Scheme Funding Update

Report on the actuarial valuation as at 30 June 2015

Welcome

Welcome to the latest Pearl Group Staff Pension Scheme Valuation Report. We have produced the information in this booklet following the Scheme's 2015 actuarial valuation. This was carried out by Neil Wearing, the Scheme Actuary from Willis Towers Watson.

It provides a snapshot of the Scheme's health, as at 30 June 2015. By law, a full actuarial valuation must be carried out every three years. It has two main purposes: it checks whether the Scheme has enough assets to be able to pay out members' benefits in the future, and it calculates the level of future contributions needed for the Scheme to be able to pay those benefits as they become due.

Pearl Group Holdings (No.2) Limited continues to be the sponsoring employer for the Scheme, and is referred to throughout this report as 'the Company'.

The next official funding update with an effective date of 30 June 2016 will be provided in *Your Pension Matters*, issued to members early in 2017. However, we monitor the funding level regularly with updates from the Scheme Actuary.

Keith Jones
Chairman of Trustees

We are pleased to confirm that the funding level in 2015 has improved since the valuation in 2012, as shown below:

Key points

- **The funding level on the intermediate funding target (Technical Provisions) has gone UP from 80% to 88%**
- **The funding level on the gilts flat funding target has gone UP from 69% to 81%**

For more details, see page 5.

Background to the valuation

The Trustees and the Company have a funding agreement in place to provide for the long-term funding and security of the Scheme. The last actuarial valuation report provided details of the funding agreement reached between the Trustees and the Company in November 2012. This agreement is still in place.

As part of the 2015 valuation, the Trustees had a covenant review (assessment of the strength of the Company) carried out by PricewaterhouseCoopers, which also considered the potential impact of Solvency II and Brexit on the Company. The covenant review provided reassurance to the Trustees of the Company's ability to continue its support for the Scheme.

The current contributions due to the Scheme are £40m each year from September 2016 (already received) to September 2021 (inclusive). If there is a shortfall after 2021, annual payments will be made to address this. These contributions are payable in addition to contributions paid by the Company for active money purchase members (see page 9).

More information on the 2012 funding agreement is available in the 2012 valuation report on the Scheme's website – visit **www.pearlstaffpensionscheme.co.uk**

The 2015 valuation – a summary of the results

The Statutory Funding Objective (SFO) requires that the Scheme holds sufficient assets to cover the value of its liabilities or 'Technical Provisions'.

The Trustees, with the Company's agreement, decides how to calculate the value of the Technical Provisions (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 Trustees 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 Company.

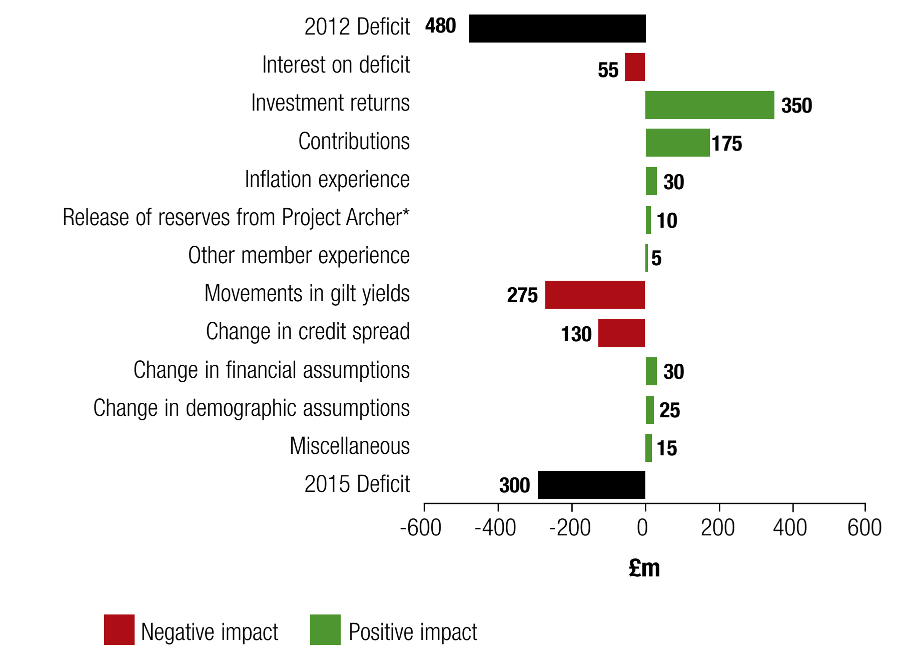
Following the funding agreement in 2012, the Scheme monitors the funding position on two bases.

	30 June 2015	
	Intermediate funding target (Technical Provisions) **£m**	**Gilts flat funding target** **£m**
Amount required to provide for the Scheme's liabilities of:		
Pensioners and dependants	1,399	1,489
Deferred pensioners	1,097	1,238
Money purchase funds and AVCs	53	53
Expenses	29	33
Total value of accrued benefits	2,578	2,814
Market value of assets	2,278	2,278
Past service deficit (value of accrued benefits less assets)	(300)	(536)
Funding level as at 30 June 2015 (assets ÷ total value of accrued benefits)	**88%**	**81%**
Funding level as at 30 June 2012	**80%**	**69%**

Figures subject to rounding

Change in funding position between valuations

The following table summarises the change in the Scheme's funding position on the **intermediate funding target** since the date of the last actuarial valuation.



* Project Archer refers to the Enhanced Transfer Value exercise that took place in 2013.

- Examples of financial assumptions include assumptions for returns on investments, inflation, future pension increases and revaluation in deferment.
- Examples of demographic assumptions include life expectancy and proportion of members that are married.

It is important to remember that pensions are a long-term investment and that the Scheme is constantly monitored. The Trustees keep the investment strategy for the Final Salary sections of the Scheme under review (page 8).

Summary Funding Statement

The latest valuation of the Scheme showed that on 30 June 2015, the funding position (excluding Money Purchase and AVC assets and liabilities) was as follows:

	Intermediate funding target	Gilts flat funding target
Assets	£2,225m	£2,225m
Amount needed to provide benefits	£2,525m*	£2,761m
Shortfall	£300m	£536m
Funding level	**88%**	**81%**

*The Scheme's Technical Provisions for the valuation. Please note these figures are subject to rounding.

The previous annual update on the **intermediate funding target**, as at **30 June 2014**, showed the funding level at 83%; this has increased to 88% as at 30 June 2015. The main factors contributing to this improvement were the additional contributions paid into the Scheme, updates to the data and the assumptions used by the Scheme Actuary to measure the liabilities as part of the formal triennial valuation as at 30 June 2015, and the investment performance of the Scheme's assets being better than assumed, offset to some extent by the reductions in gilt yields.

It is important to remember that these figures represent a snapshot of the Scheme's position on one particular day. You should also keep in mind that pensions are a long-term investment.

If the Scheme had started winding up (full solvency), it is estimated that the assets available would have been sufficient to secure 73% (2012 64%) of benefits for members of the Final Salary sections.

The Pensions Regulator requires us to provide this information to members, and 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.

The investment strategy

Final Salary sections

The Trustees agreed a new Statement of Investment Principles (SIP) in 2016 to reflect the current strategy. A copy is available on request from the Scheme Administrators.

The Trustees invest a proportion of assets in a liability hedging portfolio, which means that the impact of changes in interest rates and inflation is limited.

Asset Class	30 June 2016		Initial target value	Target range
	£m	%	%	%
Return seeking assets	**424**	**16.7**	**25.0**	(a)
Global equity	122	4.8	5.0	0-7.5
Property	208	8.2	10.0	0-15.0
Leveraged loans	25	1.0	5.0	0-7.5
Hedge funds	67	2.6	5.0	0-7.5
Other	3	0.1	0.0	0-7.5
Risk reducing assets	**2,063**	**81.3**	**75.0**	
Liability hedging portfolio	977	38.5	25.0	(b)
Corporate bonds	964	38.0	40.0	(c)
Infrastructure debt	122	4.8	10.0	0-15.0
Cash	**50**	**2.0**	**0.0**	**0-5.0**
TOTAL	**2,537**	**100.0**	**100.0**	

(a) The initial aim was to hold 25% in return seeking assets but this will reduce as de-risking occurs.

(b) The target range in relation to the liability hedging portfolio will vary in accordance with the hedging strategy.

(c) The target range for corporate bonds will vary with the intention that these holdings cover the remainder of the assets.

The above figures are provided directly by the investment managers and are unaudited (subject to rounding).

An allocation of 25% of the Scheme's assets is invested in collateral for the interest rate and inflation rate hedging. The hedge ratio will be increased from 95% to 100% when market conditions appear favourable.

The assets are managed as follows:

Return seeking assets		Risk reducing assets	
Equities	**Legal & General**	**Liability hedging portfolio**	**Legal & General**
Property	**DTZ**	**Diversified corporate bond portfolio on a buy to hold basis**	**Legal & General**
Leveraged loans	**Castle Hill** This investment was fully redeemed in July 2016.	**Infrastructure debt**	**Macquarie** Appointed in July 2015 to manage this portfolio.
Hedge funds	**Legal & General**		

Money Purchase section

The Trustees' key investment aim is to provide a range of investments that are suitable for meeting members' long and short-term investment objectives. This means ensuring that members' circumstances are considered, with particular focus on attitudes to risk and term to retirement.

The Trustees reviewed the range of money purchase funds in light of increased pensions flexibility and changes were made to these funds in early 2016. Details of the funds available and performance can be found in the Investment Guide and factsheets on the Scheme's website (www.pearlstaffpensionscheme.co.uk).

Money Purchase contributions for active members

The valuation assessed that future Company contributions for the Money Purchase section members must be paid at 12.0% of pensionable earnings. As the Final Salary sections have been closed to future accrual, no ongoing contributions for future service are required.

Q&A

Why aren't the actuarial valuation results available to us sooner?

The actuarial valuation has an effective date of 30 June 2015. Data is provided a couple of months after the effective date to allow all member movements during the period to be included and then the complex calculations take a number of months to complete.

In addition, there have been big changes to the regulatory environment for insurance companies due to the Solvency II Directive. The main impact of Solvency II is an increase in the amount of capital that EU insurance companies must hold to reduce the risk of insolvency. The EU referendum vote in June 2016 has also impacted companies and markets. As mentioned previously, the Trustees had a covenant review to assess the strength of the Company and potential impact of Solvency II and Brexit and this has also added to the time to complete the valuation this year.

The Trustees discuss the assumptions to be used in the calculations with the Company and when agreed, the valuation is completed and signed off.

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 in line with the Schedule of Contributions. 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 Trustees have 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 Trustees' 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 were to wind up?

If the Scheme were to wind up, you might not get the full amount of pension you have built up. In this situation, 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 The Pension Protection Fund, Renaissance, 12 Dingwall Road, Croydon, Surrey CR0 2NA.

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.

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 Trustees invest 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 2015.

The full Report on the Actuarial Valuation following the Actuary's check of the Scheme's financial situation as at 30 June 2015.

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 actuarial valuation

The next full actuarial valuation of the Scheme will be carried out no later than 30 June 2018.

Get in touch

If you have any queries about your benefits or the valuation, please contact the Scheme Administrators using the details below:

Pearl Group Staff Pension Scheme
First Actuarial LLP
First House
Minerva Business Park
Lynch Wood
Peterborough PE2 6FT

Telephone: 01733 447620
Fax: 01733 447699
Email: pearl@firstactuarial.co.uk

www.pearlstaffpensionscheme.co.uk

Keep in touch

It is important to tell the Scheme Administrators if you change your address or personal circumstances. Contact details for the Scheme Administrators are shown above.

Important warning

There has been an increase in companies operating schemes which encourage pension savers to transfer monies away from occupational schemes, promising cash incentives or the ability to access pension savings prior to age 55 in the form of pension loans. Unless someone is in ill health, it's against the law to access pension funds before the age of 55. The Pensions Regulator has produced written information on this topic; visit **www.pensionsadvisoryservice.org.uk** for more details.

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.