Pearl Group Staff Pension Scheme

New pension funding agreement

The Trustee has successfully negotiated with the Company a new funding agreement and brief details were provided in the Short Report to members issued in January 2013.

The key elements of the new agreement are detailed below:

- **The commitment to a gilts flat funding target has been retained.** The Trustee's target is to reach 100% funding on a gilts flat basis by 30 June 2027 or by 30 June 2031 at the latest. Initially there will be an intermediate target to be 100% funded by 30 June 2022 with the amount of the Scheme's liabilities calculated using gilt yields plus a prudent margin. You will see this measure being used in the next valuation. The intermediate target will assist in monitoring to ensure we are on track to meet the longer term target. Both the intermediate target and the gilts flat basis will be reported to members in the Report on the Valuation as at 30 June 2012 issued late in 2013.
- **Accelerated contributions have been committed by the Company.** Following on from the payment made under the terms of the existing agreement of £25m in September 2012 the Company has agreed a schedule of accelerated future payments as follows: £70m will be paid in September 2013 and September 2014 and £40m each year from September 2015 to September 2021 (inclusive). These contributions will be increased if the Scheme is not on track in relation to the intermediate target. After September 2021 annual payments will be made by the Company calculated by reference to the amount needed to meet the gilts flat funding target.
- **Additional contributions have also been agreed through an improved sharing mechanism.** In order to provide for fairness in the Company's treatment of the Scheme against its treatment of other stakeholders (for example shareholders) contributions due to the Scheme will be accelerated where certain payments are made by the Company for the benefit of others. The sharing mechanism is necessarily complex and will be monitored closely by the Trustee. .
- **The existing covenant tests have been significantly strengthened.** A new test monitors the value of the Company compared with the pension scheme deficit to ensure it is maintained at the agreed level. A further new test means that no payments can be made by the Company which would reduce the value of the Company other than those payments that the Trustee has agreed are acceptable.
- **The consequences of the Company failing to meet its key obligations have been tightened.** If the Company fails to meet its key obligations under the new funding agreement then the Trustee can look to enforce the legal security that it holds over the value in certain of the Company's subsidiary companies. The Trustee has improved the terms of enforcing this security and the amount it is able to recover will also be increased after the bank debt relating to the Company and certain members of its Group has been repaid.
- **A new investment strategy will be implemented and full details are on page 3**. The new strategy is designed to lessen the volatility of the investments.
- **The Scheme's funding level will be monitored at each annual funding update**. A programme to reduce the Fund's investment risks has been agreed with the Company and the action required will depend on the funding level at each update. Where the Trustee thinks it is appropriate more opportunistic de-risking can also take place. The aim is for the Scheme to reduce the return seeking and credit portfolios to zero by the backstop date of 30 June 2031 at the latest.

In addition to these new aspects the following key protections have been retained from the previous funding agreement:

- The Company cannot grant legal security which would have an adverse impact upon the position of the Trustee.
- The covenant test based on a measure of the Scheme deficit on the gilts flat basis will be maintained.
- The need to maintain a specified level of value in the companies over which the Trustee holds its legal security.
- The continued protection of the independence of the Trustee Board with any changes to the board membership to be agreed with the Trustee.
- The administrative and non investment expenses of the Scheme will continue to be met directly by the Company.
- Continuing information and monitoring requirements on the Company in relation to the operation of the new funding agreement.

Glossary

- **covenant** - the Company's ability to fund the Scheme now and in the future.
- **gilts flat basis** – this is a conservative basis of valuation and the amount the Scheme would need to earn on its assets to pay for benefits will be in line with Government bond yields.
- **return seeking assets** – these are assets (for example equities) that are expected to generate a higher return over the long term but with increased volatility than other matching assets (for example bonds).
- **de-risking** – this is a term used to describe actions taken by trustees and companies running final salary schemes. Trustees would prefer schemes to take less risk and also to have a fund of sufficient size so that the scheme could support itself with little reliance on the Company. One example of de-risking is to reduce the level of return seeking assets in favour of matching assets when certain targets have been met.

Changes to the final salary investment strategy

The changes in the investment strategy are in respect of the funding of the final salary sections of the Scheme only. ***There are currently no changes planned for members of the money purchase section,*** although the Trustee will continue to keep these funds under review.

Asset allocation	Initial value	Range
Return seeking assets	25%	0-30% (1)
Equities	5%	0-7.5%
Property	10%	0-15%
Leveraged loans	5%	0-7.5%
Hedge funds	5%	0-7.5%
Other assets classes after agreement with the Company	0%	0-7.5%
Cash/Gilts	0%	0-5%
Risk reducing assets	75%	70-100%
Liability hedging portfolio (2)	25%	In accordance with the hedging strategy
Diversified credit portfolio on a buy to hold basis	Remainder of assets (approximately 50%)	Remainder of assets

(1) The initial aim is to hold 25% in return seeking assets but this will reduce as de-risking occurs.
(2) The liability hedging portfolio seeks to hedge the impact of future changes in inflation and interest rates.

Investment strategy and Liability hedging portfolio
The general approach is to manage interest and inflation rate risk by investing a proportion of the assets in a Liability Driven Investment (LDI) mandate, with the remainder invested in corporate bonds and some additional return seeking assets.

An allocation of 25% of the Scheme assets will be invested in collateral for interest rate and inflation rate hedging. Initially, the intention is to hedge 65% of the interest rate and inflation rate risk (measured on the intermediate target basis described on page 1, offset for contributions).

Following further discussions with the Company, the intention is to increase the hedge to 88% in 2013. The hedge ratio will be further increased to 100% when market conditions appear favourable.

Investment managers
The assets will be managed as follows:

Equities	Legal & General will continue to manage the equities.
Property	DTZ will continue to manage the property.
Leveraged loans	A manager is still to be appointed for this portfolio following the appropriate due diligence.
Hedge funds	Ignis Investment Management will continue to manage the hedge funds.
Liability hedging portfolio	Legal & General have been appointed to manage this portfolio.
Diversified corporate bond portfolio on a buy to hold basis	Legal & General will manage this portfolio and the corporate bonds currently with Ignis will be transferred to Legal & General.

A further update on the changes in the investment strategy will be included in the Report on the Valuation as at 30 June 2012 to be issued towards the end of 2013.