

Notes on the Group financial statements

E: Asset management (including US broker-dealer) and other operations

The Group's asset management operations are based in the UK, Asia and the US where they operate different models and under different brands tailored to their markets.

Asset management in the UK is undertaken through M&G which is made up of three distinct businesses, being Retail, Wholesale and Finance, and whose operations include retail asset management, institutional fixed income, pooled life and pension funds, property and private finance.

Asset management in Asia serves both the life companies in Asia by managing the life funds and funds underlying the investment linked products and third-party customers through mutual fund business. Asia offers mutual fund investment products in a number of countries within the region, allowing customers to participate in debt, equity and money market investments.

Asset management in the US is undertaken through PPM America which manages assets for the Group's US, UK and Asian affiliates plus also provides investment services to other affiliated and unaffiliated institutional clients including CDOs, private investment funds, institutional accounts and mutual funds. In addition, broker-dealer activities are undertaken in the US where trades in securities are carried out for both third-party customers and for its own account.

Other operations covers unallocated corporate activities and includes the head office functions.

E1: Income statement for asset management operations

The profit included in the income statement in respect of asset management operations for the year is as follows:

	Asset management operations				2007 £m
	2008 £m			Total	
	M&G	US	Asia		Total
Revenue*	53	409	202	664	1,397
Charges	28	(402)	(150)	(524)	(1,053)
Profit before tax	81	7	52	140	344
Profit before tax for asset management operations comprise:					
Operating profit based on longer-term investment returns [†]	286	7	52	345	334
Short-term fluctuations in investment returns [‡]	(195)	–	–	(195)	5
Shareholders' share of actuarial gains and losses on defined benefit schemes	(10)	–	–	(10)	5
Profit before tax	81	7	52	140	344

* Included within revenue for M&G are realised and unrealised net losses of £673 million in respect of consolidated investment funds and Prudential Capital. The investment funds are managed on behalf of third-parties and are consolidated under IFRS in recognition of the control arrangements for the funds. The investment losses in respect of the investment funds are non-recourse to M&G and the Group and are added back through charges and consequently there is no impact on the profit before tax. Excluding the anomaly in respect of the consolidated investment funds the revenue for M&G would be £494 million and the charges, £413 million.

[†] Operating profit based on longer-term investment returns includes a £28 million charge for an impairment loss on a holding in Lehman Brothers.

[‡] Short-term fluctuations for M&G are primarily in respect of unrealised value movements, on Prudential Capital's bond portfolio.

E2: Balance sheet for asset management operations

Assets, liabilities and shareholders' funds included in the Group consolidated balance sheet in respect of asset management operations are as follows:

	Asset management operations				2007 £m
	2008 £m			Total	
	M&G	US	Asia		Total
Assets					
Intangible assets:					
Goodwill	1,153	16	61	1,230	1,230
Deferred acquisition costs	6	–	–	6	6
Total	1,159	16	61	1,236	1,236
Other non-investment and non-cash assets	27	169	99	295	521
Financial investments:					
Loans ^{note i}	1,763	–	–	1,763	2,334
Equity securities and portfolio holdings in unit trusts	11	–	12	23	17
Debt securities ^{note ii}	975	–	16	991	882
Other investments ^{note v}	432	24	6	462	155
Deposits	35	16	13	64	26
Total investments	3,216	40	47	3,303	3,414
Cash and cash equivalents ^{note v}	1,329	39	104	1,472	1,840
Total assets	5,731	264	311	6,306	7,011
Equity and liabilities					
Equity					
Shareholders' equity ^{note iii}	1,300	114	228	1,642	1,677
Minority interests	1	–	–	1	52
Total equity	1,301	114	228	1,643	1,729
Liabilities					
Intra Group debt represented by operational borrowings at Group level ^{note iv}	1,278	–	–	1,278	2,477
Net asset value attributable to external holders of consolidated funds ^{note v}	1,065	–	–	1,065	1,234
Other liabilities	2,087	150	83	2,320	1,571
Total liabilities	4,430	150	83	4,663	5,282
Total equity and liabilities	5,731	264	311	6,306	7,011

Notes

- i Loans
The M&G loans of £1,763 million relates to bridging loan finance managed by Prudential Capital. The bridging loan finance assets generally have no external credit ratings available, with internal ratings prepared by the Group's asset management operations as part of the risk management process rating £1,100 million BBB+ to BBB- and £663 million BB+ to BB-.
- ii Debt securities
Of the debt securities of £975 million for M&G at 31 December 2008, £959 million were rated AAA to A- by Standard and Poor's or Aaa rated by Moody's.
- iii M&G shareholder funds include those in respect of Prudential Capital, with the net reduction in the year primarily due to unrealised value movements of £190 million, on Prudential Capital's bond portfolio.
- iv Intra Group debt represented by operational borrowings at Group level
Operational borrowings for M&G are in respect of Prudential Capital's short-term fixed income security programme and comprise £1,269 million of commercial paper and £9 million of medium-term notes.
- v Consolidated investment funds
The M&G balance sheet shown above includes Prudential Capital together with investment funds which are managed on behalf of third-parties. In respect of the consolidated investment funds, the balance sheet includes cash and cash equivalents of £835 million, £345 million of other investments, £(115) million of other net assets and liabilities and the net asset value attributable to external unit holders of £1,065 million in respect of these funds, which are non-recourse to M&G and the Group.

Notes on the Group financial statements

E: Asset management (including US broker-dealer) and other operations

continued

E2: Balance sheet for asset management operations continued

Reconciliation of movement in investments

A reconciliation of the total investments of asset management operations from the beginning of the year to the end of the year is as follows:

	Asset management operations			
	M&G £m	US £m	Asia £m	Total £m
At 1 January 2007				
Total investments	2,903	35	25	2,963
Less: Derivative liabilities	(142)	–	–	(142)
Directly held investments, net of derivative liabilities	2,761	35	25	2,821
Net cash inflow from operating activities	296	–	21	317
Realised gains in the year	8	–	–	8
Unrealised (losses) in the year	(22)	–	–	(22)
Foreign exchange translation differences	105	(1)	–	104
Movement in the year of directly held investments, net of derivative liabilities	387	(1)	21	407
At 31 December 2007/1 January 2008				
Total investments	3,334	34	46	3,414
Less: Derivative liabilities	(186)	–	–	(186)
Directly held investments, net of derivative liabilities	3,148	34	46	3,228
Net cash outflow from operating activities	(601)	–	(14)	(615)
Realised gains in the year	9	–	–	9
Unrealised (losses) in the year	(148)	(7)	(1)	(156)
Foreign exchange translation differences	516	13	16	545
Movement in the year of directly held investments, net of derivative liabilities	(224)	6	1	(217)
At 31 December 2008				
Total investments	3,216	40	47	3,303
Less: Derivative liabilities	(292)	–	–	(292)
Directly held investments, net of derivative liabilities	2,924	40	47	3,011

E3: Regulatory capital positions

Asset management operations in the UK, Hong Kong, Singapore, Vietnam and China are subject to regulatory requirements based on fixed operating expenses and other operating considerations. The movement in the year of the surplus regulatory capital position of these operations, combined with the movement in the IFRS basis shareholders' funds for other asset management operations, is as follows:

	Asset management operations				2007 £m
	2008 £m			Total	
	M&G	US	Asia	Total	Total
Capital surplus position					
Beginning of year	99	81	92	272	243
Exchange movement	(3)	39	31	67	(1)
Movement in capital requirement	(28)	–	25	(3)	(9)
Gains during the year	89	1	46	136	189
Distributions made	–	(8)	(34)	(42)	(150)
End of year	157	113	160	430	272

The movement in the year reflects changes in regulatory requirements whilst gains are driven by profits generated during the year. Distributions consist of dividends paid up to the parent company.

The M&G figures include those for Prudential Capital.

E4: Sensitivity of profit and equity to market and other financial risk

i Currency translation

Consistent with the Group's accounting policies, the profits of the Asia and PPM America asset management operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2008, the rates for the most significant operations are given in note B4.

A 10 per cent increase in these rates and those of other Asian operations would have reduced reported profit before tax attributable to shareholders and shareholders' equity, excluding goodwill attributable to Asia and PPM America asset management operations, by £5 million (2007: £7 million) and £26 million (2007: £18 million) respectively.

ii Other sensitivities to other financial risks for asset management operations

The principal sensitivities to other financial risk of asset management operations are credit risk on the bridging loan portfolio (as described in note E2) of M&G's Prudential Capital operation and the indirect effect of changes to market values of funds under management. Due to the nature of the asset management operations there is limited direct sensitivity to movements in interest rates. Total debt securities held at 31 December 2008 by asset management operations were £991 million (2007: £882 million), the majority of which are held by the Prudential Capital operation of M&G. Debt securities held by M&G are in general variable rate bonds and so market value is limited in sensitivity to interest rate movements and consequently any change in interest rates would not have a material impact on profit or shareholder's equity. Asset management operations do not hold significant investments in property or equities.

E5: Other operations

Other operations consist of unallocated corporate activities relating to Group Head Office and the Asia regional head office, with net income and expenditure for the year of negative £260 million (2007: negative £260 million) as detailed in note B1. An analysis of the assets and liabilities of other operations is shown in note B6.