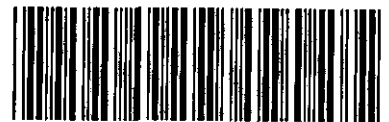


**SCOTTISH PROVIDENT LIMITED**  
**REPORT AND FINANCIAL STATEMENTS**  
**31 DECEMBER 2008**  
**INCORPORATED IN THE UNITED KINGDOM**  
**Registration No. SC212709**

TUESDAY



\*SFDTMDHT\*

SCT

22/09/2009

27

COMPANIES HOUSE

## **Directors' report**

The Directors present their annual report on the affairs of the Company, together with the financial statements and auditors' report, for the year ended 31 December 2008.

### **Business review**

#### ***Principal activities***

During the year the principal activity of the Company was the transaction of ordinary long term insurance business.

All business is written in the UK, with the exception of the euro denominated business written by the Company's registered branch in the Republic of Ireland.

#### ***Corporate developments***

On 1 May 2008, the Company's ultimate parent company, Resolution plc (subsequently renamed Pearl Group Holdings (No. 1) Limited), was acquired by Impala Holdings Limited (IHL), a subsidiary of Pearl Group Limited (PGL), and from this date PGL became the Company's ultimate parent company.

On 29 December 2008, part of the long term business funds of the Company were transferred to The Royal London Mutual Insurance Society Limited for £nil consideration in accordance with the terms of a scheme (the Scheme) under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 4 December 2008.

The business transferred under the Scheme included UK non linked, non profit Self Assurance protection business. Further details of the Scheme are set out in note 1.

The business transfer at the end of the financial year was the most significant development for the Company.

#### ***Events after the balance sheet date***

Restructuring to simplify the legal and fund structures of the life insurance companies within the Pearl group has been taking place following the financial year end. With effect from 1 January 2009, the remaining long term business and part of the shareholders' funds of the Company were transferred to Phoenix Life Limited (PLL), a fellow group company, for £nil consideration in accordance with the terms of a scheme under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 30 January 2009.

Following the Part VII scheme, the Board of Directors approved a reduction in the Company's issued share capital to £1 on 25 March 2009. Further details of the Part VII scheme and capital reduction are set out at note 38.

Following the restructuring of the Company's operations, the Board has submitted an application to the Financial Services Authority requesting cancellation of the Company's authorisation to undertake long term business and is considering the future development of the Company.

#### ***Operational activities***

The Board and management monitor business performance via a range of performance indicators, the key financial reporting items being profits in comparison to annual and quarterly targets and solvency in comparison to internal and external regulatory requirements. Details of the profit for the year are set out on page 13 and the Company's capital management process and capital resources are outlined at note 35.

The outline of the Company's operational activities, provided below, relates to 2008, prior to the transfer of its insurance operations to PLL, as of 1 January 2009.

Scottish Provident Limited has four principal funds, namely, a with profit fund, a special with profit fund, a non profit fund and a shareholder fund.

The with profit fund, which has both conventional and unitised with profit policies, is closed to new business, other than increments on certain existing business. At 31 December 2008, the with profit fund had total admissible assets calculated in accordance with the Financial Services Authority's Prudential Standards of £3,489m (2007 : £4,170m).

The special with profit fund comprises the former Prolific life business acquired by The Scottish Provident Institution in 1993 and is closed to new business, other than increments on certain existing business. At 31 December 2008, the special with profit fund had total admissible assets of £17m (2007: £25m).

Unless specified, any following references to the with profit fund, includes both the with profit fund mentioned above, and the special with profit fund.

## **Directors' report continued**

The non profit fund is closed to new business, other than increments on certain existing business. At 31 December 2008, the non profit fund had admissible assets of £1,052m (2007: £1,495m).

At 31 December 2008 the Irish branch had total admissible assets of €891m (2007: €1,338m), being €719m (2007: €1,135m) with profit fund and €172m (2007: €203m) non profit fund. The sterling equivalent values are included within the total Company figures above.

The financial statements are prepared under International Financial Reporting Standards (IFRS) and the results of the Company for the year ended 31 December 2008 are set out on page 13. These show that the Company generated a profit after tax of £32m for the year then ended (2007: £143m).

The result for the current year has been impacted by the reassurance of certain deferred annuities to a fellow group company, Phoenix Pensions Limited (PPL), with effect from 30 September 2008. Under the reassurance treaty with PPL, the reassurance premium payable was £150m and the Company recognised a corresponding reassurance asset of £166m, generating a profit before tax in the year of £16m.

The result for the prior year was impacted by the reassurance of certain immediate annuities to a fellow group company, PPL with effect from 31 December 2007. The reassurance premium payable was £407m and the Company recognised a corresponding reassurance asset of £433m at 31 December 2007 resulting in a profit before tax in 2007 of £26m.

During 2008, £113m was transferred from the Long-Term Business Fund to the Shareholder Fund and a loan of £169m was made to the Company's immediate parent, Resolution Life Limited (RLL) on 1 April 2008. This loan was repaid on 2 May 2008 and redrawn by Pearl Life Holdings Limited (previously RLL) through a lending facility on 16 May 2008. A loan of £12m was made to Impala Holdings Limited, a fellow group company, on 14 October 2008.

Shareholder net equity at 31 December 2008 was £1,416m (31 December 2007: £1,369m).

### ***Principal Risks***

The following paragraphs relate to the principal risks facing the business during 2008, prior to the Part VII scheme on 1 January 2009, as described above.

The principal risk exposure for the shareholder relate to the non profit fund business which is affected by mortality and morbidity risks and pensions business may be adversely affected by improving annuitant longevity. Persistency and expense inflation risks also apply to most products. Mortality and morbidity risks are managed primarily through reinsurance.

The non profit fund also carries some investment and credit risk on assets backing liabilities and surplus in the fund. However, a significant proportion of the business in the fund is unit linked with the investment performance risk being carried by policyholders, although shareholder profit is affected by fund based charges. For non linked business, investment risk is limited through the use of investment grade fixed interest holdings and by a relatively high degree of asset and liability matching. Excess surplus in the non profit fund is invested primarily in cash and cash equivalent securities.

The with profit fund takes controlled investment risk with the aim of enhancing policyholder investment returns. The fund aims to limit that risk, in line with the Company's risk policies, to that supportable by the with profit fund's assets.

The costs of guarantees are met within the fund, but there remains some residual risk that the shareholder may have to contribute capital to the fund in accordance with the terms of a memorandum of agreement to which the shareholder is party. However, derivative backed hedge assets are in place to protect customers and the shareholder against the risk of guarantee costs being higher than provided within the fund.

The Company faces operational risks, including the complexity of its outsourced policy administration arrangements. A Master Services Agreement was signed with Pearl Group Management Services Limited (PGMS) (formerly Resolution Management Services Limited) on 29 December 2006, which reduces the Company's exposure to future expense risks. On 30 May 2007, PGMS signed a Master Services Agreement with Capita Life & Pensions Regulated Services Limited (Capita). Through this agreement Capita delivers core aspects of customer servicing and policy administration to policyholders and IT services to the Company.

Further information on risks is provided in the notes to the financial statements.

## **Directors' report continued**

### ***Material developments***

The Company has been advised by the directors of its ultimate holding company, PGL, and PGL's 75% owned subsidiary, IHL, that discussions are taking place between the FSA, the Group's investors and other key stakeholders regarding the appropriate capital structure for the group, given the extreme market turbulence experienced in 2008 and 2009. These discussions include options to restructure the sources of finance for the Group.

These discussions are designed to facilitate an alignment of the obligations of the Group's investors with the availability of funding from the Group and to thus enable the Group to meet its obligations in the foreseeable future.

The Directors do not expect the results of these discussions to have a material effect on the financial position of the Company. In this regard, the Directors of the Company have considered the position of its parent, including potential contagion effects on the Company in respect of the recoverability of intra-group loans and the impact of any breach in its Group Capital Adequacy (GCA) requirements.

In November 2008, the FSA was informed that the Company was in technical breach of its GCA obligations. The Company is required to ensure that its capital resources are sufficient to meet the GCA requirements at all times. To rectify the situation, a capital restructuring was undertaken in the Group and, in addition, the Company applied for, and was granted, a waiver from the FSA which provides relief in respect of one of the capital restrictions within the GCA calculation and enables the Company to meet its GCA requirements. The Company has continued to meet its GCA requirements since that date.

Following the technical breach of GCA requirements, the FSA issued an Own Initiative Variation of Permission (OIVoP) which, inter alia, requires cash payments and asset transfers from regulated entities within the PGL Group to be disclosed to and approved by the FSA. This affords the Company liquidity protection whilst the OIVoP remains in force. The Directors have reasonable grounds to believe that the OIVoP will remain in place, as required by the FSA, for the foreseeable future.

### ***Going concern***

The Directors' report summarises the activities of the Company, discusses the principal risks and uncertainties it faces and comments on material developments. Notes 34 and 35 to the financial statements summarise the Company's risk and capital management objectives and policies together with its financial risks.

After making enquiries and considering in detail the Company's individual regulatory capital requirements, together with the potential impact on these from issues arising elsewhere within the Group, 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.

### ***Dividends***

The Directors do not propose the payment of a dividend for the year (2007: £nil).

### ***Share Capital***

Details of the share capital structure of the Company are given in note 12 to the financial statements. Details of the capital restructuring undertaken after the year end are set out at note 38.

### ***Employee information***

As outlined above, PGMS currently provides services to the Company and accordingly the Company had no employees in the current or prior year. Employee policies and practices are managed on a group basis and are set out in the report and financial statements of the ultimate parent undertaking Pearl Group Limited.

## Directors' report continued

### Directors

Except as shown, the Directors of the Company throughout the year were:

A Davidson	
D Ferguson	
K Luscombe	
I Owen	
M Dale	(appointed 12 June 2008)
M Merrick	(appointed 21 January 2008)
J Moss	(appointed 1 May 2008)
H Osmond	(appointed 12 June 2008)
M Ross	(appointed 12 June 2008)
J S Smith	(appointed 1 May 2008)
E Hawkes	(appointed as alternate director to H Osmond 13 August 2008)
L Tamberlin	(appointed as alternate director to M Dale 6 October 2008)
I Maidens	(resigned 22 August 2008)
F Matthews	(resigned 29 February 2008)
S McGee	(resigned 10 July 2008)
J Newman	(resigned 1 May 2008)
G Singleton	(resigned 30 September 2008)
M Potkins	(resigned as alternate director to J Newman 1 May 2008)

PGL has agreed to provide an Indemnity to certain persons within the Pearl Group. These persons include nominated directors and secretaries, subsidiary directors, subsidiary secretaries, alternate directors and approved persons, being persons in relation to whom the Financial Services Authority has given its approval under section 59 of the Financial Services and Markets Act 2000 ("FSMA") for the performance of a controlled function. This indemnity will cover all losses, costs and expenses incurred by an indemnified person incurred in the exercise, execution and discharge of his duties, or connected to the same, to the fullest extent permitted, consistent with the Companies Act 2006 and the FSA Rules, provided that if such indemnified person is also entitled to be indemnified under the terms of the Articles of another Pearl Group company, or pursuant to the terms of a indemnity granted by another Pearl Group company, then the indemnified person must first claim under that indemnity.

Directors, alternate directors and company secretaries of Pearl Group Holdings (No. 1) Limited and former subsidiaries of that company (including members of the Scottish Provident Fund Supervisory Committee) may still benefit from the provisions of an earlier Deed of Indemnity entered into by that company.

### Statement of Directors' responsibilities

The Directors are responsible for preparing their report and financial statements. Company law requires the Directors to prepare such financial statements in accordance with the Companies Act 1985. The Directors have chosen to prepare financial statements for the Company in accordance with IFRS and Article 4 of the IAS Regulations.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS.

Directors are also required to:

- properly select and apply accounting policies;
- 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 entity's financial position and financial performance; and
- prepare the financial statements on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' report which complies with the requirements of the Companies Act 1985.

## **Directors' report continued**

### ***Payment of suppliers***

In the forthcoming year, it is expected that goods and services will continue to be supplied to the Company by Pearl Group Management Services Limited. On this basis, Pearl Group Management Services Limited will continue to be responsible for agreeing terms and conditions under which business is to be transacted and for making suppliers aware of these before business is contracted. It is policy to ensure payments are made in accordance with legal and contractual obligations.

Details of payment policy and average creditor days are disclosed within the accounts of Pearl Group Management Services Limited.

### ***Auditors***

In accordance with section 487 of the Companies Act 2006, the Company's auditors, Ernst & Young LLP, will be deemed to have been reappointed at the end of the period of 28 days following circulation of copies of these accounts 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 accounts relate.

### ***Disclosure of information to auditors***

In the case of each of the persons who are Directors of the Company at the date of approval of this report:

- so far as each of the Directors is aware, there is no relevant audit information (as defined in the Companies Act 1985) 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 himself/herself 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 234ZA of the Companies Act 1985.

**By Order of the Board**



**Kerr Luscombe**  
Director

30 March 2009  
Registered office: 301 St. Vincent Street, Glasgow, G2 5HN

## **Independent auditors' report to the members of Scottish Provident Limited**

We have audited the financial statements of Scottish Provident Limited for the year ended 31 December 2008, which comprise the Accounting Policies, the Income Statement, the Statement of Recognised Income and Expense, the Balance Sheet, the Cash Flow Statement, and the related notes 1 to 39. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditors' 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 auditors**

The Directors' responsibilities for preparing the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether the information given in the Directors' report is consistent with the financial statements.

In addition we report to you if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the Directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### **Opinion**

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Company's affairs as at 31 December 2008 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the financial statements.

*Ernst & Young LLP.*

**Ernst & Young LLP**  
Registered auditor  
Glasgow  
United Kingdom  
30 March 2009

## Accounting policies

### (a) Basis of preparation

The financial statements have been prepared on the going concern basis. In adopting the going concern basis the following significant matters have been taken into consideration:

- A comprehensive review of the valuation and liquidity of investments at the balance sheet date;
- Solvency and cash flow projections under normal and stressed conditions; and
- Impact of failures of material reinsurers, service providers and investment managers.

Following a technical breach of Group Capital Adequacy (GCA) requirements, the FSA issued an Own Initiative Variation of Permission (OIVoP) which, inter alia, requires cash payments and asset transfers from regulated entities within the Pearl Group Limited Group (PGL Group) to be disclosed to and approved by, the FSA. This affords the Company liquidity protection whilst the OIVoP remains in force. The Directors have reasonable grounds to believe that the OIVoP will remain in place, as required by the FSA, for the foreseeable future.

The Company has also considered the financial position of its ultimate parent company, Pearl Group Limited (PGL), in terms of the impact of any breach in its GCA requirements and/or potential contagion impact, including the recoverability of intra-group loans.

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. These financial statements are presented in pounds sterling, rounded to the nearest £1m.

The financial statements have been prepared under the historical cost convention except as modified by the application of the following:

- financial instruments at fair value through income; and
- insurance liabilities.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

The Company has taken advantage of the exemption provided for in the Companies Act 1985 (s228) and as such, the information presented in these financial statements relates to the Company only and not the consolidated position of the Group headed by the Company.

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

- IAS 1 *Presentation of Financial Statements (Revised)* (2009). This revises and enhances the presentation of information in the financial statements.
- IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements (Revised)* (2009). Amendments relating to the recognition of puttable financial instruments and obligations arising on liquidation.
- *Annual improvements* (2009 and 2010). This makes a number of minor improvements to existing standards.

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

- IFRS 1 *First-time Adoption of International Financial Reporting Standards – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendments)* (2009)
- IFRS 2 *Share-based Payment – Vesting Conditions and Cancellations (Amendment)* (2009)
- IFRS 8 *Operating Segments* (2009)
- IAS 23 *Borrowing Costs (Revised)* (2009)
- IAS 27 *Consolidated and Separate Financial Statements* (2009)
- IFRS 3 *Business Combinations (Revised)* (2010)
- IAS 27 *Consolidated and Separate Financial Statements (Revised)* (2010)
- IAS 39 *Financial Instruments: Recognition and Measurement – Eligible hedged items (Amendment)* (2010)
- IFRIC 13 *Customer Loyalty Programmes* (2009)
- IFRIC 15 *Agreements for the Construction of Real Estate* (2009)
- IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* (2009)
- IFRIC 17 *Distributions of Non-Cash Assets to Owners* (2010)

A capital position statement has not been presented as this is disclosed in the financial statements of the ultimate parent company, PGL.



## **Accounting policies continued**

### **(b) Critical accounting estimates and judgments**

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 insurance and investment contract liabilities, determination of the fair value for financial assets and liabilities, intangible assets and income taxes.

Insurance and investment contract liability accounting is discussed in more detail in notes (e) and (f) with further detail of the key assumptions made in determining insurance and investment contract liabilities included in note 17.

The fair values of financial assets are classified and accounted for in accordance with the policies set out in accounting policy (m). They are valued on the basis of listed market prices in so far as this is possible. If prices are not readily determinable, fair value is based either on internal valuation models or management estimates of amounts that could be realised under current market conditions.

Intangible assets are subject to regular impairment reviews as required. Impairments are measured as the difference between the cost of a particular asset and the current fair value or recoverable amount. Impairments are recorded in the income statement in the period they occur. The Company's policy in relation to impairment testing is detailed in accounting policy (k).

The accounting policy for income tax is detailed in accounting policy (i).

### **(c) Foreign currency translation**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on debt securities and other monetary financial assets measured at fair value are included in foreign exchange gains and losses within net investment income. Translation differences on non-monetary items such as equities held for trading are reported as part of the fair value gain or loss.

Income statements and cash flows of foreign operations are translated into the Company's presentational currency at the appropriate rates prevailing during the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange gains and losses arising from the translation of the functional currency results and financial position of foreign operations into the presentational currency of the company are reflected in the Statement of Recognised Income and Expense and treated as a separate component of equity.

### **(d) Classification of contracts**

The Company issues insurance contracts and investment contracts.

Insurance contracts are those contracts, which transfer significant insurance risk. As a general guideline, the Company defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event. Investment contracts are those contracts which carry no significant insurance risk.

A number of insurance and investment contracts contain a discretionary participation feature (DPF) which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses that are likely to be a significant portion of the total contractual benefits and whose amount or timing is contractually at the discretion of the Company and based on the performance of specified assets. Contracts containing a DPF are also referred to as participating or with profit contracts.

For insurance contracts and investment contracts with DPF, the Company continues to use the Modified Statutory Solvency Basis (MSSB) of accounting, modified as necessary to comply with the requirements of IFRS. For contracts with DPF, this includes the adoption of FRS 27 'Life Assurance'. Investment contracts without DPF are accounted for as financial liabilities.

### **(e) Insurance contracts and investment contracts with DPF**

The significant accounting policies applied in relation to insurance contracts and investment contracts with DPF are:

#### **Premiums**

Premiums received in respect of insurance contracts and investment contracts with DPF are recognised as revenue when due and shown before deduction of commission. Reassurance premiums are charged when they become payable.

#### **Claims**

Death claims are recognised on receipt of notifications. Maturities and annuity payments are recorded when contractually due. Surrenders are recorded on the earlier of the date paid or date the policy benefit or part thereof ceases to be included within 'Liabilities under insurance contracts'. Claims on participating business include bonuses payable. Reinsurance recoveries are credited to match the relevant gross amounts.

## Accounting policies continued

### Fees and commissions

Fee and charge income from services provided in respect of insurance contracts and investment contracts with DPF is recognised in the income statement within 'change in insurance contract liabilities' when the services are performed.

### Liabilities under insurance contracts

Insurance liabilities are determined by the Directors on the advice of the Head of Actuarial Function following an annual investigation of the long-term business and reflect the value of related assets and the yield derived therefrom.

Insurance liabilities are calculated in accordance with reporting requirements under the Financial Services and Markets Act 2000 and Financial Services Authority (FSA) Prudential Sourcebook for Insurers.

Although the process for the establishment of insurance liabilities follows specified rules and guidelines, the provisions that result from the process are the subject of estimations. As a consequence, the eventual value of claims could vary from the amounts provided to cover future claims. The Company seeks to provide appropriate levels of contract liabilities taking known facts and experiences into account but nevertheless such liabilities remain uncertain.

Liabilities are calculated as follows:

#### \* Liabilities – insurance contracts without DPF which are not unit linked:

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premium is recognised. The liabilities of the Company's non profit non linked funds are calculated by estimating the future cash flows over the duration of the in-force policies and discounting them back to the valuation date allowing for probabilities of insured event occurrence. The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits which reflect changes in mortality rates. Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs. For conventional life and pensions business, the gross premium valuation method has been used. This statutory solvency basis of valuation is then adjusted by eliminating the general contingency reserves and certain reserves required under insurance company regulations.

#### \* Liabilities – insurance contracts without DPF which are unit linked:

Allocated premiums in respect of unit linked contracts are recognised as liabilities. These liabilities are increased or reduced by the change in the relevant unit prices over the period and include any amounts necessary to compensate the Company for services to be performed over future periods. They are reduced by policy administration fees, mortality charges, surrender charges and any withdrawals. The mortality charges deducted in each period from the policyholders as a group are considered adequate to cover the total death benefit claims that are expected to occur over the term of the contracts.

#### \* Liabilities – insurance and investment contracts with DPF:

Liabilities of the Company's with profit fund, including guarantees and options embedded within products written by that fund, are stated at their realistic values in accordance with the FSA's realistic capital regime. The measurement of insurance liabilities is calculated using stochastic methods and therefore reflects both the intrinsic and time value of guarantees and options embedded within products. Economic assumptions are calibrated to observed current market prices.

### Liability adequacy test

At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of insurance contract and investment contract with DPF liabilities. In performing these tests, current best estimates of future contractual cash flows, claims handling and administration expenses, as well as investment income from the assets backing such liabilities are used. Any deficiency is immediately charged to income to establish an appropriate provision against these potential losses.

### Embedded derivatives

Embedded derivative features contained within insurance contracts are accounted for at fair value and unrealised gains and losses arising on the embedded derivatives are reported in income. Where the risks and characteristics of embedded derivatives are not closely related to those of the host contract and the host contract is not carried at fair value the embedded derivatives are accounted for separately.

### Reinsurance

The Company assumes and cedes reinsurance in the normal course of business. Reinsurance assets primarily include balances due from reinsurance companies for ceded insurance liabilities. Premiums on reinsurance assumed are recognised as revenue in the same manner as they would be if the reinsurance were considered direct business taking into account the product classification of the reinsured business. Amounts recoverable from or due to reinsurers are estimated in a manner consistent with the amounts associated with the reinsured policies and in accordance with the reinsurance contract. Premiums ceded and benefits reimbursed are presented on the income statement on a gross basis.

## Accounting policies continued

Contracts entered into by the Company with reinsurers under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held. Insurance contracts entered into by the Company under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts.

The benefits to which the Company expects to become entitled under its ceded reinsurance contracts are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer-term receivables that are dependent on expected claims and benefits arising under the related reinsured insurance contracts.

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance payables are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

The Company regularly assesses its long-term reinsurance assets for impairment. A reinsurance asset is impaired if there is objective evidence that the Company may not receive all amounts due to it under the terms of the contract and that event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

### Receivables and payables related to insurance contracts and investment contracts with DPF

Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

### Unallocated surplus

The unallocated surplus comprises the excess of the assets over the policyholder liabilities of the with profit business determined in accordance with FRS 27, in so far as it represents amounts which have yet to be allocated to equity holders.

### (f) Investment contracts without DPF

Receipts and payments on investment contracts without DPF are accounted for using deposit accounting, under which the amounts collected and paid out are recognised in the balance sheet as an adjustment to the liability to the policyholder. The significant accounting policies applied in relation to investment contracts without DPF are:

#### Liabilities under investment contracts

All of the Company's investment contracts without DPF are unit linked. These contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Company's unitised investment funds. The value of the unit linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable.

#### Revenue from investment contracts

Fee and charge income from investment management and other related services provided in respect of investment contracts without DPF is recognised in the accounting period in which the services are rendered and are included within 'change in investment contract liabilities' on the income statement. These services comprise an indeterminate number of acts over the life of individual contracts. For practical purposes, the Company recognises these fees on a straight-line basis over the estimated life of the contract.

### (g) Net investment income

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accruals basis. Interest income includes coupons earned on fixed income financial assets. Dividend income is recognised in the income statement on the date the right to receive payment is established, which in the case of listed securities is the ex-dividend date.

Realised gains and losses on investments are calculated as the difference between net sales proceeds and original cost. Unrealised investment gains and losses are calculated as the difference between the valuation at the balance sheet date and their valuation at the last balance sheet date or purchase price, if acquired during the year.

Unrealised investment gains and losses include adjustments in respect of unrealised gains and losses recorded in prior years which have been realised during the year and are reported as realised gains and losses in the current income statement.

Outstanding derivative contracts, including forward foreign exchange contracts, are marked to market at the balance sheet date. Unrealised gains or losses thereon are included in the income statement as unrealised gains or losses on financial assets.

## **Accounting policies continued**

### **(h) 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 rate method.

### **(i) Income tax**

The tax expense represents the sum of tax currently payable and deferred tax. The tax currently payable is based on income and gains arising in the accounting period and comprises both shareholder tax and tax payable on behalf of policyholders.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets or liabilities using currently enacted tax rates.

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.

### **(j) Investments in subsidiaries**

Investments in subsidiary undertakings are carried in the balance sheet at cost less provision for impairment, if applicable. The carrying values of investments in subsidiaries are written down by the amount of any impairment in the underlying net assets of the subsidiary and the loss is recognised in the income statement in the period in which it occurs. A previously recognised impairment loss relating to an investment in a subsidiary may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the investment's recoverable amount. The carrying amount of the investment will only be increased up to the amount that it would have been had the original impairment not been recognised.

### **(k) Intangible assets**

Present value of acquired in-force business (PVIF)

When a portfolio of insurance contracts and/or investment contracts with DPF is acquired, whether directly from another insurance company or as part of a business combination, the difference between the fair value and the carrying amount of the insurance liabilities is recognised as the value of the acquired in-force business.

Subsequent to initial recognition, the intangible asset is carried at cost less accumulated amortisation and accumulated impairment losses. The intangible asset is amortised over the useful life of the acquired in-force policies during which future premiums are expected. Amortisation is recognised in the income statement as an expense.

An impairment review is performed at each reporting date or more frequently when an indication of impairment arises during the reporting year. When the recoverable amount is less than the carrying value, an impairment loss is recognised in the income statement. PVIF is also considered in the liability adequacy test for each reporting period.

PVIF is derecognised when the related contract is settled or disposed of.

### **(l) Loans and receivables**

Loans and receivables are valued initially at fair value, including transaction costs as relevant, and subsequently at amortised cost less impairment losses.

### **(m) Financial assets at fair value through income**

All invested financial assets were designated at fair value through income on the transition to IFRS as their performance is evaluated on a fair value basis in accordance with a documented investment strategy.

The fair values are determined by reference to quoted market bid prices or published bid prices. If quoted market prices or published prices are not available, fair values are determined or estimated by using various techniques, including but not limited to balance sheet analysis and comparison to similar quoted securities. Unlisted derivatives are valued on the basis of bid prices supplied by suitably qualified counterparties. The counterparties' valuation techniques rely on discounted cash flow models and option pricing models as appropriate.

Changes in fair value are recognised in the income statement in the period they occur.

Purchases and sales of financial assets at fair value through income are accounted for at trade date.

## **Accounting policies continued**

### **(n) Cash and cash equivalents**

Cash and cash equivalents comprise cash in hand, deposits held on call with banks and other short-term highly liquid investments with an original maturity term of 90 days or less. On the balance sheet, bank overdrafts with legal right of set off are included in cash and cash equivalents.

### **(o) Provisions**

Provisions (which do not include insurance liabilities) are recognised when the Company has a present obligation (legal or constructive) as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

Where the effect of the time value of money is material, the amount provided is the present value of the expenditures expected to be required to settle the obligation.

Where the Company has a present legal or constructive obligation but it is not probable that there will be an outflow of resources to settle the obligation or the amount cannot be reliably estimated, this is disclosed as a contingent liability.

### **(p) Dividends**

Dividends on ordinary shares are recognised in equity in the period in which they are declared.

### **(q) Offsetting financial assets and liabilities**

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention that expected future cash flows will be settled on a net basis.

### **(r) Segmental Reporting**

Business segments provide analysis of products or services that are subject to risks and returns that are different from those of other business segments. Geographical segments provide products or services within a particular geographic environment that is subject to risks and returns that are different from those of components operating in other geographical environments. The Company has only one business segment (life insurance) and one geographical segment (UK and Ireland), therefore, no segmental reporting is presented.

# Income statement for the year ended 31 December 2008

	Notes	2008 £m	2007 £m
Gross premiums written		256	298
Less: premiums ceded to reinsurers		(254)	(455)
<b>Net premiums written</b>		<b>2</b>	<b>(157)</b>
Fees and commissions	2	5	4
Net investment income	3	(435)	286
<b>Total revenue, net of reinsurance payable</b>		<b>(428)</b>	<b>133</b>
Other operating income	4	1	2
<b>Net income</b>		<b>(427)</b>	<b>135</b>
Policyholder claims		839	770
Less: reinsurance recoveries		(105)	(66)
Change in insurance contract liabilities		(1,218)	(827)
Transfer (from)/to unallocated surplus	15	(52)	2
<b>Net policyholder claims and benefits incurred</b>		<b>(536)</b>	<b>(121)</b>
Change in investment contract liabilities		(61)	3
Acquisition costs	5	6	9
Administrative expenses	6	97	55
<b>Total operating expenses</b>		<b>(494)</b>	<b>(54)</b>
<b>Operating profit before financing costs and income taxes</b>		<b>67</b>	<b>189</b>
Financing costs	8	15	13
Loss on Part VII transfer	1	11	-
<b>Profit for the year before income taxes</b>		<b>41</b>	<b>176</b>
Income taxes			
Policyholder tax		-	2
Shareholder tax		7	31
Tax on Part VII transfer		2	-
<b>Total tax expense</b>	10	<b>9</b>	<b>33</b>
<b>Profit for the year attributable to equity holders</b>		<b>32</b>	<b>143</b>

All activities of the Company are classified as continuing.

**Statement of recognised income and expense for the year ended 31 December 2008**

	2008 £m	2007 £m
Foreign currency translation of branch	21	2
Current taxation arising on foreign currency translation of branch	(6)	-
<b>Net income recognised directly in equity</b>	<b>15</b>	<b>2</b>
 <b>Profit for the year attributable to equity holders</b>	 <b>32</b>	 <b>143</b>
 <b>Total recognised income and expense for the year attributable to equity holders</b>	 <b>47</b>	 <b>145</b>

# **Balance Sheet as at 31 December 2008**

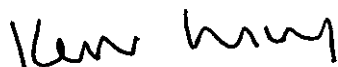
	Notes	2008 £m	2007 £m
<b>EQUITY AND LIABILITIES</b>			
<b>Equity</b>			
Share capital	12	1,765	1,765
Other reserves	13	222	222
Capital contribution reserves	13	178	178
Foreign currency translation reserve	13	17	2
Retained earnings	11	(766)	(798)
<b>Total equity attributable to equity holders of the Company</b>	11	<b>1,416</b>	<b>1,369</b>
<b>Liabilities</b>			
<b>Insurance contracts</b>			
Liabilities under insurance contracts	14	5,191	5,976
Unallocated surplus	15	42	93
		<b>5,233</b>	<b>6,069</b>
<b>Financial liabilities</b>			
Investment contracts	16	180	267
Borrowings	20	51	49
		<b>231</b>	<b>316</b>
Deferred tax	29	59	86
Reinsurance payables	18	8	8
Payables related to direct insurance contracts	19	34	34
Current tax	29	35	42
Trade and other payables	21	141	98
<b>Total liabilities</b>		<b>5,741</b>	<b>6,653</b>
<b>Total equity and liabilities</b>		<b>7,157</b>	<b>8,022</b>



**Balance Sheet as at 31 December 2008 continued**

	Notes	2008 £m	2007 £m
<b>ASSETS</b>			
Investments in subsidiaries	22	60	58
Intangible assets	23	272	336
Loans and receivables	24	1,037	-
Financial assets at fair value through income			
Derivatives	26	-	1
Equities		3	7
Fixed income securities		138	134
Collective investment schemes		4,256	5,463
	25	4,397	5,605
Insurance assets			
Reinsurers' share of insurance contract liabilities	14	1,186	967
Reinsurance receivables	27	4	47
Insurance contract receivables	28	2	3
		1,192	1,017
Deferred tax	29	13	10
Prepayments		6	38
Trade and other receivables	30	16	810
Cash and cash equivalents	31	164	148
<b>Total assets</b>		<b>7,157</b>	<b>8,022</b>

The financial statements were approved and authorised for issue by the Board of Directors on 30 March 2009 and were signed on its behalf by:



K Luscombe  
Director

# **Cash flow statement for the year ended 31 December 2008**

	Notes	2008 £m	2007 £m
<b>Cash flows from operating activities</b>			
Net decrease in operating assets and liabilities	32	262	359
Finance costs		(13)	(21)
Taxation paid		(52)	(13)
<b>Net cash flows from operating activities</b>		<b>197</b>	<b>325</b>
<b>Cash flows from investing activities</b>			
Loans granted to group undertakings		(181)	(140)
<b>Net cash flows from investing activities</b>		<b>(181)</b>	<b>(140)</b>
<b>Cash flows from financing activities</b>			
Repayment of borrowings		-	(125)
<b>Net cash flows from financing activities</b>		<b>-</b>	<b>(125)</b>
<b>Net increase in cash and cash equivalents</b>		<b>16</b>	<b>60</b>
<b>Cash and cash equivalents at the beginning of the year</b>		<b>148</b>	<b>88</b>
<b>Cash and cash equivalents at the end of the year</b>	31	<b>164</b>	<b>148</b>

Cash and cash equivalents comprise bank overdrafts and cash at bank and other short-term highly liquid investments with maturity of 90 days or less (note 31).

## Notes to the financial statements

### 1. Long term insurance funds transfer

On 29 December 2008, part of the long term business of the Company was transferred to The Royal London Mutual Insurance Society Limited (the Society) for £nil consideration in accordance with the terms of a scheme under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 4 December 2008 (the Scheme). The Scheme provides for the transfer of certain assets and liabilities, as set out below. As a result of the transfer, an additional asset has been generated and certain residual balances held have been impaired, as set out below.

Details of the assets and liabilities transferred under the Scheme, the consequential generation of an asset, the impairment of residual assets and the loss arising are as follows :

	£m
<b>Assets transferred</b>	
Reinsurers' share of insurance contract liabilities (note 14)	55
Reinsurance receivables	3
Insurance contract receivables	3
Trade and other receivables	2
Cash and cash equivalents	(1)
	<hr/> 62
<b>Liabilities transferred</b>	
Liabilities under Insurance Contracts (note 14)	48
Reinsurance payables	3
Payables related to direct insurance contracts	3
Trade and other payables	1
	<hr/> 55
	<hr/>
Net assets transferred	<hr/> 7
<b>Asset generated</b>	
Loan (note 24)	5
<b>Assets impaired</b>	
Intangible assets (note 23)	9
	<hr/>
<b>Loss on transfer</b>	<hr/> 11

The business transferred under the Scheme included UK non linked, non profit Self Assurance protection business. The Scheme provides for the Society to pay the Company for the value of net negative insurance contract liabilities transferred, less the surplus generated on the business during 2008, in equal annual instalments over 6 years.

## Notes to the financial statements continued

### 2. Fees and commissions

	2008 £m	2007 £m
Other fees	5	4

### 3. Net investment income

	2008 £m	2007 £m
Investment income :		
On items valued at fair value through income	240	271
On items valued at amortised cost	66	-
Fair value (losses) / gains	(741)	15
	(435)	286

### 4. Other operating income

	2008 £m	2007 £m
Other income	1	2

Other income in 2008 relates to income arising from an outstanding balance due from a fellow subsidiary. Other income in 2007 relates primarily to provision releases.

### 5. Acquisition costs

	2008 £m	2007 £m
Acquisition costs paid	6	9

### 6. Administrative expenses

	2008 £m	2007 £m
Movement in acquired PVIF	55	30
Operating expenses	40	23
Management Fee (Ignis Investment Services Limited, formerly Resolution Investment Services Limited)	2	2
	97	55

The Company has no employees (2007: nil). All business administration services were provided to the Company by Pearl Group Management Services (formerly Resolution Management Services). Administration charges included in operating expenses amount to £31m (2007: £23m).

Operating expenses in 2008 are net of a £1m credit from Pearl Group Management Services Limited (2007 : £6m credit) following finalisation of the Company's share of the pension scheme payments, as required under the terms of the Sale and Purchase Agreement between Resolution plc and Abbey National plc.

Operating expenses in 2008 include a charge from Pearl Group Management Services (Ireland) Limited of £5m (2007 : £2m credit) in respect of the Company's Irish branch pension scheme.

## Notes to the financial statements continued

### 7. Auditors' remuneration

The remuneration (excluding VAT) of the auditors of the Company, including their associates, in respect of services supplied to the Company is as follows:

	2008 £	2007 £
Audit Services	245,000	374,000
Other Services	157,000	370,250
	<u>402,000</u>	<u>744,250</u>

The remuneration included for other services comprises:

	2008 £	2007 £
The auditing of accounts of associates of the Company pursuant to legislation	6,000	8,250
Other services pursuant to legislation – audit related	108,000	178,000
Other services	43,000	184,000
	<u>157,000</u>	<u>370,250</u>

### 8. Financing costs

	2008 £m	2007 £m
Interest expense:		
On items valued at fair value through income	15	9
On items valued at amortised cost	-	4
	<u>15</u>	<u>13</u>

### 9. Directors' emoluments

Amounts paid to Directors for their services as Directors of the Company and its subsidiaries were:

	2008 £	2007 £
Short term employment benefits	<u>381,094</u>	<u>312,130</u>

The totals shown represent the proportion of the total remuneration of the Directors relevant to the Company and its subsidiaries, according to the proportion of their time spent on company affairs.

Amounts paid to a defined contribution scheme on behalf of the Directors, in respect of their services as Directors of the Company and its subsidiaries were:

	2008 £	2007 £
Contributions paid	<u>26,248</u>	<u>37,221</u>

The totals shown represent the proportion of the total pension contributions relevant to the Company and its subsidiaries, according to the proportion of time the Directors spent on company affairs.

## Notes to the financial statements continued

### 9. Directors' emoluments continued

	2008 £	2007 £
Remuneration of the highest paid Director included in total remuneration	<u>134,614</u>	<u>97,136</u>

At 31 December 2008, the highest paid director has an accrued pension under a defined benefit scheme of £16,987. The scheme does not permit the accrual of a lump sum.

For the year ended 31 December 2007, the amount paid to a defined contribution pension scheme on behalf of the highest paid director was £15,489.

The highest paid Director did not exercise any share options during the year (2007: nil).

Under a Resolution plc Long-Term Incentive Plan granted on 1 April 2007, one current and two former directors of the Company, including the highest paid director, were granted a conditional award of shares in Resolution plc. Following the acquisition of Resolution plc by Impala Holdings Limited on 1 May 2008 these awards were settled in cash amounts.

	2008	2007
Directors to whom retirement benefits under a defined benefit group scheme were accruing in respect of qualifying services	<u>2</u>	<u>-</u>
Directors to whom retirement benefits under a defined contribution group scheme were accruing in respect of qualifying services	<u>3</u>	<u>3</u>

Directors' emoluments for M Dale, J Moss, H Osmond, M Ross, J S Smith are disclosed in the annual report and financial statements of PGL.

Directors' emoluments for I Maidens and J Newman are disclosed in the annual report and financial statements of Pearl Group Holdings (No. 1) Limited.

The emoluments of E Hawkes are disclosed in the annual report and financial statement of Impala Holdings Limited.

The emoluments of G Singleton are disclosed in the annual report and financial statements of Pearl Life Holdings Limited.

During the year, TDR Capital LLP, of whom Manjit Dale is a designated member, and of whom Layton Tamberlin is a member, received £1,762,500 as shareholding monitoring fees.

## Notes to the financial statements continued

### 10. Income taxes

#### (a) Current year tax charge

	2008 £m	2007 £m
Current tax:		
UK Corporation tax	35	22
Overseas tax	3	-
	<u>38</u>	<u>22</u>
Adjustment in respect of prior years	1	14
	<u>39</u>	<u>36</u>
Deferred tax:		
Deferred tax on amortisation of VIF	(11)	(6)
On profit arising from the changes in assumptions used to determine insurance contract liabilities in accordance with PS06/14	(3)	3
Recognition of previously unrecognised tax losses	-	(10)
Part VII transfer (note 1)	(2)	-
Overseas tax	(7)	-
Other	(7)	10
	<u>(30)</u>	<u>(3)</u>
Total income tax expense	<u>9</u>	<u>33</u>
Attributable to: policyholders	-	2
equity holders	9	31
	<u>9</u>	<u>33</u>

Unrecognised tax losses of previous years have been used to reduce current tax expense and deferred tax by £nil (2007: £59m) and £nil (2007: £51m) respectively.

#### (b) Reconciliation of tax charge

	2008 £m	2007 £m
Profit before tax	41	176
Policyholder tax	-	(2)
Profit after policyholder tax	<u>41</u>	<u>174</u>
Tax at standard UK rate 28.5% (2007 : 30%)	12	52
Untaxed income	(4)	(10)
Disallowable expenses	2	1
Adjustment to tax charge in respect of prior years	1	14
Recognition of losses/assets not previously valued	-	(27)
Difference in tax rates	-	(2)
Impact of tax on acquired in-force amortisation at less than 28.5% (2007 : 30%)	5	3
Overseas tax	(4)	-
Other	(3)	-
Equity holders' tax	9	31
Policyholder tax	-	2
Total tax charge for the year	<u>9</u>	<u>33</u>

## Notes to the financial statements continued

### 11. Statement of changes in equity

	Share capital £m	Other Reserves £m	Capital contribution reserve £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m
Balance at 1 January 2007	1,765	222	178	-	(941)	1,224
Arising in the period:						
Foreign currency translation of branch	-	-	-	2	-	2
Net income recognised directly in equity	-	-	-	2	-	2
Profit for the year	-	-	-	-	143	143
Total recognised income and expense for the year attributable to equity holders	-	-	-	2	143	145
Balance at 31 December 2007	1,765	222	178	2	(798)	1,369
Balance at 1 January 2008	1,765	222	178	2	(798)	1,369
Arising in the period:						
Foreign currency translation of branch	-	-	-	15	-	15
Net income recognised directly in equity	-	-	-	15	-	15
Profit for the year	-	-	-	-	32	32
Total recognised income and expense for the year attributable to equity holders	-	-	-	15	32	47
Balance at 31 December 2008	1,765	222	178	17	(766)	1,416

### 12. Share capital

	2008 £m	2007 £m
Authorised: 4,335,000,000 ordinary shares at £1 each	4,335	4,335
Issued and fully paid: 1,765,000,002 ordinary shares at £1 each	1,765	1,765

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. The ordinary shareholders are entitled to any residual assets on the winding up of the Company.

### 13. Other reserves

	2008 £m	2007 £m
Other reserves	222	222
Capital contribution reserve	178	178
Foreign currency translation reserve	17	2
	417	402

Other reserves arose on the date of demutualisation and are not distributable.

The capital contribution reserve represents a capital contribution from the Company's parent in prior years. Subject to the Company having distributable reserves, the capital contribution can be repaid at the Company's discretion.

Due to the deficit in retained earnings, the Directors consider there to be no distributable reserves at 31 December 2008.



# Notes to the financial statements continued

## 14. Liabilities under insurance contracts

	Gross liabilities 2008 £m	Reinsurers' share 2008 £m
Insurance contracts	4,352	1,186
Investment contracts with DPF	839	-
	<b>5,191</b>	<b>1,186</b>
Amount due for settlement/recovery within 12 months	499	25
Amount due for settlement/recovery after 12 months	<b>4,692</b>	<b>1,161</b>

	Gross liabilities 2007 £m	Reinsurers' share 2007 £m
Insurance contracts	4,917	967
Investment contracts with DPF	1,059	-
	<b>5,976</b>	<b>967</b>
Amount due for settlement/recovery within 12 months	590	20
Amount due for settlement/recovery after 12 months	<b>5,386</b>	<b>947</b>

	Gross liabilities 2008 £m	Reinsurers' share 2008 £m
At 1 January 2008	5,976	967
Premiums	256	254
Claims	(839)	(105)
Other changes in liabilities	(430)	56
Foreign exchange adjustments	276	69
Part VII transfer (note 1)	(48)	(55)
As at 31 December 2008	<b>5,191</b>	<b>1,186</b>

	Gross liabilities 2007 £m	Reinsurers' share 2007 £m
At 1 January 2007	6,360	615
Premiums	298	455
Claims	(770)	(66)
Other changes in liabilities	(3)	(37)
Foreign exchange adjustments	91	-
As at 31 December 2007	<b>5,976</b>	<b>967</b>

## Notes to the financial statements continued

### 15. Unallocated surplus

	2008 £m	2007 £m
As at 1 January	93	89
Transfer (to)/from income statement	(52)	2
Foreign exchange adjustments	1	2
As at 31 December	<u>42</u>	<u>93</u>

### 16. Investment contract liabilities

	2008 £m	2007 £m
Investment contract liabilities	180	267
Amount due for settlement within 12 months	<u>41</u>	<u>51</u>
Amount due for settlement after 12 months	<u>139</u>	<u>216</u>

### 17. Insurance and investment contract liabilities – assumptions and sensitivities

#### (a) Assumptions

##### *Process used to determine 2008 assumptions*

For participating business written by realistic basis companies the demographic assumptions about future experience are intended to be "best estimates". These assumptions are determined after considering the companies' recent experience and/or relevant industry data. Economic assumptions are market consistent.

For other business, demographic assumptions are derived by adding a prudence margin to best estimate assumptions. Economic assumptions are prudent estimates of the returns expected to be achieved on the assets backing the liabilities.

As outlined below, particular attention was given to the impact of deteriorating credit ratings on corporate bonds.

A number of changes were made to assumptions during the year to reflect changes in expected experience. No material changes were made to demographic assumptions, although future interest and expense inflation assumptions changed substantially in line with market conditions.

##### **Valuation interest rate**

For realistic basis companies, the liabilities are determined stochastically using an appropriate number of risk neutral scenarios produced by a proprietary economic scenario generator calibrated to market conditions and gilt yields as at the valuation date.

For funds not subject to realistic reporting, the method used to determine valuation interest rates generally follows the rules set out in section 1.2.33 of the Prudential Sourcebook for insurers. Assets are firstly hypothecated to classes of business being valued.

The valuation interest rates for each block of business are based on the expected returns of the hypothecated assets. The yield is then adjusted to make allowance for credit risk, reinvestment risk and investment management expenses. Valuation interest rates (after tax for life policies) are generally in the following ranges:

Life policies : 2.15% - 3.80%

Pension policies : 2.75% - 5.22%

As a consequence of a deterioration in credit ratings on corporate bonds, a comparison of the credit ratings of assets held against actual credit spreads was undertaken and adjustments made to valuation interest rates where appropriate, resulting in a general reduction in rates.

## Notes to the financial statements continued

### 17. Insurance and investment contract liabilities – assumptions and sensitivities continued

Investment contracts with discretionary participation features are not measured at fair value, as there is currently no agreed definition of fair valuation for discretionary participation features under IFRS.

#### **Expense inflation**

Expenses are assumed to increase at the rate of increase in the RPI plus a fixed margin in accordance with the management service agreements (MSAs). For realistic basis business, the rate of RPI inflation is determined within each stochastic scenario; for other business it is assumed that RPI inflation is 2.54% per annum. For MSAs with contractual increases set by reference to national average earnings inflation, this is approximated as RPI inflation plus 1%. In instances in which inflation risk is not mitigated, a further margin for adverse deviations is then added to the rate of expense inflation.

#### **Mortality and longevity rates**

Mortality rates are based on published tables, adjusted appropriately to take account of changes in the underlying population mortality since the table was published, company experience and forecast changes in future mortality. Where appropriate, a margin is added to assurance mortality rates to allow for adverse future deviations. Annuitant mortality rates are adjusted to make allowance for future improvements in pensioner longevity.

#### **Lapse and surrender rates (persistence)**

The assumed rates for surrender and voluntary premium discontinuance depend on the length of time a policy has been in force and the type of business. Withdrawal rates used in the valuation of with profit policies are based on observed experience and adjusted when it is considered that future policyholder behaviour will be influenced by different considerations than in the past. In particular, it is assumed that withdrawal rates for unitised with profit contracts will be higher on policy anniversaries on which market value adjustments do not apply. For protection business, lapse rates are based on recent observed experience with an appropriate prudent margin for adverse future deviations.

#### **Discretionary participating bonus rates**

For realistic basis companies, the regular bonus rates assumed in each scenario are determined in accordance with each company's Principles and Practices of Financial Management (PPFM). Final bonuses are assumed at a level such that maturity payments will equal asset shares subject to smoothing rules set out in the PPFM.

#### **(b) Sensitivities**

The table below indicates the stand-alone impact of certain key assumption changes to insurance and investment contracts.

Assumption changes for with profit contracts have no direct impact on profit or equity holders' funds. Consequently these do not feature in the table below.

	Change in assumption %	Impact on profit before equity holders' tax £m	Impact on equity holders funds £m
Fixed interest yield assumptions	-1%	(0.49)	(0.36)
Fixed interest yield assumptions	+1%	(10.21)	(7.35)
Equity and property values	-10%	(0.58)	(0.42)
Mortality assumptions for annuities	-5%	(0.04)	(0.03)
Credit Spread on Corporate Bonds	+1%	0.00	0.00

In reality, given the correlation between the assumptions, it is often not possible to demonstrate the effect of key assumptions whilst other assumptions remain unchanged. It should also be noted that in some instances these sensitivities are non-linear, consequently larger or smaller impacts should not be interpolated or extrapolated from these results.

## Notes to the financial statements continued

### 18. Reinsurance payables

	2008 £m	2007 £m
Reinsurance payables	4	8
Due to fellow subsidiaries	4	-
	<u>8</u>	<u>8</u>
Amount due for settlement within 12 months	<u>8</u>	<u>8</u>

### 19. Payables related to direct insurance contracts

	2008 £m	2007 £m
Payables related to direct insurance contracts	34	34
Amount due for settlement within 12 months	<u>34</u>	<u>34</u>

### 20. Borrowings

	2008 £m	2007 £m
Loan from subsidiary undertaking	51	49
Amount payable within 12 months	<u>51</u>	<u>49</u>

### 21. Trade and other payables

	2008 £m	2007 £m
Due to fellow subsidiaries	22	10
Due to subsidiary undertakings	10	9
Net collateral loan	27	5
Exchange Traded Futures (note 26)	5	-
Other liabilities	<u>77</u>	<u>74</u>
	<u>141</u>	<u>98</u>
Amount due for settlement within 12 months	<u>116</u>	<u>93</u>
Amount due for settlement after 12 months	<u>25</u>	<u>5</u>

#### Net collateral loan

Collateral sums are deposited back to the Company by credit institutions in order to reduce the counterparty risk to the Company on particular assets held to back certain policyholder benefits. Interest on deposit back arrangements is payable on the amounts owed based on Sterling Overnight Index Average rates.

The table below provides analysis of the derivative assets and related collateral loans as described in note 26.

	2008 £m			2007 £m		
	Fair value assets	Collateral loan	Net fair value of liabilities	Fair value assets	Collateral loan	Net fair value of liabilities
OTC derivatives	<u>244</u>	<u>(271)</u>	<u>(27)</u>	<u>101</u>	<u>(106)</u>	<u>(5)</u>

## Notes to the financial statements continued

### 22. Investments in subsidiaries

	£m
Cost at 31 December 2008 and 31 December 2007	168
Carrying value at 31 December 2008	60
Carrying value at 31 December 2007	58

The subsidiary undertakings of the long-term fund are stated below. All subsidiaries have share capital consisting solely of one class with the exception of South Glasgow Retail Park Ltd. which has 'A' ordinary and 'B' ordinary shares in issue.

Subsidiary	Nature of business	% of shares held	Country of incorporation
Scottish Provident (Holdings) Ltd	Intermediate holding company	100	England
SPI Finance plc	Finance company	100	England
South Glasgow Retail Park Ltd	Property development	100	Scotland
Prolific Holdings Ltd	Investment holding company	100	England

### 23. Intangible assets

#### PVIF

	2008 £m	2007 £m
At 1 January		
Cost	1,001	1,001
Accumulated amortisation and impairment	(665)	(635)
Net book amount	336	366
Year ended 31 December		
Opening net book amount	336	366
Movement in the period	(55)	(30)
Impairment on Part VII transfer (note 1)	(9)	-
Net book amount	272	336
Amount recoverable within 12 months	27	33
Amount recoverable after 12 months	245	303

The PVIF is reported gross with related taxes included within deferred tax (note 29).

### 24. Loans and receivables

	2008 £m	2007 £m
Loan	5	-
Due from fellow subsidiaries	1,032	-
	1,037	-
Amount recoverable within 12 months	1	-
Amount recoverable after 12 months	1,036	-

The loan balance represents amounts receivable from the Society in connection with the Part VII transfer (note 1).

Amounts due from fellow subsidiaries relate to loans due to be repaid in 2016. The equivalent balance in 2007 was repayable on demand, and as such was presented within trade and other receivables (Note 30).

## Notes to the financial statements continued

### 25. Financial assets at fair value through income

	2008 £m	2007 £m
Financial Assets at fair value through income	4,397	5,605
Amount recoverable within 12 months	4,330	5,520
Amount recoverable after 12 months	67	85

### 26. Derivatives

	2008 £m	2007 £m
Exchange traded futures	-	1
Amount recoverable within 12 months	-	1

#### (a) Hedges for policy guarantees (OTC options)

During the year, the Company held OTC derivative contracts with nominal values totalling £1.8bn with Goldman Sachs (2007: £1.9bn), to provide financial protection against a range of embedded policy guarantees. The contracts take the form of a number of options, specified to capture the material elements of the economic exposure of the with profit fund to costs of guarantees attributable to equity returns, interest rate movements and foreign exchange rate movements. The terms of the options have been determined to match as closely as possible central expectations regarding asset management, management actions and customer choices.

The option types, and range of maturity dates and strike levels are set out below.

Option guarantee type	Option type	Maturity date range
Maturity guarantees on conventional with profit (CWP) policies and Market Value Adjustment (MVA) free guarantees on unitised with profit (UWP) policies	European Equity Put	Dec '09 - Dec '27
	Interest Rate Swaps	June '28 - June '47
	Interest Rate Swaptions	June '09 - June '27
	Equity Futures	Rolled every 3mths
CWP pensions maturity guarantees with guaranteed annuity options	European Equity Put	Dec '09 - Dec '27
	Interest Rate Swaps	June '28 - June '47
	Interest Rate Swaptions	June '09 - June '27
	Equity Futures	Rolled every 3mths
CWP deferred annuity contracts without guaranteed commutation options	European Equity Put	Dec '09 - Dec '27
	Interest Rate Swaps	June '28 - June '47
	Interest Rate Swaptions	June '09 - June '27
	Equity Futures	Rolled every 3mths

The premium payable by the Company for the purchase of these options was £90m in 2007. During 2008 the hedge was rebalanced generating a net release of £17m.

As at 31 December 2008, there was an unrealised gain of £177m on the options held (2007: £9m).

As security for the maturity proceeds of these derivatives, Goldman Sachs lent the Company sums amounting to £271m (2007 £106m). As there is a legal right of set off for the derivative assets and related collateral loans, and it is intended that settlement will be made on a net basis, the derivatives and collateral loans are presented as net derivative assets or net collateral loans as appropriate on the balance sheet and notes (note 21).

#### (b) Exchange traded futures

These are held for efficient portfolio management purposes.

## Notes to the financial statements continued

### 27. Reinsurance receivables

	2008 £m	2007 £m
Reinsurance receivables	4	47
Amount recoverable within 12 months	4	47

### 28. Insurance contract receivables

	2008 £m	2007 £m
Insurance contract receivables	2	3
Amount recoverable within 12 months	2	3

### 29. Tax assets and liabilities

	2008 £m	2007 £m
Deferred tax assets	13	10
Total tax assets	13	10

	2008 £m	2007 £m
Current tax payables	35	42
Deferred tax liabilities	59	86
Total tax liabilities	94	128

Deferred tax assets comprise:

	2008 £m	2007 £m
Losses carried forward	13	10

Deferred tax liabilities comprise:

	2008 £m	2007 £m
PVIF	56	69
Other temporary differences	3	-
On profit arising from the changes in assumptions used to determine insurance contract liabilities in accordance with PS06/14	-	3
Unrealised gains on investments	-	26
Excess expenses and deferred acquisition costs	-	(12)
Total deferred tax liability	59	86

An amount of £51m (2007: £63m) of the deferred tax liability is expected to crystallise after 12 months.

## Notes to the financial statements continued

### 29. Tax assets and liabilities continued

Movements in deferred tax assets comprise:

	2008 £m	2007 £m
At 1 January	10	-
Amounts released to the income statement	3	10
At 31 December	13	10

Movements in deferred tax liabilities comprise:

	2008 £m	2007 £m
At 1 January	86	79
Amounts (released)/charged to the income statement	(27)	7
At 31 December	59	86

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2007: 28%).

Deferred income tax assets are recognised for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable.

The amount of tax loss carry forwards and tax credits at 31 December 2008 is £253m (2007: £84m). No deferred tax asset has been recognised in respect of these amounts.

### 30. Trade and other receivables

	2008 £m	2007 £m
Due from fellow subsidiaries	13	805
Trade and other receivables	3	5
	16	810
Amount recoverable within 12 months	16	810

The majority of amounts due from fellow subsidiaries have been reclassified as loans and receivables in the current year, following changes in the terms of the loans (note 24).

### 31. Cash and cash equivalents

	2008 £m	2007 £m
Bank and cash balances	166	160
Bank overdrafts with legal right of set off	(2)	(12)
	164	148

All deposits are subject to fixed interest rates. The carrying amounts approximate to fair value at the balance sheet date.



## Notes to the financial statements continued

### 32. Cash flows from operating activities

	2008 £m	2007 £m
Profit before tax for the year	41	176
Non-cash movements in profit before tax for the year:		
Part VII transfer (note 1) *	12	-
Gain on sale of financial assets at fair value through income	(4)	(31)
Fair value loss on financial assets at fair value through income	745	16
Impairment and amortisation of intangible assets	28	30
Net (increase)/decrease in working capital	(560)	168
Net decrease in operating assets and liabilities	262	359

\* A bank overdraft of £1m was transferred as a result of the Part VII transfer and is included within net increase in working capital.

## Notes to the financial statements continued

### 33. Related party transactions

	Notes	2008 £m	2007 £m
<b>Gross premiums written:</b>			
Scottish Mutual International Limited	(a)	<u>1</u>	<u>-</u>
<b>Premiums ceded to reinsurers:</b>			
Phoenix Pensions Limited	(b)	<u>(207)</u>	<u>(407)</u>
<b>Fees and commission:</b>			
Ignis Fund Managers Limited (formerly Resolution Fund Managers Limited)	(c)	1	1
Scottish Mutual Investment Managers Limited	(c)	<u>2</u>	<u>2</u>
<b>Investment income:</b>			
Scottish Mutual Investment Managers Limited	(d)	75	-
Ignis Fund Managers Limited (formerly Resolution Fund Managers Limited)	(d)	101	-
Pearl Life Holdings Limited (formerly Resolution Life Limited)	(e)	65	50
Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	(d)	<u>4</u>	<u>-</u>
<b>Fair value gain/(losses):</b>			
Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	(f)	4	-
Ignis Alternative Funds plc	(f)	(15)	-
Scottish Mutual Investment Managers Limited	(f)	(560)	(60)
Ignis Fund Managers Limited (formerly Resolution Fund Managers Limited)	(f)	<u>(262)</u>	<u>75</u>
<b>Policyholder claims</b>			
Scottish Mutual International Limited	(g)	<u>-</u>	<u>3</u>
<b>Reinsurance recoveries</b>			
Phoenix Pensions Limited	(h)	<u>(36)</u>	<u>-</u>
<b>Change in insurance contract liabilities</b>			
Scottish Mutual International Limited	(i)	(6)	(4)
Phoenix Pensions Limited	(j)	<u>(305)</u>	<u>(433)</u>
<b>Administrative expenses:</b>			
Pearl Group Management Services Limited (formerly Resolution Management Services Limited)	(k)	19	22
PGMS (Glasgow) Limited (formerly Resolution Management Services (Glasgow) Limited)	(k)	(1)	(6)
PGMS (Ireland) Limited (formerly Resolution Management Services (Ireland) Limited)	(k)	13	7
Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	(k)	2	2
Scottish Mutual Assurance Limited	(l)	<u>7</u>	<u>-</u>
<b>Financing costs:</b>			
Prolific Holdings Limited	(m)	2	3
SPI Finance plc	(n)	<u>-</u>	<u>4</u>

## Notes to the financial statements continued

### 33. Related party transactions continued

#### Notes:

- (a) Premiums include £1m (2007: £nil) of net premiums reassured to Scottish Mutual International Limited.
- (b) Premiums ceded to reinsurers include £207m (2007: £407m) of net premiums reassured to Phoenix Pensions Limited.
- (c) Represents rebate income for the relevant counterparty.
- (d) Represents franked and unfranked investment income received from relevant counterparty.
- (e) Represents interest receivable on loan to relevant counterparty.
- (f) Represents net unrealised/realised gain/(loss) in period with relevant counterparty.
- (g) In 2007 represented £3m paid to Scottish Mutual International Limited in accordance with reinsurance agreements between the parties.
- (h) Represents the reinsurers share of claims.
- (i) Represents the movement in the asset to Scottish Mutual International Limited in relation to the reinsurance treaty between the two parties.
- (j) Represents the movement in the reinsurance asset with Phoenix Pensions Limited.
- (k) Management charges payable to relevant counterparty. PGMS (Ireland) Limited includes £8m (2007: £9m) of management charges and £5m (2007: £2m credit) in relation to movement in pension deficit. The balance in PGMS £1m (2007: £6m)
- (l) Represents amounts paid in respect of impairment of financial assets.
- (m) Represents interest payable on loan with Prolific Holdings Limited.
- (n) In 2007 represented interest payable to SPI Finance plc in relation to £125m 8.75% subordinated guarantee bonds.

The Company enters into transactions with related parties in the normal course of business. Transactions are carried out on an arms length basis.

In addition, the Company has a related party relationship with its Directors and the Directors of its parent entities who are the key management personnel of the Company. Details of Directors' emoluments are set out at note 9.

## Notes to the financial statements continued

### 33. Related party transactions continued

The Company had the following outstanding balances with related parties at the year end, which are included in the balance sheet under the captions noted:

	Notes	2008 £m	2007 £m
<b>Loans and receivables</b>			
Pearl Life Holdings Limited (formerly Resolution Life Limited)	(a)	1,020	-
Impala Holdings Ltd	(a)	12	-
<b>Financial assets at fair value through income:</b>			
Scottish Mutual Investment Managers Limited	(b)	1,264	4,569
Ignis Alternative Funds plc	(b)	35	-
Ignis Fund Managers Limited (formerly Resolution Fund Managers Limited)	(b)	1,861	-
Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	(b)	995	-
Scottish Mutual International Fund Managers Limited	(b)	-	1
<b>Reinsurers' share of insurance contract liabilities:</b>			
Phoenix Pensions Limited	(c)	738	433
<b>Reinsurance receivables:</b>			
Phoenix Pensions Limited	(d)	-	26
<b>Prepayments:</b>			
Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	(e)	3	-
<b>Trade and other receivables:</b>			
Pearl Life Holdings Limited (formerly Resolution Life Limited)	(a)	-	800
Scottish Mutual Investment Managers Limited	(d)	11	1
Ignis Fund Managers Limited (formerly Resolution Fund Managers Limited)	(d)	2	1
PGMS (Ireland) Limited (formerly Resolution Management Services (Ireland) Limited)	(d)	-	3
<b>Liabilities under insurance contracts:</b>			
Scottish Mutual International Limited	(f)	14	16
<b>Borrowings:</b>			
Prolific Holdings Limited	(g)	51	49
<b>Reinsurance payables</b>			
Phoenix Pensions Limited	(h)	4	-
<b>Trade and other payables:</b>			
Scottish Mutual International Limited	(i)	1	1
PGMS (Ireland) Limited (formerly Resolution Management Services (Ireland) Limited)	(j)	3	1
South Glasgow Retail Park Limited	(k)	10	9
Ignis Fund Managers Limited (formerly Resolution Fund Managers Limited)	(l)	-	1
Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	(m)	-	1
Pearl Group Management Services Limited (formerly Resolution Management Services Limited)	(n)	2	1
Scottish Mutual Assurance Limited	(o)	17	4
PGMS (Glasgow) Limited (formerly Resolution Management Services (Glasgow) Limited)	(p)	-	1

## Notes to the financial statements continued

### 33. Related party transactions continued

#### Notes:

- (a) Balance represents capital and accrued interest on loans
- (b) Balances represent the market value of investments held with the relevant counterparty.
- (c) Balance represents the reinsurance asset in relation to the reinsurance treaty between the two parties.
- (d) Balance represents debtor balances with relevant counter party.
- (e) Balances represent an inter company prepayment of interest from relevant counterparty.
- (f) Balance represents the liability to Scottish Mutual International Limited in relation to the reinsurance treaty between the two parties.
- (g) Balance represents the loan with Prolific Holdings Limited including accrued interest of £2m (2007: £3m).
- (h) Balance represents an inter company creditor with Phoenix Pensions Ltd.
- (i) Balance represents inter company creditor in relation to the reinsurance treaty between the two parties.
- (j) Balance represents an inter company creditor with PGMS (Ireland) Limited.
- (k) Balance represents an inter company creditor with South Glasgow Retail Park Ltd of £10m (2007: £9m).
- (l) Balance in 2007 represents an inter company creditor with Ignis Fund Managers Limited.
- (m) Balance in 2007 represents an inter company creditor with Ignis Investment Services Limited.
- (n) Balance represents an inter company creditor with Pearl Group Management Services Limited.
- (o) Balance represents an inter company creditor of £17m.
- (p) Balance represents an inter company creditor with PGMS (Ireland) Limited.

### 34. Risk management policies

#### **Management of insurance and financial risk**

The Company is part of the Pearl Group. The Company issues contracts that transfer insurance risk or financial risk or both. This note summarises these risks and the way the Company managed them during 2008, prior to the transfer of its insurance operations to Phoenix Life Limited (PLL), as outlined in note 38.

The Company has implemented processes and structures to support the effective management of risk. Board and Board sub-committee structures, membership and terms of reference have been implemented by PGL and have been adopted across the group. The Company's Directors are responsible for the system of risk management and internal control, including financial, operational and compliance controls and for reviewing its effectiveness. Due to the limitations that are inherent in any system of internal control, this system is designed to manage and control, rather than eliminate risk completely. In assessing these risks, the Directors take into account any benefits that may accrue from risk acceptance before making a commercial decision to ensure that risks are commensurate with the anticipated returns.

Risk within the Pearl Group is overseen by the Risk Management function. The Risk Management function uses a hierarchy of Pearl Group-wide policy documents as the basis for its approach. Accompanying these, the Pearl Risk Management Framework sets out the high level arrangements for risk management, control and assurance within the Pearl Group. It is designed to provide a structured approach for identifying, monitoring and managing financial and non-financial risk within the Pearl Group.

The risk policy documents set out the nature and level of risks that are acceptable to PGL and its various businesses, and sets out the Board's tolerance for earnings volatility and possible losses. It provides a description of the types and quantum of risk that PGL is prepared to take as a result of its various business operations.

The Pearl Group Risk Committee meets on a monthly basis to ensure that all key risks impacting the Pearl Group are suitably monitored and managed.

Risk management policies were similarly applied prior to 1 May 2008, when the Company's ultimate parent and controlling party was Resolution plc.

Contracts are split into three categories, the key risks of which are summarised as follows:

#### **With profit fund**

In the context of the Risk management policies note, the with profit fund includes the special with profit fund.

This fund takes controlled investment risk with the aim of enhancing policyholder investment returns. The fund aims to limit that risk, in line with the risk policies, to that supportable by the with profit fund's assets. The costs of guarantees are, in general, spread across the contracts in the fund, but there remains a risk that the shareholder may have to contribute capital to the fund in accordance with the terms of a memorandum of agreement to which the shareholder is party. However, derivative backed hedge assets are in place to protect against this risk.

## Notes to the financial statements continued

### 34. Risk management policies continued

For unitised with profit contracts, the Company receives an annual management charge, typically ranging between 0.5% and 1.5% per annum, so that the earnings risks to the shareholder are similar to unit linked contracts.

For traditional with profit contracts, which form the minority of the with profit fund business, the shareholder receives 1/9<sup>th</sup> of the cost of bonuses declared to policyholders as long as there is a distributable surplus within the fund.

#### Unit linked (Non profit fund)

In relation to unit linked contracts, the policyholders carry all investment risks, with any changes in underlying investments being reflected by an equal and opposite change in the related contract liabilities. The Company receives an annual management charge (AMC), typically ranging between 0.5% and 1.5% per annum of the net asset value of the underlying funds. As a result of this, AMC income can increase or decrease depending on price movements within each underlying unit linked contract.

#### Non linked (Non profit fund)

The risks relating to the non profit non linked contracts lie directly with the shareholder, in the event of assets not matching liabilities.

Further detail of the risks relevant to the above sub funds and contract types and how they are controlled is set out below.

#### (a) Insurance risk

Insurance risk is the possibility under any one insurance contract that the insured event occurs and the uncertainty of the amount of the resulting claim. It refers to the inherent uncertainties in insurance, including:

- the occurrence of any event specifically insured against;
- for long-term insurance business, adverse mortality, morbidity and persistency experience; and
- expense overruns relative to pricing or provisioning assumptions.

Those terms and conditions of insurance contracts that have a material effect on the Company's cash flows are as follows:

- fixed and guaranteed benefits for a fixed future premium;
- the option to pay reduced or no future premiums;
- the option to terminate the contract completely;
- the option to exercise a guaranteed annuity or cash option; and
- MVA free guarantees

The Company controls insurance risk through the following:

- the use of actuarial models to calculate premiums and monitor claims patterns. Past experience, as well as statistical methods, are used;
- issued guidelines for concluding insurance contracts and assuming insurance risks. In relation to life insurance, the Company concentrates on risks such as mortality, disability, illness and long-term care requirements;
- reinsurance of a large portion of the annuity business and, up to the point of the Part VII transfer to The Royal London Mutual Insurance Society Limited, protection business. Reassurance is also used to limit the Company's exposure to large single claims. When selecting a re-insurer, the Company only considers those companies that provide high security. In order to assess this, ratings information is used, both from the public domain or gathered through internal investigations;
- close monitoring of the management of assets and liabilities to attempt to match the expected pattern of claim payments with the maturity dates of assets;
- the use of underwriting with premium levels being set to reflect the calculated level of risk; and
- stress and scenario testing to monitor insurance risk as part of the Individual Capital Assessment required under the FSA realistic reporting regime. Each main category of insurance risk is subject to a detailed experience analysis to ensure that all assumptions are reasonable.

## Notes to the financial statements continued

### 34. Risk management policies continued

#### (i) Sensitivity analysis

The nature of the insurance business is such that a number of assumptions have been made in compiling the financial statements.

The table at note 17(b) provides a sensitivity analysis in relation to certain assumptions.

The Company's exposure to movements in equity markets is limited by the use of derivative backed hedges within the with profit funds. For unit linked contracts invested in equities, the investment risk is borne entirely by the contract holders. Accordingly the Company's results are less sensitive to movements in equity markets.

#### (ii) Concentrations of insurance risk

The table below presents an analysis of insured benefits across products.

2008	Liability values	
	Gross liabilities £m	Net of reinsurance £m
Property linked	535	535
Non profit annuity in payment	954	20
Traditional life non profit	79	32
Traditional pension non profit	220	15
Other non profit	38	38
With profit	3,365	3,365
Total	5,191	4,005

2007	Liability values	
	Gross liabilities £m	Net of reinsurance £m
Property linked	752	752
Non profit annuity in payment	924	29
Traditional life non profit	78	7
Traditional pension non profit	194	193
Other non profit	26	26
With profit	4,002	4,002
Total	5,976	5,009

#### (b) Financial Risk

The Company is exposed to financial risk through its financial assets, financial liabilities, insurance assets and insurance liabilities.

The key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts as they fall due. The most important components of this financial risk are market risk, credit risk and liquidity risk, as outlined in the following sections.

##### (i) Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices and comprises three types of risk: interest rate risk, price risk and currency risk. These risks impact on the Company depending on the nature of the contracts written, as follows:

## Notes to the financial statements continued

### 34. Risk management policies continued

#### Insurance and investment contracts with DPF

The main market risks inherent in these contracts are dependent upon the asset allocation of the with profit fund. The more the fund is invested in an asset class, the greater the risk attached to movements in the particular asset market.

The main market risks, reflecting the asset allocation, within the with profit fund are due to variations in:

- equity prices;
- interest rates and bond prices;
- corporate bond spreads;
- equity price volatility affecting the value of policy guarantees; and
- bond volatilities affecting the value of guaranteed annuity options and other guarantees.

There are currently no direct investments in property. Small values of property investments are held indirectly, in the unit linked funds, via Collective Investment Schemes (CISs). One of the CISs has divestment restrictions, potentially delaying redemption for up to six months if there is insufficient liquidity within the fund. There is currently sufficient cash in the fund to meet redemption levels.

#### Non linked insurance contracts without DPF

For conventional products without DPF, the contract benefits are guaranteed at outset, which implies a guaranteed rate of return (ignoring mortality risk). The Company bears the risk of the assets held failing to meet the value of liabilities.

The Company's non profit funds are invested in a mix of government bonds, corporate bonds and cash. Therefore, the main market risks within these funds are:

- variation in interest rates and bond prices; and
- variation in corporate bond spreads.

#### Unit linked insurance and investment contracts without DPF

For unit linked policies, the asset values determine the liabilities and the policyholder therefore bears all the market risk.

Fee income to the Company from unit linked policies is normally taken as a percentage of funds under management, which is determined by cash flows, including the rate of asset growth. Therefore, if markets fall the value of the fee income falls as the charges on the funds under management are reduced.

The level of market risk in the Company is monitored and a report on risk levels, including Risk Based Capital levels (both total risk and market risk), is provided regularly to the Executive Committee, the Finance, Risk and Capital Oversight Committee (FRCOC) and to the Asset and Liability Committee (ALCO).

A system of exposure limits is in place with clearly specified escalation procedures in the event of breaches. Risk positions against limits are included in the monthly reports to senior management. In the non profit fund, risk mitigation actions are likely to include adjusting asset profiles to more closely match liabilities. In relation to contracts with DPF, risk mitigation actions are likely to include switching the asset allocation into less risky assets or using derivatives to hedge positions.

Market risk can be further subdivided into the following components:

##### *Interest rate risk*

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates.

The Pearl Group interest rate risk policy requires the Company to manage interest rate risk by maintaining an appropriate mix of fixed and variable rate instruments. The policy also requires it to manage the maturity profile of these assets consistent with liabilities to policyholders.



## Notes to the financial statements continued

### 34. Risk management policies continued

#### *Currency risk*

The Company's transactions are principally carried out in pounds sterling, although some business is transacted in euros, primarily in relation to the Company's Irish branch.

The foreign currency denominated business is transacted in both the with profit fund and non profit fund and is in euros. The bulk of this is invested in euro-denominated assets held to match euro-denominated liabilities. A proportion of the with profit euro assets are included as part of the hedging programme. On a net basis, foreign currency mismatch exposure is not significant.

Limited foreign currency risk does arise within the with profit fund investment portfolios supporting the Company's insurance and investment operations, where assets are held that are denominated in a foreign currency. These positions are deliberately taken to obtain diversification benefits and exposures are generally low in proportion to total fund size.

The level of exposure in total and by currency is monitored daily.

#### *Price risk*

The Company's price risk exposure relates primarily to financial assets and liabilities whose values fluctuate as a result of changes to market prices other than from interest rate and currency fluctuations.

Equity price risk is primarily undertaken in respect of assets held in with profit or unit linked funds. For unit linked funds this risk is borne by policyholders as asset movements directly impact unit prices and hence policy values. For with profit fund policyholders' future bonuses will be impacted by price risk via investment returns achieved. However, the Company has entered into over the counter derivative contracts to provide financial protection against volatility in a range of embedded policy guarantees within the with profit fund.

There is also an exposure to credit spread changes affecting the prices of corporate bonds and derivatives. The exposure applies to the with profit fund, unit linked funds, the non profit fund and the shareholder fund.

The majority of the non profit fund is backed by debt instruments which are held to match the maturity profile of liabilities and as a result of this, price risk is minimised. The assets held in the shareholder fund that are exposed to price risk are primarily high rated short term liquid assets.

#### **(ii) Credit risk**

The Company has exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due.

The Company recognises that credit risk in its life insurance business arises from:

- cash deposits;
- holdings of debt (principally corporate bonds);
- the impact of credit default on equity holdings;
- reinsurance contracts; and
- derivatives transactions.

The Company structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or groups of counterparties, thereby ensuring concentrations of credit risk are minimised. These limits and exposures are subject to ongoing monitoring and frequent review in the context of the exposure limits placed and changes in credit ratings and spreads.

The majority of the Company's, and certain fellow subsidiary companies', cash deposits were previously invested in the Abbey Liquidity Fund (the Fund) - a collective investment vehicle, which was itself, invested in a range of short term money-market instruments and guaranteed an interest return of 7-day LIBID. The Fund prospectus requires the credit quality of all investments in the fund be equal to the highest short term credit rating available (i.e. A1+ for S&P).

The Fund held two assets, Mainsail I and Mainsail II, which defaulted on maturity in September 2007. In August 2008, the residual assets were restructured into 'put through notes' in Harbour Limited which wraps the residual portfolio into a new investment and a manager was appointed to manage the remaining slice of the investment with a view to maximising return. The Fund has subsequently received income distributions totalling £4.6m.

To date, the expected maturity amounts have yet to be recovered, however, the accounts reflect a best estimate likely recovery of 29% of the initial investment partially offset by an expected recovery from the fund manager. The loss reflected in the accounts is £2.2m in respect of the shareholder and £2.3m in respect of the with profit fund (2007: £2.5m and £2.4m respectively).

## Notes to the financial statements continued

### 34. Risk management policies continued

The tables below show the rating of fair value of assets held by the Company, which are subject to credit risk. Only credit risk on assets where risk is borne by the shareholder is shown, therefore unit linked assets are excluded.

The credit risk borne by the shareholder on with profit policies is minimal. The bonuses to with profit policyholders are designed to distribute to policyholders a fair share of the return on the assets in the with profit funds together with other elements of the experience of the fund. With profit policies are managed such that bonuses distributed to the policyholder are smoothed by building and dissolving returns over the years.

The shareholders of the Company are entitled to receive one-ninth of the cost of bonuses declared for traditional with profit contracts, which form the minority of the with profit fund business. In exceptional circumstances support to the with profit fund may be provided by the non profit or shareholder funds. The process for exercising discretion in the management of the with profit funds is set out in the principles and practices of financial management ("PPFM") for the with profit fund and is overseen by the with profit committee.

### Non Profit Non Linked & Shareholder funds

As at 31 December 2008	AAA	AA	A	BBB	BB & below	Not rated	Total
	£m	£m	£m	£m	£m	£m	£m
<b>Loans and receivables</b>	-	-	-	-	-	1,037	1,037
<b>Financial assets at fair value through income:</b>							
Derivative assets	-	-	-	-	-	-	-
Fixed interest securities	99	-	1	-	-	-	100
Loans and deposits	14	8	1	-	-	3	26
<b>Insurance assets:</b>							
Reinsurers' share of insurance contract liabilities	-	26	415	-	-	714	1,155
Reinsurance receivables	-	4	-	-	-	-	4
Insurance contract receivables	-	-	-	-	-	-	-
<b>Prepayments</b>	1	-	-	-	-	-	1
<b>Trade and other receivables</b>	-	-	-	-	-	3	3
<b>Cash and cash equivalents</b>	81	23	10	-	-	104	218

# Notes to the financial statements continued

## 34. Risk management policies continued

### With Profit fund

As at 31 December 2008	AAA	AA	A	BBB	BB & below	Not rated	Total
	£m	£m	£m	£m	£m	£m	£m
<b>Loans and receivables</b>	-	-	-	-	-	-	-
<b>Financial assets at fair value through income:</b>							
Derivative assets	-	-	-	-	-	-	-
Fixed interest securities	738	115	276	93	2	63	1,287
Loans and deposits	103	52	5	-	-	19	179
<b>Insurance assets:</b>							
Reinsurers' share of insurance contract liabilities	-	-	-	-	-	-	-
Reinsurance receivables	-	-	-	-	-	-	-
Insurance contract receivables	-	-	-	-	-	2	2
<b>Prepayments</b>	4	-	1	-	-	-	5
<b>Trade and other receivables</b>	-	-	-	-	-	-	-
<b>Cash and cash equivalents</b>	535	96	52	-	-	34	717

### Non Profit Non Linked & Shareholder funds

As at 31 December 2007	AAA	AA	A	BBB	BB & below	Not rated	Total
	£m	£m	£m	£m	£m	£m	£m
<b>Loans and receivables</b>	-	-	-	-	-	-	-
<b>Financial assets at fair value through income:</b>							
Derivative assets	-	-	-	-	-	-	-
Fixed interest securities	284	3	6	3	-	8	304
Loans and deposits	27	-	4	-	-	-	31
<b>Insurance assets:</b>							
Reinsurers' share of insurance contract liabilities	-	31	486	-	-	422	939
Reinsurance receivables	-	19	-	-	-	27	46
Insurance contract receivables	-	-	-	-	-	3	3
<b>Prepayments</b>	17	-	-	-	-	2	19
<b>Trade and other receivables</b>	-	-	-	800	-	7	807
<b>Cash and cash equivalents</b>	233	-	-	-	-	130	363

## Notes to the financial statements continued

### 34. Risk management policies continued

#### With Profit fund

As at 31 December 2007	AAA	AA	A	BBB	BB & below	Not rated	Total
	£m	£m	£m	£m	£m	£m	£m
<b>Loans and receivables</b>	-	-	-	-	-	-	-
<b>Financial assets at fair value through income:</b>							
Derivative assets	-	-	-	-	-	2	2
Fixed interest securities	913	159	313	119	2	76	1,582
Loans and deposits	42	-	5	-	-	-	47
<b>Insurance assets:</b>							
Reinsurers' share of insurance contract liabilities	-	-	-	-	-	-	-
Reinsurance receivables	-	-	-	-	-	-	-
Insurance contract receivables	-	-	-	-	-	3	3
<b>Prepayments</b>	10	2	4	1	-	1	18
<b>Trade and other receivables</b>	-	-	-	-	-	3	3
<b>Cash and cash equivalents</b>	454	-	3	-	-	(7)	450

(Source of Credit Ratings – Standard & Poor's; Moody's)

Credit ratings have not been disclosed in the above table for equities. Whilst the Company is exposed to the impact of credit default on its equity holdings, this risk is not considered significant due to the spread of holdings.

Credit risk in relation to loans and deposits, fixed income securities and cash and cash equivalents have been assessed on a look through basis where the exposure to the securities is via collective investment vehicles.

#### (iii) Liquidity risk

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities as they fall due.

The Company manages liquidity risk through a clearly articulated Liquidity Policy, Investment Guidelines and Investment Management Agreements. The Pearl Group Liquidity Policy has the objectives of ensuring low probability of loss due to liquidity risk events, documentation of systems and controls of liquidity risk and cost-efficient control of liquidity risk.

The Company effects operational control of liquidity risk through clearly documented and frequently monitored treasury guidelines.

Liquidity controls in the Company are monitored on a daily basis and breaches are escalated as provided for in the Liquidity Policy. A report on liquidity risk levels is included in the monthly risk reports submitted to the ALCO and the FRCOC.

## Notes to the financial statements continued

### 34. Risk management policies continued

The tables below summarise the maturity profile of the financial liabilities and insurance contract liabilities of the Company. The basis of presentation is such that investment contracts and insurance contracts are on a discounted basis consistent with the balance sheet. All the remaining financial liabilities are shown on an undiscounted basis.

As at 31 December 2008	Up to 1 year	1-5 years	Greater than 5 years	Total
	£m	£m	£m	£m
Insurance contract liabilities	499	1,445	3,247	5,191
Investment contract liabilities *	180	-	-	180
Borrowings	51	-	-	51
Payables	158	24	1	183

As at 31 December 2007	Up to 1 year	1-5 years	Greater than 5 years	Total
	£m	£m	£m	£m
Insurance contract liabilities	612	1,553	3,811	5,976
Investment contract liabilities *	267	-	-	267
Borrowings	49	-	-	49
Payables	134	2	4	140

\* Investment contract policyholders have the option to terminate or transfer their contracts at any time and receive the surrender or transfer value of their policies. Although these liabilities are payable on demand, the Company does not expect these amounts to all be paid out within one year of the reporting date.

### 35. Capital management

The Company's policy is to maintain a strong and flexible capital base so as to retain a strong credit rating and satisfy regulatory requirements whilst still creating shareholder and policyholder value.

The Company's capital position is monitored in the context of both the Financial Services Authority's (FSA's) Pillar 1 and Pillar 2 financial resources requirements.

In respect of Pillar 1, the table below sets out the Company's capital resources position at 31 December 2008 as reported in the annual returns to the FSA and compares this with total equity available to equity holders of the Company as reported on the IFRS balance sheet at that date:

	2008 £m	2007 £m
Total equity attributable to equity holders of the Company on an IFRS basis (note 11)	1,416	1,369
Differences in the valuation of assets and liabilities on a Pillar 1 regulatory basis	707	1,176
Unallocated surplus	42	93
Intangible assets	(216)	(266)
Asset values in excess of Pillar 1 market risk and counterparty limits	(980)	(755)
Inadmissible assets directly held	(14)	-
Capital resources on a Pillar 1 regulatory basis	955	1,617

In respect of Pillar 2, the Pearl Group has developed a capital management framework using Individual Capital Assessment (ICA) principles for identifying the risks to which each of its business units and the Pearl Group as a whole are exposed and quantifying their impact on capital. The ICA process estimates the level of capital the Company should retain to ensure that there is only an extremely small risk that the Company will be unable to meet its liabilities.

The capital required is calculated based on extreme but foreseeable risk events over a one year timeframe. Although the ICA process is an internal process, the FSA may use ICA information in discussing the target capital levels it believes the Company should have available on a Pillar 2 basis. The Company then holds a further capital buffer above this to ensure that it would be able to withstand a single stress event, whether that arose from market conditions or other causes, and have sufficient capital resources to still meet the capital requirements set by the FSA from internal resources.

## Notes to the financial statements continued

### 35. Capital management continued

The Company's capital position is monitored on both a Pillar 1 and Pillar 2 basis by the FRCOC and is reported to both the Executive Committee and the statutory Board. The FRCOC and Executive Committee monitor the Company's capital composition and position against the group targets which are regularly reviewed to ensure they remain appropriate to optimise value for the policyholders and shareholders. The level of required capital of the Company is the greater of:

- the amount of capital required to meet regulatory capital adequacy requirements (Pillar 1 and Pillar 2 regulatory bases); and
- the capital required under the Company's capital management policy.

There have been no material changes in the Company's management of capital during the period. The capital policy has been established by the Company and is not externally imposed. However, external approval from the FSA would be required before making any amendments to the policy.

Except as noted below, the Company has complied with all externally and internally imposed capital requirements throughout the period.

In addition to the requirement to maintain individual capital resources in excess of its individual capital resources requirement, the Company is required to ensure that its capital resources are sufficient to maintain group capital resources in excess of the group capital resources requirement at all times. This is calculated at the level of the Company's ultimate parent undertaking, PGL.

The group capital resources requirement is an aggregate of the individual capital resources requirements of each of the regulated entities within the PGL Group. Group capital resources are based on an aggregation of the capital resources of each of the regulated entities, net of the PGL Group's investment in them, and net of surplus assets held in the long term funds of the regulated entities, but without making any deduction for counterparty exposures in excess of defined limits.

There are different forms and quality of capital that may be admitted to the calculation of group capital resources. However, there are also restrictions, which limit lower quality capital to prescribed levels. Lower quality capital which exceeds these levels must be excluded from group capital resources, with a corresponding effect on the excess of group capital resources over Group Capital Adequacy (GCA) requirements.

In November 2008, the FSA was informed that the Company was in technical breach of its GCA obligations. To rectify the situation, Impala Holdings Limited (IHL), a fellow subsidiary of PGL, carried out a capital restructuring in which £2,598m was repaid to Sun Capital Investments 2 Limited and Hera Investments 2 Limited in settlement of existing subordinated debt obligations together with accrued interest. This was settled by IHL through the issue of 2 new ordinary C shares for consideration of £1,600m and £998m of new subordinated debt. In addition to this, the Company applied for a waiver, which was granted by the FSA and which provides relief in respect of one of the capital restrictions within the GCA calculation and enables the Company to meet its GCA requirements. The Company has continued to meet its GCA requirements since that date. The waiver expires on 30 April 2009. Regular dialogue is continuing with the FSA regarding the capital position of the PGL Group and it is intended that a waiver extension will be requested. In the event that the waiver is not extended, the PGL Group is able to restructure the term of the C shares referred to above such that there is no continued requirement for the waiver.

Following the technical breach of GCA requirements, the FSA issued an Own Initiative Variation of Permission (OIVoP) which, inter alia, requires cash payments and asset transfers from regulated entities within the PGL Group to be disclosed to and approved by the FSA. This affords the Company liquidity protection whilst the OIVoP remains in force. The Directors have reasonable grounds to believe that the OIVoP will remain in place, as required by the FSA, for the foreseeable future.

### 36. Contingent liabilities

(a) During 2008, the Company's primary regulator, the Financial Services Authority (FSA), queried the pricing of certain derivative backed hedging agreements, which were put in place in the with profit fund in 2004.

The current assessment of the maximum level of liability to the Company and a fellow group company, Scottish Mutual Assurance Limited, is £160m. However, the Directors do not accept the FSA's concerns and consider this level of liability as unlikely, based on current available information.

The Company's parent, Pearl Life Holdings Limited, has the benefit of an indemnity from a non-group third party for 70% of any liability arising out of this matter although recovery cannot be absolutely certain.

Discussions between the Company, the third party and the FSA are continuing. In the event that a liability arises between the shareholder fund and the with profit fund in relation to the pricing of hedges, the Company would seek redress for any amounts payable from the shareholder fund into the policyholder fund through the indemnity of the parent company with the third party.

## Notes to the financial statements continued

### 36. Contingent liabilities continued

(b) The Company and its subsidiaries are registered with HM Revenue and Customs as members of a group for VAT purposes and, as a result, they are jointly and severally liable on a continuing basis for amounts owing by any other member of that group in respect of unpaid VAT. Any liability in this respect is considered to be remote. At 31 December 2008 the group liability was £1.3m (2007: £3m).

(c) The Company has in the past been required to pay compensation to policyholders who were advised by agents of the Company in the purchase of pension products. At 31 December 2008 any remaining liability in this respect is considered not to be material.

There may also be a requirement to contribute under the Financial Services Compensation Scheme to compensate policyholders advised *independently* in the purchase of pension products.

The uncertainties surrounding these issues are such that the liabilities are currently unquantifiable as regards the Financial Services Compensation Scheme.

### 37. Commitments

There are no outstanding calls, uncalled liabilities or underwriting commitments on securities held as at 31 December 2008 (2007: nil).

## Notes to the financial statements continued

### 38. Events after the balance sheet date

As part of the programme of restructuring within the Pearl Group, with effect from 1 January 2009, the entire long term business and part of the shareholders' funds of the Company were transferred to PLL for £nil consideration in accordance with the terms of a scheme under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 30 January 2009. Policies in the special with profit fund will be converted to non profit and transferred to the new 'SPI with profit fund' in PLL. The assets and liabilities transferred and the consequent loss arising are set out below:

Assets	£m
Investments in subsidiaries	60
Intangible assets	272
Loans and receivables	17
Financial assets at fair value through income	
Equities	3
Fixed income securities	138
Collective investment schemes	4,249
Insurance assets	
Investment contracts	
Reinsurers' share of insurance contract liabilities	1,186
Reinsurance receivables	4
Insurance contract receivables	2
Deferred tax	13
Prepayments	6
Trade and other receivables	16
Cash and cash equivalents	164
	<b>6,130</b>
Liabilities	
Insurance contracts	
Liabilities under insurance contracts	5,191
Unallocated surplus	42
Financial liabilities	
Investment contracts	180
Borrowings	51
Deferred tax	59
Reinsurance payables	8
Payables related to direct insurance contracts	34
Current tax	35
Trade and other payables	141
	<b>5,741</b>
Loss on transfer of net assets	<b>389</b>



## **Notes to the financial statements continued**

### **38. Events after the balance sheet date continued**

The loss on transfer of net assets includes the release of the foreign currency translation reserve of £17m.

Following the Part VII transfer, the remaining shareholder fund includes loans to Pearl Life Holdings Limited and sufficient assets to cover the Company's Capital Resources Requirement.

On 25 March 2009, in accordance with section 643 of the Companies Act 2006, the Directors approved a reduction in the Company's authorised share capital from £4,335,000,000, comprising 4,335,000,000 ordinary shares of £1 each, to £1, consisting of one ordinary share of £1, by the cancellation and extinction of all of the authorised but unissued ordinary shares and 1,765,000,001 of the issued ordinary shares registered in the name of Pearl Life Holdings Limited. After lodging the required documents with Companies House, it is anticipated that this will become effective prior to 31 March 2009, resulting in the cancellation of £1,765,000,001 of paid up share capital on 1,765,000,001 ordinary shares.

Following the restructuring of the Company's operations, the Board has submitted an application to the Financial Services Authority requesting cancellation of the Company's authorisation to undertake long term business.

### **39. Parent undertaking and controlling party**

The Company's immediate parent company is Pearl Life Holdings Limited (formerly Resolution Life Limited).

Prior to 1 May 2008, the Company's ultimate parent company and controlling party was Resolution plc (subsequently renamed *Pearl Group Holdings (No. 1) Limited*). From that date the Company's ultimate parent company and controlling party has been Pearl Group Limited, a company incorporated in the United Kingdom.

The only group in which the results of the Company are consolidated is headed by Pearl Group Limited.

The consolidated accounts of Pearl Group Limited are available to the public and may be obtained from The Pearl Centre, Lynchwood, Peterborough, PE2 6FY.