

Pearl Group Holdings (No.1) Limited

Company Registration Number: 3524909

DIRECTORS' REPORT AND FINANCIAL STATEMENTS
for the year ended 31 December 2010

Pearl Group Holdings (No.1) Limited

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Directors' report

Company registration number: 3524909

Country of incorporation: United Kingdom

Registered Office:
Juxon House
100 St. Paul's Churchyard
London EC4M 8BU

The Directors present their Report and the Financial Statements of Pearl Group Holdings (No.1) Limited ("the Company"), for the year ended 31 December 2010.

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS") and the comparative information has been restated accordingly. In previous years the financial statements of the Company were prepared in accordance with applicable United Kingdom Generally Accepted Accounting Principles ("UK GAAP"). Information on the effect of the transition to IFRS is given on pages 29 to 35.

Business Review

Principal activity

The principal activity of the Company is that of an investment company. This is expected to continue to be the principal activity for the foreseeable future.

Corporate activity

On 1 January 2010, the Company had in issue £500 million of 6.5864% Perpetual Reset Capital Securities ("the Notes") which are admitted to the Official List of the UK Listing Authority and to trading on the London Stock Exchange.

On 25 March 2009, the Company gave notice to the holders of the Notes of its decision to defer the coupon payment on the Notes which would otherwise have been due on 25 April 2009.

On 22 April 2010, the holders of the Notes agreed to a number of amendments to the Notes, including a 15% reduction in the face value of the Notes, the amendment of the Alternative Coupon Settlement Mechanism ("ACSM") and the imposition of an additional restriction on the payment of dividends by the Company's ultimate parent, Phoenix Group Holdings, if future coupons are deferred. Following these amendments, the Company settled in full on 26 April 2010 the 2010 coupon due on the Notes and settled in full via the issue of ACSM instruments the 2009 coupon on 18 November 2010.

On 22 April 2010 the Company also entered into a balancing instrument under which notes with a face value of £75m (equal to the amount of the 15% reduction in principal amount of the Notes) were issued to its ultimate parent company Phoenix Group Holdings for no consideration. The aggregate nominal value of the balancing instrument and the Notes is £500m, which is the same as the total amount of the Notes before the Notes were amended. The terms of the balancing instrument are substantially the same as the terms of the Notes except that they are unlisted and are subordinate to the Notes which have a reduced nominal value of £425m, and the Notes are now referred to as the senior notes.

Further details on the Notes and the ACSM are provided in note 14 to the financial statements.

Result and dividends

The results of the Company for the year are shown in the income statement on page 7. The profit before tax was £174m (2009: £197m) and the total comprehensive income was £152m (2009: £33m).

Dividends totalling £nil were paid during the year (2009: £nil).

Position as at 31 December 2010

The net assets of the Company at 31 December 2010 were £3,619m (2009: £3,482m). The increase in the period reflects total comprehensive income arising in the period of £152m (2009: £33m), increase in share premium of £33m (2009: £nil), offset by coupon payments, net of tax relief, on the Notes of £48m (2009: £nil).

Principal risks and uncertainties

The principal risks and uncertainties facing the Company are:

- interest rate risk, since the movement in interest rates will impact the value of interest payable and receivable by the Company;
- liquidity risk, exposure to liquidity risk as a result of normal business activities, specifically the risk arising from an inability to meet short-term cash flow requirements and this is monitored on an ongoing basis;
- credit risk, arising from the default of the counterparty to a particular financial asset and is significantly reduced as assets are primarily intercompany receivables from other Group entities; and
- longevity risk in the pension scheme, arising from faster than expected improvements in life expectancy on the pensions of the members of the Scheme.

The Company's exposure to all these risks is monitored by the Directors, who agree policies for managing each of these risks on an ongoing basis.

Key Performance Indicators ("KPIs")

Given the straightforward nature of the business, the Company's Directors are of the opinion that analysis using KPIs is not necessary for an understanding of the development, performance or position of the business.

Going concern

Having reviewed the position in the light of the Financial Reporting Council Guidance issued in October 2009, 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 presenting the financial statements.

Corporate governance statement

As a result of the Company having in issue £425 million of 6.5864% Perpetual Reset Capital Securities ("the Notes") which are admitted to the Official List of the UK Listing Authority and are traded on the London Stock Exchange, there is a requirement to report on the corporate governance of the Company. Details of the Notes are found under 'Corporate Activity' section above.

The Company is a subsidiary of Phoenix Group Holdings ('PGH'), which achieved Premium Listing on the London Stock Exchange and is a member of the FTSE 250 Index. As part of the PGH Group the Board is committed to high standards of Corporate Governance and supports the 2008 Combined Code on Corporate Governance ('the Combined Code'). The Group's Corporate Governance manual is available on the Group's website at <http://www.thephoenixgroup.com>.

The Board has overall responsibility for the Company's systems of internal controls and risk management and for reviewing their effectiveness. This review is carried out annually as part of the Group review. The Group's systems of internal controls are designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

The Group Board monitors internal controls on a continual basis and there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group.

The Company's planning and financial reporting procedures include detailed operational budgets for the year ahead and a five year rolling plan. Performance is monitored and relevant action taken throughout the year through the monthly reporting of key performance indicators (primarily cash flows), updated forecasts for the year together with information on the key risk areas.

Directors

The names of those individuals who served as Directors of the Company during the year or who held office as at the date of signature of this report are as follows:

P L Miles	Appointed	1 January 2011		
J J Yates	Appointed	30 June 2010		
J S B Smith			Resigned	30 June 2010
D Cummins	Appointed	30 June 2010	Resigned	1 January 2011
J S Moss			Resigned	7 February 2011

Secretary

Pearl Group Secretariat Services Limited acted as Secretary throughout the year.

Disclosure of indemnity

Qualifying third party and pension scheme indemnity arrangements (as defined in section 234 and 235 of the Companies Act 2006) were in force for the benefit of the Directors of the Company during the year and remain in place at the date of approval of this report.

Pearl Group Holdings (No.1) Limited

Disclosure of information to auditors

So far as each of the Directors is aware, there is no relevant audit information (as defined in the Companies Act 2006) of which the Company's auditors are unaware, and each of the Directors has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information (as defined) and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418(2) of the Companies Act 2006.

Re-appointment of auditors

In accordance with section 487 of the Companies Act 2006, the Company's auditors, Ernst & Young LLP, will be deemed to have been re-appointed at the end of the period of 28 days following circulation of copies of these financial statements as no notice has been received from members pursuant to section 488 of the Companies Act 2006 prior to the end of the accounting reference period to which these financial statements relate.

On behalf of the Board



P L Miles
Director

16 June 2011

Statement of Directors' responsibilities

The Directors are required to prepare financial statements for each accounting period that comply with the relevant provisions of the Companies Act 2006 and International Financial Reporting Standards as adopted by the European Union ("IFRS"), and which present fairly the financial performance, financial position, cash flows of the Company and the information on the transition to IFRS for the accounting period. A fair presentation of the financial statements in accordance with IFRS requires the Directors to:

- select suitable accounting policies and verify they are applied consistently in preparing the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- state that the Company has complied with applicable IFRSs, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for maintaining proper accounting records which are intended to disclose with reasonable accuracy at any time the financial position of the Company. They are also ultimately responsible for the systems of internal control maintained for safeguarding the assets of the Company and for the prevention and detection of fraud and other irregularities.

Independent auditor's report to the members of Pearl Group Holdings (No.1) Limited

We have audited the financial statements of Pearl Group Holdings (No.1) Limited for the year ended 31 December 2010 which comprise the income statement, statement of comprehensive income, statement of financial position, statement of cash flows, statement of changes in equity and the related notes 1 to 31. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union ("IFRS").

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 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 Statement of Directors' Responsibilities set out on page 5, 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 Directors' Report and financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements 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 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs; 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.

Ernst & Young LLP

George M Reid (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

16 June 2011

Pearl Group Holdings (No.1) Limited

Income statement
for the year ended 31 December 2010

	Notes	2010 £m	2009 £m
Revenue			
Net investment income	4	199	225
Other operating income	5	39	14
Total income		<u>238</u>	<u>239</u>
Administrative expenses	6	(9)	(6)
Total operating expenses		<u>(9)</u>	<u>(6)</u>
Profit before finance costs and tax		<u>229</u>	<u>233</u>
Finance costs	10	(55)	(36)
Profit for the year before tax		<u>174</u>	<u>197</u>
Tax charge	11	(49)	(56)
Profit for the year attributable to owners		<u>125</u>	<u>141</u>

Statement of comprehensive income
for the year ended 31 December 2010

	Notes	2010 £m	2009 £m
Profit for the year		125	141
Other comprehensive income:			
Actuarial gains/(losses) of defined benefit pension scheme	20	14	(151)
Tax credit	11	13	43
		<u>27</u>	<u>(108)</u>
Total comprehensive income for the year		<u>152</u>	<u>33</u>

Pearl Group Holdings (No.1) Limited

Statement of financial position
as at 31 December 2010

	Notes	As at 31 December 2010 £m	As at 31 December 2009 £m	As at 1 January 2009 £m
Equity attributable to owners				
Share capital	12	34	34	34
Share premium	13	1,574	1,541	1,541
Perpetual reset capital securities	14	497	497	497
Retained earnings		1,514	1,410	1,377
Total equity		3,619	3,482	3,449
Non-current liabilities				
Pension scheme deficit	20	-	4	-
Deferred income	15	6	-	-
Deferred tax	16	21	17	57
Total non-current liabilities		27	21	57
Current liabilities				
Current tax		-	-	7
Accruals and deferred income		8	8	2
Deferred income	15	2	-	-
Amounts owed to Group entities	17	61	46	-
Other payables		-	3	2
Derivatives	18	37	64	72
Obligations for repayment of collateral received	19	11	70	-
Total current liabilities		119	191	83
Total liabilities		146	212	140
Total equity and liabilities		3,765	3,694	3,589
Non-current assets				
Pension scheme surplus	20	59	-	137
Pension reimbursement asset	20	74	66	66
Loans and receivables	21	982	963	878
Deferred tax	16	-	1	1
Amounts owed by Group entities	22	7	-	-
Total non-current assets		1,122	1,030	1,082
Current assets				
Amounts owed by Group entities	22	2,472	2,509	2,409
Prepayments and accrued income	23	112	19	27
Derivatives	18	19	63	71
Financial assets	24	25	71	-
Cash and cash equivalents	26	15	2	-
Total current assets		2,643	2,664	2,507
Total assets		3,765	3,694	3,589

On behalf of the Board



P L Miles
Director

16 June 2011

Pearl Group Holdings (No.1) Limited

Statement of cash flows
for the year ended 31 December 2010

	Notes	2010 £m	2009 £m
Cash flows from operating activities			
Cash generated by operations	27	74	19
Net cash flows from operating activities		<u>74</u>	<u>19</u>
Cash flows from investing activities			
Issue of loans to Group entities		(107)	(31)
Acquisition of financial assets			(71)
Proceeds from sale of financial assets		46	-
Repayment of borrowings by Group entities		147	45
Net cash flows from investing activities		<u>86</u>	<u>(57)</u>
Cash flows from financing activities			
Interest paid on derivatives		(55)	(30)
Proceeds from receipt of collateral		-	70
Repayment of collateral		(59)	-
Coupons paid on perpetual reset securities		(33)	-
Net cash flows from financing activities		<u>(147)</u>	<u>40</u>
Net increase in cash and cash equivalents		<u>13</u>	<u>2</u>
Cash and cash equivalents at the beginning of the year		<u>2</u>	<u>-</u>
Cash and cash equivalents at the end of the year	26	<u>15</u>	<u>2</u>

Pearl Group Holdings (No.1) Limited

Statement of changes in equity
for the year ended 31 December 2010

	Share capital (note 12) £m	Share premium (note 13) £m	Perpetual reset capital securities (note 14) £m	Retained earnings £m	Total £m
At 1 January 2010	34	1,541	497	1,410	3,482
Profit for the year	-	-	-	125	125
Other comprehensive income	-	-	-	27	27
Total comprehensive income for the year	-	-	-	152	152
Cancellation of listed perpetual reset capital securities	-	-	(75)	-	(75)
Issue of unlisted perpetual reset capital securities to Group entity	-	-	75	-	75
Issue of shares in settlement of the 2009 deferred coupon	-	33	-	(33)	-
Tax relief on 2009 deferred coupon	-	-	-	9	9
2010 Coupon on perpetual reset capital securities	-	-	-	(33)	(33)
Tax relief on 2010 coupon	-	-	-	9	9
At 31 December 2010	34	1,574	497	1,514	3,619

	Share capital (note 12) £m	Share premium (note 13) £m	Perpetual reset capital securities (note 14) £m	Retained earnings £m	Total £m
At 1 January 2009	34	1,541	497	1,377	3,449
Profit for the year	-	-	-	141	141
Other comprehensive income	-	-	-	(108)	(108)
Total comprehensive income for the year	-	-	-	33	33
At 31 December 2009	34	1,541	497	1,410	3,482

Notes to the financial statements

1. Accounting policies

(a) Basis of preparation

The financial statements have been prepared on a historical cost basis except for those financial assets and financial liabilities that have been measured at fair value.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS").

The financial statements are presented in sterling (£) rounded to the nearest £m except where otherwise stated.

Assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the income statement unless required or permitted by an international financial reporting standard or interpretation, as specifically disclosed in the accounting policies of the Company.

(b) Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Critical accounting estimates are those which involve the most complex or subjective judgements or assessments. The areas of the Company's business that typically require such estimates are the determination of the fair value of financial assets and liabilities, impairment of loans to Group entities, income taxes and pension benefit assets and liabilities.

Fair value of financial assets and liabilities

The fair values of financial assets and liabilities are classified and accounted for as set out in accounting policies (g) and (h). Where possible, financial assets and liabilities are valued on the basis of listed market prices by reference to quoted market bid prices for assets and offer prices for liabilities, without any deduction for transaction costs. These are categorised as Level 1 financial instruments and do not involve estimates. If prices are not readily determinable, fair value is determined using valuation techniques including pricing models, discounted cash flow techniques or broker quotes. Financial instruments valued where valuation techniques are based on observable market data at the period end are categorised as Level 2 financial instruments. Financial instruments valued where valuation techniques are based on non-observable inputs are categorised as Level 3 financial instruments. Level 2 and Level 3 financial instruments therefore involve the use of estimates.

Impairment of loans to Group entities

Loans to Group entities are subject to regular impairment reviews. Impairments on loans are measured as the difference between the carrying value of the loan and its estimated recoverable amount. The recoverable amount is the present value of the estimated future cash flows, excluding future credit losses that have not been incurred, discounted at the loans original effective interest rate. Impairments are recognised in the income statement in the period in which they occur.

Income taxes

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all the available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which the losses can be relieved. The UK taxation regime applies separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets. Any judgements made, and uncertainties considered, in arriving at the carrying value of deferred tax assets and liabilities in the financial statements are discussed in note 16.

The accounting policy for income taxes (both current and deferred taxes) is discussed in more detail in accounting policy (d).

Pension benefit assets and liabilities

The valuation of pension benefit assets and liabilities is determined using actuarial valuations, which involves making assumptions about discount rates, expected return rates on assets, future salary increases, mortality rates and future pension increases. As defined benefit pension plans are long term in nature, such assumptions are subject to significant uncertainty. Details of the key assumptions used are shown in note 20.

(c) Obligations for repayment of collateral received

It is the Company's practice to obtain collateral in respect of derivative transactions, usually in the form of cash or marketable securities. Where collateral is available to the Company for investment purposes it is recognised as a financial asset and the collateral repayable is recognised as 'obligations for repayment of collateral received' in the statement of financial position. The 'obligations for repayment of collateral received' are measured at amortised cost, which in the case of cash is equivalent to cost.

(d) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in the statement of comprehensive income or the statement of changes in equity, in which case it is recognised in these statements.

Current tax is the expected tax payable on the taxable income for the year, using tax rates and laws enacted or substantively enacted at the date of the statement of financial position together with adjustments to tax payable in respect of previous years.

Deferred tax is provided for on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not provided in respect of temporary differences arising from the initial recognition of goodwill and the initial recognition of assets or liabilities in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and laws enacted or substantively enacted at the period end.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(e) Employee benefits

Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Defined benefit scheme

The net surplus or deficit in respect of the defined benefit pension scheme is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine its present value and the fair value of any scheme assets is deducted. The discount rate is the yield at the period end on AA credit rated bonds that have maturity dates approximating to the terms of the Company's obligations. The calculation is performed by a qualified actuary using the projected unit credit method. To the extent that the surplus exceeds the amount that will be utilised over the remaining life of the scheme, a deduction is made from the surplus for tax that would arise on a refund of the surplus.

The movement in the reported surplus/deficit is analysed between the service cost (recognised within administrative expenses in the income statement), the net interest gain or loss on the liabilities less the expected return on assets including any reimbursement assets (recognised within net investment income in the income statement), curtailment gains/losses (recognised within administrative expenses in the income statement) and actuarial gains and losses (recognised in other comprehensive income). All actuarial gains and losses are recognised in full.

Part of the cost of changes in the longevity assumptions of the pension scheme is recoverable from certain with-profit funds to the extent that cash contributions are made to the pension scheme. Recoveries are recognised when the related cash contributions are agreed with the Trustee of the pension scheme and are recognised within other operating income in the income statement.

(f) Amounts owed by Group entities

Amounts owed by Group entities are non derivative financial assets with fixed or determinable payments that are not quoted in an active market. These investments are initially recognised at cost, being the fair value of the consideration paid for the acquisition of the investment. All transaction costs directly attributable to the acquisition are also included in the cost of the investment. Subsequent to initial recognition, these investments are carried at amortised cost, using the effective interest method. Gains and losses are recognised in the income statement through the amortisation process.

The Company assesses at each reporting date whether amounts owed by Group entities are impaired. The Company first assesses whether objective evidence of impairment exists. Evidence of impairment needs to be significant or prolonged to determine that objective evidence of impairment exists. Evidence of impairment is obtained by comparing the carrying value of the amounts owed by Group entities with the present value of the estimated future cash flows, excluding future credit losses that have not been incurred, discounted at the investments original effective interest rate.

(g) Derivatives

Derivative financial instruments are classified as held for trading. They are recognised initially at fair value and subsequently are re-measured to fair value. Exchange-traded derivatives are valued at the published bid price, or, if these are not available, by using valuation techniques such as discounted cash flow models or option pricing models. The gain or loss on re-measurement to fair value is recognised in the income statement.

Fair value estimation

The fair value of financial instruments traded in active markets such as derivatives are based on quoted market prices at the period end. The quoted market price used for financial assets is the current bid price on the trade date. The fair value of investments that are not traded in an active market is determined using valuation techniques such as broker quotes, pricing models or discounted cash flow techniques. Where pricing models are used, inputs are based on market related data at the period end. Where discounted cash flow techniques are used, estimated future cash flows are based on contractual cash flows using current market conditions and market calibrated discount rates and interest rate assumptions for similar instruments.

Collateral

The Company receives and pledges collateral in the form of cash in respect of derivative contracts in order to reduce the credit risk of these transactions. The amount and type of collateral required where the Company receives collateral depends on an assessment of the credit risk of the counterparty.

Collateral received in the form of cash, where the Company has contractual rights to receive the cash flows generated, is recognised as an asset in the statement of financial position with a corresponding liability for its repayment. Non-cash collateral received is not recognised in the statement of financial position, unless the counterparty defaults on its obligations under the relevant agreement.

Cash and non-cash collateral pledged where the Company retains the contractual rights to receive the cash flows generated is not derecognised from the statement of financial position, unless the Company defaults on its obligations under the relevant agreement, and therefore continues to be recognised in the statement of financial position within the appropriate asset classification.

(h) Financial assets

Purchases and sales of financial assets are recognised on the trade date, which is the date that the Company commits to purchase or sell the asset.

Loans and receivables are non derivative financial assets with fixed or determinable payments that are not quoted in an active market. These investments are initially recognised at cost, being the fair value of the consideration paid for the acquisition of the investment. All transaction costs directly attributable to the acquisition are also included in the cost of the investment. Subsequent to initial recognition, these investments are carried at amortised cost, using the effective interest method.

(i) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and short-term deposits with an original maturity term of three months or less at the date of placement.

(j) Dividends

Final dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Company's owners. Interim dividends are deducted from equity when they are paid.

Dividends for the year that are approved after the reporting period are dealt with as an event after the reporting period.

Declared dividends are those that are appropriately authorised and are no longer at the discretion of the entity.

(k) Income recognition

Net investment income comprises interest, dividends, net expected return on pension scheme assets and fair value gains and losses on financial assets and amounts owed by Group entities.

Interest income is recognised in the income statement as it accrues using the effective interest method.

Fair value gains and losses on financial assets designated at fair value through profit or loss are recognised in the income statement. Realised gains and losses are the difference between the net sale proceeds and the original cost. Unrealised gains and losses are the difference between the valuation at the period end and their valuation at the previous period end or purchase price, if acquired during the year.

(l) Finance costs

Interest payable is recognised in the income statement as it accrues and is calculated using the effective interest method.

(m) Share capital

Ordinary share capital

The Company has issued ordinary shares which are classified as equity. Incremental external costs that are directly attributable to the issue of these shares are recognised in the statement of changes in equity, net of tax.

(n) Perpetual Reset Capital Securities

The Perpetual Reset Capital Securities meet the definition of equity for accounting purposes. Accordingly, they are shown at the proceeds of issue and the coupons on the securities are recognised on the date of payment and are charged directly to the statement of changes in equity, net of tax relief.

(o) Events after the reporting period

The financial statements are adjusted to reflect significant events that have a material effect on the financial results and that have occurred between the period end and the date when the financial statements are authorised for issue, provided they give evidence of conditions that existed at the period end. Events that are indicative of conditions that arise after the period end that do not result in an adjustment to the financial statements are disclosed.

2. Financial information

The financial statements for the year ended 31 December 2010, set out on pages 7 to 35, were authorised by the Board of Directors for issue on 16 June 2011. The financial statements have been prepared in accordance with IFRS. The comparative amounts for the year ended 31 December 2009 are based on the Company's financial statements for that year after adjustment for the transition from United Kingdom Generally Accepted Accounting Principles ("UK GAAP") to IFRS.

Information on how the transition to IFRS has affected the financial position, financial performance and cash flows of the Company is set out on pages 29 to 35. This information includes reconciliations of equity and income as reported under UK GAAP to financial information reported under IFRS.

In preparing the financial statements the Company has adopted all applicable standards, interpretations and amendments which have been issued by the International Accounting Standards Board and have been adopted for use by the EU in 2010.

In addition, the Company has adopted the amendments to IAS 24 *Related Party Disclosures*. These amend the definition of a related party, clarify its intended meaning and eliminate inconsistencies and, as permitted, have been early adopted from 2010.

The International Accounting Standards Board has issued the following standards, interpretations and amendments which, subject to adoption for use by the EU, apply from the dates shown. The Company has decided not to early adopt any of these standards, interpretations or amendments where this is permitted. The impact of adopting them is subject to evaluation but is currently not expected to have a material effect on the results of the Company.

- IFRS 9 *Financial Instruments* (2013). IFRS 9 is the first phase of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement* and deals with the classification and measurement of financial assets and financial liabilities, including some hybrid contracts.
- Annual improvements 2010 (2011). This makes a number of minor improvements to existing standards and interpretations.
- Deferred tax: Recovery of Underlying Assets (Amendments to IAS 12) (2012). This provides a practical approach to the measurement of deferred tax liabilities and assets when investment property is measured at fair value, according to whether the entity expects to recover an asset by using or selling it.
- Disclosure – Transfer of Financial Assets (Amendments to IFRS 7) (2012). This revises the required disclosures to help users of financial statements evaluate the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position.

In addition, the following standards, interpretations and amendments have been issued but are not currently relevant to the Company:

- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* (2011).
- Classification of Rights Issues (Amendments to IAS 32) (2011).
- Prepayments of a Minimum Funding Requirement (Amendments to IFRIC 14) (2011).
- Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (Amendments to IFRS 1) (2012).

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3. Segmental analysis

The Company has one reportable segment, comprising intra-group investments. Its revenue principally comprises the interest income derived from these amounts. Information relating to this segment is included in the Company's income statement and statement of financial position on pages 7 and 8.

Revenues from all parties is predominantly sourced in the United Kingdom.

Predominantly all non-current assets are located in the United Kingdom.

4. Net investment income

	2010 £m	2009 £m
Investment income		
Interest income on loans and receivables	163	193
Interest income on financial assets held for trading	53	36
Net expected return on pension scheme assets	-	(4)
	<u>216</u>	<u>225</u>
Fair value losses		
Financial assets at fair value through profit or loss		
Held for trading - derivatives	(17)	-
	<u>(17)</u>	<u>-</u>
Net investment income	<u>199</u>	<u>225</u>

Interest income on loans and receivables includes interest of £163m (2009: £192m) on amounts due from Group entities.

5. Other operating income

	2010 £m	2009 £m
Income received from pension scheme indemnity	37	-
Contributions received from Group entity into defined benefit scheme	-	14
Release of deferred income (note 15)	2	-
	<u>39</u>	<u>14</u>

Income received from pension scheme indemnity

In accordance with an agreement dated November 2005, the with profit funds of Phoenix Life Limited have indemnified the Company in respect of contribution calls equal to their share of the costs of changes in longevity assumptions.

Completion of the 2009 triennial valuation has resulted in a recovery from the with-profit funds of £37 million in respect of the balance due in relation to the cost of changes in longevity assumptions determined by the previous triennial valuation.

The amount will be received over the period to November 2011 and will be paid to the pension scheme as each instalment is received.

6. Administrative expenses

	2010 £m	2009 £m
Professional fees	5	3
Pension scheme - current service cost	4	3
	<u>9</u>	<u>6</u>

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7. Employee information

Employee costs comprise:

	2010 £000	2009 £000
Wages and salaries	164	157
Social security contributions	20	19
	184	176
Average number of persons employed	4	4

All employee related costs for the current and prior years were borne by a fellow subsidiary, Pearl Group Management Services Limited..

8. Directors' remuneration

	2010 £	2009 £
Remuneration (excluding pension contributions and awards under share option schemes and other long-term incentive schemes)	99,140	118,800
Share-based payments	92,307	-
Contributions to money purchase pension schemes	501	2,394
Number of Directors who		
- are members of a defined benefit pension scheme	-	1
- are members of a money purchase pension scheme	2	3
	2010 £	2009 £
Highest paid director's remuneration:	52,601	57,938
Remuneration (excluding pension contributions and awards under share option schemes and other long-term incentive schemes)	52,601	57,938
Contributions to money purchase pension schemes	501	484

The Directors were employed by either Pearl Group Management Services Limited or Pearl Group Services Limited. The total compensation paid to the Directors of the Company relates to qualifying services to the Company, irrespective of which entity within the Phoenix Group has paid the compensation.

For the purposes of this note an apportionment of the total remuneration paid to the Directors of the Company by the Phoenix Group has been made based on an estimate of the services rendered to the Company.

9. Auditor's remuneration

The remuneration receivable by the Company's auditor for auditing the financial statements amounted to £92,000 (2008: £69,000). Auditor's remuneration for the current and prior year was borne by the Company's immediate parent, Impala Holdings Limited.

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10. Finance costs

	2010 £m	2009 £m
Interest expense on financial assets held for trading	<u>55</u>	<u>36</u>

This balance includes interest payable to Group entities on interest rate swaps of £54m (2009: £36m) and £1m of collateral interest and loan raising fees (2009: £nil).

11. Tax charge

Current year tax charge

	2010 £m	2009 £m
Current tax:		
UK Corporation tax	38	41
Adjustment in respect of prior years	-	12
	<u>38</u>	<u>53</u>
Deferred tax:		
Pension scheme movements	15	3
On provisions for future expenditure	(3)	-
Change in the rate of corporation tax	(1)	-
	<u>11</u>	<u>3</u>
Total tax charge	<u>49</u>	<u>56</u>

Tax credited to other comprehensive income

	2010 £m	2009 £m
Deferred tax on actuarial gains of defined benefit schemes	<u>(13)</u>	<u>(43)</u>

Reconciliation of tax charge

	2010 £m	2009 £m
Profit before tax	<u>174</u>	<u>197</u>
Tax at standard UK rate of 28%	49	55
Adjustment to tax charge in respect of prior years	-	12
Movement in unprovided deferred tax	-	(11)
Expenses not deductible for tax purposes	1	-
Effects of change in tax rate	(1)	-
Total tax charge for the year	<u>49</u>	<u>56</u>

12. Share capital

	2010 £m	2009 £m
Issued and fully paid:		
694,108,418 (2009: 687,809,559) ordinary shares of £0.05 each	<u>34</u>	<u>34</u>

The Company's Articles of Association contain a restriction on the number of shares that may be allotted

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Movements in ordinary share capital during the year:

	2010 Number	2010 £m	2009 Number	2009 £m
Share in issue at 1 January	687,809,559	34	687,809,559	34
Shares issued on 27 October 2010 (note 14)	6,298,859	-	-	-
Shares in issue at 31 December	<u>694,108,418</u>	<u>34</u>	<u>687,809,559</u>	<u>34</u>

13. Share premium

	2010 £m	2009 £m
At 1 January	1,541	1,541
Premium on shares issued in the year (note 14)	33	-
At 31 December	<u>1,574</u>	<u>1,541</u>

On 27 October 2010 6,298,859 5p ordinary shares were issued at £5.26 per share giving rise to share premium of £5.21 per share.

14. Perpetual reset capital securities

	Nominal value		Carrying value	
	2010 £m	2009 £m	2010 £m	2009 £m
Perpetual reset capital securities	<u>500</u>	<u>500</u>	<u>497</u>	<u>497</u>

At 31 December 2010, the Company had in issue £425m listed and £75m unlisted 6.5864% Perpetual Reset Capital Securities ("the Notes"), the former are admitted to the Official List of the UK Listing Authority and to trading on the London Stock Exchange.

The Notes are unsecured obligations of the Company and are subordinate to the claims of the Company's senior creditors. Payments in respect of the Notes are conditional upon the Company being solvent at the time of payment and immediately following such payment.

The Notes have no fixed maturity date and interest payments may be deferred at the option of the Company; accordingly the Notes meet the definition of equity for financial reporting purposes. The Notes also meet the conditions for Innovative Tier 1 capital treatment in the calculation of the Group Capital Resources under the rules of the Financial Services Authority ("FSA").

The Notes may be redeemed at par at the option of the Company on the first reset date of 25 April 2016 or on any coupon payment date thereafter. Redemption is subject to the agreement of the FSA. In certain circumstances the Company has the right to substitute the Notes or to redeem the Notes before the first reset date.

Coupons are payable annually in arrears on 25 April, at the rate of 6.5864% per annum, until the first reset date. Thereafter coupons are payable semi-annually at 2.73% per annum over the then prevailing offered rate for six-month sterling deposits.

Prior to 22 April 2010 if the Company opted to defer a coupon payment, then it had the option to either leave the coupon outstanding or satisfy the deferred coupon payment by the issue of securities ("ACSM instruments") by either the Company or a special purpose subsidiary of the Company established for the purpose of issuing ACSM instruments and which were guaranteed by the Company. The obligations of the Company in respect of such securities would be subordinated to and rank or be expressed to rank junior to the Notes as to rights to payments of interest and participation in the assets of the Company in a winding up and should comply with the then current requirements of the FSA in relation to Tier 1 Capital. ACSM instruments would in the first instance be offered to related parties (as defined in the Terms and Conditions of the Notes as amended by the Supplemental Trust Deed dated 30 July 2008) and to third parties if not purchased by related parties. In the event that neither such related parties nor third parties purchased the required ACSM instruments then Pearl Group Holdings (No. 2) Limited was required to use its best endeavours to raise such funds as deemed necessary to purchase the required amounts of ACSM instruments.

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For so long as a deferred coupon payment has not been satisfied the Company may not declare, pay or distribute a dividend on any of its securities in issue ranking junior to the Notes, including the ordinary shares of the Company or any parity securities or, except in particular circumstances, redeem, purchase or otherwise acquire any of its securities in issue ranking junior to the Notes, including its ordinary shares or any parity securities.

On 25 March 2009, the Board of Directors gave notice to the holders of the Notes of its decision to defer the coupon payment on the Notes at the next payment date of 25 April 2009 and the Company indicated that it had no present intention to initiate the ACSM at that time.

On 22 April 2010, the holders of the Notes agreed to a number of amendments to the Notes including a 15% reduction in the face value of the Notes, the amendment of the ACSM, and the imposition of an additional restriction on the payment of dividends by Phoenix Group Holdings if future coupons are deferred. Following these amendments, the Company settled in full on 26 April 2010 the 2010 coupon due on the Notes and settled in full via the issue of ACSM instruments (6,298,859 ordinary shares) the 2009 coupon on 18 November 2010. Both coupon payments were based on the original nominal value of the Notes, being £500 million.

On 22 April 2010 the Company also entered into a balancing instrument under which notes with a principal amount of £75m (equal to the amount of the reduction in principal amount of the Notes) were issued to its ultimate parent company Phoenix Group Holdings for no consideration. The total nominal value of the outstanding perpetual reset capital securities remains at £500m. The terms of such notes are substantially the same as the terms of the Notes except that they are unlisted and are subordinate to the Notes which have a reduced nominal value of £425m and are now referred to as the senior notes.

15. Deferred income

	2010 £m	2009 £m
<i>Deferred income on Pension Scheme</i>		
As at 1 January 2010	-	-
Transfer from Pearl Group Management Services Limited ("PGMS")	10	-
Transfer to income statement	(2)	-
As at 31 December 2010	8	-
Amounts due for settlement after 12 months	2	-

At 1 January 2010 the deferred income provision was transferred from PGMS to the Company as the boards of both entities have approved that the Company will recognise in full the account balances relating to the pension scheme.

The deferred income provision was established to cover the service costs, net interest costs and actuarial gains and losses of the PGL Pension Scheme which were not recoverable from the life funds of other group companies via per policy charges. The provision is being released in line with the terms of the related Management Services Agreement. As at 31 December 2010, the balance of the provision was £8m with £2m being released to the income statement in 2010.

16. Tax assets and liabilities

	2010 £m	2009 £m
Net deferred tax assets	-	1
Total tax assets	-	1
Net deferred tax liabilities	21	17
Total tax liabilities	21	17

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Deferred tax assets comprise:

	2010 £m	2009 £m
Provisions and other temporary differences	-	1
Net deferred tax assets	<u>-</u>	<u>1</u>

Deferred tax liabilities comprise:

	2010 £m	2009 £m
Provisions and other temporary differences	1	-
Pension scheme surplus	20	17
Net deferred tax liabilities	<u>21</u>	<u>17</u>

Movements in deferred tax assets/(liabilities) comprise:

	2010 £m	2009 £m
At 1 January	(16)	(56)
Other movements	(7)	-
Amounts charged to the income statement	(11)	(3)
Amounts credited to the statement of other comprehensive income	13	43
At 31 December	<u>(21)</u>	<u>(16)</u>

Deferred income tax assets are recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable.

A gradual reduction in the UK corporation tax rate from 28% to 24% over 4 years was announced in the Emergency Budget of 22 June 2010 with a further 1% reduction being announced in the Budget of 23 March 2011. The Finance (No. 2) Act 2010 included the first of the 1% rate reductions with effect from April 2011, with further reductions to be dealt with by future legislation. The benefit to the Company's net assets arising from the further 4% reduction of rate is estimated £3 million in total and will be recognised as the legislation is substantively enacted.

17. Amounts owed to Group entities

	2010 £m	2009 £m
Amounts owed to Group entities	<u>61</u>	<u>46</u>
Amounts due for settlement after 12 months	<u>-</u>	<u>-</u>

Amounts owed to Group entities consists of £21m of group relief (2009: £46m) and short-term intragroup borrowings of £40m (2009: £nil).

18. Derivatives

	2010 £m	2009 £m
Derivative liability	<u>37</u>	<u>64</u>
Derivative asset	<u>19</u>	<u>63</u>

The derivative assets and liabilities are to hedge the exposure to interest rate movements.

The derivative asset and a derivative liability of £19m have a termination date of 14 May 2011, with the balance of the derivative liability of £18m having a termination date of 31 October 2013. They are categorised as level 2 financial instruments as their fair value is determined using a valuation technique based on observable market data at the year end.

There were no transfers between level 1 and level 2 instruments during the year (2009: nil).

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19. Obligations for repayment of collateral received

	2010 £m	2009 £m
Carrying value: At 31 December	11	70
Amount due for settlement after 12 months	-	-

20. Pension scheme

The PGL Pension Scheme comprises a final salary section and a defined contribution section.

Defined contribution scheme

Contributions in the year amounted to £4m (2009: £4m)

Defined benefit scheme

The Company and a fellow subsidiary undertaking of Impala Holdings Limited, Pearl Group Management Services Limited ("PGMS"), are joint sponsoring employers of the Scheme. The defined benefit section of the Scheme is a final salary arrangement which is generally closed to new entrants and in respect of former members of the Phoenix Life Group Pension Scheme (which merged with the Scheme in 2006) to future service accrual.

From 1 January 2010, the Boards of PGH1 and PGMS agreed that PGH1 would recognise, in full, the pension scheme in respect of which they are joint sponsoring employers. As a result the 2009 comparatives have been restated.

The valuation has been based on an assessment of the liabilities of the PGL Scheme as at 31 December 2010, undertaken by independent qualified actuaries. Following the UK Government's announcement in the summer of 2010, the inflation index used to derive statutory pension increases (which for the Pearl Scheme applies to deferred pension benefits) has been changed from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI). Due to a number of differences between the indices, including both constituents and construction, CPI is expected to be less than RPI over the long-term and thus the scheme liabilities have reduced. The reduction in the scheme liabilities has been estimated at £16 million as at 31 December 2010; this has been treated as an assumption change and recognised within actuarial gains in other comprehensive income.

The present values of the defined benefit obligation and the related current service costs have been measured using the projected unit credit method.

A triennial valuation of the PGL Scheme as at 30 June 2009 was completed in September 2010. This showed a deficit on the funding basis as at 30 June 2009 of £255m compared with the previous triennial valuation deficit of £69m. Following discussions with the Trustee of the PGL Scheme it was agreed that new cash contributions to the scheme amounting to £159m would be paid over the period from September 2010 to August 2017.

Together with the outstanding contributions of £28m due to the scheme as at the end of August 2010 following the previous triennial valuation, this totalled £187m, of which it was agreed that £50m would be paid in 2010, £30m in each of 2011 and 2012, £22m in 2013, £15m in each of 2014, 2015 and 2016 and £10m in 2017. Contributions of £10m were made to the scheme in the period up to the end of August 2010 and a further £50m was contributed as described above, giving a total contribution for the year of £60m.

In accordance with an agreement dated November 2005, certain of the with-profit funds of Phoenix Life Limited have indemnified the Company in respect of contribution calls equal to their share of the costs of changes in longevity assumptions. Completion of the triennial valuation has resulted in a recovery from the with-profit funds of £37m, together with interest, in respect of the balance due in relation to the cost of changes in longevity assumptions determined by the previous triennial valuation.

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The principal financial assumptions of the PGL Scheme are set out below.

	2010	2009
Rate of general long-term increase in salaries	4.45%	4.60%
Rate of increase in pensions in payment	3.30%	3.50%
Rate of increase for deferred pensions (2010: CPI, 2009: RPI)	2.95%	3.60%
Discount rate	5.40%	5.70%
Inflation – RPI	3.45%	3.60%
Inflation – CPI	2.95%	n/a
Expected rate of return on scheme assets	5.10%	5.40%

The discount rate and inflation assumptions used for the calculation of the liabilities have been determined by considering the shape of the appropriate yield curves and the duration of the PGL Scheme liabilities. This method determines an equivalent single rate for both the discount and inflation rates, which is derived from the profile of projected benefit payments.

The expected rate of return on scheme assets is derived after considering historical returns and assuming that asset classes with higher volatility generate higher returns (consistent with widely accepted capital market principles). The overall expected return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation.

It has been assumed that post-retirement mortality is in line with standard tables PNA00 with a scaling factor of 105% being applied, allowing for future improvements in line with the long cohort improvement factors, subject to a minimum improvement from 2007 onwards of 1.25% p.a. and 0.75% p.a. for males and females respectively. Under these assumptions, the average life expectancy from retirement for a member currently aged 40 retiring at age 60 is 31.2 years and 32.3 years for male and female members respectively. The average life expectancy from retirement for a member currently aged 60 retiring at age 60 is 28.5 years and 30.6 years for male and female members respectively.

The value of the PGL Scheme assets as at 31 December 2010 amounted to £1,326m (2009: £1,192m) and the value of the surplus amounted to £59m (2009: deficit of £4m).

The amounts recognised in the income statement are as follows:

	2010 £m	2009 £m
Current service cost	(4)	(3)
Interest cost	(63)	(56)
Expected return on scheme assets	63	52
	<u>(4)</u>	<u>(7)</u>

The net actuarial gains and losses recognised in other comprehensive income comprise the following:

	2010 £m	2009 £m
Actual return less expected return on scheme assets	89	50
Experience (loss)/gain arising on scheme liabilities	(23)	13
Loss due to changes in assumptions underlying scheme liabilities	(20)	(214)
	46	(151)
Change in provision for tax on the economic surplus available as a refund	(32)	-
Actuarial gains/(losses)	<u>14</u>	<u>(151)</u>

The cumulative net actuarial gains recognised in other comprehensive income since 1 January 2009 amounted to a loss of £137 million (2009: £151m loss).

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The surplus recognised in the statement of financial position is as follows:

	2010 £m	2009 £m
Fair value of scheme assets, net of reimbursement asset	1,252	1,126
Present value of defined benefit obligation	<u>(1,193)</u>	<u>(1,130)</u>
Surplus/(deficit)	<u>59</u>	<u>(4)</u>

The actual return on the scheme assets comprises the following:

	2010 £m	2009 £m
Expected return on scheme assets	63	52
Actual return less expected return on scheme assets	<u>89</u>	<u>50</u>
	<u>152</u>	<u>102</u>

The change in the present value of the defined benefit obligation is as follows:

	2010 £m	2009 £m
At 1 January	1,130	918
Current service cost	4	3
Interest cost	63	56
Actuarial gains	42	201
Benefits paid	<u>(46)</u>	<u>(48)</u>
At 31 December	<u>1,193</u>	<u>1,130</u>

The defined benefit obligation arises from plans that are wholly or partly funded.

The change in the fair value of the scheme assets is as follows:

	2010 £m	2009 £m
At 1 January	1,192	1,121
Expected return on scheme assets	63	52
Actuarial gain on scheme assets	89	50
Provision for tax on the surplus available as a refund	(32)	-
Contributions by the employer	60	17
Benefits paid	<u>(46)</u>	<u>(48)</u>
At 31 December	<u>1,326</u>	<u>1,192</u>

The distribution of the scheme assets at the end of the year was as follows:

	2010 £m	2009 £m
Bonds	1,128	995
Properties	123	110
Cash and other	33	21
Provision for tax on the surplus available as a refund	<u>(32)</u>	<u>-</u>
	<u>1,252</u>	<u>1,126</u>

Contributions totalling £30m are expected to be paid into the scheme in 2011.

The pension scheme has rights under non-qualifying insurance policies issued by Group entities, and are therefore disclosed separately from the other plan assets. The fair value of the rights under these contracts are:

	2010 £m	2009 £m
Reimbursement asset – insurance policies held with related parties	<u>74</u>	<u>66</u>

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Table of historical information

	2010 £m	2009 £m
Fair value of scheme assets	1,326	1,192
Defined benefit obligation	<u>(1,193)</u>	<u>(1,130)</u>
Surplus	<u>133</u>	<u>62</u>
Experience gains on scheme assets	<u>89</u>	<u>50</u>
Experience (losses)/gains on scheme liabilities	<u>(23)</u>	<u>13</u>

21. Loans and receivables

	2010 £m	2009 £m
Cost		
At 1 January	963	878
Additions	<u>19</u>	<u>85</u>
At 31 December	<u>982</u>	<u>963</u>
Impairment		
At 1 January and 31 December	<u>-</u>	<u>-</u>
Carrying amount		
At 31 December	<u>982</u>	<u>963</u>

- a. On 1 August 2008 the Company provided a loan to Impala Holdings Limited of £736m. The loan accrues interest at six month LIBOR plus 2.94% which is capitalised half yearly on 7 April and 7 October. Interest of £15m (2009: £53m) was capitalised during the year. The loan has a maturity date of December 2016. The amount outstanding at 31 December 2010 was £816m (2009: £801m).
- b. On 4 December 2008 the Company provided a loan to Pearl Life Holdings Limited of £55m. The loan accrues interest at six month LIBOR plus 2.94% which is capitalised half yearly on 7 April and 7 October. Interest of £2m (2009: £3m) was capitalised during the year. The loan has a maturity date of December 2016 or can be repaid as agreed between the borrower and the Company. The amount outstanding at 31 December 2010 was £60m (2009: £58m).
- c. On 26 September 2008 the Company provided a loan to Pearl Life Holdings Limited of £45m. The loan accrues interest at 12 month LIBOR plus 2.00% which is capitalised annually on 31 December. Interest of £2m (2009: £3m) was capitalised during the year. The loan has a maturity date of December 2016 or can be repaid as agreed between the borrower and the Company. The amount outstanding at 31 December 2010 was £50m (2009: £48m).
- d. In September 2007, the Company granted a revolving credit facility of £110m to Pearl Group Management Services Limited. During the year there has been no further drawn down (2009: £26m) and as at 31 December 2010 the total drawn down balance is £56m. Interest is paid and is calculated at six month LIBOR plus 2.00%. Repayment of the loan is subject to a number of detailed provisions. The amount outstanding at 31 December 2010 was £56m (2009: £56m).

The carrying value of these loans approximates to their fair value.

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22. Amounts owed by Group entities

	2010 £m	2009 £m
Amounts owed by Group entities	<u>2,479</u>	<u>2,509</u>
Amounts due to be settled after 12 months	<u>7</u>	<u>-</u>

Included in the balance are:

- a. A short term inter-company balance with Phoenix Customer Care Limited, a fellow subsidiary of the Group, exists with the Company. The balance outstanding at 31 December 2010 was £1m (2009: £1m).
- b. In 2008, the Company entered into an agreement with Impala Holdings Limited and Pearl Life Holdings Limited whereby from 1 May 2008, any of those parties could lend to or borrow from each other as agreed. During the year, under this agreement, the Company lent £33m (2009: £59m) to Impala Holdings Limited and received repayments of £41m. Interest on these loans accrues at six month LIBOR plus 2.94% which is capitalised half yearly on 7 April and 7 October. Interest of £2m (2009: £2m) was capitalised during the year. The balance as at 31 December 2010 was £53m (2009: £59m).
- c. In 2008, the Company entered into an agreement with Impala Holdings Limited and Pearl Life Holdings Limited whereby from 1 May 2008, any of those parties could lend to or borrow from each other as agreed. During the year, under this agreement, the Company lent £nil (2009: £29m) to Pearl Life Holdings Limited and received repayments of £25m. Interest on these loans accrues at six month LIBOR plus 2.94% which is capitalised half yearly on 7 April and 7 October. Interest of £1m (2009: £1m) was capitalised during the year. The balance as at 31 December 2010 was £5m (2009: £29m).
- d. On 31 December 2008 the Company disposed of the entire issued share capital of its investments in subsidiaries to Impala Holdings Limited. £1,842m was left outstanding as an interest bearing intra-group loan. The loan accrues interest at 6 month LIBOR plus 3.42% which is capitalised half yearly on 30 June and 31 December. Interest of £7m (2009: £103m) was capitalised during the year. The loan is repayable upon demand but has a final maturity date of December 2016. The amount outstanding at 31 December 2010 was £1,926m (2009: £1,919m).
- e. On 1 January 2010 as part of the transfer of accounting of the PGL Pension Scheme, the pension indemnity asset from Phoenix Life Limited ("PLL"), which arose from the 2006 triennial valuation, was transferred to the Company from Pearl Group Management Services Limited. The value of the indemnity transferred on 1 January 2010 to the Company was £29m. This is due to be paid to the Company by June 2012. The amount outstanding at 31 December 2010 was £17m (2009: £nil); £7m of this is due in greater than 12 months (2009: £nil).
- f. As part of the 2009 triennial valuation, PLL has further indemnified the Phoenix Group owners in respect of contribution calls – see note 20. The value of the indemnity recognised in 2010 was £45m, of which £34m was received in 2010. The amount outstanding at 31 December 2010 was £11m (2009: £nil) and this is due to be paid by November 2011.
- g. At 31 December 2010, the balance of the £2,943m loan facility issued to Pearl Life Holdings Limited on 31 August 2006 remained at £7m (2009: £7m). The loan is repayable on demand.
- h. In November 2005, the Company granted a loan of £459m to Pearl Life Holdings Limited. Interest is calculated at 7% per annum and is payable annually on 31 December. The loan is repayable on demand. The amount outstanding at 31 December 2010 was £459m (2009: £459m).
- i. At 31 December 2009, the Company was owed £35m by various group entities on short-term intragroup borrowings. All of these amounts were settled to the Company in 2010.

The carrying value of these loans approximates to their fair value.

23. Prepayments and accrued income

	2010 £m	2009 £m
Accrued interest	<u>112</u>	<u>19</u>
Amounts due to be settled after 12 months	<u>-</u>	<u>-</u>

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24. Financial assets

	2010 £m	2009 £m
Financial assets at fair value through profit or loss		
Collective investment schemes	25	71
Amount recoverable after 12 months	-	-

25. Financial instrument fair value hierarchy

The collective investment schemes are categorised as Level 1 financial instruments. The fair value of Level 1 financial instruments traded in active markets (such as publicly traded securities and derivatives) is based on quoted market prices at the period end. The quoted market price used for financial assets is the current bid price on the trade date. If the bid price is unavailable a 'last traded' approach is adopted. For units in unit trusts and shares in open ended investment companies, fair value is by reference to published bid values.

The derivative assets are categorised as level 2 financial instruments as their fair value is determined using a valuation technique based on observable market data at the year end.

There were no transfers between level 1 and level 2 instruments during the year (2009: nil).

There were no level 3 financial instruments in 2010 or 2009.

There were no gains or losses recognised in other comprehensive income.

26. Cash and cash equivalents

	2010 £m	2009 £m
Bank and cash balances	15	2

All deposits are subject to fixed interest rates. The carrying amounts approximate to fair value at the period end.

27. Cash flows from operating activities

	2010 £m	2009 £m
Profit for the year before tax	174	197
Adjustments to reconcile profit for the year to net cash inflow from operating activities		
Net investment income	(124)	(191)
Finance costs	55	36
Other operating income	(2)	(14)
Net expected return on pension scheme assets	-	4
Pension scheme – current service cost	4	3
Unrealised loss on financial instruments	17	-
Changes in operating assets and liabilities	(50)	(16)
Cash generated by operations	74	19

28. Capital and risk management

The Company's capital comprises share capital and all reserves. At 31 December 2010 total capital was £3,619m (2009: £3,482m). The increase in the period reflects the total comprehensive income arising in the period of £152m (2009: £33m), the increase in share premium of £33m (2009: £nil), offset by coupon payment, net of tax relief, on the Notes of £48m (2009: £nil).

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There are no externally imposed capital requirements on the Company. The Company's capital is monitored by the Directors and managed on an on-going basis via a monthly close process to ensure that it remains positive at all times.

The principal risks and uncertainties facing the Company are:

- interest rate risk, since the movement in interest rates will impact the value of interest payable and receivable by the Company. An increase of 1% in interest rates, all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year and in equity of £32m (2009: £21m). A decrease of 1% in interest rates with all other variables held constant would result in an additional loss after tax in respect of a full financial year and in equity of £32m (2009: £21m).
- liquidity risk, exposure to liquidity risk as a result of normal business activities, specifically the risk arising from an inability to meet short-term cash flow requirements and this is monitored on an ongoing basis;
- credit risk, arising from the default of the counterparty to a particular financial asset and is significantly reduced as assets are primarily intercompany receivables from other group entities; and
- longevity risk in the pension scheme, arising from faster than expected improvements in life expectancy on the pensions of the members of the Scheme.

The Company's exposure to all these risks is monitored by the Directors, who agree policies for managing each of these risks on an ongoing basis.

29. Related party transactions

The Company enters into transactions with related parties in its normal course of business. These are at arm's length on normal commercial terms, apart from the issue of the Notes to its ultimate parent undertaking for no consideration – see note 14. The Company has also guaranteed the performance of a guarantee issued by a fellow subsidiary – see note 30.

In the year ended 31 December 2010 the Company received interest on loans to its fellow subsidiaries of £32m (2009: £nil), capitalised interest on loans to its fellow subsidiaries of £5m (2009: £7m) and capitalised interest on loans to its immediate parent of £25m (2009: £159m). As part of the amendments to the Notes, on 22 April 2010 the Company also entered into a balancing instrument under which notes with a principal amount of £75m were issued to its ultimate parent company, Phoenix Group Holdings, for no consideration. The Company has entered into two derivative contracts with two fellow subsidiaries. During the year, the Company paid interest under these contracts of £54m (2009: £36m).

Amounts due to related parties

	2010	2009
	£m	£m
Other amounts due to fellow subsidiaries	98	110

Amounts due from related parties

	2010	2009
	£m	£m
Loans due from parent	2,795	2,778
Other amounts due from parent	-	7
Loans due from fellow subsidiaries	637	658
Other amounts due from fellow subsidiaries	29	41

Key management compensation

The total compensation allocated to the Company and payable to employees classified as key management, which comprises the Directors, is disclosed in note 8.

Parent and ultimate parent entity

Information on the Company's parent and ultimate parent is given in note 31.

30. Pension scheme guarantee

The Company has guaranteed the performance by another Group entity of a guarantee given by Pearl Life Holdings Limited to the Trustee of the PGL Pension Scheme ('the Scheme') in respect of the obligations and liabilities of the participating employers to make payments to the Scheme. The principal obligations that are subject to the guarantee are cash contributions totalling £137m, which are payable in instalments over the period to August 2017.

31. Other information

The Company's principal place of business is the United Kingdom. The Company's immediate parent is Impala Holdings Limited and its ultimate parent is Phoenix Group Holdings, a company incorporated in the Cayman Islands and resident in Jersey. A copy of the financial statements of Phoenix Group Holdings can be obtained from the Company Secretary, 1st Floor, 32 Commercial Street, St Helier, Jersey, JE2 3RU.

Transition to International Financial Reporting Standards

Introduction

The financial statements set out on pages 7 to 28 are the Company's first annual financial statements prepared in accordance with International Financial Reporting Standards as adopted by the EU ("IFRS"). The accounting policies set out on pages 11 to 14 have been applied in preparing the financial statements for the year ended 31 December 2010 and for preparing an opening IFRS statement of financial position as at 1 January 2009, the date of transition from UK GAAP to IFRS.

An explanation of how the transition from UK GAAP to IFRS has affected the Company's financial position and financial performance for 2009 is set out in the following tables and accompanying notes. Under UK GAAP the Company was exempt from presenting a cash flow statement.

The following information is set out below in relation to the transition from UK GAAP to IFRS:

1. The selection of IFRS accounting policies that have been applied in preparing the results for 2010.
2. An explanation of the principal classification changes to the assets and liabilities as at 1 January 2009 and 31 December 2009 and total comprehensive income for the year to 31 December 2009.
3. An explanation of the changes to the measurement of assets and liabilities as at 1 January 2009 and 31 December 2009, their effect on equity and total comprehensive income for the year ended 31 December 2009.
4. An explanation of the changes to the recognition of assets and liabilities as at 1 January 2009 and 31 December 2009, their effect on equity and total comprehensive income for the year ended 31 December 2009.
5. Summary tables showing the financial impact of the above changes on total comprehensive income for the year to 31 December 2009, and equity, liabilities and assets as at 1 January 2009 and 31 December 2009.

1. Selection of accounting policies

Certain International Financial Reporting Standards permit entities to choose between alternative accounting treatments. The principal choices that have been made by the Company are set out below.

Employee benefits

IAS 19 *Employee Benefits* permits actuarial gains and losses arising on defined benefit pension schemes to be reported either in other comprehensive income or to be partially deferred under what is known as the 'corridor' approach. The International Accounting Standards Board has stated its intention to withdraw the corridor approach. The Company has elected to report all defined benefit pension scheme actuarial gains and losses directly in the statement of other comprehensive income and not to take advantage of the option to adopt the corridor approach.

IAS 19 *Employee Benefits* also permits the net interest cost to be recognised as investment income/expense or as an administrative expense. The Company has opted to recognise the net interest income/expense as investment income/expense.

There are no classification or measurement changes as a result of selecting this particular approach in accounting for employee benefits.

2. IFRS classification changes (column 2)

The principal classification changes at 1 January 2009 are as follows (see column 2 in the transition tables below). These have no effect on equity.

- Investment income of £237m and investment expenses and charges of £45m reported in the year ended 31 December 2009 under UK GAAP have been classified as net investment income of £228m and finance costs of £36m in the IFRS income statement for the comparative period to 31 December 2009.
- Deferred tax assets of £1m (31 December 2009: £1m) have been reclassified from current assets to non-current assets.
- The pension scheme surplus has been grossed up by £7m (31 December 2009: £4m) for deferred tax. Under UKGAAP the pension scheme surplus was presented net of the related deferred tax.
- Rights under non-qualifying insurance policies held in the pension scheme are shown separately in the statement of financial position. The value of these rights at 1 January 2009 was £66m and £66m at 31 December 2008. The impact of this change is reduce the pension surplus at 1 January 2009 to £137m and to show a pension deficit of £4m at 31 December 2009.
- Two intragroup loans totalling £466m at 1 January 2009 and 31 December 2009, and an intragroup loan of £1,919m at 31 December 2009 (1 January 2009: £1,842m) have been reclassified from Loans and receivables to Amounts owed by Group entities.

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- The interest accrued on intragroup indebtedness previously included under Amounts due from group undertakings is now shown under Prepayments and accrued income. The impact is £24m at 1 January 2009 and £12m at 31 December 2009.
- Other receivables of £7m at 31 December 2009 (1 January 2009: £3m) are now shown under Prepayments and accrued income.
- Current taxation of £8m at 31 December 2009 (1 January 2009: £nil) is now shown under Amounts owed to group entities.

3. Measurement changes – pension scheme (column 4)

In comparison with UK GAAP, IFRS requires the following:

- Cash contributions to the scheme are recognised on a paid basis rather than the accruals basis;
- The requirement to restrict the amount of surplus to its recoverable amount only applies if the entity does not have an unconditional right to recover the surplus. This does not apply to the Company's pension scheme and therefore the surplus has been recognised in full.
- To the extent that the surplus exceeds the amount that will be utilised over the remaining life of the scheme, the scheme itself rather than the Company is liable for tax on the surplus, currently at the rate of 35%. This reduces the amount of surplus that the Company can recognise.
- Insurance policies held by scheme which are not qualifying insurance policies are not considered to be plan assets, and have to be shown separately in the statement of financial position.

The aggregate effect of the above on the PGL pension scheme is to increase the pension scheme surplus by £48m (31 December 2009: £nil), recognise a deferred tax liability of £14m (31 December 2009: £nil), increase equity as at 1 January 2009 by £34m (31 December 2009: £nil) and to recognise actuarial losses on the pension scheme of £48m and deferred tax of £14m and a net charge of £34m in the statement of comprehensive income for the year ended 31 December 2009. The value of non-qualifying insurance policies at 1 January 2009 and 31 December 2009 was £66m.

4. Recognition adjustments – pension scheme (Column 5)

On transition from UK GAAP to IFRS, the Company has recognised in full the Group's interest in the PGL Pension Scheme rather than it being partly recognised in the Company and partly in Pearl Group Management Services Limited. This has the effect of increasing the pension scheme surplus by £129m (31 December 2009: £46m), deferred tax by £36m (31 December 2009: £13m), equity as at 1 January 2009 by £93m (31 December 2009: £33m) and of recognising a charge of £60m in the statement of comprehensive income for the year ended 31 December 2009. The net charge to the statement of comprehensive income for the year ended 31 December 2009 consists of a net expected charge on pension assets of £3m recognised within net investment income, contributions received of £14m recognised within other operating income, current service costs of £1m recognised within administrative expenses and associated tax charge of £3m recognised in the income statement, along with actuarial losses on pension scheme of £93m and associated tax credit of £26m recognised within other comprehensive income.

5. Transition tables

Statement of total comprehensive income for the year ended 31 December 2009

	UK GAAP As previously reported under UK GAAP Col 1 £m	IFRS classifica- tion changes Col 2 £m	IFRS As reclassified Col 3 £m	IFRS Measurement changes Col 4 £m	IFRS Recognition adjustment Col 5 £m	IFRS As reported under IFRS Col 6 £m
Revenue	237	(237)	-	-	-	-
Investment income	-	228	228	-	(3)	225
Net investment income	-	-	-	-	14	14
Other operating income	237	(9)	228	-	11	239
Total income	(5)	-	(5)	-	(1)	(6)
Administrative expenses	(45)	45	-	-	-	-
Investment expenses and charges	(50)	45	(5)	-	(1)	(6)
Total operating expenses	187	36	223	-	10	233
Profit/(loss) before finance costs and tax	-	(36)	(36)	-	(3)	(36)
Finance costs	(53)	-	(53)	-	(3)	(56)
Tax charge	134	-	134	-	7	141
Profit for the year	(10)	-	(10)	(48)	(93)	(151)
Other comprehensive income:	3	-	3	14	26	43
Actuarial losses of defined benefit pension scheme						
Tax credit						
Total comprehensive income for the year	127	-	127	(34)	(60)	33

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Statement of Financial Position - Equity and liabilities as at 1 January 2009

	UK GAAP As previously reported under UK GAAP Col 1 £m	IFRS classifica- tion changes Col 2 £m	IFRS As reclassified Col 3 £m	IFRS Measurement changes Col 4 £m	IFRS Recognition adjustment Col 5 £m	IFRS As reported under IFRS Col 6 £m
Equity and liabilities						
Share capital	34	-	34	-	-	34
Share premium	1,541	-	1,541	-	-	1,541
Perpetual reset capital securities	497	-	497	-	-	497
Retained earnings	1,250	-	1,250	34	93	1,377
Total equity	3,322	-	3,322	34	93	3,449
Non-current liabilities						
Deferred tax	-	7	7	14	36	57
Total non-current liabilities	-	7	7	14	36	57
Current liabilities						
Current tax	7	-	7	-	-	7
Amounts owed to Group entities	2	-	2	-	-	2
Other payables	2	-	2	-	-	2
Derivatives	72	-	72	-	-	72
Obligations for repayment of collateral received	-	-	-	-	-	-
Total current liabilities	83	-	83	-	-	83
Total liabilities	83	7	90	14	36	140
Total equity and liabilities	3,405	7	3,412	48	129	3,589

Statement of Financial Position - Assets as at 1 January 2009

	UK GAAP As previously reported under UK GAAP Col 1 £m	IFRS classifica- tion changes Col 2 £m	IFRS As reclassified Col 3 £m	IFRS Measurement changes Col 4 £m	IFRS Recognition adjustment Col 5 £m	IFRS As reported under IFRS Col 5 £m
Non-current assets						
Pension scheme surplus	19	7	26	(18)	129	137
Pension reimbursement asset	-	-	-	66	-	66
Loans and receivables	3,186	(2,308)	878	-	-	878
Deferred tax	1	-	1	-	-	1
Total non-current assets	3,206	(2,301)	905	48	129	1,082
Current assets						
Amounts owed by Group entities	125	2,284	2,409	-	-	2,409
Prepayments and accrued income	-	27	27	-	-	27
Other receivables	3	(3)	-	-	-	-
Investments	-	-	-	-	-	-
Derivatives	71	-	71	-	-	71
Cash and cash equivalents	-	-	-	-	-	-
Total current assets	199	2,308	2,507	-	-	2,507
Total assets	3,405	7	3,412	48	129	3,589

Statement of Financial Position - Equity and liabilities as at 31 December 2009

	UK GAAP As previously reported under UK GAAP Col 1 £m	IFRS classifica- tion changes Col 2 £m	IFRS As reclassified Col 3 £m	IFRS Measurement changes Col 4 £m	IFRS Recognition adjustment Col 5 £m	IFRS As reported under IFRS Col 6 £m
Equity and liabilities						
Share capital	34	-	34	-	-	34
Share premium	1,541	-	1,541	-	-	1,541
Perpetual reset capital securities	497	-	497	-	-	497
Retained earnings	1,377	-	1,377	-	33	1,410
Total equity	3,449	-	3,449	-	33	3,482
Non-current liabilities						
Pension scheme deficit	-	-	-	4	-	4
Deferred tax	-	4	4	-	13	17
Total non-current liabilities	-	4	4	4	13	21
Current liabilities						
Current tax	8	(8)	-	-	-	-
Amounts owed to Group entities	46	8	54	-	-	54
Other payables	3	-	3	-	-	3
Derivatives	64	-	64	-	-	64
Obligations for repayment of collateral	70	-	70	-	-	70
Total current liabilities	191	-	191	-	-	191
Total liabilities	191	4	195	4	13	212
Total equity and liabilities	3,640	4	3,644	4	46	3,694

Statement of Financial Position - Assets as at 31 December 2009

	UK GAAP As previously reported under UK GAAP Col 1 £m	IFRS classifica- tion changes Col 2 £m	IFRS As reclassified Col 3 £m	IFRS Measurement changes Col 4 £m	IFRS Recognition adjustment Col 5 £m	IFRS As reported under IFRS Col 5 £m
Non-current assets						
Pension scheme surplus	12	4	16	(62)	46	-
Pension reimbursement asset	-	-	-	66	-	66
Loans and receivables	3,348	(2,385)	963	-	-	963
Deferred tax	1	-	1	-	-	1
Total non-current assets	3,361	(2,381)	980	4	46	1,030
Current assets						
Amounts owed by Group entities	136	2,373	2,509	-	-	2,509
Prepayments and accrued income	-	19	19	-	-	19
Other receivables	7	(7)	-	-	-	-
Investments	71	-	-	-	-	71
Derivatives	63	-	63	-	-	63
Cash and cash equivalents	2	-	73	-	-	2
Total current assets	279	2,385	2,664	-	-	2,664
Total assets	3,640	4	3,644	4	46	3,694