# PEARL GROUP HOLDINGS (NO. 2) LIMITED

**Company Registration Number: 05282342**

DIRECTORS' REPORT AND FINANCIAL STATEMENTS
for the year ended 31 December 2015

**Contents** **Page**

**Strategic report**

The Directors present the Strategic report of Pearl Group Holdings (No. 2) Limited ('the Company'), for the year ended 31 December 2015.

***Principal activities***
The principal activity of the Company is that of an investment company. This will continue to be the principal activity for the foreseeable future.

***Corporate activity***

***Result and dividends***
The results of the Company for the year are shown in the income statement on page 6. The profit before tax was £47.5m (2014: £61.0m).

During the year no dividends were paid (2014: £399.8m dividend).

***Position as at 31 December 2015***
The net assets of the Company at 31 December 2015 were £1,488.7m (2014: £1,563.2m). The decrease in the period reflects the total comprehensive income arising in the period of £75.5m (2014: £208.8m), less loans repaid that were designated as equity instruments of £150.0m (2014: £nil), interest paid on subordinated loans treated as equity of £nil (2014: £18.7m) and dividends paid of £nil (2014: £399.8m).

***Principal risks and uncertainties***
The Phoenix Group applies a consistent methodology for the identification, assessment, management and reporting of risk that includes a high level framework for the management of key risks within each business unit.

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;
- credit risk, arising from the default of the counterparty to a particular financial asset. Credit risk is significantly reduced as financial assets are primarily cash and short term deposits, which are placed with high credit rated banks, and inter-company receivables from other group entities; and
- longevity risk in the pension scheme, 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.

**On behalf of the Board**

Jas Mcconville

J McConville
Director
15 June 2016

**Directors' report**

The Directors present their report and the financial statements of the Company for the year ended 31 December 2015.

The Company is incorporated in the United Kingdom as a private limited company. Its registration number is 05282342 and its Registered Office is 1 Wythall Green Way, Wythall, Birmingham, B47 6WG.

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

***Going concern***
Having reviewed the position in 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 preparing the financial statements.

**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:

F Clutterbuck
J McConville
R Thakrar

**Secretary**
G A Watson 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.

**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 they ought to have taken as a Director to make themselves 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**

Jeremy McConville

J McConville
Director
15 June 2016

**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 and cash flows of the Company 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. 2) Limited**

We have audited the financial statements of Pearl Group Holdings (No.2) Limited for the year ended 31 December 2015 which comprise the Income statement, the Statement of comprehensive income, the Statement of financial position, the Statement of cash flows, the Statement of changes in equity and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) 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 Statement of Directors' responsibilities set out on page 4, 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 Strategic report and the Directors' 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.

**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 2015 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.

Ernst & Young LLP

Ed Jervis (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

16 June 2016

**Income statement**
for the year ended 31 December 2015

| | Notes | 2015 £m | 2014 £m |
|---|---|---|---|
| **Revenue** | | | |
| Net investment income | 3 | 128.4 | 197.6 |
| **Total income** | | 128.4 | 197.6 |
| Administrative expenses | 4 | (7.7) | (27.4) |
| Impairment of investments in subsidiaries | 20 | (30.6) | (61.1) |
| **Total operating expenses** | | (38.3) | (88.5) |
| **Profit before finance costs and tax** | | 90.1 | 109.1 |
| Finance costs | 8 | (42.6) | (48.1) |
| **Profit for the year before tax** | | 47.5 | 61.0 |
| Tax credit | 9 | 25.9 | 16.6 |
| **Profit for the year attributable to owners** | | 73.4 | 77.6 |

**Statement of comprehensive income**
for the year ended 31 December 2015

| | Notes | 2015 £m | 2014 £m |
|---|---|---|---|
| **Profit for the year** | | 73.4 | 77.6 |
| **Other comprehensive income** | | | |
| Actuarial gain of pension scheme | 14 | 6.5 | 129.6 |
| Deferred tax (charge)/credit | 9 | (4.4) | 1.6 |
| | | 2.1 | 131.2 |
| **Total comprehensive income for the year attributable to owners** | | 75.5 | 208.8 |

**Statement of financial position**
as at 31 December 2015

| | Notes | As at 31 December 2015 £m | As at 31 December 2014 £m |
|---|---|---|---|
| **Equity attributable to owners** | | | |
| Share capital | 11 | 806.0 | 806.0 |
| Capital contribution | 12 | 9.0 | 9.0 |
| Subordinated loans | 13 | - | 150.0 |
| Retained earnings | | 673.7 | 598.2 |
| **Total equity** | | 1,488.7 | 1,563.2 |
| **Non-current liabilities** | | | |
| Long-term borrowings | 15 | 252.4 | 438.4 |
| **Total non-current liabilities** | | 252.4 | 438.4 |
| **Current liabilities** | | | |
| Short-term borrowings | 17 | 964.3 | 874.2 |
| Accruals and deferred income | 18 | 2.8 | 7.3 |
| Amounts due to Group entities | 19 | 4.4 | 6.4 |
| Other payables | | - | 8.0 |
| Current tax | 16 | 2.0 | 5.7 |
| **Total current liabilities** | | 973.5 | 901.6 |
| **Total liabilities** | | 1,225.9 | 1,340.0 |
| **Total equity and liabilities** | | 2,714.6 | 2,903.2 |
| **Non-current assets** | | | |
| Investments in subsidiaries | 20 | 2,040.2 | 2,070.8 |
| Pension scheme surplus | 14 | 104.8 | 55.7 |
| Loans and receivables | 21 | 444.1 | 679.9 |
| Deferred tax | 16 | 40.5 | 53.5 |
| **Total non-current assets** | | 2,629.6 | 2,859.9 |
| **Current assets** | | | |
| Amounts due by Group entities | 22 | 21.8 | 14.3 |
| Other receivables | | 0.1 | 0.1 |
| Financial assets | 23 | 63.1 | 28.9 |
| Cash and cash equivalents | 24 | - | - |
| **Total current assets** | | 85.0 | 43.3 |
| **Total assets** | | 2,714.6 | 2,903.2 |

On behalf of the Board

Jeo Mc Caven

J McConville
Director
15 June 2016

**Statement of cash flows**
for the year ended 31 December 2015

| | Notes | 2015 £m | 2014 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash absorbed by operations | 25 | (33.2) | (35.7) |
| **Net cash flows from operating activities** | | (33.2) | (35.7) |
| **Cash flows from investing activities** | | | |
| Repayment of borrowing by Group entities | | - | 4.1 |
| Dividends received from Group entities | | - | 90.0 |
| Issue of loans to Group entities | | - | (225.7) |
| Acquisition of financial assets | | (33.3) | (14.4) |
| Repayment of capital contribution by Group entity | | - | 100.0 |
| **Net cash flows from investing activities** | | (33.3) | (46.0) |
| **Cash flows from financing activities** | | | |
| Loans received from Group entities | | 83.4 | 410.8 |
| Repayment of borrowings from Group entities | | - | (287.0) |
| Interest paid on subordinated loans treated as equity | | - | (23.8) |
| Interest paid on borrowings from Group entities | | (16.9) | (25.9) |
| **Net cash flows from financing activities** | | 66.5 | 74.1 |
| **Net decrease in cash and cash equivalents** | | - | (7.6) |
| Cash and cash equivalents at the beginning of the year | | - | 7.6 |
| **Cash and cash equivalents at the end of the year** | 24 | - | - |

**Supplementary disclosures on cash flow from operating activities**

| | 2015 £m | 2014 £m |
|---|---|---|
| Interest received | 15.4 | 19.7 |

**Statement of changes in equity**
for the year ended 31 December 2015

| | Share capital (note 11) £m | Capital contribution (note 12) £m | Sub-ordinated loans (note 13) £m | Retained earnings £m | Total £m |
|---|---|---|---|---|---|
| **At 1 January 2015** | 806.0 | 9.0 | 150.0 | 598.2 | 1,563.2 |
| Profit for the year | - | - | - | 73.4 | 73.4 |
| Other comprehensive income | - | - | - | 2.1 | 2.1 |
| Total comprehensive income for the year | - | - | - | 75.5 | 75.5 |
| Perpetual subordinated loan notes paid | - | - | (150.0) | - | (150.0) |
| **At 31 December 2015** | 806.0 | 9.0 | - | 673.7 | 1,488.7 |

| | Share capital (note 11) £m | Capital contribution (note 12) £m | Sub-ordinated loans (note 13) £m | Retained earnings £m | Total £m |
|---|---|---|---|---|---|
| **At 1 January 2014** | 806.0 | 9.0 | 150.0 | 807.9 | 1,772.9 |
| Profit for the year | - | - | - | 77.6 | 77.6 |
| Other comprehensive income | - | - | - | 131.2 | 131.2 |
| Total comprehensive income for the year | - | - | - | 208.8 | 208.8 |
| Interest paid on subordinated loans, net of tax relief | | | | (18.7) | (18.7) |
| Dividends paid (note 10) | - | - | - | (399.8) | (399.8) |
| **At 31 December 2014** | 806.0 | 9.0 | 150.0 | 598.2 | 1,563.2 |

Included in retained earnings are reserves of £466.8m (2014: £351.6m) which are considered distributable.

**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.

The financial statements are separate financial statements and the exemptions in paragraph 10 of IAS 27 *Consolidated and Separate Financial Statements* and section 401 of the Companies Act 2006 have been used not to present consolidated financial statements. The results of the Company are consolidated into the accounts of the Company's ultimate parent Phoenix Group Holdings, a company incorporated in the Cayman Islands and resident in Jersey.

***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 £0.1m 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, impairment tests for investments in and loans to Group entities, income taxes and pensions 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 policy (g). 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 investments in subsidiaries and loans to Group entities***

Investments in subsidiaries and loans (excluding contingent loans) to Group entities are subject to regular impairment reviews when management are aware of objective evidence of impairment. Impairments of investments in subsidiaries are measured at the difference between the carrying value of a particular asset and its value in use (Life businesses) and recoverable amount (other holding entities). Impairments on loans are measured as the difference between the carrying value of the loan and 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. The Company's policy in relation to impairment testing of investments in subsidiaries and loans to Group entities is detailed in accounting policies (f) and (g) respectively.

1. **Accounting policies (continued)**

***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 values of deferred tax assets and liabilities in the financial statements are discussed in note 17.

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 14.

**(c) Borrowings**
Interest-bearing borrowings are recognised initially at fair value less any attributable transaction costs. The difference between initial cost and the redemption value is amortised through the income statement over the period of the borrowing using the effective interest method.

**(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 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, except to the extent that it relates to items recognised in the statement of changes in equity, in which case it is recognised in that statement.

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

**Defined benefit pension schemes**
The net surplus or deficit (the economic 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.

As required by IFRIC 14, IAS 19 –The limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction to the extent that the economic surplus will be available as a refund, the economic surplus is stated after a provision for tax that would be borne by the scheme administrators when the refund is made. Additionally under IFRIC 14 pension funding contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable will not be available to the Company after they are paid into the scheme, a liability is recognised when the obligation arises. The net defined benefit asset/liability represents the economic surplus net of all adjustments noted above.

**1. Accounting policies (continued)**

**(e) Employee benefits (continued)**
The Company determines the net interest expense or income on the net defined benefit asset/liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit asset/liability. 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 Phoenix Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

The movement in the net defined benefit asset/liability is analysed between the service cost, past service cost, curtailments and settlements (all recognised within administrative expenses in the income statement), the net interest cost on the net defined benefit asset/liability, including any reimbursement assets (recognised within net investment income in the income statement), remeasurements of the net defined asset/liability (recognised in other comprehensive income) and employer contributions.

**(f) Investments in subsidiaries**
Investments in shares in subsidiaries are carried in the statement of financial position at cost less impairment.

The Company assesses at each reporting date whether an investment in a subsidiary or group of investments in subsidiaries is 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 investment in the subsidiary with the value in use (Life businesses) and recoverable amount (other holding entities) of the subsidiary.

**(g) 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.

Equities, fixed and variable rate income securities and collective investment schemes are designated at fair value through profit or loss and accordingly are stated in the statement of financial position at fair value. They are designated at fair value through profit or loss because they are managed and evaluated on a fair value basis in accordance with the Company's stated risk management policies. These instruments are recognised initially at fair value (transaction costs are expensed) and subsequently are re-measured to fair value.

***Impairment of financial assets***
The Company assesses at each period end whether a financial asset or group of financial assets held at amortised cost is impaired. The Company first assesses whether objective evidence of impairment exists for financial assets. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in the collective assessment of impairment.

***Fair value estimation***
The fair value of financial instruments traded in active markets such as publicly traded securities and 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.

For units in unit trusts and shares in open-ended investment companies, fair value is by reference to published bid-values. The fair value of receivables and floating rate and overnight deposits with credit institutions is their carrying value. The fair value of fixed interest-bearing deposits is estimated using discounted cash flow techniques.

**(h) Contingent loans**
Contingent loans are amounts lent to other Group entities, the recoverability of which is contingent on uncertain future events. They are designated as fair value through profit and loss with changes in the fair value being measured by reference to changes in the value of the contingent loan liability recognised by the other group undertaking.

**1. Accounting policies (continued)**

**(i) 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 statement of comprehensive income.

**(j) 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.

**(k) Share capital and capital contributions**

***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.

***Capital contributions***
Capital contributions received by the Company and which contain no restrictions are recognised directly in the statement of changes in equity as a distributable reserve.

**(l) Subordinated loans treated as equity**
Certain subordinated loans meet the definition of equity for accounting purposes. Accordingly, they are shown at the proceeds of issue and interest payments are recognised on the date of payment and charged directly to the statement of changes in equity, net of tax relief.

**(m) 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.

**(n) Income recognition**
Net investment income comprises interest, dividends, net expected return on pension scheme assets and fair value gains and losses on financial assets.

Interest income is recognised in the income statement as it accrues using the effective interest method. Dividend income is recognised in the income statement on the date the right to receive payments is established, which in the case of listed securities is the ex-dividend date.

Fair value gains and losses on financial assets designated as 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.

**(o) Finance costs**
Interest payable is recognised in the income statement as it accrues and is calculated using the effective interest method. The treatment of interest payable on subordinated loans treated as equity is set out in accounting policy (l).

**(p) 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.

**(q) Segmental reporting**
The Company has one reportable segment. It is exempt from providing an analysis of operating segments as required by IFRS 8 *Operating Segments*.

## 2. Financial information

The financial statements for the year ended 31 December 2015, set out on pages 6 to 30 were authorised by the Board of Directors for issue on 15 June 2016.

In preparing the financial statements the Company has adopted the following standards, interpretations and amendments which have been issued by the International Accounting Standards Board ('IASB') and have been adopted for use by the EU. None of the following have a material effect on the results of the Company.

- Annual Improvements 2010 – 2012 cycle; and
- Annual Improvements 2011 – 2013 cycle.

The IASB has issued the following new or amended standards and interpretations which 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 on the Group of adopting them is subject to evaluation:

- IFRS 9 Financial Instruments (2018). This standard will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 was originally issued in November 2009 and introduced new requirements for the classification and measurement of financial assets. The standard was subsequently amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition and in November 2013 to include new requirements for general hedge accounting. Another revised version was issued in July 2014 to include a) an expected credit loss impairment model (to replace the incurred loss model of IAS 39) and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' option for certain simple debt instruments. Under IFRS 9, all financial assets will be measured either at amortised cost or fair value and the basis of classification will depend on the contractual cash flow characteristics and the business model of the financial assets. The Company currently expects that the application of IFRS 9 in the future is unlikely to have a material impact on the measurement and presentation of amounts reported in respect of the Company's financial assets and liabilities. The Company expects to continue to value the majority of its financial assets at fair value through profit or loss on initial recognition, so as to eliminate or reduce any potential accounting mismatch. The expected impact remains subject to completion of a detailed review.
- IFRS 15 Revenue from Contracts with Customers (2018). IFRS 15 establishes a single comprehensive framework for determining whether, how and when revenue is recognised. The Company anticipates that the application of IFRS 15 in the future is likely to have limited impact on the measurement and presentation of amounts reported in respect of the Company's financial statements.
- Annual Improvements to IFRS 2012-2014 cycle (2016).
- Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38) (2016).
- Disclosure initiative (Amendments to IAS 1)(2016).
- Disclosure initiative (Amendments to IAS 7)(2017).
- Recognition of Deferred tax assets for unrealised losses (Amendments to IAS 12)(2017).
- IFRS 16 Leases (2019). IFRS 16 will replace IAS 17 Leases. The new standard removes the classification of leases as either operating or finance leases for the lessee, thereby treating all leases as finance leases. This will result in the recognition of a right-to use asset and a lease liability for all of the Company's previously classified operating leases. The recognition of depreciation and an interest cost will result in a decreasing cost over the term of the lease compared to a straight line allocation of the lease rentals. Short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements. The Company anticipates that the application of IFRS 16 in the future is likely to have limited impact on amounts reported in respect of the Company's financial statements.

## 3. Net investment income

| | 2015 £m | 2014 £m |
|---|---|---|
| Investment income | | |
| Interest income on loans and receivables | 23.1 | 34.6 |
| Dividend income | 100.0 | 166.1 |
| Interest income on financial assets designated at fair value through profit or loss on initial recognition | 1.7 | - |
| Net expected return on pension assets | 2.7 | (4.5) |
| | 127.5 | 196.2 |
| Fair value gains | | |
| Financial assets at fair value through profit or loss | | |
| Designated upon initial recognition | 0.9 | 1.4 |
| Net investment income | 128.4 | 197.6 |

Interest income on loans and receivables includes interest of £23.1m (2014: £34.6m) on loans to Group entities. Dividend income includes dividends in specie from subsidiaries of £100.0m (2014: £166.1m, £90.0m in cash and £76.1m in specie).

## 4. Administrative expenses

| | 2015 £m | 2014 £m |
|---|---|---|
| Service and project costs | 15.5 | 19.0 |
| Professional fees | 0.2 | 0.4 |
| Other | (8.0) | 8.0 |
| | 7.7 | 27.4 |

Included within other administration expenses is the release of an £8.0m provision in respect of EBT income tax (2014: £8.0m provision).

## 5. Employee information

The Company has no employees. Services are provided by Pearl Group Management Services Limited and Pearl Group Services Limited.

## 6. Directors' remuneration

| | 2015<br>£ | 2014<br>£ |
|---|---|---|
| Salaries and other short-term benefits | 79,628 | 55,030 |
| Remuneration (excluding pension contributions and awards under share option schemes and other long-term incentive schemes) | 79,628 | 55,030 |
| Share-based payments | 42,758 | 29,890 |
| Contributions to money purchase pension schemes | 1,143 | 812 |
| Number of Directors who are members of a money purchase pension scheme | 1 | 1 |
| Number of Directors who exercised share options during the year | 3 | 2 |

The Directors are 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.

## 7. Auditors' remuneration

The remuneration of the auditors of the Company included in the financial statements was £0.1m (2014: £0.1m).

## 8. Finance costs

| | 2015<br>£m | 2014<br>£m |
|---|---|---|
| Interest expense on borrowings at amortised cost | 42.6 | 48.1 |

Interest expense on borrowings includes interest of £42.6m (2014: £48.1m) on loans from Group entities.

## 9. Tax credit

### *9.1. Current year tax credit*

| | 2015<br>£m | 2014<br>£m |
|---|---|---|
| **Current tax** | | |
| UK Corporation tax | (16.2) | (23.2) |
| Adjustments in respect of prior years | (18.3) | (0.3) |
| **Total Current tax** | (34.5) | (23.5) |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | 8.6 | 7.4 |
| Change in the rate of UK corporation tax | - | (0.5) |
| **Total Deferred tax** | 8.6 | 6.9 |
| Total tax credit | (25.9) | (16.6) |

**9. Tax credit (continued)**

***9.2. Tax charged/(credited) to other comprehensive income***

| | 2015 £m | 2014 £m |
|---|---|---|
| Deferred tax on re-measurement of net defined benefit schemes | 4.4 | (1.6) |

***9.3. Reconciliation of tax credit***

| | 2015 £m | 2014 £m |
|---|---|---|
| Profit before tax | 47.5 | 61.0 |
| Tax at standard UK rate of 20.25% (2014: 21.5%) | 9.6 | 13.1 |
| Non-taxable income and gains | (22.5) | (37.5) |
| Disallowable expenses | 0.7 | 0.8 |
| Adjustment to shareholder tax charge in respect of prior years | (18.3) | (0.3) |
| Deferred tax rate change | - | (0.5) |
| Temporary differences not valued | (1.6) | 1.7 |
| Previously unrecognised temporary differences now valued | - | (7.0) |
| Non-taxable impairment of investments in subsidiaries | 6.2 | 13.1 |
| Total tax credit for the year | (25.9) | (16.6) |

The prior year tax credit represents the impact of reaching agreement with HMRC in respect of the Entity's uncertain tax position for the years 2009-2014.

**10. Dividends on ordinary shares**

| | 2015 £m | 2014 £m |
|---|---|---|
| Interim dividends paid | - | 399.8 |

During the year no dividends were paid (2014: £399.8m dividend).

**11. Share capital**

| | 2015 £m | 2014 £m |
|---|---|---|
| Issued and fully paid: 806,000,020 (2014: 806,000,020) ordinary shares of £1 each | 806.0 | 806.0 |

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

**12. Capital contribution**

| | 2015 £m | 2014 £m |
|---|---|---|
| At 1 January and 31 December | 9.0 | 9.0 |

The capital contribution reserve has been treated as a distributable reserve with no restrictions.

## 13. Subordinated loans

| | 2015 | 2014 |
|---|---|---|
| | £m | £m |
| Carrying value | | |
| At 1 January | 150.0 | 150.0 |
| Disposals | (150.0) | - |
| At 31 December | - | 150.0 |
| Fair value | | |
| At 31 December | - | 150.0 |

The Company received a perpetual subordinated loan of £150.0m from Phoenix Life Holdings Limited. As this loan had no fixed maturity date and interest payments may be deferred at the option of the Company, it met the definition of equity for financial reporting purposes. Interest of £nil (2014: £23.8m) was paid on this loan in the year.

On 28 May 2015, this loan due by the Company was offset against a loan due from Phoenix Life Holdings Limited (see note 21) and cancelled.

***Determination of fair value and fair value hierarchy of subordinated loans***

Subordinated loans are categorised as Level 3 financial instruments. The fair value of subordinated loans with no external market is determined by internally developed discounted cash flow models using a risk adjusted discount rate corroborated with external market data where possible.

There were no level 1 or level 2 subordinated loans in 2015 or 2014.

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

## 14. Pension scheme

***Scheme details***

The Pearl Group Staff Pension Scheme ('the Pearl Scheme') comprises a final salary section, a money purchase section and a hybrid section (a mix of final salary and money purchase). The final salary and hybrid sections of the Pearl Scheme are closed to new members, and since 1 July 2011 are also closed to future accrual by active members.

***Defined contribution scheme***

Contributions in the year amounted to £0.6m (2014: £0.6m).

***Defined benefit scheme***

The defined benefit scheme is funded by payment of contributions to a separately administered trust fund. The Pearl Scheme is established under, and governed by, the trust deeds and rules. The Company is the principal employer of the Pearl Scheme. The principal employer meets the administration expenses of the Pearl Scheme.

The Pearl Scheme is administered by a separate Trustee company, P.A.T. (Pensions) Ltd, which is legally separate from the Company. The Trustee company is comprised of two representatives from the Phoenix Group, three member nominated representatives and one independent trustee in accordance with the Trustee company's articles of association. The Trustee is required by law to act in the interest of all relevant beneficiaries and is responsible for the investment policy with regard to the assets.

To the extent that an economic surplus will be available as a refund, the economic surplus is stated after a provision for tax that would be borne by the scheme administrators when the refund is made. Additionally pension funding contributions are considered to be a minimum funding requirement and, to the extent that the contributions payable will not be available to the Company after they are paid into the scheme, a liability is recognised when the obligation arises.

The valuation has been based on an assessment of the liabilities of the Pearl Scheme as at 31 December 2015, undertaken by independent qualified actuaries. The present values of the defined benefit obligation and the related interest costs have been measured using the projected unit credit method.

**14. Pension scheme (continued)**

***Funding***

A triennial funding valuation of the Pearl Scheme as at 30 June 2012 was completed in May 2013. This showed a deficit as at 30 June 2012 of £480.0m, on the agreed technical provisions basis.

On 27 November 2012 the principal employer and the Trustee of the Pearl Scheme entered into a revised pensions funding agreement (the 'Pensions Agreement'), which forms the basis of the 30 June 2012 triennial valuation. The principal terms of the Pensions Agreement are:

- annual cash payments into the scheme of £70.0 m in 2013 and 2014 were payable on 30 September, followed by payments of £40.0m each year from 2015 to 2021. The Pensions Agreement includes a sharing mechanism that in certain circumstances allows for an acceleration of the contributions to be paid to the Pearl Scheme;

- increased and further contributions may become payable if the scheme is not anticipated to meet the two agreed funding targets:

    i) to reach full funding on the technical provisions basis by 30 June 2022; and
    ii) to reach full funding on a gilts flat basis by 30 June 2031;

- the Trustee continues to benefit from a first charge over shares in Phoenix Life Assurance Limited, National Provident Life Limited, Pearl Group Services Limited and PGS2 Limited. Following the repayment of a £425.0m loan facility and £75.0m of secured C loan notes owed by the Phoenix Group the value of the security claim granted under the share charges is capped at the lower of £600.0m and 100% of the the Pearl Scheme deficit (calculated on a basis linked to UK government securities) revalued every three years thereafter, increasing from 60% of the Pearl Scheme deficit;

- covenant tests relating to the embedded value of certain companies within the Phoenix Group.

An additional liability of £74.4m (2014: £85.9m) has been recognised, reflecting a charge on any refund of the resultant IAS 19 surplus that arises after adjustment for discounted future contributions of £212.7m (2014: £245.4m) in accordance with the minimum funding requirement. A deferred tax asset of £34.9m (2014: £49.1m) has also been recognised to reflect tax relief at a rate of 18% (2014: 20%) that is expected to be available on the contributions, once paid into the Pearl Scheme.

Contributions totalling £40.0m are expected to be paid into the Pearl Scheme in 2016.

## 14. Pension scheme (continued)

***Summary of amounts recognised in the financial statements***

The amounts recognised in the financial statements are as follows:

| | Fair Value of Scheme Assets £m | Defined benefit obligation £m | Provision for tax on the economic surplus - available as a refund £m | Minimum funding requirement obligation £m | Total £m |
|---|---|---|---|---|---|
| **At 1 January 2015** | 2,278.7 | (2,060.9) | (76.2) | (85.9) | 55.7 |
| Interest income/(expense) | 82.0 | (73.4) | (2.8) | (3.1) | 2.7 |
| Included in profit or loss | 82.0 | (73.4) | (2.8) | (3.1) | 2.7 |
| **Remeasurements:** | | | | | |
| Return on plan assets excluding amounts included in interest income | (84.5) | - | - | - | (84.5) |
| Loss from change in demographic assumptions | - | (0.4) | - | - | (0.4) |
| Gain from change in financial assumptions | - | 55.4 | - | - | 55.4 |
| Experience gains | - | 38.9 | - | - | 38.9 |
| Change in provision for tax on economic surplus available as a refund | - | - | (17.5) | - | (17.5) |
| Change in minimum funding requirement obligation | - | - | - | 14.6 | 14.6 |
| Included in other comprehensive income | (84.5) | 93.9 | (17.5) | 14.6 | 6.5 |
| Employers contributions | 40.0 | - | - | - | 40.0 |
| Benefit payments | (103.4) | 103.4 | - | - | - |
| **At 31 December 2015** | 2,212.8 | (1,937.0) | (96.5) | (74.4) | 104.9 |

**14. Pension scheme (continued)**

| | Fair Value of Scheme Assets £m | Defined benefit obligation £m | Provision for tax on the economic surplus available as a refund £m | Minimum funding requirement obligation £m | Total £m |
|---|---|---|---|---|---|
| **At 1 January 2014** | 1,854.8 | (1,907.6) | - | (84.3) | (137.1) |
| Interest income/(expense) | 83.3 | (83.9) | - | (3.9) | (4.5) |
| Past service cost | - | - | - | - | - |
| Included in profit or loss | 83.3 | (83.9) | - | (3.9) | (4.5) |
| **Remeasurements:** | | | | | |
| Return on plan assets excluding amounts included in interest income | 360.0 | - | - | - | 360.0 |
| Gain from change in demographic assumptions | - | 18.7 | - | - | 18.7 |
| Loss from change in financial assumptions | - | (194.8) | - | - | (194.8) |
| Experience losses | - | 19.6 | - | - | 19.6 |
| Change in provision for tax on economic surplus available as a refund | - | - | (76.2) | - | (76.2) |
| Change in minimum funding requirement obligation | - | - | - | 2.3 | 2.3 |
| Included in other comprehensive income | 360.0 | (156.5) | (76.2) | 2.3 | 129.6 |
| Employers contributions | 67.7 | - | - | - | 67.7 |
| Benefit payments | (87.1) | 87.1 | - | - | - |
| **At 31 December 2014** | 2,278.7 | (2,060.9) | (76.2) | (85.9) | 55.7 |

**14. Pension scheme (continued)**

***Scheme assets***

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

| | 2015 Total £m | 2015 Of which not quoted in an active market £m | 2014 Total £m | 2014 Of which not quoted in an active market £m |
|---|---|---|---|---|
| Hedging portfolio | 1,891.4 | (24.0) | 1,914.3 | (15.8) |
| Obligations for repayment of stock lending collateral received | (1,226.8) | - | (1,166.8) | - |
| Equities | 121.7 | - | 120.2 | - |
| Debt securities | 940.8 | - | 1,075.3 | - |
| Properties | 191.0 | 191.0 | 170.3 | 170.3 |
| Fixed interest gilts | 129.8 | - | - | - |
| Private equities | 34.2 | 34.2 | 36.8 | 36.8 |
| Hedge funds | 31.6 | 31.6 | 38.2 | 38.2 |
| Cash and other | 99.1 | - | 90.4 | - |
| | 2,212.8 | 232.8 | 2,278.7 | 229.5 |

The actual loss on plan assets was £2.5m (2014: £443.1m return on plan assets).

The Company ensures that the investment positions are managed within an asset liability matching (ALM) framework that has been developed to achieve long-term investments that are in line with the obligations under the pension scheme. Within this framework an allocation of 25% of the scheme assets is invested in collateral for interest rate and inflation rate hedging where the intention is to hedge greater than 90% of the interest rate and inflation rate risk measured on the Technical Provision basis. The hedge ratio will be further increased to 100% when market conditions appear favourable.

The Pearl Scheme uses swaps, UK Government bonds and UK Government stock lending to hedge the interest rate and inflation exposure arising from the liabilities and are disclosed in the table above as 'Hedging Portfolio' assets. Under the Scheme's stock lending programme the Scheme lends a Government bond to an approved counterparty and receives a similar value in the form of cash in return which is typically reinvested into other gilts. The Scheme retains economic exposure to the Government bond hence the bonds continue to be recognised as scheme assets with a corresponding liability to repay the cash received as disclosed in the table above.

***Defined benefit obligation***

The calculation of the defined benefit obligation can be allocated to the scheme's members as follows:

Deferred scheme members: 40.0% (2014: 40.0%)

Retirees: 60.0% (2014: 60.0%)

The weighted average duration of the defined benefit obligation at 31 December 2015 is 17 years (2014: 17 years).

***Principal assumptions***

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

| | 2015 % | 2014 % |
|---|---|---|
| Rate of increase for pensions in payment (5% per annum or RPI if lower) | 2.95 | 2.90 |
| Rate of increase for deferred pensions (CPI) | 2.05 | 2.00 |
| Discount rate | 3.85 | 3.65 |
| Inflation – RPI | 3.05 | 3.00 |
| Inflation – CPI | 2.05 | 2.00 |

### 14. Pension scheme (continued)

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

It has been assumed that post-retirement mortality is in line with a scheme-specific table which was derived from the actual mortality experience in recent years, performed as part of the actuarial funding valuation as at 30 June 2012, based on the SAPS standard tables for males and for females based on year of use. Future longevity improvements are in line with current Company best estimate longevity improvements, which are based on CMI 2012 Core Projections and a long-term rate of improvement of 2% p.a. up to and including age 75 then decreasing linearly to 0% p.a. at age 110. Under these assumptions, the average life expectancy from retirement for a member currently aged 40 retiring at age 60 is 30.8 years and 33.0 years for male and female members respectively.

A quantitative sensitivity analysis for significant actuarial assumptions as at 31 December 2015 is shown below:

| Assumptions | Base | Discount rate | | Retail Price Index | | Life expectancy | |
|---|---|---|---|---|---|---|---|
| Sensitivity level | | 25bps increase | 25bps decrease | 25bps increase | 25bps decrease | 1 year increase | 1 year decrease |
| | £m | £m | £m | £m | £m | £m | £m |
| Impact on the defined benefit obligation at 31 December 2015 | 1,937.0 | (71.1) | 75.1 | 54.3 | (51.7) | 54.3 | (53.6) |
| Impact on the defined benefit obligation at 31 December 2014 | 2,060.9 | (78.9) | 84.1 | 53.2 | (50.4) | 54.6 | (53.2) |

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method has been applied as when calculating the pension liability recognised within the statement of financial position.

The UK Government currently intends to equalise benefits between males and females arising from the accrual of Guaranteed Minimum Pension ('GMP') requirements. Legislation will be implemented following completion of the current consultation on this matter. Once this consultation process has reached a conclusion, the Company will be able to quantify the impact of this change.

### 15. Long-term borrowings

| | 2015 £m Carrying value | 2014 £m Carrying value | 2015 £m Fair value | 2014 £m Fair value |
|---|---|---|---|---|
| (i) Loan from Phoenix Life Holdings Limited | - | 100.0 | - | 100.0 |
| (ii) Loan from Phoenix Life Assurance Limited | 252.4 | 338.4 | 252.4 | 338.4 |
| Total long-term borrowings | 252.4 | 438.4 | 252.4 | 438.4 |

(i) The Company received a subordinated loan from Phoenix Life Holdings Limited ('PhLHL'). Interest on the loan accrued at a rate of LIBOR plus a margin of 11% per annum, payable annually on 2 September. The loan had a maturity date of 2 September 2019. Interest of £nil (2014: £11.9m) was paid during the year.

On 28 May 2015, the loan to the Company was offset against a loan due from PhLHL (see note 21) and cancelled.

(ii) The Company received a loan from Phoenix Life Assurance Limited . Interest on the loan accrues at a rate of LIBOR plus a margin of 3.5% and is capitalised semi-annually on 30 June and 31 December. The loan has a maturity date of 31 December 2018. Interest of £14.0m was capitalised during the year (2014: £17.5m). During the year £100.0m of the outstanding amount was repaid via in-specie dividend (2014: £190.0m repaid).

## 15. Long-term borrowings (continued)

***Determination of fair value and fair value hierarchy of long-term borrowings***

Long-term borrowings are categorised as Level 3 financial instruments. The fair value of long-term borrowings with no external market is determined by internally developed discounted cash flow models using a risk adjusted discount rate corroborated with external market data where possible.

There were no level 1 or level 2 long-term borrowings in 2015 or 2014.

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

## 16. Tax assets and liabilities

| | 2015 £m | 2014 £m |
|---|---|---|
| **Current tax** | | |
| Current tax payable | (2.0) | (5.7) |
| **Deferred tax** | | |
| The balances at 31 December comprise: | | |
| Deferred tax assets | 40.5 | 53.5 |

***Deferred tax assets comprise:***

| | 2015 £m | 2014 £m |
|---|---|---|
| Pension scheme deficit | 38.3 | 49.1 |
| Provisions and other temporary differences | 2.2 | 4.4 |
| Net deferred tax assets | 40.5 | 53.5 |

***Movement in deferred tax assets and liabilities:***

Year ended 31 December 2015

| | 1 Jan | Recognised in the income statement £m | Recognised in other comprehensive income £m | 31 Dec £m |
|---|---|---|---|---|
| Provisions and other temporary differences | 4.4 | (2.2) | - | 2.2 |
| Committed future pension contributions | 49.1 | (6.4) | (4.4) | 38.3 |
| | 53.5 | (8.6) | (4.4) | 40.5 |

**16. Tax assets and liabilities (continued)**

Year ended 31 December 2014

| | 1 Jan | Recognised in the income statement £m | Recognised in other comprehensive income £m | 31 Dec £m |
|---|---|---|---|---|
| Provisions and other temporary differences | - | 4.4 | - | 4.4 |
| Committed future pension contributions | 58.8 | (11.3) | 1.6 | 49.1 |
| | 58.8 | (6.9) | 1.6 | 53.5 |

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

The Finance Act 2014 set the rate of Corporation Tax at 20% from 1 April 2015. Finance (No. 2) Act 2015 reduces the rate of corporation tax to 19% in April 2017 and 18% from April 2020. Consequently, a blended rate of tax has been used for the purposes of providing for deferred tax in these consolidated financial statements. A further 1% reduction to 17% effective from April 2020 has been announced in the 2016 Budget and will be introduced by further legislation.

| | 2015 £m | 2014 £m |
|---|---|---|
| Deferred tax assets have not been recognised in respect of: | | |
| Tax losses carried forward | 16.2 | 28.7 |
| Provisions and other temporary differences | - | 1.6 |

**17. Short-term borrowings**

| | 2015 Carrying value £m | 2014 Carrying value £m | 2015 Fair value £m | 2014 Fair value £m |
|---|---|---|---|---|
| i) Loan from Pearl Assurance Group Holdings | 764.0 | 680.6 | 764.0 | 680.6 |
| ii) Loan from Phoenix Life Assurance Limited | 107.6 | 103.1 | 107.6 | 103.1 |
| iii) Loan from Phoenix Life Assurance Limited | 92.7 | 90.5 | 92.7 | 90.5 |
| Total short-term borrowings | 964.3 | 874.2 | 964.3 | 874.2 |

(i) The Company entered into a facility with Pearl Assurance Group Holdings Limited. Interest accrues at a rate of LIBOR plus a margin of 1.75% and is payable semi-annually on 31 May and 30 November. The facility is repayable on demand. Interest of £16.9m was paid during the year (2014: £14.0m). During the year the Company repaid £nil on this facility (2014: £97.0m) and was advanced £83.4m (2014: £220.8m).

(ii) The Company received a loan of £100.0m from Phoenix Life Assurance Limited ('PLAL'). The loan accrues interest at six month LIBOR plus a margin of 3.5% which is capitalised semi-annually on 30 June and 31 December. The loan is repayable on demand and has a final maturity date of 31 December 2018. Interest of £4.5m was capitalised during the year (2014: £3.1m).

(iii) The Company received a loan of £90.0m from PLAL. The loan accrues interest at six month LIBOR plus a margin of 1.75% which is capitalised semi-annually on 30 June and 31 December. The loan is repayable on demand and has a final maturity date of 31 December 2018. Interest of £2.2m was capitalised during the year (2014: £0.5m).

## 17. Short-term borrowings (continued)

***Determination of fair value and fair value hierarchy of short-term borrowings***

Short-term borrowings are categorised as Level 3 financial instruments. The fair value of short-term borrowings with no external market is determined by internally developed discounted cash flow models using a risk adjusted discount rate corroborated with external market data where possible.

There were no level 1 or level 2 short-term borrowings in 2015 or 2014.

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

## 18. Accruals and deferred income

| | 2015 £m | 2014 £m |
|---|---|---|
| Accrued interest on loans from Group entities | 1.6 | 5.4 |
| Accrued expenses | 1.2 | 1.9 |
| Total accruals and deferred income | 2.8 | 7.3 |

## 19. Amounts owed to Group entities

| | 2015 £m | 2014 £m |
|---|---|---|
| Other amounts owed to Group entities | 4.4 | 6.4 |

## 20. Investments in subsidiaries

| | 2015 £m | 2014 £m |
|---|---|---|
| **Cost** | | |
| At 1 January | 2,443.3 | 2,943.1 |
| Disposals | - | (499.8) |
| At 31 December | 2,443.3 | 2,443.3 |
| **Impairment** | | |
| At 1 January | (372.5) | (311.4) |
| Impairment charge | (30.6) | (61.1) |
| At 31 December | (403.1) | (372.5) |
| **Carrying amount** | | |
| At 31 December | 2,040.2 | 2,070.8 |

Where indicators of impairment have been identified the carrying value of the Company's investments in its subsidiaries has been tested for impairment at the period end. An impairment of £30.6m (2014: £61.1m) has been made to write certain investments down to their recoverable amount.

### 20. Investments in subsidiaries (continued)

The value in use has been used as the recoverable amount and this has been determined using the present value of the future cash flows of the Impala group including the in force long-term business and the service company. The cash flows used in this calculation are consistent with those adopted by management in the operating plan and, beyond the period of this plan, reflecting the anticipated run-off of the in force life insurance business. Future cash flows have been valued using discount rates which reflect the risks inherent to each cash flow.

The subsidiaries of the Company at 31 December 2015 were as follows:

| | Country of incorporation and principal place of operation | Class of shares held (wholly-owned unless otherwise indicated) |
|---|---|---|
| **Insurance companies** | | |
| Phoenix Life Assurance Limited (life assurance company) | UK | 'A' ordinary shares of £0.05<br>'B' ordinary shares of £1 |
| **Non-insurance companies** | | |
| London Life Limited | UK | Ordinary shares of £1 |
| Pearl Assurance Group Holdings Limited | UK | Ordinary shares of £1 |
| Pearl Group Services Limited | UK | Ordinary shares of £1 |
| PGS2 Limited | UK | Ordinary shares of £1 |
| Pearl (Covent Garden) Limited | UK | Ordinary shares of £1 |
| Pearl (Martineau Phase 1) Limited | UK | Ordinary shares of £1 |
| Pearl (Martineau Phase 2) Limited | UK | Ordinary shares of £1 |
| Pearl MG Birmingham Limited | UK | Ordinary shares of £1 |
| Pearl MP Birmingham Limited | UK | Ordinary shares of £1 |
| Pearl (Moor House) Limited | UK | Ordinary shares of £1 |

The Company also owns the following principal subsidiaries through the subsidiary companies listed above:

| | Country of incorporation and principal place of operation | Class of shares held (wholly-owned unless otherwise indicated) |
|---|---|---|
| **Insurance companies** | | |
| National Provident Life Limited (life assurance company) | UK | Ordinary shares of £1 |

All holdings represent 100% of the normal issued share capital, unless stated otherwise.

### 21. Loans and receivables

| | 2015 £m Carrying value | 2014 £m Carrying value | 2015 £m Fair value | 2014 £m Fair value |
|---|---|---|---|---|
| **Loans** | | | | |
| Loans to PGH (LCA) Limited and PGH (LCB) Limited | - | 679.9 | - | 682.8 |
| Loan to Phoenix Life Holdings Limited | 444.1 | - | 444.1 | - |
| | 444.1 | 679.9 | 444.1 | 682.8 |
| Amounts due for settlement within 12 months | - | - | | |
| Amounts due for settlement after 12 months | 444.1 | 679.9 | | |

## 21. Loans and receivables (continued)

(i) The Company entered into a £2.0bn facility agreement with PGH (LCA) Limited ('LCA') and PGH (LCB) Limited ('LCB'). The facility accrues interest at a rate of LIBOR plus a margin of 4.3% and the final maturity date is 31 December 2018. On 27 May 2015, the Company novated its rights and obligations under the facility of £679.9m together with interest accrued of £13.6m to Phoenix Life Holdings Limited ('PhLHL').

(ii) On 28 May 2015 the Company granted a loan of £693.5m to Phoenix Life Holdings Limited ('PhLHL'), being the value of the loan receivable balances due from LCA and LCB novated by the Company to PhLHL on 27 May 2015. Loans from PhLHL of £100.0m and £150.0m (see notes 13 and 15) together with interest accrued of £8.9m were then offset against the outstanding balance on the loan. The loan accrues interest six month LIBOR plus a margin of 2.9% and has a maturity date of 28 May 2020. Interest of £9.5m was capitalised during the year.

Unless specifically noted above no loans are considered to be past due or impaired.

***Determination of fair value and fair value hierarchy of loans and receivables***

Loans and receivables are categorised as Level 3 financial instruments. The fair value of loans and receivables with no external market is determined by internally developed discounted cash flow models using a risk adjusted discount rate corroborated with external market data where possible.

There were no level 1 or level 2 loans and receivables in 2015 or 2014.

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

## 22. Amounts due by Group entities

| | 2015 £m | 2014 £m |
|---|---|---|
| Other borrowings owed by Group entities | 21.8 | 14.3 |

## 23. Financial assets

| | 2015 £m | 2014 £m |
|---|---|---|
| Financial assets at fair value through profit or loss | | |
| Designated upon initial recognition | | |
| Open ended investment companies – Level 1 | 47.9 | 14.5 |
| Corporate bonds – Level 2 | 15.2 | 14.4 |
| Total investments | 63.1 | 28.9 |
| Amount recoverable after 12 months | - | - |

***Determination of fair value and fair value hierarchy of financial assets***

The perpetual reset capital securities and 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.

There were no level 3 financial instruments in 2015 or 2014.

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

## 24. Cash and cash equivalents

| | 2015 £m | 2014 £m |
|---|---|---|
| Bank and cash balances | - | - |

The carrying amounts approximate to fair value at the year end.

## 25. Cash flows from operating activities

| | 2015 £m | 2014 £m |
|---|---|---|
| Profit for the year before tax | 47.5 | 61.0 |
| Adjustments to reconcile profit for the year to net cash inflow from operating activities: | | |
| Interest income on loans and receivables | (9.4) | (14.9) |
| Dividends received | (100.0) | (166.1) |
| Fair value gains | (0.9) | (1.4) |
| Reversal of impairment of investment in subsidiaries | - | - |
| Impairment of investment in subsidiaries | 30.6 | 61.0 |
| Impairment of loans and receivables | - | - |
| Net expected return on pension scheme assets | (8.6) | 0.6 |
| IFRIC 14 discount charge | 5.9 | 3.9 |
| Interest expense on borrowings | 42.6 | 48.1 |
| Changes in operating assets and liabilities | (40.9) | (27.9) |
| Cash absorbed by operations | (33.2) | (35.7) |

## 26. Capital and risk management

The Company's capital comprises share capital and all reserves. At 31 December 2015 total capital was £1,488.7m (2014: £1,563.2m). The decrease in the period reflects the total comprehensive income arising in the period of £75.5m (2014: £208.8m), less loans repaid that were designated as equity instruments of £150.0m (2014: £nil), interest paid on subordinated loans treated as equity of £nil (2014: £18.7m) and dividends paid of £nil (2014: £399.8m).

The Company's capital is monitored by the Directors and managed on an on-going basis via a monthly review 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;
- 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;
- credit risk, arising from the default of the counterparty to a particular financial asset and is significantly reduced as assets are primarily inter-company receivables from other group entities; and
- longevity risk in the pension scheme, 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.

## 27. 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.

In the year ended 31 December 2015 the Company received interest received on loans to fellow subsidiaries of £nil (2014: £19.7m).

## 27. Related party transactions (continued)

Interest paid by the Company on loans due to its parent amounted to £nil (2014: £11.9m), with interest payable on loans to subsidiaries amounting to £16.9m (2014: £14.0m).

***Amounts due to related parties***

| | 2015<br>£m | 2014<br>£m |
|---|---|---|
| Other amounts due to ultimate parent | - | 2.2 |
| Loans due to parent | - | 100.0 |
| Other amounts due to parent | 1.8 | 3.3 |
| Loans due to subsidiaries | 1,216.7 | 1,212.6 |
| Other amounts due to subsidiaries | 0.4 | 0.4 |
| Other amounts due to fellow subsidiaries | 2.2 | 0.5 |

***Amounts due by related parties***

| | 2015<br>£m | 2014<br>£m |
|---|---|---|
| Other amounts due from ultimate parent | 0.3 | - |
| Loans due by parent | 444.1 | - |
| Loans due by fellow subsidiaries | - | 679.9 |
| Other amounts due by fellow subsidiaries | 21.5 | 14.3 |

***Transactions with the Pearl Group Staff Pension Scheme***

| | Transactions 2015<br>£m | Balances outstanding 2015<br>£m | Transactions 2014<br>£m | Balances outstanding 2014<br>£m |
|---|---|---|---|---|
| Payment of administrative expenses | 2.1 | - | 4.3 | - |

***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 6.

***Parent and ultimate parent entity***
Information on the Company's parent and ultimate parent is given in note 28.

## 28. Other information

The Company's principal place of business is the United Kingdom. The Company's immediate parent is Phoenix Life 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.