

PEARL GROUP HOLDINGS (NO. 2) LIMITED

Company Registration Number: 05282342

DIRECTORS' REPORT AND FINANCIAL STATEMENTS
for the year ended 31 December 2018

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PEARL GROUP HOLDINGS (NO. 2) LIMITED

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Strategic report

The Directors present the Strategic report of Pearl Group Holdings (No. 2) Limited ('the Company'), for the year ended 31 December 2018.

Principal activities

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

Result and dividends

The results of the Company for the year are shown in the income statement on page 7. The profit before tax was £192.0m (2017: £190.8m loss).

No dividends were paid during the current or prior year.

Position as at 31 December 2018

The net assets of the Company at 31 December 2018 were £1,309.7m (2017: £1,197.4m). The increase in the period reflects the total comprehensive income arising in the period of £112.3m (2017: £151.7m loss).

Principal risks and uncertainties

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

The principal risks and uncertainties facing the Company are:

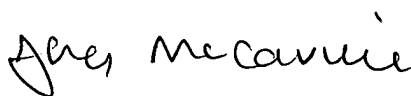
- interest rate risk, since the movement in interest rates will impact the value of interest payable and receivable by the Company;
- liquidity risk, exposure to liquidity risk as a result of normal business activities, specifically the risk arising from an inability to meet short-term cash flow requirements;
- credit risk, arising from the default of the counterparty to a particular financial asset, with the carrying value of the asset representing the Company's maximum exposure to credit risk.
- longevity risk in the pension scheme, faster than expected improvements in life expectancy on the pensions of the members of the Scheme.

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

Key Performance Indicators ('KPIs')

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

On behalf of the Board



J McConville
Director
25 June 2019

Directors' report

The Directors present their report and the financial statements of the Company for the year ended 31 December 2018.

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

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

Going concern

The Strategic report and the Directors' report summarise the Company's activities, its financial performance and its financial position together with any factors likely to affect its future development. In addition, the Strategic report discusses the principal risks and uncertainties it faces. Note 20 to the financial statements summarises the Company's capital management and risk objectives and policies together with its financial risks.

The Directors have followed the UK Financial Reporting Council's 'Guidance on Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks' (issued April 2016) when performing their going concern assessment. As part of their comprehensive assessment of whether the Company is a going concern, the Directors have prepared cash flow and solvency forecasts for the Company for the foreseeable future.

As a result of this review, 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:

J McConville
R Thakrar
S True
F Clutterbuck

Appointed 29 August 2018

Resigned 31 March 2018

Secretary

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

G Watson
Pearl Group Secretariat Services Limited

Appointed 27 February 2019

Resigned 27 February 2019

Disclosure of indemnity

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

Disclosure of information to auditors

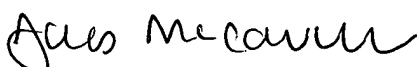
So far as each of the Directors is aware, there is no relevant audit information (as defined in the Companies Act 2006) of which the Company's auditors are unaware, and each of the Directors has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit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

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

Re-appointment of auditors

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

On behalf of the Board



J McConville
Director
25 June 2019

Statement of Directors' responsibilities

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

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

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

Independent Auditor's report to the members of Pearl Group Holdings (No. 2) Limited

Opinion

We have audited the financial statements of Pearl Group Holdings (No. 2) Limited for the year ended 31 December 2018 which comprise the Income statement, the Statement of comprehensive income, Statement of financial position, the Statement of cash flows, the Statement of changes in equity and the related notes 1 to 22 including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In our opinion, the financial statements:

- give a true and fair view of the company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or directors' report.

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the 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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement page set out on 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Use of our report

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.



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

26 June 2019

PEARL GROUP HOLDINGS (NO. 2) LIMITED

Income statement
for the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Revenue			
Investment income	3	37.2	96.8
Reversal of Impairment of investment in subsidiaries	16	226.4	-
Total income		<u>263.6</u>	<u>96.8</u>
Administrative expenses	4	(47.3)	(15.8)
Impairment of investments in subsidiaries	16	-	(241.9)
Total operating expenses		<u>(47.3)</u>	<u>(257.7)</u>
Profit/(loss) before finance costs and tax		<u>216.3</u>	<u>(160.9)</u>
Finance costs	8	(24.3)	(29.9)
Profit/(loss) for the year before tax		<u>192.0</u>	<u>(190.8)</u>
Tax credit/(charge)	9	11.6	(1.8)
Profit/(loss) for the year attributable to owners		<u><u>203.6</u></u>	<u><u>(192.6)</u></u>

Statement of comprehensive income
for the year ended 31 December 2018

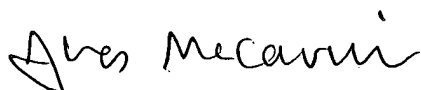
	Notes	2018 £m	2017 £m
Profit/(loss) for the year		203.6	(192.6)
Other comprehensive income			
Actuarial (loss)/gain of pension scheme	15	(85.5)	39.9
Deferred tax (charge)/credit	9	(5.8)	1.0
		<u>(91.3)</u>	<u>40.9</u>
Total comprehensive income/(loss) for the year attributable to owners		<u><u>112.3</u></u>	<u><u>(151.7)</u></u>

PEARL GROUP HOLDINGS (NO. 2) LIMITED

Statement of financial position
as at 31 December 2018

	Notes	As at 31 December 2018 £m	As at 31 December 2017 £m
Equity attributable to owners			
Share capital	10	806.0	806.0
Capital contribution	11	9.0	9.0
Retained earnings		494.7	382.4
Total equity		1,309.7	1,197.4
Non-current liabilities			
Borrowings	12	341.3	336.5
Total non-current liabilities		341.3	336.5
Current liabilities			
Borrowings	12	841.3	823.8
Accruals	13	1.3	1.7
Amounts due to Group entities		78.3	72.5
Current tax	14	1.3	1.3
Total current liabilities		922.2	899.3
Total liabilities		1,263.5	1,235.8
Total equity and liabilities		2,573.2	2,433.2
Non-current assets			
Pension scheme surplus	15	254.5	321.6
Investments in subsidiaries	16	1,828.6	1,602.2
Loans and receivables	17	434.7	434.7
Deferred tax	14	19.0	34.2
Total non-current assets		2,536.8	2,392.7
Current assets			
Amounts due by Group entities		27.8	24.9
Other receivables		0.1	0.1
Prepayments and accrued income		-	0.1
Financial assets at fair value through profit or loss	18	8.5	15.4
Total current assets		36.4	40.5
Total assets		2,573.2	2,433.2

On behalf of the Board



J McConville
Director
25 June 2019

PEARL GROUP HOLDINGS (NO. 2) LIMITED

Statement of cash flows
for the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Cash flows from operating activities			
Cash absorbed by operations	19	(17.5)	(20.4)
Net cash flows from operating activities		<u>(17.5)</u>	<u>(20.4)</u>
Cash flows from investing activities			
Sale of financial assets		6.9	-
Dividends received	3	13.0	-
Loans advanced to Group entities	17	-	(23.9)
Capital contribution repaid by subsidiary	16	-	5.0
Proceeds from disposal of financial assets		-	1.3
Net cash flows from investing activities		<u>19.9</u>	<u>(17.6)</u>
Cash flows from financing activities			
Loans received from Group entities	12	219.8	152.7
Repayment of borrowings from Group entities	12	(201.7)	(96.5)
Interest paid on borrowings from Group entities		(20.5)	(18.2)
Net cash flows from financing activities		<u>(2.4)</u>	<u>38.0</u>
Net decrease in cash and cash equivalents		<u>-</u>	<u>-</u>
Cash and cash equivalents at the beginning of the year		-	-
Cash and cash equivalents at the end of the year		<u>-</u>	<u>-</u>
<u>Supplementary disclosures on cash flow from operating activities</u>			
Interest received		<u>15.8</u>	<u>14.9</u>

PEARL GROUP HOLDINGS (NO. 2) LIMITED

Statement of changes in equity
for the year ended 31 December 2018

	Share capital (note 10) £m	Capital contribution (note 11) £m	Retained earnings £m	Total £m
At 1 January 2018	806.0	9.0	382.4	1,197.4
Income for the year	-	-	203.6	203.6
Other comprehensive income	-	-	(91.3)	(91.3)
Total comprehensive income for the year	-	-	112.3	112.3
At 31 December 2018	806.0	9.0	494.7	1,309.7

	Share capital (note 10) £m	Capital contribution (note 11) £m	Retained earnings £m	Total £m
At 1 January 2017	806.0	9.0	534.1	1,349.1
Loss for the year	-	-	(192.6)	(192.6)
Other comprehensive income	-	-	40.9	40.9
Total comprehensive loss for the year	-	-	(151.7)	(151.7)
At 31 December 2017	806.0	9.0	382.4	1,197.4

Included in retained earnings are reserves of £202.9m (2017: £275.3m) which are considered to be non-distributable.

Notes to the financial statements

1. Accounting policies

(a) Basis of preparation

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

The financial statements are separate financial statements and the exemptions in paragraph 4 of IFRS 10 *Consolidated Financial Statements* and section 401 of the Companies Act 2006 have been used not to present consolidated financial statements.

The results of the Company are consolidated into the accounts of the Company's ultimate parent Phoenix Group Holdings Public Limited Company ('PGH plc'), a company incorporated in the United Kingdom. The registered address of PGH plc is Juxon House, 100 St Paul's Churchyard, London, EC4M 8BU.

Statement of compliance

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

The financial statements are presented in sterling (£) rounded to the nearest £0.1m except where otherwise stated.

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

(b) Changes to accounting policies

In the current year, the Company has applied IFRS 9 *Financial Instruments* ('IFRS 9') which replaces IAS 39 *Financial Instruments: Recognition and Measurement* ('IAS39') for annual periods beginning on or after 1 January 2018. IFRS 9 introduces new requirements that are applicable to this Company for the classification, measurement and impairment of financial assets. The key change is the introduction of a new impairment model that is based on expected loss (rather than incurred loss as per IAS 39). The above changes have been incorporated in the financial assets accounting policy (see note (h) below).

In accordance with the transitional provisions in IFRS 9, the standard has been applied prospectively and comparative figures have not been restated. As a result, the comparative information continues to be accounted for in accordance with the Company's previous accounting policy under IAS 39. Any adjustments arising from the new impairment requirements are therefore not reflected in the comparative statement of financial position as at 31 December 2017, but would be recognised in opening retained earnings as at 1 January 2018.

Reclassifications of financial assets on adoption of IFRS 9 and reconciliation of impairment allowance balance from IAS 39 to IFRS 9

On the date of initial application, there have been no changes to the Company's classification, measurement and impairment of financial assets under both IAS 39 and IFRS 9. Accordingly, no adjustment is required to retained earnings at 1 January 2018.

(c) Critical accounting estimates and judgements

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

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

1. Accounting policies (continued)

(c) Critical accounting estimates and judgements (continued)

Fair value of financial assets and liabilities

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

Impairment of investments in subsidiaries and loans to Group entities

Investments in subsidiaries and loans (excluding contingent loans) to Group entities are subject to regular impairment reviews when management are aware of objective evidence of impairment. Impairments of investments in subsidiaries are measured at the difference between the carrying value of a particular asset and its value in use (Life businesses) and recoverable amount (other holding entities). Impairments on loans are measured as the difference between the carrying value of the loan and the present value of the estimated future cash flows, excluding future credit losses that have not been incurred, discounted at the loans original effective interest rate. Impairments are recognised in the income statement in the period in which they occur. The Company's policy in relation to impairment testing of investments in subsidiaries and loans to Group entities is detailed in accounting policies (g) and (h) respectively.

Income taxes

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all the available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which the losses can be relieved. The UK taxation regime applies separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets. Any judgements made, and uncertainties considered, in arriving at the carrying values of deferred tax assets and liabilities in the financial statements are discussed in note 14.

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

Pension benefit assets and liabilities

The valuation of pension benefit assets and liabilities is determined using actuarial valuations, which involves making assumptions about discount rates, expected return rates on assets, future salary increases, mortality rates and future pension increases. As defined benefit pension plans are long term in nature, such assumptions are subject to significant uncertainty. Details of the key assumptions used are shown in note 15.

(d) **Borrowings**

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

(e) **Income tax**

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

Current tax is the expected tax payable on the taxable income for the year, using tax rates and laws enacted or substantively enacted at the date of the statement of financial position together with adjustments to tax payable in respect of previous years, except to the extent that it relates to items recognised in the statement of changes in equity, in which case it is recognised in that statement.

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

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

1. Accounting policies (continued)**(f) Employee benefits*****Defined contribution pension plans***

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

Defined benefit pension schemes

The net surplus or deficit (the economic surplus or deficit) in respect of the defined benefit pension scheme is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine its present value and the fair value of any scheme assets is deducted.

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

The Company determines the net interest expense or income on the net defined benefit asset/liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit asset/liability. The discount rate is the yield at the period end on AA credit rated bonds that have maturity dates approximating to the terms of the Phoenix Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

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

(g) Investments in subsidiaries

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

The Company assesses at each reporting date whether an investment in a subsidiary or group of investments in subsidiaries is impaired. The Company first assesses whether objective evidence of impairment exists. Evidence of impairment needs to be significant or prolonged to determine that objective evidence of impairment exists. Evidence of impairment is obtained by comparing the carrying value of the investment in the subsidiary with the value in use (Life businesses) and recoverable amount (other holding entities) of the subsidiary.

(h) Financial assets***Classification of Financial assets*****Policy applicable before 1 January 2018**

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

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

Policy applicable from 1 January 2018

Financial assets are measured at amortised cost where they have:

- contractual terms that give rise to cash flows on specified dates, that represent solely payments of principal and interest on the principal amount outstanding; and
- are held within a business model whose objective is achieved by holding to collect contractual cash flows.

1. Accounting policies (continued)**(h) Financial assets (continued)**

These financial assets are initially recognised at cost, being the fair value of the consideration paid for the acquisition of the financial asset. All transaction costs directly attributable to the acquisition are also included in the cost of the financial asset. Subsequent to initial recognition, these financial assets are carried at amortised cost, using the effective interest method.

Financial assets measured at amortised cost are included in note 17 Loans and receivables.

There has been no change in the classification of debt securities and collective investment schemes which continue to be designated at fair value through profit or loss and accordingly are stated in the statement of financial position at fair value.

Impairment of financial assets carried at amortised cost**Policy applicable before 1 January 2018**

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.

Policy applicable from 1 January 2018

The Company assesses the expected credit losses associated with its loans and receivables and other receivables carried at amortised cost. The impairment methodology depends upon whether there has been a significant increase in credit risk.

The Company measures loss allowances which have low credit risk using the 12-month Expected Credit Loss ('ECL'). Interest revenue is recognised on a gross basis. A simplified approach is used to determine the loss allowances for other receivables as these are always measured at an amount equal to lifetime ECLs. See Note 20 for detail of how the Company assesses whether the credit risk of a financial asset has increased since initial recognition and when estimating ECLs.

The loss allowance reduces the carrying value of the financial asset and is reassessed at each reporting date. ECLs are recognised using a provision for doubtful debts account in profit and loss. For other receivables, the ECL rate is recalculated each reporting period taking into account which counter parties are included in the reporting period.

ECLs are derived from unbiased and probability-weighted estimates of expected loss, and are measured as follows:

- 12-month ECLs - Total expected credit losses that result from default events that are possible within 12 months after the reporting date.
- Lifetime ECLs - Expected credit losses that result from all possible default events over the expected life of the financial asset.

No significant changes to estimation techniques or assumptions were made during the reporting period.

Fair value estimation

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

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

(i) Contingent loans

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

1. Accounting policies (continued)

(j) Cash and cash equivalents

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

(k) Share capital and capital contributions

Ordinary share capital

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

Capital contributions

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

(l) Subordinated loans treated as equity

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

(m) Dividends

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

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

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

(n) Income recognition

Investment income comprises interest, dividends, net expected return on pension scheme assets and fair value gains and losses on financial assets.

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

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

(o) Finance costs

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

(p) Events after the reporting period

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

(q) Segmental reporting

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

2. Financial information

The financial statements for the year ended 31 December 2018, set out on pages 7 to 31 were authorised by the Board of Directors for issue on 25 June 2019.

In preparing the financial statements the Company has adopted the following standards, interpretations and amendments which have been issued by the International Accounting Standards Board ('IASB') and have been adopted for use by the EU. Apart from IFRS 9, none of the following have a material effect on the results of the Company.

- IFRS 15 Revenue from Contracts with Customers. IFRS 15 establishes a single comprehensive framework for determining whether, how and when revenue is recognised. The standard does not apply to insurance contracts or financial instruments within the scope of IAS 39 Financial Instruments: Recognition and Measurement.
- IFRS 9 Financial Instruments (2018). Under IFRS 9, all financial assets will be measured either at amortised cost or fair value and the basis of classification will depend on the business model and the contractual cash flow characteristics of the financial assets. In relation to the impairment of financial assets, IFRS 9 requires the use of an expected credit loss model, as opposed to the incurred credit loss model required under IAS 39. The expected credit loss model requires the Company to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition. Details of impacts of applying the new standard can be found in accounting policy 1(b). Additional disclosures are required by the standard and have been included in accounting policy 1(h) and note 20 to the financial statements.
- Annual Improvements Cycle 2014-2016: Amendments to IFRS 1 First-time adoption of IFRSs and Amendments to IAS 28 Investments in Associates and Joint Ventures. These are not applicable to the Company.

The IASB has issued the following new or amended standards and interpretations which apply from the dates shown. The Company has decided not to early adopt any of these standards, amendments or interpretations where this is permitted.

- Amendments to IFRS 9 Financial Instruments: Prepayment Features with Negative Compensation (2019). The proposed amendments would allow for a narrow exception to IFRS 9 that would permit particular financial instruments with prepayment features with negative compensation to be eligible for measurement at amortised cost or at fair value through other comprehensive income.
- IFRIC 23 Uncertainty over Income Tax Treatments (2019). This interpretation clarifies the accounting for income tax treatments that have yet to be accepted by tax authorities, whilst also aiming to enhance transparency.
- Amendments to References to the Conceptual Framework in IFRS Standards (2020).
- Amendments to IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors (2020). The amendments clarify the definition of material and how it should be applied and ensures that the definition of material is consistent across all IFRS Standards.
- Amendments to IFRS 3 Business Combinations (2020). The amendments have revised the definition of a business and aim to assist companies to determine whether an acquisition made is of a business or a group of assets. The amended definition emphasises that the output of a business is to provide goods and services to customers, whereas the previous definition focused on returns in the form of dividends, lower costs or other economic benefits to investors and others.

Changes excluded from above list as potentially not applicable:

- IFRS 16 Leases (2019).
- Annual Improvements Cycle 2015-2017: Amendments to IAS 12 Income Taxes, IAS 23 Borrowing Costs and IFRS 3 Business combinations/IFRS 11 Joint Arrangements (2019).
- Amendments to IAS 19 Employee Benefits: Plan Amendment, Curtailment or Settlement (2019).
- Amendments to IAS 28 Investments in Associates and Joint Ventures: Long-term interests in Associates and Joint Ventures (2019).
- IFRS 17 Insurance contracts (2021).
- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28) (Effective date deferred).

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3. Investment income

	2018 £m	2017 £m
Investment income		
Interest income on loans and receivables	15.6	14.8
Dividend income	13.0	75.0
Interest income on financial assets designated at fair value through profit or loss on initial recognition	0.1	0.2
Net expected return on pension assets (see note 15)	8.5	6.5
	<u>37.2</u>	<u>96.5</u>
Fair value gains		
Financial assets at fair value through profit or loss		
Designated upon initial recognition	-	0.3
Investment income	<u>37.2</u>	<u>96.8</u>

Interest income on loans and receivables includes interest of £15.6m (2017: £14.8m) on loans to Group entities. Dividend income includes cash dividends from subsidiaries of £13.0m (2017: £75.0m in specie).

4. Administrative expenses

	2018 £m	2017 £m
Service and project costs	17.2	15.8
Pension scheme – past service cost (see note 15)	30.1	-
Administrative expenses	<u>47.3</u>	<u>15.8</u>

5. Employee information

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

6. Directors' remuneration

	2018 £	2017 £
Salaries and other short-term benefits	<u>79,201</u>	<u>89,914</u>
Remuneration (excluding pension contributions and awards under share option schemes and other long-term incentive schemes)	<u>79,201</u>	<u>89,914</u>
Share-based payments	<u>43,775</u>	<u>47,498</u>
Contributions to money purchase pension schemes	<u>859</u>	<u>1,288</u>
Number of Directors who are members of a money purchase pension scheme	<u>1</u>	<u>1</u>
Number of Directors who exercised share options during the year	<u>3</u>	<u>3</u>

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

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

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7. Auditor's remuneration

The remuneration of the auditor of the Company included in the financial statements was £0.1m (2017: £0.1m).

8. Finance costs

	2018 £m	2017 £m
Interest expense on borrowings at amortised cost	<u>24.3</u>	<u>29.9</u>

Interest expense on borrowings includes interest of £24.3m (2017: £29.9m) on loans from Group entities.

9. Tax (credit)/charge

9.1. Current year tax (credit)/charge

	2018 £m	2017 £m
Current tax		
UK Corporation tax	(22.4)	-
Adjustments in respect of prior years	1.4	2.9
Total Current tax	<u>(21.0)</u>	<u>2.9</u>
Deferred tax		
Origination and reversal of temporary differences	11.2	(2.4)
Effect of changes in tax rate	(1.8)	1.3
Total Deferred tax	<u>9.4</u>	<u>(1.1)</u>
Total tax (credit)/charge	<u>(11.6)</u>	<u>1.8</u>

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

	2018 £m	2017 £m
Deferred tax on re-measurement of net defined benefit schemes	<u>5.8</u>	<u>(1.0)</u>

9.3. Reconciliation of tax (credit)/charge

	2018 £m	2017 £m
Profit/(loss) before tax	<u>192.0</u>	<u>(190.8)</u>
Tax at standard UK rate of 19.00% (2017: 19.25%)	36.5	(36.7)
Non-taxable income and gains	(4.7)	(16.4)
Disallowable expenses	-	0.5
Non-taxable impairment of investments in subsidiaries	(43.0)	46.6
Adjustment to shareholder tax charge in respect of prior years	1.4	2.9
Deferred tax rate change	(1.8)	1.3
Movement in unprovided deferred tax	-	3.6
Total tax (credit)/charge for the year	<u>(11.6)</u>	<u>1.8</u>

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10. Share capital

	2018 £m	2017 £m
Issued and fully paid: 806,000,020 (2017: 806,000,020) ordinary shares of £1 each	<u>806.0</u>	<u>806.0</u>

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

11. Capital contribution

	2018 £m	2017 £m
At 1 January and 31 December	<u>9.0</u>	<u>9.0</u>

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

12. Borrowings

	Carrying value		Fair value	
	2018 £m	2017 £m	2018 £m	2017 £m
(i) £198.0m loan facility	-	198.1	-	194.8
(ii) £205.0m loan facility	140.1	138.4	139.4	138.2
(iii) £1,211.0m loan facility	841.3	823.8	841.3	823.8
(iv) £198.8m loan facility	201.2	-	197.0	-
Total long-term borrowings	<u>1,182.6</u>	<u>1,160.3</u>	<u>1,177.7</u>	<u>1,156.8</u>
Amounts due for settlement within 12 months	841.3	823.8		
Amounts due for settlement after 12 months	<u>341.3</u>	<u>336.5</u>		

- (i) On 6 December 2017, the Company entered into a loan agreement with Phoenix Life Assurance Limited. The initial advance was £198.0m. This loan accrued interest at six month LIBOR plus a margin of 0.6% which was capitalised semi-annually on 30 June and 31 December. The loan had a final maturity date of 31 December 2022.

Interest of £0.1m was capitalised during the year (2017: £0.1m). The balance on the loan of £198.2m was repaid during the year.

- (ii) On 27 December 2017, the Company entered into a £205.0m loan facility with Phoenix Life Holdings Limited ('PhLHL'). Under this facility, the Company may draw down up to £205.0m at an interest rate of LIBOR plus a margin of 0.6%. The loan facility has a maturity date of 28 May 2020.

During 2018, the Company received £nil (2017: £138.4m) under the terms of this facility, and £1.8m (2017: £nil) was capitalised during the year.

- (iii) The Company entered into a facility with Pearl Assurance Group Holdings Limited. Interest accrues at a rate of LIBOR plus a margin of 1.75% and is payable semi-annually on 31 May and 30 November. The facility is repayable on demand.

Interest of £20.1m was paid during the year (2017: £18.2m). During the year the Company was advanced £21.0m on the facility (2017: £14.3m) and £3.5m was repaid (2017: £nil).

- (iv) On 17 April 2018 the Company entered into a £198.8m facility with PhLHL. Interest on the loan accrues at a rate of LIBOR plus a margin of 0.92% which is capitalised semi-annually on 30 June and 31 December. The loan has a maturity date of 31 December 2022.

During 2018, interest of £2.4m was capitalised (2017: £nil).

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12. Borrowings (continued)

Reconciliation of borrowings

The table below details the changes in the Company's liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Company's statement of cash flows as cash flows from financing activities.

2018	Cash flow items			Non cash flow items			31 Dec 2018 £m
	1 Jan 2018 £m	New loans £m	Loans repaid £m	Interest capitalised £m	Dividend receipt of loans £m	Balance transfer £m	
£198.0m loan facility	198.1	-	(198.2)	0.1	-	-	-
£205.0m loan facility	138.4	-	-	1.7	-	-	140.1
£1,211.0m loan facility	823.8	21.0	(3.5)	-	-	-	841.3
£198.8m loan facility	-	198.8	-	2.4	-	-	201.2
Total borrowings	1,160.3	219.8	(201.7)	4.2	-	-	1,182.6

2017	Cash flow items			Non cash flow items			31 Dec 2017 £m
	1 Jan 2017 £m	New loans £m	Loans repaid £m	Interest capitalised £m	Dividend receipt of loans £m	Balance transfer £m	
£507.9m loan facility	263.1	-	-	9.9	(75.0)	(198.0)	-
£198.0m loan facility	-	-	-	0.1	-	198.0	198.1
£90.0m loan facility	95.0	-	(96.5)	1.5	-	-	-
£205.0m loan facility	-	138.4	-	-	-	-	138.4
£1,211.0m loan facility	809.5	14.3	-	-	-	-	823.8
Total borrowings	1,167.6	152.7	(96.5)	11.5	(75.0)	-	1,160.3

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

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

There were no level 1 or level 2 long-term borrowings in 2018 or 2017.

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

13. Accruals

	2018 £m	2017 £m
Accrued interest on borrowings	<u>1.3</u>	<u>1.7</u>

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14. Tax assets and liabilities

	2018 £m	2017 £m
Current tax		
Current tax payable	<u>(1.3)</u>	<u>(1.3)</u>

Deferred tax

The balances at 31 December comprise:

Deferred tax assets	<u>19.0</u>	<u>34.2</u>
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Deferred tax assets comprise:

	2018 £m	2017 £m
Pension scheme deficit	18.0	24.3
Trading losses	1.0	9.9
Net deferred tax assets	<u>19.0</u>	<u>34.2</u>

Movement in deferred tax assets and liabilities:

Year ended 31 December 2018

	1 Jan	Recognised in the income statement £m	Recognised in other comprehensive income £m	31 Dec £m
Trading losses	9.9	(8.9)	-	1.0
Committed future pension contributions	24.3	(0.5)	(5.8)	18.0
	<u>34.2</u>	<u>(9.4)</u>	<u>(5.8)</u>	<u>19.0</u>

Year ended 31 December 2017

	1 Jan	Recognised in the income statement £m	Recognised in other comprehensive income £m	31 Dec £m
Trading losses	-	9.9	-	9.9
Committed future pension contributions	32.1	(8.8)	1.0	24.3
	<u>32.1</u>	<u>1.1</u>	<u>1.0</u>	<u>34.2</u>

The Finance Act 2016 reduced the rates of corporation tax from 20% to 19% in April 2017 and to 17% from April 2020. Consequently a blended rate of tax has been used for the purposes of providing for deferred tax in these financial statements.

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

	2018 £m	2017 £m
Deferred tax assets have not been recognised in respect of:		
Tax losses carried forward	26.5	25.3

14. Tax assets and liabilities (continued)

On 29 March 2017 the UK Government triggered Article 50 initiating a 2 year process for leaving the EU. There is some uncertainty about how the existing tax legislation will apply after the UK's exit. No changes are required to the measurement of tax in these financial statements but this will be monitored and reassessed at each reporting period as negotiations continue.

15. Pension scheme

Scheme details

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

Defined benefit scheme

The Pearl Scheme is established under, and governed by, the trust deeds and rules and is funded by payment of contributions to a separately administered trust fund. The Company is the principal employer of the Pearl Scheme and meets the administration expenses of the Scheme. The Pearl Scheme is administered by a separate Trustee company, P.A.T. (Pensions) Limited, which is separate from the Company. The Trustee company is comprised of two representatives from the Phoenix Group, three member nominated representatives and one independent trustee in accordance with the Trustee company's articles of association. The Trustee is required by law to act in the interest of all relevant beneficiaries and is responsible for the investment policy with regard to the assets.

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

The valuation has been based on an assessment of the liabilities of the Pearl Scheme as at 31 December 2018, undertaken by independent qualified actuaries. The present values of the defined benefit obligation and the related interest costs have been measured using the projected unit credit method.

Funding

A triennial funding valuation of the Pearl Scheme as at 30 June 2015 was completed in September 2016. This showed a deficit as at 30 June 2015 of £300.0m, on the agreed technical provisions basis. The triennial funding valuation of the Scheme as at 30 June 2018 commenced during the year and is expected to be completed by July 2019. The cash flows utilised in the IFRS valuation as at 31 December 2018 have been updated to reflect the latest data available from the 30 June 2018 funding valuation and together with the impact of modelling enhancements implemented during the year, this has resulted in the recognition of an experience loss of £144.4m in the year (2017: £13.9m).

The funding and IFRS accounting bases of valuation can give rise to different results for a number of reasons. The funding basis of valuation is based on general principles of prudence whereas the accounting valuation is based on best estimates. Discount rates are gilt-based for the funding valuation whereas the rate used for IFRS valuation purposes is based on a yield curve for high quality AA-rated corporate bonds. In addition, the values are prepared at different dates which will result in differences arising from changes in market conditions and employer contributions made in the subsequent period.

On 27 November 2012 the Company and the Trustee of the Pearl Scheme entered into a revised pensions funding agreement (the 'Pensions Agreement'), the principal terms of which were not altered following finalisation of the 30 June 2015 triennial valuation. The principal terms of the Pensions Agreement are:

- annual cash payments into the scheme of £70.0m in 2013 and 2014 payable on 30 September, followed by payments of £40.0m each year from 2015 to 2021. The timing of payment of contributions changed during 2017 so that the contributions are paid on a monthly basis following the last annual payment of £40 million completed in September 2016. The Pensions Agreement includes a sharing mechanism, related to the level of dividends paid out of the Company, that in certain circumstances allows for an acceleration of the contributions to be paid to the Pearl Scheme;

15. Pension scheme (continued)

Funding (continued)

- additional contributions may become payable if the scheme is not anticipated to meet the two agreed funding targets:
 - (i) to reach full funding on the technical provisions basis by 30 June 2022; and
 - (ii) to reach full funding on a gifts flat basis by 30 June 2031;
- the Trustee continues to benefit from a first charge over shares in Phoenix Life Assurance Limited, National Provident Life Limited, Pearl Group Services Limited and PGS2 Limited. The security claim granted under the share charges is capped at the lower of £600.0m and 100% of the Pearl Scheme deficit (calculated on a basis linked to UK government securities) revalued every three years thereafter; and
- covenant tests relating to the embedded value of certain companies with the Phoenix Group.

An additional liability of £37.1m (2017: £50.1m) has been recognised, reflecting a charge on any refund of the resultant IAS 19 surplus that arises after adjustment for discounted future contributions of £105.8m (2017: £143.1m) in accordance with the minimum funding requirement. A deferred tax asset of £18.0m (2017: £24.3m) has also been recognised to reflect tax relief at a rate of 17% (2017: 17%) that is expected to be available on the contributions, once paid into the scheme.

Contributions totalling £40.0m were paid into the scheme in 2018 (2017: £50.0m), reflecting the monthly instalments. The contributions paid into the Scheme for 2017 reflect £10 million in relation to the last quarter of 2016 and £40 million in relation to 2017 by monthly instalments. Contributions totalling £40.0m are expected to be paid into the scheme in 2019.

Liability management exercise

In June 2018, the Group commenced a pension increase exchange ('PIE') exercise in respect of the Pearl Scheme. Existing in-scope pensioners were offered the option to exchange future non-statutory pension increases for a one-off uplift to their current pension, thereby reducing longevity and inflation risk for the Company. The financial effect of all acceptances received in the period has been recognised in the financial statements as a reduction in scheme liabilities of £2.0m shown as past service credit in the income statement.

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15. Pension scheme (continued)

Summary of amounts recognised in the financial statements

The amounts recognised in the financial statements are as follows:

	Fair Value of Scheme Assets £m	Defined benefit obligation £m	Provision for tax on the economic surplus available as a refund £m	Minimum funding requirement obligation £m	Total £m
At 1 January 2018	2,722.3	(2,150.4)	(200.2)	(50.1)	321.6
Interest income/(expense)	67.1	(52.3)	(5.0)	(1.3)	8.5
Past service cost	-	(30.1)	-	-	(30.1)
Included in profit or loss	67.1	(82.4)	(5.0)	(1.3)	(21.6)
Re-measurements:					
Return on plan assets excluding amounts included in interest income	(81.2)	-	-	-	(81.2)
Gain from change in demographic assumptions	-	7.5	-	-	7.5
Loss from change in financial assumptions	-	70.1	-	-	70.1
Experience losses	-	(144.4)	-	-	(144.4)
Change in provision for tax on economic surplus available as a refund	-	-	48.2	-	48.2
Change in minimum funding requirement obligation	-	-	-	14.3	14.3
Included in other comprehensive income	(81.2)	(66.8)	48.2	14.3	(85.5)
Employers contributions	40.0	-	-	-	40.0
Benefit payments	(117.3)	117.3	-	-	-
At 31 December 2018	2,630.9	(2,182.3)	(157.0)	(37.1)	254.5

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15. Pension scheme (continued)

	Fair Value of Scheme Assets £m	Defined benefit obligation £m	Provision for tax on the economic surplus available as a refund £m	Minimum funding requirement obligation £m	Total £m
At 1 January 2017	2,685.0	(2,237.0)	(156.8)	(66.0)	225.2
Interest income/(expense)	69.6	(57.2)	(4.2)	(1.7)	6.5
Included in profit or loss	69.6	(57.2)	(4.2)	(1.7)	6.5
Re-measurements:					
Return on plan assets excluding amounts included in interest income	75.8	-	-	-	75.8
Gain from change in demographic assumptions	-	50.8	-	-	50.8
Loss from change in financial assumptions	-	(51.2)	-	-	(51.2)
Experience losses	-	(13.9)	-	-	(13.9)
Change in provision for tax on economic surplus available as a refund	-	-	(39.2)	-	(39.2)
Change in minimum funding requirement obligation	-	-	-	17.6	17.6
Included in other comprehensive income	75.8	(14.3)	(39.2)	17.6	39.9
Employers contributions	50.0	-	-	-	50.0
Benefit payments	(158.1)	158.1	-	-	-
At 31 December 2017	2,722.3	(2,150.4)	(200.2)	(50.1)	321.6

15. Pension scheme (continued)

Scheme assets

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

	2018		2017	
	Total	Of which not quoted in an active market	Total	Of which not quoted in an active market
	£m	£m	£m	£m
Hedging portfolio	2,011.6	(3.9)	1,822.5	(34.7)
Obligations for repayment of stock lending collateral received	(1,114.5)	-	(886.6)	-
Equities	-	-	165.4	-
Other debt securities	1,251.1	-	1,089.7	-
Properties	293.9	293.9	269.9	269.9
Fixed interest gilts	54.4	-	88.3	-
Private equities	27.6	27.6	35.2	35.2
Hedge funds	14.8	14.8	18.0	18.0
Cash and other	92.0	-	119.9	-
Total scheme assets	2,630.9	332.4	2,722.3	288.4

The actual return on plan assets was a loss of £14.1m (2017: £145.4m gain on plan assets).

The Company ensures that the investment positions are managed within an asset liability matching ('ALM') framework that has been developed to achieve long-term investments that are in line with the obligations under the Pearl Scheme. Within this framework an allocation of 25% of the scheme assets is invested in collateral for interest rate and inflation rate hedging where the intention is to hedge greater than 90% of the interest rate and inflation rate risk measured on the Technical Provisions basis.

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

Defined benefit obligation

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

Deferred scheme members: 40% (2017: 37%)

Retirees: 60% (2017: 63%)

The weighted average duration of the defined benefit obligation at 31 December 2018 is 16 years (2017: 17 years).

Principal assumptions

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

	2018	2017
	%	%
Rate of increase for pensions in payment (5% per annum or RPI if lower)	3.10	3.05
Rate of increase for deferred pensions (CPI)	2.40	2.20
Discount rate	2.80	2.50
Inflation – RPI	3.20	3.20
Inflation – CPI	2.40	2.20

15. Pension scheme (continued)

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

It has been assumed that post-retirement mortality is in line with a scheme-specific table which was derived from the actual mortality experience in recent years based on the SAPS standard tables for males and for females based on year of use. Future longevity improvements from 1 January 2017 are based on CMI 2017 Core Projections (2017: CMI 2016 Core Projections) and a long-term rate of improvement of 1.75% per annum for males and 1.50% per annum for females up to and including age 85 then decreasing linearly to 0% per annum at age 110 (unchanged from 2017). Under these assumptions, the average life expectancy from retirement for a member currently aged 40 retiring at age 60 is 29.9 years and 32.2 years for male and female members respectively (2017: 30.0 and 32.0 respectively).

A quantitative sensitivity analysis for significant actuarial assumptions is shown below:

Assumptions	Base	Discount rate		Retail Price Index		Life expectancy	
Sensitivity level		25bps increase	25bps decrease	25bps increase	25bps decrease	1 year increase	1 year decrease
	£m	£m	£m	£m	£m	£m	£m
Impact on the defined benefit obligation at 31 December 2018	2,182.3	(82.0)	84.5	64.8	(75.6)	78.8	(78.6)
Impact on the defined benefit obligation at 31 December 2017	2,150.4	(82.2)	87.9	57.4	(53.5)	85.2	(84.0)

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

Guaranteed Minimum Pension ('GMP') is a portion of pension that was accrued by individuals who were contracted out of the State Second Pension prior to 6 April 1997. Historically, there was an inequality of benefits between male and female members who have GMP. A High Court case concluded on 26 October 2018 and confirmed that GMPs need to be equalised. The Company has undertaken an initial assessment, and has included an allowance for the potential cost of equalising GMP for the impact between males and females in its IAS 19 actuarial liabilities as at 31 December 2018, pending further discussions with the scheme Trustees and the issuance of guidance as to how equalisation should be achieved. The cost of GMP equalisation of £30.1m has been recognised as a past service cost in the consolidated income statement. Any future changes to this estimate will be recognised in Other Comprehensive Income.

16. Investments in subsidiaries

	2018 £m	2017 £m
Cost		
At 1 January and 31 December	2,438.3	2,443.3
Capital contributions received from subsidiaries	-	(5.0)
	<u>2,438.3</u>	<u>2,438.3</u>
Impairment		
At 1 January	(836.1)	(594.2)
Reversal of impairment	226.4	-
Impairment charge	-	(241.9)
	<u>(609.7)</u>	<u>(836.1)</u>
Carrying amount		
At 31 December	<u>1,828.6</u>	<u>1,602.2</u>

On 11 December 2017, Pearl Group Services Limited returned £5.0m of the capital contribution it had received from the Company.

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16. Investments in subsidiaries (continued)

Where indicators of impairment have been identified the carrying value of the Company's investments in its subsidiaries has been tested for impairment at the period end. A reversal of impairment of £226.4m (2017: £241.9m impairment) was made to adjust certain investments to their recoverable amount. The impairment provisions were reassessed during the year, resulting reversal of previously recognised impairments.

The value in use has been used as the recoverable amount. The value in use for subsidiaries which are regulated entities has been determined using Solvency II own funds. For all other subsidiaries, value in use is determined using net assets.

The subsidiaries of the Company at 31 December 2018 were as follows:

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

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

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
Life insurance companies		
National Provident Life Limited	UK	Ordinary shares of £1

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

The registered address of all the subsidiary companies is 1 Wythall Green Way, Wythall, Birmingham, B47 6WG.

17. Loans and receivables

	Carrying value 2018 £m	2017 £m	Fair value 2018 £m	2017 £m
Amounts due by Group entities	434.7	434.7	434.7	434.7
Loan to Phoenix Life Holdings Limited	-	-	-	-
Amounts due for settlement within 12 months	434.7	434.7		
Amounts due for settlement after 12 months	-	-		

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17. Loans and receivables (continued)

On 28 May 2015 the Company granted a loan of £693.5m to Phoenix Life Holdings Limited ('PhLHL'). The loan accrues interest six month LIBOR plus a margin of 2.9% and has a maturity date of 28 May 2020.

During the year, the Company advanced £nil (2017: £23.9m) under the terms of the loan. Interest of £15.7m was received under this loan during the year (2017: £14.8m).

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

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

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

There were no level 1 or level 2 loans and receivables in 2018 or 2017

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

18. Financial assets through profit or loss

	2018 £m	2017 £m
Financial assets at fair value through profit or loss		
Designated upon initial recognition		
Shares in open ended investment companies	8.5	15.4
	<u> </u>	<u> </u>
Amount recoverable after 12 months	-	-
	<u> </u>	<u> </u>

Determination of fair value and fair value hierarchy of financial assets through profit or loss

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

There were no level 2 or 3 financial instruments in 2018 or 2017.

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

19. Cash flows from operating activities

	2018 £m	2017 £m
Profit/(loss) for the year before tax	192.0	(190.8)
Adjustments to reconcile profit/(loss) for the year to net cash inflow from operating activities:		
Interest income on loans and receivables	0.1	(0.1)
Dividends received	(13.0)	(75.0)
Fair value gains	-	(0.3)
Impairment of investment in subsidiaries	(226.4)	241.9
Past service costs	30.1	-
Net expected return on pension scheme assets	(14.8)	(12.4)
IFRIC 14 discount charge	6.3	5.9
Interest expense on borrowings	24.3	29.9
Contributions to defined benefit pension scheme	(40.0)	(50.0)
Changes in operating assets and liabilities	23.9	30.5
	<u> </u>	<u> </u>
Cash absorbed by operations	(17.5)	(20.4)

20. Capital and risk management

The Company's capital comprises share capital and all reserves. At 31 December 2018 total capital was £1,309.7m (2017: £1,197.4m). The increase in the period reflects the total comprehensive income arising in the period of £112.3m (2017: £151.7m loss).

The Company's capital is monitored by the Directors and managed on an on-going basis via a monthly review process to ensure that it remains positive at all times.

The principal risks and uncertainties facing the Company are:

- **Interest rate risk**
The movement in interest rates will impact the value of interest payable and receivable by the Company.

An increase of 1% in interest rates, with all other variables held constant, would result in a decrease in profit after tax in respect of a full financial year and in equity of £6.0m (2017: £5.8m). A decrease of 1% in interest rates, with all other variables held constant, would result in an increase in profit after tax in respect of a full financial year and in equity of £6.0m (2017: £5.7m).

- **Liquidity risk**
Exposure to liquidity risk arises as a result of normal business activities, specifically the risk arising from an inability to meet short-term cash flow requirements. The following table provides a maturity analysis showing the remaining contractual maturities of the Company's undiscounted financial liabilities and associated interest.

		1 year or less or on demand £m	1-5 years £m	Greater than 5 years £m	Total £m
2018	Borrowings	841.3	360.8	-	1,202.1
	Amounts owed to Group entities	78.3	-	-	78.3
	Current tax	1.3	-	0.6	1.3
2017	Borrowings	823.8	350.5	-	1,174.3
	Amounts owed to Group entities	72.5	-	-	72.5
	Current tax	1.3	-	-	1.3

- **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.

Credit risk management practices

The Company's current credit risk grading framework comprises the following categories:

Category	Description	Basis for recognising an expected credit loss ('ECL')
Performing	The counterparty has a low risk of default and does not have any past-due amounts	12m ECL
Doubtful	There has been a significant increase in credit risk since initial recognition	Lifetime ECL – not credit impaired
In default	There is evidence indicating the asset is credit-impaired	Lifetime ECL – credit impaired
Write-off	There is evidence indicating that the debtor is in severe financial difficulty and the Group has no realistic prospect of recovery	Amount is written off

20. Capital and risk management (continued)

The table below details the credit quality of the Company's financial assets, as well as the Company's maximum exposure to credit risk by credit risk rating grades:

2018	Note	External credit rating	Internal credit rating	12m or lifetime ECL?	Gross carrying amount £m	Loss allowance £m	Net carrying amount £m
Loans and receivables	17	N/A	Performing	12m ECL	434.7	-	434.7
Financial assets	18	Non-rated	Performing	12m ECL	8.5	-	8.5
Amounts owed by Group entities	21	N/A	Performing	12m ECL	27.8	-	6.1

The Company considers reasonable and supportable information that is relevant and available without undue cost or effort to assess whether there has been a significant increase in risk since initial recognition. This includes quantitative and qualitative information and also, forward-looking analysis.

Loans and receivables, and Amounts owed by Group entities – the Company is exposed to credit risk relating to loans and receivables advanced to other Group Companies, and other amounts owed by Group entities, both of which are considered low risk. The Company assesses whether there has been a significant increase in credit risk since initial recognition by assessing whether there has been any historic defaults, by reviewing the going concern assessment of the borrower, the long term stability of the Phoenix Group and the ability of the parent company to prevent a default by providing a capital or cash injection.

Financial assets – The Company's financial assets are held in open-ended investment companies, which values are based on quoted market prices at the period end. The Company considers that its financial assets have a low credit risk based on the credit ratings.

The Company writes off a financial asset when there is information indicating that the counterparty is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the counterparty has been placed under liquidation or has entered into bankruptcy proceedings. Financial assets written off may still be subject to enforcement activities under the Company's recovery procedures, taking into account legal advice where appropriate. Any recoveries made are recognised in profit or loss.

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

21. Related party transactions

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

In the year ended 31 December 2018 the Company received interest on loans to its parent of £15.7m (2017: £14.7m). Interest paid by the Company on loans due to subsidiaries amounted to £20.1m (2017: £18.2m).

Amounts due to related parties

	2018 £m	2017 £m
Loans due to parent	341.3	138.4
Loans due to subsidiaries	841.3	1,021.9
Other amounts due to subsidiaries	-	0.2
Other amounts due to fellow subsidiaries	78.3	72.3

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21. Related party transactions (continued)

Amounts due by related parties

	2018	2017
	£m	£m
Loans due by parent	434.7	434.7
Other amounts due from ultimate parent	-	0.3
Other amounts due from parent	21.7	24.6
Other amounts due by fellow subsidiaries	<u>6.1</u>	<u>-</u>

Key management compensation

The total compensation allocated to the Company and payable to employees classified as key management, which comprises the Directors, is disclosed in note 6.

Parent and ultimate parent entity

Information on the Company's parent and ultimate parent is given in note 22.

22. Other information

The Company's principal place of business is the United Kingdom. The Company's immediate parent is Phoenix Life Holdings Limited and its ultimate parent is Phoenix Group Holdings Public Limited Company ('PGH plc'), a company incorporated in the United Kingdom. A copy of the financial statements of PGH plc can be obtained from the Company Secretary, The Phoenix Group, Juxon House, 100 St Paul's Churchyard, London, EC4M 8BU.