 1.

Financial investments include debt securities and fixed income securities.

All Financial investments, Loans secured by residential mortgages and Loans secured by commercial mortgages are designated at fair value through profit and loss. Derivative assets are carried at fair value through profit and loss.

Cost at 31 December	2014 £000's	2013 £000's
Financial investments	3,298,543	2,991,196
Loans secured by residential mortgages at cost	950,909	796,788
Loans secured by commercial mortgages at cost	37,481	-
Total financial assets	4,286,933	3,787,984

The methodology used to derive the fair values is set out in note 19.

10 INSURANCE AND OTHER RECEIVABLES

	Note	2014 £000's	Restated[i] 2013 £000's
Amounts falling due within 12 months:			
Debtors arising out of insurance contracts[ii]	2	11,135	51,140
Debtors arising out of reinsurance contracts		22,523	24,196

Amounts due from parent undertaking		827	-
Amounts due from other group undertakings	24	3,883	48,036
Corporation tax receivable		2,895	-
Other debtors		895	1,980
		42,158	125,352

i See note 1.
ii Includes £9.7m in respect of premiums written for which funds have not yet been received from the policyholder (2013: £51.1m).

The Directors consider that the carrying value in the balance sheet is a reasonable approximation of the fair value.

11 PREPAYMENTS AND ACCRUED INCOME

	2014 *£000's*	Restated[i] 2013 *£000's*
Amounts falling due within 12 months:		
Accrued interest	28	-
	28	-

i See note 1.

The Directors consider that the carrying value in the balance sheet is a reasonable approximation of the fair value.

12 CASH AND CASH EQUIVALENTS

	2014 *£000's*	2013 *£000's*
Short term bank deposits Cash at bank and in hand	45,313	64,711
Cash at bank in hand	29,252	49
	74,565	64,760

13 SHARE CAPITAL AND OTHER RESERVES

	2014 *£000's*	2013 *£000's*
Allotted, issued and fully paid - ordinary shares of £1 each:		
Share capital and Other reserves at start of year	137,190	137,190
Capital contribution	23,000	-
	160,190	137,190

During the year the Company's parent, PAG Plc, made a capital contribution of £23m in the form of a gift. The capital contribution is recognised as an increase in equity within other reserves.

14 INSURANCE LIABILITIES AND REINSURANCE ASSETS

	2014 *£000's*	2013 *£000's*
Long term business provision	5,231,112	4,347,588
Re-insurers' share of long term business provision	(3,246,008)	(2,840,749)
Net provision	1,985,104	1,506,839

a) Principal assumptions for insurance liabilities

The principal assumptions underlying the calculation of the long-term business provision are as follows:

		Mortality tables	**Valuation discount rates**
Medically underwritten annuity products	2014	Modified E&W Population Mortality with CMI 2013m (1.25%) and CMI 2013f (1.00%)	3.53%
	2013	Modified E&W Population Mortality with	4.31%

		CMI 2012m (1.75%) and CMI 2012f (1.50%)	
Other annuity products	2014	Modified PCMA/PCFAOOu bespoke	1.35%
	2013	Modified DCMA/PCFAOOu bespoke	1.70%
Term and whole of life products	2014	86.25% TM/TFOOSelect	1.00%
	2013	86.25% TM/TFOOSelect	1.44%

Valuation discount rate assumptions are set with regard to yields on supporting assets. An allowance for risk is included by making an explicit deduction from the yields on debt and other fixed income securities based on historical default experience and expected experience of each asset class. The allowance for credit risk has been set at 42% (2013: 47%) of the spread on the yield of the corporate bonds over the yield on gilts.

The changes in the valuation discount rates at each period end reflect changes in yields on the supporting assets and changes made to the allowance for risk.

The mortality tables used have been adjusted to reflect additional mortality based on the proprietary data held by the Company developed from actual experience incurred. The valuation basis used to calculate the long-term business provisions includes an allowance for future expenses.

b) Movements

Movements in the carrying amount of insurance liabilities and reinsurance assets are explained as follows:

	Gross *£000's*	**Reinsurance** *£000's*	**Net** *£000's*
At 1 January 2014			
Carrying amount at start of year	4,347,588	(2,840,749)	1,506,839
Increase in liability from new business	692,005	(266,845)	425,160
Release of in-force liability	(130,286)	87,709	(42,577)
Release of liability due to recorded deaths	(67,743)	31,799	(35,944)
Economic changes	332,956	(211,434)	121,522
Non-economic changes	912	-	912
Other	55,680	(46,488)	9,192
At 31 December 2014	5,231,112	(3,246,008)	1,985,104
At 1 January 2013			
Carrying amount at start of year	3,723,298	(2,412,552)	1,310,746
Increase in liability from new business	1,038,011	(678,827)	359,184
Release of in-force liability	(111,110)	75,012	(36,098)
Release of liability due to recorded deaths	(69,967)	31,040	(38,927)
Economic changes	(209,299)	144,164	(65,135)
Non-economic changes	(25,847)	1,609	(24,238)
Other	2,502	(1,195)	1,307
At 31 December 2013	4,347,588	(2,840,749)	1,506,839

c) Analysis of expected maturity

The following table analyses insurance liabilities and reinsurance assets by duration.

	Expected cash flows (undiscounted)				
	less than one year *£000's*	**one to five years** *£000's*	**five to ten years** *£000's*	**more than ten years** *£000's*	**Carrying value (discounted)** *£000's*
At 31 December 2014					
Long term business provision	411,885	1,510,716	1,624,201	4,367,492	5,231,112
Re-insurers' share of long term business provision	(258,539)	(966,479)	(1,053,161)	(2,699,933)	(3,246,008)
Net	**153,346**	**544,237**	**571,040**	**1,667,559**	**1,985,104**
At 31 December 2013					
Long term business provision	373,419	1,360,968	1,450,164	3,829,024	4,347,588
Re-insurers' share of long term business	(241,692)	(903,711)	(985,311)	(2,544,018)	(2,840,749)

	Expected cash flows (undiscounted)				
	less than one year	**one to five years**	**five to ten years**	**more than ten years**	**Carrying value (discounted)**
	£000's	***£000's***	***£000's***	***£000's***	***£000's***
provision					
Net	131,727	457,257	464,853	1,285,006	1,506,839

d) Sensitivity analysis

Life insurance results are inherently uncertain due to actual experience being different to modelled assumptions. Sensitivity analysis is provided below to illustrate the impact of changes in key assumptions.

Sensitivity factor	**Description of sensitivity factor applied**
Interest rate & investment return	The impact of a change in the market interest rates by + / - 1% (e.g. if a current interest rate is 5%, the impact of an immediate change to 4% and 6% respectively). The test allows consistently for similar changes to investment returns and movements in the market backing fixed interest securities.
Credit spreads	The impact of credit spreads widening by 50bps with a corresponding pro-rated change to defaults.
Expenses	The impact of an increase in maintenance expenses by 10%.
Mortality rates	The impact of a decrease in mortality rates by 5%.
Property values	The impact of an immediate decrease in the value of properties by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the loans secured by residential mortgages and loans secured by commercial mortgages used to back the liabilities.
Voluntary redemptions	The impact of an increase in voluntary redemption rates on loans secured by residential mortgages by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the loans secured by residential mortgages that are used to back the liabilities.

The table below demonstrates the effect of a change in a key assumption whilst other assumptions remain unchanged. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results. The sensitivity analyses do not take into consideration that the Company's assets and liabilities are actively managed and may vary at the time that any actual market movement occurs.

	Increase / (decrease) in profit before tax	
	2014	2013
	£000's	*£000's*
Change in assumption:		
Interest rates +1%	2,866	2,954
Interest rates -1%	(5,993)	(3,308)
Credit spreads +50bps	(11,621)	(10,917)
Expenses +10%	(10,906)	(9,962)
Mortality -5%	(32,027)	(22,140)
Property prices - 10%	(38,583)	(25,313)
Voluntary redemptions + 10%	(6,412)	(2,402)

15 INSURANCE AND OTHER PAYABLES

	2014 £000's	Restated[i] 2013 £000's
Amounts payable within one year:		
Payables arising from insurance contracts	4,775	9,546
Payables arising from reinsurance contracts	3,159	1,916
Amounts due to parent undertaking	-	24,277
Amounts due to other group undertakings	65	-
Other creditors and accruals	2,151	1,889
	10,150	37,628

i See note 1.

The Directors consider that the carrying value in the balance sheet is a reasonable approximation of the fair value.

16 FINANCIAL LIABILITIES

	Note	**2014** £000's	Restated[i] 2013 £000's
Deposits from reinsurers		2,491,797	2,182,439
Derivative liabilities	18	79,493	32,391
		2,571,290	2,214,830

i See note 1.

Payables arising from reinsurance contracts at fair value through profit and loss are designated as such on initial recognition. Derivative liabilities are carried at fair value through profit and loss.

17 CURRENT TAX LIABILITIES

	2014 £000's	2013 £000's
Amounts payable within one year:		
Income taxes	-	12,962
Other taxes and social security costs	2,849	3,383
	2,849	16,345

18 DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses various derivative financial instruments to manage its exposure to interest rates, counterparty credit risk, inflation and foreign exchange risk, including foreign exchange forward contracts, interest rate swaps, credit default swaps and inflation swaps.

Derivatives	**Asset fair value £000's**	**Liability fair value £000's**	**Notional amount £000's**
Non-sterling interest rate swaps	7,335	1,615	553,106
Interest rate swaps	66,651	62,030	1,119,400
Inflation swaps	309	15,848	414,646
Credit default swaps	1,597	-	38,104
Total at 31 December 2014	**75,892**	**79,493**	**2,125,256**
Non-sterling interest rate swaps	8,488	278	548,392
Interest rate swaps	24,848	31,271	1,242,924
Inflation swaps	3,078	842	162,135
Total at 31 December 2013	36,414	32,391	1,953,451

All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Company has collateral agreements between

the individual group entities, of which the Company is one, and relevant counterparties in place under each of these market master agreements.

At 31 December 2014, the Company had pledged £29.8m (2013: £10.1 m) and held collateral of £19.0m (2013: £0.9m) in respect of over-the-counter derivative transactions.

19 FINANCIAL INSTRUMENTS - FAIR VALUE METHODOLOGY

All financial instruments are classified at fair value through profit and loss.

In accordance with IFRS 13 Financial Instruments Disclosures, financial instruments at fair value have been classified into three categories.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices);

Level 3: Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

An analysis of financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below. All these financial assets and liabilities relate to recurring fair value measurements. There are no non¬recurring fair value measurements as at 31 December 2014 and 31 December 2013.

31 December 2014	**Level 1** *£000's*	**Level 2** *£000's*	**Level 3** *£000's*	**Total** *£000's*
Financial investments (a)	3,583,183	-	-	3,583,183
Loans secured by residential mortgages (b)	-	-	1,212,323	1,212,323
Derivative assets (d)	-	75,892	-	75,892
Loans secured by commercial mortgages (c)	-	-	37,869	37,869
Total financial assets held at fair value	**3,583,183**	**75,892**	**1,250,192**	**4,909,267**
Deposits from reinsurers (e)	-	-	2,491,797	2,491,797
Derivative liabilities (d)	-	79,493	-	79,493
Total financial liabilities held at fair value	**-**	**79,493**	**2,491,797**	**2,571,290**

31 December 2013 Restated[i]	Level 1 *£000's*	Level 2 *£000's*	Level 3 *£000's*	Total *£000's*
Financial investments (a)	3,122,222	-	-	3,122,222
Loans secured by residential mortgages (b)	-	-	840,066	840,066
Derivative assets (c)	-	36,414	-	36,414
Total financial assets held at fair value	3,122,222	36,414	840,066	3,998,702
Deposits from reinsurers (e)	-	-	2,182,439	2,182,439
Derivative liabilities (d)	-	32,391	-	32,391
Total financial liabilities held at fair value	-	32,391	2,182,439	2,214,830

i See note 1.

The Company's policy is to recognise transfers into and transfers out of Levels 1, 2 and 3 as of the date at which the Statement of Financial Position is prepared.

There were no transfers between Levels 1, 2 and 3 in 2014.

The table below reconciles the opening and closing recorded amount of level 3 financial liabilities and financial assets which are stated at fair value.

	Deposits from reinsurers *£000's*	**Loans secured by residential mortgages** *£000's*	**Loans secured by commercial mortgages** *£000's*
At 1 January 2014	(2,182,439)	840,066	-
Loans advanced (to the Company)/ by the Company	(307,959)	232,518	37,481
Total (losses)/ gains in Income Statement	(139,376)	140,420	263
Redemptions paid by the Company/ (paid to the Company)	229,169	(51,273)	-
(Interest payable accrued)/ interest receivable accrued	(91,192)	50,592	125
At 31 December 2014	**2,491,797**	**1,212,323**	**37,869**

Restated[i]	Deposits from reinsurers *£000's*	Loans secured by residential mortgages *£000's*	Loans secured by commercial mortgages *£000's*
At 1 January 2013	(1,728,997)	478,097	-
Loans advanced (to the Company)/ by the Company	(733,849)	416,475	-
Total (losses)/ gains in Income Statement	155,522	(25,695)	-
Redemptions paid by the Company/ (paid to the Company)	203,744	(34,189)	-
(Interest payable accrued)/ interest receivable accrued	(78,859)	5,378	-
At 31 December 2013	(2,182,439)	840,066	-

i See note 1.

The gains and losses are included within net investment income in the Consolidated Statement of Comprehensive Income.

The unrealised gains/ (losses) in respect of payables arising out of reinsurance contracts, loans secured by residential mortgages and loan secured by commercial mortgages for the period to 31 December 2014 are £139.4m, £l 91.0m and £0.2m respectively (31 December 2013: £l 55.5m, £(20.3m) and £nil respectively. These unrealised gains and losses are included within net investment income in the Statement of Comprehensive Income.

Level 3 Sensitivity Analysis

As at 31 December 2014	**Significant assumption**	**Current fair value** *£000's*	**Increase in fair value** *£000's*	**Decrease in fair value** *£000's*
Assets				
Loans secured by residential mortgages	Discount rate	**1,212,323**	**156,367**	**(132,186)**
Loans secured by commercial mortgages	Discount rate	**37,869**	**2,744**	**(2,501)**
Liabilities				
Deposits from reinsurers	Discount rate	**(2,491,797)**	**(220,538)**	**192,268**

Restated[i] As at 31 December 2013	Significant assumption	Current fair value *£000's*	Increase in fair value *£000's*	Decrease in fair value *£000's*
Assets				
Loans secured by residential mortgages	Value of no negative equity guarantee	840,066	100,863	86,046
Liabilities				
Deposits from reinsurers	Discount rate	(2,182,439)	(182,645)	161,733

i See note 1.

The impact of reasonably possible alternative assumptions are estimated by modelling alternative scenarios for the key assumptions for each valuation model.

a) Financial investments

All financial investments are listed and are designated at fair value through profit and loss.

In assessing the fair value of the debt securities and other fixed income securities, the Directors have relied upon values provided by an independent third-party which specialises in providing such values to companies. The third-party provides prices based upon quoted market prices, or where not available, modelled prices using observable market inputs. At 31 December 2014, 100% of values provided were based on quoted prices that are observable for the asset or liability.

b) Loans secured by residential mortgages

The fair value recognised in the Financial Statements is determined using a marked to model valuation technique where a significant proportion of inputs are not base on observable market data and so these assets are considered to be Level 3 within the valuation category prescribed by lFRS13.

The valuation model discounts the expected future cash flows using and interest rate swap curve with an additional spread or yield factor minus the cost of the no-negative equity guarantee. The no-negative equity guarantee represents an embedded guarantee that the repayment of the loan cannot exceed the value of the property at the time of repayment.

Although such valuations are sensitive to estimates, it is the discount rate and no-negative equity guarantee assumptions that are considered to impact the fair value significantly.

Discount rate: Loans secured by residential mortgages are valued using the swap rate appropriate to the term of each contract with adjustment to reflect the credit and liquidity risk associated with such long-dated contracts. The risk adjusted swap rate for the portfolio weighted by average value at 31 December 2014 was 5.05% (2013: 6.24%).

No-negative equity guarantee: The fair value of loans secured by residential mortgages takes into account an explicit provision in respect of the no-negative equity guarantee which is calculated using a variant of the Black Scholes option pricing model. The key assumptions used to derive the value of the no-negative equity guarantee include property growth, volatility and over-valuation. The property growth and volatility assumed at 31 December 2014 were 5.5% (2013: 5.5%) and 13% (2013: 13% respectively.) The over-valuation assumption used at 31 December 2014 was 27.4% (2013: 22%). The value of the no-negative equity guarantee as at 31 December 2014 was £1 12.5m (31 December 2013: £67.3m).

The valuation technique that the Company uses to assess the fair value of loans secured by mortgages is consistent with that used to derive the prices applied at the initial transaction. As such, there is no difference between the fair value of loans backed by mortgages at initial recognition and the amount that would have been determined at that date using the valuation technique.

c) Loans secured by commercial mortgages

The fair value recognised in the financial statements for loans secured by commercial mortgages is determined using a marked to model valuation technique where a significant proportion of inputs are not based on observable market data and so these assets are considered to be Level 3 within the valuation category prescribed by IFRS 13.

The valuation model produces a series of projected future cash flows for each mortgage, based on a range of simulations of changes in property prices drawn from a distribution based on historic observed changes. Potential changes in property tenancy (e.g. tenant default, exercise of break clause or non-renewal of lease) are also modelled in a range of simulations. A risk adjusted cash flows is calculated as the average across the range of simulations.

The risk adjusted cash flows are discounted using a swap curve with an additional spread. The additional spread is the increase in swap discount rates required so that the initial discounted risk adjusted cash flows equal the initial purchase price. This uplift is reviewed if there is evidence that market has moved materially.

The discount rate and changes in property prices and tenancy are the most significant assumptions applied in calculating the fair value of the loans.

d) Derivative assets and liabilities

The estimated fair value of derivative instruments reflects the estimated amount the Company would receive or pay in an arm's length transaction. All the derivatives held at 31 December 2014 and 2013 were purchased over-the-counter.

The Company's derivative assets and liabilities largely relate to forward currency positions, interest rate swaps and inflation swaps.

Forward currency positions: Forward currency exchange contracts are priced from independent third parties.

Interest rate swaps: The fair value of the interest rate swaps is derived using an interest rate swap pricing model, using a time series of historic LIBOR rates, an applicable zero coupon interest rate swap curve to discount future cash flows ("discount curve") as inputs. The forward curve is used by the pricing model to determine the future LIBOR rates to be applied in the calculation of the floating leg cash flow(s). The discount curve is used to calculate the present value of the future cash flow(s) of both the fixed and floating legs of the swaps and its composition is driven by the terms of the Credit Support Annex under which the swap is traded.

Inflation swaps: The fair value of the inflation swaps is derived using the inflation swap pricing model, using a time series of historic inflation index levels, a zero coupon swap inflation expectation curve, and inflation seasonality model and zero coupon interest rate swap curve as inputs. The inflation rate swap pricing model generates a future cash flow for both the fixed and inflation legs of a swap for which present value is determined using zero coupon interest rate swap curve.

The derivative assets and liabilities are presented on a gross basis in the Statement of Financial position. All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Company has collateral agreements between the individual Group entities and relevant counterparties in place under each of these market master agreements. Details of amounts pledged and collateral held against over-the-counter derivative transactions are included in note 18.

e) Deposits from reinsurers

The fair value recognised in the financial statements is determined using a marked to model valuation technique where not all inputs are based on observable market data and so these liabilities are considered to be Level 3 within the valuation category prescribed by IFRS13

The valuation model discounts the expected future cash flows using a discount rate, derived from the assets hypothecated to back these liabilities at a product level.

As payables arising from reinsurance contracts do not have a single fixed maturity date it is not possible to determine an amount that would be contractually required to be paid at maturity.

Discount rate: The key inputs to the derivation of the discount rate include market observable gross redemption yields, contractual investment expenses and an allowance for credit risk on a best estimate basis. The discount rate used as at 31 December 2014 for Retirement and Care was 4.16% and 1.67% respectively (2013: 4.95% and 1.97% respectively).

20 NOTES TO THE CASH FLOW STATEMENT

	2014 *£000's*	Restated[i] 2013 *£000's*
Profit before tax	**23,631**	134,384
Non-cash movements in profit before income tax:		
Fair value gains and (interest accrued) on financial assets	(368,390)	(29,033)
Fair value losses and interest accrued on financial liabilities	257,638	54,215
Net investment in financial assets	(542,175)	(756,242)
Net receipt of financial liabilities	356,460	394,916
Increase in reinsurance assets	(662,897)	(482,412)
Decrease in insurance and other receivables excluding corporation tax receivable	86,089	20,440

Increase in prepayments and accrued income	(28)	-
Increase in insurance liabilities	883,524	624,290
Increase in insurance and other payables excluding dividend	(27,478)	(38,962)
(Decrease)/ increase in other taxes and social security payables	(534)	496
Cash generated from/ (used in) operations	5,840	(77,908)

i See note 1.

21 DEPOSITS RECEIVED FROM REINSURERS

Financial assets arising from the payment of reinsurance premiums, less the repayment of claims, to certain reinsurers in relation to specific treaties are legally and physically deposited back with the Company. Although the funds are managed by the Company (as the Company controls the investment of the asset), no future benefits accrue to the Company as any returns on the deposits are paid to reinsurers. Consequently the deposits are not recognised as assets of the Company and the investment income they produce does not accrue to the Company.

In addition, the Company has trust agreements with one reassurer (2013: one) whereby the assets are held in trust in order to fully fund the reassurer obligations under the reinsurance treaty. As the Company has no control over these funds and does not accrue any future benefit these funds are not recognised as assets of the Company.

	2014	2013
	£000's	*£000's*
Deposits managed by the Company	269,630	272,493
Deposits held in trust	279,619	241,699
	549,249	514,192

22 MANAGEMENT OF INSURANCE AND FINANCIAL RISK

The Company issues contracts that accept insurance risk in return for a premium. In addition, the Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. In particular, the key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from contracts with policyholders. The most important components of this financial risk are interest rate risk and credit risk. The Company is not exposed to any equity price risk and to currency risk only to an immaterial extent.

a) Insurance risk

a1) Underwriting, pricing and reserving risk

Underwriting and pricing risk is the risk that insurance contracts will be written that are not within the Board's risk appetite, or that the premium charged for that business is not adequate to cover the risks borne by the Company.

The accurate pricing of non-standard annuities is dependent on the Company's assessment of the impact on prospective customers' longevity of various medical and lifestyle factors and an estimate of future investment yields and credit default.

The actual timing of deaths and investment income experience may be inconsistent with the assumptions and pricing models used in underwriting and setting prices for its products.

Reserving risk is the risk that the reserves have been calculated incorrectly, or the assumptions used in the calculations are inappropriate.

As the Company's insurance business is targeted at people with conditions affecting their life expectancy, or people seeking to fund domiciliary or residential care, the underwriting risk is managed through the use of highly trained, and qualified underwriting staff, together with detailed underwriting manuals designed to cover a large range of medical conditions.

Partnership has developed its own proprietary underwriting manuals for retirement annuity business and those seeking care funding, based on industry standard mortality tables modified to take account of experience data recorded by Partnership.

The assumptions used in the reserving for future policyholder payments are set based on available market and experience data, on the advice of Partnership's Actuarial Function Holder. The assumptions are approved by the Board. The reserves are calculated using recognised actuarial methods with due regard to the actuarial principles set out in the PRA's sourcebooks, including appropriate levels of prudential margin against future adverse experience.

a2) Specific insurance risk

Insurance risk on the Company's annuity contracts arises through longevity risk and through the risk that operating factors, such as administration expenses, are worse than expected.

Insurance risk on the Company's protection policies arises through higher than expected mortality levels.

The Company's longevity and mortality experience is monitored on a regular basis and compared to the underlying assumptions used to reserve for future insurance payments. The exposure to longevity and mortality risk is reduced through the use of reinsurance.

Expense risk is managed through regular assessment and quarterly reforecasting of expenses incurred against budgets.

b) Interest rate and other market risk

Interest rate risk arises from open positions in fixed and variable rate stock issued by government and corporate bodies that are exposed to general and specific market movements. The Company is exposed to the market movements in interest rates to the extent that the asset value movement is different to the accompanying movement in the value of its insurance liabilities.

The difference between asset and liability movements can arise from both a change in the absolute level of interest rates, and from a change in the "spread" (that is the level of interest rates applying to an asset in excess of the risk-free interest rate).

The Company manages its interest rate risk within an asset liability management (ALM) framework that has been developed to achieve investment returns in excess of its obligations under insurance contracts. The principal technique of the ALM framework is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to policyholders.

The Company monitors interest rate risk by calculating the mean duration and cash flow profile of the investment portfolio and the liabilities. The mean duration is an indicator of the sensitivity of the assets and insurance liabilities to changes in current interest rates but is not sufficient in isolation. The mean duration of the liabilities is determined by means of projecting expected cash flows from the contracts using best estimates of mortality and voluntary terminations. No future discretionary supplemental benefits are assumed to accrue. The mean duration of the assets is calculated in a consistent manner. Any gap between the mean duration of the assets and the mean duration of the liabilities is minimised by means of buying and selling fixed interest securities of different durations or purchasing interest rate swap derivatives to alter the effective mean duration of the assets. Periodically the cash flow matching is reviewed and rebalanced.

At 31 December 2014, the mean duration of the assets including surplus assets was 8.3 years (2013: 7.5 years) measured with reference to a gross redemption yield and the mean duration of the liabilities (including both retirement and care liabilities) was at 9.6 years (2013: 8.9 years), measured with reference to the valuation interest rate.

The Company has reinsurance arrangements in place which provide for fixed payments to the reinsurer over future periods. In assessing the fair value of this liability, the Directors have used a discount rate derived from current market yields earned on assets held to fund the future cash outflows, adjusted for the risk of default on those assets. No further adjustment to the discount rate to reflect any risk of the Company defaulting on those payments to the reinsurer was deemed appropriate.

c) Credit risk

Market credit risk is the risk that the Company invests in assets that may default.

If an asset fails to repay either interest or capital, or that payment is significantly delayed, the Company may make losses and be unable to meet liabilities as they fall due.

The Company's Investment Management Guidelines set out maximum exposure to bonds issued by a single, or related group of, counterparty(lies) and to credit ratings. The allowance made for issuer default in the Company's valuation is regularly monitored and kept up to date.

At 31 December 2014, £19.0m of collateral (2013: £0.9m) had been pledged to the Company to mitigate the credit risk exposure associated with the derivative assets held at that time.

Counterparty credit risk arises if another party fails to honour its obligations to the Company including failure to honour these obligations in a timely manner.

The Company's primary counterparty credit risk exposure arises from the inability of the reinsurers to meet their claim payment obligations.

The Company has arrangements with its reinsurers whereby most reinsurance premiums are either deposited back to the Company or held by a third party in a trust arrangement.

In addition, the Company's reinsurance policy is to seek to choose companies with a minimum "A" credit rating.

The following table analyses the credit exposure of the Company by type of asset and includes the credit risk arising out of reinsurance exposures, based on the credit ratings of the reinsurer, as published by Standard & Poors, or an equivalent rating from another recognised rating agency.

	AAA	AA	A	BBB	Unrated	Total
At 31 December 2014	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***
Financial Investments	815,605	234,771	1,251,103	1,280,870	834	3,583,183
Loans secured by residential mortgages	-	-	-	-	1,212,323	1,212,323
Loans secured by commercial mortgages	-	-	-	-	37,869	37,869
Derivative assets	-			-	75,892	75,892
Reinsurance assets	-	1,290,232	1,955,776	-	-	3,246,008
Insurance and other receivables	-	17,762	4,761	-	19,635	42,158
	815,605	**1,542,765**	**3,211,640**	**1,280,870**	**1,346,553**	**8,197,433**
Restated[i]						
At 31 December 2013						
Financial Investments	611,062	260,620	1,193,352	1,057,188	-	3,122,222
Loans secured by mortgages	-	-	-	-	840,066	840,066
Derivative assets	-	-	-	-	36,414	36,414
Reinsurance assets	-	1,240,280	1,600,469	-	-	2,840,749
Insurance and other receivables	-	13,132	11,064	-	101,156	125,352
	611,062	1,514,032	2,804,885	1,057,188	977,636	6,964,803

i See note 1.

The following table presents an aging analysis of financial assets by payment due status:

No financial assets were past due at 31 December 2014.

At 31 December 2014		**past due but not impaired**				**Impaired**	**Total**
	Not past due	**1 month**	**1-3 months**	**3-6 months**	**More than 6 months**		
	£000's	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***	***£000's***
Loans secured by residential mortgages	1,212,323	**-**	**-**	**-**	**-**	**-**	1,212,323
Loans secured by commercial mortgages	37,869	**-**	**-**	**-**	**-**	**-**	37,869
Other Financial assets	6,947,241	**-**	**-**	**-**	**-**	**-**	6,947,241

Restated[i] At 31 December 2013		past due but not impaired				Impaired	Total
	Not past due	1 month	1-3 months	3-6 months	More than 6 months		
	£000's	*£000's*	*£000's*	*£000's*	*£000's*	*£000's*	*£000's*
Loans secured by residential mortgages	840,066	-	-	-	-	-	840,066
Other Financial assets	6,124,737	-	-	-	-	-	6,124,737

i See note 1.

d) Liquidity risk

Liquidity risk arises where cash flows from investments and from new premiums prove insufficient to meet our obligations to policyholders and other third parties as they fall due.

The Company's ALM framework ensures that cash flows are sufficient to meet both long- and short-term liabilities.

The Company maintains a minimum level of cash and highly liquid assets such that, in the extreme scenario of new business cash flows being insufficient to meet current obligations, those obligations can continue to be met.

In accordance with PRA regulations, the Company's assets are reviewed to ensure they are of sufficient amount and of an appropriate currency and term to ensure that the cash inflows from those assets will meet the expected cash outflows from the Company's insurance and other financial liabilities.

In the following table expected cash outflows for:

- net insurance liabilities have been modelled with reference to underlying mortality and longevity assumptions;
- payables arising from reinsurance include interest and payments due under the terms of reinsurance treaties; and
- derivative liabilities have been modelled with reference to the yield curves that existed at the balance sheet date and assumed to be held to maturity.

The following table includes insurance and financial liabilities that are exposed to liquidity risk.

As at 31 December 2014	less than one year *£000's*	one to five years *£000's*	five to ten years *£000's*	more than ten years *£000's*	Carrying value (discounted) *£000's*
Net insurance liabilities (note 14)	153,346	544,237	571,040	1,667,559	1,985,104
Deposits from reinsurers (note 16)	213,142	793,042	843,324	2,005,880	2,491,797
Derivative liabilities (note 18)	13,523	37,602	10,603	34,097	79,493
	380,011	**1,374,881**	**1,424,967**	**3,707,536**	**4,556,394**
Restated[i]					
At 31 December 2013					
Net insurance liabilities (note 14)	131,727	457,257	464,853	969,613	1,506,839
Deposits from reinsurers (note 16)	114,153	576,795	619,048	1,496,027	2,182,439
Derivative liabilities (note 18)	584	10,252	14,381	15,596	32,391
	246,464	1,044,304	1,098,282	2,481,236	3,721,669

i See note 1.

The maximum exposure to credit risk is equal to the balance sheet value of debt instruments/derivatives.

e) Property risk

Property risk arises from the provision of a protected equity guarantee on the mortgages underlying the equity release assets purchased. The Company is exposed to the risk that property values do not rise sufficiently, or that the property is not maintained properly, to recover the full value of the loan made plus accrued interest.

The Company manages its purchase of loan assets to a level appropriate to its liability profile and ensures that the purchase prices of loan assets reflect a prudent assessment of future property price growth. Appropriate limits are applied to the "loan to value ratio" in order to limit the risk exposure to the Company. The Company seeks to avoid excess concentration of property holdings in any geographical area.

Property risk on commercial mortgages is the risk that property values decline or property tenancy changes such that the full value of the commercial mortgage loan is not recovered. The initial loan value is restricted to a maximum "loan to value" ration that limits its exposure for the Company.

23 AVAILABLE CAPITAL RESOURCES

The relevant capital requirement for the Company is the minimum solvency requirement determined in accordance with the PRA regulations and the EU directives for insurance and other PRA regulated business. The Company must hold assets in excess of the higher of two amounts, the first being calculated using the PRA rules (known as Pillar 1), the second being an economic capital assessment by the Company which is reviewed by the PRA (known as Pillar 2, or the Individual Capital Assessment). The Pillar 2 assessment is an assessment of the capital required to ensure that the Company can meet its liabilities, with a high likelihood, as they fall due. This is achieved by application of stochastic modelling and scenario testing. The results of this assessment may be modified by, the PRA.

Any changes or release of capital from long-term funds is subject to there being an established surplus shown by an actuarial investigation.

For the purposes of meeting the relevant capital requirements, available capital is defined by the PRA regulations to include Equity Shareholders funds adjusted to reflect certain inadmissible assets, together with subordinated debt, but subject to a maximum allowance of that debt contributing to overall capital resources. The available Pillar 1 capital resources of the Company are set out below.

	2014 ***£000's***	2013 *£000's*
Equity Shareholders funds	458,957	415,504
Inadmissible assets	(2,332)	(2,332)
Total available capital resources	**456,625**	413,172

24 RELATED PARTIES

a) Trading transactions

The following transactions were made with related parties:

	2014	2013
	£000's	*£000's*
Staff costs, director's remuneration, operating expenses and management fees charged by PSL	94,930	89,503
Commission charged by Eldercare Group Limited and Gateway Specialist Advice Services Ltd	**-**	78
Fee for origination of mortgage loans charged by Partnership Home Loans Limited	1,868	2,712
Loan advances made by PLACL to PASPV	**-**	42,810
Partial redemption of loans made by PASPV to PLACL	(23,375)	(16,121)
Interest on loan balances charged by PLACL	1,240	1,543

b) Trading balances

Balances in respect of the related parties, PSL, Eldercare Group Limited, Gateway Specialist Advice services Limited, PHLL and PASPV are included in balances in note 10 and 15. Amounts due from other group undertakings includes £863,066 in respect of loans made to PASPV (2013: £26,102,162).

c) Remuneration of key management personnel

Included in the payments to Partnership Services Limited is the remuneration of the Directors, who are the key management personnel of the Company, for their services as Directors of the Company. The amounts payable are set out below:

	2014	2013
	£000's	*£000's*
Aggregate emoluments including benefits	5,955	6,501
Contribution to money purchase pension scheme	105	386
	6,060	6,887
The aggregate remuneration of the highest paid director was:		
Aggregate emoluments including benefits:	1,265	1,483
Contribution to money purchase pension scheme	**-**	**-**
	1,265	1,483

During the year four Executive Directors contributed to the money purchase pension scheme (2013: two).

25 ULTIMATE HOLDING COMPANY

The Company's immediate parent company is Partnership Assurance Group plc, registered in England and Wales.

The Company's ultimate parent undertakings are the partnerships comprising the Fourth Cinven Fund (the "Cinven Funds"), being funds managed and advised by Cinven Limited, a company incorporated in the UK and registered in England and Wales. Accordingly, the Directors consider the Company's ultimate controlling party to be Cinven Limited, the manager and advisor to the Cinven Funds.

26 POST BALANCE SHEET EVENT

Loan and bond guarantee

On 2 March 2015 the Company entered into an agreement to borrow £100m under an intercompany loan with PAG plc. The bond is repayable after a 10 year term with possible redemption at option of the Company at the fifth anniversary or on any interest payment date thereafter, in each case subject to PRA consent. The loan has an annual interest rate of 9.5% payable annually in arrears from the issue date. The loan is a Tier 2 qualifying regulatory capital instrument under existing solvency regulations and Solvency II compliant following implementation of the Solvency II regime on 1 January 2016. Simultaneously PAG plc has entered into an agreement to issue a £100m bond, with similar terms to the intercompany

loan, via a private placing to funds managed by Cinven Capital Management, PAG plc's majority shareholder. The Company has provided a guarantee over the payments due on this bond.

AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF PARTNERSHIP LIFE ASSURANCE COMPANY LIMITED FOR THE YEAR ENDED 31 DECEMBER 2013

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF PARTNERSHIP LIFE ASSURANCE COMPANY LIMITED

We have audited the Financial Statements of Partnership Life Assurance Company Limited for the year ended 31 December 2013 which comprise the Statement of Comprehensive Income, the Statement of Changes in Equity, the Statement of Financial Position, the Cash Flow Statement and the related notes 1 to 26. The financial reporting framework that has been applied in their preparation is applicable law and IFRS as adopted by the European Union.

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, 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

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatement or inconsistencies we consider the implications for our report.

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 IFRS as adopted by the European Union; 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.

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.

Alexander Arterton
BSc (Hons) ACA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK
18 March 2014

AUDITED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2013

	Note	**2013**	2012
		£000's	*£000's*
Gross premiums written	2	1,159,561	1,468,007
Outward re-insurance premiums		(733,849)	(554,620)
Net premiums earned before restructure of reinsurance treaty		425,712	913,387
Premium on restructure of re-insurance treaty		-	(495,803)
Net premiums earned		425,712	417,584
Net investment income	3	136,207	290,766
Total Income		561,919	708,350
Gross claims paid		(341,126)	(273,654)
Reinsurers' share of claims paid in the year		225,277	188,462
Recovery on recapture of reinsurance		-	99,748
		(115,849)	14,556
Change in insurance liabilities:			
Gross amount	15	(624,290)	(1,564,761)
Reinsurers' share not related to restructure and recapti	15	428,197	663,453
Reinsurers' share related to restructure and recapture	15	-	396,212
		(196,093)	(505,096)
Acquisition costs		(11,508)	(34,147)
Investment expenses and charges		(12,737)	(8,172)
Interest on subordinated debt		_	(496)
Other operating expenses		(91,348)	(69,406)
		(115,593)	(112,221)
Total claims and expenses		**(427,535)**	(602,761)
Profit before tax	4	**134,384**	105,589
Income tax expense	5	(23,001)	(17,090)
Profit for the year		**111,383**	88,499

The Company's results are from continuing operations.

The profit for each year is entirely attributable to equity.

The notes are an integral part of these Financial Statements.

AUDITED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2013

	Note	**Share Capital** *£000's*	**Retained earnings** *£000's*	**Total** *£000's*
At 1 January 2012		25,390	103,432	128,822
Shares issued for cash	14	111,800	-	111,800
Profit for the year		-	88,499	88,499
At 31 December 2012		**137,190**	**191,931**	**329,121**
At 1 January 2013		137,190	191,931	329,121
Profit for the year		-	111,383	111,383
Dividends payable	6	-	(25,000)	(25,000)
At 31 December 2013		**137,190**	**278,314**	**415,504**

The profit for each year is entirely attributable to equity.

The notes are an integral part of these Financial Statements.

AUDITED STATEMENT OF FINANCIAL POSITION

For the year ended 31 December 2013

	Note	**2013** **£000's**	2012 £000's
Assets			
Goodwill	7	1,332	1,332
Other intangible assets	8	1,000	1,000
Financial assets	10	3,939,620	3,159,001
Reinsurance assets	15	2,840,749	2,412,552
Insurance and other receivables	1 1	110,195	99,124
Prepayments and accrued income	12	59,082	54,426
Cash and cash equivalents	13	64,760	159,436
Total assets		7,016,738	5,886,871
Equity			
Share capital	14	137,190	137,190
Retained earnings		278,314	191,931
Total equity and reserves		**415,504**	329,121
Liabilities			
Insurance liabilities	15	4,347,588	3,723,298
Insurance and other payables	16	35,712	46,072
Financial liabilities	17	2,201,589	1,778,764
Current tax liabilities	18	16,345	9,616
Total liabilities		**6,601,234**	5,557,750
Total equity and liabilities		**7,016,738**	5,886,871

The notes are an integral part of these Financial Statements.

The financial statements of the Company were approved by the board of Directors and authorised for issue on 18 March 2014.

They were signed on its behalf by:

SJ Groves, FIA
Chief Executive Officer
Company Registered Number: 5465261

AUDITED CASH FLOW STATEMENT

For the year ended 31 December 2013

	Note	**2013**	2012
		£000's	*£000's*
Cash used in operations	21	**(77,908)**	36,955
Income taxes paid		(16,768)	(17,073)
Dividends paid to Company shareholder		25,000	
Dividends settled via intercompany	6	(25,000)	-
Net cash (used in)/ from operating activities		**(94,676)**	19,882
Cash flows from investing activities:			
Interest on subordinated debt			(496)
Net cash used in investing activities		**-**	(496)
Cash flows from financing activities:			
Repayment of subordinated debt		-	(16,000)
Proceeds from issuance of share capital	14	-	111,800
Net cash from financing activities		-	95,800
Net increase in cash and cash equivalents		**(94,676)**	115,186
Cash and cash equivalents at beginning of year		159,436	44,250
Cash and cash equivalents at end of year	13	**64,760**	159,436

Cash flows related to the sale and purchase of financial investments are included in operating cash flows as they are associated with the origination of insurance contracts and payment of insurance claims.

The notes are an integral part of these Financial Statements.

NOTES TO THE FINANCIAL STATEMENTS

1 SIGNIFICANT ACCOUNTING POLICIES

General Information

Partnership Life Assurance Company Limited ("**the Company**") underwrites life assurance and annuity business in the UK.

Note 23 to the Financial Statements sets out the Company's policies and procedures for managing insurance and financial risk, and note 24 sets out how the Company manages its capital resources. Having regard to the Company's financial position, its expected performance in the future, and having made appropriate enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Basis of preparation

These Financial Statements are prepared in accordance with International Financial Reporting Standards ("**IFRS**") adopted by the European Union as defined by IAS 1, and in accordance with the provisions of Sections 1165 (5) and 1165 (6) of the Companies Act 2006 and the special provisions relating to insurance companies of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008, Schedule 3.

The financial information has been prepared in accordance with applicable accounting standards and under the historical cost convention, modified to include the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss.

The Company is exempt from consolidated accounts under the provision of IAS27. The Company is a subsidiary undertaking of Partnership Assurance Group plc (PAG Plc) and its results are consolidated in the Financial Statements of that company (note 26).

Critical accounting judgements and key sources of estimation uncertainty

The preparation of financial information in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial information and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

Insurance contracts

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event would cause an insurer to pay significant additional benefits 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.

The Company's long-term insurance contracts include annuities to fund retirement income, annuities to fund care fees (immediate needs and deferred), long-term care insurance and whole of life and term protection insurance. These contracts are expected to remain in force for an extended period of time, and insure events associated with human life.

Premiums

Premiums are recognised in the accounting period in which an insurance contract is commenced, gross of any commission paid. Premiums which have been received and for which no contract is yet in-force are classified as creditors arising out of direct insurance operations. Where a contract has been issued but premiums have not yet been received, a debtor arising out of direct insurance operations is recognised for the expected premiums due. Reinsurance premiums and recoveries are accounted for in the accounting period in accordance with the contractual terms of the reinsurance treaties. Premiums exclude any taxes or duties based on premiums.

Claims

Maturity claims and annuities are charged against revenue when due for payment. Death claims and all other claims are accounted for when notified. Claims reinsurance recoveries are accounted for in the same period as the related claim. Where reinsurance treaties are commuted, amounts received to compensate for the transfer of risk from the reinsurer are accounted for when received or, if earlier, on the date the treaty ceases to be included within the calculation of the reinsurers' share of long term business provision.

Long term business provision

One of the purposes of insurance is to enable policyholders to protect themselves against future uncertain events such as death or specific types of illness. Insurance companies accept the transfer of uncertainty from policyholders and seek to add value through the aggregation and management of these risks. As a consequence of this uncertainty, estimation techniques are employed by suitably qualified personnel in computing the levels of provisions held against such uncertainty.

The long-term business provision is determined by the Board on the advice of the Company's Actuarial Function Holder on the modified statutory basis using recognised actuarial methods with due regard to the actuarial principles set out in the PRA's (formally the FSA) Insurance Prudential Sourcebook. In particular, a prospective gross premium valuation method has been adopted for major classes of business.

Although the process for the establishment of insurance liabilities follows specified rules and guidelines, the provisions that result from the process remain uncertain. As a consequence of this uncertainty, the eventual value of claims could vary from the amounts provided to cover future claims. The Company seeks to provide for appropriate levels of contract liabilities taking known facts and experiences into account but nevertheless such provisions remain uncertain.

The estimation process used in determining the long term business provision involves projecting future annuity payments and the costs of maintaining the contracts. For non-annuity contracts, the long term business provision is determined as the sum of the discounted value of future benefit payments and future administration expenses less the expected value of premiums payable under the contract. The key sensitivities are the assumed level of interest rates and the mortality experience.

At the balance sheet date, provision is made for all notified claims plus an estimate for those claims that have been incurred but not reported. The principal assumptions underlying the calculation of the long term business provision are set out in note 15.

Acquisition costs

Acquisition costs comprise direct costs such as commissions and indirect costs of obtaining and processing new business. They are allocated to particular categories of business based on available information. Acquisition costs are not deferred as they are largely recovered at inception through profit margins.

Long term reinsurance contracts

Long term business is ceded to reinsurers under contracts to transfer part or all of one or more of the following risks: mortality, morbidity, investment, persistency and expenses. The benefits to which the Company are entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers (classified within "Insurance and other receivables") as well as longer term receivables that are dependent on the expected benefits arising under the related reinsured contracts.

Amounts recoverable from reinsurers are estimated in a consistent manner with the long term business provision, and are classified as "reinsurance assets".

Some contracts, which provide for the transfer of significant risk, are also structured to provide financing. When, under such contracts, financing components are to be repaid in future accounting periods, the amount outstanding under the contract at the balance sheet date are classified as "payables arising from reinsurance contracts".

If the reinsurance asset were impaired, the Company reduces the carrying amount accordingly and recognises that impairment loss in the income statement. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Company may not receive all amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

Investment income & expenses

Investment income comprises interest received on financial investments, realised investment gains and losses and movements in unrealised gains and losses.

Expenses and charges are included on an accruals basis.

Realised gains and losses on investments are calculated as the difference between net sales proceeds less costs of sale and original cost. Unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or if they have been previously valued their valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Goodwill

Goodwill represents the excess of cost of acquisition over the fair value of the separable net assets of businesses acquired. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill that is recognised as an asset is reviewed for impairment at least annually, or when circumstances or events indicate there may be uncertainty over this value and any impairment is recognised immediately in the income statement and is not subsequently reversed.

Other intangible assets

Other intangible assets comprise intellectual property in the form of specific mortality tables derived from data collected over an extended period. The intangible asset is deemed to have an indefinite life and consequently no amortisation is charged against its carrying value.

Impairment of tangible and intangible assets excluding goodwill

The carrying amounts of tangible and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable and at least at each balance sheet date. An impairment loss is recognised in the income statement for the amount by which the asset’s carrying amount exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its net selling price (fair value less selling costs) and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit, or company of units, to which the asset belongs.

Investments in Subsidiaries

Investments in subsidiaries are stated at cost less impairment, as determined by the Company’s Directors.

Financial instruments

The Company classifies its financial investments, loans backed by mortgages, derivative financial instruments and other financial liabilities at fair value through profit and loss. The category of fair value through profit and loss has two sub-categories – those that meet the definition as being held for trading and those that the Company chooses to designate as fair value. The fair value through profit and loss is used as the Company manages its financial instruments as a portfolio on a fair value basis.

Financial investments

Purchases and sales of debt securities and other fixed income securities are recognised on the trade date, which is the date that the Company commits to purchase or sell the assets, at their fair values. Transaction costs are expensed as incurred. These investments are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Debt securities and other fixed income securities are subsequently carried at fair value with changes in fair value included in the Statement of Comprehensive Income in the period in which they arise.

The fair values of debt securities are based on quoted bid prices, or based on modelled prices (using observable market inputs) where quoted bid-prices are not available.

Loans secured by mortgages

Loans secured by mortgages are recognised when the cash is advanced to borrowers at their fair values. These loans are derecognised when the contractual rights to receive cash flows from the investments expire, or where the investments have been transferred, together with substantially all the risks and rewards of ownership.

Loans secured by mortgages are subsequently carried at fair value with changes in fair value included in the Statement of Comprehensive Income in the period in which they arise.

The fair value of loans secured by mortgages is initially deemed to be the transaction price and subsequently marked to model. The underlying model follows the methodology used to establish transaction prices. It uses longevity assumptions to derive expected cash flows and the Black Scholes option pricing methodology to establish the value of the no negative equity guarantee that is embedded in the product. The discount rates that are applied to cash flows to produce fair value are based on long dated swaps adjusted so that they would produce transaction date prices on the date of transaction.

Derivative financial instruments

The Company enters into a variety of derivative financial instruments to manage its exposure to interest rates, inflation, credit default and foreign exchange rate risk, including foreign exchange forward contracts, interest rate swaps, credit default swaps and inflation swaps.

Derivative contracts are traded either through an exchange or over-the-counter ("OTC"). OTC derivative contracts are individually negotiated between contracting parties and can include options, swaps, caps and floors.

Derivatives are initially recognised at fair value at the date that a derivative contract is entered into and are subsequently remeasured to fair value at each balance sheet date. The resulting gain or loss is recognised in the Statement of Comprehensive Income. The fair values are obtained from quoted market prices or, if these are not available, by using standard valuation techniques based on discounted cash flow models or option pricing models. All derivatives are carried as assets when the fair value is positive and liabilities when the fair values are negative. Premiums paid for derivatives are recorded as an asset on the balance sheet at the date of purchase representing their fair value at that date.

Financial liabilities

As well as derivative financial liabilities, the Company carries financial liabilities where assets under specific reinsurance treaties are legally and physically deposited back to the Company by reinsurers. Financial liabilities are initially recognised at fair value on the same date that the value of underlying deposited assets is recognised and are subsequently remeasured at fair value at each balance sheet date. The resulting gain or loss is recognised in the Statement of Comprehensive Income and incorporates any interest paid on the financial liability. Fair value is determined as the amount payable discounted from the first date that the amount is required to be paid.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into.

Subordinated debt

Subordinated debt is recognised initially at fair value, net of transaction costs incurred. Subordinated debt is subsequently stated at amortised cost. Any difference between the proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Taxation

Provision is made for taxation on taxable profits for the year, using tax rates enacted or substantively enacted at the balance sheet date.

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. A deferred tax asset is recognised to the extent that it is regarded as more likely than not that it will be recovered. Deferred tax assets and liabilities are not discounted.

Pension costs

All staff are employed by Partnership Services Limited, a fellow subsidiary undertaking of the parent undertaking. Partnership Services Limited operates money purchase company personal pension plans. The pension charge attributable to the Company is recharged from Partnership Services Limited and is expensed to the income statement as the charges arise.

Foreign currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the end of the financial period. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held on call with banks and other short term highly liquid investments with original maturities of 90 days or less. Bank overdrafts are included in cash and cash equivalents.

Operating segments

The Company is not required to include a segmental analysis as it is not a listed company with traded debt or equity. Segmental analysis for the Partnership Assurance Group is included in the financial statements of Partnership Assurance Group plc.

Adoption of new and revised standards

The Company has adopted the following new standards and changes to existing standards which are relevant to the Company's operations, and became effective for financial years beginning on or after 1 January 2013:

- **Amendments to IFRS 7 'Offsetting Financial Assets and Financial Liabilities'** - these amendments require disclosure about rights to set-off financial instruments and related arrangements. During the period the Company had no such arrangements, and therefore the adoption of this amendment has not affected these financial statements.

- **IFRS 13 'Fair Value Measurement' -** IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when the entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The standard is applied prospectively. IFRS 13 also requires specific disclosures on fair values which are set out in note 20.

- **Amendments to IAS 1** "**Presentation of Items of Other Comprehensive Income**" - the amendments to IAS 1 require items of other comprehensive income to be grouped by those items that will be reclassified subsequently to profit and loss and those that will never be reclassified, together with their associated income tax. During the period the Company had no items reported within Other Comprehensive Income, and therefore the adoption of this amendment has not affected these financial statements.

- **Amendments to IAS 12** "**Income Taxes**" - These amendments provide a presumption that recovery of the carrying amount of an asset measured using the fair value model in IAS 40 Investment Property will, normally, be through sale. The Company has held no investment property measured using the fair value model during the year, and therefore the adoption of this amendment has not affected these financial statements.

- **Annual Improvements 2009 – 2011 cycle** - Amendments to five standards, IFRS 1 First Time Adoption, IAS 1 Presentation of Financial Statements, IAS 16 Property, Plant and Equipment, IAS 32, Financial Instruments – Presentation, and IAS 34, Interim Financial Reporting. The amendments clarify existing guidance and have no impact on these financial statements.

The following new or revised or amended standards, in issue, were not yet effective, or in some cases not yet endorsed by the EU. The Company has not early adopted any of these standards.

Standard/ Interpretation	**Content/ amendment**	**Applicable for financial periods beginning on or after**
IFRS 10	**Consolidated financial statements**	1 January 2014*
IFRS 11	**Joint arrangements**	1 January 2014*
IFRS 12	**Disclosures of interests in other entities**	1 January 2014*
IAS 27	**Separate financial statements**	1 January 2014*
IAS 28	**Associates and joint ventures**	1 January 2014*
IFRS 10, IFRS 12 and IAS 27	**Investment Entities**	1 January 2014*
IAS 32	**Financial Instruments -Presentation**	1 January 2014*
IAS 36	**Recoverable Amount Disclosures for Non-Financial Assets**	1 January 2014*
IAS 39	**Novation of Derivatives and Continuation of Hedge Accounting**	1 January 2014*
IFRS 9	**Financial Instruments**	1 January 2018

* As adopted by the EU

2 GROSS PREMIUMS WRITTEN

Premiums are written at the point the insurance contract comes into force. In November 2012, the Company changed the terms of its offer to potential retirement policyholders such that an insurance contract would come into force at the point of their acceptance of the offered terms. Previously a contact only came into force when all funds had been received from the policyholder. If it were not for these change of terms £109.6m of premium recognised in 2012 would otherwise have been recognised in 2013 and £40.3m of the premium recognised in 2013 would have been recognised in 2014 so that total premium recognised in 2013 is £69.3m lower that would otherwise have been recognised. This also gives rise to amounts due from policyholders for premiums not yet received, as shown in note 11.

3 NET INVESTMENT INCOME

	2013	2012
	£000's	*£000's*
Interest received from financial assets	138,850	101,116
Interest payable on financial liabilities	(71,597)	(46,579)
Movement in fair value of financial assets	24,377	206,886
Movement in fair value of financial liabilities	17,382	1,453
Realised gains on financial assets	72,972	65,531
Realised losses on financial liabilities	(45,777)	(37,641)
	136,207	290,766

All financial assets and liabilities are classified at fair value through profit and loss.

Movement in fair value of financial assets includes a £1.8m reduction to the value of a loan to a subsidiary undertaking. This loan has been impaired to reduce its carrying value to the expected recoverable amount.

4 PROFIT BEFORE TAX

All overheads are paid by Partnership Services Limited ("PSL"), a fellow subsidiary company, and recharged to the Company through a management charge. Included within the recharge was an amount of £181,756 (2012: £155,516) in respect of auditors' remuneration and £82,800 (2012: £69,000) paid to the Company's auditor in respect of non-audit services for the Company.

Details of directors' remuneration and other overheads charged to the Company are included in note 26.

The staff and Directors are remunerated as employees of PSL, which also bears all pension costs. Remuneration and pension costs are charged to the Company through the management charge.

5 INCOME TAX

	2013	2012
	£000's	*£000's*
Current taxation:		
Tax charge for the year	22,647	17,385
Adjustment in respect of prior years	354	(295)
Total tax charge for the year	23,001	17,090

The actual tax charge differs from the expected tax charge, computed by applying the average rate of UK corporation tax for the year of 23.25% (2012: 24.5%), as follows:

	2013	2012
	£000's	*£000's*
Profit before tax	134,384	105,589
Current taxation at 23.25% (2012: 24.5%)	31,237	25,865
Utilisation of losses of other group companies transferred without charge	(9,020)	(8,480)
Adjustment in respect of prior years	354	(295)
Cost of impairment of loan to subsidiary undertaking - not allowable for tax	430	-
Income tax expense	**23,001**	17,090
Unutilised tax losses	-	14,139
Unrecognised deferred tax assets	-	2,828

From 1 January 2013 insurers carrying long-term insurance business in the UK are required to calculate taxable trading profits or losses by reference to the statutory accounts rather than their annual Return to the Prudential Regulatory Authority. This change has little impact on the tax arrangements of the Company as it has treated all insurance profits as pension business (rather than BLAGAB or any other tax category) in its corporation tax calculations since 2007.

Under this new regime the carried forward unutilised tax losses on BLAGAB business, as a result of excess management expenses, cannot be utilised after 31 December 2013 since taxable BLAGAB profits will not arise. No deferred tax asset is recognised for any of these losses because the Group does not expect to be able to utilise them.

6 DIVIDEND PAYABLE

On 13 December 2013 the company declared and paid a dividend to Partnership Group Holdings Limited ("**PGHL**") totalling £25 million, and were settled by intercompany account (2012: nil).

7 GOODWILL

	£000's
At start of year	1,332
At end of year	**1,332**

Goodwill is allocated to the new business cash generating unit, which represents the net assets and cash flows of the segment of the Company's operations that enter into new insurance contracts.

The carrying value of goodwill has been tested for impairment at the balance sheet date. Value in use has been determined as the present value of expected future cash flows associated with new business. The cash flows used in this calculation are consistent with those monitored by management.

Expected future new business cash flows are based on financial plans approved by management, covering a period of 3 years from the balance sheet date. A rate of 10% has been applied to discount cash flows to a present value.

No impairment has been recognised in 2013 or 2012.

8 OTHER INTANGIBLE ASSETS

	£000's
At start of year	1,000
At end of year	**1,000**

The Intellectual property comprises specific mortality tables derived from data collected over an extended period. Its value has been determined based upon an estimate of the costs to employ adequately skilled individuals over an appropriate period of time to develop intellectual property of a similar nature sufficient to enable the Company to replicate the estimated future cash flows and profits deriving from that intellectual property.

The Intellectual property is continually updated through the collection of further data, updated analyses, and conversion into new and more detailed underwriting manuals and mortality tables. For this reason, the intangible asset is deemed to have an indefinite life, and consequently, no amortisation is provided against the value of the intangible asset. The carrying value of the intangible asset is assessed for impairment at each reporting date, by considering the future cash flows generated through its use.

No impairment of intellectual property has been recognised in 2012 or 2013.

9 INVESTMENT IN SUBSIDIARY

On 20 December 2012, the Company purchased all of the capital of PASPV Limited for £1. PASPV Limited principal activity is facilitating commodity trade finance, and started trading on 11 April 2013.

10 FINANCIAL ASSETS

	2013	2012
	£000's	*£000's*
Financial investments	3,063,140	2,645,997
Loans secured by mortgages	840,066	478,097
Derivative assets (note 19)	36,414	34,907
Total financial assets	**3,939,620**	3,159,001

Financial investments include debt securities and fixed income securities.

Financial investments and Loans secured by mortgages are designated at fair value through profit and loss. Derivative assets are carried at fair value through profit and loss.

Cost of Financial investments and Loans secured by mortgages	**2013**	2012
	£000's	*£000'*
Financial investments	2,991,196	2,464,790
Loans secured by mortgages at cost	796,788	414,500

The methodology used to derive the fair values is set out in note 20.

11 INSURANCE AND OTHER RECEIVABLES

	Note	**2013**	2012
		£000's	*£000's*
Amounts falling due within 12 months:			
Debtors arising out of insurance contracts*	2	51,140	85,153
Debtors arising out of reinsurance contracts		9,039	5,627
Amounts due from other group undertakings	25	48,036	5,484
Other debtors		1,980	2,860
		110,195	99,124

* The 2013 balances are impacted relative to 2012 as they reflect the revised policy contract terms explained in note 2.

The Directors consider that the carrying value in the balance sheet is a reasonable approximation of the fair value.

12 PREPAYMENTS AND ACCRUED INCOME

	2013	2012
	£000's	*£000's*
Amounts falling due within 12 months:		
Accrued interest	59,082	54,426
	59,082	**54,426**

The Directors consider that the carrying value in the balance sheet is a reasonable approximation of the fair value.

13 CASH AND CASH EQUIVALENTS

	2013	2012
	£000's	*£000's*
Short term bank deposits	64,711	151,529
Cash at bank and in hand	49	7,907
	64,760	159,436

14 SHARE CAPITAL

	2013	2012
	£000's	*£000's*
Allotted, issued and fully paid - ordinary shares of £1 each:		
At start of year	137,190	25,390
Issued and paid in the year		111,800
At end of year	**137,190**	137,190

15 INSURANCE LIABILITIES AND REINSURANCE ASSETS

	2013	2012
	£000's	*£000's*
Long term business provision	4,347,588	3,723,298
Re-insurers' share of long term business provision	(2,840,749)	(2,412,552)
Net provision	**1,506,839**	1,310,746

a) Principal assumptions for insurance liabilities

The principal assumptions underlying the calculation of the long-term business provision are as follows:

		Mortality tables	Valuation discount rates
Medically underwritten annuity products	2013	Modified E&W Population Mortality with CMI 2012 M (1.75%) and CMI 2012 F (1.50%)	4.31%
	2012	Modified PML/PFL92 (U=2013) modified ave MC& LC floor 1.5%	3.76%
Other annuity products	2013	Modified PCMA/PCFA00u2013 p-spline	1.70%
	2012	Modified PCMA/PCFA00u2012 p-spline	2.26%
Term and whole of life products	2013	86.25% TM/TFOOSelect	1.44%
	2012	97.75% TM/TFOOSelect	1.07%

Valuation discount rate assumptions are set with regards to yields on supporting assets. An allowance for risk is included by making an explicit deduction from the yields on debt and other fixed income securities based on historical default experience and expected experience of each asset class. The allowance for credit risk has been set at 40% (2012: 37%) of the spread on the yield of corporate bonds over gilts.

The changes in the valuation discount rates at each period end reflect changes in yields on the supporting assets and changes made to the allowance for risk. The allowance for credit default risk has been strengthened during 2013, and this change in assumption results in an increase to the insurance liabilities of £3m.

The mortality tables used have been adjusted to reflect additional mortality based on the proprietary data held by the Company developed from actual experience incurred. The allowance for mortality risk on medically underwritten annuity products has been strengthened during 2013, and this change in assumption results in an increase to the insurance liabilities of £1.8m. The valuation basis used to calculate the long-term business provisions includes an allowance for future expenses.

b) Movements

Movements in the carrying amount of insurance liabilities and reinsurance assets are explained as follows:

	Gross *£000's*	**Reinsurance** *£000's*	**Net** *£000's*
At 1 January 2013			
Carrying amount at start of year	3,723,298	(2,412,552)	1,310,746
Increase in liability from new business	1,038,011	(678,827)	359,184
Release of in-force liability	(111,110)	75,012	(36,098)
Release of liability due to recorded deaths	(69,967)	31,040	(38,927)
Economic changes	(209,299)	144,164	(65,135)
Non-economic changes	(25,847)	1,609	(24,238)
Other	2,502	(1,195)	1,307
At 31 December 2013	**4,347,588**	**(2,840,749)**	**1,506,839**
At 1 January 2012			
Carrying amount at start of year	2,158,537	(1,352,886)	805,651
Increase in liability from new business	1,324,979	(532,265)	792,714
Release of in-force liability	(48,465)	30,083	(18,382)
Release of liability due to recorded deaths	(61,815)	36,098	(25,717)
Recapture and restructure of reinsurance treaties*	-	(396,213)	(396,213)
Economic changes	335,573	(200,464)	135,109
Non-economic changes	11,266	-	11,266
Other	3,223	3,095	6,318
At 31 December 2012	3,723,298	(2,412,552)	1,310,746

* The impact of the recapture and restructure of reinsurance treaties has been calculated as if both transactions occurred on 31 December 2012 before the impact of year end basis changes.

c) Analysis of expected maturity

The following table analyses insurance liabilities and reinsurance assets by duration.

	Expected cash flows (undiscounted)				Carrying value (discounted)
	less than one year	one to five years	five to ten years	more than ten years	
	£000's	*£000's*	*£000's*	*£000's*	*£000's*
At 31 December 2013					
Gross	373,419	1,360,968	1,450,164	3,829,024	4,347,588
Reinsurance	(241,692)	(903,711)	(985,311)	(2,544,018)	(2,840,749)
Net	**131,727**	**457,257**	**464,853**	**1,285,006**	**1,506,839**
At 31 December 2012					
Gross	300,885	1,080,196	1,122,562	2,998,611	3,723,298
Reinsurance	(191,170)	(711,459)	(767,756)	(2,028,997)	(2,412,552)
Net	109,716	368,737	354,806	969,613	1,310,746

d) Sensitivity analysis

Life insurance results are inherently uncertain due to actual experience being different to modelled assumptions. Sensitivity analysis is provided below to illustrate the impact of changes in key assumptions.

Sensitivity factor	**Description of sensitivity factor applied**
Interest rate & investment return	The impact of a change in the market interest rates by + / - 1% (e.g. if a current interest rate is 5%, the impact of an immediate change to 4% and 6% respectively). The test allows consistently for similar changes to investment returns and movements in the market backing fixed interest securities.
Credit spreads	The impact of credit spreads widening by 50bps with a corresponding pro-rated change to defaults.
Expenses	The impact of an increase in maintenance expenses by 10%.
Mortality rates	The impact of a decrease in mortality rates by 5%.
Property values	The impact of an immediate decrease in the value of properties by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the equity release assets used to back the liabilities.
Voluntary redemptions	The impact of an increase in voluntary redemption rates on equity release loans by 10%. The test allows for the impact on the annuity liabilities arising from any change in yield on the equity release assets used to back the liabilities.

The table below demonstrates the effect of a change in a key assumption whilst other assumptions remain unchanged. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results. The sensitivity analyses do not take into consideration that the Company's assets and liabilities are actively managed and may vary at the time that any actual market movement occurs.

	Increase / (decrease) in profit before tax	
	2013	2012
	£000's	*£000's*
Change in assumption:		
Interest rates+1%	2,954	1,362
Interest rates -1%	(3,308)	(8,610)
Credit spreads +50bps	(10,917)	(779)
Expenses +10%	(9,962)	(8,894)
Mortality -5%	(22,140)	(19,791)
Property prices -10%	(25,313)	(11,093)
Voluntary redemptions -10%	(2,402)	(2,861)

16 INSURANCE AND OTHER PAYABLES

	2013	2012
	£000's	*£000's*
Amounts payable within one year:		
Payables arising from insurance contracts	9,546	40,207
Amounts due to parent undertaking	24,277	4,012
Ot her creditors and accruals	1,889	1,853
	35,712	46,072

The Directors consider that the carrying value in the balance sheet is a reasonable approximation of the fair value.

17 FINANCIAL LIABILITIES

	Note	**2013**	2012
		£000's	*£000's*
Payables arising from reinsurance contracts		2,169,198	1,728,997
Derivative liabilities	19	32,391	49,767
		2,201,589	1,778,764

Payables arising from reinsurance contracts at fair value through profit and loss are designated as such on initial recognition. Derivative liabilities are carried at fair value through profit and loss.

18 CURRENT TAX LIABILITIES

	2013	2012
	£000's	*£000's*
Amounts payable within one year:		
Income taxes	12,962	6,729
Othertaxes and social security costs	3,383	2,887
	16,345	9,616

19 DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses various derivative financial instruments to manage its exposure to interest rates, counterparty credit risk, inflation and foreign exchange risk, including foreign exchange forward contracts, interest rate swaps, credit default swaps and inflation swaps.

Derivatives	**Asset fair value *£000's***	**Liability fair value *£000's***	**Notional amount *£000's***
Non-sterling interest rate swaps	8,488	278	548,392
Interest rate swaps	24,848	31,271	1,242,924
Inflation swaps	3,078	842	162,135
Total at 31 December 2013	**36,414**	**32,391**	**1,953,451**
Non-sterling interest rate swaps	860	2,957	372,062
Interest rate swaps	33,657	41,187	792,980
Inflation swaps	390	5,623	121,355
Total at 31 December 2012	34,907	49,767	1,286,397

All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual group entities, of which the Company is one, and relevant counterparties in place under each of these market master agreements.

At 31 December 2013, the Company had pledged £10.1 (2012: £13.8m) and held collateral of £0.9m (2012: £0.5m) in respect of over-the-counter derivative transactions.

20 FINANCIAL INSTRUMENTS – FAIR VALUE METHODOLOGY

All financial instruments are classified at fair value through profit and loss.

In accordance with IFRS 13 Financial Instruments Disclosures, financial instruments at fair value have been classified into three categories.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices);

Level 3: Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

An analysis of financial assets and liabilities held at fair value in accordance with the fair value hierarchy is set out below. All these financial assets and liabilities relate to recurring fair value measurements. There are no non-recurring fair value measurements as at 31 December 2013 and 31 December 2012.

31 December 2013	**Level 1**	**Level 2**	**Level 3**	**Total**
	£000's	***£000's***	***£000's***	***£000's***
Financial investments (a)	3,063,140	-	-	3,063,140
Loans secured by mortgages (b)	-	-	840,066	840,066
Derivative assets (c)	-	36,414	-	36,414
Total financial assets held at fair value	**3,063,140**	**36,414**	**840,066**	**3,939,620**
Payables arising from reinsurance contracts (d)		_	2,169,198	2,169,198
Derivative liabilities (c)	-	32,391	-	32,391
Total financial liabilities held at fair value	**-**	**32,391**	**2,169,198**	**2,201,589**

31 December 2012	Level 1	Level 2	Level 3	Total
	£000's	*£000's*	*£000's*	*£000's*
Financial investments (a)	2,645,997	-	-	2,645,997
Loans secured by mortgages (b)	-	-	478,097	478,097
Derivative assets (c)	-	34,907	-	34,907
Total financial assets held at fair value	2,645,997	34,907	478,097	3,159,001
Payables arising from reinsurance contracts (d)	-	. -	1,728,997	1,728,997
Derivative liabilities (c)	-	49,767	-	49,767
Total financial liabilities held at fair value	-	49,767	1,728,997	1,778,764

The Company's policy is to recognise transfers into and transfers out of Levels 1, 2 and 3 as of the date at which the Statement of Financial Position is prepared.

During 2012, the financial investments have been reclassified from Level 2 to Level 1. Since the financial crisis in 2008, there has been a continual improvement in the level of liquidity in the fixed and variable rate securities markets, and having considered this during 2012, the Directors now consider that the market is sufficiently active to allow classification of the financial investments as Level 1. There have been no other transfers between levels 1, 2 or 3 in 2013.

The table below reconciles the opening and closing recorded amount of level 3 financial liabilities and financial assets which are stated at fair value.

	Payables arising out of reinsurance contracts *£000's*	**Loans secured by mortgages** *£000's*
At 1 January 2013	(1,728,997)	478,097
Loans advanced (to the Company)/ by the Company	(733,849)	416,475
Total (losses)/ gains in Income Statement excluding reinsurance restructure	155,522	(25,695)
Redemptions paid by the Company/ (paid to the Company)	216,985	(34,189)
(Interest payable accrued)/ interest receivable accrued	(78,859)	5,378
At 31 December 2013	**(2,169,198)**	**840,066**

	Payables arising out of reinsurance contracts *£000's*	Loans secured by mortgages *£000's*
At 1 January 2012	(809,641)	316,729
Loans advanced (to the Company)/ by the Company	(1,050,423)	148,028
Total (losses)/gains in Income Statement excluding reinsurance restructure	(75,427)	7,246
Total gains in Income Statement from reinsurance restructure (note 3)	35,186	-
Redemptions paid by the Company/ (paid to the Company)	259,269	(13,845)
(Interest payable accrued)/ interest receivable accrued	(52,775)	19,939
At 31 December 2013	(1,728,997)	478,097

The gains and losses are included within net investment income in the Consolidated Statement of Comprehensive Income.

The unrealised gains/(losses) in respect of payables arising out of reinsurance contracts and loans secured by mortgages for the period to 31 December 2013 are £105.6m and (£14.1m) respectively (31 December 2012: (£40.2m) and £27.2m respectively.

Level 3 Sensitivity Analysis

As at 31 December 2013		**Current fair value** *£000's*	**Increase in fair value** *£000's*	**Decrease in fair value** *£000's*
Assets				
Loans secured by mortgages	Discount rate, Value of no negative equity guarantee	**840,066**	**100,863**	**(86,046)**
Liabilities				
Payables arising out of reinsurance contracts	Discount Rate	**2,169,198**	**182,645**	**(161,733)**

The impact of reasonably possible alternative assumptions are estimated by modelling alternative scenarios for the key assumptions for each valuation model.

a) Financial Investments

All financial investments are listed and are designated at fair value through profit and loss.

In assessing the fair value of the debt securities and other fixed income securities, the Directors have relied upon values provided by an independent third-party which specialises in providing such values to companies. The third-party provides prices based upon quoted market prices, or where not available, modelled prices using observable market inputs. At 31 December 2013, 100% of values provided were based on quoted prices that are observable for the asset or liability.

b) Loans secured by mortgages

The fair value recognised in the Financial Statements is determined using a marked to model valuation technique where a significant proportion of inputs are not base on observable market data and so these assets are considered to le Level 3 within the valuation category prescribed by IFRS13.

The valuation model discounts the expected future cash flows using and interest rate swap curve with an additional spread or yield factor minus the cost of the no-negative equity guarantee. The no-negative equity guarantee represents an embedded guarantee that the repayment of the loan cannot exceed the value of the property at the time of repayment.

Although such valuations are sensitive to estimates, it is the discount rate and no-negative equity guarantee assumptions that are considered to impact the fair value significantly.

Discount rate: Loans secured by mortgages are valued using the swap rate appropriate to the term of each contract with adjustment to reflect the credit and liquidity risk associated with such long-dated contracts. The risk adjusted swap rate for the portfolio weighted by average value at 31 December 2013 was 6.24% (2012: 5.89%).

No-negative equity guarantee: The fair value of loans secured by mortgages takes into account an explicit provision in respect of the no-negative equity guarantee which is calculated using a variant of the Black Scholes option pricing model. The key assumptions used to derive the value of the no-negative equity guarantee include property growth, volatility and over-valuation. The property growth and volatility assumed at 31 December 2013 were 5.5% (2012: 5.5%) and 13% (2012: 13% respectively.) The over-valuation assumption used at 31 December 2013 was 22% (2012: 17%). The value of the no-negative equity guarantee as at 31 December 2013 was £67.3m (31December 2012: £27.6m).

The valuation technique that the Company uses to assess the fair value of loans secured by mortgages is consistent with that used to derive the prices applied at the initial transaction. As such, there is no difference between the fair value of loans backed by mortgages at initial recognition and the amount that would have been determined at that date using the valuation technique.

c) Derivative assets and liabilities

The estimated fair value of derivative instruments reflects the estimated amount the Company would receive or pay in an arm’s length transaction. All the derivatives held at 31 December 2013 and 2012 were purchased over-the-counter.

The Company’s derivative assets and liabilities largely relate to forward currency positions, interest rate swaps and inflation swaps.

Forward currency positions: Forward currency exchange contracts are priced from independent third parties.

Interest rate swaps: The fair value of the interest rate swaps is derived using and interest rate swap pricing model, using a time series of historic LIBOR rates, an applicable zero coupon interest rate swap curve to discount future cash flows (“discount curve”) as inputs. The forward curve is used by the pricing model to determine the future LIBOR rates to be applied in the calculation of the floating leg cash flow(s). The discount curve is used to calculate the present value of the future cash flow(s) of both the fixed and floating legs of the swaps and its composition is driven by the terms of the Credit Support Annex under which the swap is traded.

Inflation swaps: The fair value of the inflation swaps is derived using the inflation swap pricing model, using a time series of historic inflation index levels, a zero coupon swap inflation expectation curve, and inflation seasonality model and zero coupon interest rate swap curve as inputs. The inflation rate swap pricing model generates a future cash flow for both the fixed and inflation legs of a swap for which present value is determined using zero coupon interest rate swap curve.

The derivative assets and liabilities are presented on a gross basis in the Statement of Financial position. All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Company has collateral agreements between the individual Group entities and relevant counterparties in place under each of these market master agreements. Details of amounts pledged and collateral held against over-the-counter derivative transactions are included in note 25.

d) Payables arising from reinsurance contracts

The fair value recognised in the financial statements is determined using a marked to model valuation technique where not all inputs are based on observable market data and so these liabilities are considered to be Level 3 within the valuation category prescribed by IFRS13

The valuation model discounts the expected future cash flows using a discount rate, derived from the assets hypothecated to back these liabilities at a product level.

As payables arising from reinsurance contracts do not have a single fixed maturity date it is not possible to determine an amount that would contractually required to pay at maturity.

Discount rate: The key inputs to the derivation of the discount rate include market observable gross redemption yields, contractual investment expenses and an allowance for credit risk on a best estimate basis. The discount rate used as at 31 December 2013 for Retirement and Care was 4.95% and 1.97% respectively (2012: 4.53% and 2.45% respectively).

21 NOTES TO THE CASH FLOW STATEMENT

	2013	2012
	£000's	*£000's*
Profit before tax	**134,384**	105,589
Non-cash movements in profit before income tax		
Fair value gains and (interest accrued) on financial assets	(29,033)	(308,002)
Fair value losses and interest accrued on financial liabilities	54,215	45,126
Interest on subordinated debt	-	496
Amortisation of capitalised subordinated debt costs	-	75
Increase in financial assets	(751,586)	(1,100,621)
Increase in reinsurance assets	(482,412)	(1,104,792)
Increase in insurance and other receivables	(11,071)	(86,139)
Increase in prepayments and accrued income	(4,656)	(19,461)
Increase in insurance liabilities	624,290	1,564,761
Increase in insurance and other payables excluding dividend	387,465	938,977
Increase in other taxes and social security payables	496	946
Cash (used in)/ generated from operations	**(77,908)**	36,955

22 DEPOSITS RECEIVED FROM REINSURERS

Financial assets arising from the payment of reinsurance premiums, less the repayment of claims, to certain reinsurers in relation to specific treaties are legally and physically deposited back with the Company. Although the funds are managed by the Company (as the Company controls the investment of the asset), no future benefits accrue to the Company as any returns on the deposits are paid to reinsurers. Consequently the deposits are not recognised as assets of the Company and the investment income they produce does not accrue to the Company.

In addition, the Company has trust agreements with one reassurer (2012: one) whereby the assets are held in trust in order to fully fund the reassurer obligations under the reinsurance treaty. As the Company has no control over these funds and does not accrue any future benefit these funds are not recognised as assets of the Company.

	2013	2012
	£000's	*£000'*
Deposits managed by the Company	272,493	330,012
Deposits held in trust	241,699	192,781
	514,192	522,793

23 MANAGEMENT OF INSURANCE AND FINANCIAL RISK

The Company issues contracts that accept insurance risk in return for a premium. In addition, the Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. In particular, the key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from contracts with policyholders. The most important

components of this financial risk are interest rate risk and credit risk. The Company is not exposed to any equity price risk and to currency risk only to an immaterial extent.

a) Insurance risk

a1) Underwriting, pricing and reserving risk

Underwriting and pricing risk is the risk that inappropriate business will be written, or an inappropriate premium will be charged for that business. Reserving risk is the risk that policyholder reserves have been calculated incorrectly, or the assumptions used in the calculations are incorrect.

As the Company's insurance business is specifically targeted at people with medical conditions affecting their life expectancy, or people seeking to fund domiciliary or residential care, the underwriting risk is managed through the use of highly trained and qualified underwriting staff, together with tailored underwriting manuals designed to specifically cover a large array of medical conditions.

The Company has developed its own proprietary underwriting manuals for retirement annuity business and those seeking care funding, based on industry standard mortality tables modified to take account of experience data recorded by the Company and its predecessor organisations.

The assumptions used in the reserving for future policyholder payments are set based on available market and experience data, on the advice of the Actuarial Function Holder. The assumptions are approved by the Partnership Board. The policyholder reserves are calculated using recognised actuarial methods with due regard to the actuarial principles set out in the Financial Services Authority's Prudential sourcebooks.

a2) Specific insurance risk

Insurance risk on the annuity contracts arises through longevity risk and through the risk that operating factors, such as administration expenses, are worse than expected. Insurance risk on the protection policies arises through higher than expected mortality levels. Longevity and mortality experience is monitored on a regular basis and compared to the underlying assumptions used to reserve for future insurance payments. The exposure to longevity and mortality risk is also reduced significantly through the use of reinsurance. Expense risk is managed through regular assessment of expenses incurred against budgets and overall impact on profitability of the insurance contracts.

a3) Concentration of insurance risk

The Company writes annuity contracts for the provision of retirement income or care fees and protection insurance contracts, primarily for individuals in the UK with one or more medical conditions or lifestyle factors that are likely to reduce their overall life expectancy. The Company's insurance risk is therefore concentrated on longevity and mortality risk. These risks are significantly reduced through the Company's use of external reinsurance arrangements.

b) Interest rate and other market risk

Interest rate risk arises from open positions in fixed and variable rate stock issued by government and corporate bodies that are exposed to general and specific market movements. The Company is exposed to the market movements in interest rates to the extent that the asset value movement is different to the accompanying movement in the value of insurance liabilities.

The Company manages its interest rate risk within an asset liability management ("ALM") framework that has been developed to achieve long-term investment returns in excess of its obligations under insurance and investment contracts. The principal technique of the Company's ALM framework is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to policyholders.

The Company monitors interest rate risk by calculating the mean duration and cash flow profile of the investment portfolio and the liabilities. The mean duration is an indicator of the sensitivity of the assets and insurance liabilities to changes in current interest rates but is not sufficient in isolation. The mean duration of the liabilities is determined by means of projecting expected cash flows from the contracts using best estimates of mortality and voluntary terminations. No future discretionary supplemental benefits are assumed to accrue. The mean duration of the assets is calculated in a consistent manner. Any

gap between the mean duration of the assets and the mean duration of the liabilities is minimised by means of buying and selling fixed interest securities of different durations or purchasing interest rate swap derivatives to alter the effective mean duration of the assets. Periodically the cash flow matching is reviewed and rebalanced.

At 31 December 2013, the mean duration of the assets including surplus assets was 7.6 years measured with reference to a gross redemption yield (2012: 7.74 years) and the mean duration of the liabilities was 9.7 years measured with reference to the valuation interest rate (2012: 8.91 years).

The Company has reinsurance arrangements in place which provide for fixed payments to the reinsurer over future periods. In assessing the fair value of this liability, the Directors have used a discount rate derived from current market yields earned on assets held to fund the future cash outflows, adjusted for the risk of default on those assets. No further adjustment to the discount rate to reflect any risk of the Company defaulting on those payments to the reinsurer was deemed appropriate.

c) Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Company is exposed to credit risk are exposure to:

- the issuer of corporate bonds;
- counter-parties in derivative contracts;
- reinsurers' in respect of their share of insurance liabilities; and
- reinsurers in respect of claims already paid.

The Company places limits on its exposures to a single counterparty, or groups of connected counterparties.

With respect to its investment in corporate bonds, the credit rating is derived from the Standard & Poor's, Moody and Fitch ratings for each individual stock, if two or more ratings are available the second highest rating is used otherwise the single available rating is used. The Company places limits on the exposure to bond issuers with different credit ratings. Credit default swaps are also used to manage exposure to single issuers. Current restrictions do not allow investment in any corporate bond with a rating below BBB (or equivalent). Where investments already held are subsequently downgraded, the Directors will review each holding to determine whether to retain that exposure.

At 31 December 2013, £0.9m of collateral (2012: £0.5m) had been pledged to the Company to mitigate the credit risk exposure associated with the derivative assets held at that time.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Company's liability as primary insurer, and consequently, if a reinsurer fails to pay a claim, the Company remains liable for the payment to the policyholder. As a result, the Company is exposed to credit risk in relation to the reinsurers' ability to fulfil its obligations to the Company. The creditworthiness of reinsurers is considered by reviewing their financial strength prior to finalisation of any contract and then subsequently at least on an annual basis.

We seek to place new business with reinsurers with a minimum credit rating of "A".

The following table analyses the credit exposure of the Company by type of asset and includes the credit risk arising out of reinsurance exposures, based on the credit ratings of the reinsurer, as published by Standard & Poors, or an equivalent rating from another recognised rating agency.

The following table presents an aging analysis of financial assets by payment due status:

	AAA *£000's*	AA *£000's*	A *£000's*	BBB *£000's*	Below BBB / Unrated *£000's*	Total *£000's*
At 31 December 2013						
Financial Investments	601,351	257,263	1,170,898	1,033,628	-	3,063,140
Loans secured by mortgages	-	-	-	-	840,066	840,066
Derivative assets	-	-	-	-	36,414	36,414
Reinsurance assets	-	1,240,280	1,600,469	-	-	2,840,749
Insurance and other receivables	-	29	9,010	-	101,156	110,195
	601,351	**1,497,572**	**2,780,377**	**1,033,628**	**977,636**	**6,890,564**
At 31 December 2012						
Financial Investments	621,927	220,684	1,036,268	767,118	-	2,645,997
Loans secured by mortgages	-	-	-	-	478,097	478,097
Derivative assets	-	-	-	-	34,907	34,907
Reinsurance assets	-	1,353,221	1,059,331	-	-	2,412,552
Insurance and other receivables	-	-	5,627	-	93,497	99,124
	621,927	1,573,905	2,101,226	767,118	606,501	5,670,677

As at 31 December 2013	**Not past due** *£000's*	**Less than 1 month** *£000's*	**1 -3 months** *£000's*	**3-6 months** *£000's*	**More than 6 months** *£000's*	**Impaired** *£000's*	**Total** *£000's*
Loans secured by mortgages	840,066	-	-	-	-	-	**840,066**
Other Financial assets	6,050,498	-	-	-	-	-	**6,050,498**

d) Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Partnership Board sets limits on the minimum amount of highly liquid assets to be available to meet such obligations.

Short term cash requirements are monitored on a daily basis to ensure sufficient funds are available to meet immediate payments. The nature of the Company's business means that, in general, cash flows into the Company (through up-front premium payments) before annuity payments become due. Annuity payments are substantially fixed in nature, and consequently the cash requirements are not subject to excessive uncertainty.

In accordance with PRA regulations, the company's assets are reviewed to ensure they are of sufficient amount and of an appropriate currency and term to ensure that the cash inflows from those assets will meet the expected cash outflows from the company's insurance and other financial liabilities.

In the following table expected cash outflows for:

- net insurance liabilities have been modelled with reference to underlying mortality and longevity assumptions;
- payables arising from reinsurance include interest and payments due under the terms of reinsurance treaties;
- derivative liabilities have been modelled with reference to the yield curves that existed at the balance sheet date and assumed to be held to maturity; and
- subordinated debt is assumed to be repaid in accordance with the terms set out in the loan agreement.

The following table includes insurance and financial liabilities that are exposed to liquidity risk.

	Expected cashflows (undiscounted)				
At 31 December 2013	**less than one year** ***£000's***	**one to five years** ***£000's***	**five to ten years** ***£000's***	**more than ten years** ***£000's***	**Carrying value (discounted)** ***£000's***
Net insurance liabilities (note 15)	131,727	457,257	464,853	1,285,006	1,506,839
Payables arising from reinsurance contracts (note 17)	1,831,083	735,336	792,792	1,934,163	2,169,198
Derivative liabilities (note 19)	584	10,252	14,381	15,596	32,391
	1,963,393	1,202,844	1,272,025	3,234,765	3,708,428
At 31 December 2012					
Net insurance liabilities (note 15)	109,716	368,737	354,806	969,613	1,310,746
Payables arising from reinsurance contracts (note 17)	114,153	576,795	619,048	1,496,027	1,728,997
Derivative liabilities (note 19)	8,406	27,856	5,412	11,971	49,767
	232,275	973,388	979,266	2,477,611	3,089,510

The maximum exposure to credit risk is equal to the balance sheet value of debt instruments/ derivatives.

e) Property risk

Property risk is the risk that property values do not rise sufficiently to recover the full value of equity release loans made plus accrued interest. The initial loan value is restricted to a maximum "loan to value" ratio that limits the risk exposure for the Company.

Loans backed by mortgages represent little credit risk as the debt is ultimately repayable from the proceeds of the sale of the property on death of the policyholder or on their transfer to long-term care.

24 AVAILABLE CAPITAL RESOURCES

The relevant capital requirement for the Company is the minimum solvency requirement determined in accordance with the PRA regulations and the EU directives for insurance and other PRA regulated business. The Company must hold assets in excess of the higher of two amounts, the first being calculated using the PRA rules (known as Pillar 1), the second being an economic capital assessment by the Company which is reviewed by the PRA (known as Pillar 2, or the Individual Capital Assessment). The Pillar 2 assessment is an assessment of the capital required to ensure that the Company can meet its liabilities, with a high likelihood, as they fall due. This is achieved by application of stochastic modelling and scenario testing. The results are reviewed, and may be modified by, the PRA.

Any changes or release of capital from long-term funds is subject to there being an established surplus shown by an actuarial investigation.

For the purposes of meeting the relevant capital requirements, available capital is defined by the PRA regulations to include Equity Shareholders funds adjusted to reflect certain inadmissible assets, together with subordinated debt, but subject to a maximum allowance of that debt contributing to overall capital resources. The available Pillar 1 capital resources of the Company are set out below.

	2013 ***£000's***	2012 *£000's*
Equity Shareholders funds	415,504	329,121
Inadmissible assets	(2,332)	(2,332)
Total available capital resources	**413,172**	326,789

25 RELATED PARTIES

a) Trading transactions

The following transactions were made with related parties:

	2013	2012
	£000's	*£000's*
Staff costs, director's remuneration, operating expenses and management fees charged by PSL	89,503	68,272
Commission charged by Eldercare Group Limited and Gateway Specialist Advice Services Ltd	78	454
Fee for origination of mortgage loans charged by Partnership Home Loans Lin-	2,712	1,160
Loan advances made by PLACLto PASPV	42,810	-
Partial redemption of loans made by PASPV to PLACL	(16,121)	-
Interest on loan balances charged by PLACL	1,543	-

b) Trading balances

Balances in respect of the related parties, PSL, Eldercare Group Limited, Gateway Specialist Advice services Limited, PHLL and PASPV are included in balances in note 11 and 16. Amounts due from other group undertakings includes £26,102,162 in respect of loans made to PASPV (2012: nil).

c) Remuneration of key management personnel

Included in the payments to Partnership Services Limited is the remuneration of the Directors, who are the key management personnel of the Company, for their services as Directors of the Company. The amounts payable are set out below:

	2013	2012
	£000's	*£000's*
Aggregate emoluments including benefits	6,501	5,305
Contribution to money purchase pension scheme	386	59
	6,887	5,364
The aggregate remuneration of the highest paid director was:		
Aggregate emoluments including benefits:	1,483	1,336
Contribution to money purchase pension scheme	-	-
	1,483	1,336

During the year two Executive Directors contributed to the money purchase pension scheme (2012: two).

26 ULTIMATE HOLDING COMPANY

The Company's immediate parent company is Partnership Assurance Group plc, registered in England and Wales.

The Company's ultimate parent undertakings are the partnerships comprising the Fourth Cinven Fund (the "Cinven Funds"), being funds managed and advised by Cinven Limited, a company incorporated under the laws of England and Wales. Accordingly, the Directors consider the Company's ultimate controlling party to be Cinven Limited, the manager and advisor to the Cinven Funds.

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Guarantor

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