

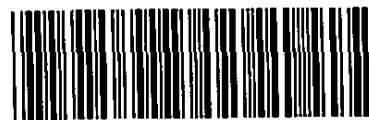
# PA (GI) LIMITED

Company Registration Number: 71805

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

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**PA (GI) LIMITED**

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## **Directors' report**

The Directors present their Report and Financial Statements of PA (GI) Limited ("the Company") for the year ended 31 December 2010

The Company is incorporated in the United Kingdom. Its registration number is 71805 and its registered office is 1, Wythall Green Way, Wythall, Birmingham B47 6WG

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS") and the comparative information has been restated accordingly. In previous years, the financial statements of the Company were prepared in accordance with applicable United Kingdom Generally Accepted Accounting Principles ("UK GAAP"). Information on the effect of the transition to IFRS is given in note 2 to the financial statements.

## **Business review**

### ***Principal activities***

The principal activity of the Company is associated with managing the residual general insurance liabilities acquired in July 2004 under a general sale and purchase agreement relating to a number of companies within the Royal & Sun Alliance Insurance Group.

### ***Business transacted***

As noted above, the Company transacts general insurance business which is in run off. This business is fully reinsured to, and administered by, Royal & Sun Alliance Insurance plc ("RSA").

Administrative expenses, external costs and other costs and expenses arising out of the general insurance business, which forms the entirety of the Company's portfolio, are the subject of an indemnity from RSA's parent, Royal & Sun Alliance Insurance Group plc, granted at the time of acquisition of the Company by Pearl Life Holdings Limited.

### ***Result and dividends***

The results of the Company for the year are shown in the statement of comprehensive income on page 9. The loss before tax was £20,000 (2009: loss £419,000).

No dividends were paid during the year (2009: £nil).

### ***Principal risks and uncertainties***

The principal risks to which the Company was exposed during the year relate to long tail insurance liabilities. These liabilities are predominantly asbestos-related claims and as such there is significant uncertainty as to the amounts at which they will ultimately be settled. The insurance business of the Company is administered on its behalf by RSA.

As noted above, the general insurance liabilities of the company are wholly reinsured to RSA and as such any movement in the gross outstanding claims will have no impact on the result for the year or the net asset position of the Company.

The Company is exposed to the counterparty risk that RSA is unable to meet its obligations under the reinsurance contract as well as the risk of default on the Company's invested assets, which are considered to be relatively low risk.

The Company's assets are primarily invested in a US government bond and an authorised unit trust which in turn invests only in low risk money market instruments. Whilst the assets are exposed to elements of credit risk, the risk profile is low.

Further information on financial risks is provided in note 19 to the financial statements.

### ***Key Performance Indicators ("KPIs")***

The Company's performance is measured and monitored by the Board with particular regard paid to the following KPIs:

### ***Capital resources***

The aim of the Company is to maintain an appropriate margin of regulatory capital over capital resource requirements calculated in accordance with the handbook issued by the Financial Services Authority (FSA). As at 31 December 2010, the Company's free assets were £4,222,000 (2009: £4,236,000).

### ***Profits after taxation and distributable reserves***

For the year ended 31 December 2010 the Company reported a loss after taxation of £14,000 (2009: Loss £302,000). As at 31 December 2010, the Company had distributable reserves amounting to £6,602,000 (2009: £6,616,000).

**Cash flows**

Cash flows are monitored closely by the business to ensure that all liabilities can be met as they fall due

**Future developments**

The Company is presently in discussion with RSA and with its shareholder with regards to the transfer of the general insurance business. As part of these discussions, a standstill agreement has been entered into to preserve the Company's claims under the indemnity arrangement.

**Going concern**

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

**Directors**

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

|             |                                                           |
|-------------|-----------------------------------------------------------|
| D Cummins   | Appointed on 16 August 2010, resigned on 20 December 2010 |
| M Ellis     | Appointed on 27 May 2010                                  |
| M R Kipling | Resigned on 30 July 2010                                  |
| M J Merrick | Resigned on 10 September 2010                             |
| J S Moss    | Resigned on 7 February 2011                               |
| J S B Smith | Resigned on 30 June 2010                                  |

**Secretary**

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

**Disclosure of Indemnity**

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

**Disclosure of information to auditors**

So far as each of the Directors is aware, there is no relevant audit information (as defined in the Companies Act 2006) of which the Company's auditors are unaware, and each of the Directors has taken all the steps that he/she 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 418(2) of the Companies Act 2006.

**Re-appointment of auditors**

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

On behalf of the Board



G A Watson  
For and on behalf of Pearl Group Secretariat Services Limited  
Company Secretary

29 March 2011

**Statement of Directors' responsibilities**

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

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

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

**Independent auditors' report to the members of PA (GI) Limited**

We have audited the financial statements of PA (GI) Limited for the year ended 31 December 2010 which comprise the accounting policies, the statement of comprehensive income, the statement of financial position, the statement of cash flows, the statement of changes in equity and the related notes 1 to 21. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union ("IFRS")

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of Directors and auditor**

As explained more fully in the Statement of Directors' Responsibilities set out on page 4, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

**Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements.

**Opinion**

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2010 and of its loss for the year then ended,
- have been properly prepared in accordance with IFRS as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

**Opinion on other matter prescribed by the Companies Act 2006**

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

**Matters on which we are required to report by exception**

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

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit



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

30 March 2011

## **Accounting policies**

### **(a) Basis of preparation**

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

### **Statement of compliance**

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

The financial statements are presented in sterling (£) rounded to the nearest £000 except where otherwise stated

The Company presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement more than twelve months after the period end is presented in the notes

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

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

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

Critical accounting estimates are those which involve the most complex or subjective judgements or assessments. The areas of the Company's business that typically require such estimates are insurance contract assets and liabilities and the determination of the fair value of financial assets

### **Insurance contract liabilities**

The uncertainty in the financial statements principally arises in respect of the long tail insurance liabilities of the Company. The technical provisions include provisions for claims reported and claims incurred but not reported

There is considerable uncertainty with regard to the eventual outcome of the claims that have occurred by the period end but remain unsettled. This includes claims that may have occurred but have not yet been notified to the Company and those that are not yet apparent to the insured

As a consequence of this uncertainty, sophisticated estimation techniques need to be applied to determine the appropriate provisions

### **Fair value of financial assets**

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

### **(c) Foreign currency transactions**

Assets and liabilities denominated in foreign currencies are translated into sterling at the closing rate at the period end. Income and expenses denominated in foreign currencies are translated at the prevailing rate at the date of the transaction. 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 within fair value gains and losses in the statement of comprehensive income

### **(d) General business**

The general insurance business has been closed to new business for a number of years and is in run off. Provisions are made for the estimated ultimate cost of settling claims notified but not settled by the period end. It includes related expenses and a deduction for the expected value of salvage and other recoveries. The provision is determined using the best information available of claims settlement patterns, forecast inflation and settlement of claims. Movements in the provisions (including any associated foreign exchange movement) are reflected in the statement of comprehensive income in the year in which they arise

Under current IFRS requirements, insurance contract assets and liabilities are measured using accounting policies consistent with those previously adopted under United Kingdom Generally Accepted Accounting Principles ("UK GAAP")

Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy. Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Company may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer. The impairment loss is recorded in the statement of comprehensive income.

**(e) Income tax**

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

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

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

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

**(f) Financial assets**

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

Equities, fixed and variable rate income securities and collective investment schemes are designated at fair value through profit or loss and accordingly are stated in the statement of financial position at fair value. They are designated at fair value through profit or loss because they are managed and evaluated on a fair value basis in accordance with the Company's stated risk management policies.

***Impairment of financial assets***

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

***Fair value estimation***

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

For units in unit trusts and shares in open-ended investment companies, fair value is by reference to published bid-values. The fair value of receivables and floating rate and overnight deposits with credit institutions is their carrying value.

**(g) Reinsurance**

The Company cedes insurance risk and investment risk in the normal course of business. Reinsurance assets represent balances due from reinsurance companies. Reinsurers' share of insurance and investment contract liabilities are dependent on expected claims and benefits arising under the related reinsured policies.



Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Company may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer. The impairment loss is recorded in the statement of comprehensive income. The reinsurers' share of investment contract liabilities is measured on a basis that is consistent with the valuation of the liability to policyholders to which the reinsurance applies.

Gains or losses on purchasing reinsurance are recognised in the statement of comprehensive income at the date of purchase and are not amortised. They are the difference between the premiums ceded to reinsurers and the related change in the reinsurers' share of insurance contract liabilities.

**h) Cash and cash equivalents**

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

**(i) Dividends**

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

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

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

**(j) Income recognition**

***Net investment income***

Net investment income comprises interest and fair value gains and losses on financial assets.

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

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

**(k) Claims recognition**

***Gross claims***

Claims paid represent all payments made during the period whether arising from events during that or earlier periods.

Differences between the estimated costs (as included in the payables related to direct insurance contracts) and subsequent settlement of claims are dealt with in the statement of comprehensive income for the year in which the claims are settled or re-estimated.

***Reinsurance claims***

Reinsurance claims are recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

**(l) Share capital and capital contributions**

***Ordinary share capital***

The Company has issued ordinary shares and deferred shares which are classified as equity.

***Capital contributions***

Capital contributions received by the Company and which contain no agreement for their repayment are recognised directly in the statement of changes in equity as a distributable reserve.

**(m) Events after the reporting period**

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

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**PA (GI) LIMITED**

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**Statement of comprehensive income**  
for the year ended 31 December 2010

|                                                               | Notes | 2010<br>£000 | 2009<br>£000 |
|---------------------------------------------------------------|-------|--------------|--------------|
| Net investment income                                         | 3     | 223          | (371)        |
| <b>Net income</b>                                             |       | <u>223</u>   | <u>(371)</u> |
| Policyholder claims                                           |       | (1,976)      | (8,453)      |
| Less reinsurance recoveries                                   |       | 1,976        | 8,453        |
| Change in insurance contract liabilities                      | 10    | 6,034        | 11,475       |
| Change in reinsurers' share of insurance contract liabilities | 10    | (6,034)      | (11,475)     |
| <b>Net policyholder claims and benefits incurred</b>          |       | <u>-</u>     | <u>-</u>     |
| Administrative expenses                                       | 4     | (243)        | (48)         |
| <b>Total operating expenses</b>                               |       | <u>(243)</u> | <u>(48)</u>  |
| <b>Loss for the year before tax attributable to owners</b>    |       | (20)         | (419)        |
| Tax credit                                                    | 7     | 6            | 117          |
| <b>Loss for the year attributable to owners</b>               |       | <u>(14)</u>  | <u>(302)</u> |
| Other comprehensive income                                    |       | -            | -            |
| <b>Total comprehensive income for the year</b>                |       | <u>(14)</u>  | <u>(302)</u> |

**PA (GI) LIMITED**

**Statement of financial position**  
as at 31 December 2010

|                                                | Notes | As at 31<br>December<br>2010<br>£000 | As at 31<br>December<br>2009<br>£000 | As at 1<br>January<br>2009<br>£000 |
|------------------------------------------------|-------|--------------------------------------|--------------------------------------|------------------------------------|
| <b>EQUITY AND LIABILITIES</b>                  |       |                                      |                                      |                                    |
| <b>Equity attributable to owners</b>           |       |                                      |                                      |                                    |
| Share capital                                  | 8     | 3,000                                | 3,000                                | 3,000                              |
| Capital contribution reserve                   | 9     | 2,000                                | 2,000                                | 2,000                              |
| Retained earnings                              |       | 4,602                                | 4,616                                | 4,918                              |
| <b>Total equity</b>                            |       | <b>9,602</b>                         | <b>9,616</b>                         | <b>9,918</b>                       |
| <b>Liabilities</b>                             |       |                                      |                                      |                                    |
| Payables related to direct insurance contracts | 10    | 218,480                              | 209,251                              | 232,626                            |
| Accruals                                       | 11    | 242                                  | 48                                   | -                                  |
| Other payables                                 | 12    | 568                                  | 975                                  | 1,147                              |
| <b>Total liabilities</b>                       |       | <b>219,290</b>                       | <b>210,274</b>                       | <b>233,773</b>                     |
| <b>Total equity and liabilities</b>            |       | <b>228,892</b>                       | <b>219,890</b>                       | <b>243,691</b>                     |
| <b>ASSETS</b>                                  |       |                                      |                                      |                                    |
| <b>Financial assets</b>                        |       |                                      |                                      |                                    |
| Fixed and variable rate income securities      |       | 3,942                                | 3,930                                | 4,569                              |
| Collective investment schemes                  |       | 5,798                                | 6,112                                | 5,908                              |
|                                                | 13    | 9,740                                | 10,042                               | 10,477                             |
| <b>Insurance assets</b>                        |       |                                      |                                      |                                    |
| Reinsurance receivables                        | 10    | 218,480                              | 209,251                              | 232,626                            |
|                                                |       | 218,480                              | 209,251                              | 232,626                            |
| Prepayments                                    | 14    | 4                                    | 3                                    | 18                                 |
| Other receivables                              | 15    | 98                                   | -                                    | -                                  |
| Cash and cash equivalents                      | 16    | 570                                  | 594                                  | 570                                |
| <b>Total assets</b>                            |       | <b>228,892</b>                       | <b>219,890</b>                       | <b>243,691</b>                     |

On behalf of the Board



M Ellis  
Director

29 March 2011

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**PA (GI) LIMITED**

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**Statement of cash flows**  
for the year ended 31 December 2010

|                                                                         | Notes | 2010<br>£000      | 2009<br>£000      |
|-------------------------------------------------------------------------|-------|-------------------|-------------------|
| <b>Cash flows from operating activities</b>                             |       |                   |                   |
| Cash generated/(absorbed) by operations                                 | 17    | (24)              | 24                |
| <b>Net cash flows from operating activities</b>                         |       | <u>(24)</u>       | <u>24</u>         |
| <b>Net increase/(decrease) in cash and cash equivalents</b>             |       | (24)              | 24                |
| Cash and cash equivalents at the beginning of the year                  |       | 594               | 570               |
| <b>Cash and cash equivalents at the end of the year</b>                 | 16    | <u><u>570</u></u> | <u><u>594</u></u> |
| <b>Supplementary disclosures on cash flow from operating activities</b> |       |                   |                   |
| Interest received                                                       |       | 210               | 266               |

**PA (GI) LIMITED**

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

|                                         | Share capital<br>(note 8)<br>£000 | Capital<br>contribution<br>reserve<br>(note 9)<br>£000 | Retained<br>earnings<br>£000 | Total<br>£000 |
|-----------------------------------------|-----------------------------------|--------------------------------------------------------|------------------------------|---------------|
| At 1 January 2010                       | 3,000                             | 2,000                                                  | 4,616                        | 9,616         |
| Loss for the year                       | -                                 | -                                                      | (14)                         | (14)          |
| Other comprehensive income for the year | -                                 | -                                                      | -                            | -             |
| Total comprehensive income for the year | -                                 | -                                                      | (14)                         | (14)          |
| At 31 December 2010                     | 3,000                             | 2,000                                                  | 4,602                        | 9,602         |

Of the above, the capital contribution reserve of £2,000,000 (2009 2,000,000) and £4,602,000 (2009 £4,616,000) of retained earnings is considered distributable

|                                         | Share capital<br>(note 8)<br>£000 | Capital<br>contribution<br>reserve<br>(note 9)<br>£000 | Retained<br>earnings<br>£000 | Total<br>£000 |
|-----------------------------------------|-----------------------------------|--------------------------------------------------------|------------------------------|---------------|
| At 1 January 2009                       | 3,000                             | 2,000                                                  | 4,918                        | 9,918         |
| Loss for the year                       | -                                 | -                                                      | (302)                        | (302)         |
| Other comprehensive income for the year | -                                 | -                                                      | -                            | -             |
| Total comprehensive income for the year | -                                 | -                                                      | (302)                        | (302)         |
| At 31 December 2009                     | 3,000                             | 2,000                                                  | 4,616                        | 9,616         |

## Notes to the financial statements

### 1. Financial information

The financial statements for the year ended 31 December 2010, set out on pages 6 to 21, were authorised by the Board of Directors for issue on 29 March 2011. The financial statements have been prepared in accordance with IFRS. The comparative amounts for the year ended 31 December 2009 are based on the Company's financial statements for that year after adjustment for the transition from United Kingdom Generally Accepted Accounting Principles ("UK GAAP") to IFRS.

Information on how the transition to IFRS has affected the financial position, financial performance and cash flows of the Company is set out in note 2.

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

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

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

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

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

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

### 2 Transition to IFRS

The financial statements for 2010 have been prepared in accordance with IFRS adopted for use by the EU. The date of transition from UK GAAP to IFRS is 1 January 2009 and accordingly the comparative amounts presented for the year ended 31 December 2009 are based on the Company's financial statements for that year after adjustment for the transition to IFRS.

The transition to IFRS has not resulted in any change to the amount of equity reported as at either 1 January 2009 or 31 December 2009 or to the total comprehensive income reported under IFRS for the year ended 31 December 2009 compared to the equivalent income reported under UK GAAP. Under UK GAAP, the Company presented a technical and non-technical account within its profit and loss account. For IFRS reporting, the technical and non-technical accounts are combined into a single statement of comprehensive income. The effect of this on the Company's result for 2009 is set out below. Under UK GAAP the Company was exempt from presenting a cash flow statement.

No classification changes have arisen on presenting the IFRS statement of financial position as at 1 January 2009 and 31 December 2009, or on presenting the statement of comprehensive income for the comparative period to 31 December 2009.

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Reconciliation of income presented under UK GAAP to income presented under IFRS for the year ended 31 December 2009

|                                                               | As previously reported under UK GAAP |                       | IFRS                   |
|---------------------------------------------------------------|--------------------------------------|-----------------------|------------------------|
|                                                               | Technical account                    | Non-technical account | As reported under IFRS |
|                                                               | £000                                 | £000                  | £000                   |
| Net investment income                                         | -                                    | (371)                 | (371)                  |
| <b>Net income</b>                                             | -                                    | (371)                 | (371)                  |
| Policyholder claims                                           | (8,453)                              | -                     | (8,453)                |
| Less reinsurance recoveries                                   | 8,453                                | -                     | 8,453                  |
| Change in insurance contract liabilities                      | 11,475                               | -                     | 11,475                 |
| Change in reinsurers' share of insurance contract liabilities | (11,475)                             | -                     | (11,475)               |
| Administrative expenses                                       | -                                    | (48)                  | (48)                   |
| <b>Loss for the year before tax</b>                           | -                                    | (419)                 | (419)                  |
| Tax credit                                                    | -                                    | 117                   | 117                    |
| <b>Loss for the year attributable to owners</b>               | -                                    | (302)                 | (302)                  |

**3. Net investment income**

|                                                                                                            | 2010       | 2009         |
|------------------------------------------------------------------------------------------------------------|------------|--------------|
|                                                                                                            | £000       | £000         |
| Investment income                                                                                          |            |              |
| Interest income on financial assets designated at fair value through profit or loss on initial recognition | 211        | 266          |
|                                                                                                            | <u>211</u> | <u>266</u>   |
| Fair value gains/(losses)                                                                                  |            |              |
| Financial assets at fair value through profit or loss                                                      |            |              |
| Designated upon initial recognition                                                                        | 12         | (639)        |
|                                                                                                            | <u>12</u>  | <u>(639)</u> |
| Net investment income                                                                                      | <u>223</u> | <u>(371)</u> |

**4. Administrative expenses**

|                         | 2010       | 2009      |
|-------------------------|------------|-----------|
|                         | £000       | £000      |
| Administrative expenses | <u>243</u> | <u>48</u> |

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

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**5. Directors' remuneration**

|                                                                                                                            | 2010<br>£000 | 2009<br>£000 |
|----------------------------------------------------------------------------------------------------------------------------|--------------|--------------|
| Salaries and other short term benefits                                                                                     | 106          | 19           |
| Remuneration (excluding pension contributions and awards under share option schemes and other long-term incentive schemes) | 106          | 19           |
| Post-employment benefits                                                                                                   | 21           | 1            |
| Other long-term benefits                                                                                                   | 39           | -            |
|                                                                                                                            | 60           | 1            |
| Contributions to money purchase pension schemes                                                                            | 1            | 1            |
| Number of Directors who                                                                                                    |              |              |
| - are members of a defined benefit pension scheme                                                                          | 2            | 2            |
| - are members of a money purchase pension scheme                                                                           | 1            | 1            |
|                                                                                                                            | 2010<br>£000 | 2009<br>£000 |
| Highest paid Directors' remuneration                                                                                       | 95           | 9            |

The Directors are employed by Pearl Group Services Limited and Pearl Group Management Services Limited

**6. Auditors' remuneration**

The remuneration of the auditors of the Company, including their associates, in respect of services supplied to entities included in the financial statements was £29,000 (2009 £21,000)

|                                   | 2010<br>£000 | 2009<br>£000 |
|-----------------------------------|--------------|--------------|
| Audit of the financial statements | 6            | 4            |
| Other                             | 23           | 17           |
|                                   | 29           | 21           |

**7. Tax credit**

**Current year tax credit**

|                                         | 2010<br>£000 | 2009<br>£000 |
|-----------------------------------------|--------------|--------------|
| Current tax                             |              |              |
| UK Corporation tax                      | 6            | 117          |
| Total tax credit attributable to owners | 6            | 117          |

UK corporation tax for the current year is equal (2009 equal) to the standard UK corporation tax rate of 28.0% (2009 28.0%)



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**8. Share capital**

|                                                                               | 2010<br>£000 | 2009<br>£000 |
|-------------------------------------------------------------------------------|--------------|--------------|
| Issued and fully paid 60,000,000 (2009 60,000,000) ordinary shares of 1p each | 600          | 600          |
| Issued and fully paid 9,600,000 (2009 9,600,000) deferred shares of 25p each  | <u>2,400</u> | <u>2,400</u> |
|                                                                               | <u>3,000</u> | <u>3,000</u> |

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

The deferred shares do not entitle the holders to receive any dividend in respect of any accounting reference period of the Company unless, and until, there has been declared, and paid in respect of that period, a dividend of not less than £5 per ordinary share. Thereafter the holders of the deferred shares shall participate equally with the holders of such ordinary shares in the profits of the Company. The deferred shares do not entitle any holders to receive notice of, attend or vote at any general meeting of the Company.

On a return of assets on liquidation or otherwise, the assets to be returned shall be applied to the holders of deferred shares, after paying to the holders of the ordinary shares £5,000 per share. In paying to the holders of the deferred shares the amounts paid up thereon and the balance of such assets shall belong to and be distributed among the holders of the ordinary shares in proportion to the amounts paid up on the ordinary shares held by them respectively.

**9. Capital contribution reserve**

|                              | 2010<br>£000 | 2009<br>£000 |
|------------------------------|--------------|--------------|
| At 1 January and 31 December | <u>2,000</u> | <u>2,000</u> |

**10. Payables related to direct insurance contracts**

|                                                    | Gross          |                | Reinsurers' share |                  |
|----------------------------------------------------|----------------|----------------|-------------------|------------------|
|                                                    | 2010<br>£000   | 2009<br>£000   | 2010<br>£000      | 2009<br>£000     |
| At 1 January                                       | 209,251        | 232,642        | (209,251)         | (232,642)        |
| Movement in year                                   | 6,034          | (11,475)       | (6,034)           | 11,475           |
| Exchange rate movements                            | 3,195          | (11,916)       | (3,195)           | 11,916           |
| As at 31 December 2010                             | <u>218,480</u> | <u>209,251</u> | <u>(218,480)</u>  | <u>(209,251)</u> |
| Amount due for settlement/recovery after 12 months | <u>212,435</u> | <u>203,344</u> | <u>212,435</u>    | <u>203,344</u>   |

As noted in the accounting policies, the calculation of the outstanding insurance contract liabilities, and corresponding reinsurance assets, gives rise to a significant level of uncertainty within these financial statements.

The Company's general business technical provisions are calculated primarily by independent, actuarial specialists with the balance calculated by adequately qualified personnel, employed by RSA.

Where possible, multiple techniques are adopted to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The estimates of losses and loss expenses are reached after a review of several commonly accepted actuarial projection methodologies and a number of different bases to determine these provisions. These include methods based upon the following:

- the development of previously settled claims, where payments to date are extrapolated for each prior year,
- estimates based upon a projection of claims numbers and average cost,
- notified claims development, where notified claims to date for each year are extrapolated based upon observed.

- development of earlier years, and
- expected loss ratios

The process is designed to select the most appropriate best estimate. However the estimation of the provisions for the ultimate cost of claims for asbestos-related liability and environmental pollution is subject to a range of uncertainties that is generally greater than those encountered for other classes of insurance business. As a result it is not possible to determine the future development of asbestos-related and environmental claims with the same degree of reliability as with other types of claims. Consequently, traditional techniques for estimating claims provisions cannot wholly be relied upon and RSA employs specialised techniques to determine provisions using the extensive knowledge of both internal experts and external legal and professional advisors.

Factors contributing to this higher degree of uncertainty include

- the long delay in reporting claims from the date of exposure (for example, cases of mesothelioma can have a latent period of up to 40 years). This makes estimating the ultimate number of claims we will receive particularly difficult,
- issues of allocation of responsibility among potentially responsible parties and insurers,
- emerging court decisions and the possibility of retrospective legislative changes increasing or decreasing insurer liability,
- the tendency for social trends and factors to influence court awards, and
- for US liabilities within the London market business, developments in the tactics of US plaintiff lawyers and court decisions and awards.

The Company mitigates this type of risk by wholly reinsuring the general business liabilities to RSA. Therefore, any movement in the gross claims outstanding will have no effect on the result for the year or the net asset position of the Company.

#### 11. Accruals

|                                           | 2010<br>£000 | 2009<br>£000 |
|-------------------------------------------|--------------|--------------|
| Accruals                                  | <u>242</u>   | <u>48</u>    |
|                                           | <u>242</u>   | <u>48</u>    |
| Amount due for settlement after 12 months | <u>-</u>     | <u>-</u>     |

#### 12. Other payables

|                                           | 2010<br>£000 | 2009<br>£000 |
|-------------------------------------------|--------------|--------------|
| Other payables                            | <u>568</u>   | <u>975</u>   |
| Amount due for settlement after 12 months | <u>568</u>   | <u>568</u>   |

#### 13. Financial assets and financial instrument fair value hierarchy

|                                                       | 2010<br>£000 | 2009<br>£000  |
|-------------------------------------------------------|--------------|---------------|
| Financial assets at fair value through profit or loss |              |               |
| Designated upon initial recognition                   |              |               |
| Fixed and variable rate income securities             | 3,942        | 3,930         |
| Collective investment schemes                         | <u>5,798</u> | <u>6,112</u>  |
|                                                       | <u>9,740</u> | <u>10,042</u> |
| Amount recoverable after 12 months                    | <u>-</u>     | <u>3,930</u>  |

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Determination of fair value and fair value hierarchy of financial instruments,

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

All financial assets have been classified as level 1 financial instruments throughout the year in the fair value hierarchy.

**14. Prepayments**

|                                    | 2010<br>£000 | 2009<br>£000 |
|------------------------------------|--------------|--------------|
| Prepayments                        | <u>4</u>     | <u>3</u>     |
| Amount recoverable after 12 months | <u>-</u>     | <u>-</u>     |

The carrying amount of prepayments approximate to their fair values

**15 Other receivables**

|                                    | 2010<br>£000 | 2009<br>£000 |
|------------------------------------|--------------|--------------|
| Amount owed by group companies     | <u>98</u>    | <u>-</u>     |
|                                    | <u>98</u>    | <u>-</u>     |
| Amount recoverable after 12 months | <u>-</u>     | <u>-</u>     |

The carrying amounts of other receivables approximates to their fair values

**16. Cash and cash equivalents**

|                        | 2010<br>£000 | 2009<br>£000 |
|------------------------|--------------|--------------|
| Bank and cash balances | <u>570</u>   | <u>594</u>   |

The carrying amounts approximate to fair value at the period end

**17 Cash flows**

***Cash flows from operating activities***

|                                                    | 2010<br>£000 | 2009<br>£000 |
|----------------------------------------------------|--------------|--------------|
| Loss for the year before tax                       | (20)         | (419)        |
| Non-cash movements in loss for the year before tax |              |              |
| Fair value (gains)/losses on                       |              |              |
| Financial assets                                   | (12)         | 639          |
| Changes in operating assets and liabilities        |              |              |
| Decrease /(increase) in investment assets          | 314          | (204)        |
| (Increase)/decrease in other assets                | (99)         | 15           |
| Decrease in other payables                         | <u>(207)</u> | <u>(7)</u>   |
| Cash generated by operations                       | <u>(24)</u>  | <u>24</u>    |

## 18. Capital management

The Company must retain sufficient capital at all times to meet the regulatory capital requirements mandated by the FSA. In addition to EU-directive-based "Pillar 1" and Group capital requirements, the FSA has also stipulated a "Pillar 2" of risk-based capital requirements that have been implemented in the UK. The Company's actual capital requirement is based on whichever of the Pillar 1 or Pillar 2 requirement turns out to be more onerous for the Company. The Company generally holds an amount of capital that is greater than the minimum required amount to allow for adverse events in the future that may use capital and might otherwise cause the Company to fail the minimum level of regulatory capital test.

At the period end, the Company's Pillar 1 capital resources amounted to £9,602,000 (2009: £9,616,000).

The Company has complied with all externally imposed capital requirements throughout the year.

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 (GCR) requirement at all times. This is calculated at the level of the Company's highest EEA insurance parent undertaking, Phoenix Life Holdings Limited ("PhLHL").

The group capital resources requirement is an aggregate of the individual capital resources requirements of each of the regulated entities within the PhLHL Group. Group capital resources are based on an aggregation of the capital resources of each of the regulated entities, net of the PhLHL 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 and 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 GCR requirements.

The Company met its GCR requirements during the year.

## 19 Risk management

The Company is exposed to a number of risks in its business including those arising from underlying assets and liabilities. The Company complies with the Group approach to risk management which is described in the Performance section of Phoenix Group Holdings annual report and accounts.

### ***Risk management objectives***

The risk management objectives and policies of the Company are based on the requirement to protect the Company's regulatory capital position and ensure the Company can meet cash flow requirements, including policyholder liabilities as and when they fall due.

In pursuing these objectives, the Company deploys financial assets and incurs financial liabilities. Financial assets principally comprise investments in fixed and variable rate income securities, collective investment schemes and bank deposits.

In addition the Company is exposed to insurance risk arising from insurance contract assets and liabilities.

### ***Financial risk analysis***

Transactions in financial instruments may result in the Company assuming financial risks. This includes credit risk, market risk and liquidity risk. Each of these are described below, together with a summary of how the company manages them.

#### ***Credit risk***

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. These obligations can relate to both recognised and unrecognised assets and liabilities.

There are two principal sources of credit risk for the Company.

Credit risk results from direct investment activities, including investments in fixed income securities, collective investment vehicles and the placing of cash deposits, and also arises indirectly from activities undertaken in the normal course of business. Such activities include reinsurance.

#### ***Credit risk which results from direct investment activities***

During the year, the Company's only significant financial assets have been held in fixed income securities and authorised collective investment schemes which in turn invest only in money market instruments. The only material credit risk to which the Company is exposed is the possible default of the Company's invested assets, which is considered to be relatively low risk.

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***Credit risk which results indirectly from activities undertaken in the normal course of business***

The general insurance liabilities of the company are wholly reinsured to Royal & Sun Alliance Insurance plc ("RSA") In the normal course of business, RSA engage third parties to provide actuarial services which inform the setting of gross claims outstanding at the period end

In view of the reinsurance with RSA, movements in claims outstanding would only affect the result for the year or net assets if RSA ceased to pay claims The Company is exposed to the counterparty risk that RSA is unable to meet its obligations under the reinsurance contract

**Quality of credit assets**

An indication of the Company's exposure to credit risk is the quality of the investments and counterparties with which it transacts The following table provides information regarding the aggregate credit exposure with external credit ratings

**2010**

|                                           | AA<br>£000 | A<br>£000 | Non-rated<br>£000 | Total<br>£000 |
|-------------------------------------------|------------|-----------|-------------------|---------------|
| Fixed and variable rate income securities | -          | 3,942     | -                 | 3,942         |
| Cash and cash equivalents                 | -          | 2         | 568               | 570           |
| Reinsurance receivables                   | -          | 218,480   | -                 | 218,480       |

**2009**

|                                           | AA<br>£000 | A<br>£000 | Non-rated<br>£000 | Total<br>£000 |
|-------------------------------------------|------------|-----------|-------------------|---------------|
| Fixed and variable rate income securities | -          | 3,930     | -                 | 3,930         |
| Cash and cash equivalents                 | 26         | -         | 568               | 594           |
| Reinsurance receivables                   | -          | 209,251   | -                 | 209,251       |

Credit ratings have not been disclosed in the above tables for holdings in collective investment schemes The risk of loss to the Company due to credit default on its holdings in collective investment schemes is considered low due to the tradeable nature of these investments

A further indicator of the quality of the Company's financial assets is the extent to which they are neither past due nor impaired The company has no assets are past due or impaired (2009 £nil)

**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 Market risk comprises interest risk and currency risk

**Interest risk**

Interest risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates due to the effect such movements have on the value of interest-bearing assets

The sensitivity analysis for interest risk indicates how changes in the fair value or future cash flows of a financial instrument arising from changes in market interest rates at the reporting date result in a change in profit after tax and in equity

**Currency risk**

The Company's principal transactions are carried out in sterling and therefore its exchange risk is limited to the investment in fixed income securities which is denominated in US dollars

The sensitivities to interest risk and currency risk are shown below

|                           | Change in<br>assumption<br>% | Impact on profit after<br>tax and equity<br>holders' funds<br>2010<br>£000 | Impact on profit after<br>tax and equity<br>holders' funds<br>2009<br>£000 |
|---------------------------|------------------------------|----------------------------------------------------------------------------|----------------------------------------------------------------------------|
| Interest rate assumptions | +1                           | 124                                                                        | 120                                                                        |
| Interest rate assumptions | -1                           | (123)                                                                      | (120)                                                                      |
| Currency rate assumptions | Strengthens by 10            | 315                                                                        | 314                                                                        |
| Currency rate assumptions | Weakens by 10                | (258)                                                                      | (257)                                                                      |

**Liquidity risk**

Liquidity risk is defined as the failure of the Company to maintain adequate levels of financial resources to enable it to meet its obligations as they fall due

The Company's policy is to maintain sufficient liquid assets of suitable credit quality at all times so as to be able to meet all foreseeable current liabilities as they fall due in a cost-effective manner

**Insurance risk**

Insurance risk refers to the risk that the frequency or severity of insured events may be worse than expected and includes expense risk

The uncertainty in the financial statements principally arises in respect of the long tail insurance liabilities of the Company. The payables related to direct insurance contracts include provisions for claims reported and claims incurred but not reported

In addition to the inherent uncertainty of having to make provision for future events, there is also considerable uncertainty with regard to the eventual outcome of the claims that have occurred by the reporting date but remain unsettled. This includes claims that may have occurred but have not yet been notified to the Company and those that are not yet apparent to the insured. As a consequence of this uncertainty, sophisticated estimation techniques need to be applied to determine the appropriate provisions

Note 10 provides details of the basis by which the Company calculates its assets and liabilities arising under insurance contracts, the risks and uncertainties inherent in the calculation and the sensitivity of the Company's financial position to the movement in the calculation of these assets and liabilities

**20 Related party transactions**

The Company enters into transactions with related parties in its normal course of business. These are at arm's length on normal commercial terms

**Amounts due from related parties**

|                                            | 2010<br>£m | 2009<br>£m |
|--------------------------------------------|------------|------------|
| Other amounts due from fellow subsidiaries | 98         | -          |

**Key management compensation**

The compensation payable to employees classified as key management, which comprises the Directors, is disclosed in note 5

During the year to 31 December 2010, key management and other family members had no other transactions with the Company

**21 Other information**

The Company's principal place of business is the United Kingdom. The Company's immediate parent is Pearl Life Holdings Limited and its ultimate parent is Phoenix Group Holdings. A copy of the financial statements of Phoenix Group Holdings can be obtained from the Company Secretary, 1<sup>st</sup> Floor, 32 Commercial Street, St Helier, Jersey, JE2 3RU