

ANNUAL REPORT
by the
BOARD
of
PEARL ASSURANCE PLC
to its
WITH-PROFITS POLICYHOLDERS
on compliance with the
PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT
for the year ended 31st December 2007

Purpose

The Principles and Practices of Financial Management (PPFM) for Pearl Assurance plc (Pearl) is a detailed document that sets out how Pearl manages its with-profits business.

You will have been sent 'A Guide to How We Manage Our With-Profits Fund', explaining the main points of the PPFM.

The purpose of this report is to describe how Pearl has complied with its PPFM in the period covered by the report. In particular, it deals with how Pearl has exercised its discretion in areas such as setting annual bonuses, policy payouts and surrender values, and how it has addressed any competing or conflicting rights of policyholders and shareholders.

Independent Review

A With-Profits Committee (WPC) was formed in 2004 to review how the with-profits business is managed. The WPC is responsible for overseeing that the management of with-profits business is consistent with the PPFM. The WPC provides independent verification that processes followed and decisions taken are consistent with the PPFM. The WPC has seen and supports this report.

Summary

Insurance policies sold by Pearl are classified as either 'with-profits' or 'non profit' policies. Payouts for with-profits policies depend on the discretion exercised by Pearl, and therefore the interests of customers with these policies are protected by the requirement to treat customers fairly as described in the PPFM.

The With-Profits Actuary has a legal duty to advise Pearl on the way it exercises its discretion over with-profits policies. Each year Pearl has to produce a report such as this to the with-profits policyholders, summarising how this discretion has been used over the previous year.

Overall, we are able to say that Pearl has complied with the PPFM in its exercise of discretion over with-profits policies.

The main areas of discretion are as follows. Each of these is expanded on in the sections below:

- Amounts Payable
- Investment strategy
- Business Risk
- Charges and Expenses
- Management of Estate
- New Business
- Equity between the with-profits fund and Shareholders
- Changes to the PPFM
- Communications to Policyholders

Amounts Payable

Bonus Rates

Bonuses are the additions that Pearl makes to the value of your policy. They come in the form of annual bonuses (that are added each year) and final bonuses (that are added when the policy pays out). Pearl sets bonus rates by reference to asset shares. The general aim is to pay the asset share.

Asset Shares

Asset shares are intended to be a reasonable approximation of the contribution a policy has made to the with-profits fund. Calculation of asset shares in 2007 followed the methodology set out in the PPFM.

Annual Bonus Rates

As in 2006, no annual bonuses were added to conventional or personal pension policies at 31 December 2007. For unitised policies annual bonuses are added in daily steps and the daily rates for adding annual bonuses were reviewed regularly during 2007. These bonus rates comply with the PPFM. The annual bonuses were set with the view that a proportion of the final payout comprises a final bonus.

Final Bonus Rates

Final bonus rates for conventional policies were reviewed twice for the 2007 calendar year with new final bonus scales being implemented from 1 January and 1 July. The final bonus rates were calculated using the methodology set out in the PPFM.

Final bonus rates and Market Value Reduction Factors ("MVRFs") on unitised policies were reviewed quarterly during 2007. The rates were calculated in accordance with the PPFM.

Investment Strategy

Pearl holds assets that it uses to make payments when policies pay out. Pearl needs to invest these assets sensibly, so that it can afford to make payouts when they are due, but also must aim to earn investment return on these assets so that bonuses can be paid.

From 1 January 2007, Pearl has decided to increase the target for the Equity Backing Ratio to 50% for certain classes of life with-profits policies (please refer to the PPFM). The increased exposure to shares and property gives the prospect of higher long-term investment returns. In the short term the investment returns may be higher or lower.

Over the long term, the higher Equity Backing Ratio is expected to provide better investment growth although this cannot be guaranteed.

Pearl will keep this policy under review.

Business Risk

During 2007 Pearl did not take on any significant risks that would be likely to jeopardise the interests of with-profits policyholders.

Charges and Expenses

The way charges and expenses were set was unchanged during the year. The Board is satisfied that the allocation of expenses and the charges deducted were in line with the PPFM.

Management of Estate

The estate of Pearl Assurance began to be distributed with effect from 1 July 2007. The distributions as at 1 July 2007 and 31 December 2007 were in accordance with the PPFM.

New Business

During 2007 Pearl did not sell new with-profits business.

Equity between Policyholders and Shareholders

There was no change to the method used to split profit between with-profits policyholders and shareholders during 2007.

Changes to the PPFM

A number of changes to the PPFM were made effective from 1 July 2007 to reflect changes in the principles and practices by which the Pearl with-profits business is managed. The main changes to principles and practices in the PPFM were in relation to:

- the distribution of the estate
- the impact of linking payouts to individual asset shares for Personal Pension (PP) and Free Standing Additional Voluntary Contribution (FSAVC) business
- the mechanism for charging smoothing and guarantee costs to asset shares

Full details of the changes are in the current version of the Pearl PPFM which sets out the principles and practices both before and after the changes effective from 1 July 2007.

Communications to Policyholders

A 'customer friendly' version of the PPFM has been sent to with-profits policyholders, in addition to the usual annual policy statements and other communications to specific groups of policyholders. A copy was available on Pearl's website throughout 2007.

Conclusion

Pearl believes that it has complied with the obligations relating to its PPFM.

Pearl Assurance plc

14 May 2008

With-Profits Actuary of Pearl Assurance plc
Annual Report to With-Profits Policyholders
for the year ended 31st December 2007

Purpose

The Principles and Practices of Financial Management (PPFM) for Pearl Assurance plc (Pearl Assurance) is a set of rules that governs how Pearl Assurance exercises discretion in relation to its with-profits policyholders.

Pearl Assurance has discretion in a number of areas, such as setting annual bonuses, policy payouts and surrender values, and in addressing any competing or conflicting rights of policyholders and shareholders.

The purpose of this report is to give my opinion as to whether Pearl Assurance has taken the interests of with-profits policyholders into account in a 'reasonable and proportionate' manner in exercising this discretion during 2007.

Conclusion

I consider that during 2007 Pearl Assurance has taken the interests of with-profits policyholders into account in a reasonable and proportionate manner.

My opinion is based on the information provided by Pearl Assurance during the year.

Kevin Arnott

With-Profits Actuary

14 May 2008