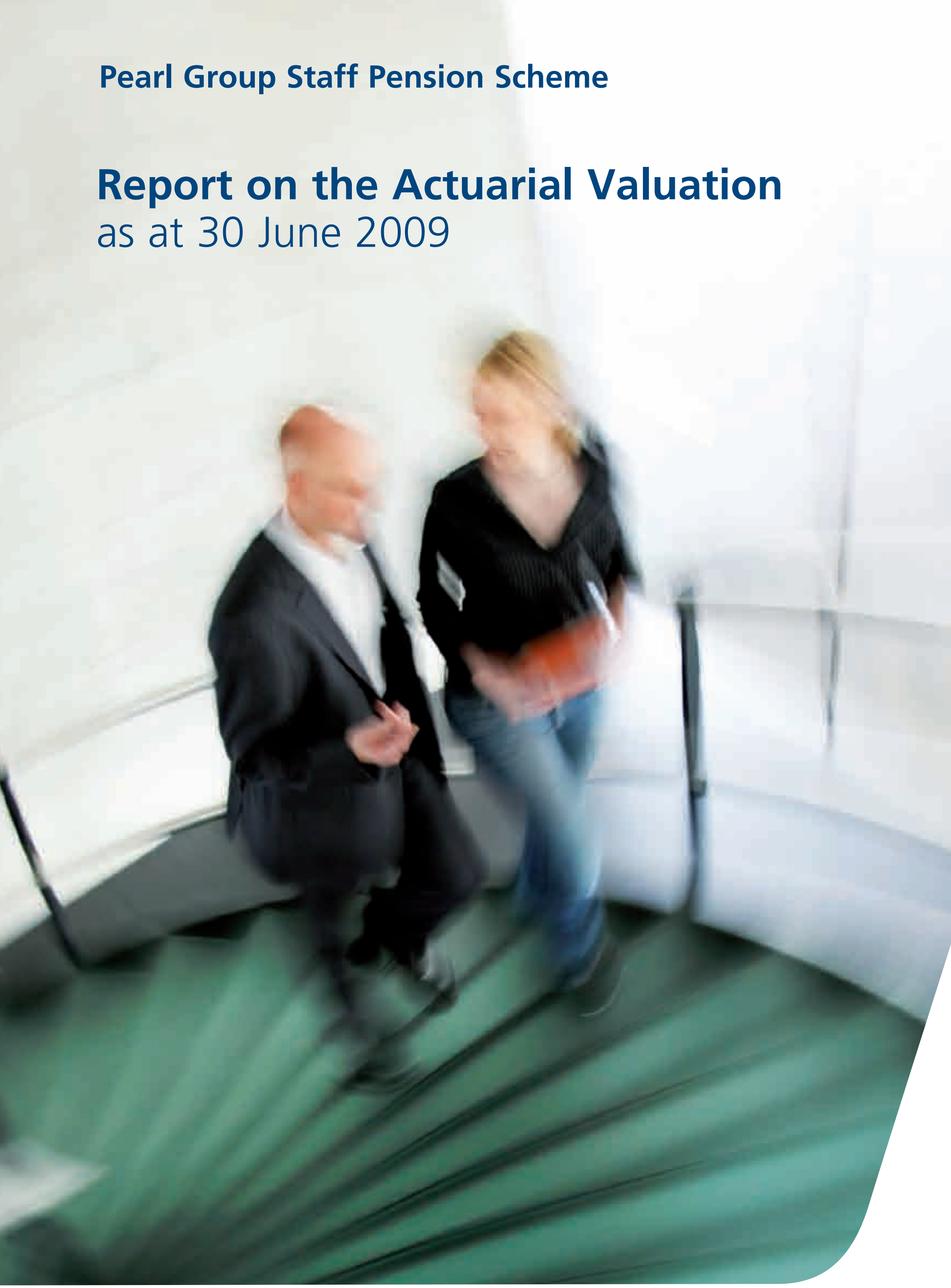
Pearl Group Staff Pension Scheme

Report on the Actuarial Valuation
as at 30 June 2009



Welcome

Welcome to the Pearl Group Staff Pension Scheme Actuarial Valuation Report. This booklet provides a summary of the actuarial valuation of the Scheme carried out by Towers Watson (formerly Watson Wyatt) as at 30 June 2009.

Pearl Group changed its name to Phoenix Group Holdings on 15 March 2010 and has now achieved listing on the London Stock Exchange. Pearl Group Holdings (No.2) Limited continues to be the principal sponsoring employer for the Scheme which is referred to throughout as 'the Company'. The Pension Scheme name remains unchanged.

The recent market volatility experienced over the three years since 2006 led to poor investment returns. This, coupled with the fall in the government bond yields used to value the liabilities, has resulted in a decreased funding level. In addition, some of the assumptions used to calculate the Scheme's funding at the 2006 valuation have been reconsidered, which also reduced the funding level – for more information, please see page 4.

It is important to remember that pensions should be viewed in the long term – whilst the funding level is temporarily below target, P.A.T (Pensions) Limited ('the Trustee') has put in place plans to reduce the shortfall over the period to 2027. The Pearl Group Staff Pension Scheme is not alone in having such a deficit – across the UK, large numbers of pension schemes are in a similar position, and are having to make important decisions in a bid to improve funding. For more information on the ways in which the Trustee is working to improve the funding of our Scheme, please see page 3 for a summary of the replacement funding agreement, and pages 8 and 9 for details of the new investment strategy. The summary funding statement on page 7 gives an update of the funding position as at 30 June 2009.

Contents

The replacement funding agreement

Following the results of the 2006 valuation, a funding agreement was drawn up between the Trustee, the Employer (Pearl Group Services Limited) and the Company (Pearl Group Holdings (No.2) Limited) (PGH2L). This included Company payments into the Scheme to reduce the shortfall which had been identified, and the target was to remove the shortfall by 2027.

Since the original funding agreement was put in place, the recent economic downturn has caused widespread concern across the globe, and it was recognised after much consideration that the Company's planned contribution due as at 30 June 2009 could not be paid without risk of serious detrimental effect on the business. You may recall that the replacement funding agreement was outlined in the 2009 Trustee Report, which was distributed at the end of January this year.

The replacement agreement began with a payment of £50 million from the Company to the Scheme during October 2009, to be followed by yearly payments of £25 million over the next ten years. A further contribution of over £10 million was also released to the Scheme from the escrow account (which was previously set up by the Company to help secure the Scheme's assets).

In addition to these payments, steps were taken to link future improvements in business, and consequently cashflow, to Scheme funding, so that the Scheme can share in the Company's success. The original plan for the Company to cover administration and other non-investment expenses until June 2027 was also maintained in the terms of the new agreement.

It is important to remember that the replacement funding agreement has been put in place to help improve the Scheme's funding. However, it is one of a range of measures undertaken by the Trustee and should not be viewed as a single solution to the Scheme's current deficit. The Trustee will continue to monitor the funding position over time, with the help of the Actuary, and appropriate action will be taken and reported upon where necessary.

The 2009 valuation – a summary of the results

The actuarial valuation carried out as at 30 June 2009 was the second to be completed using the new funding regime introduced by the Pensions Act 2004.

The Statutory Funding Objective (SFO) requires that schemes hold sufficient assets to cover the value of their liabilities or 'Technical Provisions'.The Trustee, with the Employer's agreement, decides how to calculate the value of the Technical Provisions which is an estimate of the assets needed to pay benefits when they are due.

If a valuation shows that a scheme is not meeting the SFO it must put in place a recovery plan to show how the scheme will achieve its target over a set period of time.

The Trustee and Company agree the following documents as part of the valuation:

- Statement of Funding Principles which sets out the Scheme's funding plan, and the method and assumptions used for the valuation.
- Recovery Plan which sets out the steps to be taken to ensure that any shortfall against the SFO is made up in a set period of time.
- Schedule of Contributions which sets out the contributions due from the Employer.

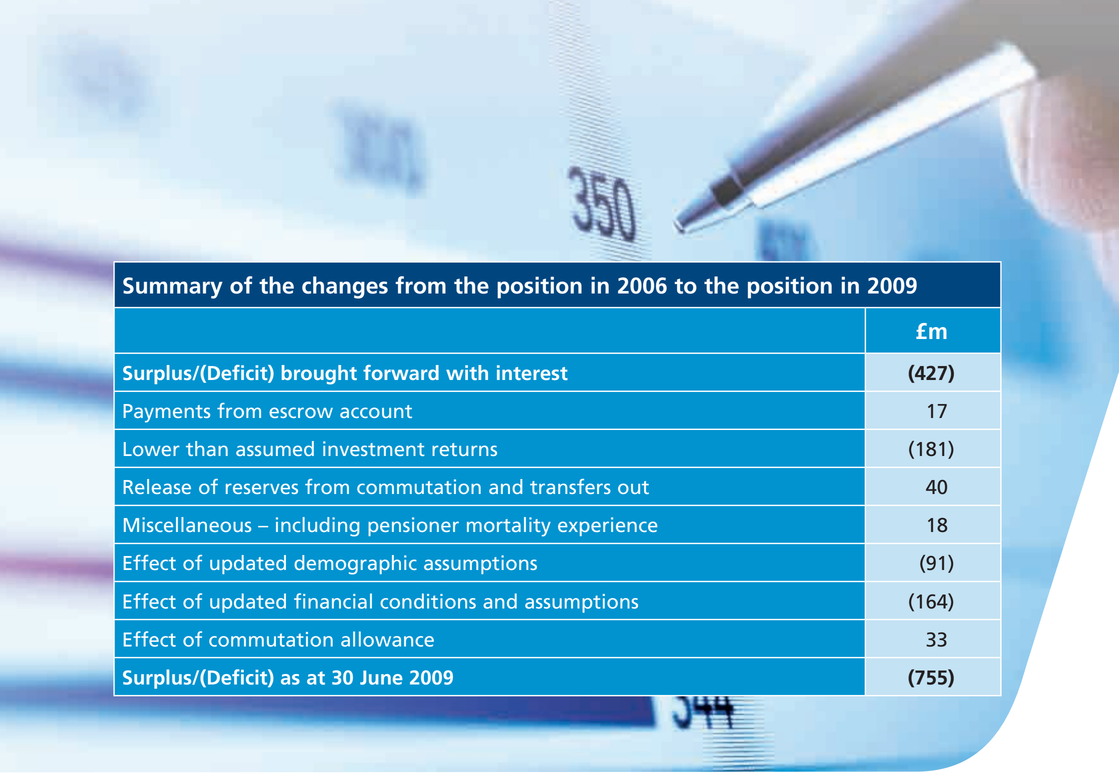
Valuation statement as at 30 June 2009	£m
Value of Technical Provisions in respect of:	
- pensioners and dependants	1,139
- deferred pensioners	1,056
- actives	27
- Money Purchase funds and AVCs	37
- expenses	22
Total Technical Provisions	**2,281**
Market value of assets	**1,526**
Shortfall of assets compared with Technical Provisions	**755**
Funding level	**67%**

When the Scheme was valued in 2006, it was shown to have a funding position of 82%. As previously mentioned in this report, the main reason for the decrease was a fall in the government bond yields used to value the liabilities, together with the poor investment returns experienced during the three-year period.

Reasons for the change in funding level

As well as the effect of the struggling economy, factors involved in the valuation process itself influenced the Scheme's funding. For each valuation, the Company and the Trustee agree a set of assumptions for use when making the complex calculations which determine the Scheme's funding position.

Such assumptions are arrived at by taking into account relevant criteria such as current investment markets, inflation and life expectancy of members (which has increased significantly over recent years).



Summary of the changes from the position in 2006 to the position in 2009	
	£m
Surplus/(Deficit) brought forward with interest	**(427)**
Payments from escrow account	17
Lower than assumed investment returns	(181)
Release of reserves from commutation and transfers out	40
Miscellaneous – including pensioner mortality experience	18
Effect of updated demographic assumptions	(91)
Effect of updated financial conditions and assumptions	(164)
Effect of commutation allowance	33
Surplus/(Deficit) as at 30 June 2009	**(755)**

Change of assumptions from 2006

If the valuation had been carried out on the previous 2006 assumptions it would have resulted in a better funding position, but this would not reflect current conditions. Therefore, as mentioned previously, the assumptions used in 2006 have been updated.

Improvement in mortality (resulting in pensions being in payment for longer) is one good example of how the Scheme is using more up-to-date assumptions to value member's benefits.

As well as the updated funding agreement, the Trustee has reviewed its investment strategy – you can find more information on this on pages 8 and 9.

A long-term view

It is important to remember that pensions are a long-term investment, and that the Scheme is constantly monitored. The expected improvement in funding will take time and, as with any investment, values can go down as well as up over that period of time. Although it is not strictly necessary for pension schemes to have 100% funding (benefits will not all become payable together), the Trustee feels this is a prudent target to achieve, and is aiming to reach that point by 2027, under the terms of the funding agreement.

Summary Funding Statement

The valuation of the Scheme showed that on 30 June 2009 the funding position (excluding Money Purchase and AVC assets and liabilities) was as follows:

Assets	£1,489m
Amount needed to provide benefits (Technical Provisions)	£2,244m
Shortfall	£755m
Funding level	67%

The Trustee and the Company have entered into an agreement to remove this deficit by 30 June 2027 (as described on page 3).

The previous annual update as at 30 June 2008 showed a funding level of 75% and the funding level of the Scheme has worsened since the last valuation as previously described.

It is important to remember that these figures are given as a snapshot of the Scheme's position at a particular date. You should also keep in mind that pensions should be considered a long-term investment.

The cost of accrual of future service benefits allowing for contributions to be paid annually in December is:

Final Salary section members:
50.7% of pensionable earnings

Hybrid members:
20.3% of pensionable earnings

Money Purchase members:
11.7% of pensionable earnings

If the Scheme had started winding up (full solvency), it is estimated that the assets available would have been sufficient to secure, on average, 62% of benefits for members of the Final Salary sections.

Inclusion of this information does not imply that the Company is thinking of winding-up the Scheme.

Payment to the Company

There has not been any payment to the Company out of Scheme funds since the last statement was issued.

Important: If you are thinking of leaving the Scheme for any reason, you should consult a professional adviser, such as an independent financial adviser, before taking any action.

Reviewing the investment strategy

The Trustee regularly monitors the investment performance of the Scheme's assets to maximise returns where possible.

The Scheme revised its Statement of Investment Principles in July 2010, and the new strategy is summarised below.

Final Salary sections

Investment objective

The Trustee aims to invest the assets of the Scheme prudently to ensure that the benefits promised to members are provided. In setting the investment strategy, the Trustee first considered the lowest risk asset allocation that it could adopt in relation to the Scheme's liabilities. The asset allocation strategy it has selected is designed to achieve a higher return than the lowest risk strategy while maintaining a prudent approach to meeting the Scheme's liabilities.

The revised asset allocation strategy takes into account the Scheme's current strength and the profile of its liabilities, and is aimed at improving the funding position within acceptable risk levels. It is intended that the actual asset allocation will move towards the planned allocation in a phased manner.

When choosing the Scheme's planned asset allocation strategy, the Trustee considered written advice from its

	Actual assets held at 30 June 2009	Planned asset allocation
	%	%
Equities	7.9	15.0
Gilts	32.5	45.0
Corporate bonds	31.1	10.0
Hedge Funds	16.7	15.0
Property	8.0	15.0
Cash/Other	3.8	-
Total	**100.0**	**100.0**

investment advisers. The table on page 8 shows the planned asset allocation strategy chosen to meet the investment objective.

As part of the previous funding agreement with the Company, the assets were invested using a single manager, Ignis Investment Services Ltd (formerly Axial Investment Management/Ignis Asset Management). Ignis' past role was to select external managers to assist in managing the Scheme's assets; however, two further managers have now been appointed as part of the ongoing review of the investment strategy, allowing the assets to be invested on a specialist basis by asset class.

Legal and General Investment Management deal with gilts and equities, both on a passive basis, and this will allow the gilts portfolio to be tailored to the Scheme's liabilities using Legal and General's expertise. DTZ Investment Management now manage the Scheme's property portfolio. Ignis will continue to manage the corporate bond (credit) and hedge fund portfolios.

By spreading the responsibility for investing the Scheme's assets, each manager will have a concentrated area of focus, and in addition, will bring specialist experience to the Scheme. It is commonplace to appoint individual managers for the various skills required, and performance will continue to be monitored.

Money Purchase section

Investment objective

In investing the assets of the Scheme in a prudent manner, the Trustee's key aim is to provide a range of investments that are suitable for meeting members' long and short-term investment objectives. They have taken into account members' circumstances, in particular members' attitudes to risk and term to retirement.

There are no changes to the choice of Money Purchase funds available at this time but the Trustee does keep this under regular review.

How the Scheme operates

How is my pension paid for?

The assets of the Scheme are held in a common fund which is used to pay pensions and other benefits to Scheme members as they fall due. The Company pays contributions into this fund as required. The money to pay for the Final Salary benefits is held in a common fund. It is not held in separate funds for each individual.

How is the amount the Scheme needs worked out?

The Trustee has a funding plan (the Statement of Funding Principles) agreed with the Company, which aims to make sure there is enough money in the Scheme to pay for pensions now and in the future. The amount of money that the Company pays into the Scheme may go up or down following regular funding checks by our Actuary (called actuarial valuations).

The importance of the Company's support

The Trustee's objective is to have enough money in the Scheme to pay pensions now and in the future. However, the success of the Scheme relies on the Company continuing to support it because:

- the Company will be paying the future expenses of running the Scheme on an annual basis
- the funding level can fluctuate, and when there is a funding shortfall, the Company will usually need to put in more money
- if the target funding level should turn out not to be enough, the Company will need to put in more money.

What would happen if the Scheme started to wind up?

Whilst the Scheme remains ongoing, even though funding may temporarily be below target, benefits will continue to be paid in full. If the Scheme winds up, you might not get the full amount of pension you have built up. If the Scheme were to start to wind up, the Company is required to pay enough into the Scheme to enable the members' benefits to be completely secured with an insurance company. It may be, however, that the Company would not be able to pay this full amount. If the Company became insolvent, the Pension Protection Fund might be able to take over the Scheme and pay compensation to members.

Further information and guidance is available on the Pension Protection Fund's website at www.pensionprotectionfund.org.uk. Or you can write to the Pension Protection Fund at Knollys House, 17 Addiscombe Road, Croydon, Surrey, CR0 6SR.

Why does the funding plan not call for full solvency at all times?

The full solvency position assumes that benefits will be secured by buying insurance policies. Insurers are obliged to take a very cautious view of the future and need to make a profit. The cost of securing pensions in this way also incorporates the future expenses involved in administration. By contrast, our funding plan assumes that the Company will continue in business and support the Scheme.

Where can I get more information?

If you have any other questions, or would like any more information, please contact the Scheme Administrators. The following is a list of more detailed documents that provide further information. If you want us to send you any of these documents please let us know.

Please help us to keep in touch with you by telling us if you change address.

Additional documents available on request

The Statement of Funding Principles, which sets out the Scheme's funding plan.

The Recovery Plan, which explains how the funding shortfall is being made up.

The Statement of Investment Principles, which explains how the Trustee invests the money paid into the Scheme.

The Schedule of Contributions, which shows how much money is being paid into the Scheme.

The Annual Report and Accounts of the Pearl Group Staff Pension Scheme, which shows the Scheme's income and expenditure in the year up to 30 June 2009.

The full Report on the Actuarial Valuation following the Actuary's check of the Scheme's financial situation as at 30 June 2009.

An Annual Benefit Statement – If you are an active member of the Scheme (and have not received a benefit statement in the previous 12 months), you can ask for a statement that provides an illustration of your likely pension.

Next review

The next full actuarial valuation of the Scheme will be carried out no later than 30 June 2012.

Get in touch

Members are reminded to inform the Scheme Administrators of any address changes to ensure records are up to date. If members have any queries concerning their benefits or the valuation, they should contact First Actuarial, the Scheme Administrators.

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