PHOENIX GROUP REPORTS STRONG 2010 OPERATING CASHFLOWS AHEAD OF TARGET AT £734 MILLION

Phoenix Group, the UK's largest specialist closed life fund consolidator, reports strong, target-beating financial results for 2010, with £734 million of operating cashflows and MCEV enhancement of £296 million. Phoenix is confident in its ability to create shareholder and customer value in 2011 and beyond; setting a 2011 target for cash generation of £750-850 million and raising its 2010 -14 cash generation target by £300 million to £3 billion.

2010 Highlights

- Operating companies' cash generation at £734 million, beating £625 -725 million target
- MCEV up 15% at £2,104 million
- £296 million MCEV enhancement, beating £145 million target
- Group IFRS operating profit £373 million
- IGNIS IFRS operating profit up 35% at £46 million
- Group assets under management £67.5 billion
- Gearing reduced to 52% at end 2010 from 58% at end 2009
- 21p final dividend per share recommended, total 42p for 2010
- Achieved Premium Listing on the London Stock Exchange and entered FTSE 250 Index

New Financial Targets include

- £750-850 million target for 2011 cash generation
- £300 million increase in 2010-14 cash generation target to £3.0 billion
- Forward looking cash generation target for 2011-2016 of £3.2 billion
- £100 million p.a. contribution to MCEV from management actions between 2011-2014
- Gearing target of under 50%, by the end of 2011, to be met from organic cashflows

Commenting on the results, Group CEO, Clive Bannister said:

"Phoenix made considerable progress in 2010, operationally and financially. We identified the critical tasks and delivered on them all, beating our financial targets. We are confident in the prospects for 2011 and beyond and have set challenging new targets to reflect this.

In 2011, we will focus on the further development of "The Phoenix Way", our proposition for the integration and management of closed life funds. The Phoenix Way is characterised by a unique and consistent approach and an infrastructure that provides best practice solutions to the complex problems of closed life funds. This way of applying our business model extends throughout Phoenix Life and IGNIS and is the basis on which we protect and create value, both for our customers and our shareholders."

Speaking about Phoenix Group's debt facilities, Clive Bannister continued:

"We will continue to explore options with our lenders regarding the best structure and timing for the restructuring of our banking facilities, with a view to changing some of the current covenant constraints. However, our present facilities feature favourable interest margins and we will only agree to new arrangements if an opportunity arises that we consider to be in the best interests of our shareholders."

Presentation

There will be a presentation for analysts and investors today at 9.00 am (BST) at:

Deutsche Bank, Winchester House, 1 Great Winchester Street, London, EC2N 2DB.

A link to a live webcast of the presentation, with the facility to raise questions, and a copy of the presentation will be available at www.thephoenixgroup.com

A replay of the presentation will also be available through the website.

Participants may also dial in as follows:

UK	020 3059 5845
International	+44 (0) 20 3059 5845

Participant password: Phoenix

Enquiries

Investors
Lorraine Rees, Head of Investor Relations, Phoenix Group
+ 44 (0) 20 7489 4456

Media
Daniel Godfrey, Director of Corporate Communications, Phoenix Group
+ 44 (0) 20 7489 4517

Notes

1. Phoenix Group is the UK's largest specialist consolidator of closed life funds with over six million customers and £67.5 billion of assets under management.
2. Gearing is calculated as net shareholder debt as a percentage of the sum of Group MCEV, net shareholder debt and the present value of future profits of IGNIS. Net shareholder debt is shareholder debt (including hybrid debt) less Holding Company cash and cash equivalents.
3. Operating companies' cash generation is a measure of cash and cash equivalents, remitted by the Group's operating subsidiaries to the Holding Companies and is available to cover dividends, bank interest and other items.
4. The recommended final dividend of 21p per share is expected to be paid on 17 May 2011, subject to shareholder approval at the Phoenix Group Holding's AGM. The ordinary shares will be quoted ex-dividend on the London Stock Exchange as of 6 April 2011. The record date for eligibility for payment will be 8 April 2011 and the date of payment of the dividend is expected to be 17 May 2011. The Company will be also offering a scrip dividend alternative, details of which will be made available to shareholders shortly.
5. The financial information set out in this announcement has been extracted without material adjustment from the audited accounts of Phoenix Group Holdings for the year ended 31 December 2010. The Ernst & Young Accountants LLP audit opinion on the Phoenix Group Holdings accounts is unqualified. The Annual Report & Accounts of

Phoenix Group Holdings will be published on 7 April 2011 in advance of the Annual General Meeting on 13 May 2011.

6. This announcement in relation to Phoenix Group Holdings and its subsidiaries (the 'Group') contains, and we may make other statements (verbal or otherwise) containing, forward-looking statements about the Group's current plans, goals and expectations relating to future financial conditions, performance, results, strategy and/or objectives.

   Statements containing the words: 'believes', 'intends', 'expects', 'plans', 'seeks', 'targets', 'continues' and 'anticipates' or other words of similar meaning are forward-looking. Forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the Group's control. For example, certain insurance risk disclosures are dependent on the Group's choices about assumptions and models, which by their nature are estimates. As such, actual future gains and losses could differ materially from those that we have estimated.

   Other factors which could cause actual results to differ materially from those estimated by forward-looking statements include but are not limited to: domestic and global economic and business conditions; asset prices; market related risks such as fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of governmental and/or regulatory authorities, including, for example, new government initiatives related to the financial crisis and the effect of the European Union's "Solvency II" requirements on the Group's capital maintenance requirements; the impact of inflation and deflation; market competition; changes in assumptions in pricing and reserving for insurance business (particularly with regard to mortality and morbidity trends, gender pricing and lapse rates); the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; risks associated with arrangements with third parties, including joint ventures; inability of reinsurers to meet obligations or unavailability of reinsurance coverage; the impact of changes in capital, solvency or accounting standards, and tax and other legislation and regulations in the jurisdictions in which members of the Group operate.

   As a result, the Group's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set out in the forward-looking statements within this announcement. The Group undertakes no obligation to update any of the forward-looking statements contained within this announcement or any other forward-looking statements it may make. Nothing in this announcement should be construed as a profit forecast.

Introduction

Business overview

Phoenix Group is the UK's largest specialist closed life and pension fund consolidator with over 6 million policyholders and in excess of £67 billion of assets under management.

As a closed life business consolidator Phoenix Life focuses on the efficient run-off of existing policies, maximising economies of scale and generating capital efficiencies through operational improvements. IGNIS focuses on the management of multi-asset funds, delivering strong investment performance and high quality service to its clients.

The Group's strength is derived from the intelligent combination and leverage of both the Phoenix Life and IGNIS Asset Management businesses.

Our mission

To improve returns for Phoenix policyholders and IGNIS customers and deliver value for shareholders.

Our vision

To be recognised as 'the industry solution' for the safe, innovative and profitable decommissioning of closed life funds and as a specialised global asset manager.

Our strategy framework

Our mission and vision are based on the three pillars of structure, manage and acquire. These are underpinned by trust and competence.

Key financial objectives

In 2010 the Phoenix Group performed at the top of its target range for its key financial objectives.

£734m Operating companies' cash generation

£2,104m Group MCEV

Other financial highlights

£373m Group IFRS operating profit

£1.0bn IGD capital surplus (estimated)

£2.8bn IGD Excess Capital (estimated)

52% Gearing ratio

42p Dividend per share

£67.5bn Assets under management

£46m Asset management operating profit

Financial Targets

£750m – £850m Operating companies' cash generation in 2011

£100m Contribution to MCEV from management actions per annum until 2014

<50% Reduce gearing to below 50% by the end of 2011

Chairman’s statement

“A year of considerable progress, both strategically and financially”

Phoenix Group has enjoyed a year of considerable progress, both strategically and financially. We met all our key financial objectives; exceeded the top of our range for the generation of cash and cash equivalents; saw the integration of our two asset management businesses under the IGNIS brand; delivered our targets for management actions; simplified the Group’s capital structure and achieved a Premium Listing on the LSE with subsequent FTSE 250 Index inclusion. These achievements create an excellent platform for further development in 2011 and beyond.

As a consequence of this performance, I am pleased to report to shareholders that the Board has decided to recommend a final dividend for the year of 21p per share, making a total of 42p per share for the financial year. Shareholders may again elect to receive their dividends as scrip.

The simplification of our capital structure in 2010 and the subsequent achievement of the Premium Listing on the LSE were significant steps forward for Phoenix and rightly attracted considerable attention. Less publicised were our continuing investments in the development of our operating platform for the management of our closed life funds and the policies dependent on them. The Phoenix platform represents a unique proposition for the integration, structuring, de-risking and management of closed funds, presenting a rich source of future value for both policyholders and shareholders alike. We have identified a number of opportunities for further development, both in Phoenix Life and IGNIS, which will be pursued in 2011.

The Phoenix business model, and the investment proposition that it delivers, rest on cash generation. It is the scale and predictability of the Group’s cash flows that give us confidence in our long-term financial stability and the consistency of our financial performance. The investments we are making in the Phoenix operating platform underpin our cash flows and deliver opportunities to enhance and accelerate these. Our debt structure, whilst low cost, includes various constraints and we are in dialogue with our lenders to find ways of removing some of these burdens but they will only be pursued if they represent good value for our shareholders.

In due course, we expect to grow further by acquisition. There are many hundreds of billions of pounds in closed or quasi-closed life funds, particularly in the with-profits sector. We are aware that current operators of those funds are reviewing whether they wish to continue to apply scarce capital to maintain this line of business and we expect that many will decide that they wish to exit.

Millions of individuals have a substantial portion of their savings invested in closed life funds. Running these off as individual funds creates an uncertain future of escalating administrative costs and diminishing expertise to look after these policies. This is why the Phoenix consolidation vision is so important to policyholders as well as to our shareholders. We are the only specialist participant in the UK market with the scale, expertise and low-cost operating platform that is capable of taking on large closed books of business and integrating them into a larger whole. In doing so, we can reduce costs and diversify risk. This enables us to invest in a broader range of asset classes with the aim of improving policyholder returns and releasing surplus capital to shareholders.

During the year, a search was initiated for a successor to Jonathan Moss as our Group Chief Executive Officer and I am delighted that this concluded in early February 2011 with the appointment of Clive Bannister to the role. Clive has spent sixteen years in a variety of senior roles at HSBC including his most recent position as a member of the Group Management Board and Global Managing Director of Insurance and Asset Management. He has a first class track record of success in growing businesses, and in developing and leading large teams. On behalf of the Board and all our colleagues at Phoenix, I was pleased to welcome Clive to the Group and I am very much looking forward to working with him. The Board was also pleased to welcome Jonathan Yates, who joined the Board as Group Finance Director in June 2010.

We now have an executive team in situ that is well equipped to lead the Group through the next phase of its development.

The Board wishes to express its thanks to Jonathan Moss and Simon Smith, former Group CEO and Group FD respectively. With skill and resilience, they led the Group through challenging times and brought us to the position of opportunity that we enjoy today. We are very grateful to Jonathan and Simon for their service to Phoenix Group and wish them both well for the future.

Phoenix Group is financially strong and strategically well positioned. The Board wishes to thank all of our colleagues throughout the Group who have produced such good results for 2010 and upon whose efforts we rely for success in the future.

Ron Sandler

Chairman

28 March 2011

Group Chief Executive Officer's report

"Phoenix Group has taken major strides forward in 2010. We set a clear focus on the most important tasks – and we delivered on them all. We have proved that the Phoenix business model works."

£734m Operating companies' cash generation

£2,104m Group MCEV

Introduction

I was proud and honoured to be offered the opportunity to become Group Chief Executive Officer in February this year. The Phoenix business model creates value by combining our closed life business in Phoenix Life with the asset management capability of IGNIS. This combination delivers a unique and unrivalled potential to play a key role in the decommissioning of the closed sector.

Phoenix Life companies generate cash flows for Group and investment funds for IGNIS, who both manage and leverage the scale of the life company assets to attract talent and produce performance that can also win third party business. This is a blueprint that offers rewards for our shareholders, our customers and the policyholders of other closed life funds that we may seek to integrate into our existing business in the future.

Working for Phoenix is an exciting challenge, because it is a business that does something of real importance for millions of customers, who are always at the heart of our work.

I am excited by the quality of the operating platform that has already been constructed by my colleagues and by the opportunities to develop it further in the years ahead. This applies both to our capacity to structure and manage closed life funds in Phoenix Life as well as to the potential for IGNIS to deliver outstanding performance in the management of policyholder, shareholder and third party assets.

All of the above is being achieved in a culture that is both risk sensitive and alert. The Group is self-evidently actively managing its risk across all aspects of the business. The Group has invested heavily in people, processes and systems ensuring that the consideration of and management of risk is at the forefront of all that we do. This protects our policyholders and other Group stakeholders from unexpected negative outcomes. We will be relentless in managing risk going forward.

People

Phoenix Group is very fortunate in the quality of its people. The Group has assembled true 'centres of expertise' in Phoenix Life and IGNIS as well as within its Group functions. We are well placed to deliver outstanding investment returns and to integrate and manage closed funds. I am grateful to my colleagues who have made me welcome and who have given me great support.

That the Group comprises a highly talented and motivated team is a tribute to our Human Resources professionals who have done an exceptional job in recruitment, learning and development and employee engagement initiatives as demonstrated by some industry-leading scores in our employee surveys.

Group highlights

Phoenix Group started the year with its main listing on the NYSE Euronext, with a capital structure that included dilutive instruments equivalent to around 80 percent of the issued shares and Tier 1 Bonds on which a coupon had been deferred. The year ended with dilutive instruments at less than 20 percent of the issued shares, our Tier 1 Bond coupons fully up to date, a £33 million placing of new shares completed, a Premium Listing on the LSE and membership of the FTSE 250 Index.

In 2010, the Phoenix Group performed at the top of its target range for all its financial objectives. In particular, the operating companies delivered £734 million of cash and cash equivalents to the holding company. This very strong performance, exceeding our target of £625 million to £725 million, enabled us to meet all our financial commitments and allowed us to pre-pay £122 million of our bank debt. The total net bank debt stands at £2.3 billion (2009: £2.7 billion).

Cash is the most important financial measure for a closed life business. This year, Phoenix Group has again demonstrated the cash generative strength of our business model. We have now increased our cash generation target for the five year period from 2010 to 2014 by £0.3 billion to £3.0 billion and published a revised target for 2011 of £750 million to £850 million.

The Phoenix Group business model will naturally release capital to shareholders as policies run off and, without new business strain or risk, that release of cash becomes increasingly reliable and predictable. Although market dislocation does have the power to disrupt emerging cash flows temporarily, the embedded value in the business remains substantial and ready to be released when temporary factors recede.

IFRS operating profit was £373 million, including a £46 million contribution from IGNIS, against 2009's pro forma £457 million. The 2009 IFRS operating profit benefited from significant positive longevity assumption changes.

Our year end MCEV was up 15 percent to £2,104 million. We achieved incremental EV from value enhancing management actions of £296 million, which was in excess of our target of £145 million.

Our estimated IGD surplus was £1.0 billion at 31 December 2010, with headroom of £0.1 billion over our new IGD capital policy. Following the transfer of the business of Phoenix & London Life Assurance Limited to Phoenix Life Limited on 1 January 2011, the headroom increased to £0.2 billion. We have identified additional actions that will improve this surplus further. We hold an additional £1.8 billion of excess policyholder and shareholder capital within Phoenix Life Holdings Limited, which is also available to the Group, making total capital available to the Group £2.8 billion at the end of 2010 (2009: £3.1 billion).

Phoenix Group has taken major strides forward in 2010. We set a clear focus on the most important tasks – and we delivered on them all. We have proved that the Phoenix business model works.

Phoenix Life highlights

Phoenix Life, led by Chief Executive Officer Mike Merrick, contributed MCEV operating earnings after tax of £560 million, an increase of 39 percent on the comparative period (on a consistent basis). Our ability to grow MCEV, even from an existing book of business that is in run-off, is a particular feature of the Phoenix business model. We have the operating platform, the skills and the experience to make this performance repeatable as and when we make accretive acquisitions.

We have received approval to enter into the pre-application process for the use of our internal model under Solvency II. Furthermore, our actuarial systems transformation project is well underway and on track to deliver a single actuarial platform to replace the numerous legacy systems that are currently in use. It will also provide us with real time reporting of our solvency position.

We have continued to develop our outsourced service model. Our largest outsourced service partner, Diligenta, has successfully introduced the BaNCS policy administration platform and has already transferred over 1.6 million live policies and 2.5 million non-live policies onto BaNCS from a variety of outdated and expensive legacy systems. It is vital for the sustainability of our model and the profitability of our partners that we continue to complete these transformations across our book of business.

IGNIS highlights

IGNIS Asset Management, led by Chief Executive Officer, Chris Samuel, was able to grow assets under management from £66.9 billion to £67.5 billion despite the run-off characteristics of the life company assets. This was made possible by a very strong £1.3 billion of net third party sales as well as investment growth. IGNIS also delivered £46 million of IFRS profits in 2010, 35 percent higher than the £34 million pro forma number for 2009.

The IGNIS executive team has been considerably strengthened with the hires of Tim Roberts as Chief Operating Officer, Chris Fellingham as Chief Investment Officer, Mark Lovett as Chief Investment

Officer – Equities and Michiel Timmerman as Managing Director of IGNIS Advisers. This brings together the multi-manager and fund of funds capacities in hedge funds, real estate, private equity and retail into a single team.

Simplification of our banking arrangements

We will continue to explore options with our lenders regarding the best structure and timing for the restructuring of our banking facilities, with a view to changing some of the current covenant constraints. However, our present facilities feature favourable interest margins and we will only agree to new arrangements if an opportunity arises that we consider to be in the best interests of our shareholders.

In parallel, we are setting a new target for gearing of below 50% by the end of 2011.

Economic and industry overview

Financial markets have continued to be volatile and global economic growth has been patchy. Phoenix Group has refined its approach to risk appetite and risk management over the course of the year. We have modelled our solvency and cash flows under a range of testing stress scenarios and we are confident in our ability to meet our commitments.

The approach of the introduction of Solvency II and Basel III, combined with very low levels of net new business in the with-profit sector and the prospect of ever-increasing costs as with-profits funds run-off, will, we believe, lead to opportunities for Phoenix and IGNIS to grow earnings by accretive acquisitions in the coming years.

Generating shareholder value

The Phoenix Group is committed to delivering improved shareholder value. This will be achieved by applying 'The Phoenix Way' to all that we do in the closed life business and leveraging the specialist investment management skills of IGNIS. We are committed to ensuring that there is a better market understanding of the robustness of our business model in 2011 and hope to see shareholders rewarded accordingly. It is our task to ensure that the capital which is in the business is used to best effect to improve policyholder outcomes and shareholder returns.

Customers and brand

Treating Customers Fairly ('TCF') is not just an FSA requirement, but something that characterises the ethos of our business and which is central to everything we do. As with all retail financial services companies, we bear a heavy responsibility to keep our customers' savings safe, to treat them with respect and to give our all in pursuit of better returns. It is a heavy responsibility, but also an exhilarating challenge and one that Phoenix and IGNIS are well equipped to meet.

Phoenix Life has improved its customer proposition by taking a more qualitative approach to our requirements for our outsource service partners and the number of complaints has fallen by 24 percent. We expect to make further progress in 2011 with the introduction of an in-house team to deal with those complaints which customers feel have not been dealt with to their satisfaction.

I am a firm believer in the power of brands. Both IGNIS and Phoenix have customer bases that present opportunity for business development through the leverage of those brands. Over the next few months, I intend to review our brands and their commercial potential. We will construct and implement plans which will maximise value from brand development and consequential revenue generation.

2011 Outlook and prospects

Developing 'The Phoenix Way'

'The Phoenix Way' characterises an approach and infrastructure, which is unique in the industry for the integration and management of closed funds. By applying a consistent framework, the Phoenix Way reduces risk, complexity and cost; improves investment performance; improves customer service through effectively working with our outsourcers; enhances MCEV and releases capital to shareholders.

In 2011, continued development of the Phoenix Way will be delivered by our actuarial system transformation, intra group mergers of regulated businesses and the further transformation of our outsource service proposition from legacy systems onto modern platforms. For IGNIS, this means the strengthening of its capacity to deliver sustained investment performance.

We have identified a number of areas for further management actions that will deliver accelerated cash flows and enhance MCEV and I hope to be able to report on these in the course of the year.

Conclusion

I look forward to 2011 with great enthusiasm for all the opportunities that lie in front of us, to serve our customers and make a difference to their lives; to build and deliver value for shareholders; to develop great brands; and to grow our business.

The Phoenix business model, combining the strength of our life companies with our asset management capacity in IGNIS, is a powerful driver of value for our customers and our shareholders.

As Phoenix Group makes that journey, it is essential that we have values to steer us. I believe that this business needs to be action orientated, professional, reliable and to have complete integrity in the way it acts if it is to continue to be successful.

Whether we succeed or fail in our objectives rests on the efforts of all of our colleagues. As Phoenix Group moves into the future, I know how fortunate I am in the quality of the teams we have in IGNIS, in Phoenix Life and in Group. I have every confidence that Phoenix Group is well-equipped for a fulfilling and rewarding journey for all our stakeholders.

Clive Bannister

Group Chief Executive Officer

28 March 2011

2010 Highlights	
Financial	£734 million operating companies' cash generation – exceeded target range of £625-£725 million
	Delivered £296 million of MCEV enhancement through management actions
	IGNIS IFRS operating profit increased by 35 percent to £46 million (2009 pro forma: £34 million)
Operational	Achieved a Premium Listing on the London Stock Exchange and FTSE 250 Index inclusion
	Restructured Tier 1 Bonds and settled all outstanding issues with bondholders
	£33 million share issue to settle 2009 Tier 1 Bond Coupon
	Received approval to enter into the pre-application process for the use of an internal model for Solvency II

2010 Highlights	
	Successful migration of over 4 million policies from legacy systems onto a modern, purpose-built administration platform
Customer	Enhanced customer proposition – working with our outsource service partners to increase focus on qualitative measures
	Arranged for transfer of business from one outsource service partner (UISL) to another (Diligenta) to enhance and protect customer service and to provide a path to further policy transformation
	Customer complaint volumes down by 24 percent on 2009
	Exceeded industry benchmark for open market option transfer payment processing

BUSINESS AND STRATEGY

Our business

The markets in which we operate continue to be subject to considerable pressures that we believe will present us with significant opportunities in the future.

We have further simplified our outsourcing arrangements in 2010, successfully arranging for the transfer of our UISL business to our existing partner, Diligenta.

Our businesses provide us with a unique base from which to improve performance for our customers and in turn deliver shareholder value.

We operate in two complementary market sectors: life assurance and asset management. Whilst these sectors continue to face numerous challenges driven by a combination of market volatility, regulatory change and shifts in customer product choice, we believe they present significant opportunities in the future on which we are uniquely positioned to capitalise.

Within our life business we have an array of skills and experience in the management of closed funds which we are able to apply to generate value for customers and shareholders which others would not be able to achieve.

Central to our proposition is listening to our policyholders. Millions of customers depend on Phoenix to manage their funds effectively and communicate clearly and honestly with them in a timely fashion. To ensure we honour this trust, in 2009 we created a wide-ranging programme of customer research enabling us to solicit and respond to policyholders' views. Our rolling programme of telephone and face-to-face surveys by independent research companies ensures we are in touch with customer wants and needs. The findings help us continually to refine our customer proposition.

In order to manage the life businesses efficiently while the policies are in run-off, we aim to minimise the fixed cost element of our operations. This ensures that the Group does not become exposed to high fixed costs in relation to the volume of policies under management.

Our management services team is charged with all sourcing strategies including putting in place arrangements for third party policy administration and maintaining oversight of their performance. Financial and risk management are core skills which are retained in-house.

IGNIS Asset Management manages the funds that back the investments of our policyholders and promotes product propositions that are appropriate to third party clients in the institutional, retail and international markets.

To implement our model we invest heavily in our employees, infrastructure and outsourcer partnerships. As a result we now have a scalable platform into which we can integrate acquired funds and maximise synergy benefits. This is key for the sustainability of our business, providing security and the opportunity to improve both asset performance for customers and the profitability of the business.

Unlike open life businesses, we do not allocate significant capital to support the writing and distribution of new insurance products. This means that the capital requirements of our operating businesses decline as policies mature, thereby releasing excess capital as free cash flow. This emerging cash flow can be used to fund future acquisitions, reduce financial leverage and pay dividends to shareholders.

In operating this way the Group's management is able to focus its attention on enhancing customer outcomes, financial control, investment management and risk management.

Operating structure

Our structure is aligned to the market sectors in which we operate. The Group has two core segments: life assurance – Phoenix Life; and asset management – IGNIS.

In addition, our Group functions provide support and coordination for the delivery of the Group's strategic initiatives.

Group functions

At Group level, Phoenix operates centralised functions that provide Group-wide and corporate-level services and manage corporate activity. The Group-level operations include Group Finance and Treasury, Group Tax, Corporate Development and Corporate Finance, Group Risk, Legal Services, HR, Corporate Communications, Strategy and Planning, Investor Relations, Company Secretariat and Internal Audit.

The Group functions have 183 employees, of whom 101 provide services directly to Phoenix Life.

Phoenix Life

Phoenix Life is responsible for the customer, financial and operational management of the closed life funds. Phoenix Life is led by its Chief Executive Officer, Mike Merrick.

Phoenix Life provides specialist skills with the proven ability to deliver improved customer outcomes from the innovative management of closed funds and annuities which in turn delivers significant value to shareholders. It has a track record of successfully integrating businesses and is developing a leading-edge model and infrastructure into which future acquired funds can be incorporated.

The business comprises seven regulated life companies including well-known brands such as Phoenix, Pearl, Scottish Mutual, London Life and NPI that have been acquired over a number of years. The Group is currently undertaking a programme of activity to further integrate its life companies in order to optimise economies of scale and capital allocation.

Although the life companies are closed and do not generally write new business, they do accept additional policyholder contributions on in-force policies and allow certain policies, such as pension savings plans, to be reinvested at maturity into annuities. Writing annuities offers the Group a further opportunity to increase its embedded value through incremental investment returns.

Phoenix Group Holdings is also the parent company of Opal Re, a reinsurer based in Bermuda. Opal Re provides reinsurance solely to Phoenix Life to support the diversification of risk on annuity books.

Management service companies deliver all administrative services required by the life companies thereby ensuring they benefit from economies of scale, established outsourcer relationships and an innovative integrated technology infrastructure.

Phoenix Life has 580 employees mainly centred at the Group's Wythall office near Birmingham.

IGNIS Asset Management

IGNIS Asset Management is the Group's asset management business and is led by its Chief Executive, Chris Samuel. It provides services to the Group's life companies as well as to third party clients, including both retail and institutional investors in the UK and overseas. Now one of the top 15 fund managers in the UK, IGNIS is responsible for £67.5 billion of assets, including £60 billion of assets for the Group's life companies.

With offices in London and Glasgow, and over 500 employees, IGNIS has investment capabilities across multiple asset classes organised into six investment business units:

- Fixed Income
- Equities
- Advisors – offering Fund of Funds products
- Real Estate
- Solutions – offering asset/liability and risk services
- Joint ventures and partnerships.

Throughout 2010 teams from across IGNIS have been working together to develop its strategy for the next round of growth. The aim is clear: to develop IGNIS into a leading asset management business that delivers strong investment performance and high quality service to both Phoenix Life and third party clients.

Our latest transfer of business (PALAL to PLL) was implemented to take effect from 1 January 2011.

The Group wrote c.£800 million of new annuity business in 2010.

IGNIS has continued to develop its capabilities in 2010 with the successful attraction of a number of senior management and investment individuals.

Management team

Day-to-day direction of the UK operations is the responsibility of the Board of Phoenix Life Holdings Limited ('PLHL') (a subsidiary of Phoenix Group Holdings) and its Executive Management Committee ('ExCo').

ExCo oversees matters relating to the implementation of the Group's strategy and recommends the optimal operating structure. The members of ExCo and their key roles and responsibilities are outlined below.

Clive Bannister

Group Chief Executive Officer and Director of PLHL

- Lead and direct the Group's businesses in the delivery of the Group strategy and business plan.
- Safeguard returns for policyholders and grow shareholder value.
- Embed a risk-sensitive Group culture which recognises our policyholder obligations in terms of service and security.
- Manage the Group's key external stakeholders.

Jonathan Yates

Group Finance Director and Director of PLHL

- Develop and deliver the Group's financial business plan in line with the strategy.
- Ensure that the Group's finances and capital are managed and controlled.
- Ensure that the Group has effective processes in place to ensure all reporting obligations are met.
- Assist the Group Chief Executive Officer in managing the Group's key external stakeholders.
- Maximise shareholder value though clear, rigorous and innovative assessment of business opportunities.

Chris Samuel

Chief Executive Officer, IGNIS Asset Management

- Maximise the value of IGNIS by delivering top quartile investment performance and a profitable service to all managed clients (including Phoenix Life).
- Lead the development and delivery of the IGNIS business strategy, generating net new money from third party clients.
- Ensure that the activities of IGNIS are undertaken with due regard to regulatory requirements.

Mike Merrick

Chief Executive Officer, Phoenix Life

- Lead the development and delivery of the Phoenix Life business strategy, including the continued integration of life businesses.
- Ensure the optimisation of outcomes for customers in terms of both value and security.
- Ensure Phoenix Life deploys capital efficiently and effectively, with due regard to regulatory requirements.

Alan Jones

Group Human Resources Director

- Deliver high quality Human Resources services to the Group Board, ExCo and operating companies.
- Lead in the implementation of the Group's Employee Strategy in order to recruit, retain, motivate and develop employees.
- Provide guidance and support on HR matters to the Group Chief Executive Officer, ExCo and the Group Board.

Jane MacLeod

General Counsel

- Lead the provision of legal advice to the Group Board, ExCo and other Group Company Boards and senior management.
- Oversee and co-ordinate the maintenance of and adherence to appropriate corporate governance procedures across the Group.
- Oversee statutory administration of Group Companies, ensuring compliance by Companies and staff with relevant legal obligations.

Jean Park

Chief Risk Officer

- Lead the Group's risk management function, embracing changes in best practice and regulation including Solvency II.
- Oversee and manage the Group's relationship with the FSA.
- Support the Group Board Risk Committee in the oversight of the Group's risk framework in line with risk strategy and appetite.

Our strategy

Simple mission, focused vision

Our strategy framework continues to build on plans first put in place in 2009.

Our mission is simple: to improve returns for Phoenix policyholders and IGNIS customers, and deliver value for shareholders. Our vision is focused: to be recognised as the 'industry solution' for the safe, innovative and profitable decommissioning of closed life funds and as a specialised asset manager. Our mission and vision are based on three pillars: 'structure', 'manage' and 'acquire', underpinned by trust and competence. This powerful combination of simplicity and focus sets us apart from the crowd.

By bringing together our specialisms of closed fund management and asset management, and responding to the views of our policyholders, we find innovative ways to improve the performance of funds.

The size of our Group means we are able to maximise economies of scale and capital efficiencies. We also have a keen focus on operational excellence and embedding enduring operational improvements.

Underpinning everything we do is attracting and retaining highly talented people who bring not only expertise and new thinking into our business and industry, but also have a passion for improving outcomes for our customers.

Creating the platform for growth

The Group has made considerable progress during 2010 in creating a more stable and simplified business. Results to date, both financial and non-financial, have sown the seeds of a convincing track record.

The 2011-2013 strategy framework

Mission To improve performance for policyholders and investors and deliver value for shareholders

Vision To be recognised as 'the industry solution' for the safe, innovative and profitable decommissioning of closed life funds in the UK with a specialised asset manager alongside

Structure Building and maintaining efficient capital structures releasing cash to shareholders, increasing security and identifying opportunities to improve customer returns

Manage Applying proven Phoenix standards to deliver operational efficiency and drive consistently strong performance

Acquire Growing through acquisition of additional funds offering increased opportunities for shareholder and customer value

Trust Inspiring confidence in customers, vendors, regulators, investors and other key stakeholders by demonstrating we can be trusted to deliver

Competence Achieving high standards of performance and pioneering thought leadership through a highly skilled and motivated team

Our strategy in more detail

Structure

How we do it

- Create a stable, robust and simplified business.
- Actively manage our debt.
- Create efficient capital structures.

What we said we would do in 2010

- Maintain strong financial position.
- Achieve Premium Listing on LSE.
- Achieve all Solvency II programme 2010 milestones.
- Complete IGNIS Asset Management operational integration.

What we actually did

- Reduced dilutive instruments to <20 percent ahead of our Premium Listing on LSE and FTSE 250 Index inclusion.
- Completed QIS 5 and obtained approval from the FSA to enter the pre-application process for the use of an internal model for Solvency II.
- Completed the transfer of Axial to IGNIS.
- Restructured Tier 1 bonds and settled all outstanding issues with bondholders.

- Restructured National Provident Life, strengthening the capital position and increasing flexibility.
- Resolved a number of legacy tax issues allowing the release of over £20 million of provisions in addition to a £30 million capital strengthening as a result of closing down a tax exposure.
- Agreed a new capital policy with the FSA.

What we plan to do next

- Examine opportunities to refinance and/or restructure existing Group debt arrangements.
- Further reduction in tax risks and resolution of legacy tax issues.
- Optimisation of life company capital through further transfers of business.

Manage

How we do it

- Deliver reliable financial performance.
- Seek value enhancing performance.
- Manage risk in line with our stated appetite.
- Build efficient, effective and scalable operations.

What we said we would do in 2010

- Drive further cash flow acceleration.
- Create value within Phoenix Life.
- Increase third party asset management business.
- Enhance the Group-wide risk and capital management frameworks.
- Continue life company and outsourcer transformation programmes.

What we actually did

- Achieved cash flow generation of £734 million.
- Delivered £296 million of EV enhancement through management actions.
- Increased IGNIS operating profit by 35 percent to £46 million.
- Enhanced the Group Risk Framework.
- Strengthened IGNIS management and investment teams.
- Transferred Phoenix Life operations in Peterborough to Wythall with no service deterioration.
- Arranged transfer of business from one outsource provider (UISL) to another (Diligenta).
- Transferred £37 billion of assets into new IGNIS performance fee structures.
- Repatriated c.£5 billion of assets from external asset managers.
- Transferred over 4 million policies from legacy systems to improve service and contain future costs.
- Implemented improved annuitant data management.

What we plan to do next

- Maintain strong cash flow delivery.
- Grow third party sales and revenue in IGNIS.
- Further strengthen risk capabilities.
- Achieve all Solvency II programme critical milestones.

Acquire

How we do it

- Stay well positioned in the market.
- Have the right skills in place.

- Make robust selection and execution decisions.

What we said we would do in 2010

- We stated that acquisitions were not a priority for our business in 2010 and, as planned, there has been limited activity.

What we actually did

- Opened dialogue with a number of key potential vendors.

What we plan to do next

- Continue to develop our business readiness to acquire and integrate new funds in the future.
- Maintain our market presence to ensure visibility of potential opportunities.

Trust

How we do it

- Develop customer trust by delivering against commitments.
- Maintain strong relationships with regulators and media.
- Demonstrate we are a sound long-term investment.

What we said we would do in 2010

- Implement initiatives to enhance customer experience.
- Develop alternative solutions for low value products.
- Pursue management actions to enhance distributable with-profits fund estate.
- Develop with-profits fund restructure strategy.
- Further strengthen corporate governance arrangements.
- Develop Phoenix Group brand awareness.
- Strengthen Investor Relations capability to increase market, industry and media engagement.

What we actually did

- Revised our customer proposition following customer research in order to strengthen performance in key areas.
- Drove down complaint volumes by 24 percent on 2009.
- Developed first alternative low value product solution and scheduled implementation for Q2 2011.
- Increased distributable estate by over £50 million in 2010.
- Fully established Phoenix Group Holdings' board membership and supporting committees.
- Developed and launched new Phoenix Group brand.
- Increased analyst coverage and sales force engagement driving growth in share trading volumes.
- Developed with-profits strategy for implementation in 2011/12.
- Outperformed industry 14 day target for Origo Open Market Option transfers.

What we plan to do next

- Improve speed of payments across all claims and enhance complaint handling processes.
- Develop with-profits 'Model Fund' investment strategy.
- Enhance complaint handling capability.
- Increase IGNIS brand recognition.

Competence

How we do it

- Ensure we have the right people with the right skills.
- Maintain recognition as a leader in our industry.

What we said we would do in 2010

- Implement and further develop action plans from 2009 engagement survey.
- Expand the leadership development programme.
- Strengthen Group succession planning process.
- Embed recently announced people values.

What we actually did

- Increased employee engagement within Group Functions and Phoenix Life to 77 percent against industry benchmark of 70 percent.
- Implemented employee engagement measurement in IGNIS.
- Launched a leadership development website and high impact training courses.
- Agreed and implemented Group succession planning process including regular reviews at senior level.
- Successfully attracted a number of high calibre people to senior appointments across the Group.
- Ran a Group-wide programme focused on embedding our values.
- Maintained progress in the Group's Corporate Responsibility programme.

What we plan to do next

- Maintain high employee engagement.
- Achieve employee retention above sector benchmark for each business unit.
- Build reputation in public policy arena.

The following pages demonstrate how we are delivering our strategy.

We are delivering our strategy by…

Competence

Driving success through engaging with our people

It is vital to our continuing success that our people understand our vision for the Company, enjoy their work and are keen to share in our future.

Our 2010 Employee Engagement Survey showed we continue to outperform our peers across all key employee engagement metrics. The Survey demonstrated that we are now within touching distance of achieving 'best in class' levels of engagement: our overall score of 77 percent is 7 percent above the Financial Services benchmark and 17 percent above the results achieved in 2009.

Throughout 2010 several cross-company focus groups met to explore issues and propose actions. These included:

- Launching new values
- Communicating the Group strategy in different ways
- 360 degree feedback exercise for senior management
- A variety of employee social, sport and charity events
- Improvements to performance management, development opportunities and career coaching
- Local management visibility initiatives

- A new leadership behavioural framework
- Employee involvement forums for key business changes

In addition, we launched a flexible benefits scheme and our Premium Listing has also enabled us to introduce a Sharesave scheme.

We are committed to maintaining this level of employee engagement in 2011.

Structure

Attracting a broader shareholder base

The year saw the beginning of an important change to our shareholder base, as the Group achieved a Premium Listing on the London Stock Exchange and was included in the FTSE 250 Index. This led to a dramatic increase in liquidity, which rose from an average daily volume of c.17,000 to c.200,000.

Historically, a significant proportion of our shareholders have been US-based and the liquidity of our shares on Euronext had been low. Now, with a Premium Listing on the London Stock Exchange, we are attracting a broader shareholder base.

The move to a Premium Listing owes much to the commitment and expertise of a wide range of individuals from across the Group, who worked hard to prepare the accounts on an IFRS basis, reduce our dilutive instruments from around 80 percent of the issued share capital to below 20 percent, and to publish the prospectus.

During the year, we established a formal Investor Relations function capable of responding to the needs of our shareholders, and developed a full Investor Relations programme consistent with a group of our scale. As well as a broader shareholder base, it is pleasing that analyst coverage of the Phoenix Group has increased, and this is reflective of our greatly expanded City profile. We are very excited about continuing this journey in 2011 and beyond.

Manage

Continuity through times of change

The closure of one site and transfer of work to another can be a traumatic experience, for both business and employees.

Following the successful closure of the Life Company Glasgow office early in 2010, our most recent challenge has been to close the Peterborough site and to ensure that all 2010 Life Company year-end work could be carried out from Wythall (Birmingham). The project, which incorporated a gradual process to facilitate knowledge transfer and systems integration, was completed ahead of budget and plan.

Its success was due in no small part to the commitment and dedication of our employees, a high percentage of whom (over 40 percent) relocated with the work. They were supported throughout the move by a range of initiatives that included familiarisation visits to Wythall, a permanent relocation information room, support from leading relocation specialists and a comprehensive relocation package.

More than 80 percent of those surveyed cited a positive relocation experience. The redundancy support exceeded statutory requirements and included enhanced terms, counselling assistance and the opportunity for career management planning through our award-nominated Next Steps programme.

The high level of support minimised the impact on the morale of the remaining employees, resulting in a 79 percent engagement score at the Peterborough site in November 2010.

Manage

Maximising business performance and value

The IGNIS Sterling and Euro Liquidity funds surpassed revenue expectations for 2010, thanks to a combination of exceptional investment performance and a successful drive from the sales team to expand the institutional client base.

By the end of 2010 the Sterling Fund had achieved excellent growth, doubling in size and maintaining its performance at the top end of the market. This fund was a Top 5 performer throughout 2010 and ended the year in 2nd position overall.

The Euro Fund also grew significantly, ending the year as the top-performing fund.

Trust

Listening to our customers

“Everyone that I have spoken to knows what’s what and have been able to answer my queries”

Customer survey, 2010

Listening to our customers and acting on their feedback lies at the heart of our new Customer Proposition. During the year we again strengthened our Customer Research Programme to improve the quality of our information and ensure that customers get the most out of their relationship with us.

The customer feedback tools we have employed in recent years – such as telephone surveys and participation in the ABI Customer Impact Scheme – have now been complemented by a new range of initiatives. These include refreshing our telephone surveys and also engaging third party specialists to carry out in-depth customer interviews as well as an automated survey. In 2010, some 24,000 customers took part in these surveys, with very positive results.

Furthermore, customers can now leave comments about their interactions with us. This feedback is reviewed regularly and is an important driver in the continuing commitment to improving our processes.

Trust

Reducing risks and increasing benefits for policyholders

A number of our with-profits funds have surplus assets, which are used to provide a buffer against adverse events.

Over the last year we have taken action to reduce the risks faced by our funds – and have therefore been able to reduce the surplus assets that have to be held back, without impacting the funds’ ability to withstand adverse effects. In addition, as the number of policyholders remaining in our funds falls, we have also been able to release a further percentage of this surplus.

The excess surplus we were able to distribute during 2010 has meant that payouts in the Pearl With-Profits Fund in the second half of the year were around 7 percent higher than would otherwise have been achieved. Although higher payouts cannot be guaranteed in the future, we will keep working hard to realise potential wherever possible.

Competence

Balancing security with opportunities for growth

In a leading-edge move within the UK life assurance industry, pension policyholders with guaranteed annuity rates in Phoenix and London Assurance Limited (PALAL) were offered the opportunity to increase their potential return.

They were given the chance to convert their policies by releasing their guarantees in exchange for an immediate enhancement to their fund value and changes to the investment mix to include a significant exposure to investments with potentially higher returns.

Guarantees are valuable because they offer a degree of certainty. However, in order to provide that certainty, PALAL has had to follow a cautious investment policy which constrains returns for most pension policies. The terms of the conversion offered a significant opportunity to receive a higher pension, albeit dependent on future performance.

Policyholders could opt out and have their policy and investment strategy remain unchanged – however only 5 percent chose to do so. Around 50,000 policies were converted at the start of the year. Whilst future returns are unknown, 2010 saw both the new equity and property investments performing well.

Performance

Basis of preparation

The Group performance section provides a review of the Group's development and performance for the year and of its financial position at the year end on both an MCEV and IFRS basis.

Cash generation is a key measure of the Group's performance. The cash generation section sets out an analysis of the operating companies' cash generation, a measure of cash and cash equivalents remitted by the Group's operating subsidiaries to the Holding Companies, and the Holding Companies' cash outflows.

Phoenix Group Holdings listed on Euronext Amsterdam in February 2008 as a non-operating special purpose acquisition company. In the third quarter of 2009 it acquired a group of businesses that specialise in the consolidation and management of closed life and pension funds referred to as the Pearl businesses.[1] The results of the Pearl businesses are included in the consolidated IFRS results of Phoenix GroupHoldings from 28 August 2009, the date of acquisition for IFRS purposes.

To assist users and give shareholders a basis for comparison, the Directors have provided additional comparative financial information on a pro forma basis. This information includes for the year ended 31 December 2009 the Pearl businesses from 1 January 2009 to 27 August 2009 in addition to the consolidated results of Phoenix Group Holdings from 1 January 2009 to 31 December 2009. Pro forma information therefore includes a full year's results for the Pearl businesses.

Pro forma information is separately referenced throughout the Annual Report and is predominantly located within the following Group performance section and the MCEV supplementary information.

Key performance indicators

The Group's financial key performance indicators ('KPIs') are those that demonstrate the financial performance and strength of the Group as a whole.

These KPIs comprise:

Operating companies' cash generation £734m (2009 pro forma: £716 million)

Group MCEV £2,104m (2009: £1,827 million)

Group IFRS operating profit £373m (2009 pro forma: £457 million)

IGD surplus (estimated) £1.0bn (2009: £1.2 billion)

IGD excess capital (estimated) £2.8bn (2009: £3.1 billion)

Dividend per share 42p (2009: €0.17 per share*)

Assets under management** £67.5bn (2009: £66.9 billion)

Asset management IFRS operating profit £46m (2009 pro forma: £34 million)

Gearing ratio 52% (2009: 58%)

* For the four month period from the date of acquisition of the Pearl businesses to 31 December 2009.
** £76.7 billion including stock lending collateral managed by IGNIS.

Operating companies' cash generation £734m (2009 pro forma: £716 million)

The Board's intention is to develop a progressive dividend policy subject to restrictions in the Group's credit agreements. The Board seeks to achieve this through maintaining strong cash flow delivery:

Analysis: Continued strong cash generation by the Group's operating subsidiaries of £492 million enabled the Group to achieve the upper end of its target for cash generation, before value enhancing management actions.

Management actions have generated additional cash flows of £242 million in 2010, exceeding the target of £225 million.

Definition and calculation: Operating companies' cash generation is a measure of cash and cash equivalents remitted by the Group's operating subsidiaries to the Holding Companies and is available to cover dividends, debt servicing and repayments and other operating expenses.

Quantified target: The target cash flows for 2011 to 2016 are £3.2 billion.

£750 million to £850 million of these cash flows are expected to be generated in 2011.

Group MCEV £2,104m (2009: £1,827 million)

The Board considers that MCEV provides the most relevant and consistent means of assessing the Group's ability to enhance value:

Analysis: The Group continues to focus on the operating performance of its underlying businesses. Value enhancing management actions in 2010 delivered an incremental uplift in embedded value of £296 million against a target of £145 million. Management actions include the restructuring of a £1.2 billion portfolio of corporate loans leading to a reduction in asset volatility and an MCEV uplift of £139 million. This restructuring exemplifies one aspect of 'The Phoenix Way' of developing innovative approaches to enhancing shareholder value.

Definition and calculation: Note 1 of the MCEV supplementary information sets out the basis of calculation of the Group MCEV.

Quantified target: The Group's target is a £100 million per annum contribution to MCEV from management actions to 2014.

IFRS operating profit £373m (2009 pro forma: £457 million)

The Board considers that IFRS operating profit is a more representative measure of performance than IFRS profit before tax as it provides long-term performance information and gives an insight into the Group's ability to generate cash flows to support dividends[1]:

Analysis: The IFRS operating profit of £373 million reflects a strong performance from both the Group's operating segments. The reduction compared to the prior year is due to the 2009 Phoenix Life operating profit benefiting from favourable longevity assumption changes of £139 million.

Definition and calculation: Note 5 of the IFRS financial statements sets out the basis of calculation of IFRS operating profit.

1 Phoenix Group Holdings is subject to Cayman Islands Companies Law. Under Cayman Islands Companies Law distributions can be made out of profits or share premium subject, in each case, to a solvency test. The solvency test is broadly consistent with the Group's going concern assessment criteria.

IGD surplus (estimated) £1.0bn (2009: £1.2 billion)

Insurance Groups' Directive ('IGD') surplus is the regulatory assessment of capital adequacy on a Group-wide basis:

Analysis: The decrease in the IGD surplus from 2009 reflects the payment of dividends, pension contributions and debt servicing and repayment costs partially offset by the strong performance of the non-profit funds. The surplus of £1.0 billion represents headroom of £0.1 billion over the Group's new IGD capital policy as set out below and in the Capital management section on page 43.

The court sanctioned funds transfer of the PALAL business into PLL was effective from 1 January 2011 and increased the headroom to £0.2 billion as at 1 January 2011.

Definition and calculation: The IGD surplus is a regulatory capital measure which calculates surplus capital at the highest EEA level insurance group holding company, which is Phoenix Life Holdings Limited ('PLHL'), a subsidiary of Phoenix Group Holdings. IGD surplus is defined as group capital resources less the group capital resource requirement.

IGD capital policy: The Group maintains group capital resources at the PLHL level at an amount in excess of 105 percent of the with-profits insurance capital component ('WPICC'), an additional capital requirement of with-profit funds, plus 145 percent of the group capital resource requirement less the WPICC.

IGD Excess Capital (estimated) £2.8bn (2009: £3.1 billion)

IGD Excess Capital includes the total capital available to the Group (both policyholder and shareholder) in excess of capital requirements. It is a measure of the capital strength of the Group and the capital available to protect policyholders and shareholders from adverse events as demonstrated by the insensitive nature of the IGD surplus to market stresses.

We manage the Group's capital on this basis in order to maximise shareholder and policyholder value..

Analysis: The decrease in the IGD Excess Capital from 2009 reflects the payment of dividends, pension contributions and debt servicing and repayment costs partially offset by the strong performance of the with-profit and non-profit funds.

The IGD Excess Capital coverage percentage was 170% at 31 December 2010 (2009: 191%).

Definition and calculation: IGD Excess Capital includes policyholder and certain shareholder capital currently excluded under FSA rules from the calculation of IGD surplus at the PLHL level and is explained on page 43.

Dividend per share 42p (2009: €0.17 per share)[1]

This is a measure of owner return. The Board's intention is to develop a progressive dividend policy subject to restrictions in the Group's two main credit agreements:

Analysis: The Board has recommended a final dividend of 21 pence per share. This brings the total dividend for the year to 42 pence. This dividend is due to be paid on 17 May 2011, subject to shareholder approval at the Company's AGM. A scrip dividend option will be available to shareholders.

Assets under management ('AUM') £67.5bn (2009: £66.9 billion)

Asset management IFRS operating profit £46m (2009 pro forma: £34 million)

For the IGNIS Asset Management segment, assets under management are a key driver of revenues:

Analysis: Total assets under management were stable, increasing by £0.6 billion to £67.5 billion[2]. The increase was driven by positive market movements and net third party sales which offset the run-off of the closed life book.

IGNIS delivered a strong IFRS operating profit of £46 million, up 35 percent from 2009. The results benefited from improving markets as well as increased performance fees following revised fee arrangements with Phoenix Life. These new fee arrangements have been externally benchmarked and better align IGNIS' fee structure with Phoenix Life's objective of superior investment returns, thereby rewarding IGNIS for performance above the benchmark.

Definition and calculation: AUM represents all assets actively managed or administered by the asset management operations of the Group excluding the cash collateral managed through stock lending arrangements.

Note 5 of the IFRS financial statements sets out the basis of calculation of IFRS operating profit.

Gearing ratio 52% (2009: 58%)

The gearing ratio is the Group's measure of its level of debt compared to its equity on an MCEV basis.

Analysis: The reduction in gearing reflects the prepayment of £122 million of debt in 2010 and the increase in the MCEV.

Definition and calculation: Gearing is calculated as net shareholder debt[3] divided by the sum of Group MCEV, net shareholder debt and the present value of future profits of IGNIS

Target: The Group is targeting a reduction in the gearing ratio to below 50% by the end of 2011.

1 For the four month period from the date of acquisition of the Pearl businesses to 31 December 2009.
2 Including stock lending collateral now managed by IGNIS, assets under management were £76.7 billion.
3 Net shareholder debt is defined as shareholder debt (including hybrid debt) less Holding Company cash as set out on page 44.

Group performance

Cash generation

The Group's cash flows are generated from the interest earned on capital, the release of excess capital as the life funds run down, policyholder charges and management fees earned on assets under management. The Group's closed life funds provide predictable fund maturity and liability profiles, creating stable long-term cash flows for distribution to owners and for repayment of outstanding debt. Although investment returns are less predictable, some of the investment risk is borne by policyholders.

Holding Companies' cash flows

The statement of cash flows prepared in accordance with IFRS combines cash flows relating to policyholders and cash flows relating to owners, but the practical management of cash within the Group maintains a distinction between the two, as well as taking into account regulatory and other restrictions on availability and transferability of capital. For this reason, the following analysis of cash flows focuses on the Holding Companies' cash flows, which reflect cash flows relating only to owners and which are therefore, more representative of the cash that could potentially be distributed to the Group's owners, or used for the repayment of debt. This cash flow analysis reflects the cash paid by the operating subsidiaries to the Group's Holding Companies, as well as the uses of the cash receipts.

The Group has delivered cash flows from its operating subsidiaries of £734 million, including cash flows of £242 million from value enhancing management actions. Accelerated cash flows were achieved through improved asset liability matching, investment portfolio derisking, the resolution of legacy tax issues and fund restructurings.

Holding Companies' cash flows	Year ended 31 December 2010 £m	Year ended 31 December 2009 pro forma[1] £m
Cash and cash equivalents at 1 January	**202**	86
Operating companies' cash generation		
Cash receipts from Phoenix Life[2]	**708**	695
Cash receipts from IGNIS Asset Management	**26**	21
Total receipts of cash by Holding Companies[3]	**734**	716
Uses of cash		
Recurring cash outflows		
Pension scheme contributions	**38**	33
Other operating expenses	**45**	27
Debt interest	**123**	102
Shareholder dividend	**43**	–
Debt prepayment	**122**	D
Total recurring outflows	**371**	162
Non-recurring cash outflows		
IT and other business transformation costs	**30**	67
Transaction and restructuring costs	**35**	30
Settlement with Royal London	**–**	240
Debt interest	**6**	72
Pension scheme contributions	**–**	25
Other	**8**	4
Total non-recurring outflows	**79**	438
Total uses of cash	**450**	600
Cash and cash equivalents at 31 December[4]	**486**	202

1 Restated to include the cash flows of Phoenix Group Holdings.

2 Includes cash equivalents of £39 million (2009: £194 million). Cash equivalents are defined by management as investments that can readily be converted into cash.

3 Amounts received by Holding Companies in respect of Group relief are included within cash receipts from the relevant subsidiaries.

4 Closing balance at 31 December 2010 includes required prudential cash buffer of £150 million (2009: £114 million).

Free surplus movement	£m
Free surplus at 1 January 2010	464
Phoenix Life IFRS operating profit	388
Phoenix Life IFRS economic variances and non-recurrings	(73)
Phoenix Life IFRS tax	76
Movements in capital requirements and policy	405
Valuation differences and other[1]	198
Cash and cash equivalents distributed to Holding Companies	(708)
Free surplus at 31 December 2010	**750**

1 Represents differences between IFRS valuation of assets and liabilities and valuation for capital purposes.

Operating companies' cash generation

Phoenix Life remitted cash and cash equivalents of £708 million (2009 pro forma: £695 million) from its opening free surplus and current year surplus emergence and capital releases. This strong cash generation coupled with higher cash flows from IGNIS Asset Management of £26 million (2009 pro forma: £21 million) exceeded the Group's 2010 cash generation target of £625 to £725 million.

The chart above analyses the movement in free surplus of Phoenix Life which represents the life companies free surplus plus the IFRS net assets of the service companies.

The life companies' free surplus is the excess of the net worth over the required capital reflected in the MCEV and represents capital in excess of what is required under the life companies' capital policies.

Movements in capital requirements and policy include the benefits of value enhancing management actions relating to investment portfolio derisking, fund restructurings and the resolution of legacy tax issues.

Included in valuation differences and other is a benefit of £125 million from the value of liquidity premiums expected to be earned following the restructuring of a portfolio of corporate bonds. These liquidity premiums are not recognised under IFRS.

Pension scheme contributions

The Group operates two main staff pension schemes, the PGL Pension Scheme and the Pearl Group Staff Pension Scheme. The triennial valuation of the PGL Pension Scheme completed in the second half of 2010 and a new funding arrangement has been agreed. The new funding arrangement will result in additional contributions of £160 million being paid to the scheme over an 8-year period from 2010. Additional contributions in 2010 of £45 million were largely recovered from certain of the Group's with-profits funds in line with the indemnity provided in 2005 and are not, therefore, reflected in this cash flow analysis. The additional contributions of £115 million from 2011 will be funded by the Holding Companies. There have been no changes to the underlying funding arrangements for the Pearl Group Staff Pension Scheme; however, completion of the 2009 triennial valuation has enabled the Trustee to establish the payments due between 2020 and 2027 under the 2009 funding agreement. Information on these payments is included in note 32 of the IFRS financial statements.

Other operating expenses

Other operating expenses include Group functions' costs. The increase in operating expenses in 2010 reflects the ongoing costs from having a Premium Listing and the reallocation of certain functional costs from operating companies to Group.

Debt interest

Debt servicing cash outflows were £123 million in 2010 comprising £96 million of interest on bank debt and associated swaps and £27 million in recurring coupons on the Tier 1 Bonds.

The 2010 Tier 1 coupon of £33 million was paid in April 2010. £6 million of this coupon payment is non-recurring due to the subsequent 15 percent reduction in the face value of the Bonds and the purchase of Bonds from an external party. The 2009 deferred Tier 1 coupon was paid through funds raised from the placing of 5 million Phoenix Group Holdings shares and is not therefore reflected in the cash flow analysis.

Shareholder dividend

The shareholder dividend of £43 million comprises the payment of the 2009 final and 2010 interim dividend.

Debt prepayment

£122 million voluntary debt prepayments were made in respect of one of the Group's main credit facilities in 2010. Scheduled repayments of the Group's main facilities commence in 2011.

IT and other business transformation costs

The Group's Holding Companies incurred IT and other business transformation costs of £30 million in 2010, including costs associated with the Group's transformation programme with its outsourcers. Business transformation costs are expected to reduce going forward as the investment programmes complete.

Transaction and restructuring costs

Transaction and restructuring costs include cash payments related to the Premium Listing, Tier 1 Bond restructuring and consent fees paid to the lending banks for various internal restructurings and corporate activity.

Target cash flows

The Group is targeting operating companies' cash generation of £3.2 billion for the period from 2011 to 2016:

Sources of future cash flows	1 January 2011 to 31 December 2016 £bn
Emergence of surplus[1]	**1.5**
Release of capital[1]	**1.4**
Recurring cash receipts generated by life companies	**2.9**
Other[2]	**0.3**
Operating companies' cash generation	**3.2**

1 Includes cash flows from management actions.

2 Includes cash flows from IGNIS and management services.

£750 million to £850 million of these cash flows are expected to be generated in 2011.

The resilience of the cash generation target is demonstrated by the following stress testing:

Stress testing	1 January 2011 to 31 December 2016 £bn
Base case 6-year projections	**3.2**
20% fall in equity markets	**3.0**
15% fall in property values	**3.1**
75 bps increase in yields	**3.2**
Credit spreads widening[3]	**2.9**
Combined stress of 25% fall in equity markets, 20% fall in property, 75 bps increase in yields and credit spreads widening[3]	**2.3**

3 10 year term: AAA – 48bps, AA – 77bps, A – 108bps, BBB – 162bps.

One-off shocks would be expected to lead to a deferral of cash emergence rather than a permanent diminution.

Group performance

MCEV

Group MCEV operating earnings[1]

The Board is pleased to report that embedded value performance was strong reflecting the resilience of Phoenix Life and the realisation of significant value from management actions. The Group has delivered growth in embedded value from management actions of £296 million, exceeding the 2010 target of £145 million.

The Group generated MCEV operating earnings after tax of £543 million in 2010, an increase of £156 million on the 2009 pro forma period (on a consistent basis).

MCEV operating earnings	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 pro forma £m	Adjustment to move to a longer term rate of return[3] £m	Year ended 31 December 2009 on a consistent basis £m
Life MCEV operating earnings[2]	**758**	380	164	544
Management services operating profit	**20**	14	–	14
IGNIS Asset Management operating profit	**46**	34	–	34
Group costs	**(70)**	(54)	–	(54)
Group MCEV operating earnings before tax	**754**	374	164	538
Tax on operating earnings	**(211)**	(105)	(46)	(151)
Group MCEV operating earnings after tax	**543**	269	118	387

1 The Phoenix Group Market Consistent Embedded Value methodology (referred to herein and in the supplementary information as MCEV) is set out in note 1 in the MCEV supplementary information. The asset management and management services businesses are included in the Group MCEV at the value of IFRS net assets. The Group MCEV does not include the future earnings from their existing business.

2 Life MCEV operating earnings are derived on an after tax basis. For presentational purposes Life MCEV operating earnings before tax has been calculated by grossing up the after tax Life MCEV operating earnings. Life MCEV operating earnings before tax of £758 million (2009 pro forma: £380 million) is therefore calculated as £546 million operating earnings (2009 pro forma: £273 million) grossed up for tax at 28 percent (2009 pro forma: 28 percent).

3 The Group has moved to calculating the expected contribution on existing business using longer term expectations of investment returns.

Life MCEV operating earnings after tax

Other than vesting annuities and increments to existing policies, the Group’s life companies are closed to new business. The principal underlying components of its operating earnings are therefore the expected existing business contribution together with non-economic experience variances and assumption changes.

Life MCEV operating earnings after tax	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 pro forma £m
Expected existing business contribution	**306**	95
New business value	**19**	22
Non-economic experience variances and assumption changes		
Experience variances	**264**	62
Other operating variances	**(5)**	21
Assumption changes	**(38)**	73
Total non-economic experience variances and assumption changes	**221**	156
Life MCEV operating earnings after tax	**546**	273

Expected existing business contribution

The Group uses long-term investment returns in calculating the expected existing business contribution. From 2010, the Group has moved to calculating the expected contribution using a long-term risk-free rate (15-year gilt rate plus 10 basis points) plus long-term expectations of excess investment returns. The Group considers that an average return over the remaining term of the in-force business is more appropriate than a short-term rate and more consistent with its expectation of longer term rates of return.

This change in assumption only affects the analysis of movement and does not impact the total calculated embedded value. The pro forma expected contribution in 2009 would have been £118 million higher if it had been calculated using expectations of longer term rates of return but economic variances within the analysis of Group MCEV earnings would have been reduced by the same amount.

The expected contribution in 2010 of £306 million after tax is £93 million higher than the contribution in 2009 (2009 pro forma: £213 million on a consistent basis) largely due to the increase in the long-term risk-free rate and the higher opening MCEV.

New business value

New business profits generated from vesting annuities during 2010 were £19 million after tax (2009 pro forma: £22 million).

The new business margin is 5 percent after tax (2009 pro forma: 5 percent) and represents the ratio of the net of tax new business value to the amount received as new single premiums.

Non-economic experience variances and assumption changes

Non-economic experience variances and assumption changes increased the MCEV by £221 million after tax in 2010, the main driver being positive experience variances.

Experience variances include a benefit of £139 million from the restructuring of a £1.2 billion portfolio of corporate loans, primarily from the liquidity premium expected to be earned following this restructuring. Experience variances also include £78 million from converting intragroup debt into listed Eurobonds, which are exempt from UK withholding tax, and other benefits from managing the back book. Negative assumption changes were driven by a reduction in assumed surrender rates in funds with valuable policyholder guarantees.

Favourable assumption changes in 2009 largely related to the harmonisation of longevity assumptions across the Group and the results of an annuitant survival investigation.

Management services

The operating profit for management services comprises income from the life companies in accordance with the respective management service agreements less fees related to the outsourcing of services and other operating costs.

Management services generated an operating profit before tax of £20 million in 2010 compared to a pro forma operating profit of £14 million in 2009.

IGNIS Asset Management

IGNIS performed well in 2010 with operating profit increasing 35 percent to £46 million (2009 pro forma: £34 million). The higher operating profits reflect stronger markets and higher performance fees following revised fee arrangements with Phoenix Life.

IGNIS Asset Management operating profit	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 pro forma £m
Third party[1]	**29**	29
Life fund revenue[2]	**115**	82
Total revenues[3]	**144**	111
Staff costs	**(59)**	(49)
Other operating expenses	**(39)**	(28)
Total expenses	**(98)**	(77)
IGNIS Asset Management operating profit before tax	**46**	34

1 Includes performance fees of nil (2009 pro forma: £3 million).
2 Includes performance fees of £35 million (2009 pro forma: £1 million).
3 Revenues are stated net of rebates from collective investment schemes.

The new fee arrangements with Phoenix Life have been externally benchmarked and better align the fee structure with Phoenix Life's objective of superior investment returns, thereby rewarding IGNIS for performance above the benchmark. Strong investment performance supports policyholder persistency in Phoenix Life and improves cash generation. Looking forward, the new fee arrangements will potentially bring greater variability to IGNIS' operating profit as the base fees have been reduced in exchange for the potential for greater performance fees.

AuM Development	**£bn**
AuM at 31 December 2009	66.9
Life Company outflows	(5.4)
Third party inflows	1.3
Net Group pensions and other flows	(0.8)
Market movements[1]	5.5
AUM at 31 December 2010[2]	**67.5**

1. 1 Includes market movement on life companies' assets of £5.3 million and market movements on third partyassets of £0.2 million.
2. 2 Group pension assets managed by IGNIS are included in third party assets under management. Third party assets under management at 31 December 2010 include £1.0 billion of assets in respect of the HEXAM partnership which are due to transfer from IGNIS administration in the first half of 2011.
3. 3 Including stock lending collateral assets under management were £76.7 billion. Collateral assets of £9.2 billion now managed by IGNIS includes £6.4 billion from a new stock lending programme in Phoenix Life as well as a transfer from a third party manager of £2.8 billion of collateral assets during the period.

The increase in staff costs has been mainly driven by the increased cost of and investment in Corporate and Investment Management resources.

Assets under management increased by £0.6 billion to £67.5 billion at 31 December 2010, as shown above[3].

Internal funds under management decreased by £0.1 billion to £60.0 billion in the year as positive market movements of £5.3 billion almost fully offset the run-off of the closed life business of £5.4 billion.

Third party net sales were £1.3 billion (2009 pro forma: £0.4 billion) for the year reflecting strong sales of liquidity funds and retail products.

Group costs

Costs relating to Group functions amounted to £40 million before tax (2009 pro forma: £20 million), the balance of the charge in both periods relates primarily to the pension schemes. The increase in Group costs reflects the ongoing costs from having a Premium Listing and the reallocation of certain functional costs from operating companies to Group.

Reconciliation of Group MCEV operating earnings to Group MCEV earnings

Group MCEV earnings are reconciled to the Group MCEV operating earnings, as follows:

	Year ended 31 December 2010 £m	Year ended 31 December 2009 pro forma £m	Adjustment to move to a longer term rate of return[4] £m	Year ended 31 December 2009 on a consistent basis £m
Group MCEV operating earnings after tax	**543**	269	118	387
Economic variances on covered business5	**101**	701	(164)	537
Economic variances on non-covered business	**(38)**	(245)	–	(245)
Other non-operating variances on covered business	**(54)**	9	–	9
Non-recurring items	**(75)**	(87)	–	(87)
Gain on debt refinancing	**–**	491	–	491
Finance costs attributable to owners	**(168)**	(390)	–	(390)
Tax on non-operating earnings	**(54)**	(197)	46	(151)
Group MCEV earnings after tax	**255**	551	–	551

4 The Group has moved to calculating the expected contribution on existing business using longer term expectations of investment returns.

5 Covered business includes all long term insurance business written by the Group, but excludes the asset management and management service companies.

Economic variances on covered business

Positive economic variances reflect changes in interest rate yields, favourable equity movements and strong returns on hedge funds.

Economic variances on non-covered business

2010 was impacted by an increase in the market value of the listed Tier 1 Bonds which reduced MCEV earnings by £40 million before tax (2009 pro forma: £169 million).

Other non-operating variances on covered business

Other non-operating variances on covered business include regulatory change and systems transformation costs and the costs of a risk transfer payment which brings the two service companies' outsourcing models more in line with each other. These costs were partly offset by a gain on finalising the revised asset shares in the PALAL with-profit fund as a result of a guaranteed annuity option compromise scheme last year which reduced longevity risk for the Group whilst providing policyholder benefit enhancements.

Non-recurring items

Overall non-recurring items reduced embedded value by £75 million before tax (2009 pro forma: £87 million before tax). Non-recurring items primarily relate to Premium Listing and other restructuring costs, including site rationalisation and outsourcer transformation.

Gain on debt refinancing

As part of their acquisition by Phoenix Group Holdings, the Pearl businesses refinanced their external borrowings in 2009 resulting in an overall net reduction of £491 million. In addition, the remainder of the £2.9 billion of this external debt was also restructured and the terms amended.

Finance costs attributable to owners

	Year ended 31 December 2010 £m	Year ended 31 December 2009 pro forma £m
Debt finance costs[1]	**102**	176
Debt issue costs	**–**	202
Tier 1 coupon	**66**	–
Other finance costs	**–**	12
Finance costs attributable to owners	**168**	390

1 Finance costs in respect of the Impala and Pearl facility agreements (and associated swap interest) and the Royal London Payments in Kind ('PIK') notes and facility.

Debt finance costs reduced by 42 percent on the pro forma comparative period as a result of the above mentioned restructuring and lower interest rates.

The Group paid the 2010 coupon on the Tier 1 Bonds on 26 April 2010. The 2009 deferred Tier 1 Bond coupon of £33 million was paid in November 2010 through funds raised from the placing of 5 million Phoenix Group Holdings shares.

Group MCEV

The Group MCEV increased by £277 million over the year to £2,104 million at 31 December 2010 as shown below. The increase was mainly due to MCEV earnings generated in the year of £255 million.

Movement in Group MCEV	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 £m
Group MCEV at 1 January	**1,827**	1,044
Group MCEV earnings after tax	**255**	551
Other comprehensive income		
Actuarial gains/(losses) on defined benefit pension scheme	**27**	(14)
Exchange differences on translating foreign operations	**–**	(44)
	27	(58)
Capital and dividend flows	**(5)**	290
Group MCEV at 31 December	**2,104**	1,827

Exchange differences on translating foreign operations have not occurred in 2010 as Phoenix Group Holdings changed its functional currency to sterling in the second half of 2009.

Capital and dividend flows in 2010 mainly comprise external dividend payments in cash of £43 million partly offset by an issue of share capital of £33 million related to the 2009 deferred Tier 1 Bond coupon.

IFRS operating profit

Group operating profit – IFRS

The Group has delivered a strong performance, generating an IFRS operating profit of £373 million (2009 pro forma: £457 million), demonstrating both its ability to deliver high quality returns for shareholders and the strength of its business model.

Group operating profit	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 pro forma £m
Phoenix Life	**388**	469
IGNIS Asset Management	**46**	34
Group costs	**(61)**	(46)
Operating profit before tax[1]	**373**	457

1 Operating profit is presented before adjusting items.

Phoenix Life

Operating profit for Phoenix Life is based on expected investment returns on financial investments backing owners' and policyholder funds over the reporting period, with consistent allowance for the corresponding expected movements in liabilities (being the release of prudential margins and the interest cost of unwinding the discount on the liabilities). The principal assumptions underlying the calculation of the longer term investment return are set out in note 5 to the IFRS consolidated financial statements.

Operating profit includes the effect of variances in experience for non-economic items, such as mortality and expenses, and the effect of changes in non-economic assumptions. Changes due to economic items which give rise to variances between actual and expected investment returns, and the impact of changes in economic assumptions on liabilities, are accounted for outside of operating profit. Phoenix Life operating profit is net of policyholder finance charges and policyholder tax.

Phoenix Life operating profit	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 pro forma £m
With-profit	**55**	49
With-profit where internal capital support provided	**(7)**	20
Non-profit and unit-linked	**278**	331
Longer term return on owners' funds	**42**	55
Management services	**20**	14
Phoenix Life operating profit before tax	**388**	469

The owners' one-ninth share of the policyholder with-profit bonus of £55 million increased by 12 percent on the result for the comparative pro forma period of £49 million as bonus rates improved following better market conditions.

The with-profit funds where internal capital support has been provided experienced an operating loss of £7 million (2009 pro forma: £20 million operating profit). The 2010 result was negatively impacted by a reduction in assumed surrender rates in funds with valuable policyholder guarantees.

The operating profit on non-profit and unit-linked funds was £278 million (2009 pro forma: £331 million). This includes margin emergence of £168 million (2009 pro forma: £154 million), return on surplus assets of £18 million (2009 pro forma: £9 million) and new business from vesting annuities of £22 million (2009 pro forma: £35 million). The 2009 pro forma result also benefited from positive longevity assumption changes of £139 million.

The longer term return on owners' funds for 2010 of £42 million reflects the asset mix of owners' funds: primarily cash based assets and fixed interest securities. The return has decreased from the comparative pro forma period due to lower returns on cash given the continuing low interest rate environment. Returns on cash are not normalised.

The operating profit for management services of £20 million (2009 pro forma: £14 million) comprises income from the life companies in accordance with the respective management service agreements less fees payable in relation to the outsourcing of services and other operating costs.

IGNIS Asset Management

Operating profit of the asset management business increased from the pro forma comparative period by 35 percent to £46 million. The results benefited from stronger markets and higher performance fees from the life companies. Further information on the results of IGNIS Asset Management is included in the Group performance – MCEV section.

Group costs

Costs relating to Group functions amounted to £40 million before tax (2009 pro forma: £20 million), the balance of the charge in both periods relates primarily to the pension schemes. The increase in Group costs reflects the ongoing costs from having a Premium Listing and the reallocation of certain functional costs from operating companies to Group.

IFRS profit after tax

IFRS profit after tax is reconciled to operating profit, as follows[1]:

	Year ended 31 December 2010 £m
Operating profit before adjusting items	**373**
Investment return variances and economic assumption changes on long-term business	**18**
Variance on owners' funds	**19**
Amortisation of acquired in-force business and other intangibles	**(150)**
Non-recurring items	**(139)**
Profit before finance costs attributable to owners	**121**
Finance costs attributable to owners	**(115)**
Profit before the tax attributable to owners	**6**
Tax credit attributable to owners	**74**
Profit for the period attributable to owners	**80**

Investment return variances and economic assumption changes on long-term business

Overall, the Phoenix Life business had favourable investment return variances and economic assumption changes of £18 million in 2010, which reflects strong returns on investments in hedge funds and property partly offset by changes in interest rate yields, leading to lower discount rates on non-profit liabilities.

Variance on owners' funds

The favourable variance on owners' funds of £19 million for 2010 mainly relates to fair value gains on interest rate swaps held in the shareholder fund partially offset by losses on interest rate swaps held in the Holding Companies.

Amortisation of acquired in-force business and other intangibles

Acquired in-force business and other intangibles of £2.7 billion were recognised on the acquisition of the Pearl businesses.

The acquired in-force business is being amortised in line with the run-off of the acquired businesses. Amortisation of acquired in-force business during the period totalled £132 million. Amortisation of other intangible assets totalled £18 million in the period.

Non-recurring items

Non-recurring items include:

- Premium Listing and other restructuring costs, including site rationalisation and outsourcer transformation, of £80 million.
- Regulatory change and systems transformation costs of £36 million.
- An increase in the expense reserves of Phoenix Life of £23 million following the new fee arrangement between Phoenix Life and IGNIS. IGNIS will recognise the benefit of this new arrangement as it is earned on an annual basis and so this charge should reverse over time.

Finance costs attributable to owners

	Year ended 31 December 2010 £m
Debt finance costs[1]	**102**
Other finance costs	**13**
Finance costs attributable to owners	**115**

1 Finance costs in respect of the Impala and Pearl facility agreements (and associated swap interest) and the Royal London PIK notes and facility.

Tax credit attributable to owners

The Company is exempt from tax in the Cayman Islands on any profits, income, gains or appreciations for a period of 30 years from 11 May 2010 (the previous exemption was for 20 years from 15 January 2008).

With effect from the acquisition of the Pearl businesses in the third quarter of 2009 the Company has been managed and controlled from Jersey, where its permanent office premises are located. As a Jersey resident holding company the Company is subject to a zero percent tax rate on its income. Consequently, tax charged in these accounts primarily represents UK tax on profits earned in the UK, where the principal subsidiaries, excluding Opal Re, have their centre of operations.

The Group tax credit for the year attributable to owners is £74 million despite profits (after policyholder tax) of £6 million. This reflects the benefit of tax losses crystallised on the restructuring of the Group's life insurance businesses and the effect of non-taxable dividend income.

The Group has significant excess tax losses and expenses at the end of the year which have not been recognised in full.

1 Pro forma comparatives are not provided on the basis that it is inappropriate to pro forma acquisition balance sheet adjustments, for example, amortisation of acquired in-force business and other intangibles and debt finance costs following the associated debt restructure.

Capital management

Capital management framework

The Group's capital management framework is designed to achieve the following objectives:

- Provide appropriate security for policyholders and meet all regulatory capital requirements whilst not retaining unnecessary excess capital
- Ensure sufficient liquidity to meet obligations to policyholders and creditors
- Optimise the overall gearing ratio to ensure an efficient capital base
- Meet the dividend expectations of owners as set by the Group's dividend policy, within the restrictions in the Group's two main credit agreements.

The framework comprises a suite of capital management policies that govern the allocation of capital throughout the Group to achieve these objectives under a range of stress conditions. The policies are defined with reference to policyholder security, creditor obligations, owner dividend policy and regulatory capital requirements.

The capital policy of the Group Holding Companies ensures sufficient liquidity to meet creditor obligations and dividend expectations. This is monitored at both executive and Board level.

Targets are established in relation to regulatory capital requirements, liquidity and debt ratios and are used in managing capital in accordance with the Group's risk appetite and the interests of its stakeholders.

The capital policy of each life company is set and monitored by each life company Board. These policies ensure there is sufficient capital within each life company to meet regulatory capital requirements under a range of stress conditions. The capital policy of each life company varies according to the risk profile and financial strength of the company.

Regulatory capital requirements

Each UK life company must maintain sufficient capital at all times to meet the regulatory capital requirements mandated by the FSA[1]. These measures are aggregated under the European Union Insurance Groups' Directive ('IGD') as implemented by the FSA, to calculate regulatory capital adequacy at a Group level.

The Group's IGD assessment is made at the level of the highest EEA insurance group holding company, which is Phoenix Life Holdings Limited ('PLHL'), a subsidiary of Phoenix Group Holdings. The estimated IGD surplus at 31 December 2010 is £1.0bn (2009: £1.2bn). The components of the estimated IGD calculation are shown below:

	31 December 2010 £bn	31 December 2009 £bn
Group capital resources ('GCR')	**5.3**	5.0
Group capital resource requirement ('GCRR')	**(4.3)**	(3.8)
IGD surplus (estimated)	**1.0**	1.2
Coverage percentage	123%	132%

1 Further details on the regulatory capital requirements of the individual life companies are included within note 42 of the IFRS financial statements.

The key drivers of the change in solvency position in the year are:

- Dividend payments, pension contributions and debt servicing and repayments of £0.4 billion, partly offset by
- Capital generation items of £0.2 billion including capital benefits from the NPL funds transfer in the first quarter of 2010 and surpluses in the non-profit funds established during the period which are available for transfer to shareholders.

The Group's capital policy, which is agreed with the FSA, is to maintain GCR at the PLHL level of:

- 105 percent of the with-profit insurance component ('WPICC'), an additional capital requirement of with-profit funds; plus
- 145 percent of the GCRR less the WPICC.

The policy was revised in 2010 from the previous policy of maintaining 125 percent of the capital resource requirement, to mitigate the anomalies of market movements on the WPICC. The headroom over the new policy is £0.1 billion (2009: £0.4 billion).

The court sanctioned funds transfer of the PALAL business into PLL was effective from 1 January 2011. This increased the headroom to £0.2 billion as at 1 January 2011.

IGD Excess Capital

IGD Excess Capital represents a more realistic measure of the capital strength of the Group as it includes policyholder and certain shareholder capital which is currently excluded under FSA rules from the PLHL Group's IGD surplus calculation. This capital provides the Group with financial flexibility and is available to protect policyholders and shareholders from adverse events as demonstrated by the insensitive nature of the IGD surplus to market stresses.

The excluded capital relates to:

- the surplus estate of the with-profits funds which is treated as a policyholder liability for IGD purposes due to the closed fund nature of the business
- restricted assets which mainly relate to assets excluded from the IGD calculation due to the corporate structure of the PLHL Group.

At 31 December 2010 the IGD Excess Capital was £2.8 billion (2009: £3.1 billion) as shown below:

	31 December 2010 £bn	31 December 2009 £bn
IGD Excess Capital	**2.8**	3.1
Restricted assets	**(0.4)**	(0.6)
Excess policyholder capital	**(1.4)**	(1.3)
IGD surplus	**1.0**	1.2
Coverage percentage on IGD Excess Capital	**170%**	191%

Sensitivity and scenario analysis

As part of the Group's internal risk management processes the estimated IGD surplus is tested against a number of financial and non-financial scenarios to ensure it remains in excess of our target in a range of reasonably foreseeable circumstances. The results of that stress testing are provided below:

	1 January 2011 IGD surplus £bn	1 January 2011 IGD Excess Capital £bn
Estimated IGD surplus/Excess Capital:	**1.0**	**2.8**
Following a 20% fall in equity markets	**1.0**	**2.4**
Following a 15% fall in property values	**1.0**	**2.7**
Following a 75 bps parallel increase in yields	**1.0**	**2.8**
Following a 75 bps parallel decrease in yields	**0.9**	**2.7**
Following credit spread widening[1]	**0.9**	**2.5**
Following a combined 25% fall in equity markets, 20% fall in property, 75 bps increase in yields and credit spreads widening[1]	**0.9**	**1.8**

1 AAA – 100bps, AA – 113bps, A – 120bps, BBB – 153bps, BB – 370bps, B – 613bps.

Solvency II

It is anticipated that 2011 will be a key year in the development of Solvency II with the European Commission expected to release Level 2 implementing measures in June and consultation on the Level 3 guidance expected to commence soon after. The Group remains actively engaged in supporting the development of Solvency II through industry consultation and participation in FSA and ABI industry forums.

The Group has a well established Solvency II programme and has continued to progress development towards meeting the Solvency II requirements. The Group remains on track to deliver an approved partial Group internal model and has been accepted into the FSA internal model pre-application process following the submission of the pre-application process qualifying criteria (’PAQC’) template in 2010. The Group’s actuarial IT systems transformation project will deliver a single actuarial modelling platform across the business, transforming modelling capability and efficiency and underpinning development of the Solvency II internal model and Own Risk and Solvency Assessment (’ORSA’).

Between July and November 2010, the European Commission undertook Quantitative Impact Study 5 (’QIS5’), a European-wide exercise supporting development of the Solvency II level 2 implementing measures. The Group participated fully in this exercise recognising it as an important step in assessing the Group’s readiness for Solvency II.

Capital resources

The primary sources of capital used by the Group are equity, perpetual reset capital securities and subordinated debt.

Leverage

In managing capital the Group seeks to optimise the level of debt in its balance sheet. The Group’s closed book business model allows it to operate with higher leverage than other life companies that are still writing new business, as it does not need to fund upfront capital requirements and new business acquisition expenses.

The Group has net shareholder debt of £2,733 million (2009: £3,080 million). The gearing ratio[1] is 52% (2009: 58%), based on IGNIS PVFP of £0.4 billion (2009: £0.4 billion).

Shareholder debt (including hybrid debt) at 31 December 2010:

	31 December 2010 £m	31 December 2009 £m
Bank debt at face value		
– Pearl facility	**425**	425
– Pearl loan notes	**76**	75
– Impala facility	**2,138**	2,260
– Royal London PIK notes and facility	**106**	102
Tier 1 Bonds at market value	**304**	264
PLL subordinated debt at market value	**170**	165
Shareholder debt (including hybrid debt)[2]	**3,219**	3,282
Holding Company cash and cash equivalents	**(486)**	(202)
Net shareholder debt	**2,733**	3,080

Further detail on shareholder debt is included in note 22 to the IFRS financial statements.

The Group has two main credit agreements (the Pearl and Impala facilities), separately secured on the shares of two separate sets of companies. Although the current debt carries favourable interest rates and is tax efficient it is of relatively short duration and the covenants and structure can create some inflexibility in achieving the Group's objectives.

The Group intends to improve operational and financial flexibility through a targeted reduction in the gearing ratio to below 50 percent by the end of 2011, a level consistent with the relative stability of our cash flows in our closed book business model.

Liquidity management

Details of the Group's objectives and policies for the management of liquidity risk are included within the Risk management section and note 43 of the IFRS financial statements.

£1.0bn Estimated IGD surplus

£2.8bn Estimated IGD Excess Capital

IGD surplus is relatively insensitive to market movements

4. 1 Net shareholder debt as a percentage of the sum of Group MCEV, net shareholder debt and PVFP of IGNIS.
5. 2 The unsecured loan notes are excluded from this shareholder debt analysis as their repayment will be funded from an escrow account which is not included in the Holding Company cash and cash equivalents.

Risk management

Risk management is a core component of the Group's strategic agenda. The Board seeks to ensure that the Group identifies and manages all risks accordingly; to either create additional value for its stakeholders or to mitigate any potentially adverse effects.

A Group-wide risk framework is in place which seeks to establish a coherent and interactive set of risk management arrangements comprising formal committees, risk review functions, risk management policies and risk assessment processes. The framework provides assurance that risks are being appropriately identified and managed and that an independent assessment of management's approach to risk management is being performed. A summary of the key risks and uncertainties facing the Group is provided on page 47.

Risk culture, oversight and governance

Overall responsibility for approving, establishing and maintaining the risk framework rests with the Group Board. The Board recognises the critical importance of having efficient and effective risk management systems and appropriate oversight of their output. A clear organisation structure with documented, delegated authorities and responsibilities from the Phoenix Group Holdings Board to the Board of PLHL and the PLHL ExCo is in place.

The Group Board Risk Committee has responsibility for the oversight of risk across the Group. The Group Board Risk Committee comprises five Non-Executive Directors and met five times during the year. The Committee is supported by the Group Chief Risk Officer, Jean Park.

A series of divisional management oversight committees covering financial and operational risks exists within the Group. These committees are responsible for ensuring the risks associated with the divisional business activities are identified, controlled, monitored and reported to the relevant Boards and Board Committees.

Each committee has formal terms of reference which are approved by the relevant divisional Executive team. Overall reporting of risk management and escalation of emerging issues is undertaken through divisional management committees to the PLHL ExCo and reported to the PLHL and Group Boards via regular risk reporting.

Risk management framework overview

The Group's risk management framework is underpinned by its governance model which includes statutory boards and their committees, management committees, risk policies, oversight committees and established governance functions.

Three Lines of Defence

The Group operates a Three Lines of Defence model:

First line:

- management of risk is delegated from the Group Board to the Group Chief Executive, PLHL Board and its ExCo members and through to divisional business managers.
- Second line: risk oversight is provided by the Group and divisional risk and compliance functions and established oversight committees, including the Board Risk Committee.
- Third line: independent verification of the adequacy and effectiveness of the internal risk and control management systems is provided by Board Audit Committees. The Board Audit Committees are supported by the Group Internal Audit function.

Risk appetite

The Phoenix Group risk appetite framework consists of a set of statements and targets that articulate the risk appetite of the Group Board with respect to policyholder security, earnings volatility, liquidity and regulatory compliance.

By the end of the year the Group had strengthened this framework to include appetite statements and targets for individual risks against which assurance and capacity reporting will be provided to the relevant Boards in 2011.

Risk assessment processes

The Group has a standardised assessment framework for the identification and assessment of the different types of risk it may be exposed to and how much capital should be held in relation to those exposures. This framework is applicable across the Group as a whole and establishes a basis not only for the approach to risk assessment, management and reporting processes but also for determining and embedding capital management at all levels of the Group.

Risk assessment activity is a continuous process and is performed on the basis of identifying and managing the significant risks to the achievement of the Group's objectives. Stress and scenario tests are used to support the assessment of risk and analysis of their financial impact.

A Group-level risk assessment process determines the most significant risks to the Group and the options available for their management. The Board Risk Committee receives a Consolidated Risk Report on a quarterly basis, detailing the risks facing the Group within each of the Group's main risk categories (Strategy, Market, Credit, Insurance, Financial Soundness and Operational). Regular risk reporting is provided to the Boards, PLHL ExCo and the respective divisional oversight committees

Risk review functions

The Group Chief Risk Officer manages the Group risk function and has responsibility for the implementation and oversight of the Group's overall risk management framework. The Group risk function has responsibility for financial and operational risk, risk governance, FSA relationship management and regulatory risk. Risk review functions across the Group manage the framework in line with the Group standards. Their responsibilities include the evaluation of changes in the business operating environment and business processes, the assessment of the impact of these changes on risks to business and the monitoring of the mitigating actions. The risk functions also ensure that divisional risk committees are provided with meaningful risk reports and that there is appropriate information to assess risks.

Risk policies and categorisation

A policy framework exists, which sets out the high level risk appetite of the Group, together with risk management, internal control and business conduct standards for the Group's operating units. During the course of the year work has been undertaken to enhance the Group's existing policy suite and update the policy framework in support of the broader enhancements to the Risk Management Framework.

The policies define:

- The risks the policy is intended to manage
- The degree of risk the Group is prepared to accept in managing the risks the policy is intended to manage – the risk appetite
- The minimum controls required in order to manage the risk to an acceptable level
- The frequency of the control's operation.

Each policy is the responsibility of a member of the PLHL ExCo who is charged with overseeing compliance with the policy throughout the Group.

Principal risks and uncertainties facing the Group

Risk	Impact	Mitigation
In times of extreme market turbulence, the Group may not have sufficient liquid assets to meet its payment obligations or may suffer a loss in value.	The Group has ongoing obligations to meet payments to creditors which are funded by the release of capital and profits from the underlying operating companies. The emerging cash flows of the Group may be impacted during periods of extreme market turbulence by the need to maintain appropriate levels of regulatory capital. The impact of market turbulence may also result in a material adverse impact on the Group's embedded value, financial condition and prospects.	The Group undertakes regular monitoring activities in relation to market risk exposure, including the monitoring of asset mixes, cash flow forecasting and stress and scenario testing. In response to this, the Group may implement de-risking strategies to mitigate against unwanted outcomes. The Group also maintains cash buffers at the holding company level to reduce reliance on emerging cash flows.
The potential limitation on distributions from the Group's FSA regulated companies may impair the ability of the Group to service its existing debt commitments.	The Group has ongoing principal repayment and interest obligations to its lending syndicates. In the event that transfers from the Group's insurance and investment management subsidiaries are limited by any law, regulatory action or change in established approach, this may impair the Group's ability to service these obligations. The implementation of directives and other legislative changes such as Solvency II could have this effect and may therefore have a material adverse effect on the Group's results, financial condition and cash flows, including the exercise by the external finance providers of their security rights over Group companies.	The Group puts considerable efforts into managing relationships with its regulators so that it is able to maintain a forward view regarding potential changes in the regulatory landscape. The Group assesses the risks of regulatory change and their impact on our operations and lobbies where appropriate.
Significant counterparty failure.	The Phoenix Life segment is exposed to deterioration in the actual or perceived creditworthiness or default of issuers of relevant debt securities or from trading counterparties failing to meet all or part of their obligations, such as reinsurers failing to meet obligations assumed under reinsurance arrangements or derivative counterparties or stock-borrowers failing to pay as required. Assets held to meet obligations to policyholders include debt securities. An increase in credit spreads on such securities,	The Group regularly monitors its counterparty exposure and has specific limits relating to counterparty credit rating. Where possible, exposures are diversified through the use of a range of counterparty providers. All reinsurance and derivative positions are appropriately collateralised and guaranteed.

Risk	Impact	Mitigation
	particularly if it is accompanied by a higher level of actual or expected issuer defaults, could have a material adverse impact on the Group’s financial condition.	
Adverse changes in experience versus actuarial assumptions.	The Group has liabilities under annuities and other policies that are sensitive to future longevity and mortality rates. Changes in assumptions may lead to changes in the assessed level of liabilities to policyholders. The amount of additional capital required to meet those liabilities could have a material adverse impact on the Group’s embedded value, results, financial condition and prospects.	The Group undertakes regular reviews of experience and annuitant survival checks to identify any variances in assumptions.
Competition and the ability to finance acquisitions may make it difficult for the Group to grow.	There are other closed fund consolidators as well as a number of other potential purchasers. While the prices of closed fund life companies and portfolios may have decreased due to recent market conditions, there can be no assurance that prices will not increase if markets continue to recover. Moreover, the Group may face difficulties in obtaining additional financing for any acquisitions.	The Group is well positioned to be the natural consolidator for closed funds and maintains an ongoing dialogue with potential vendors.

IFRS FINANCIAL STATEMENTS

Consolidated income statement
for the year ended 31 December 2010

	Notes	**2010 £m**	2009 £m
Gross premiums written		**1,534**	545
Less: premiums ceded to reinsurers		**(85)**	(31)
Net premiums written		**1,449**	514
Fees	6	**162**	101
Net investment income	7	**5,907**	1,032
Total revenue, net of reinsurance payable		**7,518**	1,647
Other operating income	8	**25**	67
Net income		**7,543**	1,714
Policyholder claims		**(5,260)**	(2,043)
Less: reinsurance recoveries		**210**	105
Change in insurance contract liabilities		**(252)**	1,137
Change in reinsurers' share of insurance contract liabilities		**89**	142
Transfer to unallocated surplus	21	**(143)**	(175)
Net policyholder claims and benefits incurred		**(5,356)**	(834)
Change in investment contract liabilities		**(964)**	(429)
Acquisition costs	9	**(12)**	(8)
Change in present value of future profits	33	**7**	4
Amortisation of acquired in-force business	33	**(147)**	(50)
Amortisation of customer relationships	33	**(18)**	(7)
Administrative expenses	10	**(676)**	(255)
Net (expense)/income attributable to unitholders		**(97)**	43
Total operating expenses		**(7,263)**	(1,536)
Profit before finance costs and tax		**280**	178
Finance costs	12	**(269)**	(87)
Profit for the year before tax		**11**	91
Tax attributable to policyholders' returns	13	**(5)**	60
Profit before the tax attributable to owners		**6**	151

	Notes	**2010 £m**	2009 £m
Tax credit	13	**69**	44
Add/(deduct): tax attributable to policyholders' returns	13	**5**	(60)
Tax credit/(charge) attributable to owners	13	**74**	(16)
Profit for the year attributable to owners		**80**	135
Attributable to:			
Owners of the parent		**30**	95
Non-controlling interests	19	**50**	40
		80	135
Earnings per ordinary share			
Basic earnings per ordinary share	15	**20.1p**	102.9p
Diluted earnings per ordinary share	15	**20.1p**	89.8p

The consolidated income statement for the year ended 31 December 2009 incorporates the results of the acquired Pearl businesses for the four month post-acquisition period only.

Statement of consolidated comprehensive income

for the year ended 31 December 2010

	Notes	**2010 £m**	2009 £m
Profit for the year		**80**	135
Other comprehensive income:			
Actuarial gains of defined benefit pension schemes	32	**45**	105
Contribution in respect of actuarial losses of defined benefit pension scheme by the with-profit funds	32	**27**	–
Exchange differences on translating foreign operations		**–**	(40)
		72	65
Tax credit/(charge)	13	**4**	(31)
		76	34
Total comprehensive income for the year		**156**	169
Attributable to:			
Owners of the parent		**106**	129
Non-controlling interests		**50**	40
		156	169

The statement of consolidated comprehensive income for the year ended 31 December 2009 incorporates the results of the acquired Pearl businesses for the four month post-acquisition period only.

Pro forma reconciliation of Group operating profit to profit attributable to owners
for the year ended 31 December 2010

	Notes	**2010 £m**	2009 £m
Operating profit			
Phoenix Life		**388**	285
IGNIS Asset Management		**46**	14
		434	299
Group costs		**(61)**	(17)
Total operating profit before adjusting items	4.2	**373**	282
Investment return variances and economic assumption changes on long-term business	5	**18**	145
Variance on owners' funds	5	**19**	(70)
Amortisation of acquired in-force business		**(132)**	(45)
Amortisation of customer relationships		**(18)**	(7)
Non-recurring items	4.2	**(139)**	(105)
Profit before finance costs attributable to owners		**121**	200
Finance costs attributable to owners		**(115)**	(49)
Profit before the tax attributable to owners	4.2	**6**	151
Tax credit/(charge) attributable to owners	13	**74**	(16)
Profit for the year attributable to owners		**80**	135

The analysis of pro forma profit attributable to owners for the year ended 31 December 2009 incorporates the results of the acquired Pearl businesses for the four month post-acquisition period only.

Statement of consolidated financial position
as at 31 December 2010

	Notes	**2010 £m**	2009 £m
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital	16	**-**	-
Share premium		**1,109**	859
Other reserves		**5**	257
Shares held by employee trust and group entities	17	**(13)**	(4)
Foreign currency translation reserve		**93**	93
Retained earnings		**386**	207
Total equity attributable to owners of the parent		**1,580**	1,412

	Notes	2010 £m	2009 £m
Non-controlling interests	19	**720**	728
Total equity		**2,300**	2,140
Liabilities			
Pension scheme deficit	32	**77**	125
Insurance contract liabilities			
Liabilities under insurance contracts	20	**50,479**	50,291
Unallocated surplus	21	**864**	721
		51,343	51,012
Financial liabilities			
Investment contracts		**8,849**	8,570
Borrowings	22	**4,028**	4,181
Deposits received from reinsurers	23	**419**	431
Derivatives	24	**2,431**	2,842
Net asset value attributable to unit holders		**1,937**	946
Obligations for repayment of collateral received	25	**10,160**	4,106
	26	**27,824**	21,076
Provisions	27	**73**	101
Deferred tax	28	**569**	776
Reinsurance payables		**25**	17
Payables related to direct insurance contracts	29	**713**	759
Current tax	28	**99**	103
Accruals and deferred income	30	**214**	177
Other payables	31	**327**	650
Total liabilities		**81,264**	74,796
Total equity and liabilities		**83,564**	76,936

	Notes	**2010 £m**	2009 £m
ASSETS			
Pension scheme surplus	32	**59**	-
Intangible assets			
Goodwill		**77**	77
Acquired in-force business		**2,016**	2,163
Customer relationships		**420**	438
Present value of future profits		**42**	35
	33	**2,555**	2,713
Property, plant and equipment	34	**34**	34
Investment property	35	**1,732**	1,915
Financial assets			
Loans and receivables		**2,293**	1,081
Derivatives	24	**3,197**	3,540
Equities		**12,460**	13,151
Fixed and variable rate income securities		**40,899**	37,658
Collective investment schemes		**7,144**	6,094
	36	**65,993**	61,524
Deferred tax assets	28	**-**	81
Insurance assets			
Reinsurers’ share of insurance contract liabilities	20	**2,939**	2,860
Reinsurance receivables		**263**	264
Insurance contract receivables		**19**	17
		3,221	3,141
Current tax	28	**5**	44
Prepayments and accrued income		**603**	622
Other receivables	39	**174**	781
Cash and cash equivalents	40	**9,188**	6,081

	Notes	**2010 £m**	2009 £m
Total assets		**83,564**	76,936

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

	Notes	**2010 £m**	2009 £m
Cash flows from operating activities			
Cash generated/(absorbed) by operations	41.1	**3,392**	(357)
Taxation recovered		**3**	37
Net cash flows from operating activities		**3,395**	(320)
Cash flows from investing activities			
On acquisition of the Pearl businesses	41.2	**-**	6,146
Purchase of property, plant and equipment		**(3)**	-
Interest received		**-**	2
Net change in cash invested in trust account		**-**	591
Net cash flows from investing activities		**(3)**	6,739
Cash flows from financing activities			
Gross proceeds from issue of share capital		**33**	-
Repayment on redemption of shares		**-**	(41)
Proceeds from issuing shares in subsidiaries to non-controlling interests		**96**	-
Repurchase of shares in subsidiaries from non-controlling interests		**-**	(3)
Partial buy back of non-controlling interests		**(4)**	-
Proceeds of new borrowings		**-**	42
Ordinary share dividends paid		**(43)**	-
Coupon on Perpetual Reset Capital Securities paid		**(62)**	-
Dividends paid to non-controlling interests		**(18)**	(8)
Interest paid on borrowings		**(122)**	(221)
Repayment of borrowings		**(165)**	(110)
Net cash flows from financing activities		**(285)**	(341)
Net increase in cash and cash equivalents		**3,107**	6,078
Cash and cash equivalents at the beginning of the year		**6,081**	2
Effect of exchange rate changes on cash and cash equivalents		**-**	1

	Notes	**2010 £m**	2009 £m
Cash and cash equivalents at the end of the year	40	**9,188**	6,081

The statement of consolidated cash flows for the year ended 31 December 2009 incorporates the cash flows of the acquired Pearl businesses for the four month post-acquisition period only.

Statement of consolidated changes in equity

for the year ended 31 December 2010

	Share capital (note 16) £m	Share premium £m	Other reserves £m	Shares held by the employee trust and group entities (note 17) £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m	Non-controlling interests (note 19) £m	Total £m
At 1 January 2010	-	859	257	(4)	93	207	1,412	728	2,140
Profit for the year	-	-	-	-	-	30	30	50	80
Other comprehensive income for the year	-	-	-	-	-	76	76	-	76
Total comprehensive income for the year	-	-	-	-	-	106	106	50	156
Dividends paid on ordinary shares	-	(34)	(20)	-	-	-	(54)	-	(54)
Dividends paid to non-controlling interests	-	-	-	-	-	-	-	(18)	(18)
Coupon paid to non-controlling interests, net of tax relief	-	-	-	-	-	-	-	(47)	(47)
Issue of share capital	-	33	-	-	-	-	33	-	33
Shares issued in lieu of dividends	-	11	-	-	-	-	11	-	11
Issue of ordinary shares – Chairman's shares	-	1	-	-	-	(1)	-	-	-
Conversion of contingent rights over shares	-	230	(230)	(3)	-	-	(3)	-	(3)
Credit to equity	-	-	-	-	-	8	8	-	8

for equity-settled share-based payment									
Conversion of warrants into ordinary shares	-	9	(2)	-	-	-	7	-	7
Shares in subsidiaries subscribed for by non-controlling interests	-	-	-	-	-	-	-	96	96
Partial buy back of non-controlling interest	-	-	-	-	-	-	-	(19)	(19)
Restructure of non-controlling interests	-	-	-	-	-	70	70	(70)	-
Shares acquired by employee trust	-	-	-	(10)	-	-	(10)	-	(10)
Shares distributed by employee trust	-	-	-	4	-	(4)	-	-	-
At 31 December 2010	-	1,109	5	(13)	93	386	1,580	720	2,300

Statement of consolidated changes in equity

for the year ended 31 December 2009

	Share capital (note 16) £m	Share premium £m	Other reserves £m	Shares held by the employee trust (note 17) £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m	Non-controlling interests (note 19) £m	Total £m
At 1 January 2009	-	401	6	-	133	33	573	-	573
On acquisition of the Pearl businesses	-	-	-	-	-	-	-	699	699
Profit for the year	-	-	-	-	-	95	95	40	135
Other comprehensive income for the year	-	-	-	-	(40)	74	34	-	34
Total comprehensive income for the year	-	-	-	-	(40)	169	129	40	169
Dividends paid to non-controlling	-	-	-	-	-	-	-	(8)	(8)

interests									
Issue of share capital	-	440	-	-	-	-	440	-	440
Issue of share capital into employee trust	-	4	-	(4)	-	-	-	-	-
Redemption of shares	-	(41)	-	-	-	-	(41)	-	(41)
Contingent rights over shares: shares to be issued	-	-	255	-	-	-	255	-	255
Credit to equity for equity-settled share-based payment	-	-	-	-	-	5	5	-	5
Conversion of warrants into ordinary shares	-	55	(4)	-	-	-	51	-	51
Repurchase of shares in subsidiaries from non-controlling interests	-	-	-	-	-	-	-	(3)	(3)
At 31 December 2009	-	859	257	(4)	93	207	1,412	728	2,140

Phoenix Group Holdings is subject to Cayman Islands Companies Law. Under Cayman Islands Companies Law distributions can be made out of profits or share premium subject, in each case, to a solvency test. The solvency test is broadly consistent with the Group's going concern assessment criteria.

Retained earnings comprises the owners' interest in the post-acquisition retained earnings of the subsidiary companies and the retained earnings of the Company. Distribution of the retained earnings held within the long term business funds and surplus assets held within the owners' funds of the life companies is subject to retaining sufficient funds to protect policyholders' interests. There is a restriction on the ability of certain subsidiary companies to distribute funds to Phoenix Group Holdings as a result of restrictions imposed by the Group's two main credit agreements.

Notes to the consolidated financial statements

for the year ended 31 December 2010

1. Accounting policies

(a) Basis of preparation

The consolidated financial statements for the year ended 31 December 2010 comprise the financial statements of Phoenix Group Holdings ('the Company') and its subsidiaries (together referred to as 'the Group').

The consolidated financial statements have been prepared on a historical cost basis except for investment property, owner-occupied property, and those financial assets, financial liabilities and insurance and investment contracts with DPF that have been measured at fair value.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS') and also in accordance with Part 9, Book 2, of the Netherlands Civil Code.

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

The Group presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement more than 12 months after the period end is presented in the notes.

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

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiary undertakings including collective investment schemes where the Group exercises overall control. Certain of the collective investment schemes have non-coterminous period ends and are consolidated on the basis of additional financial statements prepared to the period end. The non-controlling interest in the collective investment schemes is classified as a liability and shown in the statement of consolidated financial position as net asset value attributable to unit holders. Intragroup balances and income and expenses arising from intragroup transactions are eliminated in preparing the consolidated financial statements.

Subsidiary undertakings are consolidated from the date that effective control is obtained by the Group and are excluded from consolidation from the date they cease to be subsidiary undertakings.

The Group uses the purchase method to account for the acquisition of subsidiary undertakings. The cost of an acquisition is measured at the fair value of the consideration. Any excess of the cost of acquisition over the fair value of the net assets acquired is recognised as goodwill. Any excess of the fair value of the net assets acquired over the cost of acquisition is recognised in the consolidated income statement. Directly attributable acquisition costs are included within administrative expenses except for acquisitions undertaken prior to 2010 when they are included within the cost of the acquisition. Costs directly related to the issuing of debt or equity securities are included within the initial carrying amount of debt or equity securities where these are not carried at fair value.

Non-controlling interests are stated at the initial amount attributed adjusted for the relevant share of subsequent changes in equity.

(b) Critical accounting estimates and judgements

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

Critical accounting estimates are those which involve the most complex or subjective judgements or assessments. The areas of the Group's business that typically require such estimates are insurance and investment contract liabilities, determination of the fair value of financial assets and liabilities, impairment tests for intangible assets, income taxes and pension benefit assets and liabilities.

Insurance and investment contract liabilities

Insurance and investment contract liability accounting is discussed in more detail in accounting policies (e) and (f) with further detail of the key assumptions made in determining insurance and investment contract liabilities included in note 43.

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 policies (r) and (g) respectively. 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 intangible assets

Intangible assets are subject to regular impairment reviews as detailed in accounting policy (n). Impairments are measured at the difference between the carrying value of a particular asset and its recoverable amount. Impairments are recognised in the consolidated income statement in the period in which they occur.

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 value of deferred tax in the financial statements are discussed in note 28.

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

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 32.

(c) Foreign currency transactions

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in sterling, which is the Group's presentation currency.

The results and financial position of all Group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities are translated at the closing rate at the period end;
- income and expenses denominated in foreign currencies are translated at average exchange rates;
- all resulting exchange differences are recognised through the statement of consolidated comprehensive income; and
- cash flows are translated at average exchange rates.

Foreign currency transactions are translated into the functional currency of the transacting Group entity using average exchange rates at the date of translation. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement.

Translation differences on debt securities and other monetary financial assets measured at fair value through profit or loss are included in foreign exchange gains and losses. Translation differences on non-monetary items at fair value through profit or loss are reported as part of the fair value gain or loss.

(d) Classification of contracts

Contracts under which the Group accepts significant insurance risk are classified as insurance contracts.

Contracts under which the transfer of insurance risk to the Group from the policyholder is not significant are classified as investment contracts.

Some insurance and investment contracts contain a discretionary participation feature ('DPF'). This feature entitles the policyholder to additional discretionary benefits as a supplement to guaranteed benefits. Investment contracts with a DPF are recognised, measured and presented as insurance contracts.

(e) Insurance contracts and investment contracts with DPF

Under current IFRS requirements, insurance contracts and investment contracts with DPF are measured using accounting policies consistent with those adopted under UK GAAP. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy.

Insurance liabilities

The insurance contract liability for non-participating non-linked business is calculated initially to comply with the requirements of the FSA Handbook for Insurers. The liability for insurance contracts in the non-profit fund is adjusted where necessary by removing excessively prudent margins required for statutory solvency purposes together with general contingency reserves and those reserves required only under the Prudential Sourcebook for Insurers.

Insurance contract liabilities for non-participating business are calculated using either a net premium or gross premium method. Where a gross premium method is used, the liability includes allowance for prudent lapses. Negative policy values are allowed for on individual policies:

- where there are no guaranteed surrender values; or
- in the periods where guaranteed surrender values do not apply even though guaranteed surrender values are applicable after a specified period of time.

The principal assumptions are given in note 43.

For participating business, the Group follows the provisions of the UK Accounting Standard Board's FRS 27 *Life Assurance*. In accordance with these requirements, the liabilities under insurance contracts and investment contracts with DPF are calculated in accordance with the FSA's realistic capital regime. The key aspects of this methodology are:

- liabilities to policyholders arising from the with-profit business are stated at the amount of the realistic value of the liabilities, adjusted to exclude the owners' share of projected future bonuses;
- acquisition costs are not deferred; and
- reinsurance recoveries are measured on a basis that is consistent with the valuation of the liability to policyholders to which the reinsurance applies.

The principal assumptions are given in note 43.

Financial guarantee contracts

Where a group company enters into a financial guarantee contract to guarantee the indebtedness of other companies within the Group, the Group considers these to be insurance arrangements and accounts for them as such. On this basis the Group only recognises a liability in circumstances whereby it is likely a payment will need to be made under the terms of the guarantee.

Present value of future profits on non-participating business in the with-profit funds

For UK with-profit life funds falling within the scope of the FSA realistic capital regime, and hence FRS 27, an amount may be recognised for the present value of future profits ('PVFP') on non-participating business written in a with-profit fund where the determination of the realistic value of liabilities in that with-profit fund takes account, directly or indirectly, of this value.

Where the value of future profits can be shown to be due to policyholders this amount is recognised as a reduction in the liability rather than as an intangible asset, and is then apportioned between the amounts that have been taken into account in the measurement of liabilities and other amounts which are shown as an adjustment to the unallocated surplus.

Where it is not possible to apportion the future profits on this non-participating business to policyholders the PVFP on this business is recognised as an intangible asset and changes in its value are recorded as a separate item in the consolidated income statement.

The value of the PVFP is determined in accordance with the FSA's realistic capital regime. The principal assumptions used to calculate the PVFP are the same as those used in calculating the insurance contract liabilities given in note 43.

Embedded derivatives

Embedded derivatives, including options to surrender insurance contracts, that meet the definition of insurance contracts or are closely related to the host insurance contract, are not separately measured. All other embedded derivatives are separated from the host contract and measured at fair value through profit or loss.

Liability adequacy

At each reporting date, liability adequacy tests are performed to assess whether the insurance contract and investment contract with DPF liabilities are adequate. Current best estimates of future cash flows are compared to the carrying value of the liabilities. Any deficiency is charged to the consolidated income statement.

The Group's accounting policies for insurance contracts meet the minimum specified requirements for liability adequacy testing under IFRS 4 *Insurance Contracts*, as they allow for current estimates of all contractual cash flows and of related cash flows such as claims handling costs. Cash flows resulting from embedded options and guarantees are also allowed for, with any deficiency being recognised in the consolidated income statement.

Unallocated surplus

The unallocated surplus comprises the excess of the assets over the policyholder liabilities of the with-profit business of the Group's life operations. For the Group's with-profit funds, the amount included in the statement of consolidated financial position line item 'Unallocated surplus' represents amounts which have yet to be allocated to owners since the unallocated surplus attributable to policyholders has been included within liabilities under insurance contracts. The with-profit funds are closed to new business and as permitted by IFRS 4, the whole of the unallocated surplus has been classified as a liability (either within insurance contract liabilities or unallocated surplus).

If the realistic value of liabilities to policyholders exceeds the value of the assets in the with-profit fund, the unallocated surplus is valued at £nil.

(f) Investment contracts without DPF

Receipts and payments on investment contracts without DPF are accounted for using deposit accounting, under which the amounts collected and paid out are recognised in the statement of consolidated financial position as an adjustment to the liability to the policyholder.

The valuation of liabilities on unit-linked contracts is based on the fair value of the related assets and liabilities. The financial liability is measured based on the carrying value of the assets and liabilities that are held to back the contract. The liability is the sum of the unit-linked liabilities plus an additional amount to cover the present value of the excess of future policy costs over future charges.

Investment income and the movements in the fair value of investment contracts without DPF are included in the 'change in investment contract liabilities' in the consolidated income statement.

(g) Financial liabilities

On initial recognition, financial liabilities are recognised when due and measured at the fair value of the consideration received less directly attributable transaction costs (with the exception of liabilities at fair value through profit or loss for which all transaction costs are expensed).

Subsequent to initial recognition, financial liabilities (except for liabilities under investment contracts and other liabilities designated at fair value through profit or loss) are measured at amortised cost using the effective interest method.

Financial liabilities are designated upon initial recognition at fair value through profit or loss when doing so results in more meaningful information because either:

- it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the Group is provided internally on that basis to the Group's key management personnel.

Warrants issued by the Company are recognised as a financial liability unless they can be exchanged for a fixed number of the Company's own shares, or are accounted for as equity-settled share-based payments, in which case they are recognised as equity.

(h) Borrowings

The majority of 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 consolidated income statement over the period of the borrowing using the effective interest method.

Certain borrowings are designated upon initial recognition at fair value through profit or loss and measured at fair value where doing so provides more meaningful information due to the reasons stated above in the financial liabilities accounting policy. Transaction costs relating to borrowings designated upon initial recognition at fair value through profit or loss are expensed as incurred.

(i) Deposits from reinsurers

It is the Group's practice to obtain collateral to cover certain reinsurance transactions, usually in the form of cash or marketable securities. Where cash collateral is available to the Group for investment purposes, it is recognised as a 'financial asset' and the collateral repayable is recognised as 'deposits received from reinsurers' within the statement of consolidated financial position.

(j) Net asset value attributable to unitholders

The net asset value attributable to unitholders represents the non-controlling interest in collective investment schemes where the Group has a holding in excess of 50%. This interest is classified at fair value through profit or loss and measured at fair value, which is equal to the bid value of the number of units of the collective investment scheme not owned by the Group.

(k) Obligations for repayment of collateral received

It is the Group's practice to obtain collateral in stock lending, derivative and reinsurance transactions, usually in the form of cash or marketable securities. Where cash collateral is available to the Group for investment purposes, it is recognised as a 'financial asset' and the collateral repayable is recognised as 'obligations for repayment of collateral received' in the statement of consolidated financial position. The 'obligations for repayment of collateral received' are measured at amortised cost, which in the case of cash is equivalent to cost.

(l) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the consolidated income statement except to the extent that it relates to items recognised in the statement of consolidated comprehensive income or the statement of consolidated 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 consolidated financial position together with adjustments to tax payable in respect of previous years.

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

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

The tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on owners' returns. This allocation is calculated based on an assessment of the effective rate of tax that is applicable to owners for the year.

(m) Employee benefits

Defined contribution plans

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

Defined benefit schemes

The net surplus or deficit (the economic surplus or deficit) in respect of the defined benefit pension schemes 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. 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 Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method. As required by IFRIC 14 to the extent that the economic surplus will be available as a refund the scheme assets are stated after a provision for tax that would be borne by the scheme administrators when the refund is made.

The economic surplus or deficit is subsequently adjusted to eliminate on consolidation the carrying value of insurance policies issued by Group entities to the defined benefit pension schemes (the reported surplus or deficit). A corresponding adjustment is made to the carrying values of insurance contracts liabilities and investment contracts liabilities.

The movement in the reported surplus/deficit is analysed between the service cost, past service cost, curtailments and settlements (recognised within administrative expenses in the consolidated income statement), the interest cost on the liabilities less the expected return on assets, including any reimbursement assets (recognised within net investment income in the consolidated income statement), actuarial gains and losses (recognised in other comprehensive income) and employer contributions. All actuarial gains and losses are recognised in full.

Part of the cost of changes in the longevity assumptions of the PGL pension scheme is recoverable from certain with-profit funds to the extent that cash contributions are made to the pension scheme. Recoveries are recognised when the related cash contributions are agreed with the Trustee of the pension scheme and are accounted for as a transfer to other comprehensive income from insurance contract liabilities.

(n) Intangible assets

Goodwill

Business combinations are accounted for by applying the purchase method. Goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill is measured on initial recognition at cost. Following initial recognition, goodwill is stated at cost less any accumulated impairment losses. It is tested for impairment annually or when there is evidence of possible impairment. Goodwill is not amortised. For impairment testing, goodwill is allocated to cash-generating units (Phoenix Life and IGNIS Asset Management). Goodwill is impaired when the recoverable amount is insufficient to support its carrying value.

Acquired in-force business

Insurance and investment contracts with and without DPF acquired in business combinations and portfolio transfers are measured at fair value at the time of acquisition. The difference between the fair value of the contractual rights acquired and obligations assumed and the liability measured in accordance with the Group's accounting polices for such contracts is recognised as acquired in-force business.

Acquired in-force business is amortised over the estimated life of the contracts on a basis which recognises the emergence of the economic benefits.

An impairment review is performed whenever there is an indication of impairment. When the recoverable amount is less than the carrying value, an impairment loss is recognised in the consolidated income statement. Acquired in-force business is also considered in the liability adequacy test for each reporting period.

Customer relationships

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets are not capitalised and expenditure is reflected in the consolidated income statement in the year in which the expenditure is incurred.

Intangible assets with finite lives are amortised on a straight-line basis over their useful economic lives and assessed for impairment whenever there is an indication that the fair value of the intangible asset is less than its carrying value.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortised.

(o) Property, plant and equipment

Owner-occupied property is stated at fair value, being the estimated amount for which the property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction. Owner-occupied property is depreciated over its estimated useful life, which is taken as 50 years, except where the residual value is greater than its carrying value in which case no depreciation is charged to profit or loss. Land is not depreciated. Gains and losses on owner-occupied property are recognised in the statement of consolidated comprehensive income.

Plant and equipment is stated at cost less accumulated depreciation. Depreciation is charged to the consolidated income statement on a straight-line basis over the estimated useful lives.

(p) Investment property

Investment property is stated at fair value. Fair value is based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction. Gains and losses arising from the change in fair value are recognised in the consolidated income statement.

(q) Investments in associates and joint ventures

Investments in associates and joint ventures that are held for investment purposes are accounted for under IAS 39 *Financial Instruments: Recognition and Measurement* as permitted by IAS 28 *Interests in Associates* and IAS 31 *Interests in Joint Ventures*. These are measured at fair value through profit or loss. There are no investments in associates and joint ventures which are of a strategic nature.

(r) Financial assets

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

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.

Derivative financial instruments are classified as held for trading. They are recognised initially at fair value and subsequently are re-measured to fair value. Exchange-traded derivatives are valued at the published bid price, or, if these are not available, by using valuation techniques such as discounted cash flow models or option pricing models. The gain or loss on re-measurement to fair value is recognised in the consolidated income statement.

Equities, fixed and variable rate income securities and collective investment schemes are designated at fair value through profit or loss and accordingly are stated in the statement of consolidated 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 Group's stated risk management policies.

Impairment of financial assets

The Group assesses at each period end whether a financial asset or group of financial assets held at amortised cost is impaired. The Group 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.

1. Accounting policies (continued)

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.

Stock lending

Financial assets that are lent under the Group's stock lending programme do not qualify for derecognition from the statement of consolidated financial position as the Group retains substantially all the risks and rewards of the transferred assets.

Collateral

The Group receives and pledges collateral in the form of cash or non-cash assets in respect of stock lending transactions, derivative contracts and reinsurance arrangements in order to reduce the credit risk of these transactions. The amount and type of collateral required where the Group receives collateral depends on an assessment of the credit risk of the counterparty.

Collateral received in the form of cash, where the Group has contractual rights to receive the cash flows generated, is recognised as an asset in the statement of consolidated financial position with a corresponding liability for its repayment. Non-cash collateral received is not recognised in the statement of consolidated financial position, unless the counterparty defaults on its obligations under the relevant agreement.

Cash and non-cash collateral pledged where the Group retains the contractual rights to receive the cash flows generated is not derecognised from the statement of consolidated financial position, unless the Group defaults on its obligations under the relevant agreement, and therefore continues to be recognised in the statement of consolidated financial position within the appropriate asset classification.

(s) Reinsurance

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

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

Reinsurance premiums payable in respect of certain reinsured individual and group pensions annuity contracts are payable by quarterly instalments. Due to the period of time over which reinsurance premiums are payable under these arrangements, the reinsurance premiums and related payables are discounted to present values using a pre-tax risk-free rate of return. The unwinding of the discount is included as a charge within the consolidated income statement.

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

(t) 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. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are deducted from cash and cash equivalents for the purpose of the statement of consolidated cash flows.

(u) Provisions and contingent liabilities

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where the Group has a present legal or constructive obligation but it is not probable that there will be an outflow of resources to settle the obligation or the amount cannot be reliably estimated, this is disclosed as a contingent liability.

A provision is recognised for onerous contracts in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs reflect the net cost of exiting the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

(v) Earnings per ordinary share

Basic earnings per share is calculated using the earnings attributable to ordinary equity holders of the parent, divided by the weighted average number of ordinary shares and 'B' ordinary shares in issue during the year.

For the diluted earnings per share, the weighted average number of ordinary shares and 'B' ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares, including warrants and potentially issuable ordinary shares.

(w) Dividends

Final dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Group's owners. Interim dividends are deducted from equity when they are paid. As permitted by Cayman Islands Companies Law, dividends have been charged within equity against share premium account and other reserves account. Where shareholders exercise a scrip dividend option the amount of the related dividend is credited to share premium in the statement of consolidated changes in equity and an amount equal to the nominal value of the shares issued is transferred from share premium to share capital.

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.

(x) Income recognition

Gross premiums

In respect of insurance contracts and investment contracts with DPF, premiums are accounted for on a receivable basis and exclude any taxes or duties based on premiums. Funds at retirement under individual pension contracts converted to annuities with the Group are, for accounting purposes, included in both claims incurred and premiums within gross premiums written.

Reinsurance premiums

Outward reinsurance premiums are accounted for on a payable basis.

Fee and commission income

Fee and commission income relates to the following:

- fund management based fees, which are recognised as the services are provided;
- investment contract income – investment contract policyholders are charged for policy administration services, investment management services, surrenders and other contract fees. These fees are recognised as revenue over the period in which the related services are performed. If the fees are for services provided in future periods, then they are deferred and recognised over those periods. 'Front end' fees are charged on some non-participating investment contracts. Where the non-participating investment contract is measured at fair value, such fees which relate to the provision of investment management services are deferred and recognised as the services are provided; and
- other fees, which are recognised as the services are provided.

Net investment income

Net investment income comprises interest, dividends, rents receivable, net expected return on pension assets, fair value gains and losses on financial assets and investment property and impairment losses on loans and receivables.

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

Rental income from investment property is recognised in the consolidated income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

Fair value gains and losses on financial assets designated at fair value through profit or loss are recognised in the consolidated 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.

Other operating income

Other operating income comprises the general business result and other non-investment income which is recognised on an accruals basis.

(y) Benefits, claims and expenses recognition

Gross benefits and claims

Claims on insurance contracts and investment contracts with DPF reflect the cost of all claims arising during the period, including policyholder bonuses allocated in anticipation of a bonus declaration. Claims payable on maturity are recognised when the claim becomes due for payment and claims payable on death are recognised on notification. Surrenders are accounted for at the earlier of the payment date or when the policy ceases to be included within insurance contract liabilities. Where claims are payable and the contract remains in-force, the claim instalment is accounted for when due for payment. Claims payable include the costs of settlement.

Reinsurance claims

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

Share-based payments

Equity-settled share-based payments to employees and others providing services are measured at the fair value of the equity instruments at the grant date. The fair value excludes the effect of non-market-based vesting conditions. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in note 18.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest. At each period end, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the consolidated income statement such that the cumulative expense reflects the revised estimate with a corresponding adjustment to equity.

Where the terms and conditions of warrants are modified before they vest, the increase in the fair value of the warrants, measured immediately before and after the modification, is also charged to the consolidated income statement over the remaining vesting period.

Finance costs

Interest payable is recognised in the consolidated income statement as it accrues and is calculated by using the effective interest method.

(z) Share capital and shares held by the employee trust and group entities

Ordinary share capital

The Group 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 equity, net of tax.

Shares held by the employee trust and group entities

Where an employee trust or a group entity acquires shares in the Company or obtains rights to purchase its shares, the consideration paid (including any attributable transaction costs, net of tax) is shown as a deduction from owners' equity. Gains and losses on sales of shares held by the employee trust and group entities are charged or credited to the own shares account in equity. Currently, any shares in the Company which are purchased by the Company itself would be cancelled automatically by operation of law and would not be held as own shares.

(aa) General business

The general insurance business has been closed to new business for a number of years and is in run-off. The results are included within other operating income in the consolidated income statement. Provisions are made for the estimated cost of claims, including claims incurred but not reported after taking into account handling costs, anticipated inflation and settlement trends. Any difference between the estimated provision and subsequent settlement is included in the consolidated income statement in later years.

(bb) Segmental reporting

The Group's results are analysed across two reportable segments: Phoenix Life and IGNIS Asset Management. The revenues generated in each reported segment are shown in the segmental information in note 4.

There are no differences between the measurement of the assets and liabilities reflected in the primary statements and that reported for the segments. A reconciliation between the reported segment revenues and expenses and the Group's revenues and expenses is shown in note 4.

Assets, liabilities, revenues or expenses that are not directly attributable to a particular segment are allocated between segments where there is a reasonable basis for doing so.

(cc) 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.

2. Financial information

The consolidated financial statements for the year ended 31 December 2010, set out on pages 88 to 169, were authorised by the Board of Directors for issue on 28 March 2011. The financial statements have been prepared in accordance with IFRS adopted for use by the EU and also in accordance with Part 9, Book 2, of the Netherlands Civil Code.

In preparing the consolidated financial statements the Group has adopted the following standards, interpretations and amendments which have been issued by the International Accounting Standards Board and have been adopted for use by the EU. None of these have a material effect on the results of the Group.

- IFRS 3 Business Combinations (Revised). This converges International and US reporting requirements relating to business combinations.
- IAS 24 Related Party Disclosures (Amended). This amends the definition of a related party, clarifies its intended meaning and eliminates inconsistencies. These amendments have, as permitted, been early adopted from 2010.
- IAS 27 Consolidated and Separate Financial Statements (Revised). This revises the accounting for non-controlling interests and the loss of control of subsidiaries.

- Annual improvements 2009. This makes a number of minor improvements to existing standards and interpretations.
- IFRIC 17 Distributions of Non-Cash Assets to Owners. IFRIC 17 provides guidance on how an entity should account for distributions of non-cash assets to its owners, other than in limited circumstances.
- IFRIC 18 Transfers of Assets from Customers. IFRIC 18 applies to the accounting for transfers of property, plant and equipment by entities that receive such transfers from their customers.
- Additional Exemptions for First-time Adopters (Amendments to IFRS 1).
- Embedded Derivatives (Amendments to IFRIC 9 and IAS 39). This clarifies the treatment of embedded derivatives.
- Group Cash-settled Share-based Payment Transactions (Amendments to IFRS 2). This clarifies the scope of IFRS 2 and the accounting for group cash-settled share-based payment transactions in the separate or individual financial statements of the entity receiving the goods or services.

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

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

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

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

3. Acquisition of the Pearl businesses

With effect from 28 August 2009, the Company acquired 100% of the issued share capital of PGH (LCA) Limited, PGH (LCB) Limited, PGH (TC1) Limited, PGH (TC2) Limited and Opal Reassurance Limited, collectively the 'Pearl businesses', for a total consideration of £493 million. At the same time a third party's interest in a 49.4% holding in IGNIS Investment Management Limited was purchased by Pearl Group Holdings (No. 2) Limited ('PGH2') for a consideration of £1. The Pearl businesses are involved in the management of various classes of insurance business and the provision of investment management services through their subsidiary companies.

The consolidated performance statements and associated notes to the accounts for the year ended 31 December 2009 therefore incorporate the results of the acquired Pearl businesses for the four month post-acquisition period only.

On 2 September 2009, the date of legal completion of the acquisition, certain external debt of the Pearl businesses was restructured as an integral part of the acquisition transaction, specifically the £905 million Pearl facility, the £2,260 million Impala facility and the Royal London PIK notes and facility. Of the £825 million outstanding under the £905 million Pearl facility, £325 million was assigned to Phoenix Group Holdings in exchange for £75 million consideration, £75 million of the remaining £500 million was converted into two tranches of £37.5 million each of secured C loan notes and the terms of the remaining £425 million were amended. The terms of the £2,260 million Impala facility were also amended. Of the £350 million Royal London PIK notes and facility outstanding (comprising principal and capitalised interest), £250 million was assigned to Phoenix Group Holdings in exchange for the issue to Royal London of 1.5 million 'B' ordinary shares and 12.36 million warrants for 'B' ordinary shares. The terms of the remaining £100 million PIK notes and facility were then amended. The banks and other lenders involved in this restructuring are collectively known as 'the Lenders'.

4. Segmental analysis

The Group defines and presents operating segments based on the information which is provided to the Board.

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses relating to transactions with other components of the Group.

For management purposes, the Group is organised into business units based on their products and services and has two reportable segments as follows:

- Phoenix Life – this segment manages a range of whole life, term assurance and pension products; and
- IGNIS Asset Management – this segment provides investment management services to the life companies within the Group and to third parties, covering both retail and institutional investors.

Segment performance is evaluated based on profit or loss which in certain respects is measured differently from profit or loss in the consolidated financial statements. Group financing (including finance costs) and owners' taxes are managed on a Group basis and are not allocated to individual operating segments.

Inter-segment transactions are set on an arm's length basis in a manner similar to transactions with third parties. Segment results include those transfers between business segments which are then eliminated on consolidation.

Predominantly all revenues from external customers are sourced in the UK.

Predominantly all non-current assets are located in the UK.

No revenue transaction with a single customer amounts to greater than 10% of the Group's revenue.

4.1 Segmental result

2010

	Phoenix Life £m	IGNIS Asset Management £m	Unallocated group £m	Eliminations £m	Total £m
Net premiums written					

	Phoenix Life £m	IGNIS Asset Management £m	Unallocated group £m	Eliminations £m	Total £m
from:					
External customers	**1,449**	**-**	**-**	**-**	**1,449**
Other segment	**-**	**-**	**-**	**-**	**-**
	1,449	**-**	**-**	**-**	**1,449**
Fees from:					
External customers	**100**	**62**	**-**	**-**	**162**
Other segment	**-**	**82**	**-**	**(82)**	**-**
	100	**144**	**-**	**(82)**	**162**
Net investment income:					
Recurring	**5,877**	**-**	**35**	**-**	**5,912**
Offset interest income on interest swaps against interest expenses*	**-**	**-**	**(53)**	**-**	**(53)**
Non-recurring	**(5)**	**-**	**-**	**-**	**(5)**
	5,872	**-**	**(18)**	**-**	**5,854**
Other operating income:					
Recurring	**25**	**-**	**-**	**-**	**25**
Net income	**7,446**	**144**	**(18)**	**(82)**	**7,490**
Net policyholder claims and benefits incurred:					
Recurring	**(5,292)**	**-**	**-**	**-**	**(5,292)**
Non-recurring	**(64)**	**-**	**-**	**-**	**(64)**
	(5,356)	**-**	**-**	**-**	**(5,356)**
Depreciation and amortisation:					
Depreciation of property, plant and equipment	**-**	**(3)**	**-**	**-**	**(3)**
Amortisation of acquired in-force business	**(147)**	**-**	**-**	**-**	**(147)**
Amortisation of customer relationships	**(15)**	**(3)**	**-**	**-**	**(18)**
	(162)	**(6)**	**-**	**-**	**(168)**
Other operating					

	Phoenix Life £m	IGNIS Asset Manage ment £m	Unallocated group £m	Eliminations £m	Total £m
expenses:					
Recurring	**(1,616)**	**(95)**	**(40)**	**82**	**(1,669)**
Non-recurring	**(38)**	**-**	**(32)**	**-**	**(70)**
	(1,654)	**(95)**	**(72)**	**82**	**(1,739)**
Total operating expense	**(7,172)**	**(101)**	**(72)**	**82**	**(7,263)**
Profit/(loss) before finance costs and tax	**274**	**43**	**(90)**	**-**	**227**
Finance costs	**(101)**	**-**	**(168)**	**-**	**(269)**
Offset interest income on interest swaps against interest expense*	**-**	**-**	**53**	**-**	**53**
	(101)	**-**	**(115)**	**-**	**(216)**
Profit before tax	**173**	**43**	**(205)**	**-**	**11**
Tax attributable to policyholders' returns	**(5)**	**-**	**-**	**-**	**(5)**
Segmental result before the tax attributable to owners	**168**	**43**	**(205)**	**-**	**6**

* The Group has entered into derivatives to protect the Group's net exposure to interest rate fluctuations and this reallocation derives the net economic interest exposure of the Group.

2009

	Phoenix Life £m	IGNIS Asset Manage ment £m	Unallocated group £m	Eliminations £m	Total £m
Net premiums written from:					
External customers	514	-	-	-	514
Other segment	-	-	-	-	-
	514	-	-	-	514
Fees from:					
External customers	71	30	-	-	101
Other segment	-	28	-	(28)	-
	71	58	-	(28)	101

	Phoenix Life £m	IGNIS Asset Management £m	Unallocated group £m	Eliminations £m	Total £m
Net investment income:					
Recurring	1,095	-	(63)	-	1,032
Offset interest income on interest swaps against interest expenses	-	-	(16)	-	(16)
	1,095	-	(79)	-	1,016
Other operating income:					
Recurring	49	-	-	-	49
Non-recurring	18	-	-	-	18
	67	-	-	-	67
Net income	1,747	58	(79)	(28)	1,698
Net policyholder claims and benefits incurred:					
Recurring	(760)	-	-	-	(760)
Non-recurring	(74)	-	-	-	(74)
	(834)	-	-	-	(834)
Depreciation and amortisation:					
Depreciation of property, plant and equipment	(1)	(1)	-	-	(2)
Amortisation of acquired in-force business	(50)	-	-	-	(50)
Amortisation of customer relationships	(6)	(1)	-	-	(7)
	(57)	(2)	-	-	(59)
Other operating expenses:					
Recurring	(562)	(43)	(17)	28	(594)
Non-recurring	(45)	(4)	-	-	(49)
	(607)	(47)	(17)	28	(643)
Total operating expense	(1,498)	(49)	(17)	28	(1,536)
Profit/(loss) before finance costs and tax	249	9	(96)	-	162
Finance costs	(22)	-	(65)	-	(87)
Offset interest income on	-	-	16	-	16

	Phoenix Life £m	IGNIS Asset Management £m	Unallocated group £m	Eliminations £m	Total £m
interest swaps against interest expense					
	(22)	-	(49)	-	(71)
Profit before tax	227	9	(145)	-	91
Tax attributable to policyholders' returns	60	-	-	-	60
Segmental result before the tax attributable to owners	287	9	(145)	-	151

4.2 Reconciliation of operating profit/(loss) before adjusting items to the segmental result

2010

	Phoenix Life £m	**IGNIS Asset Management £m**	**Unallocated group £m**	**Eliminations £m**	**Total £m**
Operating profit/(loss) before adjusting items	**388**	**46**	**(61)**	**-**	**373**
Investment return variances and economic assumption changes on long-term business	**18**	**-**	**-**	**-**	**18**
Variance on owners' funds	**16**	**-**	**3**	**-**	**19**
Amortisation of acquired in-force business	**(132)**	**-**	**-**	**-**	**(132)**
Amortisation of customer relationships	**(15)**	**(3)**	**-**	**-**	**(18)**
Non-recurring items	**(107)**	**-**	**(32)**	**-**	**(139)**
Financing costs attributable to owners	**-**	**-**	**(115)**	**-**	**(115)**
Segment result before the tax attributable to owners	**168**	**43**	**(205)**	**-**	**6**

Non-recurring items include:

- premium listing and other restructuring costs, including site rationalisation and outsourcer transformation, of £80 million;
- regulatory change and systems transformation costs of £36 million; and

- an increase in the expense reserves of Phoenix Life of £23 million following the new fee arrangement between Phoenix Life and IGNIS. IGNIS will recognise the benefit of this new arrangement as it is earned and so this charge will reverse over time.

2009

	Phoenix Life £m	IGNIS Asset Management £m	Unallocated group £m	Eliminations £m	Total £m
Operating profit/(loss) before adjusting items	285	14	(17)	-	282
Investment return variances and economic assumption changes on long-term business	145	-	-	-	145
Variance on owners' funds	9	-	(79)	-	(70)
Amortisation of acquired in-force business	(45)	-	-	-	(45)
Amortisation of customer relationships	(6)	(1)	-	-	(7)
Non-recurring items	(101)	(4)	-	-	(105)
Financing costs attributable to owners	-	-	(49)	-	(49)
Segment result before the tax attributable to owners	287	9	(145)	-	151

Non-recurring items included:

- a charge of £78 million related to the court approved Guaranteed Annuity Option Compromise scheme for Phoenix & London Assurance Limited. This reduced longevity risk from the business whilst providing immediate policyholder benefit enhancements and resulted in a charge recognised in the consolidated income statement as a change in insurance contract liabilities and administrative expenses of £74 million and £4 million respectively; and
- other non-recurring items of £27 million include costs associated with the Phoenix Life site rationalisation and associated staff reductions and the Group's transformation programme with its outsourcers.

4.3 Segmental total assets and total liabilities

	Assets 2010 £m	**Liabilities 2010 £m**	Assets 2009 £m	Liabilities 2009 £m
Phoenix Life	**83,168**	**78,120**	76,633	71,652
IGNIS Asset Management	**337**	**128**	303	120
Unallocated Group	**59**	**3,016**	-	3,024
	83,564	**81,264**	76,936	74,796

5. Investment return variances and economic assumption changes

The long-term nature of much of the Group's operations means that, for internal performance management, the effects of short-term economic volatility are treated as non-operating items. The

Group focuses instead on an operating profit measure that incorporates an expected return on investments supporting its long-term business. This note explains the methodology behind this.

5.1 Life assurance business

Operating profit for life assurance business is based on expected investment returns on financial investments backing owners' and policyholder funds over the reporting period, with consistent allowance for the corresponding expected movements in liabilities. Operating profit includes the effect of variance in experience for non-economic items, for example mortality, persistency and expenses, and the effect of changes in non-economic assumptions. Changes due to economic items, for example market value movements and interest rate changes, which give rise to variances between actual and expected investment returns, and the impact of changes in economic assumptions on liabilities, are disclosed separately outside operating profit.

The movement in liabilities included in operating profit reflects both the change in liabilities due to the expected return on investments and the impact of experience variances and assumption changes for non-economic items.

The effect of differences between actual and expected economic experience on liabilities, and changes to economic assumptions used to value liabilities, are taken outside operating profit. For many types of long-term business, including unit-linked and with-profit funds, movements in asset values are offset by corresponding changes in liabilities, limiting the net impact on profit. For other long-term business the profit impact of economic volatility depends on the degree of matching of assets and liabilities, and exposure to financial options and guarantees.

The investment variances and economic assumption changes excluded from the long-term business operating profit reflects the impact of the reduction in credit spreads on corporate bonds and equity, property and yield movements.

5.2 Owners' funds

For non-long-term business including owners' funds, the total investment income, including fair value gains, is analysed between a calculated longer term return and short-term fluctuations.

The variances excluded from operating profit in relation to owners' funds are as follows:

	2010 £m	2009 £m
Variances on owners' funds of:		
Subsidiary undertakings	**7**	9
The Company	**12**	(79)
	19	(70)

The variances on owners' funds of the Company comprises fair value gains/(losses) arising from movements in the fair value of warrants in issue over the Company's shares.

5.3 Calculation of the long-term investment return

The expected return on investments for both owner and policyholder funds is based on opening economic assumptions applied to the funds under management at the beginning of the reporting period. Expected investment return assumptions are derived actively, based on market yields on risk-free fixed interest assets at the start of each financial year. The same margins are applied on a consistent basis across the Group to gross risk-free yields, to obtain investment return assumptions for equities and properties.

The principal assumptions underlying the calculation of the longer term investment return are:

	2010 %	2009 %
Equities	**7.6**	6.3
Property	**6.6**	5.8
Gilts (15 year gilt)	**4.5**	3.7
Other fixed interest (15 year gilt plus 0.6%)	**5.1**	4.3

6. Fees

	2010 £m	2009 £m
Fund management based fees	**62**	30
Investment contract income	**100**	71
	162	101

7. Net investment income

	2010 £m	2009 £m
Investment income		
Interest income on loans and receivables	**57**	76
Interest income on impaired financial assets	**5**	-
Interest income on financial assets designated at fair value through profit or loss on initial recognition	**1,911**	818
Dividend income	**492**	321
Rental income	**78**	52
Net expected return on pension assets	**(18)**	(9)
	2,525	1,258
Impairment losses on loans and receivables	**(12)**	-
Fair value gains/(losses)		
Financial assets at fair value through profit or loss		
Held for trading – derivatives	**(17)**	(385)
Designated upon initial recognition	**3,324**	-
Investment property	**87**	159
	3,382	(226)
Net investment income	**5,907**	1,032

8. Other operating income

	2010 £m	2009 £m
General business result	**-**	2
Income received from outsourcer	**14**	-
Income under Royal London transitional services agreement	**5**	31
Insurance claim	**-**	11
Other income	**6**	23
	25	67

9. Acquisition costs

	2010 £m	2009 £m
Acquisition costs paid	**12**	8

10. Administrative expenses

	2010 £m	2009 £m
Employee costs	**158**	65
Outsourcer expenses	**147**	58
Investment management expenses and transaction costs	**142**	73
Non-recurring administrative expenses	**70**	27
Operating expenses in respect of investment properties	**4**	11
Depreciation of property, plant and equipment	**3**	2
Other	**152**	19
	676	255

Other expenses mainly comprise professional fees, information technology expenses and other general expenses.

Employee costs comprise:

	2010 £m	2009 £m
Wages and salaries	**134**	56
Social security contributions	**13**	5
Other pension costs	**11**	4
	158	65

	2010 Number	2009 Number
Average number of persons employed		
Phoenix Life	**758**	875
IGNIS Asset Management	**520**	534
	1,278	1,409

The average number of employees for the year ended 31 December 2009 has been presented for the period following the acquisition of the Pearl businesses on 28 August 2009.

11. Auditors' remuneration

The remuneration of the auditors of the Company, including their associates, in respect of services supplied to entities included in the consolidated financial statements was £13.6 million (2009: £7.2 million). No services were provided by the auditors of the Company to associated pension schemes.

	2010 £m	2009 £m
Audit of the consolidated financial statements	**0.7**	0.8
The auditing of accounts of associates of the Company pursuant to legislation	**3.5**	3.5
Other services supplied pursuant to such legislation:		
Audit related	**0.7**	0.7
Services as reporting accountants	**6.6**	0.2
Other services:		
Audit of MCEV supplementary information	**0.8**	0.6
Other	**1.3**	1.4
	13.6	7.2

The total remuneration of the auditors of the Company for services as reporting accountants mainly comprised services provided in respect of the premium listing.

12. Finance costs

	2010 £m	2009 £m
Interest expense		
On borrowings at amortised cost	**196**	64
On borrowings at fair value through profit or loss	**73**	23
	269	87
Attributable to:		
– policyholders	**101**	22
– owners	**168**	65
	269	87

13. Tax (credit)/charge

13.1 Current year tax (credit)/charge

	2010 £m	2009 £m
Current tax:		
UK Corporation tax	**30**	(15)
Overseas tax	**7**	5
	37	(10)
Adjustment in respect of prior years	**16**	(3)
	53	(13)
Deferred tax:		
Reversal/origination of temporary differences		
On non-profit surpluses	**(32)**	(51)
On amortisation of acquired in-force business	**(50)**	(17)
On amortisation of customer relationship intangible	**(5)**	-
On profit arising from the changes in assumptions used for determining insurance liabilities in accordance with PS 06/14	**-**	(5)
Capital allowances in excess of depreciation	**-**	1
On accrued interest	**(38)**	-
Losses on group restructuring not matched in accounts	**(33)**	-
Tax losses arising in the current year carried forward	**(17)**	(26)
Pension scheme movements	**19**	16
On provisions for future expenditure	**(6)**	(12)
Utilisation of tax losses	**57**	63
Change in the rate of corporation tax	**(19)**	-
Write down of deferred tax assets	**2**	-
	(122)	(31)
Total tax credit	**(69)**	(44)
Attributable to:		
– policyholders	**5**	(60)
– owners	**(74)**	16
	(69)	(44)

The Group, as a proxy for policyholders in the UK, is required to pay taxes on investment income and gains each year. Accordingly, the tax benefit or expense attributable to UK life assurance policyholder earnings is included in income tax expense. The tax charge/(benefit) attributable to policyholder earnings was £5 million (2009: £(60) million).

13.2 Tax charged to other comprehensive income

	2010 £m	2009 £m
Deferred tax on actuarial gains of defined benefit schemes	**(4)**	31

13.3 Reconciliation of tax credit

	2010 £m	2009 £m
Profit before tax	**11**	91
Policyholder tax (charge)/credit	**(5)**	60
Profit before the tax attributable to owners	**6**	151
Tax at standard UK* rate of 28%	**2**	42
Net tax losses on group restructuring not matched in accounts	**(110)**	(63)
Untaxed income and gains	**(61)**	-
Disallowable expenses	**18**	10
Adjustment to tax charge in respect of prior years	**16**	(3)
Movement in non-profit surplus taxed at less than 28%	**20**	(51)
Policyholder tax calculation methodology	**-**	48
Tax relief on accrued interest not valued	**-**	11
Profits taxed at rates other than 28%	**(3)**	12
Tax losses not previously valued	**(8)**	-
Prior year deferred tax	**12**	-
Deferred tax rate change	**(19)**	-
Current year losses not valued	**41**	-
Deductible temporary differences not valued	**11**	-
Other	**7**	10
Owners' tax (credit)/charge	**(74)**	16
Policyholder tax charge/(credit)	**5**	(60)
Total tax credit for the year	**(69)**	(44)

* The Group's two operating segments operate predominantly in the UK. The reconciliation of the tax credit has, therefore, been completed by reference to the standard rate of UK tax rather than by reference to the Jersey income tax rate of 0% which is applicable to Phoenix Group Holdings.

14. Dividends on ordinary shares

	2010 £m	2009 £m
Dividends declared and paid in 2010	**54**	-

On 30 March 2010, the Board declared a dividend of €0.17 per share in respect of the year ended 31 December 2009. The total dividend amounted to £20 million and was paid on 15 April 2010.

On 27 August 2010, the Board declared an interim dividend of £0.21 per share. A scrip dividend option was available to shareholders and the dividend that was settled on 15 October 2010 amounted to £34 million. The value of the dividend that settled via the scrip dividend option was £11 million.

15. Earnings per share

The profit attributable to owners for the purposes of calculating earnings per share has been calculated as set out below. This is after adjusting for profits attributable to non-controlling interests.

	2010 £m	2009 £m
Profit for the year	**80**	135
Share of result attributable to non-controlling interests	**(50)**	(40)
Profit attributable to owners	**30**	95

The basic earnings per share of 20.1p (2009: 102.9p) has been based on the profit of £30 million (2009: £95 million) and a weighted average number of ordinary shares outstanding during the year of 149 million (2009: 92 million), calculated as follows:

	2010 Number million	2009 Number million
Issued ordinary shares at beginning of the year	**130**	53
Effect of ordinary shares issued/redeemed	**19**	39
Weighted average number of ordinary shares	**149**	92

The diluted earnings per share of 20.1p (2009: 89.8p) has been based on the profit of £30 million (2009: £95 million) and a diluted weighted average number of ordinary shares outstanding during the year of 149 million (2009: 106 million) calculated as follows:

	2010 Number million	2009 Number million
Weighted average number of ordinary shares	**149**	92
Effect of warrants in issue	**-**	14
Weighted average number of ordinary shares (diluted)	**149**	106

The Founders', Sponsors' and IPO warrants were not dilutive in 2010 due to the exercise price of the warrants being significantly higher than the share price of the Company. In light of the current share price of the Company, it is considered unlikely that the warrants will vest. The Founders' and Sponsors' warrants were converted into ordinary shares during 2010.

In 2009, the Founders', Sponsors' and IPO warrants were dilutive up until 2 September 2009 and had the effect of increasing the weighted average number of ordinary shares in calculating the diluted weighted average number of ordinary shares.

The following instruments could potentially dilute basic earnings per share in the future but have not been included in the diluted earnings per share figure because, due to their exercise price, they do not have a dilutive effect for the periods presented:

- 5 million warrants issued to the Lenders on 2 September 2009;
- 12.36 million warrants issued to Royal London on 2 September 2009; and

- the Founders', Sponsors' and IPO warrants from 2 September 2009 on which date the exercise price of the outstanding warrants was increased from €7 to €11.

Details of the warrants are given in note 24.

On 2 September 2009 the Company issued 36,000,000 contingent rights over its shares, none of which have been included in diluted earnings per share figures as none of the conditions were satisfied and therefore no shares would have been issued. On 5 July 2010, the Company completed the restructure of these contingent rights over shares which saw 32,400,000 of the contingent rights over shares converted into the same number of ordinary shares and the holders of the contingent rights over shares become entitled to receive a further 3,600,000 ordinary shares in aggregate if before 22 June 2013 (i) an offer is made to acquire all or a majority of the Company's issued ordinary share capital or substantially all of the Company's assets (in each case such transaction having become unconditional in all respects); or (ii) any party or parties acting in concert becomes interested in more than 50% of the ordinary shares of the Company through the issue of shares by the Company. As the conditions of this entitlement were not met in the period, these additional shares have not been included in the diluted earnings per share figures.

16. Share capital

	2010 **£**	2009 £
Authorised:		
410 million (2009: 300 million) ordinary shares of €0.0001 each	**31,750**	22,050
Nil (2009: 110 million) 'B' ordinary shares of €0.0001 each	**-**	9,700
	31,750	31,750
Issued and fully paid:		
171.5 million (2009: 80.4 million) ordinary shares of €0.0001 each	**13,904**	6,067
Nil (2009: 49.8 million) 'B' ordinary shares of €0.0001 each	**-**	4,383
	13,904	10,450

In connection with the Company's Premium listing, all 52,032,123 issued and fully paid 'B' ordinary shares were converted into ordinary shares on 5 July 2010 by way of a variation of rights and re-designation on a one-for-one basis. The holders of the ordinary shares are entitled to one vote per share on matters to be voted on by owners and to receive such dividends, if any, as may be declared by the Board of Directors in its discretion out of legally available profits. Prior to this, the holders of the ordinary and 'B' ordinary shares had identical rights to returns and voting.

Movements in issued share capital during the year:

2010

	Number	**£**
Shares in issue at 1 January	**130,200,732**	**10,450**
'B' ordinary shares issued on conversion of warrants	**2,085,123**	**177**
'B' ordinary shares issued to the Chairman	**177,000**	**16**
Ordinary shares issued on conversion of contingent rights over shares	**32,400,000**	**2,677**
Ordinary shares issued for scrip dividend (note 14)	**1,567,416**	**138**
Ordinary shares issued in connection with Alternative Coupon Satisfaction Mechanism	**5,020,000**	**445**
Other ordinary shares issued in the year	**5,339**	**1**
Shares in issue at 31 December	**171,455,610**	**13,904**

2009

	Number	£
Shares in issue at 1 January	75,000,000	5,583
‘B’ ordinary shares issued on acquisition of the Pearl businesses	40,700,000	3,588
Ordinary shares issued in part settlement of debt restructuring fees	3,500,000	307
‘B’ ordinary shares issued in part settlement of debt restructuring fees	7,070,000	620
‘B’ ordinary shares issued on assignment of PIK notes and facility	1,500,000	131
‘B’ ordinary shares issued to the employee trust	500,000	44
Ordinary shares redeemed on acquisition of the Pearl businesses	(6,038,344)	(533)
Ordinary shares issued on conversion of warrants	7,969,076	710
Shares in issue at 31 December	130,200,732	10,450

On 13 January 2010, 147,925 ‘B’ ordinary shares were issued and on 15 January 2010, a further 1,937,198 ‘B’ ordinary shares were issued totalling 2,085,123. Both of these issues were pursuant to the exchange invitation for the insiders’ warrants and were issued at a premium of £9 million.

On 31 March 2010, 177,000 ‘B’ ordinary shares were issued to the Chairman at a premium of £1 million. As announced previously, the Chairman had the entitlement under his letter of appointment to an award of 300,000 ‘B’ ordinary shares. In order to satisfy this agreement, shares were issued representing the net of tax value, with the Group funding the relevant taxes.

On 5 July 2010, the Company completed the restructuring of the contingent rights over its shares. Under this restructuring the Company issued to each holder of contingent rights over shares 9 ordinary shares for every 10 ordinary shares that such holder would have received on crystallisation of the contingent rights over shares. 32,400,000 contingent rights over shares in issue were, therefore, converted into the same number of ordinary shares and were issued at a premium of £230 million.

On 22 October 2010, the Company implemented a placing in connection with the operation of the Alternative Coupon Satisfaction Mechanism (‘ACSM’) in respect of the 2009 deferred coupon on the £500 million Perpetual Reset Capital Notes issued by Pearl Group Holdings (No. 1) Limited (‘PGH1’). The Company issued 5,020,000 new ordinary shares on 27 October 2010 at a premium of £33 million.

During the year, the Company issued a further 5,339 shares at a premium of £30,058.

17. Shares held by the employee trust and group entities

	2010 £m	2009 £m
At 1 January	**4**	-
Issued in year	**-**	4
Purchased in year	**10**	-
Vested to employees in year	**(4)**	-
Shares issued to group entity on conversion of contingent rights	**3**	-
At 31 December 2010	**13**	4

This reserve represents the value of the shares held by the Phoenix Group Holdings Employee Benefit Trust (‘PGH EBT’) to satisfy awards granted to employees under the Group’s share-based payment schemes and shares held by group entities. During the year 1,580,671 further shares were purchased on market and 595,740 shares were awarded to employees (see note 18). The number of shares held by the PGH EBT at 31 December 2010 was 1,484,931 (2009: 500,000).

On 5 July 2010, the Company implemented a restructuring of the contingent rights over its shares as explained in note 16. As a result 383,188 shares were issued to Pearl Assurance Limited.

18. Share-based payment

18.1 Share-based payment expense

The expense recognised for employee services receivable during the year is as follows:

	2010 £m	2009 £m
Expense arising from equity-settled share-based payment transactions	**8**	3
Expense arising from cash-settled share-based payment transactions	**1**	-
Total expense arising from share-based payment transactions	**9**	3

The carrying amount of the liability relating to the cash-settled options at 31 December 2010 is £1 million (2009: £nil) and is included within other payables.

18.2 Share-based payment schemes in issue

2010 Long-term incentive plan

During 2010, the Group implemented a long-term incentive plan to retain and motivate its senior management group. The awards under this plan are in the form of nil-cost options to acquire an allocated number of ordinary shares. Assuming no good leavers or other events which would trigger early vesting rights, these awards will be subject to performance conditions tied to the Company's financial performance in respect of growth in embedded value and cumulative cash generation over a three year period and will not vest until 28 May 2013. There are no cash settlement alternatives.

The fair value of these awards is estimated at the share price at the grant date, taking into account the terms and conditions upon which the instruments were granted.

2009 Long-term incentive plan

Certain employees were granted nil-cost options to acquire an allocated number of ordinary shares during 2009. These options vested in full on achievement of the Company's premium listing. There were no cash settlement alternatives.

The fair value of these awards was estimated at the share price at the grant date, taking into account the terms and conditions upon which the instruments were granted.

Save As You Earn ('SAYE')

The SAYE scheme allows participating employees to save up to £250 each month over a period of either 3 or 5 years.

Under the SAYE arrangement, participants remaining in the Group's employment at the end of the 3 or 5 year saving period are entitled to use their savings to purchase shares at an exercise price of £5.63. Employees leaving the Group for certain reasons are able to use their savings to purchase shares within six months of their leaving before the end of their 3 and 5 year periods.

The fair value of the awards has been determined using a Black-Scholes valuation model. Key assumptions within this valuation model included expected share price volatility and expected dividend yield.

The following information was relevant in the determination of the fair value of the SAYE awards in the year:

Share price (£)	**6.50**
Exercise price (£)	**5.63**
Expected life (years)	**3.25 and 5.25**
Risk-free rate (%)	**2.0 (for 3.25 year scheme) and 2.8 (for 5.25 year scheme) based on UK Government Gilts with a term commensurate with the expected term for each award.**
Expected volatility (%)	**30.0 which is based on the Company's share price volatility to date.**
Dividend yield (%)	**zero**

Bonus share plan

In 2009, certain employees were granted nil-cost options to acquire an allocated number of ordinary shares. There were no performance criteria associated with these awards and no cash settlement alternatives. The contractual life of the awards is 2 years.

Deferred cash plan

With effect from 2 September 2009, a number of executives were given deferred cash awards the value of which will be equal to a fixed number of Phoenix Group Holdings shares on 2 September 2012 and will be payable on this date provided the executive remains in employment.

The fair value of the awards has been determined assuming that all granted shares vest. As the award is a cash settled scheme, the fair value of the expense is updated at every period and to reflect movements in the Phoenix Group Holdings share price.

Sponsors' warrants

For the year ended 31 December 2010 £nil has been recognised as a

payment charge (31 December 2009: £2 million).

On 15 January 2010 the remaining 4,000,000 outstanding Sponsors' warrants were converted into 727,271 ordinary shares.

Chairman's shares

On 24 September 2009 it was agreed to grant the Chairman 300,000 'B' ordinary shares as part of the remuneration package to secure his appointment. On 26 February 2010 it was agreed to modify the terms of the award. On 31 March 2010 177,000 'B' ordinary shares were issued and a cash payment of £1 million was made. The effect of this modification is to leave the 2009 charge of £2.5 million unchanged and to recognise a reduction in equity for the cash payment to settle the tax liability associated with the award of the shares.

18.3 Movements in the year

The following table illustrates the number of, and movements in, share options during the year:

	No of share options 2010					No of share options 2009	
	2009 LTIP	**2009 BSP**	**Deferred cash plan**	**2010 LTIP**	**SAYE**	2009 LTIP	2009 BSP
Outstanding at the beginning of the year	**403,750**	**403,750**	**-**	**-**	**-**	-	-
Granted during the	**70,297**	**40,000**	**229,370**	**1,530,790**	**1,163,948**	403,750	403,750

			No of share options 2010			No of share options 2009	
year							
Forfeited during the year	**-**	**-**	**-**	**(106,241)**	**(121,395)**	-	-
Exercised during the year	**(474,047)**	**(117,500)**	**-**	**-**	**(5,339)**	-	-
Outstanding at the end of the year	**-**	**326,250**	**229,370**	**1,424,549**	**1,037,214**	403,750	403,750

The weighted average fair value of options granted during the year was £4.95 (2009: £8.42).

The weighted average share price at the date of exercise for the rewards exercised is £6.77 (2009: £nil).

The weighted average remaining contractual life for the rewards outstanding as at 31 December 2010 is 2.5 years (2009: 2.0 years).

19. Non-controlling interests

2010

	Perpetual Reset Capital Securities £m	**UK Commercial Property Trust Limited £m**	**Total £m**
At 1 January	**527**	**201**	**728**
Profit for the year	**20**	**30**	**50**
Dividends paid	**-**	**(18)**	**(18)**
Restructure of non-controlling interest	**(70)**	**-**	**(70)**
Coupon paid, net of tax relief	**(47)**	**-**	**(47)**
Partial buyback of non-controlling interest	**(19)**	**-**	**(19)**
Shares in subsidiaries subscribed for by non-controlling interests	**-**	**96**	**96**
At 31 December	**411**	**309**	**720**

2009

	Perpetual Reset Capital Securities £m	UK Commercial Property Trust Limited £m	Total £m
At 1 January	-	-	-
On acquisition of the Pearl businesses	518	181	699
Profit for the year	9	31	40
Dividends paid	-	(8)	(8)
Effect of share transactions	-	(3)	(3)

	Perpetual Reset Capital Securitie s £m	UK Comm ercial Propert y Trust Limited £m	Total £m
At 31 December	527	201	728

19.1 Perpetual Reset Capital Securities

On 1 January 2010, PGH1 had in issue £500 million of Perpetual Reset Capital Securities ('the Notes') which are admitted to the Official List of the UK Listing Authority and to trading on the LSE.

The Notes are unsecured obligations of PGH1 and are subordinate to the claims of senior creditors. Payments in respect of the Notes are conditional upon PGH1 being solvent at the time of payment and immediately following such payment.

The Notes have no fixed maturity date and interest payments may be deferred at the option of PGH1; accordingly the Notes meet the definition of equity for financial reporting purposes. The Notes also meet the conditions for Innovative Tier 1 capital treatment in the calculation of Group Capital Resources under the rules of the FSA. As the Notes are not held by the Company, these are disclosed as a non-controlling interest in the consolidated financial statements.

The Notes may be redeemed at par at the option of PGH1 on the first reset date of 25 April 2016 or on any coupon payment date thereafter. Redemption is subject to the agreement of the FSA. In certain circumstances PGH1 has the right to substitute the Notes or to redeem the Notes before the first reset date.

Coupons are payable annually in arrears on 25 April, at the rate of 6.5864% per annum, until the first reset date. Thereafter coupons are payable semi-annually at 2.73% per annum over the then prevailing offered rate for six month sterling deposits.

If PGH1 opts to defer a coupon payment, then PGH1 has the option to either leave the coupon outstanding or satisfy the deferred coupon payment by the issue of securities ('ACSM instruments') by either PGH1 or a special purpose subsidiary of PGH1 established for the purpose of issuing ACSM instruments and which are guaranteed by PGH1. The obligations of PGH1 in respect of such securities will be subordinated to and rank or be expressed to rank junior to the Notes as to rights to payments of interest and participation in the assets of PGH1 in a winding-up and shall comply with the then current requirements of the FSA in relation to Tier 1 Capital. ACSM instruments will in the first instance be offered to related parties (as defined in the Terms and Conditions of the Notes as amended by the Supplemental Trust Deed dated 30 July 2008) and to third parties if not purchased by related parties. In the event that neither such related parties nor third parties will purchase the required ACSM instruments then PGH2 is required to use its best endeavours to raise such funds as are deemed necessary to purchase the required amounts of ACSM instruments.

For so long as a deferred coupon payment has not been satisfied PGH1 may not declare, pay or distribute a dividend on any of its securities in issue ranking junior to the Notes including the ordinary shares of PGH1 or any parity securities or, except in particular circumstances, redeem, purchase or otherwise acquire any of its securities in issue ranking junior to the Notes, including its ordinary shares or any parity securities.

On 25 March 2009, the Board of PGH1 gave notice to the holders of the Notes of its decision to defer the coupon payment on the Notes at the next payment date of 25 April 2009 and PGH1 indicated that it had no present intention to initiate the ACSM at that time.

On 22 April 2010, the holders of the Notes agreed to a number of amendments to the Notes, including a 15% reduction in the face value of the Notes, the amendment of the ACSM and the imposition of an additional restriction on the payment of dividends by the Company if future coupons are deferred. The 15% reduction in face value of the Notes emerges in the statement of consolidated financial position as a £70 million reduction in non-controlling interests representing the impact of this reduction on the Notes held by external noteholders. Following these amendments, PGH1 settled in full on 26 April 2010 the 2010 coupon due on the Notes and settled in full via the issue of ACSM instruments the 2009 coupon on 18 November 2010.

During the year the Company exercised a call option to acquire a number of the Notes from an external party for consideration of £4 million. This transaction has been recognised in the statement of consolidated financial position as a reduction of £19 million in non-controlling interests.

19.2 UK Commercial Property Trust Limited

UK Commercial Property Trust Limited ('UKCPT') is a property investment subsidiary which is domiciled in Guernsey and is admitted to the Official List of the UK Listing Authority and to trading on the LSE.

20. Liabilities under insurance contracts

	Gross liabilities 2010 £m	**Reinsurers' share 2010 £m**	Gross liabilities 2009 £m	Reinsurers' share 2009 £m
Life assurance business:				
Insurance contracts	**38,770**	**2,939**	38,965	2,860
Investment contracts with DPF	**11,709**	**-**	11,326	-
	50,479	**2,939**	50,291	2,860
Amounts due for settlement after 12 months	**42,376**	**2,719**	40,150	2,722

	Gross liabilities 2010 £m	**Reinsurers' share 2010 £m**	Gross liabilities 2009 £m	Reinsurers' share 2009 £m
At 1 January	**50,291**	**2,860**	-	-
On acquisition of the Pearl businesses	**-**	**-**	51,413	2,689
Premiums	**1,534**	**85**	545	31
Claims	**(5,260)**	**(210)**	(2,043)	(105)
Other changes in liabilities	**3,978**	**214**	361	216
Foreign exchange adjustments	**(37)**	**(10)**	15	29
Transfer to statement of consolidated comprehensive income in respect of actuarial losses of defined benefit pension scheme	**(27)**	**-**	-	-
At 31 December	**50,479**	**2,939**	50,291	2,860

21. Unallocated surplus

	2010 £m	2009 £m
At 1 January	**721**	-
On acquisition of the Pearl businesses	**-**	546
Transfer from income statement	**143**	175
At 31 December	**864**	721

22. Borrowings

	Carrying value		Fair value	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Limited recourse bonds 2012 7.39% (note a)	**29**	48	**29**	45
Limited recourse bonds 2022 7.59% (note a)	**94**	86	**97**	93
£779 million loan (note b)	**757**	764	**766**	751
£15 million loan (note c)	**14**	15	**15**	14
£80 million facility agreement (note d)	**42**	42	**42**	42
Refinancing loan (note e)	**234**	258	**234**	258
£4 million loan (note f)	**4**	-	**4**	-
Total policyholder borrowings	**1,174**	1,213	**1,187**	1,203
£200 million 7.25% unsecured subordinated loan (note g)	**127**	119	**170**	156
Unsecured loan notes (note h)	**12**	18	**12**	18
£2,260 million syndicated loan (note i)	**2,138**	2,260	**2,138**	2,260
£100 million PIK notes and facility (note j)	**106**	102	**106**	102
£75 million secured loan note (note k)	**72**	70	**72**	70
£425 million loan facility (note k)	**399**	399	**399**	399
Total shareholder borrowings	**2,854**	2,968	**2,897**	3,005
Total borrowings	**4,028**	4,181	**4,084**	4,208
Amount due for settlement after 12 months	**3,838**	4,086		

Debenture loans

(a) In 1998, National Provident Institution raised £260 million of capital through the securitisation of embedded value on a block of existing unit-linked and unitised with-profit life and pension policies. Following the demutualisation of National Provident Institution, these were transferred to National Provident Life Limited ('NPLL'). The bonds are split between two classes, which rank pari passu. The £140 million 7.39% class A1 limited recourse bonds with an outstanding principal of £27 million (2009: £42 million) have an average remaining life of 1 year maturing in 2012. A principal repayment of £15 million was made in September 2010 as per the terms of the agreement. The £120 million 7.59%

limited recourse bonds with an outstanding principal of £120 million (2009: £120 million) have an average remaining life of 8 years maturing in 2022. NPLL has provided collateral of £77 million (2009: £88 million) to provide security to the holders of the NPLL recourse bonds in issue.

(b) On 3 June 2008, Axial Fixed Income Opportunities S.a.r.l. issued A loans consisting of €459,886,325; £39,480,573 and US$288,125,702. On 13 June 2008, Axial Fixed Income Opportunities S.a.r.l. issued further A loans of £128,401,000 and on 11 July 2008, Axial Fixed Income Opportunities S.a.r.l. issued further A loans of US$29,780,400. These loans accrue interest at LIBOR plus 125 bps and mature in June 2015. Due to the strengthening of the pound against the dollar, the carrying value has fallen during the year. These loans were settled in full on 21 March 2011.

(c) On 3 June 2008, Axial Fixed Income Opportunities S.a.r.l. issued B loans consisting of €9,397,311; £3,015,429 and US$4,476,558. These loans accrue a fixed interest rate of 0.1% plus a variable profit related element and mature in June 2015. Due to the strengthening of the pound against the dollar, the carrying value has fallen during the year. These loans were settled in full on 21 March 2011.

(d) In 2008, UKCPT entered into an £80 million revolving loan facility agreement. This loan accrues interest at LIBOR plus a variable margin of 0.50% to 0.60% per annum. The lender holds a floating charge over certain assets of UKCPT and its subsidiaries. The repayment date for this facility is 19 June 2015.

(e) The refinancing loan from Abbey National Property Investments was brought into the consolidated financial statements at fair value. It relates to the sale of Extra-Income Plan policies that Abbey National Property Investments finances to the value of the associated property reversions. As part of the arrangement Abbey National Property Investments receive an amount calculated by reference to the movement in the Halifax House Price Index and NPLL and NPI Limited have undertaken to indemnify Abbey National Property Investments against profits or losses arising from mortality or surrender experience which differs from the basis used to calculate the reversion amount. Repayment will be on a policy-by-policy basis and is expected to occur over the next 10 to 20 years. During the year, a repayment of £24 million was made.

(f) On 9 February 2010 the Group sold a portion of its loan holding in Axial Credit Opportunities Holdings Limited to an external third party. This loan included two credit facilities, namely the B1 and B2 loans. The B1 loans are entitled to interest calculated at LIBOR plus a margin of 3.50%. The B2 loans are entitled to a variable profit related element. These loans would have matured in May 2016, but were settled in full on 21 March 2011.

(g) Scottish Mutual Assurance Limited issued £200 million 7.25% undated, unsecured subordinated loan notes on 23 July 2001. The earliest repayment date of the notes is 25 March 2021 and thereafter on each fifth anniversary so long as the notes are outstanding. With effect from 1 January 2009, as a part of a Part VII transfer, these loan notes were transferred into the shareholder fund of Phoenix Life Limited ('PLL'). In the event of the winding-up of PLL, the right of payment under the notes is subordinated to the rights of the higher-ranking creditors (principally policyholders). Phoenix Group Holdings acquired these subordinated loan notes at their fair value and as such, the outstanding principal of these subordinated loan notes differs from the carrying value in the statement of financial position. The fair value adjustments which were recognised on acquisition will unwind over the remaining life of these subordinated loan notes.

(h) Unsecured loan notes of £72 million were issued by Impala Holdings Limited ('Impala') at par on 14 May 2008 at an interest rate of LIBOR minus 1% per annum with a final maturity date of 2012. During the year £6 million of these loan notes have been repaid and £12 million were outstanding.

Debenture loans (continued)

(i) On 14 May 2008, PGH (LC1) Limited and PGH (LC2) Limited jointly obtained a £2,260 million loan facility from a syndicate of external banks (the 'Impala Facility'). This facility was split into Tranche loans A, B and C of £1,275 million, £492.5 million and £492.5 million respectively. The terms of this facility were subsequently amended on 2 September 2009, to the following:

- Tranche A loan of £1,275 million is repayable over the period from 30 April 2011 to 30 November 2014 and attracts interest at LIBOR plus a cash margin of 1.00% and a PIK margin of 1.00% for the first four years, and LIBOR plus a cash margin of 2.50% for the subsequent years;
- Tranche B loan of £492.5 million is repayable on 30 November 2015 and attracts interest at LIBOR plus a cash margin of 1.25% and a PIK margin of 0.75% for the first four years, and LIBOR plus a cash margin of 3.25% for the subsequent years; and
- Tranche C loan of £492.5 million is repayable on 30 November 2016 and attracts interest at LIBOR plus a cash margin of 1.75% and a PIK margin of 0.25% for the first four years, and LIBOR plus a cash margin of 3.75% for the subsequent years.

The borrowings under the £2,260 million facility are secured by:

- first fixed and floating charges over all the assets and undertaking of PGH (LC1) Limited and PGH (LC2) Limited (including their respective 12.5% shareholding in Impala, all real estate, book debts, bank accounts, investments and other assets); and
- a limited recourse share charge granted by PGH2 over its 75% shareholding in Impala.

During 2010, a voluntary repayment of £122 million was made.

(j) On 14 May 2008, PGH (MC1) Limited issued PIK notes to the value of £154.5 million to Royal London and PGH (MC2) Limited obtained a £154.5 million PIK facility from Royal London. On 2 September 2009, £250 million in aggregate of the PIK notes and the facility outstanding (comprising principal and capitalised interest) was assigned to Phoenix Group Holdings in exchange for the issue of 1.5 million ‘B‘ ordinary shares and 12.36 million warrants. Interest accrues on the PIK notes and facility at LIBOR plus a margin of 2% unless an election is made by PGH (MC1) Limited or PGH (MC2) Limited to capitalise the interest, in which case the margin increases to 3.5%. During 2010, interest of £4 million (2009: £2 million) was capitalised on the PIK notes and facility. The final maturity date on the PIK notes and facility is 30 June 2019.

(k) On 15 November 2006, PGH (LCA) Limited and PGH (LCB) Limited jointly became a party to a £905 million loan facility from a syndicate of external banks (the ‘Pearl Facility‘). On 2 September 2009, this facility was restructured as follows:

- £75 million of the existing facility was converted into two tranches of £37.5 million each of secured C loan notes repayable after 15 years and attracting interest at LIBOR plus a margin of 1.00%;
- £325 million of the existing facility was assigned to Phoenix Group Holdings from the lending banks for consideration of £75 million, with a maturity date of 30 June 2016, attracting interest at LIBOR plus a margin of 1.25%; and
- the terms of the remaining £425 million outstanding under the existing facility were amended and the facility is repayable over the period from 30 June 2011 to 30 June 2016, attracting interest at LIBOR plus a margin of 1.25%.

The borrowings under the £425 million facility are secured by first fixed and floating charges over all of the assets and undertakings of PGH (LCA) Limited and PGH (LCB) Limited (including their respective 50% shareholdings in Phoenix Life Holdings Limited (‘PLHL’), all real estate, book debts, bank accounts, investments and other assets).

During the year, interest of £2 million was capitalised on the £75 million secured loan note.

23. Deposits received from reinsurers

	2010 £m	2009 £m
Carrying value and fair value:		
At 31 December	**419**	431
Amount due for settlement after 12 months	**384**	394

In addition to receiving the cash collateral set out above, it is also the Group's practice to obtain collateral in the form of marketable securities. This collateral is held on behalf of the Group and is not recognised in the statement of consolidated financial position as either an asset or an associated liability. The total value of the collateral held under such arrangements in respect of reinsurance treaties was £1,898 million (2009: £1,846 million).

24. Derivatives

The Group purchases derivative financial instruments in connection with the management of its insurance contract and investment contract liabilities based on the principles of reduction of risk and efficient portfolio management.

The fair values of derivative financial instruments are as follows:

	Assets 2010 £m	Liabilities 2010 £m	Assets 2009 £m	Liabilities 2009 £m
Warrants over shares in Phoenix Group Holdings	**-**	**5**	-	23
Forward currency	**641**	**692**	189	181
Credit default options	**3**	**11**	4	29
Interest rate swaps	**1,991**	**1,685**	1,683	1,430
Swaptions	**241**	**-**	285	-
Inflation swaps	**26**	**2**	20	2
Total return bond swaps	**73**	**24**	27	-
Equity options	**186**	**-**	191	-
Stock index futures	**36**	**12**	1,141	1,177
	3,197	**2,431**	3,540	2,842

The amount recoverable after one year is £2,247 million (2009: £2,143 million). The amount payable after one year is £1,517 million (2009: £1,394 million).

It is the Group's practice to obtain collateral to mitigate the counterparty risk related to derivative transactions, usually in the form of cash or marketable securities.

Where the Group receives collateral in the form of marketable securities which it is not permitted to sell or re-pledge except in the case of default, it is not recognised in the statement of financial position. The fair value of financial assets accepted as collateral but not recognised in the statement of financial position amounts to £313 million (2009: £188 million).

Where the Group receives collateral on derivatives in the form of cash it is recognised in the statement of financial position along with a corresponding liability to repay the amount of the collateral received, disclosed as 'Obligations for the repayment of collateral received'. The amount recognised as a financial asset and a financial liability at 31 December 2010 is £818 million (2009: £1,041 million) and £821m (2009: £1,099 million) respectively.

Where the Group pledges collateral in the form of cash or marketable securities and retains all the risks and rewards of the transferred assets, they continue to be recognised in the statement of financial position. The value of assets pledged at 31 December 2010 amounted to £500 million (2009: £455 million).

Warrants over shares

On 1 January 2009, the Company had in issue 15 million Founders' warrants and 60 million IPO warrants. On 2 September 2009 12.36 million warrants were issued to Royal London and 5 million were issued to the Lenders. The table below shows a reconciliation of the outstanding number of these warrants:

2010

	IPO warrants Number	**Founders' warrants Number**	**Lenders' warrants Number**	**Royal London warrants Number**
At 1 January	**8,169,868**	**7,468,200**	**5,000,000**	**12,360,000**
Conversion of Founders' warrants into new ordinary shares (January 2010)	**-**	**(7,468,200)**	**-**	**-**
At 31 December	**8,169,868**	**-**	**5,000,000**	**12,360,000**

2009

	IPO warrants Number	Founders' warrants Number	Lenders warrants Number	Royal London warrants Number
At 1 January	60,000,000	15,000,000	-	-
Forfeiture of Founders' warrants and shares (2 September 2009)	-	(63,600)	-	-
Conversion of 50% of outstanding warrants into ordinary shares (2 September 2009)	(30,000,000)	(7,468,200)	-	-
Issue of warrants to Royal London and Lenders (2 September 2009)	-	-	5,000,000	12,360,000
Conversion of IPO warrants into new ordinary shares (31 December 2009)	(21,830,132)	-	-	-
At 31 December	8,169,868	7,468,200	5,000,000	12,360,000

IPO and Founders' warrants

The IPO and Founders' warrants originally entitled the holder to purchase one ordinary share at a price of €7.00 per share, subject to adjustment, at any time commencing on the consummation of a business combination. On 2 September 2009 the exercise price was increased to €11 and on 15 October 2010, following an issue of ordinary shares by the Company under a scrip dividend, the terms of the IPO warrants were amended to entitle the holder to purchase 1.009507 ordinary shares per IPO warrant and the exercise price was reduced to €10.90.

During January 2010, the remaining Founders’ warrants in issue were converted into ordinary shares. On 5 July 2010, the IPO warrants were admitted to trading on the London Stock Exchange. The IPO warrants were subsequently delisted from Euronext on 17 November 2010.

The exercise period for both the IPO and Founders’ warrants commenced on the later of:

- consummation by the Company of a business combination; and
- first anniversary of the date the units were admitted to trading on Euronext.

The warrants will expire at the close of trading on the London Stock Exchange on the first business day after 6 February 2013 or earlier upon redemption or liquidation. Once the warrants become exercisable, the Company may call the warrants for redemption:

- in whole but not in part;
- at a price of €0.01 per warrant;
- upon not less than 30 days’ prior written notice of redemption to each warrant holder; and
- if, and only if, the reported last sale price of the share equals or exceeds €13.75 per share for any 20 trading days within a period of 30 consecutive trading days ending on the third business day prior to the notice of redemption to warrant holders. On 2 September 2009 the threshold of €13.75 was increased to €16.50 and was subsequently amended to €16.34 on 15 October 2010.

If the foregoing conditions are satisfied and the Company issues notice of redemption of the warrants, each warrant holder shall be entitled to exercise their warrant prior to the scheduled redemption date. However, the price of the shares may fall below the redemption trigger price or the warrant exercise price after the redemption notice is issued.

If the Company calls the warrants for redemption as described above, it will have the option to require any holder that wishes to exercise its warrant to do so on a cashless basis.

The IPO warrants are listed and were previously valued using the warrant price quoted on the London Stock Exchange for the Company. Due to the relatively low number of IPO warrants in issue, they are thinly traded and the quoted price is not considered to be the best indicator of their fair value. As a result the IPO warrants have been valued using an extended Black-Scholes valuation model. The key assumptions used to ascertain a value as at 31 December 2010 are as follows:

- share price as at 31 December 2010 of £6.11;
- volatility of 30%;
- the warrants are not adjusted for dividends; and
- the valuation incorporates the impact of amending some of the terms of the warrants on 15 October 2010.

At 31 December 2010 the Founders’ warrants were valued at £nil million (2009: £7 million) and the IPO warrants were valued at £2 million (2009: £8 million).

Lenders’ warrants

On 2 September 2009, the Company issued 5 million warrants over its shares to the Lenders. These warrants entitled the holder to purchase one ‘B’ ordinary share at a price of £15 per share, subject to adjustment. Following the achievement of the Company’s Premium Listing on 5 July 2010, the Lenders’ warrants relate to ordinary shares rather than ‘B’ ordinary shares. On 15 October 2010, following an issue of ordinary shares by the Company under a scrip dividend, the terms of the warrants were amended to entitle the holder to purchase 1.009507 ordinary shares per warrant.

The exercise period terminates on the first to occur of:

- 15th anniversary of the date issued;
- date fixed for the redemption of the warrants; and
- liquidation of the Company.

All outstanding Lenders' warrants may be redeemed at the option of the Company at any time after they become exercisable and prior to their expiration at a price of €0.01 per warrant provided that the last closing bid price of the ordinary shares is equal to or exceeds £19.50 on each of 20 consecutive trading days. On 15 October 2010, this threshold of £19.50 was amended to £19.32. The Company must give not less than 30 days notice of the redemption date. Each warrant may then be exercised by the warrant holder (in whole or any part) at its option.

The holders are entitled to exercise their warrants for cash, assignment of an amount of outstanding principal/accrued interest of any Global Debt (i.e. any debt owed to the registered holder by any Group company) or on a cashless basis where the Company redeems the warrants. Any warrant either not exercised or tendered back to the Company by the redemption date shall be cancelled on the books of the Company and have no further value except for the €0.01 redemption price.

These Lenders' warrants are not traded in an active market and have therefore been valued using an extended Black-Scholes valuation model to capture the embedded barrier feature. The key assumptions used to ascertain a value are the same as for the IPO warrants (see above). The value of the warrants at the year end was £280,000 (2009: £2 million).

Royal London warrants

On 2 September 2009, the Company issued 12.36 million warrants (2 million transferable and 10.36 million non-transferable) over its shares to Royal London as part consideration for acquiring the benefit of £250 million of the PIK notes and facility outstanding (comprising principal and capitalised interest). These warrants entitled the holder to purchase one 'B' ordinary share at a price of €11 per share, subject to adjustment. Following the achievement of the Company's Premium Listing, the Royal London warrants relate to ordinary shares rather than 'B' ordinary shares. On 15 October 2010, following an issue of ordinary shares by the Company under a scrip dividend, the terms of the warrants were amended to entitle the holder to purchase 1.009507 ordinary shares per warrant.

The exercise period terminates on the first to occur of:

- 5th anniversary of the date issued;
- date fixed for the redemption of the warrants; and
- liquidation of the Company.

All outstanding warrants may be redeemed at the option of the Company at any time after they become exercisable and prior to their expiration at a price of €0.01 per warrant provided that the last closing bid price of the ordinary shares is equal to or exceeds €16.50 on each of 20 consecutive trading days. On 15 October 2010, this threshold of €16.50 was amended to €16.34. The Company must give not less than 30 days notice of the redemption date. Each warrant may then be exercised by the warrant holder (in whole or any part) at its option.

The holders are entitled to exercise their warrants for cash, assignment of an amount of outstanding principal plus accrued interest of any Global Debt (i.e. the PIK facility) or on a cashless basis where the Company redeems the warrants. Any warrant either not exercised or tendered back to the Company by the redemption date shall be cancelled on the books of the Company and have no further value except for the €0.01 redemption price.

The Royal London warrants are not traded in an active market and have therefore been valued using an extended Black-Scholes valuation model.

The key assumptions used to ascertain a value as at 31 December 2010 are as for the IPO warrants (see above). The value of the warrants at the year end was £3 million (2009: £6 million).

25. Obligations for repayment of collateral received

	2010 £m	2009 £m
Carrying value and fair value:		
At 31 December	**10,160**	4,106
Amount due for settlement after 12 months	**628**	1,054

26. Financial liabilities

	Carrying value		Fair value	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Financial liabilities at fair value through profit or loss:				
Designated upon initial recognition	**11,020**	9,774	**11,020**	9,774
Held for trading – derivatives	**2,431**	2,842	**2,431**	2,842
Financial liabilities measured at amortised cost	**14,373**	8,460	**14,376**	8,487
	27,824	21,076	**27,827**	21,103
Amount due for settlement after 12 months	**6,366**	6,928		

27. Provisions

2010

	Restructuring £m	Leasehold properties £m	Staff related £m	Known incidents £m	Other £m	Total £m
At 1 January	**7**	**37**	**17**	**8**	**32**	**101**
Additions in the year	**1**	**8**	**5**	**2**	**3**	**19**
Utilised during the year	**(4)**	**(6)**	**(4)**	**(8)**	**(3)**	**(25)**
Released during the year	**-**	**(2)**	**(1)**	**(1)**	**(18)**	**(22)**
At 31 December	**4**	**37**	**17**	**1**	**14**	**73**

The restructuring provision relates principally to the anticipated redundancy costs associated with the closure of the Group's Glasgow and Peterborough life operations. This provision is expected to be fully utilised within 12 months.

The leasehold properties provision has been made for amounts in respect of the excess of lease rentals and other payments on properties that are currently vacant or are expected to become vacant, over the amounts to be recovered from subletting these properties. The discount rate used ranged between 5.00% and 5.46% and it is expected that the provision will be utilised over the next 10 years.

Staff related provisions primarily relate to redundancy costs of staff that have been transferred under outsourcing contracts. This provision will be utilised over the next 2 years.

The known incidents provision was created for historical data quality, administration systems problems and process deficiencies on the policy administration, financial reconciliations and operational finance aspects of business outsourced.

Included in other provisions are litigation and onerous contract provisions.

28. Tax assets and liabilities

	2010 £m	2009 £m
Current tax receivables	**5**	44
Net deferred tax assets	**-**	81
Total tax assets	**5**	125
Current tax payables	**99**	103
Net deferred tax liabilities	**569**	776
Total tax liabilities	**668**	879

Deferred tax assets comprise

	2010 £m	2009 £m
Trading losses	**82**	28
Expenses and deferred acquisition costs carried forward	**86**	142
Provisions and other temporary differences	**20**	30
Pension scheme deficit	**21**	34
Accelerated capital allowances	**25**	24
Unpaid interest	**82**	45
Gross deferred tax assets	**316**	303
Less: offset against deferred tax liabilities	**(316)**	(222)
Net deferred tax assets	**-**	81

Deferred tax liabilities comprise

	2010 £m	2009 £m
Acquired in-force business	**670**	736
Customer relationships	**114**	123
Unrealised gains on investments	**-**	7
Surplus within the non-profit funds	**64**	96
Provisions and other temporary differences	**17**	19
Adjustment for insurance policies held with related parties in respect of the PGL Pension Scheme	**20**	17
Gross deferred tax liabilities	**885**	998
Less: offset against deferred tax assets	**(316)**	(222)
Net deferred tax liabilities	**569**	776

Movements in net deferred tax assets/(liabilities) comprise

	2010 £m	2009 £m
At 1 January	**(695)**	-
On acquisition of the Pearl businesses	**-**	(695)
Amounts credited to the income statement	**122**	31
Amounts charged/(credited) to the statement of other comprehensive income	**4**	(31)
At 31 December	**(569)**	(695)

Deferred tax has been provided on the surpluses within the non-profit funds on the assumption that all such surpluses will eventually be distributed to owners.

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

A gradual reduction in the UK corporation tax rate from 28% to 24% over the next 4 years was announced in the Emergency Budget of 22 June 2010 with a further 1% reduction being announced in the Budget of 23 March 2011. The Finance (No. 2) Act 2010 included the first of the 1% rate reductions with effect from April 2011, with further reductions to be dealt with by future legislation. The benefit to the Group’s net assets arising from the further 4% reduction of rate is estimated as £65 million in total and will be recognised as the legislation is substantively enacted.

	2010 £m	2009 £m
Deferred tax assets have not been recognised in respect of:		
Tax losses carried forward	**103**	141
Excess expenses and deferred acquisition costs carried forward	**22**	50
Provisions and other temporary differences	**7**	3
Deferred tax assets not recognised on capital losses*	**165**	210

* These can only be offset against future capital gains and have no expiry date.

29. Payables related to direct insurance contracts

	2010 £m	2009 £m
Payables related to direct insurance contracts	**713**	759
Amount due for settlement after 12 months	**40**	66

Payables relating to direct insurance contracts includes claims outstanding on general insurance and life assurance. The general insurance element amounts to £263 million (2009: £254 million).

General insurance

Due to the historic diversity of issued general insurance policies and taking into account the legal and regulatory environment for hazardous risks, it is possible that additional claims could emerge from long tail unexpired risks albeit it is not possible to predict the quantum, location or timing of such occurrences.

The estimation of the provisions for the ultimate cost of claims for asbestos and environmental pollution is subject to a range of uncertainties that is generally greater than those encountered for other classes of insurance business and as a consequence of this uncertainty the eventual costs of settlement of outstanding claims and unexpired risks can vary substantially from the estimates.

Pearl Assurance Limited

Within Pearl Assurance Limited the provision for the future claims payments has primarily been assessed in accordance with actuarial methods projecting the number and amount of claims separately. Where there is a notable exposure to long-term asbestos, pollution and health hazard liabilities, external independent actuaries provide best estimate benchmarks. An appropriate prudential margin is applied to certain lines of business as it is recognised that the estimation of certain future claims payments is an inherently uncertain exercise and future experience could be more adverse.

PA (GI) Limited

Within PA (GI) Limited the provision for outstanding general insurance claims comprises the estimated ultimate cost of settling claims notified but not settled by the period end. It includes related expenses and a deduction for the expected value of salvage and other recoveries. The provision is determined using the best information available of claims settlement patterns, forecast inflation and settlement of claims. The general insurance liabilities of PA (GI) Limited are wholly reinsured externally to RSA.

30. Accruals and deferred income

	2010 £m	2009 £m
Accruals	**214**	177
Amount due for settlement after 12 months	**9**	4

31. Other payables

	2010 £m	2009 £m
Investment broker balances	**187**	420
Other payables	**140**	230
	327	650
Amount due for settlement after 12 months	**-**	8

32. Pension schemes

The Group operates two main staff pension schemes, the Pearl Group Staff Pension Scheme and the PGL Pension Scheme.

The carrying value of the defined benefit pension schemes is set out below.

	2010 £m	2009 £m
Pearl Group Staff Pension Scheme deficit	**(77)**	(121)
PGL Pension Scheme		
Economic surplus (including £92 million available as a refund on a winding up of the scheme)	**165**	62
Provision for tax on that part of the economic surplus available as a refund on a winding up of the scheme	**(32)**	-
Net economic surplus	**133**	62
Adjustment for insurance policies held with related parties and eliminated on consolidation	**(74)**	(66)
Reported surplus/(deficit)	**59**	(4)

Information on each of these schemes is set out below.

32.1 Pearl Group Staff Pension Scheme

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.

Defined contribution scheme

Contributions in the year amounted to £2 million (period from 28 August to 31 December 2009 £1 million).

Defined benefit scheme

The defined benefit scheme is funded by payment of contributions to a separately administered trust fund. A Group company, Pearl Group Holdings (No. 2) Limited is the principal employer of the Pearl Scheme. The principal employer meets the administration expenses of the Pearl Scheme.

The valuation has been based on an assessment of the liabilities of the Pearl Scheme as at 31 December 2010, undertaken by independent qualified actuaries. Following the UK Government's announcement in the summer of 2010, the inflation index used to derive statutory pension increases (which for the Pearl Scheme applies to deferred pension benefits) has been changed from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI). Due to a number of differences between the indices, including both constituents and construction, CPI is expected to be less than RPI over the long term and thus the scheme liabilities have reduced. The reduction in the scheme liabilities has been estimated at £50 million as at 31 December 2010. This has been treated as an assumption change and recognised within actuarial gains in other comprehensive income. The present values of the defined benefit obligation and the related current service costs have been measured using the projected unit credit method.

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

	2010 **%**	2009 %
Rate of general long-term increase in salaries	**4.45**	4.50
Rate of increase for pensions in payment (5% per annum or RPI if lower)	**3.45**	3.50
Rate of increase for deferred pensions (2010: CPI, 2009: RPI)	**2.95**	3.50
Discount rate	**5.40**	5.65
Inflation – RPI	**3.45**	3.50
Inflation – CPI	**2.95**	n/a
Expected rate of return on scheme assets	**4.80**	5.10

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

The expected rate of return on scheme assets is derived after considering historical returns and assuming that asset classes with higher volatility generate higher returns (consistent with widely accepted capital market principles). The overall expected return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation.

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, performed as part of the actuarial valuation as at 30 June 2009, based on t he standard tables PMA92 for males and PFA92 for females and based on year of use. This includes medium cohort projections for future mortality improvements, subject to a minimum annual improvement of 1.25% at each age. Under these assumptions, the average life expectancy from retirement for a member currently aged 40 retiring at age 60 is 29.6 years and 31.7 years for male and female members respectively.

A triennial funding valuation of the Pearl Scheme as at 30 June 2009 was completed in June 2010. This showed a deficit on the funding basis as at 30 June 2009 of £755 million compared with the previous triennial funding valuation deficit of £383 million.

The principal employer and the Trustees of the Pearl Scheme entered into an agreement which became effective on 2 September 2009, the principal terms of which provided for the following:

- A cash payment into the scheme of £63 million in October 2009 followed by cash payments of £25 million per annum for a period of 10 years, commencing on 30 September 2010, subject to certain capital resource and other requirements being maintained. As a result of the 2009 triennial valuation, the Trustee has established the payments due between 2020 and 2027 under the 2009 agreement. These contributions are calculated from projected scheme deficits, calculated on a funding basis, as follows: £2 million payable on or before 30 June 2020, £39 million payable on or before 30 June 2021; £35 million payable on or before each of 30 June 2022, 30 June 2023 and 30 June 2024, and £41 million payable on each of 30 June 2025, 30 June 2026 and 30 June 2027. The amounts payable on and from 30 June 2021 may alter in the light of any funding shortfall disclosed as at the triennial funding valuation immediately preceding their date of payment.
- The Trustees being granted a first charge over shares in Pearl Assurance Limited, National Provident Life Limited, London Life Limited, Pearl Group Services Limited and PGS 2 Limited to secure an amount not exceeding 60% of the deficit arising on the triennial scheme valuation (as calculated in accordance with the terms of the agreement), subject to an initial amount and a maximum of £600 million, such security ceasing on a scheme buy out, the principal employer discharging its liabilities under the agreement or upon a valuation of the

scheme demonstrating there is no funding deficit if earlier. Enforcement of the security may take place on the occurrence of various events, the main ones being (i) a failure by the principal employer to pay agreed cash contributions to the scheme, (ii) an insolvency or other similar financial difficulties of the principal employer, (iii) except in certain defined circumstances, payments of interest or principal to the principal employer's lenders or of dividends to the principal employer's owners being made at a time when the principal employer has failed to maintain an embedded value of at least 1.3 times the amount secured, (iv) the principal employer failing to maintain an embedded value of at least 1.05 times the amount secured or (v) the principal employer granting certain types of security over its assets. NP Life Holdings Limited has also granted a limited recourse share charge over the shares it holds in National Provident Life Limited in favour of the Trustee in respect of the principal employer's obligation under this agreement. This security is granted on substantially the same terms as the security granted by the principal employer.

The amounts recognised in the income statement are as follows:

	2010 £m	2009 £m
Current service cost	**(1)**	-
Interest cost	**(100)**	(32)
Expected return on scheme assets	**82**	27
	(19)	(5)

The net actuarial gains recognised in other comprehensive income comprise the following:

	2010 £m	2009 £m
Actual return less expected return on scheme assets	**19**	36
Experience gains arising on scheme liabilities	**70**	58
Loss due to changes in assumptions underlying scheme liabilities	**(51)**	(65)
	38	29

The cumulative net actuarial gains recognised in other comprehensive income since 28 August 2009 amount to £67 million (2009: £29 million).

The deficit recognised in the statement of financial position is as follows:

	2010 £m	2009 £m
Fair value of scheme assets	**1,725**	1,684
Present value of defined benefit obligation	**(1,802)**	(1,805)
	(77)	(121)

The actual return on the scheme assets comprises the following:

	2010 £m	2009 £m
Expected return on scheme assets	**82**	27
Actual return less expected return on scheme assets	**19**	36
	101	63

The change in the present value of the defined benefit obligation is as follows:

	2010 £m	2009 £m
At 1 January	**1,805**	-
On acquisition of the Pearl businesses	**-**	1,791
Current service cost	**1**	-
Interest cost	**100**	32
Actuarial (gains)/losses	**(19)**	7
Benefits paid	**(85)**	(25)
At 31 December	**1,802**	1,805

The defined benefit obligation arises from plans that are wholly or partly funded.

The change in the fair value of the scheme assets is as follows:

	2010 £m	2009 £m
At 1 January	**1,684**	-
On acquisition of the Pearl businesses	**-**	1,583
Expected return on scheme assets	**82**	27
Actual return less expected return on scheme assets	**19**	36
Contributions by the employer	**25**	63
Benefits paid	**(85)**	(25)
At 31 December	**1,725**	1,684

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

	2010 £m	2009 £m
Equities	**203**	318
Bonds	**1,228**	1,215
Properties	**119**	63
Cash and other	**175**	88
	1,725	1,684

Contributions totalling £25 million are expected to be paid into the scheme in 2011 in accordance with the agreement with the Trustee of the Pearl Scheme.

Table of historical information:

	2010 £m	2009 £m
Fair value of scheme assets	**1,725**	1,684
Defined benefit obligation	**(1,802)**	(1,805)
	(77)	(121)
Experience gains on scheme assets	**19**	36
Experience gains on scheme liabilities	**70**	58

32.2 PGL Pension Scheme

The PGL Pension Scheme comprises a final salary section and a defined contribution section.

Defined contribution scheme

Contributions in the year amounted to £4 million (period from 28 August 2009 to 31 December 2009 £1 million).

Defined benefit scheme

The defined benefit section of the PGL Scheme is a final salary arrangement which is generally closed to new entrants.

The valuation has been based on an assessment of the liabilities of the PGL Scheme as at 31 December 2010, undertaken by independent qualified actuaries. Following the UK Government's announcement in the summer of 2010, the inflation index used to derive statutory pension increases (which for the PGL Scheme applies to deferred pension benefits) has been changed from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI). Due to a number of differences between the indices, including both constituents and construction, CPI is expected to be less than RPI over the long term and thus the scheme liabilities have reduced. The reduction in the scheme liabilities has been estimated at £16 million as at 31 December 2010; this has been treated as an assumption change and recognised within actuarial gains in other comprehensive income.

The present values of the defined benefit obligation and the related current service costs have been measured using the projected unit credit method.

A triennial funding valuation of the PGL Scheme as at 30 June 2009 was completed in September 2010. This showed a deficit on the funding basis as at 30 June 2009 of £255 million compares with the previous triennial funding valuation deficit of £69 million. Following discussions with the Trustee of the PGL Scheme it was agreed that new cash contributions to the scheme amounting to £159.5 million would be paid over the period from September 2010 to August 2017.

Together with the outstanding contributions of £28 million due to the scheme as at the end of August 2010 following the previous triennial valuation, this totalled £187 million, of which it was agreed that £50 million would be paid in 2010, £30 million in each of 2011 and 2012, £23 million in 2013, £15 million in each of 2014, 2015 and 2016 and £10 million in 2017. Contributions of £10 million were made to the scheme in the period up to the end of August 2010 and a further £50 million was contributed as described above, giving a total contribution for the year of £60 million.

In accordance with an agreement dated November 2005, certain of the Group's with-profit funds have indemnified the Group's owners in respect of contribution calls equal to their share of the costs of changes in longevity assumptions. Completion of the triennial valuation has resulted in a recovery from the with-profit funds of £37 million, together with interest, in respect of the balance due in relation to the cost of changes in longevity assumptions determined by the previous triennial valuation. Accordingly a contribution in respect of actuarial losses has been made by the with-profit funds of this amount, less tax, resulting in £27 million being recognised in the consolidated statement of comprehensive income.

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

	2010 %	2009 %
Rate of general long-term increase in salaries	**4.45**	4.60
Rate of increase for pensions in payment	**3.30**	3.50
Rate of increase for deferred pensions (2010: CPI, 2009: RPI)	**2.95**	3.60
Discount rate	**5.40**	5.70
Inflation – RPI	**3.45**	3.60
Inflation – CPI	**2.95**	n/a
Expected rate of return on scheme assets	**5.10**	5.40

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

The expected rate of return on scheme assets is derived after considering historical returns and assuming that asset classes with higher volatility generate higher returns (consistent with widely accepted capital market principles). The overall expected return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation.

It has been assumed that post retirement mortality is in line with standard tables PNA00 with a scaling factor of 105% being applied, allowing for future improvements in line with the long cohort improvement factors, subject to a minimum improvement from 2007 onwards of 1.25% p.a. and 0.75% p.a. for males and females respectively. Under these assumptions, the average life expectancy from retirement for a member currently aged 40 retiring at age 60 is 31.2 years and 32.3 years for male and female members respectively. The average life expectancy from retirement for a member currently aged 60 retiring at age 60 is 28.5 years and 30.6 years for male and female members respectively.

The economic value of the PGL Scheme assets as at 31 December 2010 amounted to £1,326 million (2009: £1,192 million) and the economic value of the surplus amounted to £133 million (2009: £62 million). For financial reporting purposes the carrying value of the insurance policies effected by the PGL Scheme with the Group amounting to £74 million (2009: £66 million) has been eliminated on consolidation, resulting in reported assets of the PGL Scheme as at 31 December 2010 of £1,252 million (2009: £1,126 million) and a reported surplus of £59 million (2009: deficit of £4 million).

The amounts recognised in the income statement are as follows:

	2010 £m	2009 £m
Current service cost	**(4)**	(2)
Interest cost	**(63)**	(21)
Expected return on scheme assets	**63**	17
	(4)	(6)

The net actuarial gains recognised in other comprehensive income comprise the following:

	2010 £m	2009 £m
Actual return less expected return on scheme assets	**81**	23
Experience (loss)/gain arising on scheme liabilities	**(23)**	18
(Loss)/gain due to changes in assumptions underlying scheme liabilities	**(19)**	35
	39	76
Change in provision for tax on the economic surplus available as a refund	**(32)**	-
	7	76

The cumulative net actuarial gains recognised in other comprehensive income since 28 August 2009 amounted to £83 million (2009: £76 million).

The surplus/(deficit) recognised in the statement of financial position is as follows:

	2010 £m	2009 £m
Fair value of scheme assets	**1,252**	1,126
Present value of defined benefit obligation	**(1,193)**	(1,130)
	59	(4)

The actual return on the scheme assets comprises the following:

	2010 £m	2009 £m
Expected return on scheme assets	**63**	17
Actual return less expected return on scheme assets	**81**	23
	144	40

The change in the present value of the defined benefit obligation is as follows:

	2010 £m	2009 £m
At 1 January	**1,130**	-
On acquisition of the Pearl businesses	**-**	1,176
Current service cost	**4**	2
Interest cost	**63**	21
Actuarial losses/(gains)	**42**	(53)
Benefits paid	**(46)**	(16)
At 31 December	**1,193**	1,130

The defined benefit obligation arises from plans that are wholly or partly funded.

The change in the fair value of the scheme assets is as follows:

	2010 £m	2009 £m
At 1 January	**1,126**	-
On acquisition of the Pearl businesses	**-**	1,096
Expected return on scheme assets	**63**	17
Actual return less expected return on scheme assets	**81**	23
Provision for tax on the economic surplus available as a refund	**(32)**	-
Contributions by the employer	**60**	6
Benefits paid	**(46)**	(16)
At 31 December	**1,252**	1,126

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

	2010 £m	2009 £m
Bonds	**1,128**	995
Properties	**123**	110
Cash and other	**33**	21
Provision for tax on the economic surplus available as a refund	**(32)**	-
	1,252	1,126

Contributions totalling £30 million are expected to be paid into the scheme in 2011.

Table of historical information:

	2010 £m	2009 £m
Fair value of scheme assets	**1,252**	1,126
Defined benefit obligation	**(1,193)**	(1,130)
Surplus/(deficit)	**59**	(4)
Experience gains on scheme assets	**81**	23
Experience (losses)/gains on scheme liabilities	**(23)**	18

33. Intangible assets

2010

	Goodwill £m	Acquired in-force business £m	Customer relations hips £m	Present value of future profits £m	Total £m
Cost or valuation					
At 1 January	**77**	**2,213**	**445**	**35**	**2,770**
Revaluation	**-**	**-**	**-**	**7**	**7**
At 31 December	**77**	**2,213**	**445**	**42**	**2,777**
Amortisation					
At 1 January	**-**	**50**	**7**	**-**	**57**
Charge for the year	**-**	**147**	**18**	**-**	**165**
At 31 December	**-**	**197**	**25**	**-**	**222**
Carrying amount					
At 31 December	**77**	**2,016**	**420**	**42**	**2,555**
Amount recoverable after 12 months	**77**	**1,881**	**402**	**42**	**2,402**

2009

	Goodwill £m	Acquired in-force business £m	Customer relations hips £m	Present value of future profits £m	Total £m
Cost or valuation					
At 1 January					
On acquisition of the Pearl businesses	77	2,213	445	31	2,766
Revaluation	-	-	-	4	4
At 31 December	77	2,213	445	35	2,770
Amortisation					
At 1 January	-	-	-	-	-
Charge for the year	-	50	7	-	57
At 31 December	-	50	7	-	57
Carrying amount					
At 31 December	77	2,163	438	35	2,713
Amount recoverable after 12 months	77	1,992	420	35	2,524

Goodwill

Goodwill of £77 million was created upon the acquisition of the Pearl businesses and is not amortised. The carrying value of goodwill has been tested for impairment at the period end. No impairment has resulted as the value in use of this intangible continues to exceed its carrying value. Value in use has been determined as the present value of certain future cash flows associated with the IGNIS Asset Management business and the management services business of the Phoenix Life segment. The cash flows used in this calculation are consistent with those adopted by management in the Group's operating plan and for the period 2014 and beyond, reflect the anticipated run-off of the Phoenix Life insurance business. Future cash flows have been valued using a discount rate of 9.5% (2009: 10.0%).

The carrying amount of goodwill allocated to the Phoenix Life segment is £39 million (2009: £39 million) and to the IGNIS Asset Management segment is £38 million (2009: £38 million).

Acquired in-force business

Acquired in-force business of £2,213 million was recognised upon the acquisition of the Pearl businesses and represents the difference between the fair value of the contractual rights acquired and obligations assumed under insurance and investment contracts with and without DPF and the liability measured in accordance with the Group's accounting policies for such contracts.

The acquired in-force business is allocated to the Phoenix Life segment.

Customer relationships

The customer relationships intangible includes an intangible representing vesting pension premiums which captures the new business arising from policies in-force at the acquisition date, specifically top-ups made to existing policies and annuities vested from matured pension policies. The total value of this customer relationship intangible at acquisition was £297 million and has been allocated to the Phoenix Life segment. This intangible is being amortised over a 20 year period.

The second part of the customer relationships intangible relates to the investment management contracts ('IMCs') held within IGNIS Asset Management. These are further split into IMCs held with open ended funds and institutional mandates. The open ended IMCs had a value at acquisition of £130 million and an indefinite useful economic life ('UEL'). The reason for the indefinite UEL is that funds are open ended and indefinite in nature. An impairment review has been completed for these intangibles at the period end with an indefinite life and no impairment has arisen. Under this impairment review, value in use has been determined as the present value of future cash flows associated with the open-ended IMCs. The cash flows used in this calculation are consistent with those adopted by management in the Group's operating plan with a declining growth rate assumed for the extended forecast period beyond the period of this plan and a terminal value applied at the year where growth stabilises to 2% per annum. Future cash flows have been valued using a discount rate of 9.6% (2009: 11.4%). The institutional mandate IMCs had a value at acquisition of £18 million and a UEL of between 5 and 7 years.

These investment management contract customer relationships have been allocated to the IGNIS Asset Management segment.

The amortisation charge for customer relationships is presented separately in the consolidated income statement.

PVFP on non-participating business in the with-profit fund

The value of the PVFP is determined in accordance with the FSA's realistic capital regime and is allocated in full to the Phoenix Life segment. The principal assumptions used to calculate the PVFP are the same as those used in calculating the insurance contract liabilities given in note 43.5.1.

During the year £7 million (2009: £4 million) of PVFP was credited directly to the consolidated income statement.

34. Property, plant and equipment

	2010 **£m**	2009 £m
Cost or valuation		
At 1 January	**36**	-
On acquisition of the Pearl businesses	**-**	35
Additions	**3**	1
At 31 December	**39**	36
Depreciation		
At 1 January	**(2)**	-
Charge for the year	**(3)**	(2)
At 31 December	**(5)**	(2)
Carrying amount		
At 31 December	**34**	34

The useful lives of plant and equipment have been taken as follows: motor vehicles 3–4 years, computer equipment 3–4 years, furniture and office equipment 5–10 years.

The valuation of land and buildings is carried out at least every three years as at 31 December by external surveyors in accordance with the Royal Institution of Chartered Surveyors' requirements under an open market valuation basis. The latest valuation was undertaken on 31 December 2009.

35. Investment property

	2010 **£m**	2009 £m
At 1 January	**1,915**	-
On acquisition of the Pearl businesses	**-**	1,807
Additions	**139**	189
Improvements	**12**	5
Disposals	**(421)**	(245)
Gains on adjustments to fair value	**87**	159
At 31 December	**1,732**	1,915

Investment property is stated at fair value and is independently valued in accordance with the Royal Institute of Chartered Surveyors' guidelines on the basis of the open market value of such properties.

Investment properties include £235 million (2009: £252 million) property reversions arising from sales of the NPI Extra Income Plan. The reversionary interest is valued as the NPI and NPLL proportion of the current market value, projected for the lifetime of the policyholder at the assumed future increase in house prices, then discounted back by the valuation rate of interest.

Direct operating expenses (included within administrative expenses) in respect of investment properties that generated rental income during the year amounted to £2 million (2009: £8 million). The direct operating expenses arising from investment property that did not generate rental income during the year amounted to £2 million (2009: £3 million).

36. Financial assets

	2010 £m	2009 £m
Loans and receivables at amortised cost	**2,293**	1,081
Financial assets at fair value through profit or loss		
Held for trading – derivatives	**3,197**	3,540
Designated upon initial recognition		
Equities	**12,460**	13,151
Fixed and variable rate income securities	**40,899**	37,658
Collective investment schemes	**7,144**	6,094
	65,993	61,524
Amount recoverable after 12 months	**39,758**	39,822

The fair value of loans and receivables at amortised cost amounted to £2,320 million (2009: £1,074 million).

37. Financial instrument fair value hierarchy

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

Level 1 financial instruments.

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

Level 2 financial instruments.

The fair values of investments that are not traded in an active market are determined using valuation techniques with observable market inputs. The fair value of shares and other variable yield securities and of derivative financial instruments, are estimated using pricing models, discounted cash flow techniques or broker quotes. 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 management's best estimates and the discount rate used is a market related rate for a similar instrument.

Level 3 financial instruments.

The Group's financial assets determined by valuation techniques using non-observable inputs are based on a combination of independent third party evidence and internally developed models. Third party evidence in the form of net asset valuation statements, are used in the valuation of the majority of indirect property, private equity and hedge funds. Broker quotes are received for certain bonds where the market is considered to be inactive. Internally developed models have been used in the valuation of a small number of investment vehicles which due to their nature and complexity have no external market. Inputs into the internally developed models are based on market observable data where available.

37.2 Fair value hierarchy of financial instruments measured at fair value

2010

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets at fair value				
Derivatives	24	3,084	89	3,197
Financial assets designated at fair value through profit or loss upon initial recognition				
Equities	11,667	-	793	12,460
Fixed and variable rate income securities	34,336	5,816	747	40,899
Collective investment schemes	5,786	1,042	316	7,144
	51,789	6,858	1,856	60,503
Total financial assets at fair value	51,813	9,942	1,945	63,700

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial liabilities at fair value				
Derivatives	1	2,419	11	2,431
Financial liabilities designated at fair value through profit or loss upon initial recognition				
Investment contract liabilities	-	8,849	-	8,849
Borrowings	-	234	-	234
Net asset value attributable to unit holders	1,769	-	168	1,937
	1,769	9,083	168	11,020
Total financial liabilities at fair value	1,770	11,502	179	13,451

2009

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets at fair value				
Derivatives	1,312	2,228	-	3,540
Financial assets designated at fair value through profit or loss upon initial recognition				
Equities	11,012	645	1,494	13,151
Fixed and variable rate income securities	33,672	3,167	819	37,658
Collective investment schemes	5,859	-	235	6,094
	50,543	3,812	2,548	56,903
Total financial assets at fair value	51,855	6,040	2,548	60,443

	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial liabilities at fair value				
Derivatives	1,297	1,545	-	2,842
Financial liabilities designated at fair value through profit or loss upon initial recognition				
Investment contract liabilities	-	8,570	-	8,570
Borrowings	-	258	-	258
Net asset value attributable to unit holders	792	-	154	946
	792	8,828	154	9,774
Total financial liabilities at fair value	2,089	10,373	154	12,616

37.3 Level 3 financial instrument sensitivities

Included in Level 3 investments are two property investment structures with a value of £96 million (2009: £106 million) and £117 million (2009: £110 million) respectively.

The first of these investments has been independently valued using a multi scenario discounted cash flow model. Under the optimistic scenario, the fair value of the investment would increase by £36 million (2009: £18 million) and in the worst case scenario the fair value would decrease by £63 million (2009: £8 million).

The second investment has been valued by taking the fair value of the property within the structure, which has been independently valued, less the fair value of the debt within the structure. The valuation is sensitive to movements in yields on the underlying property portfolio. An increase in yields of 25bps would reduce the value of the investment by £23 million (2009: £19 million) and a reduction in yields of 25bps would increase the value by £25 million (2009: £21 million).

Level 3 investments in indirect property, private equity and hedge funds are valued using net asset statements provided by independent third parties and therefore no sensitivity analysis has been prepared.

Debt securities categorised as Level 3 investments are valued using broker quotes. Although such valuations are sensitive to estimates, it is believed that changing one or more of the assumptions to reasonably possible alternative assumptions would not change the fair value significantly.

37.4 Significant transfers of financial instruments between Level 1 and Level 2

2010

	From Level 1 to Level 2 £m	**From Level 2 to Level 1 £m**
Financial assets at fair value		
Derivatives	**-**	**-**
Financial assets designated at fair value through profit or loss upon initial recognition		
Equities	**-**	**-**
Fixed and variable rate income securities	**96**	**573**
Collective investment schemes	**-**	**-**
	96	**573**

There were no transfers of financial liabilities at fair value between Level 1 and Level 2 and between Level 2 and Level 1.

2009

	From Level 1 to Level 2 £m	From Level 2 to Level 1 £m
Financial assets at fair value		
Derivatives	-	-
Financial assets designated at fair value through profit or loss upon initial recognition		
Equities	-	-
Fixed and variable rate income securities	226	334
Collective investment schemes	-	-
	226	334
Financial liabilities at fair value		
Derivatives	9	-
Financial liabilities designated at fair value through profit or loss upon initial recognition		
Investment contract liabilities	-	-
Borrowings	-	-
Net asset value attributable to unit holders	-	-
	9	-

The Group continued to see an improvement in the liquidity of the fixed and variable rate securities market throughout 2010 and 2009, which has resulted in a number of securities moving from Level 2 into Level 1. There were however, a number of securities that moved from Level 1 to Level 2 as a result of a downgrading in their credit rating. These securities were mainly in the financial sector with issuers such as banks and insurance companies.

37.5 Movement in Level 3 financial instruments measured at fair value

2010

	At 1 January 2010 £m	Total gains/ (losses) in income statement £m	Purchases and sales £m	Transfers (to)/ from Level 1 and Level 2 £m	At 31 December 2010 £m	Unrealised gains/(losses) on assets held at end of year £m
Financial assets						
Derivative assets	**-**	**(22)**	**111**	**-**	**89**	**(202)**
Financial assets designated at fair value through profit or loss upon initial recognition						
Equities	**1,494**	**64**	**(766)**	**1**	**793**	**19**
Fixed and variable rate income securities	**819**	**(43)**	**32**	**(61)**	**747**	**150**
Collective investment schemes	**235**	**97**	**152**	**(168)**	**316**	**214**
	2,548	**118**	**(582)**	**(228)**	**1,856**	**383**
Total financial assets	**2,548**	**96**	**(471)**	**(228)**	**1,945**	**181**

	At 1 January 2010 £m	Total gains in income statement £m	Purchases and sales £m	Transfers from Level 1 and Level 2 £m	At 31 December 2010 £m	Unrealised gains on liabilities held at end of year £m
Financial liabilities						
Derivative liabilities	-	(5)	-	16	11	11
Financial liabilities designated at fair value through profit or loss upon initial recognition						
Net asset value attributable to unitholders	154	14	-	-	168	43
Total financial liabilities	154	9	-	16	179	54

2009

	At 1 January 2009 £m	Arising on acquisition of the Pearl businesses £m	Total gains / (losses) in income statement £m	Purchases and sales £m	Transfers (to)/ from Level 1 and Level 2 £m	At 31 December 2009 £m	Unrealised gains/(losses) on assets held at end of year £m
Financial assets designated at fair value through profit or loss upon initial recognition							
Equities	-	1,513	2	(25)	4	1,494	29
Fixed and variable rate income securities	-	839	(18)	80	(82)	819	(18)
Collective investment schemes	-	259	40	(64)	-	235	37
	-	2,611	24	(9)	(78)	2,548	48

	At 1 January 2009 £m	Arising on acquisition of the Pearl businesses £m	Total gains in income statement £m	Purchases and sales £m	Transfers from Level 1 and Level 2 £m	At 31 December 2009 £m	Unrealised gains on liabilities held at end of year £m
Financial liabilities designated at fair value through profit or loss upon initial recognition							
Net asset value attributable to unitholders	-	170	8	(24)	-	154	29

Gains and losses on Level 3 financial instruments are included in net investment income in the consolidated income statement. There were no gains or losses recognised in other comprehensive income.

Level 3 financial instruments are transferred to Level 1 or Level 2 as and when the conditions of each Level are met. During 2010 the Group has seen an increase in observable inputs leading to a reduction in Level 3 financial instruments.

38. Stock lending

The Group lends listed financial assets held in its investment portfolio to other institutions. The Group conducts its stock lending programme only with well-established, reputable institutions in accordance with established market conventions.

The financial assets do not qualify for derecognition as the Group retains all the risks and rewards of the transferred assets except for the voting rights. The carrying value of listed financial assets lent at 31 December 2010 that have not been derecognised amounted to equities of £nil (2009: £398 million) and fixed and variable rate income securities of £9,994 million (2009: £8,214 million).

It is the Group's practice to obtain collateral in stock lending transactions, usually in the form of cash or marketable securities.

Where the Group receives collateral in the form of marketable securities which it is not permitted to sell or re-pledge except in the case of default, such collateral is not recognised in the statement of consolidated financial position. The fair value of financial assets accepted as such collateral amounts to £648 million (2009: £5,135 million).

Where the Group receives collateral in the form of cash it is recognised in the statement of consolidated financial position along with a corresponding liability to repay the amount of the collateral received. The amount recognised as a financial asset and a financial liability at 31 December 2010 is £9,222 million (2009: £2,780 million) and £9,339 million (2009: £3,007 million) respectively.

39. Other receivables

	2010 £m	2009 £m
Investment broker balances	**69**	550
Other debtors	**105**	231
	174	781
Amount recoverable after 12 months	**-**	-

40. Cash and cash equivalents

	2010 £m	2009 £m
Bank and cash balances	**2,101**	2,223
Short-term deposits (including demand and time deposits)	**7,087**	3,858
	9,188	6,081

All deposits are subject to fixed interest rates. The carrying amounts approximate to fair value at the period end. Cash and cash equivalents in long-term business operations and collective investment schemes of £8,545 million (2009: £5,551 million) are primarily held for the benefit of policyholders and so are not generally available for use by the owners.

41. Cash flows

41.1 Cash flows from operating activities

	2010 £m	2009 £m
Profit for the year before tax	**11**	91
Non-cash movements in profit for the year before tax		
Fair value (gains)/losses on:		
Investment property	**(87)**	(159)
Financial assets	**(3,324)**	354
Unrealised gains on:		
Borrowings	**12**	32
Depreciation of property, plant and equipment	**3**	2
Amortisation of intangible assets	**165**	57
Change in present value of future profit	**(7)**	(4)
Change in unallocated surplus	**143**	175
Change in deposits received from reinsurers	**(12)**	(25)
Interest income on trust account	**-**	(2)
Share-based payment (income)/charge	**(3)**	5
Interest expense on borrowings	**269**	87
Net expected return on pension assets	**18**	9
Foreign currency exchange gains	**(10)**	(1)
(Increase)/decrease in investment assets	**(1,308)**	487
Increase in reinsurance assets	**(69)**	(160)
Increase/(decrease) in insurance contract and investment contract liabilities	**423**	(951)
Increase/(decrease) in obligation for repayment of collateral received	**6,054**	(85)
Net decrease/(increase) in working capital	**1,114**	(269)
Cash generated/(absorbed) by operations	**3,392**	(357)

41.2 Cash flows on acquisition of the Pearl businesses

	2010 £m	2009 £m
Consideration settled in cash	**-**	-
Acquisition expenses	**-**	9
		9
Cash and cash equivalents of the Pearl businesses	**-**	(6,155)
	-	(6,146)

42. Capital statement

Capital Management Framework

The Group's Capital Management Framework is designed to achieve the following objectives:

- provide appropriate security for policyholders and meet all regulatory capital requirements whilst not retaining unnecessary excess capital;
- ensure sufficient liquidity to meet obligations to policyholders and other creditors;
- optimise the overall debt to equity ratio to ensure an efficient capital base; and
- meet the dividend expectations of owners as set by the Group's dividend policy.

The framework comprises a suite of capital management policies that govern the allocation of capital throughout the Group to achieve the framework objectives under a range of stress conditions. The policy suite is defined with reference to policyholder security, creditor obligations, owner dividend policy and regulatory capital requirements.

The capital policy of each Group holding company ensures sufficient liquidity to meet creditor obligations and dividend expectations through the combination of cash buffers and cash flows from the Group's operating companies.

The capital policy of each life company is set and monitored by each life company Board. These policies ensure there is sufficient capital within each life company to meet regulatory capital requirements under a range of stress conditions. The capital policy of each life company varies according to the risk profile and financial strength of the company.

Regulatory capital requirements

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

Pillar 1

With the exception of with-profit businesses, the regulatory capital requirement under Pillar 1 is the total amount held in respect of investment, expense and insurance risks (the 'long-term insurance capital requirement' ('LTICR')) and any additional amounts required to cover the more onerous of two specified stress tests (the 'resilience capital requirement' ('RCR')). The regulatory capital requirement is then deducted from the available capital resources to give the excess capital on a regulatory basis.

A further test is required under Pillar 1 in respect of with-profit funds which may result in an additional capital requirement referred to as the 'with-profit insurance capital component' ('WPICC').

Pillar 2

The Pillar 2 capital requirements are based on a self-assessment methodology, called the Individual Capital Assessment ('ICA'). This methodology determines the capital requirement to ensure that the life company's realistic liabilities can be met in one year's time with a 99.5% confidence level, or in other words to be able to withstand a one in 200 year event. The FSA reviews each life company's ICA and may impose additional capital requirements if necessary in the form of Individual Capital Guidance ('ICG').

Insurance Groups' Directive ('IGD')

FSA regulated insurance groups (including their holding companies) are also required to provide an assessment of capital adequacy on a Group-wide basis to enable the FSA to assess both the level of insurance and financial risk within the group and the capital resources available to cover that risk. The assessment is known as the IGD and is the Group's primary capital and solvency measure.

The Group's IGD assessment is made at the highest EEA level insurance Group holding company, which is PLHL. PLHL is a subsidiary of the Company.

Regulatory capital position statement

The purpose of the capital position statement is to set out the capital resources of the life assurance businesses of the Phoenix Life segment of the Group and to provide an analysis of the disposition and constraints over the availability of capital to meet risks and regulatory requirements. The capital position statement also provides a reconciliation of owners' funds to regulatory capital and an analysis of the regulatory capital between the Group's with-profit funds, non-participating business, life business owners' funds and its other activities.

The Group's material with-profit funds at 31 December 2010 are shown separately in the capital position statement and the less material with-profit funds are aggregated and shown as 'Other'. The with-profit funds shown separately are the Phoenix with-profit fund ('PLL PWP'), the Britannic with-profit fund ('PLL BWP'), the SMA with-profit fund ('SMA WPF'), the Scottish Provident with-profit fund ('SPL WPF') and the Pearl with-profit fund ('Pearl WPF'). The with-profit funds of London Life Limited and Phoenix & London Assurance Limited ('PALAL') are aggregated within the 'Other' column.

The Group has a number of internal loan arrangements in place, which allow the Group to provide capital support to other areas of the business. In addition to these internal loan arrangements, the Group has in place a number of internal reinsurance contracts which are structured to manage the capital position between certain life funds. For the purposes of presentation in the capital position statement, an allocation of capital is made from Phoenix Life owners' funds to non-participating and with-profit funds in respect of life assurance subsidiaries of the Phoenix Life owners' funds.

The available capital resources in each part of the business are generally subject to restrictions as to their availability to meet requirements that may arise elsewhere in the Group. The principal restrictions are:

With-profit funds – any available surplus held in each fund can only be used to meet the requirements of the fund itself or be distributed to policyholders and owners. In 90:10 with-profit funds, policyholders are entitled to at least 90% of the distributed profits while owners receive the balance. In 100:0 with-profit funds, policyholders are entitled to 100% of the distributed profits. Any distribution to the owners would be subject to a tax charge which, for some funds, would be deducted from the amount received by owners.

Non-participating funds – any available surplus held in these funds is attributable to owners. Capital within the non-participating funds may be made available to meet capital requirements elsewhere in the Group subject to meeting regulatory and legal requirements, and after consideration of the internal capital requirements of the relevant fund and company. Any transfer of surplus may give rise to a tax charge subject to availability of tax relief elsewhere in the Group.

Pearl Pacific fund – the owner attributed assets, known as the Pacific fund, are held within the surplus of the 0:100 fund of Pearl and are attributable to owners. The assets can only be released when, in the opinion of the Actuarial Function Holder and the Board, to do so would not adversely affect either the reasonable expectations of with-profit policyholders or the security of non-profit policyholders.

The capital statement and movement analysis that follows presents information about the capital resources for the Group's UK life businesses.

2010

	With-profit (see below) £m	Non-participating £m	Phoenix Life owners' funds £m	Total Phoenix Life business £m	Other activities and consolidation adjustments (note 4) £m	Group total £m
Owners' funds held outside long-term fund	-	-	2,194	2,194	(1,329)	865
Owners' funds held in long-term fund	-	715	-	715	-	715
Total owners' funds at 31 December 2010	-	715	2,194	2,909	(1,329)	1,580
Adjustments onto a regulatory basis:						
Unallocated surplus	853	11	-	864		
Adjustments to assets (note 1)	(93)	(319)	(422)	(834)		
Adjustments to liabilities (note 2)	3,526	(120)	54	3,460		
Other qualifying capital:						
Subordinated debt (note 3)	-	-	645	645		
Contingent loans	736	216	(772)	180		
Allocation of Group capital	52	206	(258)	-		
Total available capital resources at 31 December 2010	5,074	709	1,441	7,224		

With-profit

2010

	Pearl WPF £m	PLL PWP £m	PLL BWP £m	SMA WPF £m	SPL WPF £m	Other £m	Total £m

	Pearl WPF £m	PLL PWP £m	PLL BWP £m	SMA WPF £m	SPL WPF £m	Other £m	Total £m
Owners' funds held outside long-term fund	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Owners' funds held in long-term fund	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total owners' funds at 31 December 2010	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Adjustments onto a regulatory basis:							
Unallocated surplus	**294**	**153**	**273**	**34**	**62**	**37**	**853**
Adjustments to assets (note 1)	**(7)**	**(2)**	**(11)**	**-**	**(1)**	**(72)**	**(93)**
Adjustments to liabilities (note 2)	**761**	**812**	**770**	**261**	**652**	**270**	**3,526**
Other qualifying capital:							
Subordinated debt (note 3)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Contingent loans	**-**	**-**	**-**	**-**	**-**	**736**	**736**
Allocation of Group capital	**-**	**-**	**-**	**-**	**-**	**52**	**52**
Total available capital resources at 31 December 2010	**1,048**	**963**	**1,032**	**295**	**713**	**1,023**	**5,074**

Note 1: Regulatory adjustments to assets reflect adjustments to derecognise inadmissible assets such as intangibles and deferred tax assets as well as those adjustments that are necessary where asset and counterparty exposures exceed the prescribed regulatory limits.

Note 2: Regulatory adjustments to liabilities primarily reflect differences between the realistic valuation basis for the with-profit business used in calculating owners' funds on an IFRS basis, and the more prudent regulatory valuation basis used to calculate the FSA peak 1 capital resources.

Note 3: Of the £645 million (2009: £720 million) subordinated debt attributed to the Phoenix Life segment of the Group £445 million (2009: £520 million) is internal to the Group, comprising £250 million (2009: £250 million) provided to Pearl and £195 million (2009: £270 million) provided to PALAL. The remaining £200 million (2009: £200 million) is external subordinated debt issued by PLL.

Note 4: 'Other activities and consolidation adjustments' represent the contribution to consolidated owners' funds arising outside of the Phoenix Life business. This includes the owners' funds of IGNIS Asset Management and the holding companies of the Group but primarily consists of the consolidation adjustments to eliminate the cost of the Group's investment in the Phoenix Life business.

2009

	With-profit (see below) £m	Non-participating £m	Phoenix Life owners' funds £m	Total Phoenix Life business £m	Other activities and consolidation adjustments (note 4) £m	Group total £m
Owners' funds held outside long-term fund	-	-	2,475	2,475	(1,955)	520

	With-profit (see below) £m	Non-participating £m	Phoenix Life owners' funds £m	Total Phoenix Life business £m	Other activities and consolidation adjustments (note 4) £m	Group total £m
Owners' funds held in long-term fund	-	902	(10)	892	-	892
Total owners' funds at 31 December 2009	-	902	2,465	3,367	(1,955)	1,412
Adjustments onto a regulatory basis:						
Unallocated surplus	710	-	11	721		
Adjustments to assets (note 1)	(64)	(298)	(810)	(1,172)		
Adjustments to liabilities (note 2)	3,237	(87)	40	3,190		
Valuation difference between IFRS basis and regulatory basis	-	91	(8)	83		
Other qualifying capital:						
Subordinated debt (note 3)	83	-	637	720		
Contingent loans	382	(228)	(88)	66		
Allocation of Group capital	122	206	(328)	-		
Total available capital resources at 31 December 2009	4,470	586	1,919	6,975		

With-profit

2009

	Pearl WPF £m	PLL PWP £m	PLL BWP £m	SMA WPF £m	SPL WPF £m	Other £m	Total £m
Owners' funds held outside long-term fund	-	-	-	-	-	-	-
Owners' funds held in long-term fund	-	-	-	-	-	-	-
Total owners' funds at 31 December 2009	-	-	-	-	-	-	-
Adjustments onto a regulatory basis:							
Unallocated surplus	209	128	254	29	55	35	710
Adjustments to assets (note 1)	(34)	(3)	(11)	-	1	(17)	(64)
Adjustments to liabilities (note 2)	604	802	560	265	587	419	3,237
Other qualifying capital:							
Subordinated debt (note 3)	83	-	-	-	-	-	83
Contingent loans	-	-	-	-	-	382	382
Allocation of Group capital	122	-	-	-	-	-	122
Total available capital resources at 31 December 2009	984	927	803	294	643	819	4,470

Note 1: Regulatory adjustments to assets reflect adjustments to derecognise inadmissible assets such as intangibles and deferred tax assets as well as those adjustments that are necessary where asset and counterparty exposures exceed the prescribed regulatory limits.

Note 2: Regulatory adjustments to liabilities primarily reflect differences between the realistic valuation basis for the with-profit business used in calculating owners' funds on an IFRS basis, and the more prudent regulatory valuation basis used to calculate the FSA peak 1 capital resources.

Note 3: Of the £720 million subordinated debt attributed to the Phoenix Life segment of the Group £520 million is internal to the Group, comprising £250 million provided to Pearl and £270 million provided to PALAL. The remaining £200 million is external subordinated debt issued by PLL.

Note 4: 'Other activities and consolidation adjustments' represent the contribution to consolidated owners' funds arising outside of the Phoenix Life business. This includes the owners' funds of IGNIS Asset Management and the holding companies of the Group but primarily consists of the consolidation adjustments to eliminate the cost of the Group's investment in the Phoenix Life business.

An analysis of the movement in available capital resources for the period 1 January 2010 to 31 December 2010 is shown below:

	With-profit								
	Pearl WPF £m	**PLL PWP £m**	**PLL BWP £m**	**SMA WPF £m**	**SPL WPF £m**	**Other £m**	**Non-participating £m**	**Phoenix Life owners' funds £m**	**Total Phoenix Life business £m**
Total available capital resources at 1 January 2010	**984**	**927**	**803**	**294**	**643**	**819**	**586**	**1,919**	**6,975**
Regular surplus	**75**	**64**	**(15)**	**49**	**8**	**30**	**167**	**-**	**378**
Investment return	**585**	**261**	**375**	**105**	**184**	**379**	**(76)**	**77**	**1,890**
Cost of bonus	**(93)**	**(124)**	**(85)**	**(55)**	**(58)**	**(66)**	**-**	**39**	**(442)**
Changes in methodology and assumptions:									
Longevity	**-**	**-**	**4**	**3**	**1**	**1**	**40**	**-**	**49**
Expenses	**(6)**	**21**	**-**	**(3)**	**(1)**	**10**	**3**	**-**	**24**
Other	**(1)**	**(4)**	**-**	**(5)**	**(3)**	**(26)**	**16**	**-**	**(23)**
Management actions:									
Dividends paid by Phoenix Life	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(433)**	**(433)**
New business and other factors:									
Intragroup capital movement	**(205)**	**-**	**-**	**-**	**-**	**179**	**(4)**	**(225)**	**(255)**
Valuation rate of interest	**(254)**	**(140)**	**(15)**	**(170)**	**(118)**	**(270)**	**-**	**-**	**(967)**
Adjustment for internal loans in excess of counterparty limits	**-**	**-**	**-**	**-**	**-**	**-**	**(15)**	**64**	**49**
Other	**(37)**	**(42)**	**(35)**	**77**	**57**	**(33)**	**(8)**	**-**	**(21)**
Total available capital resources at 31 December 2010	**1,048**	**963**	**1,032**	**295**	**713**	**1,023**	**709**	**1,441**	**7,224**

An analysis of the movement in available capital resources for the period 1 January 2009 to 31 December 2009 is shown below:

	With-profit								
	Pearl	PLL PWP	PLL BWP	SMA	SPL WPF	Other	Non-	Phoenix	Total

				With-profit					
	WPF £m	£m	£m	WPF £m	£m	£m	participating £m	Life owners' funds £m	Phoenix Life business £m
Total available capital resources at 1 January 2009	-	-	-	-	-	-	-	-	-
On acquisition of the Pearl businesses	850	738	634	357	619	427	659	1,902	6,186
Regular surplus	111	27	17	48	(2)	20	101	-	322
Investment return	60	224	230	82	203	248	(17)	100	1,130
Cost of bonus	(27)	(47)	(33)	(16)	(26)	(13)	-	15	(147)
Changes in methodology and assumptions:									
Longevity	1	26	1	18	15	32	(4)	-	89
Expenses	-	(6)	-	(9)	14	(18)	13	-	(6)
Other	1	(13)	(2)	-	-	(7)	21	-	-
Management actions:									
Investment strategy	-	-	-	-	-	276	-	-	276
Proceeds from issue of subordinated debt	-	-	-	-	-	-	-	250	250
Dividends paid by Phoenix Life	-	-	-	-	-	-	-	(406)	(406)
New business and other factors:									
Intragroup capital movement	-	-	-	-	-	(6)	(241)	216	(31)
Valuation rate of interest	-	(72)	(7)	(126)	(160)	(142)	(2)	-	(509)
Adjustment for internal loans in excess of counterparty limits	-	-	-	-	-	-	-	(37)	(37)
Other	(12)	50	(37)	(60)	(20)	2	56	(121)	(142)
Total available capital resources at 31 December 2009	984	927	803	294	643	819	586	1,919	6,975

Changes in methodology and assumptions

Changes to capital resources arising from changes in methodology and assumptions occur in the normal course of the assumption setting process and reflect changes in available data inputs.

Management actions

The management actions that have had the most significant impact on available capital resources of the Phoenix Life segment of the Group during the period to 31 December 2010 generally comprise payment of dividends to group entities.

43. Risk management

The Group is exposed to a number of risks in its business including those arising from underlying assets and liabilities. The Group's overall approach to risk management is described in the Performance section of the annual report and accounts.

43.1 Risk and capital management objectives

The risk management objectives and policies of the Group are based on the requirement to protect the Group's regulatory capital position, thereby safeguarding policyholders' guaranteed benefits whilst also ensuring the Group can meet various cash flow requirements. Subject to this, the Group seeks to use available capital to achieve increased investment returns, balancing risk and reward, to generate additional value for policyholders and shareholders.

In pursuing these objectives, the Group deploys financial assets and incurs financial liabilities. Financial assets principally comprise investments in equity securities, fixed and variable rate income securities, collective investment schemes, property, derivatives, reinsurance, trade and other receivables, and banking deposits. Financial liabilities comprise investment contracts, borrowings for financing purposes, derivative liabilities and other payables.

43.2 Asset liability management ('ALM') framework

The use of financial instruments naturally exposes the Group to the risks associated with them, chiefly, market risk, credit risk and financial soundness risk. Financial soundness risk is a broad risk category encompassing liquidity and funding risk, tax risk and pension risk.

Responsibility for agreeing the financial risk profile rests with the Board of each life company, as advised by investment managers, internal committees and the actuarial function. In setting the risk profile, the Board of each life company will receive advice from the appointed investment managers and the relevant actuary as to the potential implications of that risk profile with regard to the probability of both realistic insolvency and of failing to meet the regulatory minimum capital requirement. The actuary will also advise the extent to which the investment risk taken is consistent with the Group's commitment to treat customers fairly.

Derivatives are used in a number of the Group's funds, within policy guidelines agreed by the Board of each life company and overseen by Investment Committees of the Boards of each life company supported by management oversight committees. Derivatives are primarily used for efficient portfolio management or for risk hedging purposes.

More detail on the Group's exposure to financial risk is provided in note 43.3 below.

The Group is also exposed to insurance risk arising from its Phoenix Life segment. Life assurance risk in the Group arises through its exposure to mortality, longevity and to variances between assumed and actual experience in factors such as persistency levels and management and administrative expenses. More details on the Group's exposure to insurance risk are provided in note 43.5 below.

The Group's overall exposure to investment risk is monitored by appropriate committees, which agree policies for managing each type of risk on an ongoing basis, essentially within the ALM framework that has been developed to achieve investment returns in excess of amounts due in respect of insurance contracts. The effectiveness of the Group's ALM relies on close matching of assets and liabilities arising from insurance and investment contracts, taking into account the types of benefits payable to policyholders under each type of contract. Separate portfolios of assets are maintained for with-profit business, which includes all of the Group's participating business, non-linked non-participating business and unit-linked business.

43.3 Financial risk analysis

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

43.3.1 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 on and off balance sheet assets and liabilities.

There are two principal sources of credit risk for the Group:

- Credit risk which results from direct investment activities, including investments in fixed and variable rate income securities, equities, derivatives, collective investment schemes and the placing of cash deposits; and
- Credit risk which results indirectly from activities undertaken in the normal course of business. Such activities include premium payments, outsourcing contracts, reinsurance, exposure from material suppliers and the lending of securities.

The amount disclosed in the statement of consolidated financial position in respect of all financial assets, together with rights secured under off balance sheet collateral arrangements, and excluding those that back unit-linked liabilities, represents the Group's maximum exposure to credit risk.

The impact of non-government fixed and variable rate income securities and, inter alia, the change in market credit spreads during the year is fully reflected in the values shown in these financial statements. Similarly, the value of derivatives that the Group holds takes into account fully the changes in swap spreads.

There is an exposure to spread changes affecting the prices of corporate bonds and derivatives. This exposure applies to with-profit funds, unit-linked funds, non-profit funds (where risks and rewards fall wholly to shareholders) and to shareholders' funds.

A 100 basis point widening of credit spreads, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full financial year and in equity of £223 million (2009: £196 million).

A 100 basis point narrowing of credit spreads, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year and in equity of £246 million (2009: £216 million).

Credit risk is managed by the monitoring of aggregate Group exposures to individual counterparties and by appropriate credit risk diversification. The Group manages the level of credit risk it accepts through divisional credit risk tolerances. In certain cases, protection against exposure to particular credit risk types may be achieved through the use of derivatives. The credit risk borne by the shareholder on with-profit policies is usually minimal unless the insurance fund is relying on shareholder support.

Quality of credit assets

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

2010

	AAA £m	AA £m	A £m	BBB £m	BB £m	B and below £m	Non-rated £m	Unit-linked £m	Total £m
Loans and receivables	**-**	**-**	**1,619**	**13**	**145**	**467**	**44**	**5**	**2,293**
Derivatives	**-**	**2,372**	**630**	**-**	**-**	**-**	**94**	**101**	**3,197**
Fixed and variable rate income securities	**25,694**	**4,872**	**5,369**	**3,145**	**343**	**511**	**828**	**137**	**40,899**
Reinsurers' share of insurance contract liabilities	**-**	**599**	**2,199**	**20**	**-**	**-**	**109**	**12**	**2,939**
Cash and cash equivalents	**2,371**	**5,634**	**912**	**81**	**-**	**-**	**1**	**189**	**9,188**
	28,065	**13,477**	**10,729**	**3,259**	**488**	**978**	**1,076**	**444**	**58,516**

2009

	AAA £m	AA £m	A £m	BBB £m	BB £m	B and below £m	Non-rated £m	Unit-linked £m	Total £m
Loans and receivables	-	-	-	-	-	1,027	46	8	1,081
Derivatives	-	73	3,368	-	-	-	50	49	3,540
Fixed and variable rate income securities	23,690	3,873	5,343	2,474	514	400	843	521	37,658
Reinsurers' share of insurance contract liabilities	13	595	2,124	20	-	-	98	10	2,860
Cash and cash equivalents	2,141	2,442	1,003	6	-	-	92	397	6,081
	25,844	6,983	11,838	2,500	514	1,427	1,129	985	51,220

Credit ratings have not been disclosed in the above tables for equities. Whilst the Group is exposed to the impact of credit default on its equity holdings, this risk is not considered significant due to the spread of holdings. Non-equity based derivatives are included in the credit risk table above.

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

It is also the Group's policy to maintain accurate and consistent internal risk ratings across its asset portfolio. This enables management to focus on the applicable risks and to compare credit exposures across all lines of business, geographical regions and products. The rating system is supported by a variety of financial analytics combined with market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories of assets and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly.

A further indicator of the quality of the Group's financial assets is the extent to which they are neither past due nor impaired. The following table gives information regarding the ageing of financial assets that are past due but not impaired and the carrying value of financial assets that have been impaired.

2010

	Neither past due nor impaired £m	**Less than 30 days £m**	**30-90 days £m**	**Greater than 90 days £m**	**Impaired £m**	**Unit-linked £m**	**Carrying value £m**
Loans and receivables	**2,284**	**-**	**-**	**-**	**4**	**5**	**2,293**
Derivatives	**3,096**	**-**	**-**	**-**	**-**	**101**	**3,197**
Fixed and variable rate income securities	**40,762**	**-**	**-**	**-**	**-**	**137**	**40,899**
Reinsurers' share of insurance contract liabilities	**2,927**	**-**	**-**	**-**	**-**	**12**	**2,939**
Reinsurance receivables	**263**	**-**	**-**	**-**	**-**	**-**	**263**
Prepayments and accrued income	**603**	**-**	**-**	**-**	**-**	**-**	**603**
Other receivables	**173**	**-**	**-**	**-**	**1**	**-**	**174**
Cash and cash equivalents	**8,999**	**-**	**-**	**-**	**-**	**189**	**9,188**

2009

	Neither past due nor impaired £m	Less than 30 days £m	30-90 days £m	Greater than 90 days £m	Impaired £m	Unit-linked £m	Carrying value £m
Loans and receivables	1,073	-	-	-	-	8	1,081
Derivatives	3,491	-	-	-	-	49	3,540
Fixed and variable rate income securities	37,137	-	-	-	-	521	37,658
Reinsurers' share of insurance contract liabilities	2,850	-	-	-	-	10	2,860
Reinsurance receivables	264	-	-	-	-	-	264
Prepayments and accrued income	518	84	-	1	-	19	622
Other receivables	765	6	1	6	3	-	781
Cash and cash equivalents	5,684	-	-	-	-	397	6,081

Assets backing unit-linked business have not been analysed in these tables as the credit risk on such financial assets is borne by the policyholders. However, these assets have been included as a separate column in these tables to reconcile the information to the statement of consolidated financial position. Shareholder credit exposure on unit-linked assets is limited to the level of asset manager fee which is dependent on the underlying assets. In certain circumstances the shareholder funds may be used to re-establish unit-linked assets in line with regulatory and policyholder expectations.

Concentration of credit risk

Concentration of credit risk might exist where the Group has significant exposure to an individual counterparty or a group of counterparties with similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic and other conditions. The Group has most of its counterparty risk within its life business and this is monitored by the counterparty limits contained within the investment guidelines and investment management agreements, overlaid by regulatory requirements.

The Group is also exposed to concentration risk with outsourced service providers. This is due to the nature of the outsourced services market. The Group operates a policy to manage outsourcer service counterparty exposures and the impact from default is reviewed regularly by executive committees and measured though the ICA stress and scenario testing.

Collateral

The credit risk of the Group is mitigated, in certain circumstances, by entering into collateral agreements. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and the valuation parameters. Collateral is mainly obtained for securities lending, certain reinsurance arrangements and to provide security against the maturity proceeds of derivative financial instruments. Management monitors the market value of the collateral received, requests additional collateral when needed and performs an impairment valuation when impairment indicators exist and the asset is not fully secured.

43.3.2 Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market influences. Market risk comprises interest rate risk, currency risk and other price risk (comprising equity risk, property risk, inflation risk and alternative asset class risk).

The Group is mainly exposed to market risk as a result of:

- the mismatch between liability profiles and the related asset investment portfolios;
- the investment of surplus assets including shareholder reserves yet to be distributed, surplus assets within the with-profit funds and assets held to meet regulatory capital and solvency requirements; and
- the income flow of management charges from the invested assets of the business.

The Group manages the levels of market risk that it accepts through an approach to investment management that determines:

- the constituents of market risk for the Group;
- the basis used to fair value financial assets and liabilities;
- the asset allocation and portfolio limit structure;
- diversification from benchmarks by type of instrument and geographical area;
- the net exposure limits by each counterparty or group of counterparties, geographical and industry segments;
- control over hedging activities;
- reporting of market risk exposures and activities; and
- monitoring of compliance with market risk policy and review of market risk policy for pertinence to the changing environment.

All operations comply with regulatory requirements relating to the taking of market risk.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates due to the effect such movements have on the value of interest-bearing assets and on the value of future guarantees provided under certain contracts of insurance.

Interest rate risk is managed by matching assets and liabilities where practicable and by entering into swap arrangements where appropriate. This is particularly the case for the non-participating funds. For participating business, some element of investment mismatching is permitted where it is consistent with the principles of treating customers fairly. The with-profit funds of the Group provide capital to allow such mismatching to be effected. In practice, the life companies of the Group maintain an appropriate mix of fixed and variable rate instruments according to the underlying insurance or investment contracts and will review this at regular intervals to ensure that overall exposure is kept within the risk profile agreed for each particular fund. This also requires the maturity profile of these assets to be managed in line with the liabilities to policyholders.

The sensitivity analysis for interest rate risk indicates how changes in the fair value or future cash flows of a financial instrument arising from changes in market interest rates at the reporting date result in a change in profit after tax and in equity. It takes into account the effect of such changes in market interest rates on all assets and liabilities that contribute to the Group's reported profit after tax and in equity.

With-profits business and non-participating business within the with-profit funds are exposed to interest rate risk as guaranteed liabilities are valued relative to market interest rates and investments include fixed interest stocks and derivatives. For with-profit business the profit or loss arising from mismatches between such assets and liabilities is largely offset by increased or reduced discretionary policyholder benefits. The contribution of these funds to the Group result is determined primarily by either the shareholders' share of the declared annual bonus or by the shareholders' interest in any change in value in the capital advanced to the Group's with-profit funds.

In the non-participating funds, policy liabilities are duration matched with primarily fixed and variable rate income securities, with the result that sensitivity to changes in interest rates is very low.

An increase of 1% in interest rates, with all other variables held constant, would result in decreases in the profit after tax in respect of a full financial year and in equity of £103 million (2009: £61 million). A decrease of 1% in interest rates, with all other variables held constant, would result in an additional profit after tax in respect of a full financial year and an increase in equity of £78 million (2009: £89 million).

Price risk (equity risk, property risk, inflation risk and alternative asset class risk)

The Group's price risk exposure relates to financial assets and liabilities whose values will fluctuate as a result of changes in market prices other than from interest rate and currency fluctuations. This is due to factors specific to individual instruments, their issuers or factors affecting all instruments traded in the market. Accordingly, the Group limits its exposure to any one counterparty in its investment portfolios and to any one foreign market.

The portfolio of marketable equity securities and property investments which is carried in the statement of consolidated financial position at fair value has exposure to price risk. The Group's objective in holding these assets is to earn higher long-term returns by investing in a diverse portfolio of high quality equities and properties. Portfolio characteristics are analysed regularly and price risks are actively managed in line with investment mandates. The Group's holdings are diversified across industries and concentrations in any one company or industry are limited.

Equity and property price risk is primarily borne in respect of assets held in with-profit or unit-linked funds. For unit-linked funds this risk is borne by policyholders and asset movements directly impact unit prices and hence policy values. For with-profit funds policyholders' future bonuses will be impacted by the investment returns achieved and hence the price risk. In addition some equity investments are held in respect of equity holders' funds. The Group as a whole is exposed to price risk fluctuations impacting the income flow of management charges from the invested assets of all funds.

Equity and property price risk is managed through the agreement and monitoring of financial risk profiles that are appropriate for each of the Group's life funds in respect of maintaining adequate regulatory capital and treating customers fairly. This is largely achieved through asset class diversification.

The sensitivity analysis for equity and property price risk illustrates how a change in the fair value of equities and properties affects the Group result. It takes into account the effect of such changes in equity and property prices on all assets and liabilities that contribute to the Group's reported profit after tax and in equity.

A 10% decrease in equity prices, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full financial year and in equity of £22 million (2009: an increase of £5 million).

A 10% increase in equity prices, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year and in equity of £21 million (2009: a decrease of £8 million).

A 10% decrease in property prices, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full financial year and in equity of £52 million (2009: £22 million).

A 10% increase in property prices, with all other variables held constant, would result in an increase in the profit after tax in respect of a full financial year and in equity of £51 million (2009: £21 million).

Currency risk

The Group's principal transactions are carried out in sterling and therefore its exchange risk is limited principally to historic business that was written in the Republic of Ireland, where the assets are generally held in the same currency denomination as their liabilities, therefore, any foreign currency mismatch is largely mitigated. Consequently, the foreign currency risk relating to this business mainly arises when the assets and liabilities are translated into sterling.

The Group's financial assets are primarily denominated in the same currencies as its insurance and investment liabilities. Thus the main foreign exchange risk arises from recognised assets and liabilities denominated in currencies other than those in which insurance and investment liabilities are expected to be settled and, indirectly, from the earnings of UK companies arising abroad.

Certain Phoenix Life with-profit funds have an exposure to overseas assets which is not driven by liability considerations. The purpose of this exposure is to reduce overall risk whilst maximising returns by diversification. This exposure is limited and managed through investment mandates which are subject to the oversight of the Investment Committees of the Boards of each life company. Fluctuations in exchange rates from holdings in overseas assets are hedged against currency risks.

Sensitivity of profit after tax and in equity to fluctuations in currency exchange rates is not considered significant at 31 December 2010, since unhedged exposure to foreign currency was relatively low.

43.3.3 Financial soundness risk

Financial soundness risk is a broad risk category encompassing liquidity and funding risk, as well as tax risk and pension risk.

Liquidity and funding risk is defined as the failure of the Group to maintain adequate levels of financial resources to enable it to meet its obligations as they fall due. The Group has exposure to liquidity risk as a result of servicing its external debt and equity investors, and from the operating requirements of its subsidiaries. The Group's subsidiaries have 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.

The Board of Phoenix Group Holdings has defined a number of governance objectives and principles and the liquidity risk frameworks of each subsidiary are designed to ensure that:

- liquidity risk is managed in a manner consistent with the subsidiary companies Boards' strategic objectives, risk appetite and Principles and Practices of Financial Management ('PPFM');
- cash flows are appropriately managed and the reputation of the Group is safeguarded; and
- appropriate information on liquidity risk is available to those making decisions.

The Group's policy is to maintain sufficient liquid assets of suitable credit quality at all times and, where appropriate, to have access to borrowings so as to be able to meet all foreseeable current liabilities as they fall due in a cost-effective manner. Forecasts are prepared regularly to predict required liquidity levels over both the short and medium term allowing management to respond appropriately to changes in circumstances.

Some of the Group's commercial property investments are held through a unit trust managed by IGNIS Asset Management. This unit trust has the power to restrict and/or suspend withdrawals, which would, in turn, affect liquidity. To date, the unit trust has continued to process both investments and realisations in a normal manner and has not imposed any restrictions or delays.

The following table provides a maturity analysis showing the remaining contractual maturities of the Group's undiscounted financial liabilities and associated interest. Liabilities under insurance contract contractual maturities are included based on the estimated timing of the amounts recognised in the statement of consolidated financial position in accordance with the requirements of IFRS 4:

2010

	1 year or less or on demand £m	**1-5 years £m**	**Greater than 5 years £m**	**No fixed term £m**	**Total £m**
Liabilities under insurance contracts	**8,103**	**14,556**	**25,882**	**1,938**	**50,479**
Investment contracts	**8,849**	**-**	**-**	**-**	**8,849**
Borrowings	**190**	**2,751**	**2,153**	**234**	**5,328**
Deposits received from reinsurers	**35**	**130**	**492**	**1**	**658**
Derivatives	**914**	**343**	**2,801**	**-**	**4,058**
Net asset value attributable to unitholders	**1,937**	**-**	**-**	**-**	**1,937**
Obligations for repayment of collateral received	**9,532**	**122**	**506**	**-**	**10,160**
Reinsurance payables	**25**	**-**	**-**	**-**	**25**
Payables related to direct insurance contracts	**673**	**40**	**-**	**-**	**713**
Accruals and deferred income	**205**	**9**	**-**	**-**	**214**
Other payables	**327**	**-**	**-**	**-**	**327**

2009

	1 year or less or on demand £m	1-5 years £m	Greater than 5 years £m	No fixed term £m	Total £m
Liabilities under insurance contracts	10,141	14,539	23,748	1,863	50,291
Investment contracts	8,570	-	-	-	8,570
Borrowings	95	2,447	1,950	258	4,750
Deposits received from reinsurers	38	138	522	-	698
Derivatives	1,448	363	1,511	-	3,322
Net asset value attributable to unitholders	946	-	-	-	946
Obligations for repayment of collateral received	3,054	158	412	484	4,108
Reinsurance payables	17	-	-	-	17
Payables related to direct insurance contracts	693	66	-	-	759
Accruals and deferred income	174	3	-	-	177
Other payables	325	8	-	317	650

Investment contract policyholders have the option to terminate or transfer their contracts at any time and to receive the surrender or transfer value of their policies. Although these liabilities are payable on demand, and are therefore included in the contractual maturity analysis as due within one year, the Group does not expect all these amounts to be paid out within one year of the reporting date.

A significant proportion of the Group's financial assets are held in gilts, cash, supranationals and highly rated securities which the Group considers sufficient to meet the liabilities as they fall due.

43.4 Unit-linked contracts

For unit-linked contracts the Group matches all the liabilities with assets in the portfolio on which the unit prices are based. There is therefore no interest, price, currency or credit risk for the Group on these contracts.

In extreme circumstances, the Group could be exposed to liquidity risk in its unit-linked funds. This could occur where a high volume of surrenders coincides with a tightening of liquidity in a unit-linked fund to the point where assets of that fund have to be sold to meet those withdrawals. Where the fund affected consists of property, it can take several months to complete a sale and this would impede the proper operation of the fund. In these situations, the Group considers its risk to be low since there are steps that can be taken first within the funds themselves both to ensure the fair treatment of all investors in those funds and to protect the Group's own risk exposure.

43.5 Insurance risk

Insurance risk refers to the risk that the frequency or severity of insured events may be worse than expected and includes expense risk. The Phoenix Life segment contracts include the following sources of insurance risk:

Mortality – higher than expected number of death claims on assurance products and occurrence of one or more large claims;

Longevity – faster than expected improvements in life expectancy on immediate and deferred annuity products;

Morbidity – higher than expected number of serious illness claims or more sickness claims which last longer on income protection policies;

Expenses – policies cost more to administer than expected;

Lapses – the numbers of policies terminating early is different to that expected in a way which increases expected claims costs or expenses or reduces future profits;

Options – unanticipated changes in policyholder option exercise rates giving rise to increased claims costs; and

General insurance – higher than expected number of non-life claims on general insurance policies and occurrence of one or more large claims.

Objectives and policies for mitigating insurance risk

The Group uses several methods to assess and monitor insurance risk exposures both for individual types of risks insured and overall risks. These methods include internal risk measurement models, experience analyses, external data comparisons, sensitivity analyses, scenario analyses and stress testing.

The profitability of the run-off of the closed long-term insurance businesses within the Group depends to a significant extent on the values of claims paid in the future relative to the assets accumulated to the date of claim. Typically, over the lifetime of a contract, premiums and investment returns exceed claim costs in the early years and it is necessary to set aside these amounts to meet future obligations. The amount of such future obligations is assessed on actuarial principles by reference to assumptions about the development of financial and insurance risks.

It is therefore necessary for the Directors of each life company to make decisions, based on actuarial advice, which ensure an appropriate accumulation of assets relative to liabilities. These decisions include investment policy, bonus policy and, where discretion exists, the level of payments on early termination.

Phoenix has a number of small books of general insurance business across the Group. These have been closed to new business for a number of years and are in run-off.

Due to the historic diversity of issued general insurance policies and taking into account the legal and regulatory environment for hazardous risks, it is possible that additional claims could emerge from long tail unexpired risks albeit it is not possible to predict the quantum, location or timing of such occurrences.

The estimation of the provisions for the ultimate cost of claims for asbestos and environmental pollution is subject to a range of uncertainties that is generally greater than those encountered for other classes of insurance business and as a consequence of this uncertainty the eventual costs of settlement of outstanding claims and unexpired risks can vary substantially from the estimates.

This general insurance business is managed by an experienced team of specialists who are responsible for all aspects of claims management, reserving and oversight of any activities undertaken by third parties. All such activity is carried out in accordance with the relevant regulations and industry standards.

Sensitivities

Insurance liabilities are sensitive to changes in risk variables, such as prevailing market interest rates, currency rates and equity prices, since these variations alter the value of the financial assets held to meet obligations arising from insurance contracts and changes in investment conditions also have an impact on the value of insurance liabilities themselves. Additionally, insurance liabilities are sensitive to the assumptions which have been applied in their calculation, such as mortality and lapse rates. Sometimes allowance must also be made for the effect on future assumptions of management or policyholder actions in certain economic scenarios. This could lead to changes in assumed asset mix or future bonus rates. The most significant non-economic sensitivities arise from mortality, longevity and lapse risk.

A decrease of 5% in assurance mortality, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year and an increase in equity of £23 million (2009: £27 million).

An increase of 5% in assurance mortality, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year and a decrease in equity of £24 million (2009: £27 million).

A decrease of 5% in annuitant longevity, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year and an increase in equity of £164 million (2009: £91 million).

An increase of 5% in annuitant longevity, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year and a decrease in equity of £162 million (2009: £83 million).

A decrease of 25% in lapse rates, with all other variables held constant, would result in a decrease in the profit after tax in respect of a full year and a decrease in equity of £61 million (2009: £50 million).

An increase of 25% in lapse rates, with all other variables held constant, would result in an increase in the profit after tax in respect of a full year and an increase in equity of £49 million (2009: £41 million).

43.5.1 Assumptions

Valuation of participating insurance and investment contracts

For participating business, which is with-profit business (insurance and investment contracts), the insurance contract liability is calculated in accordance with the FSA’s realistic capital regime, adjusted to exclude the shareholders’ share of future bonuses and the associated tax liability as required by FRS 27 *Life Assurance*. This is a market consistent valuation, which involves placing a value on liabilities similar to the market value of assets with similar cash flow patterns.

Valuation of non-participating insurance contracts

The non-participating insurance contract liabilities are determined using either a net premium or gross premium valuation method.

Process used to determine assumptions

For participating business in realistic basis companies the assumptions about future demographic trends are intended to be ‘best estimates’. They are determined after considering the companies’ recent experience and/or relevant industry data. Economic assumptions are market consistent.

For other business, demographic assumptions are derived by adding a prudent margin to best estimate assumptions. Economic assumptions are prudent estimates of the returns expected to be achieved on the assets backing the liabilities.

During the year a number of changes were made to assumptions to reflect changes in expected experience or to harmonise the approach across the enlarged Group. The impact of material changes during the year was as follows:

	Increase/ (decrease) in insurance liabilities 2010 £m	Increase/ (decrease) in insurance liabilities 2009 £m
Change in longevity assumptions	**(43)**	(73)
Change in persistency assumptions	**35**	94
Change in expenses assumptions	**10**	-

Valuation interest rate

For realistic basis companies the liabilities are determined stochastically using an appropriate number of risk neutral scenarios produced by an economic scenario generator calibrated to market conditions and gilt yields as at the valuation date.

For funds not subject to realistic reporting, the method used to determine valuation interest rates generally follows the regulations set out in the Prudential Sourcebook for Insurers.

Assets are firstly hypothecated to classes of business being valued. The valuation interest rates for each block of business are based on the expected returns of the hypothecated assets. The yield is then adjusted to make allowance for credit risk, liquidity risk, reinvestment risk and investment management expenses.

Valuation interest rates (after tax for life policies) are typically in the following ranges:

	2010 %	2009 %
Life policies	**2.32 – 3.64**	2.14 – 3.82
Pension policies	**2.67 – 4.46**	2.76 – 4.84

Expense inflation

Expenses are assumed to increase at the rate of increase in the Retail Price Index (‘RPI’) plus fixed margins in accordance with the various management service agreements (‘MSAs’) the Group has in place with outsourced service providers. For with-profit business the rate of RPI inflation is determined within each stochastic scenario. For other business it is based on the Bank of England inflation spot curve. For MSAs with contractual increases set by reference to national average earnings inflation, this is approximated as RPI inflation plus 1%. In instances in which inflation risk is not mitigated, a further margin for adverse deviations may then be added to the rate of expense inflation.

Mortality and longevity rates

Mortality rates are based on published tables, adjusted appropriately to take account of changes in the underlying population mortality since the table was published, company experience and forecast changes in future mortality. Where appropriate, a margin is added to assurance mortality rates to allow for adverse future deviations. Annuitant mortality rates are adjusted to make allowance for future improvements in pensioner longevity.

Lapse and surrender rates (persistency)

The assumed rates for surrender and voluntary premium discontinuance depend on the length of time a policy has been in force and the relevant company. Surrender or voluntary premium discontinuances are only assumed for realistic basis companies. Withdrawal rates used in the valuation of with-profit policies are based on observed experience and adjusted when it is considered that future policyholder behaviour will be influenced by different considerations than in the past. In particular, it is assumed that withdrawal rates for unitised with-profit contracts will be higher on policy anniversaries on which Market Value Adjustments do not apply.

Discretionary participating bonus rate

For realistic basis companies, the regular bonus rates assumed in each scenario are determined in accordance with each company's PPFM. Final bonuses are assumed at a level such that maturity payments will equal asset shares subject to smoothing rules set out in the PPFM.

Policyholder options and guarantees

Some of the Group's products give potentially valuable guarantees, or give options to change policy benefits which can be exercised at the policyholders' discretion. These products are described below.

Most with-profit contracts give a guaranteed minimum payment on a specified date or range of dates or on death if before that date or dates. For pensions contracts, the specified date is the policyholder's chosen retirement date or a range of dates around that date. For endowment contracts, it is the maturity date of the contract. For with-profit bonds it is often a specified anniversary of commencement, in some cases with further dates thereafter. Annual bonuses when added to with-profit contracts usually increase the guaranteed amount.

There are guaranteed surrender values on a small number of older contracts.

Some pensions contracts include guaranteed annuity options (see deferred annuities in section 43.5.2 for details). The total amount provided in the with-profit and non-profit funds in respect of the future costs of guaranteed annuity options are £1,541 million (2009: £1,469 million) and £20 million (2009: £52 million) respectively.

In common with other life companies in the UK which have written pension transfer and opt-out business, the Group has set up provisions for the review and possible redress relating to personal pension policies. These provisions, which have been calculated from data derived from detailed file reviews of specific cases and using a certainty equivalent approach, which give a result very similar to a market consistent valuation, are included in liabilities arising under insurance contracts. The total amount provided in the with-profit funds and non-profit funds in respect of the review and possible redress relating to pension policies, including associated costs, are £329 million (2009: £325 million) and £20 million (2009: £46 million) respectively.

With-profits deferred annuities participate in profits only up to the date of retirement. At retirement, a guaranteed cash option allows the policyholder to commute the annuity benefit into cash on guaranteed terms.

43.5.2 Managing product risk

The following sections give an assessment of the risks associated with the Group's main life assurance, products as shown below, and the ways in which the Group manages those risks.

2010

	Gross		Reinsurance	
	Insurance contracts £m	**Investment contracts with DPF £m**	**Insurance contracts £m**	**Investment contracts with DPF £m**
With-profit funds:				
Pensions:				
Deferred annuities – with guarantees	**8,660**	**73**	**469**	**-**
Deferred annuities – without guarantees	**1,593**	**107**	**-**	**-**
Immediate annuities	**4,450**	**-**	**705**	**-**
Unitised with-profit	**1,291**	**9,143**	**102**	**-**
Total pensions	**15,994**	**9,323**	**1,276**	**-**
Life:				
Immediate annuities	**95**	**-**	**9**	**-**
Unitised with-profit	**965**	**936**	**38**	**-**
Life with-profit	**7,209**	**-**	**2**	**-**
Total life	**8,269**	**936**	**49**	**-**
Other	**1,820**	**7**	**67**	**-**
Non-profit funds:				
Deferred annuities – with guarantees	**132**	**-**	**56**	**-**
Deferred annuities – without guarantees	**1,013**	**6**	**477**	**-**
Immediate annuities	**8,592**	**-**	**701**	**-**
Protection	**636**	**-**	**282**	**-**
Unit-linked	**2,078**	**1,435**	**12**	**-**
Other	**236**	**2**	**19**	**-**
	38,770	**11,709**	**2,939**	**-**

2009

	Gross		Reinsurance	
	Insurance contracts £m	Investment contracts with DPF £m	Insurance contracts £m	Investment contracts with DPF £m
With-profit funds:				
Pensions:				
Deferred annuities - with guarantees	8,821	73	392	-
Deferred annuities - without guarantees	1,550	112	-	-
Immediate annuities	3,679	-	671	-
Unitised with-profit	1,279	9,051	90	-
Total pensions	15,329	9,236	1,153	-
Life:				
Immediate annuities	74	-	7	-
Unitised with-profit	1,398	601	40	-
Life with-profit	7,725	-	12	-
Total life	9,197	601	59	-
Other	2,290	6	92	-
Non-profit funds:				
Deferred annuities - with guarantees	117	-	59	-
Deferred annuities - without guarantees	1,012	5	474	-
Immediate annuities	8,073	-	704	-
Protection	610	-	290	-
Unit-linked	1,888	1,423	13	-
Other	449	55	16	-
	38,965	11,326	2,860	-

With-profit fund (unitised and traditional)

The Group operates a number of with-profit funds in the UK in which the with-profit policyholders benefit from a discretionary annual bonus (guaranteed once added in most cases) and a discretionary final bonus. Non-participating business is also written in some of the with-profit funds and some of the funds may include immediate annuities and deferred annuities with Guaranteed Annuity Rates (‘GAR’).

The investment strategy of each fund differs, but is broadly to invest in a mixture of fixed interest investments and equities and/or property in such proportions as is appropriate to the investment risk exposure of the fund and its capital resources.

The Group has significant discretion regarding investment policy, bonus policy and early termination values. The process for exercising discretion in the management of the with-profit funds is set out in the PPFM for each with-profit fund and is overseen by with-profit committees. Advice is also taken from the with-profit actuary of each company which has a with-profit fund. Compliance with the PPFM is reviewed annually and reported to the FSA and policyholders.

The bonuses are designed to distribute to policyholders a fair share of the return on the assets in the with-profit funds together with other elements of the experience of the fund. The shareholders of the Group are entitled to receive one-ninth of the cost of bonuses declared for some funds and £nil for others.

Unitised and traditional with-profit policies are exposed to equivalent risks, the main difference being that unitised with-profit policies purchase notional units in a with-profit fund whereas traditional with-profit policies do not. Benefit payments for unitised policies are then dependent on unit prices at the time of a claim, although charges may be applied. A unitised with-profit fund price is typically guaranteed not to fall and increases in line with any discretionary bonus payments over the course of one year.

Deferred annuities

Deferred annuity policies are written to provide either a cash benefit at retirement, which the policyholder can use to buy an annuity on the terms then applicable, or an annuity payable from retirement. The policies contain an element of guarantee expressed in the form that the contract is written in i.e. to provide cash or an annuity. Deferred annuity policies written to provide a cash benefit may also contain an option to convert the cash benefit to an annuity benefit on guaranteed terms; these are known as GAR policies. Deferred annuity policies written to provide an annuity benefit may also contain an option to convert the annuity benefit into cash benefits on guaranteed terms; these are known as Guaranteed Cash Option ('GCO') policies.

During the last decade, interest rates and inflation have fallen and life expectancy has increased more rapidly than originally anticipated. The guaranteed terms on GAR policies are more favourable than the annuity rates currently available in the market available for cash benefits. The guaranteed terms on GCO policies are currently not valuable. Deferred annuity policies which are written to provide annuity benefits are managed in a similar manner to immediate annuities and are exposed to the same risks.

The option provisions on GAR policies are particularly sensitive to downward movements in interest rates, increasing life expectancy and the proportion of customers exercising their option. Adverse movements in these factors could lead to a requirement to increase reserves which could adversely impact profit and potentially require additional capital. In order to address the interest rate risk (but not the risk of increasing life expectancy or changing customer behaviour with regard to exercise of the option), insurance subsidiaries within the Group have purchased derivatives that provide protection against an increase in liabilities and have thus reduced the sensitivity of profit to movements in interest rates.

The Group seeks to manage this risk in accordance with both the terms of the issued policies and the interests of customers, and has obtained external advice supporting the manner in which it operates the long-term funds in this respect.

Immediate annuities

This type of annuity is purchased with a single premium at the outset, and is paid to the policyholder for the remainder of their lifetime. Payments may also continue for the benefit of a surviving spouse or partner after the annuitant's death. Annuities may be level, or escalate at a fixed rate, or may escalate in line with a price index and may be payable for a minimum period irrespective of whether the policyholder remains alive.

The main risks associated with this product are longevity and investment risks. Longevity risk arises where the annuities are paid for the lifetime of the policyholder, and is managed through the initial pricing of the annuity and through reinsurance (appropriately collateralised) or transfer of existing liabilities. Annuities may also be a partial 'natural hedge' against losses incurred in protection business in the event of increased mortality (and vice versa) although the extent to which this occurs will depend on the similarity of the demographic profile of each book of business.

The pricing assumption for mortality risk is based on both historic internal information and externally generated information on mortality experience, including allowances for future mortality improvements. Pricing will also include a contingency margin for adverse deviations in assumptions.

Investment risk depends on the extent to which the annuity payments under the contracts have been matched by suitable assets which is managed under the ALM framework. Asset/liability modelling is used to monitor this position on a regular basis.

Protection

These contracts are typically secured by the payment of a regular premium payable for a period of years providing benefits payable on certain events occurring within the period. The benefits may be a single lump sum or a series of payments and may be payable on death, serious illness or sickness.

The main risk associated with this product is the claims experience and this risk is managed through the initial pricing of the policy (based on actuarial principles), the use of reinsurance and a clear process for administering claims.

44. Operating leases

Operating lease rentals charged within administrative expenses amounted to £7 million (2009: £15 million).

The Group has commitments under non-cancellable operating leases as set out below:

	2010 £m	2009 £m
Not later than 1 year	**11**	11
Later than 1 year and no later than 5 years	**41**	42
Later than 5 years	**47**	54

The principal operating lease commitments concern office space located at Bothwell Street, Glasgow; St Vincent Street, Glasgow; Juxon House, London; Harcourt Street, London and Cheapside, London.

45. Commitments

	2010 £m	2009 £m
To subscribe to private equity funds and other unlisted assets	**409**	520
To purchase, construct or develop investment property	**80**	108
For repairs, maintenance or enhancements of investment property	**2**	3
To acquire property, plant and equipment	**2**	-

46. Related party transactions

The Group has related party transactions with certain of its shareholders, its pension schemes and its key management personnel.

Transactions with pension schemes

During the year the Group entered into the following transactions with its pension schemes:

	Transactions 2010 £m	**Balances outstandi ng 2010 £m**	Transactions 2009 £m	Balances outstandi ng 2009 £m
Pearl Scheme				
Investment management fees	**0.5**	**0.7**	1.4	1.4
Payment of administrative expenses	**(3.0)**	**-**	(1.0)	(0.3)
	(2.5)	**0.7**	0.4	1.1
PGL Scheme				
Investment management fees	**2.2**	**0.8**	0.7	0.5

The Pearl Scheme has invested in collective investment schemes that are controlled by the Group. At 31 December 2010 the Pearl Scheme held 1,118,197 units (2009: 1,118,197 units) in the IGNIS Systematic Strategies Fund and 147,928,525 units (2009: 115,477,491 units) in the IGNIS Liquidity Fund. The value of these investments at 31 December 2010 was £168 million (2009: £154 million) and £148 million (2009: £115 million) respectively.

Information on other transactions with the pension schemes is included in note 32.

Transactions with key management personnel

The total compensation of key management personnel, being those having authority and responsibility for planning, directing and controlling the activities of the Group, including the Executive and Non-Executive Directors, are as follows:

	2010 £m	2009 £m
Salary and other short-term benefits	**4.1**	2.3
Equity compensation plans	**3.1**	3.6
Termination benefits	**0.5**	-

Persuant to the Placing referred to in note 16, Hugh Osmond took up his contractual pre-emption rights and received 310,000 shares at 660 pence per share.

As a result of the acquisition of the Pearl businesses, some of the Directors received shares and contingent rights over shares in Phoenix Group Holdings in exchange for shares they held in the acquired group of companies. In addition, some Directors have received share-based payments. Details of the shareholdings and emoluments of individual Directors are provided in the Remuneration Report.

Transactions with other related parties

The following information is provided in accordance with the UKLA's Listing Rule 11:

Pursuant to the Placing referred to in note 16, TDR Capital Nominees Limited ('TDR') took up its contractual pre-emption rights and received 707,318 shares at 660 pence per share. The subscription by TDR and Hugh Osmond represented an aggregate allocation of approximately 20% of the Placing.

On 29 November 2010, Pearl Assurance Limited and London Life Limited invested a total of €7,774,476 in Sant Topco Holdings II S.a.r.l ('Topco') through a subscription of 3,110 'B' ordinary shares with a par value of € 25. This brings the Group's direct investment in Topco and its ultimate holding company to approximately €166 million. As shareholders in Topco, TDR, Hugh Osmond and Edward Hawkes also subscribed for 'B' ordinary shares alongside Pearl Assurance Limited and London Life Limited.

TDR, Hugh Osmond and Edward Hawkes are related parties for the purposes of the UKLA's Listing Rules.

47. Contingent liabilities

In the normal course of business the Group is exposed to certain legal issues, which involve litigation and arbitration, and as at the period end, the Group has a contingent liability in this regard.

Following a previous acquisition by the Pearl businesses, the shares in PLL and certain loans were transferred from the non-profit fund to the shareholder fund of PA (GI) Limited at their admissible regulatory value. HM Revenue & Customs ('HMRC') had challenged the tax treatment of these transfers in the year ended 31 December 2004 and litigation was anticipated in 2010. During the year, HMRC confirmed that they will not pursue litigation.

London Life Limited has provided information to the FSA on its categorisation of working capital to owner funds in 2006. The Directors are confident in this treatment, which is supported by legal and actuarial advice, but note that the FSA have not concluded their review into the matter and therefore a contingent liability of £27 million (2009: £54 million) exists if London Life Limited were required to transfer this working capital back to policyholder funds.

48. Group entities

The principal subsidiary undertakings of the Group are as follows:

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
Insurance companies		
BA (GI) Limited (general insurance company)	UK	Ordinary shares of £0.05
London Life Limited	UK	Ordinary shares of £1
National Provident Life Limited	UK	Ordinary shares of £1
NPI Limited	UK	Ordinary shares of £1
Pearl Assurance Limited	UK	'A' ordinary shares of £0.05 'B' ordinary shares of £1
PA (GI) Limited (general insurance company)	UK	Ordinary shares of £0.01 deferred shares of £0.25
Phoenix Life Limited	UK	Ordinary shares of £1
Phoenix & London Assurance Limited	UK	Ordinary shares of £1
Phoenix Pensions Limited	UK	Ordinary shares of £1
Scottish Mutual International Limited	ROI	Ordinary shares of €1.25
Non-insurance companies		

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
Axial Fixed Income Opportunities S.a.r.l. (investment vehicle)	Luxembourg	Ordinary shares of €100
IGNIS Asset Management Limited (investment management company)	UK	Ordinary shares of £1
IGNIS Fund Managers Limited (unit trust management)	UK	Ordinary shares of £1
IGNIS Investment Services Limited (investment management company)	UK	Ordinary shares of £1
Impala Holdings Limited (holding company)	UK	'A' ordinary shares of £1, 'B' ordinary shares of £1 'C' ordinary shares of £1 and 'D' ordinary shares of £1
Mutual Securitisation plc (finance company)	ROI	Quasi subsidiary
NP Life Holdings Limited (holding company)	UK	'A' ordinary shares of £1 and 'B' ordinary shares of £1
Opal Reassurance Limited	Bermuda	'A' ordinary shares of £1 'B' ordinary shares of £1 and Preference shares of £1
PGH (LCA) Limited (finance company)	UK	Ordinary shares of £1
PGH (LCB) Limited (finance company)	UK	Ordinary shares of £1
PGH (LC1) Limited (finance company)	UK	Ordinary shares of £1 and Preference shares of £1
PGH (LC2) Limited (finance company)	UK	Ordinary shares of £1 and Preference shares of £1
PGH (MC1) Limited (finance company)	UK	Ordinary shares of £1 and Preference shares of £1
PGH (MC2) Limited (finance company)	UK	Ordinary shares of £1 and Preference shares of £1
PGH (TC1) Limited (holding company)	UK	'A' ordinary shares of £1 and Preference shares of £1
PGH (TC2) Limited (holding company)	UK	'A' ordinary shares of £1 and Preference shares of £1

	Country of incorporation and principal place of operation	Class of shares held (wholly-owned unless otherwise indicated)
Pearl Group Holdings (No. 1) Limited (finance company)	UK	Ordinary shares of £0.05
Pearl Group Holdings (No. 2) Limited (holding company)	UK	Ordinary shares of £1
Pearl Life Holdings Limited (holding company)	UK	Ordinary shares of £1
Pearl Group Services Limited (service company)	UK	Ordinary shares of £1
PGS 2 Limited (finance company)	UK	Ordinary shares of £1
Pearl Group Management Services Limited (service company)	UK	Ordinary shares of £1
Phoenix Life Holdings Limited (holding company)	UK	Ordinary shares of £1
UK Commercial Property Trust Limited (property fund)	Guernsey	66% of ordinary shares of £0.25

The information disclosed above is only in respect of those undertakings which materially affect the figures shown in the Group's accounts. There are a number of other subsidiaries and associated undertakings whose business does not materially affect the Group's profits or the amount of its assets and particulars of these have been omitted in view of their excessive length.

49. Events after the reporting period

With effect from 1 January 2011, all of the long-term business and some of the shareholders' funds of Phoenix & London Assurance Limited were transferred to Phoenix Life Limited for £nil consideration in accordance with the terms of a scheme under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 11 February 2011. Both of these companies are wholly owned subsidiaries of the Group and therefore there is no financial impact from an IFRS perspective for the Group.

On 1 March 2011, the European Court of Justice ruled that insurance companies will, with effect from 21 December 2012, no longer be allowed to use gender as a basis for calculating premiums. At this time, the precise impact of this judgement is uncertain, and management is currently examining the implications. Consequently, it is not yet possible to determine with any certainty what the effect of this judgement may be on the Group.

On 21 March 2011, the Group successfully completed the restructuring of a £1.2 billion portfolio of corporate loans leading to a reduction in asset volatility. The restructuring has involved the repayment of a number of borrowings (see note 22). The restructuring has minimal financial impact from an IFRS perspective.

On 23 March 2011, HMRC issued a technical note on 'Solvency II and the Taxation of Insurance Companies', outlining changes to the taxation of UK insurance companies with effect from 2013. The timing of the announcement and the complexity of the proposed changes means that it has not been possible to estimate their potential future impact on the deferred tax balances shown in these accounts.

On 28 March 2011 the Board declared a dividend of £0.21 per share (2009: €0.17 per share) for the year ended 31 December 2010. The cost of this dividend has not been recognised as a liability in the financial statements for 2010 and will be charged to the statement of changes in equity in 2011.

R Sandler C Bannister J Yates A Lyons I Ashken R P Azria D Barnes C Clarke I Cormack T Cross Brown M Dale I Hudson H Osmond D Woods

St Helier

28 March 2011

MCEV SUPPLEMENTARY INFORMATION

SUMMARISED CONSOLIDATED INCOME STATEMENT – GROUP MCEV BASIS

For the year ended 31 December 2010

	2010 £m	Pro for ma 200 9 £m
Life MCEV operating earnings	758	380
Management services operating profit	20	14
Ignis Asset Management operating profit	46	34
Group costs	(70)	(54)
Group MCEV operating earnings before tax1	754	374
Economic variances on covered business	101	701
Economic variances on non-covered business	(38)	(245)
Other non-operating variances on covered business	(54)	9
Non-recurring items on non-covered business	(75)	(87)
Gain on debt refinancing	–	491
Finance costs attributable to owners	(168)	(390)
Group MCEV earnings before tax	520	853
Tax on operating earnings	(211)	(105)
Tax on non-operating earnings	(54)	(197)
Total tax	(265)	(302)
Group MCEV earnings after tax	255	551

1. The Group has moved to calculating the expected contribution on existing business using longer term expectations of investment returns. The pro forma 'Group MCEV operating earnings before tax' and 'Economic variances on covered business' before tax would have been £538 million and £537 million respectively for the year ended 31 December 2009 if the expected contribution had been calculated using longer term rates of return.

MCEV earnings per ordinary share

For the year ended 31 December 2010

	2010	Pro for ma 200 9
Group MCEV operating earnings after tax		
Basic[1]	363.2p	291.5p
Diluted[2]	363.2p	254.4p
Group MCEV earnings after tax		
Basic[1]	170.6p	597.2p
Diluted[2]	170.6p	521.1p

1. Based on 149 million shares (2009: 92 million) as set out in note 15 of the IFRS consolidated financial statements.
2. Based on 149 million shares (2009: 106 million), allowing for warrants in issue as set out in note 15 of the IFRS consolidated financial statements.

The earnings on covered business are calculated on a post-tax basis and are grossed up at the effective rate of shareholder tax for presentation in the income statement. The tax rate used is the UK corporate tax rate of 28%.

STATEMENT OF CONSOLIDATED COMPREHENSIVE INCOME – GROUP MCEV BASIS

For the year ended 31 December 2010

	2010 £m	Pro for ma 200 9 £m
Group MCEV earnings for the year after tax	255	551
Other comprehensive income		
Actuarial gains/(losses) on defined benefit pension scheme	27	(14)
Exchange differences on translating foreign operations	–	(44)
	27	(58)
Total comprehensive income for the year	282	493

Reconciliation of movement in equity – Group MCEV basis
for the year ended 31 December 2010

	2010 £m	Pro forma 2009 £m
Group MCEV equity at 1 January	1,827	1,044
Total comprehensive income for the year	282	493
Issue of share capital	33	275
Conversion of warrants into ordinary shares	7	51
Redemption of shares	–	(41)
Movement in equity for equity-settled share-based payments	(2)	5
Dividends paid on ordinary shares	(54)	–
Shares issued in lieu of dividends	11	–
Group MCEV equity at 31 December	2,104	1,827

GROUP MCEV ANALYSIS OF EARNINGS
For the year ended 31 December 2010

		Non-covered business			
	Covered business MCEV £m	Management services IFRS £m	Asset Managemen t IFRS £m	Other Group companies ¹ IFRS £m	Group MCEV £m
Group MCEV at 1 January 2010	4,731	56	39	(2,999)	1,827
Operating MCEV earnings (after tax)	546	14	33	(50)	543
Non-operating MCEV earnings (after tax)	34	(54)	–	(268)	(288)
Total MCEV earnings	580	(40)	33	(318)	255
Other movements	–	–	–	27	27
Capital and dividend flows – internal[2]	(794)	64	(18)	748	–
Capital and dividend flows – external	–	–	–	(5)	(5)
Closing value at 31 December 2010	4,517	80	54	(2,547)	2,104

- Comprises the Group holding companies that do not form part of the Phoenix Life and Ignis Asset Management divisions.

- Includes a re-allocation of a £250 million loan asset from Covered business to Other Group companies. This does not affect the closing Group MCEV or MCEV earnings.

for the year ended 31 December 2009 (pro forma)

		Non-covered business			
	Covered business MCEV £m	Management services IFRS £m	Asset Management IFRS £m	Other Group companies[1] IFRS £m	Group MCEV £m
Pro forma Group MCEV at 1 January 2009	4,081	122	34	(3,193)	1,044
Operating MCEV earnings (post-taxation)	273	10	24	(38)	269
Non- operating MCEV earnings (post-taxation)	511	(25)	(4)	(200)	282
Total MCEV earnings	784	(15)	20	(238)	551
Foreign exchange	–	–	–	(44)	(44)
Other movements	–	–	–	(14)	(14)
Capital and dividend flows – internal	(134)	(51)	(15)	200	–
Capital and dividend flows – external	–	–	–	290	290
Closing value at 31 December 2009	4,731	56	39	(2,999)	1,827

1. Comprises the Group holding companies that do not form part of the Phoenix Life and Ignis Asset Management divisions.

RECONCILIATION OF GROUP IFRS EQUITY TO MCEV NET WORTH

	2010 £m	2009 £m
Group net assets attributable to owners of the parent as reported under IFRS	1,580	1,412
Goodwill and other intangibles in accordance with IFRS removed (net of tax)	(391)	(413)
Value of in-force business in accordance with IFRS removed (net of tax)	(1,345)	(1,419)
Adjustments to IFRS reserving	(138)	(98)
Tax adjustments	(90)	(99)
Revalue listed debt to market value	94	235
Eliminate value of contingent loan asset[1]	(276)	(194)
Fair value adjustments[2]	5	(40)
Eliminate pension scheme surplus[3] (net of tax)	(112)	(45)
Other adjustments	30	(9)
MCEV net worth attributable to owners of the parent	(643)	(670)
MCEV value of in-force business included (net of tax) as set out in note 2	2,747	2,497
Closing Group MCEV	2,104	1,827

1. Removal of value attributed to contingent loans issued by holding companies to long-term funds as their expected repayments are captured within the MCEV VIF calculations.
- Investments carried at amortised cost under IFRS are revalued at market value.

- The pension scheme surplus removed is the economic surplus of the PGL Pension scheme net of tax, as described in note 32 to the IFRS consolidated financial statements.

NOTES TO THE MCEV FINANCIAL STATEMENTS

1. Basis of preparation

Overview

The supplementary information on pages 174 to 188 has been prepared on a Market Consistent Embedded Value ('MCEV') basis except for the items described further below.

Whilst the IFRS consolidated financial statements consolidate the results of the Pearl businesses for the period from acquisition on 28 August 2009, the MCEV supplementary information treats the Pearl businesses as having been acquired on 1 January 2009. For this reason the results for the year ended 31 December 2009 are referred to as pro forma.

The MCEV methodology adopted by the Group is in accordance with the MCEV principles and guidance published by the CFO Forum in October 2009, except that:

- risk-free rates have been defined as the annually compounded UK Government nominal spot curve plus 10 basis points rather than as a swap rate curve;
- no allowance for the cost of residual non-hedgeable risk ('CNHR') has been made because, in the opinion of the Directors, the Group operates a robust outsourcer model in terms of operational risk, does not write new business, is focused entirely on the back book, and has succeeded in closing out significant legacy risks. The theoretical value of CNHR is disclosed separately in note 1 (b); and
- the asset management and management service companies are calculated on an IFRS basis. Under CFO Forum principles and guidance productivity gains should not be recognised until achieved. This treatment is inconsistent with the cost profile of a closed fund where continual cost reductions are expected to maintain unit costs as the business runs off. In the opinion of the Directors, if the MCEV principles and guidance were to be applied to the asset management and the management service companies, it would not provide a fair reflection of the Group's financial position. These companies are therefore reported alongside the Group's other non-life holding companies at their IFRS net asset value.

On 21 March 2011 the restructuring of a £1.2 billion portfolio of corporate loans was completed. The December MCEV includes a benefit of £139 million from this restructuring primarily from the additional liquidity premium expected to be earned following the restructuring.

With effect from 1 January 2011, all of the long-term business and some of the shareholders' funds of Phoenix & London Assurance Limited were transferred to Phoenix Life Limited for £nil consideration in accordance with the terms of a scheme under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 11 February 2011. The 2010 MCEV includes a £19 million benefit from the transfer.

A gradual reduction in the UK corporation tax rate from 28% to 24% over the next 4 years was announced in the Emergency Budget of 22 June 2010 with a further 1% reduction being announced in the Budget of 23 March 2011. The Finance (No. 2) Act 2010 included the first of the 1% rate reductions with effect from April 2011, with subsequent reductions to be dealt with by future legislation. The 2010 MCEV includes the impact of the tax rate being reduced to 27%. The impact of the further 4% reduction of rate is not expected to be material.

On 1 March 2011, the European Court of Justice ruled that insurance companies will, with effect from 21 December 2012, no longer be allowed to use gender as a basis for calculating premiums. At this time, the precise impact of this judgement is uncertain, and management is currently examining the implications. Consequently, it is not yet possible to determine with any certainty what the effect of this judgement may be on the Group.

On 23 March 2011, HMRC issued a technical note on ‘Solvency II and the Taxation of Insurance Companies’, outlining changes to the taxation of UK insurance companies with effect from 2013. The timing of the announcement and the complexity of the proposed changes means that it has not been possible to estimate their potential future impact on the Group MCEV.

Covered business

The MCEV calculations cover all long-term insurance business written by the Group, but exclude Ignis Asset Management and the management service companies.

Opal Re is included within covered business and is valued on a basis consistent with the annuity business within the life companies.

MCEV methodology

The embedded value of covered business is based on a market-consistent methodology. Under this methodology, assets and liabilities are valued in line with market prices and consistently with each other.

The key components of MCEV are net worth plus the value of in-force covered business.

a) Net worth

For the Group’s life companies, net worth is defined as the market value of shareholder funds plus the shareholders’ interest in surplus assets held in long-term business funds less the market value of any outstanding debt of the life companies.

Loans from the life companies to holding companies have been consolidated out such that they do not appear as an asset in the life company or as a liability in the holding company. This presentation has no impact on the overall MCEV but does affect the allocation of net assets between covered and non-covered business.

b) Value of in-force business (‘VIF’)

The value of in-force covered business consists of the following components:

- present value of future profits;
- time value of financial options and guarantees; and
- frictional costs of required capital.

The market consistent value of in-force business represents the present value of profits attributable to shareholders arising from the in-force business, less an allowance for the time value of financial options and guarantees embedded within life insurance contracts and frictional costs of required capital.

The approach adopted to calculate VIF combines deterministic and stochastic techniques (each of which is discussed in more detail below):

- deterministic techniques have been used to value cash flows whose values vary in a linear fashion with market movements. These cash flows are valued using discount rates that reflect the risk inherent in each cash flow. In practice, it is not necessary to discount each cash flow at a different discount rate, as the same result is achieved by projecting and discounting all cash flows at risk-free rates. This is known as the ‘certainty equivalent approach’; and
- stochastic techniques have been used to value cash flows that have an asymmetric effect on cash flows to shareholders. Here, the calculation involves the use of stochastic models developed for the purposes of realistic balance sheet reporting.

Present value of future profits ('PVFP')

The present value of future profits represents the present value of profits attributable to shareholders arising from the in-force business. The PVFP is calculated by projecting and discounting using risk-free rates, with an allowance for liquidity premiums where appropriate.

The projection is based on actively reviewed best estimate non-economic assumptions. Best estimate assumptions make appropriate allowance for expected future experience where there is sufficient evidence to justify; for example in allowing for future mortality improvements on annuity business.

Time value of financial options and guarantees ('TVFOGs')

The Group's embedded value includes an explicit allowance for the time value of financial options and guarantees embedded within insurance contracts, including investment performance guarantees on participating business and guaranteed vesting annuity rates. The cost of these options and guarantees to shareholders is calculated using market-consistent stochastic models calibrated to the market prices of financial instruments as at the period end.

The TVFOGs allow for the impact of management actions, consistent with those permitted by the Principles and Practices of Financial Management. The modelling of management actions vary for each of the funds but typically include management of bonus rates and policy enhancements, charges to asset share to cover increases to the cost of guarantees and alterations to investment strategy.

Frictional cost of capital ('COC')

Cost of capital is defined as the difference between the market value of shareholder-owned assets backing required capital and the present value of future releases of those assets allowing for future investment returns on that capital, investment expenses and taxes.

Required capital is defined as the minimum regulatory capital requirement, which is the greater of Pillar1 and Pillar 2 capital requirements, plus the capital required under the Group's capital management policy.

This equates to 119% (2009: 125%) of the minimum regulatory capital requirement.

Solvency II will introduce a new capital regime for insurers from the end of 2012. These disclosures do not take account of the impact of the change in regime as this is still under development.

Cost of residual non-hedgeable risks ('CNHR')

The CNHR should allow for risks that can have an asymmetric impact on shareholder value to the extent these risks have not already been reflected in the PVFP or TVFOGs. The majority of such risks within the Group are operational and tax risks.

No allowance for the CNHR has been made, as in the opinion of the Directors, the CNHR calculated in accordance with CFO Forum principles and guidance does not anticipate further risk management actions and therefore does not provide a fair reflection of the Group's ongoing risk.

However, the CNHR calculated in accordance with the CFO Forum principles and guidance, and therefore without anticipating further risk management actions, has been disclosed below.

For with-profits business the CNHR would increase the TVFOGs by £64 million (2009: £93 million).

For other business the cost would be £137 million (2009: £141 million). This equates to an equivalent average cost of capital charge of 1.2% (2009: 1.6%). The level of capital assumed in this calculation is determined based on a 99.5% confidence level over a one year time horizon, consistent with the ICA methodology. Allowance is made for diversification benefits between non-hedgeable risks, but not between hedgeable and non-hedgeable risks.

c) Valuation of debt

Listed debt issued by the Group is valued at the market value quoted at the reporting date which is consistent with MCEV principles.

The National Provident Life limited recourse bonds are backed by surpluses that are expected to emerge on blocks of its unit-linked and unitised with-profits business. This securitisation has been valued on a cash flow basis, allowing for payments expected to be due based on the projected level of securitised surpluses emerging. The full VIF of the securitised unit-linked and unitised with-profits business is expected to be payable to bondholders; therefore, no additional value accrues to the embedded value.

Unlisted bank debt owed by the holding companies is included at face value.

d) Taxation

Full allowance has been made for the value of tax that would become payable on the transfer of surplus assets out of non-profit funds. This allowance reflects the projected pace of releases of surplus from non-profit funds that is not required to support with-profits funds.

Allowance has also been made for the tax relief arising from interest payments made on the debt of the holding companies. The value of the tax relief is determined by offsetting the tax payable on profits emerging from covered business against the tax relief afforded by interest payments on the debt. Interest payments are projected assuming that current levels of debt are reduced and then refinanced to maintain a long-term level of debt that the Directors consider to be supported by the projected embedded value of the Group's businesses.

e) New business

The MCEV places a value on the profits expected to be earned on annuities arising from policies vesting with guaranteed annuity terms. These policies are excluded from the definition of new business on the basis that the annuity being provided is an obligation under an existing policy and the life companies are already reserving for the cost of these guarantees.

New business includes all other annuities written by the life insurance companies.

f) Participating business

Allowance is made for future bonus rates on a basis consistent with the projection assumptions and established company practice.

The time value of options and guarantees used in the calculation of MCEV also allows for expected management action and policyholder response to the varying external economic conditions simulated by the economic scenario generators. Policyholder response has been modelled based on historical experience. Management actions have been set in accordance with each life companies' Principles and Practices of Financial Management.

g) Pension schemes

The MCEV allows for pension scheme deficits as calculated on an IFRS basis, but no benefit is taken for pension scheme surpluses.

2. Components of the MCEV of covered business

	2010 £m	2009 £m
Net worth	1,770	2,234
PVFP	3,022	2,864
TVFOG	(113)	(97)
COC	(162)	(270)
Total VIF	**2,747**	**2,497**
	4,517	4,731

The net worth of covered business of £1,770 million at 31 December 2010 (2009: £2,234 million) consists of £670 million of free surplus in excess of required capital (2009: £408 million). This does not include the IFRS net assets of management services of £80 million (2009: £56 million) as shown in the free surplus reconciliation for Phoenix Life on page 32.

3. Analysis of covered business MCEV earnings (after tax)

	Net wort h £m	VIF £m	Total Life MCE V £m
Life MCEV at 1 January 2010	2,234	2,497	4,731
New business value	16	3	19
Expected existing business contribution (reference rate)[1]	102	122	224
Expected existing business contribution (in excess of reference rate)[2]	43	39	82
Transfer from VIF to net worth	145	(145)	–
Experience variances	35	229	264
Assumption changes	53	(91)	(38)
Other operating variances	(28)	23	(5)
Life MCEV operating earnings	366	180	546
Economic variances	(94)	167	73
Other non-operating variances	58	(97)	(39)
Total Life MCEV earnings	330	250	580
Capital and dividend flows	(794)	–	(794)
Life MCEV at 31 December 2010	1,770	2,747	4,517

1. Expected existing business contribution (reference rate) represents the expected return on the opening MCEV at the long term risk free rate.

- Expected existing business contribution (in excess of reference rate) represents the additional expected return above the risk free rate arising from long term risk premiums on equities, property and corporate bonds.

3. Analysis of covered business MCEV earnings (after tax) (continued)

	Net worth £m	VIF £m	Total Life MCEV £m
Life pro forma MCEV at 1 January 2009	1,816	2,265	4,081
New business value	18	4	22
Expected existing business contribution (reference rate)	32	27	59
Expected existing business contribution (in excess of reference rate)	10	26	36
Transfer from VIF to net worth	181	(181)	–
Experience variances	51	11	62
Assumption changes	165	(92)	73
Other operating variances	(14)	35	21
Life MCEV operating earnings	443	(170)	273
Economic variances	66	438	504
Other non-operating variances	12	(5)	7
Total Life MCEV earnings	521	263	784
Capital and dividend flows	(103)	(31)	(134)
Life MCEV at 31 December 2009	2,234	2,497	4,731

4. New business

The value generated by new business written during the period is calculated as the present value of the projected stream of after-tax distributable profits from that business. This contribution has been valued using economic and non-economic assumptions at the point of sale. The value of new business is shown after the effect of frictional costs of holding required capital on the same basis as for the in-force covered business.

	Premium £m	MCEV £m	MCEV/Premium. %
Year ended 31 December 2010	388	19	5%
Year ended 31 December 2009 (pro forma)	401	22	5%

5. Maturity profile of business

This note sets out how the PVFP is expected to emerge into net worth over future years. Surpluses are projected on a certainty equivalent basis with allowance for liquidity premiums as appropriate and are discounted at risk-free rates.

						Years
Present value of future profits (PVFP)	1-5 £m	6-10 £m	11-15 £m	16-20 £m	20+ £m	Total
31 December 2010	1,147	848	488	271	268	3,022
31 December 2009	975	767	508	305	309	2,864

6. Assumptions

Reference rates

(a) Risk-free rates

Risk-free rates are based on the annually compounded UK Government bond nominal spot curve plus ten basis points, extrapolated as necessary to meet the term of the liabilities. Recognising that this is a departure from MCEV principles, a sensitivity based on swap yields is disclosed.

The risk-free rates assumed for a sample of terms were as follows:

		2010		2009
Term	**Gilt Yield +10 bps**	**Swap Yield**	Gilt Yield +10 bps	Swap Yield
1 year	0.73%	0.88%	0.97%	1.02%
5 years	2.51%	2.69%	3.13%	3.49%
10 years	3.79%	3.70%	4.35%	4.27%
15 years	4.37%	4.08%	4.80%	4.55%
20 years	4.58%	4.17%	4.86%	4.55%

The swaps rates above are only applicable to sensitivity (16) as disclosed in note 7.

(b) Liquidity premiums

In October 2009, the CFO Forum published an amendment to MCEV principles to reflect the inclusion of a liquidity premium. The changes affirm that the reference rate may include a liquidity premium over and above the risk-free yield curve for liabilities which are not liquid, given that the matching assets are able to be held to maturity.

The liabilities to which a liquidity premium is applied include immediate annuities, pensions policies with benefits defined as an annuity or in-the-money guaranteed annuity options. The liquidity premium is determined by reference to the yield on the bond portfolios held after allowing for credit risk by deducting margins for best estimate defaults and unexpected default risk premiums. The additional yield above risk-free rates implied by the calculated liquidity premium is as follows:

	2010	2009
Additional yield over risk-free rates	0.48%	0.30%

Inflation

For purposes of the MCEV calculation, the rate of increase in the UK Retail Price Index ('RPI') as at 31 December 2010 was taken from the implied inflation curve at a term appropriate to the liabilities. The rate of increase in UK National Average Earnings inflation is assumed to be RPI + 100 basis points as at 31 December 2010 (2009: RPI + 100 basis points).

Stochastic economic assumptions

The time value of options and guarantees is calculated using an economic scenario generator. The model is calibrated to market conditions as at 31 December 2010. The scenario generator and calibration are consistent with that used for realistic balance sheet reporting.

A LIBOR Market Model is used to generate risk-free rates over a complete yield curve, calibrated to the UK nominal spot curve plus 10 basis points, consistent with the deterministic projections. Interest rate volatility is calibrated to swaption implied volatilities, as per the sample below.

	Option term (years)					
Interest rate volatility	**5**	**10**	**15**	**20**	**25**	**30**
2010 Swap term (years)						
5	17.5%	13.3%	13.6%	13.9%	14.7%	15.1%
10	15.8%	13.5%	13.6%	13.9%	14.5%	14.3%
20	15.2%	13.2%	13.2%	13.0%	13.0%	12.6%
30	14.6%	12.6%	12.2%	11.7%	11.5%	11.2%

	Option term (years)					
Interest rate volatility	5	10	15	20	25	30
2009 Swap term (years)						
5	17.0%	13.1%	14.3%	15.1%	15.9%	15.4%
10	15.7%	13.8%	14.8%	15.4%	15.6%	14.7%
20	15.9%	14.1%	14.6%	14.4%	14.0%	13.0%
30	15.7%	13.6%	13.5%	13.0%	12.3%	11.5%

Real interest rates have been modelled using the two-factor Vasicek model, calibrated to index-linked gilts

Equity volatility is calibrated to replicate the prices on a range of FTSE equity options, and extrapolated beyond terms available in the market. The equity volatility model used allows volatility to vary with both term and the level of the equity index.

						Term (years)
Equity implied volatility (ATM)	5	10	15	20	25	30
2010	24.3%	26.1%	26.4%	26.7%	26.8%	27.0%
2009	25.3%	26.6%	27.3%	27.5%	27.6%	27.7%

Best estimate levels of volatility are assumed for directly held property. The model implied volatility for 2010 is 15% (2009: 15%).

The modelling of corporate bonds allows for credit transitions and defaults, calibrated to historic data, with an additional allowance for the credit risk premium, derived from current markets.

6. Assumptions (continued)

Operating earnings

The Group uses normalised investment returns in calculating the expected existing business contribution. In 2009 the expected contribution was calculated using a one-year gilt forward rate plus the Group's long-term expectations of excess investment returns on equities, properties and bonds. From 2010, the Group considers that an average return over the remaining term of our in-force business is more appropriate than using a short-term rate and is more consistent with the Group's expectation of longer term rates of return. Therefore, the Group has moved to calculating the expected contribution on existing business using a 15-year gilt rate at the beginning of the reporting period plus 10 basis points and long-term expectations of excess investment returns.

The table below sets outs the asset risk premiums used:

	2010	2009
Equities	3.0%	2.5%
Property	2.0%	2.0%
Gilts	0.0%	0.0%

The return assumed on corporate bond portfolios is the redemption yield for the portfolio less an allowance for credit risk.

Expenses

Each life company's projected per policy expenses are based on existing management services agreements with the Group's service companies, adjusted to allow for additional costs incurred directly by the life companies, including, for example, regulatory fees and one-time expenses.

The life companies' projected investment expenses are based on the fees agreed with Ignis Asset Management, (or external fund managers, where appropriate), allowing for current and projected future asset mixes.

Valuation of debt and non-controlling interests

The Group's consolidated balance sheet as at 31 December 2010 includes Perpetual Reset Capital Securities with a face value of £425 million (2009: £500 million) and subordinated debt with a face value of £200 million (2009: £200 million) in relation to Phoenix Life Limited. These listed securities have been included within the MCEV at their market value quoted at the reporting date.

The table below summarises the value of these debt obligations.

	Face value (including	Market	Face	Market

	accrued interest) £m	value £m	value (including accrued interest) £m	value £m
Listed debt and non-controlling interests				
Perpetual Reset Capital Securities	439	304	540	264
Phoenix Life Limited subordinated debt	216	170	211	156

Unlisted debt has been included at face value.

	2010 Face value	2009 Face value
Unlisted debt		
Pearl and Impala facilities	2,639	2,760
Royal London PIK notes and facility	106	102

7. Sensitivity to assumptions

The table below summarises the key sensitivities of the MCEV of covered business at 31 December 2010:

	2010 Life MCEV £m
(1) Base	4,517
(2) 1% decrease in risk-free rates	183
(3) 1% increase in risk-free rates	(167)
(4) 10% decrease in equity market values	(105)
(5) 10% increase in equity market values	102
(6) 10% decrease in property market values	(77)
(7) 10% increase in property market values	76
(8) 100 bps increase in credit spreads[1]	(267)
(9) 100 bps decrease in credit spreads	250
(10) 25% increase in equity/property implied volatilities	(35)
(11) 25% increase in swaption implied volatilities	(23)
(12) 25% decrease in lapse rates and paid-up rates	(21)
(13) 5% decrease in annuitant mortality	(166)
(14) 5% decrease in non-annuitant mortality	35
(15) Required capital equal to the minimum regulatory capital[2]	31
(16) Swap curve as reference rate, retaining appropriate liquidity premiums	(272)

1. 44 bps is assumed to relate to default risk.

- Minimum regulatory capital is defined as the greater of Pillar 1 and Pillar 2 capital requirements without any allowance for the Group's capital management policy.

No expense sensitivity has been shown as maintenance costs incurred by the covered business are largely fixed under the terms of agreements with the management services companies.