

Notes to the condensed consolidated interim financial statements

1. Basis of preparation

The interim financial statements for the half year ended 30 June 2010 comprise the interim financial statements of Phoenix Group Holdings (“the Company”) and its subsidiaries (together referred to as “the Group”) as set out on pages 29 to 53 and were authorised by the Board of Directors for issue on 26 August 2010. The interim financial statements are unaudited but have been reviewed by the auditors, Ernst & Young Accountants LLP and their review report appears on page 28.

The interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the European Union and in accordance with the accounting policies set out in the 2009 financial statements which were prepared in accordance with International Financial Reporting Standards (“IFRSs”) adopted for use in the European Union, except for the amendments referred to below.

In preparing the interim financial statements the Group has adopted the following standards, amendments and interpretations:

- IFRS 3 *Business Combinations (Revised)*. This converges International and US Reporting requirements relating to business combinations;
- 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;
- Embedded Derivatives (Amendments to IFRIC 9 and IAS 39). This clarifies the treatment of embedded derivatives;
- 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 owners, other than in limited circumstances; and
- IAS 24 *Related Party Disclosures*. This amends the definition of a related party and clarifies its intended meaning. As permitted, the amended standard has been applied prior to its implementation date of 1 January 2011.

Adoption of these standards has not lead to any measurement or presentational changes to the results of any period presented in these interim financial statements.

After making enquiries, the Directors have a reasonable expectation that the Company and the Group as a whole have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

The financial statements for the year ended 31 December 2009 have been audited by the Group’s auditor, Ernst & Young Accountants LLP.

2. Prior period adjustments and changes in accounting policies

The financial statements for the year ended 31 December 2009 reported the effect of prior period adjustments and changes in accounting policies on the total consolidated comprehensive income for the period ended 31 December 2008 and the consolidated financial position of the Group at both 2 January and 31 December 2008.

There have been no changes in accounting policies and no prior period adjustment identified in the current reporting period, and the comparatives for the year ended 31 December 2009 included in these interim financial statements are as presented in the financial statements for the year ended 31 December 2009. However, comparatives for the half year ended 30 June 2009 as reported in the 2009 interim financial statements of the Company have been restated in these interim financial statements to reflect the impact of the prior period adjustments and changes in accounting policies disclosed in the financial statements for the year ended 31 December 2009. The impact of this restatement is as follows:

- the reclassification of the Company’s Initial Public Offering and Founders’ warrants from equity instruments to financial liabilities has increased the derivative financial liabilities as stated in the condensed statement of consolidated financial position as at 30 June 2009 by £35 million with a corresponding charge in net investment income within the condensed consolidated income statement for the half year ended 30 June 2009; and

- the change in the presentational currency of the Group from euros to sterling has decreased the foreign currency translation reserve in the condensed statement of consolidated financial position as at 30 June 2009 by £70 million and this emerges as a corresponding charge in the condensed statement of consolidated comprehensive income for the half year ended 30 June 2009.

3. 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.

3.1. Segmental result

Half year ended 30 June 2010

	Phoenix Life £m	Ignis Asset Management £m	Unallocated corporate £m	Eliminations £m	Total £m
Net premiums written from:					
External customers	764	–	–	–	764
Other segment	–	–	–	–	–
	764	–	–	–	764
Fees from:					
External customers	74	44	–	–	118
Other segment	–	45	–	(45)	–
	74	89	–	(45)	118
Net investment income:					
Net investment income	1,979	–	12	–	1,991
Offset interest income on interest swaps against interest expense	–	–	(27)	–	(27)
	1,979	–	(15)	–	1,964
Other operating income:					
Recurring	6	–	–	–	6
Non-recurring	2	–	–	–	2
	8	–	–	–	8
Net income	2,825	89	(15)	(45)	2,854
Net policyholder claims and benefits incurred:					
Recurring	(2,389)	–	–	–	(2,389)
Non-recurring	24	–	–	–	24
	(2,365)	–	–	–	(2,365)
Depreciation and amortisation:					
Depreciation of property, plant and equipment	–	(1)	–	–	(1)
Amortisation of acquired in-force business	(74)	–	–	–	(74)
Amortisation of other intangible assets	(8)	(1)	–	–	(9)
	(82)	(2)	–	–	(84)
Other operating expenses:					
Recurring	(29)	(66)	(18)	45	(68)
Non-recurring	(27)	(1)	(17)	–	(45)
	(56)	(67)	(35)	45	(113)
Total operating expense	(2,503)	(69)	(35)	45	(2,562)
Profit/(loss) before finance costs and tax	322	20	(50)	–	292
Finance costs	(36)	–	(87)	–	(123)
Offset interest income on interest swaps against interest expense	–	–	27	–	27
	(36)	–	(60)	–	(96)
Profit before tax	286	20	(110)	–	196
Tax attributable to policyholders' returns	(16)	–	–	–	(16)
Segmental result before the tax attributable to owners	270	20	(110)	–	180

Half year ended 30 June 2009

In the half year ended 30 June 2009 the results related to unallocated corporate items.

Year ended 31 December 2009

	Phoenix Life £m	Ignis Asset Management £m	Unallocated corporate £m	Eliminations £m	Total £m
Net premiums written from:					
External customers	514	–	–	–	514
Other segment	–	–	–	–	–
	<u>514</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>514</u>
Fees from:					
External customers	71	30	–	–	101
Other segment	–	28	–	(28)	–
	<u>71</u>	<u>58</u>	<u>–</u>	<u>(28)</u>	<u>101</u>
Net investment income:					
Net investment income	1,095	–	(63)	–	1,032
Offset interest income on interest swaps against interest expense	–	–	(16)	–	(16)
	<u>1,095</u>	<u>–</u>	<u>(79)</u>	<u>–</u>	<u>1,016</u>
Other operating income:					
Recurring	49	–	–	–	49
Non-recurring	18	–	–	–	18
	<u>67</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>67</u>
Net income	1,747	58	(79)	(28)	1,698
Net policyholder claims and benefits incurred:					
Recurring	(760)	–	–	–	(760)
Non-recurring	(74)	–	–	–	(74)
	<u>(834)</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>(834)</u>
Depreciation and amortisation:					
Depreciation of property, plant and equipment	(1)	(1)	–	–	(2)
Amortisation of acquired in-force business	(50)	–	–	–	(50)
Amortisation of other intangible assets	(6)	(1)	–	–	(7)
	<u>(57)</u>	<u>(2)</u>	<u>–</u>	<u>–</u>	<u>(59)</u>
Other operating expenses:					
Recurring	(562)	(43)	(17)	28	(594)
Non-recurring	(45)	(4)	–	–	(49)
	<u>(607)</u>	<u>(47)</u>	<u>(17)</u>	<u>28</u>	<u>(643)</u>
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 interest swaps against interest expense	–	–	16	–	16
	<u>(22)</u>	<u>–</u>	<u>(49)</u>	<u>–</u>	<u>(71)</u>
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

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

Half year ended 30 June 2010

	Phoenix Life £m	Ignis Asset Management £m	Unallocated corporate £m	Eliminations £m	Total £m
Operating profit/(loss) before adjusting items	182	22	(28)	–	176
Investment return variances and economic assumption changes on long-term business	128	–	–	–	128
Variance on owners' funds	33	–	(5)	–	28
Amortisation of acquired in-force business	(64)	–	–	–	(64)
Amortisation of other intangible assets	(8)	(1)	–	–	(9)
Non-recurring items	(1)	(1)	(17)	–	(19)
Financing costs attributable to owners	–	–	(60)	–	(60)
Segment result before the tax attributable to owners	270	20	(110)	–	180

Non-recurring items include:

- costs associated with the Phoenix Life site rationalisation and associated staff reductions and the Group's transformation programme with its outsourcers of £11 million;
- Premium Listing and other restructuring costs of £28 million;
- regulatory change and systems transformation costs of £13 million; and
- a gain of £29 million following the near finalisation of revised asset shares in the Phoenix & London Assurance 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. This partially offsets the overall charge of £78 million recognised in the second half of 2009 which was based on estimated asset shares.

Half year ended 30 June 2009

In the half year ended 30 June 2009 the results related to unallocated corporate items.

Year ended 31 December 2009

	Phoenix Life £m	Ignis Asset Management £m	Unallocated corporate £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 other intangible assets	(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 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 included costs associated with the Phoenix Life site rationalisation and associated staff reductions and the Group's transformation programme with its outsourcers.

3.3. 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.

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 changes in credit spreads on corporate bonds and equity, property and yield movements and are as follows:

	Half year ended 30 Jun 2010 £m	Half year ended 30 Jun 2009 £m	Year ended 31 Dec 2009 £m
Investment return variances and economic assumption changes on long-term business	128	–	145

Owners' funds

For non long-term business including owners' funds, the total investment income, including realised and unrealised 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:

	Half year ended 30 Jun 2010 £m	Half year ended 30 Jun 2009 Restated £m	Year ended 31 Dec 2009 £m
Variance on owners' funds of:			
Subsidiary undertakings	24	–	9
The Company	4	(35)	(79)
	28	(35)	(70)

The variances on owners' funds of the Company comprises unrealised fair value gains/(losses) arising from movements in the fair value of warrants in issue over the Company's shares together with foreign exchange gains/(losses) experienced in the period.

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:

	Half year ended 30 Jun 2010 %	Half year ended 30 Jun 2009 %	Year ended 31 Dec 2009 %
Equities	7.6	6.3	6.3
Property	6.6	5.8	5.8
Gilts (15 year gilt)	4.5	3.7	3.7
Other fixed interest (15 year gilt plus 0.6%)	5.1	4.3	4.3

3.4. Segmental total assets and total liabilities

	30 Jun 2010		30 June 2009		31 Dec 2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Phoenix Life	76,625	71,265	–	–	76,633	71,652
Ignis Asset Management	319	110	–	–	303	120
Unallocated corporate	72	3,226	519	52	–	3,024
	77,016	74,601	519	52	76,936	74,796

4. Tax credit

4.1. Current period tax (credit)/charge

	Half year ended 30 Jun 2010 £m	Half year ended 30 Jun 2009 £m	Year ended 31 Dec 2009 £m
Current tax:			
UK Corporation tax	28	–	(15)
Overseas tax	3	–	5
	31	–	(10)
Adjustment in respect of prior years	–	–	(3)
	31	–	(13)
Deferred tax:			
Reversal/(origination) of temporary differences			
On non-profit surpluses	(2)	–	(51)
On amortisation of acquired in-force business	(25)	–	(17)
On amortisation of other intangible assets	(3)	–	–
On profit arising from the changes in assumptions used for determining insurance liabilities in accordance with PS 06/14	–	–	(5)
Other temporary differences	(2)	–	–
Losses on corporate restructuring not matched in accounts	(35)	–	–
Write down of deferred tax assets	15	–	–
Capital allowances in excess of depreciation	–	–	1
Pension scheme movements	(9)	–	16
On provisions for future expenditure	4	–	(12)
Utilisation of tax losses	15	–	63
Tax losses arising in the current period carried forward	–	–	(26)
	(42)	–	(31)
Total tax credit	(11)	–	(44)
Attributable to:			
policyholders	16	–	(60)
owners	(27)	–	16
	(11)	–	(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 £16 million (half year ended 30 June 2009: £nil; year ended 31 December 2009: £(60) million).

4.2. Tax charged to other comprehensive income

	Half year ended 30 Jun 2010 £m	Half year ended 30 Jun 2009 £m	Year ended 31 Dec 2009 £m
Deferred tax on actuarial gains of defined benefit schemes	2	–	31

4.3. Reconciliation of tax credit

	Half year ended 30 Jun 2010 £m	Half year ended 30 Jun 2009 £m	Year ended 31 Dec 2009 £m
Profit/(loss) before tax	196	(37)	91
Policyholder tax (charge)/credit	(16)	–	60
Profit/(loss) before the tax attributable to owners	180	(37)	151
Tax at standard UK rate of 28%	50	(10)	42
Net tax losses on corporate restructuring not matched in accounts	(126)	–	(63)
Untaxed income	(37)	–	–
Disallowable expenses	3	–	10
Adjustment to tax charge in respect of prior years	–	–	(3)
Non taxable unrealised gains	(13)	–	–
Decrease in deferred tax on movement in non-profit surplus	–	–	(51)
Policyholder tax calculation methodology	–	–	48
Tax relief on accrued interest not valued	–	–	11
Profits taxed at rates other than 28%	6	10	12
Tax losses not valued	72	–	–
Write down of deferred tax assets	15	–	–
Other	3	–	10
Owners' tax (credit)/charge	(27)	–	16
Policyholder tax charge/(credit)	16	–	(60)
Total tax credit for the period	(11)	–	(44)

5. Earnings per share

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

	Half year ended 30 Jun 2010 £m	Half year ended 30 Jun 2009 Restated £m	Year ended 31 Dec 2009 £m
Profit/(loss) for the period	207	(37)	135
Share of result attributable to non-controlling interests	(28)	–	(40)
Profit/(loss) attributable to owners	179	(37)	95

The basic earnings per share of 135.6p (half year ended 30 June 2009: (67.1)p; year ended 31 December 2009: 102.9p) has been based on the profit of £179 million (half year ended 30 June 2009 restated: £(37) million; year ended 31 December 2009: £95 million) and a weighted average number of ordinary shares outstanding during the period of 132 million (half year ended 30 June 2009: 55 million; year ended 31 December 2009: 92 million), calculated as follows:

	Half year ended 30 Jun 2010 No. million	Half year ended 30 Jun 2009 No. million	Year ended 31 Dec 2009 No. million
Issued ordinary shares at beginning of the period	130	53	53
Effect of ordinary shares issued	2	2	39
Weighted average number of ordinary shares	132	55	92

The diluted earnings per share of 135.6p (half year ended 30 June 2009: (67.1)p; year ended 31 December 2009: 89.8p) has been based on the profit of £179 million (half year ended 30 June 2009 restated: £(37) million; year ended 31 December 2009: £95 million) and a diluted weighted average number of ordinary shares outstanding during the year of 132 million (half year ended 30 June 2009: 55 million; year ended 31 December 2009: 106 million), calculated as follows:

	Half year ended 30 Jun 2010 No. million	Half year ended 30 Jun 2009 No. million	Year ended 31 Dec 2009 No. million
Weighted average number of ordinary shares	132	55	92
Effect of warrants in issue	–	–	14
Weighted average number of ordinary shares (diluted)	132	55	106

The Founders', Sponsors' and IPO warrants issued in 2008 were dilutive up until 2 September 2009 and had the effect of increasing the weighted average number of ordinary shares by nil (half year ended 30 June 2009: 16 million; year ended 31 December 2009: 14 million) in calculating the diluted weighted averaged number of ordinary shares. However, as the Group reported a loss in the half year ended 30 June 2009, the increase in the weighted average number of ordinary shares of 16 million from the conversion of these warrants would have an antidilutive effect on the diluted earnings per share calculation and has therefore been excluded.

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 they do not have a dilutive effect for the periods presented:

- 5 million warrants issued to the banks and other lenders involved in the restructuring of certain of the external debt of the Pearl businesses (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.

The following contingent rights over shares have not been included in the diluted earnings per share figure, as none of the conditions would have been satisfied and therefore no shares would have been issued:

- 26.5 million contingent rights over shares issued to the vendors on 2 September 2009 as part of the consideration for the acquisition of the Pearl businesses. These were issuable in three tranches conditional upon the share price reaching thresholds of €13, €14 and €15 for 20 consecutive dealing days;
- 1 million contingent rights over shares were granted in satisfaction of the contingent underwriting fee. These were issuable conditional upon the share price reaching €15; and
- 8.5 million contingent rights over shares were granted on 2 September 2009 to the Lenders in part satisfaction of the financing fees incurred by the UK finance companies. These were issuable in three tranches conditional upon the share price reaching thresholds of €13, €14 and €15 for 20 consecutive dealing days.

On 5 July 2010, the Company's Standard Listing on the London Stock Exchange was upgraded to a Premium Listing. In connection with the Premium Listing, 32,400,000 of the contingent rights over shares were restructured through the issue of the same number of ordinary shares to the holders of such rights.

6. Share capital

	30 Jun 2010 £	30 Jun 2009 £	31 Dec 2009 £
Authorised:			
300 million (30 June 2009: 300 million; 31 December 2009: 300 million) ordinary shares of €0.0001 each	22,050	22,050	22,050
110 million (30 June 2009: nil; 31 December 2009: 110 million) 'B' ordinary shares of €0.0001 each	9,700	–	9,700
Nil (30 June 2009: 1 million; 31 December 2009: nil) preferred shares of €0.0001 each	–	74	–
	31,750	22,124	31,750
Issued and fully paid:			
80.4 million (30 June 2009: 75 million; 31 December 2009: 80.4 million) ordinary shares of €0.0001 each	6,067	5,583	6,067
52.0 million (30 June 2009: nil; 31 December 2009: 49.8 million) 'B' ordinary shares of €0.0001 each	4,576	–	4,383
	10,643	5,583	10,450

The holders of the ordinary and 'B' ordinary shares had the same rights to returns and voting. The holders were 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.

As at 30 June 2010, ordinary shares and 'B' ordinary shares comprised 61 percent and 39 percent respectively of total issued shares.

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.

Movements in share capital during the period:

	Number	£
Shares in issue at 1 January 2009 and 30 June 2009	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 2009	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
Shares in issue at 30 June 2010	132,462,855	10,643

On 13 January 2010, 147,925 'B' ordinary shares were issued and on 15 January 2010, 1,937,198 'B' ordinary shares were issued. 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 an 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.

7. Dividends on ordinary shares

	Half year ended 30 Jun 2010 £m	Half year ended 30 Jun 2009 £m	Year ended 31 Dec 2009 £m
Dividend declared and paid in 2010 at 15p per share (2009: nil)	20	–	–

On 30 March 2010, the Board declared a dividend of €0.17 per share in respect of the year ended 31 December 2009. This dividend was paid on 15 April 2010.

8. Non-controlling interests

	Perpetual Reset Capital Securities £m	UK Commercial Property Trust Limited £m	Total £m
At 1 January 2009 and 30 June 2009	–	–	–
On acquisition of the Pearl businesses	518	181	699
Profit for the period	9	31	40
Dividend paid	–	(8)	(8)
Effect of share transactions	–	(3)	(3)
At 1 January 2010	527	201	728
Profit for the period	9	19	28
Dividends paid	–	(7)	(7)
Restructure of non-controlling interests	(70)	–	(70)
Coupons paid, net of tax relief	(24)	–	(24)
Partial buyback of non-controlling interest	(19)	–	(19)
Effect of share transactions	–	97	97
At 30 June 2010	423	310	733

8.1. Perpetual Reset Capital Securities

On 1 January 2010, Pearl Group Holdings (No. 1) Limited ("PGH1") had in issue £500 million Perpetual Reset Capital Securities ("the Notes"). On 22 April 2010, the holders of the Notes ("the Noteholders") agreed to a number of amendments to the Notes, including a 15% reduction in the face value of the Notes, the amendment of the Alternative Coupon Satisfaction Mechanism and the imposition of an additional restriction on the payment of dividends by Phoenix Group Holdings if future coupons are deferred. The 15% reduction in face value of the Notes emerges in the condensed 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. In connection with the amendments to the Notes, the coupon which was deferred during 2009 is required to be settled by 31 December 2010.

During the period 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 condensed statement of consolidated financial position as a reduction of £19 million in non-controlling interests.

8.2. UK Commercial Property Trust Limited

UK Commercial Property Trust Limited is a property investment subsidiary which is domiciled in Guernsey and listed on the London Stock Exchange.

9. Pension schemes

The condensed statement of consolidated financial position incorporates the reported surplus/(deficit) of the PGL Pension Scheme and the Pearl Staff Pension Scheme at 30 June 2010 respectively. The economic surplus of the PGL Pension Scheme amounted to £143 million (31 December 2009: £62 million); this has been adjusted to eliminate on consolidation the carrying value of insurance policies held by the scheme of £71 million (31 December 2009: £66 million) in deriving the reported surplus/(deficit) of the scheme.

The triennial valuations as at 30 June 2009 for the PGL Pension Scheme and the Pearl Staff Pension Scheme are nearing completion/completed respectively and the reported surplus/(deficit) of both schemes reflects the assumptions underlying these latest triennial valuations. As an integral step in finalising the results of the PGL Pension Scheme triennial valuation, discussions are ongoing between the Group and the Trustees of the scheme over future funding contributions. These discussions were sufficiently well advanced at the interim reporting date to recognise a receivable under an indemnity agreement within the with-profit funds of the Group for contributions arising as a result of changes in longevity assumptions resulting from the previous triennial valuation of the PGL Pension Scheme. Accordingly, an amount of £27 million after tax has been recognised in the condensed statement of consolidated comprehensive income in respect of actuarial losses attributable to the with-profit fund.

10. Liabilities under insurance contracts – 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 period, a number of changes were made to assumptions to reflect changes in expected experience or to harmonise the approach across the enlarged Group. The impacts of material changes during the period were as follows:

	Increase/ (decrease) in insurance liabilities 30 Jun 2010 £m	Increase/ (decrease) in insurance liabilities 30 Jun 2009 £m	Increase/ (decrease) in insurance liabilities 31 Dec 2009 £m
Change in longevity assumptions	–	–	(73)
Change in persistency assumptions	13	–	94

11. Borrowings

	30 Jun 2010 £m	30 Jun 2009 £m	31 Dec 2009 £m
Carrying value			
Debtore loans			
Limited recourse bonds 2012 7.39%	46	–	48
Limited recourse bonds 2022 7.59%	83	–	86
Unsecured loan notes	14	–	18
£200 million 7.25% unsecured subordinated loans	123	–	119
£779 million loan	748	–	764
£15 million loan	11	–	15
£2,260 million syndicated loan	2,238	–	2,260
£80 million facility agreement	42	–	42
£100 million PIK notes and facility	104	–	102
£75 million secured loan note	70	–	70
£425 million syndicated loan	399	–	399
£4 million loan	4	–	–
	3,882	–	3,923
Abbey National Property Investments refinancing loan	253	–	258
	4,135	–	4,181

On 13 April 2010, a voluntary prepayment of £22 million was made on the £2,260 million syndicated loan.

12. Fair value hierarchy

12.1. Fair value hierarchy of financial instruments measured at fair value

At 30 June 2010	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets at fair value				
Derivative assets	90	3,102	66	3,258
Financial assets designated at fair value through profit or loss upon initial recognition				
Equities	10,388	21	888	11,297
Fixed and variable rate securities	34,671	2,860	643	38,174
Collective investment schemes	5,098	900	569	6,567
	50,157	3,781	2,100	56,038
Total financial assets at fair value	50,247	6,883	2,166	59,296
Financial liabilities at fair value				
Derivative liabilities	41	2,232	–	2,273
Financial liabilities designated at fair value through profit or loss upon initial recognition				
Investment contract liabilities	–	7,969	–	7,969
Borrowings	–	253	–	253
Net asset value attributable to unit holders	966	–	168	1,134
	966	8,222	168	9,356
Total financial liabilities at fair value	1,007	10,454	168	11,629

At 31 December 2009	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets at fair value				
Derivative assets	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 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
Financial liabilities at fair value				
Derivative liabilities	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

At 30 June 2009

All of the Groups financial assets and liabilities at fair value at 30 June 2009 were designated at fair value through profit or loss upon initial recognition and categorised as Level 1 financial instruments.

12.2. Movement in Level 3 financial instruments measured at fair value

	At 1 Jan 2010 £m	Total gains/ (losses) in income statement £m	Purchases and sales £m	Transfers from/(to) Level 1 and Level 2 £m	At 30 Jun 2010 £m	Unrealised gains/ (losses) on assets held at end of period £m
Financial assets at fair value through profit or loss – held for trading						
Derivative assets	–	(21)	87	–	66	(201)
Financial assets designated at fair value through profit or loss upon initial recognition						
Equities	1,494	103	(476)	(233)	888	72
Fixed and variable rate securities	819	(41)	(53)	(82)	643	(37)
Collective investment schemes	235	81	442	(189)	569	33
	2,548	122	–	(504)	2,166	(133)

	At 1 Jan 2010 £m	Total (gains)/ losses in income statement £m	Purchases and sales £m	Transfers from/(to) Level 1 and Level 2 £m	At 30 Jun 2010 £m	Unrealised (gains)/ losses on assets held at end of period £m
Financial liabilities designated at fair value through profit or loss upon initial recognition						
Net asset value attributable to unit holders	154	14	–	–	168	43
	154	14	–	–	168	43

	At 1 Jan and 30 Jun 2009 £m	Arising on acquisition of the Pearl businesses £m	Total gains/ (losses) in income statement £m	Purchases and sales £m	Transfers from/(to) Level 1 and Level 2 £m	At 31 Dec 2009 £m	Unrealised gains/ (losses) on assets held at end of period £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 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 Jan and 30 Jun 2009 £m	Arising on acquisition of the Pearl businesses £m	Total (gains)/ losses in income statement £m	Purchases and sales £m	Transfers from/(to) Level 1 and Level 2 £m	At 31 Dec 2009 £m	Unrealised (gains)/ losses on liabilities held at end of period £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
	–	170	8	(24)	–	154	29

Gains and losses on Level 3 financial instruments are included in net investment income in the income statement. There were no gains or losses recognised in other comprehensive income.

13. Cash flows from operating activities

	Half year ended 30 Jun 2010 £m	Half year ended 30 Jun 2009 £m	Half year ended 31 Dec 2009 £m
Profit/(loss) for the period before tax	196	(37)	91
Non-cash movements in profit/(loss) for the period before tax			
Fair value (gains)/losses on:			
Investment property	(62)	–	(159)
Financial assets	(539)	–	354
Fair value (losses)/gains on:			
Borrowings	(15)	–	32
Depreciation of property, plant and equipment	1	–	2
Amortisation of intangible assets	83	–	57
Change in present value of future profit	–	–	(4)
Change in unallocated surplus	(6)	–	175
Change in deposit received from reinsurers	1	–	(25)
Interest income on trust account	–	(1)	(2)
Interest expense on borrowings	123	–	87
Share-based payment charge	1	1	5
Net expected return on pension assets	10	–	9
Foreign currency exchange gains	–	–	(1)
Decrease in investment assets	1,377	–	487
Increase in reinsurance assets	(74)	–	(160)
Decrease in insurance contract and investment contract liabilities	(934)	–	(951)
Net increase in working capital	542	37	(354)
Cash generated/(absorbed) by operations	704	–	(357)

14. Related party transactions

The nature of the related party transactions of the Group has not changed from those referred to in the Group's consolidated financial statements for the year ended 31 December 2009.

There were no other transactions with related parties during the six months ended 30 June 2010 which have had a material effect on the results or financial position of the Group.

15. Contingent liabilities

Following a previous acquisition by the Pearl businesses, the shares in Phoenix Life Limited 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 period HMRC have confirmed that they will not pursue litigation.

London Life Limited has provided information to the Financial Services Authority 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 Financial Services Authority have not concluded their review into the matter and therefore a contingent liability of £20 million exists if London Life Limited were required to transfer this working capital back to policyholder funds.

16.Events after the reporting period

On 5 July 2010, the Company's Standard Listing on the London Stock Exchange was upgraded to a Premium Listing. In connection with the Premium Listing, the Company converted all 52,032,123 of its issued and fully paid 'B' ordinary shares into ordinary shares by way of a variation of rights and redesignation on a one-for-one basis.

Also on 5 July 2010, the Company completed the restructuring of the contingent rights over its shares as follows:

- the Company issued to each holder of contingent rights over shares nine ordinary shares for every ten 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
- the holders of the contingent rights over shares shall have the right to receive a further 3,600,000 ordinary shares in aggregate if any party or parties acting in concert obtain more than 50% of the ordinary shares of the Company or an event occurs which has an equivalent effect or the Company disposes of substantially all of its assets within three years of the occurrence of the Premium Listing.