DIRECTORS' REPORT AND FINANCIAL STATEMENTS

HERMES FUND MANAGERS LIMITED

31 DECEMBER 2009

Registered No: 1661776

HERMES FUND MANAGERS LIMITED

CEO OVERVIEW OF HERMES - 2009

2009 was the second full year of transitioning the business of Hermes Fund Managers (hereafter called "Hermes" or "the Group") from an 'in-house' pension and asset management business into its two principal component parts a fiduciary business focused on the needs of the BT Pension Scheme (BTPS) and a multi-boutique asset management business able to offer a wide range of specialised investment solutions to existing and new third party clients This is part of our five year strategy which will ensure that BTPS, our shareholder and principal client, has direct access to market leading fiduciary and asset management capabilities and benefits from the investment, operational and financial advantages and insights gained from growing our asset management offering in the third party market

The first phase of the five year plan has been to transform the operational investment and risk infrastructure, a process which, combined with the creation of a strong third party sales and marketing capability in our Business Development team, is due to be completed and fully functional by the end of 2010 Excellent progress on delivering this plan on time and to budget was made during 2009 in the following areas

- **Leadership:** We have made significant changes to our leadership team Key executive hires have been made in each of the three areas which are core to our business plan a new Head of Investment, Chief Operating Officer and Global Head of Business Development and Marketing, the latter joining during the first quarter of 2010 In addition, we have also been able to attract exceptional talent across all investment and operational areas with a total of 102 new hires during the year, taking our headcount to 417

- **Investment capabilities:** We acquired new investment teams in Global Equities (seven investment professionals), European Equities (four investment professionals) and, at the end of the year, in Credit (nine investment professionals) In a post-year end event we also merged our Private Equity Fund of Funds business with a similar business owned by Gartmore in a joint venture arrangement, having previously divested of our direct private equity business to Bridgepoint In addition, where necessary, we have added additional investment professionals to strengthen capabilities in our eight other specialist investment teams

- **Risk management:** Hermes' investment philosophy is built on delivering sustainable risk-adjusted returns to its clients Within a multi-boutique model a strong centralised investment and risk management function is essential to ensure alignment and integrity of the investment approach We have created an independent investment risk function, the 'Investment Office', to continuously challenge the investment teams, to better inform their investment decisions and to ensure that our investment strategies are operating within agreed risk parameters This complements a separate operational risk function which was also substantially strengthened during the year

- **Support functions:** Comprehensive and fundamental re-engineering of our systems and processes, including significant outsourcing, is at the centre of our initial three year reinvestment programme Northern Trust is our primary outsource provider, taking on Investment Operations, Fund Accounting, Custody and post year-end, the Back Office functions The programme remains on track - an excellent achievement given the scale and complexity of the work involved

HERMES FUND MANAGERS LIMITED

CEO OVERVIEW OF HERMES – 2009 (continued)

- **Distribution capabilities**· During the last quarter of 2009 and into 2010, we expanded our sales force to enable us to penetrate the global institutional third party market place We now have sales coverage across three continents (Europe, Asia and North America) and we have also created third party distribution partnerships to further increase our leverage into the marketplace In addition, we have been upgrading our business development and client reporting systems

With the very recent arrival, for the first time, of a global sales and marketing capability in our new Business Development team, we expect to grow the diversity and volume of third party assets under management (AuM) substantially In the meantime, and during 2009, 100% of activity has been focused on continuing to service existing clients and to lead and manage the major operational and cultural change programme currently underway

Over the year AuM moved from £27 5bn to £24 6bn, the reduction principally due to the decision to move a £4 0bn credit mandate to M&G in April 2009 Since then, the arrival of a new credit team at Hermes taking on a £0 4bn allocation from BTPS, provides us with a more robust proposition to meet BTPS' ongoing investment requirements in Credit and to grow third party business We have now adjusted the quantum of BTPS assets directly managed by Hermes to the target of around 50% of BTPS total assets This new equilibrium of BTPS allocations between Hermes and third party managers maintains the benefits of transparency and investment insights of working closely with the more industrial strength Hermes and, at the same time, delivers to BTPS the significant diversification and benchmarking benefits of actively selecting other best in class third party managers From hereon, whilst there will inevitably be some fine tuning of individual investments, overall BTPS allocations to Hermes are expected to remain at around the 50% level

In a market environment where delivering performance has been challenging, overall a high proportion of our strategies beat or met their benchmarks in 2009 Highlights were our largest investment capability, Index-linked, where the flagship active portfolio outperformed by 330 bps and there were also good performances in our Fund of Hedge Fund business (Hermes BPK) and in the Hermes Property Unit Trust Holding overall performance back were the two main segregated Real Estate mandates that underperformed their benchmarks principally due to leverage Excluding these two mandates, 85% of all our mandates delivered above median percentage relative to peers with a similarly strong record over three and five years, a very promising foundation upon which to grow new business

As part of our commitment to increase focus in each part of the business, further steps were taken to define and separate the roles of Hermes' asset management business from the fiduciary management business dedicated to meeting the pension fund needs of BTPS During the year Hermes Pension Fund Management Limited obtained regulatory approval as a separate business from the asset management activities within Hermes and changed its name to BT Pension Scheme Management Limited (BTPSM) These changes deliver further benefits in clarifying roles, responsibilities and governance

The Hermes mission is to deliver sustainable, risk-adjusted alpha both to BTPS and to a growing number of third party institutional clients, building on our commitment and belief in the importance of the principles of Responsible Investment by expanding those principles into all aspects of the asset management offer to our clients in the form of Responsible Asset Management At the core of this is our commitment to BTPS, as a shareholder and as our largest client, which puts the business in a relatively unique position to commit to putting clients first – and really mean it

HERMES FUND MANAGERS LIMITED

CEO OVERVIEW OF HERMES – 2009 (continued)

We recognise that a commitment to generating sustainable risk-adjusted alpha will deliver substantially more value to BTPS as a major client than they could ever expect to receive as a shareholder in Hermes This commitment, to place client interests ahead of maximising our own profitability, further underpins the integrity of the Hermes offer and is a core foundation to differentiating and growing our business in the open market

Business Outlook

By the end of 2010 all the building blocks needed to enable Hermes to compete in the third party market should be in place and fully operational

In embarking on the current five year strategy, both the Board and the shareholder recognised the need for major investment in infrastructure and people and that the cost of investment would act as a restraint on financial performance until converted into significant growth in new third party AuM Establishing momentum in the institutional investor markets takes time and although there are already some very positive indicators that our boutiques will attract third party investor AuM, tangible evidence of significant volumes of third party revenue are unlikely to be visible until well into 2011

On that basis, our current forecasts show that the largest impact of our current investment programme on our profitability is expected in 2010, with the position improving through 2011 to arrive at a return to profitability in 2012 The eventual financial outcome will be primarily influenced by the performance delivered in our investment strategies, the quantum of new AuM and the overall health of the financial markets Whatever the financial result, we recognise that the long-term success of our business and the maximisation of returns to our shareholder will be founded on delivering sustained risk-adjusted alpha and that will remain our core focus and priority, notwithstanding the potential distractions of growing a third party business

We anticipate the financial markets will face the same challenges in 2010 and 2011 as they did in 2009 Governments will be desperate to sustain what modest growth there is whilst central banks will remain relaxed on interest rates given the low inflation outlook

Rupert Clarke
CEO

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW

Investment Capabilities

Dunng 2009 Hermes strengthened its existing investment capabilities by recruiting individual key hires and by reviewing investment processes and sales strategies of the respective teams The company also acquired new teams with investment strategies that meet BTPS's needs and have third party potential

- **Hermes Global Equities:** An experienced and complementary sector-based global team This is an important addition to our equity offering Operating from Boston, the team adds to Hermes' global strategy and increased presence in the US

- **Hermes Sourcecap:** A high-alpha, unconstrained European equities capability which holds Financial Services Authority (FSA) and U S Securities and Exchange Commission (SEC) registrations Hermes Sourcecap has a history of strong performance and asset-raising which has continued since its integration into the Hermes Group Client assets have now risen to $1 3bn with prospects for further growth notwithstanding disruption in European financial markets

- **Hermes Private Equity:** During the year Hermes disposed of its direct private equity investment vehicles to Bridgepoint Capital to focus on its fund of funds activity as Hermes Private Equity In December 2009 Hermes Private Equity was appointed one of the fund of fund managers allocated funding by the UK Government as part of the UK Innovative Investment Fund (UKIIF) With this allocation the team have launched the HPE Environmental Innovation Fund Separately, in April 2010, Hermes completed a joint venture with Gartmore to merge their existing private equity fund of funds businesses with Hermes Private Equity The new entity, Hermes GPE, starts with some c £4bn under management and a significantly strengthened team, which will maximise its third party business potential

- **Hermes OCL:** In January 2010 Hermes acquired an experienced and highly-rated global credit team which has launched as Hermes OCL LLP Seed money has already been invested in UCITS High Yield and Investment Grade Funds Further fund launches are planned

These developments follow the acquisition of Hermes BPK Partners, a hedge fund of funds team which joined Hermes in the fourth quarter of 2008 Based in London and New York the team has launched three funds since commencing operations which have performed strongly relative to the competition

As the number and diversity of boutiques grows we have invested further in our independent investment risk monitoring function within the Investment Office, introducing Style Research alongside BARRA for equity portfolios, Barclays Point for fixed income portfolios and in 2010 Algorithmics for Commodities funds, as well as a proprietary system MultiFrame This provides suitable analysis and early warnings for each asset class ensuring appropriate oversight

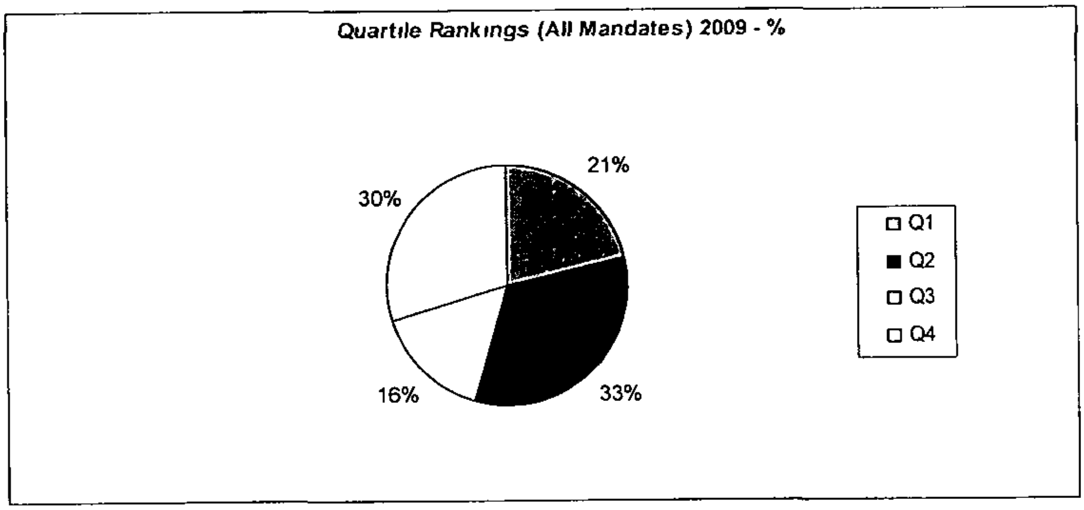
HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

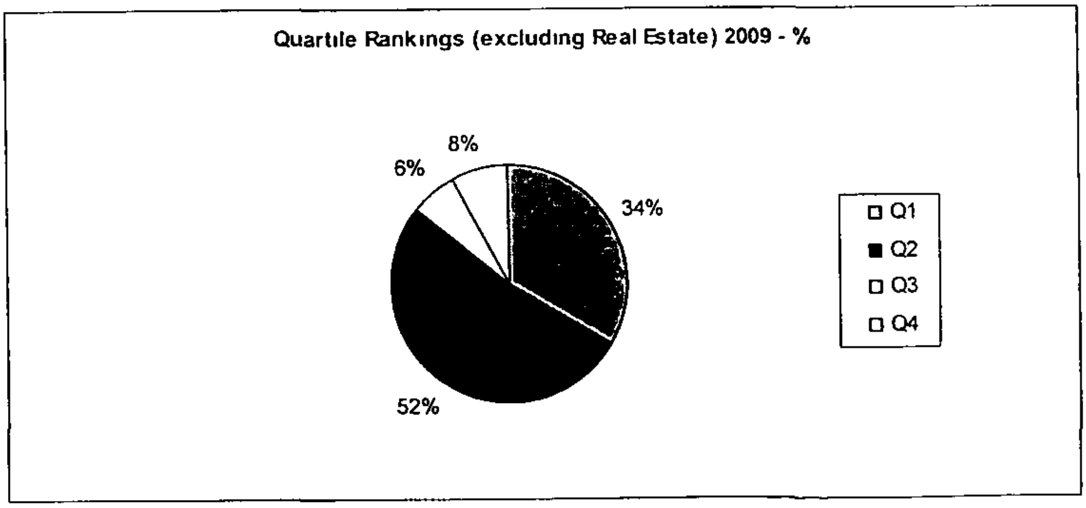
Investment Performance

2009 was another extraordinary year for markets after the traumatic events of 2008, with the first quarter extending losses in 'risk' assets March 2009 however saw a significant turning point, with a strong recovery seen in equities Against such fast-moving markets most mandates outperformed their client benchmarks, particularly Index-linked and BPK's funds of hedge funds, offset by disappointing performance in our two largest real estate segregated mandates almost exclusively as a result of underlying leverage in some of the principal investments

As we prepare to market our products externally, we compare our performance to relevant peer groups (using Lipper, Mercer, IMA, eVestment Alliance) Quartile ranking analysis has been prepared for all mandates (by value) for which we have both a full year record and a suitable peer group This analysis showed that 54% of our assets were above median relative to our peers Excluding the large Real Estate mandates, the median percentage rose to more than 85%, with a similarly strong record over three and five years This gives us great confidence as we seek to grow our business



Note - Portfolios with full year history comprise 93 7% of total, and those for whom suitable peer groups are available comprise 78 2% of total



HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Financial Performance

Turnover for the year was £102 2m, down 6 6% on prior year (2008 - £109 4m) Following the strategic investment in new team capabilities and the operational investment in infrastructure and business development, the Group result for the year was a loss of £1 9m before interest and tax (2008 profit of £15 5m before interest and tax) The result was better than management expectations and ahead of performance forecast in the Group's three to five year growth plan for the business

Group net assets at 31 December 2009 were £70 6m (31 December 2008 £93 6m) The reduction on prior year net assets is principally a result of the retained loss for the year of £10 8m as disclosed in the Consolidated Profit and Loss Account, and the net £10 1m losses experienced in relation to the Company's defined benefit pension scheme (Hermes Group Pension Scheme) due to changes in actuarial liability assumptions, as reflected in movements in the Consolidated Statement of Total Recognised Gains and Losses In response to the cumulative adverse movement in net pension deficit over the past two years, we are currently reviewing our approach to pension provision for future years to address what seems to have become an increasingly unsustainable commitment Despite the reduction in Group net assets on prior year, the Group cash balance at 31 December 2009 remains high at £119 5m (2008 - £131 5m), current assets remain significantly higher than current liabilities, and there has been no growth in total liabilities (excluding pension deficit) year on year Consequently, the Group has been able to absorb the impact of current year performance with no adverse impact on the growth plan for the business

A dividend payment of £13m to the shareholder has been declared in respect of the year (2008 - £nil)

Business Development

Hermes has a clearly stated objective of significantly growing its participation in the third party asset management market on a global basis To this end, the Company has invested considerable time and effort pre- and post-year end in building a world-class Business Development team From modest beginnings, with a small UK-based team, Hermes has now achieved global reach with a sales team focused on UK, North America, Europe, Australia and the Middle East and North Africa

At the end of 2009 we established a three person sales team based in Boston who will cover the North American marketplace This team brings with it a wealth of experience in asset management, a deep relationship with consultants and a successful track record in building a client base across North America

We also hired an established industry player to become Head of Sales for Australia and two experienced sales people to cover Europe and the Middle East and North Africa markets respectively as well as a key hire to head up the UK consultancy marketing

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Operating Model and Re-engineering

To underpin the strategic development of the business, a comprehensive programme (named 'Genesis') to re-engineer the operating model commenced late in 2007 Genesis is a three year programme of significant investment in systems and processes with the aim of delivering a platform that will support the ambition and requirements of both BTPSM and the asset management business Fundamental to this has been the selection of Northern Trust to provide outsourced services such as Investment Operations, Fund Accounting and Custody To date, the programme remains broadly on time and on budget and has delivered further key milestones since the start of the year, the most significant of which is the completion of the outsource migration to Northern Trust

Hermes Board

There were a number of key changes to the Hermes Fund Managers Limited (HFML) Board in 2009 intended to substantially strengthen both the executive team and the independent non-executive strategic input

Saker Nusseibeh joined Hermes in June 2009 as a main Board director and the Head of Investment to develop, support and represent the investment capabilities of Hermes He is responsible for ensuring that all of Hermes' investment capabilities deliver investment excellence and are able to compete at the highest level in the third party market Saker previously worked with Fortis Investments as the Global Head of Equities responsible for managing the Company's 12 equity centres

John Mould joined the HFML Board in August 2009 as Chief Operating Officer of the Group John is a chartered accountant and has 20 years of financial services experience running finance and other infrastructure teams for companies such as New Star Asset Management and Morgan Stanley At Hermes he is responsible for the infrastructure functions as well as playing an integral part in Hermes' drive to grow its third party business

Post year-end, in July 2010, Chris Goudie joined as a main Board director as Head of Global Business Development and Chief Executive of Hermes Fund Managers (North America) Previously Chris worked for Fidelity Management and Research, where he helped to establish their institutional fund management company Pyramis Global Advisors Prior to joining Fidelity, Chris worked for Wellington Management Company and Baring Asset Management

Nigel Labram resigned from the HFML Board to focus on his role as Board director and Chief Executive of BTPSM following its FSA registration during 2009

Non-Executive changes to the Board include the appointment of Jim Pettigrew and Kathryn Matthews Jim Pettigrew has a wealth of experience having been Chief Executive Officer of CMC Markets, Chief Operating Officer of Ashmore Group and Group Financial Director of ICAP, a FTSE 100 company He is a chartered accountant and is currently a non-executive director of Edinburgh Investment Trust Plc, RBC Europe Limited and Aberdeen Asset Management Plc He has joined the Hermes Board and Audit Committee and chairs the Remuneration Committee

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Hermes Board (continued)

Kathryn Matthews' career has been spent entirely in the asset management industry with extensive UK and international experience managing money, leading investment management teams and building the institutional businesses of asset managers Her career has included senior roles at William Mercer, Axa Investment Managers, Santander Global Advisers, Baring Asset Management and more recently Fidelity

Our Board has the collective requisite skills to succeed in enabling the Group to become a significant player in the global asset management industry

Human Resources

At Hermes we continuously strive toward being the employer of choice for our people We have a stable platform with low people turnover To strengthen the succession pool of our enterprise, we have been hiring experienced and talented professionals from the asset management industry and upgrading the quality and skills of our people through extensive training and development programmes

All Hermes reward schemes are focused on promoting the development of a long-term sustainable business Together our bonus, co-investment and equity ownership structures represent a comprehensive commitment to leading industry best practice on ensuring alignment with our clients

- **Performance and related bonuses·** To align the interests of our investment boutique professionals with the interests of their clients, the boutiques are incentivised by participating directly in their business economics Remuneration is determined in relation to client performance as well as boutique profitability In setting those parameters and approving the awards, the executive and the Remuneration Committee were aware of the market environment, peer group practice and the financial and investment performance of Hermes in 2009

- **Co-investment:** A Group-wide plan for part of the annual bonuses for investment professionals and senior staff to be deferred and co-invested alongside Hermes funds is in place and has been further refined during the year to increase the amount of deferral This co-investment and deferral of bonuses combines with a commitment to measuring and rewarding investment performance over a three year period, reinforcing the alignment of our teams to meet clients' long-term performance objectives

- **Equity Ownership:** To embed a culture of partnership, equity participation schemes have been introduced and all members of staff from across the business, both centrally and in key subsidiaries, are invited to participate to share in the long-term success of the Hermes Group These schemes allow employees to share in the long-term profits and value generated by the growth in third party (excluding BTPS) assets

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Risk Management

Key risks and uncertainties are managed at the HFML Group level

Hermes Group companies do not trade on their own account and therefore do not have any principal market risk The companies' primary risk exposure is to operational, reputation and business risk related to the possibility of a significant decrease in revenue arising from a decrease in AuM due to a fall in market value, clients leaving or Hermes' inability to grow AuM

As Hermes' interests are closely aligned with those of our clients our business strategy necessitates a conservative approach to risk The Board has limited appetite for accepting operational risk However, the Board recognises that no system of internal controls can fully mitigate the risk of error, loss or inappropriate activity occurring

The Hermes Board ensure that Hermes maintains sufficient levels of capital to meet its regulatory requirements and to mitigate the key risks present in both its current business and future strategy

In order to embed risk management throughout the firm, Hermes has a comprehensive risk governance structure, Group-wide policies and procedures, effective management reporting and system controls in place to identify, mitigate and control risks In addition, the Hermes Board has documented and approved their risk appetite which contains both qualitative and quantitative measures

Whilst the Hermes Board is ultimately responsible for the oversight of risk management within its subsidiary operating companies and as such is responsible for setting and periodically reviewing Hermes' risk strategy, including operational risk, counterparty credit risk and investment risk aspects, the Board has delegated oversight of day-to-day risk matters primarily to the Executive Committee, Business Executive, the Operating Executive and the Hermes Audit Committee, although a number of other governance committees exist within Hermes to support this process, including

- Risk and Control Executive,
- New Product and Instrument Approval Committee,
- Valuations Committee,
- Outsourcing Review Group,
- Counterparty Credit Risk Group,
- Investment Committee, and
- Portfolio Review Committee

Hermes also has dedicated Risk Assurance which consists of Internal Audit, Compliance, Operational Risk and Product Delivery Risk Assurance is headed by the Chief Risk Officer who has a reporting line to the Chief Operating Officer, the Hermes Chairman, the Chairman of the Hermes Audit Committee and also the Chairman of the BTPS Trustee and the Chairman of the BTPS Audit Committee

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Risk Management (continued)

The key risks that relate to Hermes, and where a significant part of our capital is assigned, are as follows

- **Operational/Business Risk:** the majority of the risks affecting Hermes can be classified under this heading and include
  - Poor investment performance,
  - Loss of key clients – in particular Hermes has key client dependency on BTPS, which is the sole shareholder of Hermes and by far Hermes' largest client,
  - Loss of key staff,
  - Business disruption, e g failure of systems,
  - Regulatory breaches/regulatory change,
  - Significant business change, and
  - Mandate breaches

- **Credit Risk:** Hermes acts as agent on behalf of its clients in dealing with market counterparties, and as such does not incur any credit risk in relation to its own balance sheet or capital in relation to market trading activities However, Hermes will have credit risk in relation to its own funds, specifically exposures to market counterparties (e g banks) where Hermes deposits are held and fees receivable from clients Deposits are split only amongst highly-rated banks, the ratings of which are regularly reviewed with market data Concentration limits are maintained

- **Market Risk:** Hermes' fee revenue is based on the underlying value of the portfolios that it manages for its clients If there is a decrease in the market value of these portfolios as a result of a fall in market values, then revenue may be impacted as a result of a market downturn

Hermes ensures that appropriate controls are in place to mitigate the above risks and these are monitored on a regular basis

The Group manages capital adequacy with reference to the Internal Capital Adequacy Assessment Process (ICAAP), as required by the FSA The ICAAP document informs the Board of the ongoing assessment of the Group's risks, how the Group intends to mitigate those risks, how much current and future capital is necessary having considered other mitigating factors and explains the Group's internal capital adequacy assessment process The ICAAP is formally undertaken annually, with more frequent updates made as necessary when a material change occurs Stress and scenario testing has been developed in order to test the robustness of Hermes' regulatory capital against a variety of events and changes to both Hermes and the financial markets as a whole The ICAAP is formally challenged and approved by the Hermes Board

Further details of the Group's approach to capital adequacy are to be found in its disclosures, as required under Pillar III of the Capital Requirements Directive, which are to be found at the following website address http //www hermes co uk/literature_general aspx

HERMES FUND MANAGERS LIMITED

DIRECTORS' REPORT

Directors	G P Jones	(Chairman)
	R J Clarke	(Chief Executive)
	R M Gray	(resigned 19 June 2009)
	N Labram	(resigned 12 January 2010)
	M M Webb	(resigned 10 December 2009)
	D R Barford	(Non executive)
	J A Biles	(Non executive)
	D W Davies	(Non executive, resigned 24 July 2009)
	R D Kent	(Non executive, resigned 14 April 2010)
	S A Nusseibeh	(appointed 3 June 2009)
	K Matthews	(Non executive, appointed 1 August 2009)
	J N Pettigrew	(Non executive, appointed 1 August 2009)
	J C Mould	(appointed 10 August 2009)
	C J Goudie	(appointed 14 July 2010)

Secretary	M S Green
Registered Office	Lloyds Chambers, 1 Portsoken Street, London E1 8HZ
Registered Number	1661776

The directors submit their report and the audited financial statements for the year ended 31 December 2009

The directors who served throughout the year or part of the year are listed above

PRINCIPAL ACTIVITIES

The principal activities of the Group comprise two distinct functions asset management and pension fund management The asset management arm of Hermes operates under a multi-specialist structure and is made up of a series of investment capabilities ranging across a variety of asset classes BT Pension Scheme Management Limited (BTPSM) acts as the executive arm for BTPS and is responsible for pension fund management BTPS is also the 100% owner of Hermes In addition to these functions, Hermes has also developed an equity overlay service, the Hermes Equity Ownership Service (HEOS)

RESULTS AND DIVIDEND

The results for the year are shown in the Consolidated Profit and Loss Account The directors consider the results of the Group and Company to be satisfactory in light of the current investment phase of development of the business and that the Company is well placed to take advantage of future opportunities The directors recommend the payment of a dividend of £13m in respect of the year (2008 - £nil)

The overall performance of the Group, its principal risks, uncertainties and key performance indicators are detailed in the "Business Review" section

1,597 Growth shares of £1 each in the capital of the Company were issued during the year to employees as part of a Group-wide incentive scheme, as disclosed in Note 17

HERMES FUND MANAGERS LIMITED

DIRECTORS' REPORT (continued)

GOING CONCERN

The following factors have been considered in making an assessment of the appropriateness of adopting the going concern basis in preparing the Group financial statements

Following the strategic and operational investment made during the year in infrastructure and business development, the Group has returned an operating loss for the year of £7 4m (2008 operating profit of £14 8m) as disclosed in the Consolidated Profit and Loss Account Adverse movement in the Company's defined benefit pension deficit has contributed in large part to total recognised losses for the year of £20 9m (2008 total recognised gains of £4 6m) as presented in the Consolidated Statement of Total Recognised Gains and Losses

As a result of current year losses, net assets have decreased by 25% on prior year However, the Group's financial position remains robust despite these losses, with net assets totalling £70 6m at year-end (2008 - £93 6m) as disclosed in the Consolidated Balance Sheet The Group is able to meet current liabilities as they fall due in the ordinary course of business, as demonstrated by the fact that current assets significantly exceed current liabilities and liquid cash reserves comprise in excess of 80% of total current assets at year-end In addition, given the nature of the Group's business, trade debtors are collectable within a short timescale

The strength of the Group's balance sheet has allowed, firstly, current year performance to be absorbed with no adverse impact on the growth plan for the business, and secondly, a dividend payment to be declared to the shareholder of £13m (2008 - £nil) in respect of the year

The directors have assessed the key risks impacting the Group, as disclosed in the Business Review The current economic environment and in particular its impact on fee income poses a challenge for the Group, but the directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook Strategic and operational investment is being undertaken with a view to enhancing the future scale and profitability of Group operations Short-term losses are budgeted for in the business plan The Group is able to withstand short-term pressure on results as capital resources are maintained at a level significantly in excess of the regulatory capital requirement The Company also has a loan facility of £50m with its ultimate parent, BTPS, of which £10m has been drawn down to date With these factors in mind, and having made all reasonable enquiries and having respect to the nature of the Group and its activities, the Directors are satisfied at the time of approving the financial statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future Accordingly, they continue to adopt the going concern basis in preparing the financial statements

FINANCIAL INSTRUMENTS

Group operations are primarily financed from retained earnings and a loan from BTPS The Group has other financial instruments including debtors, creditors, loans, investments and cash These mostly arise from the Group's operations The Group has a policy of identifying and controlling the risks associated with such instruments These risks include credit risk, liquidity risk and interest rate risk Bearing in mind the nature of the exposure to financial instruments within the Group and the limited risks associated, the Directors are satisfied that there is adequate control of the risks Note 24 discloses further information on the Group's financial risk management objectives and strategy

HERMES FUND MANAGERS LIMITED

DIRECTORS' REPORT (continued)

POST BALANCE SHEET EVENTS

On 15 January 2010, under the terms of the shareholder agreement following the Company's acquisition of Hermes Sourcecap Limited (HSL, formerly Sourcecap International Limited) in December 2009, 1,650 Ordinary 'A' shares held by the Company in the capital of HSL were transferred at par value to Ordinary 'B' shareholders and that issuance of capital altered from Ordinary 'A' to Ordinary 'B' The transfer reduces the Company's controlling shareholding in HSL from 75 01% to 58 51%

On 26 March 2010 the Company made an additional contribution of £3,000,000 to its subsidiary undertaking Hermes BPK Partners LLP (in accordance with the Limited Liability Partnership Agreement) to enable it to continue to satisfy the FSA Tier 1 regulatory capital requirements

On 1 April 2010, Hermes GPE LLP (a joint venture vehicle established by the Company and Gartmore Investment Management Limited to manage the merged Hermes and Gartmore private equity fund of funds business) replaced Hermes Private Equity Limited (HPEL) as manager of all the partnerships that HPEL managed as at the year end, other than HPEP I (the "HPE Funds") Also on that date, ownership of (i) the general partner entities of the HPE Funds (being HPE GP Limited and HPE Scotland GP Limited), and (ii) HPEL interests in Hermes UOB Capital Management Limited UOB Hermes Asia Management PTE Limited, were transferred to Hermes GPE LLP Hermes GPE LLP became authorised by the FSA on 1 April 2010 As such, it began trading from that date

On 28 April 2010, 75 'A', 125 'B', 120 'E' and 751 'G' Growth shares of £1 each in the capital of the Company were allotted to employees, increasing the total called up, allotted and fully paid share capital of the Company to £30,002,668

Following incorporation on 21 April 2010 and the granting of a regulatory licence on 13 July 2010, Hermes Fund Managers (Australia) Pty Limited, a 100% owned subsidiary of the Company, has commenced sales and marketing activity in Australia

DIRECTORS' INDEMNITIES

The Company has made qualifying third party indemnity provisions for the benefit of directors

EMPLOYEE INVOLVEMENT

During the year meetings are held to discuss the performance of the Group Opportunity is given at these meetings for senior executives to be questioned about matters which concern the employees

DISABLED POLICY

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and that appropriate training is arranged It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible be identical with that of other employees

HERMES FUND MANAGERS LIMITED

DIRECTORS' REPORT (continued)

AUDITORS

Deloitte LLP have indicated their willingness to continue in office as auditors and will be deemed to be reappointed at the end of the next period for appointing auditors as defined in section 485(2) of the Companies Act 2006

STATEMENT ON DISCLOSURE OF INFORMATION TO AUDITORS

The directors, having made enquiries to fellow directors and the Company's auditors, can state that

- so far as they are aware, there is no relevant audit information of which the Company's auditors are unaware, and
- they have taken all reasonable steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006

Approved by order of the Board of Directors and signed on behalf of the Board

J C Mould
Director

16 August 2010

HERMES FUND MANAGERS LIMITED

REPORT OF THE AUDIT COMMITTEE

MEMBERSHIP

The Audit Committee currently comprises four non-executive directors, John Biles (Chairman), David Barford, Kathryn Matthews (appointed 1 August 2009) and Jim Pettigrew (appointed 1 August 2009) Kathryn Matthews acted as Marketing and Business Development Director until Chris Goudie's appointment in March 2010 David Davies, having served on the Committee during the year, resigned on 24 July 2009 Members of the Committee are appointed by the Board following recommendations from the Nomination Committee

Each member of the Committee brings relevant financial experience from senior executive levels John Biles, the Committee Chairman, and Jim Pettigrew are considered by the Board to have significant, recent and relevant financial experience The Board considers that each member of the Committee is independent, although David Barford does not meet the definition of independence in the Combined Code as he serves as a Trustee of the BT Pension Scheme, the Group's ultimate parent

WORK OF THE COMMITTEE DURING 2009

During the year the Committee reviewed (i) the progress of Hermes' detailed internal controls review, (ii) the operating models for new boutiques, (iii) the progress of Genesis (the three year programme of investment in systems and processes to re-engineer the Group operating model), and (iv) the implementation of a risk management system, '*SWORD*'

The Committee reviewed and endorsed, prior to submission to the Board, the Company's financial statements It considered Internal Audit reports and risk management updates, agreed external audit strategy and plans and received updates on management responses to audit recommendations The Committee also approved a number of new and revised Group policies

POLICY ON AUDITOR INDEPENDENCE

When commissioning non-audit work from Deloitte LLP, Hermes management will consider such work in four categories

1 The assignment will normally be given to Deloitte LLP when it is clearly linked to the Hermes audit or which regulators would expect the auditors to perform

2 Even though other advisers could provide the work, Deloitte LLP will be asked to do work where there are demonstrable efficiencies from using them, derived from the knowledge they gain from audit work

3 Deloitte LLP will not normally be given work where there is a potential for a conflict of interest during the supply of non-audit services Such services may include actuarial, valuation, remuneration and accounting services together with investment advice or investment banking

4 In all other cases when Hermes requires non-audit services Deloitte LLP will be regarded equally with all other suppliers and, if appropriate, will be asked to submit proposals for consideration alongside other suppliers

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE

MEMBERSHIP

The Remuneration Committee currently comprises five non-executive directors, Jim Pettigrew (Chairman, appointed 1 August 2009), Glyn Jones, John Biles (appointed 24 April 2009), David Barford (appointed during the year following the execution of the Master Services Agreement between BT Pension Scheme and Hermes), Kathryn Matthews (appointed 1 August 2009) and David Davies, having chaired the Committee during the year, resigned on 24 July 2009 Roderick Kent, having served on the Committee during the year, resigned on 14 April 2010

WORK OF THE COMMITTEE DURING 2009

During the year the Committee received updates on the continued development of the following elements of the remuneration structure

- A firm-wide plan for part of annual bonuses for investment professionals and senior staff to be deferred and co-invested alongside Hermes funds This was implemented for 2008 bonus awards Further refinements to term sheets were approved during the year

- An equity plan for senior staff centrally and in key subsidiary entities that will allow these employees to share over the long term in the profits and value generated by the growth in assets outside of BTPS Further refinements to term sheets were adopted during the year and various recommendations in respect of the structure of the scheme, associated valuation structure and initial allocations were made In addition, the implementation of an employee scheme and the creation of an Employee Pool were approved in principle

The Committee believes that these plans provide an alignment of management, shareholder and clients and are in accordance with best practice

The Committee reviewed and endorsed salary and bonus awards for 2009 under the agreed reward plans and in accordance with parameters previously approved by the Committee

In setting those parameters and approving the awards the Committee was aware of the market environment, peer group practice and the financial and investment performance of Hermes in 2009

DIRECTORS' EMOLUMENTS

Directors' emoluments, all approved by the Remuneration Committee, are shown in Note 5 to the financial statements

HERMES FUND MANAGERS LIMITED

REPORT OF THE NOMINATION COMMITTEE

MEMBERSHIP

The Nomination Committee currently comprises three non-executives, Glyn Jones (Chairman), David Barford, and John Biles David Davies served on the Committee during the year but resigned on 24 July 2009 Roderick Kent served on the Committee during the year but resigned on 14 April 2010

WORK OF THE COMMITTEE IN 2009

During the year external search consultants were engaged to identify and help assess a shortlist of candidates to join the Board in both an executive and non-executive capacity Various candidates were interviewed by members of the Board to assess their suitability

During the year the Committee approved the appointment of Kathryn Matthews and Jim Pettigrew as Non-Executive Directors of the Company and also approved a number of appointments to the Boards of both the Company and subsidiary operating companies In addition, the Committee approved a number of appointments to the Remuneration Committee and to the Audit Committee

HERMES FUND MANAGERS LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law)

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss of the Company for that period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

HERMES FUND MANAGERS LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF HERMES FUND MANAGERS LIMITED

We have audited the financial statements of Hermes Fund Managers Limited for the year ended 31 December 2009 which comprise the Consolidated Profit and Loss account, the Consolidated Statement of Total Recognised Gains and Losses, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement, the accounting policies and the related notes 1 to 29 The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

This report is made solely to the Company's members in accordance with Chapter 3 of Part 16 of the Companies Act 2006 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements

Opinion on financial statements

In our opinion the financial statements
- give a true and fair view of the state of the Group's and Company's affairs as at 31 December 2009 and of the Group's loss for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF HERMES FUND MANAGERS LIMITED (CONTINUED)

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Mark FitzPatrick (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

16 August 2010

HERMES FUND MANAGERS LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 £'000	2008 £'000
TURNOVER (including joint ventures' share)	1	104,111	110,185
Less share of joint ventures' turnover	1	(1,925)	(830)
GROUP TURNOVER		102,186	109,355
Administrative expenses		(109,577)	(94,527)
GROUP OPERATING (LOSS)/PROFIT		(7,391)	14,828
Share of net operating profit of joint ventures	2	407	200
Share of net operating profit of associates	2	299	227
Dividends receivable		18	-
Realised currency (loss)/gain		(237)	18
Profit on disposal of investments	4	5,043	240
(LOSS)/PROFIT ON ORDINARY ACTIVITIES BEFORE INTEREST AND TAXATION		(1,861)	15,513
Interest receivable and similar income	3	920	5,982
Other finance (charges)/income	16	(1,000)	300
Interest payable and similar charges	3	(241)	(865)
(LOSS)/PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	4	(2,182)	20,930
Tax on (loss)/profit on ordinary activities			
- Group	6	(5,112)	(6,125)
- Joint ventures	6	(91)	(111)
- Associates	6	(83)	(69)
(LOSS)/PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		(7,468)	14,625
Equity minority interests	26	(3,334)	(14)
RETAINED (LOSS)/PROFIT FOR THE FINANCIAL YEAR	18	(10,802)	14,611

All of the results are derived from continuing operations

HERMES FUND MANAGERS LIMITED

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 £'000	2008 £'000
Retained (loss)/profit for the financial year		(10,802)	14,611
Defined benefit pension scheme – actuarial gain/(loss) on assets	16	8,000	(20,727)
Defined benefit pension scheme – actuarial (loss)/gain on liability experience	16	(3,400)	300
Defined benefit pension scheme – actuarial (loss)/gain on change in assumptions	16	(20,400)	8,800
Deferred tax credit/(charge) – attributable to net actuarial (loss)/gain	6	5,688	1,652
Currency translation differences on foreign currency net investments	18	32	-
Total recognised (losses)/gains relating to the year	18	(20,882)	4,636

HERMES FUND MANAGERS LIMITED

CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2009

		Notes	2009 £'000	2008 £'000
FIXED ASSETS				
Intangible assets – goodwill		9	3,223	-
Tangible assets		10	12,891	12,697
Associates		11	88	1,067
Joint ventures	– share of gross assets	11	1,348	672
	– share of gross liabilities	11	(1,145)	(483)
Investments	– other	11	58	58
			16,463	14,011
CURRENT ASSETS				
Debtors		13	26,529	28,725
Cash at bank		21	119,477	131,512
			146,006	160,237
CURRENT LIABILITIES				
Creditors - amounts falling due within one year		14	(57,350)	(52,425)
NET CURRENT ASSETS			88,656	107,812
TOTAL ASSETS LESS CURRENT LIABILITIES			105,119	121,823
CREDITORS - amounts falling due after more than one year		14	(7,073)	(10,372)
PROVISIONS FOR LIABILITIES AND CHARGES		15	(750)	-
NET ASSETS EXCLUDING PENSION LIABILITIES			97,296	111,451
Net pension deficit		16	(26,739)	(17,825)
NET ASSETS INCLUDING PENSION LIABILITIES			70,557	93,626
CAPITAL AND RESERVES				
Called up share capital		17	30,002	30,000
Non-distributable capital reserves		18	98	98
Capital contribution from parent company		18	510	510
Profit and loss account		18	41,969	62,851
SHAREHOLDER'S FUNDS			72,579	93,459
Minority Interest		26	(2,022)	167
TOTAL CAPITAL EMPLOYED			70,557	93,626

These financial statements were approved by the Board of Directors and authorised for issue on 16 August 2010

Signed on behalf of the Board of Directors

J C Mould
Director

HERMES FUND MANAGERS LIMITED

COMPANY BALANCE SHEET AS AT 31 DECEMBER 2009

	Notes	2009 £'000	2008 £'000
FIXED ASSETS			
Tangible assets	10	12,839	12,697
Investments	11	33,642	26,775
		46,481	39,472
CURRENT ASSETS			
Debtors	13	53,317	33,636
Cash at bank		17,070	17,364
		70,387	51,000
CURRENT LIABILITIES			
Creditors - amounts falling due within one year	14	(59,050)	(37,307)
NET CURRENT ASSETS		11,337	13,693
TOTAL ASSETS LESS CURRENT LIABILITIES		57,818	53,165
CREDITORS – amounts falling due after more than one year	14	(2,493)	(8,713)
NET ASSETS EXCLUDING PENSION LIABILITIES		55,325	44,452
Net pension deficit	16	(26,739)	(17,825)
NET ASSETS INCLUDING PENSION LIABILITIES		28,586	26,627
CAPITAL AND RESERVES			
Called up share capital	17	30,002	30,000
Capital contribution from parent company	18	510	510
Profit and loss account	18	(1,926)	(3,883)
SHAREHOLDER'S FUNDS		28,586	26,627

These financial statements were approved by the Board of Directors and authorised for issue on 16 August 2010

Signed on behalf of the Board of Directors

J C Mould
Director

HERMES FUND MANAGERS LIMITED

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 £'000	2008 £'000
NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES	20	(9,490)	4,921
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		885	5,981
Interest paid		(241)	(865)
Dividends received from associates/joint ventures		828	426
Other dividends received		17	-
Drawings by minority interests		(3,020)	-
NET CASH (OUTFLOW)/INFLOW FROM RETURNS ON INVESTMENTS AND SERVICING OF FINANCE		(1,531)	5,542
TAXATION			
Corporation tax received		394	828
TAX RECEIVED		394	828
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT			
Payments to acquire tangible fixed assets	10	(4,893)	(7,861)
NET CASH OUTFLOW FROM CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT		(4,893)	(7,861)
ACQUISITIONS AND DISPOSALS			
Purchase of subsidiary undertaking		(3,474)	-
Cash acquired with subsidiary		700	-
Sale of subsidiary undertaking		5,548	-
Disposal of associates		696	396
Investment in joint ventures		(25)	(200)
NET CASH INFLOW FROM ACQUISITIONS AND DISPOSALS		3,445	196
FINANCING			
Issue of share capital	18	2	-
Issue of capital to minority interest members		38	-
NET CASH INFLOW FROM FINANCING		40	-
(DECREASE)/INCREASE IN CASH	21	(12,035)	3,626

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009

ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable law and United Kingdom Accounting Standards The particular accounting policies adopted by the directors are described below

a) Accounting convention

The financial statements are prepared under the historical cost convention and on the going concern basis as described in the Directors' Report

b) Change in accounting policy

The Group has changed accounting policy in the current year in relation to the recognition and measurement of financial instruments The application of FRS 26 Financial Instruments Recognition and Measurement has been replaced by the application of FRS 4 Capital Instruments The change was in response to the cessation of trade of Hermes Assured Limited (HAL), a wholly-owned subsidiary of the Company HAL formerly operated an index-tracking insurance business and held unit-linked investment contracts and linked liabilities on balance sheet HAL adopted FRS 26 in 2006 HAL ceased to trade in 2007 and consequently no longer holds financial instruments associated with the former trade There are no other Group companies that hold significant complex financial instruments The principal instruments in the Group are cash, investments in Group companies, and debtors/creditors arising in the ordinary course of trading activity The change in accounting policy has therefore been made to enhance understanding of the Group financial statements No prior period adjustment has resulted from the change in policy and there is no material impact on current year results

c) Turnover

Turnover is recognised on an accruals basis

d) Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and its subsidiary undertakings drawn up to 31 December each year Acquisitions are accounted for under the acquisition method The results of subsidiaries acquired or sold are consolidated for the period from or to the date on which control passed

Subsidiary companies of the Group include general partners of limited partnerships where the substance of the arrangements is that the Group provides investment management services in return for investment management fees The Group's beneficial interest in these particular limited partnerships is restricted to the fees it earns from managing the partnerships Furthermore, the limited partnerships were set up for the beneficial interest of external parties who collectively own the entire equity of the partnerships The directors have departed from the Companies Act 2006 requirements and accounted for the interests in such partnerships at cost on the basis that this reflected the substance of the arrangements and to consolidate would not give a true and fair view The effect of this departure is quantified in Note 23

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009

ACCOUNTING POLICIES (continued)

e) Goodwill

Goodwill arising in respect of acquisitions is capitalised in the year in which it arises within intangible fixed assets and amortised over its estimated useful life up to a maximum of 20 years with a full year's charge for amortisation in the year of acquisition Provision is made for any permanent diminution in the value of goodwill

f) Investments

Fixed asset investments are shown at cost less provision for impairment

g) Associates

In the Group financial statements investments in associates are accounted for using the equity method The consolidated profit and loss account includes the Group's share of associates' profits less losses while the Group's share of the net assets of the associates is shown in the consolidated balance sheet Goodwill arising on the acquisition of associates is accounted for in accordance with the policy set out above Any unamortised balance of goodwill is included in the carrying value of the investment in associates

h) Joint ventures

In the Group financial statements investments in joint ventures are accounted for using the equity method The consolidated profit and loss account includes the Group's share of joint venture profits less losses clearly indicated while the Group's share of the gross assets and gross liabilities of the joint ventures is shown separately in the consolidated balance sheet Goodwill arising on the acquisition of joint ventures is accounted for in accordance with the policy set out above Any unamortised balance of goodwill is included in the carrying value of the investment in joint ventures

i) Foreign exchange

Transactions denominated in foreign currencies are translated into the functional currency at the rates ruling at the dates of the transactions Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated at the rates ruling at that date These translation differences are dealt with in the profit and loss account

j) Tangible fixed assets

Tangible fixed assets are stated at cost or valuation, net of depreciation and any provision for impairment

Depreciation is provided on cost in equal annual instalments over the estimated useful economic lives of the assets The estimated useful economic lives are as follows

Fixtures, fittings and equipment	-	One to five years
Leasehold improvements	-	Period of the lease

Software is included within the fixtures, fittings and equipment category and is depreciated over the applicable useful economic life which is between one and three years

ACCOUNTING POLICIES (continued)

j) Tangible fixed assets (continued)

Leasehold improvements and fixtures, fittings and equipment have a full year's depreciation charged in the year of acquisition and no depreciation charged in the year of disposal, with the exception of the component of fixtures, fittings and equipment which relates to the business development information technology platform, which is depreciated from the month of acquisition

k) Operating leases

Rentals in respect of operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease

l) Pension benefits

For the Group's defined benefit scheme the amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments They are included as part of staff costs Past service costs are recognised immediately in the profit and loss account if the benefits have vested If the benefits have not vested immediately, the costs are recognised over the period until vesting occurs The interest cost and expected return on assets are shown as a net amount of other finance charges or income adjacent to interest Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses

The Group's defined benefit scheme is funded, with the assets of the scheme held separately from those of the Group, in separate trustee administered funds Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities The actuarial valuations are obtained at least triennially and are updated at each balance sheet date The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet

For defined contribution schemes, the amount charged to the profit and loss account in respect of pension costs is the contribution payable in the year Differences between contributions payable in the year and contributions actually paid are shown either as accruals or prepayments in the balance sheet

m) Investment income

Income from investments is accounted for on an accruals basis

n) Current taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date

ACCOUNTING POLICIES (continued)

o) Deferred taxation

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax at a future date, at rates expected to apply when they crystallise based on current tax rates and law Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered Deferred tax balances are not discounted

p) Bonus costs

Provision is made for bonuses attributable to performance prior to the year end

1 TURNOVER

Turnover comprises the value of services provided in the UK by the Group exclusive of VAT and is analysed as follows

	2009	**2008**
	£'000	**£'000**
Investment management services (including share of joint ventures)	102,703	108,452
Miscellaneous fees	1,408	1,733
Less Share of joint ventures	(1,925)	(830)
TOTAL GROUP TURNOVER	102,186	109,355

Turnover for investment management services includes performance fees based upon rolling three-year performance periods These are recognised in the year the performance period ends

All of the Group's operations consist of investment management and are carried out in the United Kingdom

2 JOINT VENTURES AND ASSOCIATES

Share of net operating profit/(loss) of joint ventures and associates

	2009 £'000	2008 £'000
Joint ventures		
50% share of Logistics Management Limited	232	371
50% share of Perception UK LLP	1	(171)
50% share of X-Leisure Limited	174	-
	407	200
Associates		
40% share of UOB Hermes Asia Management Pte Limited	27	30
33% share of NLI Investments Europe Limited	272	197
	299	227
	706	427

The Company sold its interest in NLI Investments Europe Limited on 31 December 2009 to Schroders International Holdings Limited for consideration of £695,640 (see Note 11)

Hermes Real Estate Investment Management Limited entered into a joint venture investment in X-Leisure Limited with Capital & Regional Property Management Limited during the year (see Note 11)

Note 22 discloses further information on principal Group subsidiaries, associates and joint ventures

3 INTEREST RECEIVABLE AND SIMILAR INCOME AND INTEREST PAYABLE AND SIMILAR CHARGES

	2009 £'000	2008 £'000
Interest receivable and similar income in respect of		
Bank deposit balances	917	5,929
Joint ventures	3	17
Associates	-	36
	920	5,982
Interest payable and similar charges in respect of		
Bank interest	24	147
Loan from ultimate parent	217	718
	241	865

Interest payable to the ultimate parent relates to the loan from the BT Pension Scheme as disclosed in Note 14

4 (LOSS)/PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2009 £'000	2008 £'000
(Loss)/profit on ordinary activities before taxation is stated after charging		
Depreciation of tangible fixed assets	3,459	3,937
Amortisation of goodwill	358	3,714
Rentals under operating leases		
- Charges	1,588	1,615
- Receipts	-	(125)
Auditors' remuneration		
Audit fees - Subsidiaries	223	197
- Company	53	46
	276	243
Non-audit fees		
Other services pursuant to legislation	21	15
Tax services	-	235
Other services	456	245
	477	495

Fees payable to the Company's auditors and their associates in respect of associated pension schemes during the year were £14,250 (2008 - £12,150) These fees were charged to and paid directly by the pension scheme

The profit on disposal of investments in the year of £5,043,000 relates to the strategic decision taken to exit the direct private equity investment business Bridgepoint Capital was appointed as the manager of two Hermes direct private equity investment vehicles and as part of the agreement the Hermes direct private equity investment team transferred to Bridgepoint Capital

5 INFORMATION REGARDING DIRECTORS AND EMPLOYEES

The total remuneration of the directors in respect of the year was £6,962,189 (2008 - £3,507,950)

As outlined in the CEO Overview of Hermes, the business is in the second full year of transition as part of the delivery of a five year strategy The change in total remuneration on prior year is mainly due to the strengthening of the Board following the appointment of executive and non-executive directors (£1,659,818), the net increase in awards to departing executive directors due principally to the payment of severance and bonuses (£432,429) and the increase in awards for investment performance (£1,600,000) Other downward adjustments totalling £238,008 comprise the balance of movement year on year

During the year, the Group adopted a new co-investment/bonus deferral scheme whereby parts of bonus awards in respect of the year are deferred The full value of deferred awards granted to directors in respect of the year is £1,908,000 (2008 - £98,500) This figure is included in total remuneration disclosed above, although the deferred awards will be received by the directors only after satisfying future service conditions The cost attributable to the deferred awards is being accrued evenly over time until vesting date, therefore the full cost of the deferred awards will be charged to profit and loss over a two to three year period

Six directors (2008 – four) were directors of other entities in the Group Their total emoluments during the year were £6,236,627 (2008 - £3,065,450) but it is not practicable to allocate these between services to the Group and the Company

The highest paid director received emoluments in the year in respect of services to the Group comprising £1,232,104 in cash payments and £1,597,400 in deferred awards vesting on a phased basis over three years (2008 - emoluments totalling £1,228,700) The total number of directors who received such deferred awards during the year was seven (2008 – six)

Four directors (2008 – none) were awarded 335 Growth Shares in total in the capital of the Company during the year under review under a new Equity Participation Plan, at a cost of £1 per share The fair value of awards at grant date was equivalent to the nominal value of shares issued

Four directors (2008 – four) are accruing benefits under the Hermes Group Pension Scheme, which is a defined benefit scheme, in respect of their services to Hermes Group companies Details of the scheme are disclosed in note 16 The accrued benefit of the highest paid director at 31 December 2009 was £14,560 per annum (31 December 2008 - £11,212)

Contributions paid by the Group during the year in respect of directors' defined contribution pension schemes totalled £22,939 (2008 - £nil)

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009 (continued)

5 INFORMATION REGARDING DIRECTORS AND EMPLOYEES (continued)

	2009 No.	2008 No
Average number of persons employed by the Group and Company in the year		
Investment management	238	216
Administration	159	154
	397	370

	2009 £'000	2008 £'000
Staff costs during the year in respect of these directors and employees were		
Wages and salaries	49,565	39,297
Social security costs	6,344	5,030
Pension cost related to Group scheme (see note 16)	3,300	5,200
	59,209	49,527

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009 (continued)

6 TAX ON (LOSS)/PROFIT ON ORDINARY ACTIVITIES

		2009 £'000	2008 £'000
a)	Profit and loss account		
	UK corporation tax at 28% (2008 – 28 5%)	84	2,800
	Overseas tax	44	-
	Share of tax charge in joint venture and associates	174	180
	Adjustment in respect of prior periods	32	(84)
		334	2,896
	Deferred tax		
	Timing differences, origination and reversal	5,272	2,164
	Adjustment in respect of prior periods	(320)	1,245
	Tax on profit on ordinary activities	5,286	6,305
	Statement of total recognised gains and losses		
	Deferred tax		
	Timing differences, origination and reversal	(5,688)	(1,652)
	Total tax on items in Statement of total recognised gains and losses	(5,688)	(1,652)

b) The tax charged in the year differs from that resulting from applying the standard rate of corporation tax in the UK of 28% (2008 – 28 5%) The differences are explained below

	2009 £'000	2008 £'000
(Loss)/profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 28% (2008 – 28 5%)	(611)	5,964
Non-taxable income, such as UK dividends	(890)	(2,429)
Non-deductible expenses	526	2,301
Depreciation in excess of capital allowances	1,106	(285)
Movement in unprovided deferred tax	1,394	(657)
Short-term timing differences	(1,285)	(1,878)
Adjustment in respect of prior periods	32	(84)
Effect of overseas rate differences	11	-
Group relief not paid for	55	-
Effect of small companies tax rate	(4)	-
Deferred tax rate change	-	(36)
	334	2,896

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009 (continued)

6 TAX ON (LOSS)/PROFIT ON ORDINARY ACTIVITIES (continued)

c) **The Group**

	2009 Provided £'000	2009 Unprovided £'000	2008 Provided £'000	2008 Unprovided £'000
Deferred tax asset				
Accelerated capital allowances	-	2,810	1,612	1
Tax losses	-	1,675	357	138
Short-term timing differences	-	2,734	76	232
	-	7,219	2,045	371

The Company

	2009 Provided £'000	2009 Unprovided £'000	2008 Provided £'000	2008 Unprovided £'000
Deferred tax asset				
Accelerated capital allowances	-	2,805	1,622	-
Tax losses	-	1,516	-	-
Short-term timing differences	-	1,953	3,006	-
	-	6,274	4,628	-

Deferred tax assets of £2,045,000 were recognised in 2008 but have been reversed in 2009 due to uncertainty of recovery of these assets within a relatively short period of time

Deferred tax assets totalling £7,219,000 (2008 - £371,000) have not been recognised in respect of losses and short-term timing differences as the Group is not sufficiently certain that it will be able to recover those assets within a relatively short period of time

d) Movement on Deferred Tax

	Group £'000
1 January 2009	2,045
Transfer to current tax	336
Transfer to associated company	2,907
Profit and loss charge	(5,288)
31 December 2009	-

The 'transfer to associated company' deferred tax movement relates to the disposal of two subsidiary companies during the year, MEPC (HPE) Limited and Hermes Asset Management Limited (HAML), to an associated company controlled by the Company's immediate parent (see Note 12)

7 CAPITAL STATEMENTS AND CAPITAL MANAGEMENT

Objectives, policies and processes for managing capital

The Group's capital is represented by the equity and reserves as set out in the consolidated balance sheet

The objective of the Group is to maximise shareholder return through the provision of investment management and pension management services The Group had no externally imposed capital requirements

The Group maintained monthly checks to ensure that capital was maintained above the required amount These were circulated to and reviewed by senior management Capital forecasting was performed to ensure that there was little risk of a future breach of the requirement

8 PROFIT OF THE PARENT COMPANY

As permitted by Section 408 of the Companies Act 2006, the profit and loss account of the parent company is not presented as part of these accounts The parent company's profit for the year amounted to £12,069,000 (2008 – loss of £3,298,000)

9 INTANGIBLE FIXED ASSETS

	Goodwill £'000
The Group	
Cost	
At 1 January 2009	8,614
Addition	3,581
31 December 2009	12,195
Accumulated amortisation	
At 1 January 2009	(8,614)
Amortisation charge	(358)
At 31 December 2009	(8,972)
Net book value	
At 31 December 2009	3,223
At 31 December 2008	-

The addition relates to the acquisition of 75 01% of Hermes Sourcecap Limited (formerly Sourcecap International Limited) from Execution Holdings Limited on 3 December 2009 for consideration of £4,376,776 (see Note 12)

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009 (continued)

10 TANGIBLE FIXED ASSETS

The Group	**Leasehold Improvements £'000**	**Fixtures, Fittings and Equipment £'000**	**Total £'000**
Cost			
At 1 January 2009	5,773	18,296	24,069
Acquisition of subsidiary undertaking	-	283	283
Additions	142	4,751	4,893
Asset write-off	-	(1,292)	(1,292)
At 31 December 2009	5,915	22,038	27,953
Accumulated depreciation			
At 1 January 2009	3,189	8,183	11,372
Acquisition of subsidiary undertaking	-	231	231
Charge for the year	265	3,194	3,459
At 31 December 2009	3,454	11,608	15,062
Net book value			
At 31 December 2009	2,461	10,430	12,891
At 31 December 2008	2,584	10,113	12,697

The Company	**Leasehold Improvements £'000**	**Fixtures, Fittings and Equipment £'000**	**Total £'000**
Cost			
At 1 January 2009	5,773	18,296	24,069
Additions	142	4,751	4,893
Asset write-off	-	(1,292)	(1,292)
At 31 December 2009	5,915	21,755	27,670
Accumulated depreciation			
At 1 January 2009	3,189	8,183	11,372
Charge for the year	265	3,194	3,459
At 31 December 2009	3,454	11,377	14,831
Net book value			
At 31 December 2009	2,461	10,378	12,839
At 31 December 2008	2,584	10,113	12,697

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009 (continued)

11 INVESTMENTS HELD AS FIXED ASSETS

	Investment in Joint Ventures £'000	**Investment in Associates £'000**	**Unlisted Investments £'000**	**Total £'000**
The Group				
At 1 January 2009	189	1,067	58	1,314
Share of retained profit	319	215	-	534
Additions	25	-	-	25
Disposals	-	(696)	-	(696)
Dividends received from joint venture/associates	(330)	(498)	-	(828)
At 31 December 2009	203	88	58	349

Additions relate to an investment by Hermes Real Estate Investment Management Limited in X-Leisure Limited during the year Disposals relate to the sale by the Company of NLI Investments Europe Limited during the year Unlisted investments are valued at cost

Investments in joint ventures and associates comprise

	2009 £'000
Joint ventures	
Logistics Management Limited - share of net assets	202
Perception UK LLP - share of net liabilities	(169)
X-Leisure Limited - share of net assets	170
Associates	
UOB Hermes Asia Management Pte Limited - share of net assets	88

11 INVESTMENTS HELD AS FIXED ASSETS (continued)

The Company

Shares in subsidiaries and associated undertakings

	2009 £'000
At 1 January 2009	26,775
Additions	18,377
Disposal	(770)
Repayment of share capital by subsidiary	(10,740)
At 31 December 2009	33,642
Net book value	
At 31 December 2009	33,642
At 31 December 2008	26,775

The additions relate to investments in Hermes BPK Partners LLP (£11,000,000), BT Pension Scheme Management Limited (£3,000,000) and Hermes Sourcecap Limited (formerly Sourcecap International Limited) (£4,376,776)

The disposal relates to the sale of NLI Investments Europe Limited on 31 December 2009

Hermes Assured Limited repaid £10,740,000 share capital to the Company in September 2009

12 ACQUISITIONS AND DISPOSALS OF SUBSIDIARY UNDERTAKINGS

(a) Hermes Sourcecap Limited (formerly Sourcecap International Limited)

On 3 December 2009 the Company acquired 75 01% of the issued ordinary share capital of Hermes Sourcecap Limited (formerly Sourcecap International Limited) The total cost of acquisition was £4,376,776, comprising £3,187,000 cash, £1,234,910 capitalised acquisition costs, less a £45,134 completion adjustment Acquisitions are accounted for under the acquisition method The following table sets out the book values of the identifiable assets and liabilities acquired and their fair value to the Group

	Book value £'000	Fair value to Group £'000
Tangible fixed assets	72	72
Debtors	379	379
Cash	700	700
Total assets	1,151	1,151
Trade creditors	(716)	(716)
Other liabilities	(1,876)	(1,876)
Total liabilities	(2,592)	(2,592)
Net liabilities	(1,441)	(1,441)
Minority interest		361
Goodwill		3,581
Consideration for acquisition of business		2,501
Consideration for acquisition of preference shares		1,876
		4,377
Satisfied by		
Cash consideration paid		3,187
Capitalised acquisition costs		1,235
Completion adjustment		(45)
		4,377
Net cash outflows in respect of the acquisition comprised		
Cash consideration		(3,187)
Cash acquisition costs		(287)
Cash at hand and in bank acquired		700
		(2,392)

12 ACQUISITIONS AND DISPOSALS OF SUBSIDIARY UNDERTAKINGS (continued)

(a) Hermes Sourcecap Limited (formerly Sourcecap International Limited) (continued)

Hermes Sourcecap Limited (formerly Sourcecap International Limited) incurred a loss after taxation of £982,500 in the year ended 31 December 2009, of which £1,036,538 arose in the period from 1 January 2009 to 3 December 2009 The summarised profit and loss account of the company for the period from 1 January 2009 to 3 December 2009 and the comparative period from incorporation to 31 December 2008 are set out below

Profit and loss account

	Period from 1 January 2009 to 3 December 2009 £'000	Period from 26 June 2008 to 31 December 2008 £'000
Turnover	1,238	588
Net operating expenses	(2,273)	(1,002)
Operating loss	(1,035)	(414)
Net finance charges	(1)	9
Loss on ordinary activities before taxation	(1,036)	(405)
Tax on loss on ordinary activities	-	-
Loss on ordinary activities after taxation	(1,036)	(405)

(b) MEPC (HPE) Limited and Hermes Asset Management Limited

On 11 June 2009 the Group disposed of its 100% interest in the ordinary share capital of MEPC (HPE) Limited and Hermes Asset Management Limited (HAML) to an associate company controlled by the Company's ultimate parent, BTPS The disposals have no material impact on the results of the Group

13 DEBTORS

	2009 Group £'000	2009 Company £'000	2008 Group £'000	2008 Company £'000
Due within one year				
Owed by subsidiaries	-	47,291	-	18,292
Owed by associates	200	-	143	36
Owed by parent	6,606	-	14,445	10
Trade debtors	8,829	-	2,197	27
Taxation	1,659	1,972	4,131	5,360
Other debtors	1,726	1,633	2,073	2,025
Prepayments and accrued income	7,396	2,421	5,736	2,886
	26,416	53,317	28,725	28,636
Due after one year				
Subordinated loan – subsidiary	-	-	-	5,000
Other debtors	113	-	-	-
	26,529	53,317	28,725	33,636

14 CREDITORS

	2009 Group £'000	2009 Company £'000	2008 Group £'000	2008 Company £'000
Amounts falling due within one year				
Owed to parent	10,000	10,000	10,000	10,000
Other creditors	12,868	14,524	5,843	5,697
Accruals and prepaid income	34,482	34,526	36,582	21,610
	57,350	59,050	52,425	37,307
Amounts falling due after more than one year				
Other creditors	7,073	2,493	10,372	8,713
	7,073	2,493	10,372	8,713

The amount owed to parent represents a loan from the BT Pension Scheme which is repayable on demand, with no maturity date The interest on the loan is calculated and paid quarterly at LIBOR + 1%

15 PROVISIONS FOR LIABILITIES AND CHARGES

	2009 £'000
The Group	
At 1 January 2009	-
Provision	750
At 31 December 2009	750

The provision, which has been recognised as a result of an ongoing legal dispute disclosed in Note 28, relates to the excess amount payable on the Group's professional indemnity insurance policy

16 PENSION COMMITMENTS

The Group operates a defined benefit scheme, Hermes Group Pension Scheme (the "Scheme"), funded by the payment of contributions to a separately administered trust fund The scheme was closed to new members on 1 July 2008 and the Company makes contributions to a defined contribution scheme for new employees from that date Contributions to the defined contribution scheme amounted to £732,599 during the year (2008 - £103,869)

Defined Benefit Pension Scheme

The financial statements provide for full adoption of FRS 17 – Retirement Benefits Contributions to the Scheme are determined with the advice of independent qualified actuaries on the basis of triennial valuations using the Projected Unit method The actuarial valuation was updated at 31 December 2009 by a qualified actuary using assumptions that are consistent with the requirements of FRS 17 Investments have been valued, for this purpose, at fair value

The contributions of the Company during the year were 18 7% of pensionable payroll until 1 October 2009, when the contributions increased to 20 1% of pensionable payroll, in line with the Schedule of Contributions Members of the Scheme contribute 5% of pensionable earnings An additional contribution of £2 0m was made during the year The amounts recognised in the balance sheet are as follows

	2009 **£m**	**2008** **£m**
Present value of funded Scheme obligation	(110 4)	(79 1)
Fair value of Scheme assets	73 3	56 6
Deficit	(37 1)	(22 5)
Related deferred tax asset	10 4	4 7
Net liability	(26 7)	(17 8)

The amounts recognised in the profit and loss account are as follows

	2009 **£m**	**2008** **£m**
Current service cost (charged to operating profit)	3 3	5 2
Interest on Scheme obligation (included in Other finance (charges)/income)	5 1	4 8
Expected return on Scheme assets (included in Other finance (charges)/income)	(4 1)	(5 1)
Total	4 3	4 9
Actual return on Scheme assets	12 1	(15 6)

'Interest on Scheme obligation' and 'Expected return on Scheme assets' are disclosed as 'Other finance (charges)/income' in the Consolidated Profit and Loss Account

16 PENSION COMMITMENTS (continued)

Analysis of the actuarial loss recognised in the statement of total recognised gains and losses

	2009 £m	2008 £m
Actual return less expected return on Scheme assets, i e gain/(loss)	8 0	(20 7)
Experience gains and losses arising on Scheme liabilities, i e (loss)/gain	(3 4)	0 3
Changes in assumptions underlying the present value of Scheme liabilities, i e (loss)/gain	(20 4)	8 8
Actuarial loss	(15 8)	(11 6)

The cumulative amount of actuarial gains and losses recognised in the statement of total recognised gains and losses since the adoption of FRS 17 is a loss of £18 5 million (2008 – loss of £2 7 million)

Changes in the present value of the Scheme obligation are as follows

	2009 £m	2008 £m
Opening Scheme obligation	79 1	78 6
Current service cost	3 3	5 2
Interest cost	5 1	4 8
Actuarial loss/(gain)	23 8	(9 1)
Scheme participants' contributions	0 9	1 4
Benefits paid	(1 3)	(1 4)
Administrative expenses paid	(0 5)	(0 4)
Closing Scheme obligation	110 4	79 1

16 PENSION COMMITMENTS (continued)

Changes in the fair value of Scheme assets are as follows

	2009 £m	2008 £m
Opening fair value of Scheme assets	56 6	67 9
Expected return	4 1	5 1
Actuarial gains/(losses)	8 0	(20 7)
Contributions by employer	5 5	4 6
Scheme participants' contributions	0 9	1 4
Benefits paid	(1 3)	(1 4)
Administrative expenses paid	(0 5)	(0 3)
Closing fair value of Scheme assets	73 3	56 6

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows

	2009 %	2008 %
Equities	73	87
Bonds / Gilts	9	8
Real estate / Other	18	5

Principal actuarial assumptions at the balance sheet date

	2009 %	2008 %
Discount rate at 31 December	5 7	6 4
Expected return on plan assets at 31 December	7 5	7 1
Future salary increases	4 7	3 1
Future increases to pensions in payment (pensioners)	3 6	3 3
Future increases to pensions in payment (non-pensioners)	3 6	3 1
Deferred pension revaluation (HGPS members)	3 7	3 1
Deferred pension revaluation (HPS members)	3 7	3 3

On 17 May 1999 all assets and liabilities of the Hermes Pension Scheme (HPS) were transferred to the Hermes Group Pension Scheme (HGPS)

16 PENSION COMMITMENTS (continued)

The rate of return has been determined on an asset class basis reflecting factors including equity market movements, future expectations, bond yields and inflation

Amounts for the current and previous four periods are as follows

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Scheme obligation	(110 4)	(79 1)	(78 6)	(74 1)	(67 4)
Scheme assets	73 3	56 6	67 9	59 3	50 8
Deficit	(37 1)	(22 5)	(10 7)	(14 8)	(16 6)
Experience adjustments on Scheme assets	8 0	(20 7)	0 9	2 0	6 3
Experience adjustments on Scheme liabilities	(3 4)	0 3	(0 1)	3 4	(0 2)

17 CALLED UP SHARE CAPITAL

	2009 £	2008 £
Called up, allotted and fully paid		
30,000,000 (2008 30,000,000) Ordinary Shares of £1 each	30,000,000	30,000,000
607 (2008 nil) 'A' Growth Shares of £1 each	607	-
525 (2008 nil) 'B' Growth Shares of £1 each	525	-
465 (2008 nil) 'E' Growth Shares of £1 each	465	-
	30,001,597	30,000,000

Shares allotted during the year

The 'A', 'B', and 'E' Growth Shares disclosed in the table above are shares issued at par during the year to employees as part of a Group-wide incentive scheme Other than the right to the holders to share in the profits of the Company by way of future dividend stream, there are no other rights attached to these share classes

Shares allotted post year-end

On 28 April 2010, 75 'A', 125 'B', 120 'E' and 751 'G' Growth shares of £1 each in the capital of the Company were allotted to employees, increasing the total called-up, allotted and fully paid share capital of the Company to £30,002,668

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009 (continued)

18 COMBINED STATEMENT OF MOVEMENTS IN SHAREHOLDER'S FUNDS AND STATEMENT OF MOVEMENTS ON RESERVES

	2009 Called up share capital	2009 Non-distributable capital reserves	2009 Contribution from parent company	2009 Profit and loss account	2009 Total	2008 Total
	£'000	£'000	£'000	£'000	£'000	£'000
The Group						
At 1 January	30,000	98	510	62,851	93,459	88,823
Issue of share capital	2	-	-	-	2	-
Loss/(profit) for the financial year	-	-	-	(10,802)	(10,802)	14,611
Defined Benefit Pension Scheme - Actuarial (loss)/gain on liability experience	-	-	-	(3,400)	(3,400)	300
Defined Benefit Pension Scheme - Actuarial gain/(loss) on assets	-	-	-	8,000	8,000	(20,727)
Defined Benefit Pension Scheme - Actuarial (loss)/gain on change in assumptions	-	-	-	(20,400)	(20,400)	8,800
Deferred tax credit on pension liabilities	-	-	-	5,688	5,688	1,652
Currency translation differences on foreign currency net investments	-	-	-	32	32	-
At 31 December	30,002	98	510	41,969	72,579	93,459

The directors recommend a dividend payment of £13,000,000 in respect of the year (2008 - £nil)

18 COMBINED STATEMENT OF MOVEMENTS IN SHAREHOLDER'S FUNDS AND STATEMENT OF MOVEMENTS ON RESERVES (continued)

	2009 Called up share capital £'000	2009 Capital contribution from parent £'000	2009 Profit and loss account £'000	2009 Total £'000	2008 Total £'000
The Company					
At 1 January	30,000	510	(3,883)	26,627	39,900
Issue of share capital	2	-	-	2	-
Profit/(loss) for the financial year	-	-	12,069	12,069	(3,298)
Defined Benefit Pension Scheme - Actuarial (loss)/gain on liability experience	-	-	(3,400)	(3,400)	300
Defined Benefit Pension Scheme - Actuarial gain/(loss) on assets	-	-	8,000	8,000	(20,727)
Defined Benefit Pension Scheme - Actuarial (loss)/gain on change in assumptions	-	-	(20,400)	(20,400)	8,800
Deferred Tax credit/(charge) on Pension Liabilities	-	-	5,688	5,688	1,652
At 31 December	30,002	510	(1,926)	28,586	26,627

19 COMMITMENTS UNDER OPERATING LEASES

The Group and Company annual commitments for the year to 31 December 2009 under operating leases are as follows

	2009 Land and buildings £'000	2009 Other £'000	2008 Land and buildings £'000	2008 Other £'000
Operating Leases which expire within				
One year	193	-	-	-
Two - five years	-	50	-	40
Over five years	1,500	-	1,630	-
	1,693	50	1,630	40

All operating leases which are related to land and buildings are subject to five-yearly, upward-only, rent reviews

The Company previously sub-let a portion of its building space The sub-lease agreements expired in 2008 and were not renewed

20 RECONCILIATION OF OPERATING (LOSS)/PROFIT TO NET CASH (OUTFLOW)/ INFLOW FROM OPERATING ACTIVITIES

	2009 £'000	2008 £'000
Operating (loss)/profit	(7,391)	14,828
Realised currency (loss)/gain	(237)	18
Difference between pension contributions and charge against operating profit	(2,200)	531
Depreciation	3,459	3,937
Amortisation/write-off	1,650	3,714
Increase in debtors	(3,590)	(2,339)
Decrease in creditors	(1,181)	(15,768)
Net cash (outflow)/inflow from operating activities	(9,490)	4,921

21 RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS

	2009 £'000	2008 £'000
(Decrease)/increase in cash in year	(12,035)	3,626
Movement in net funds in year	(12,035)	3,626
Net funds at beginning of year	131,512	127,886
Net funds at end of year	119,477	131,512

Net funds at 31 December 2009 comprised cash of £119,477,000 (2008 - £131,512,000)

22 ADDITIONAL INFORMATION ON PRINCIPAL SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

The parent company and the Group have investments in the following subsidiary undertakings, associates and joint ventures which principally affected the profits and net assets of the Group To avoid a statement of excessive length, details of investments which are not significant have been omitted

SUBSIDIARY UNDERTAKINGS	ACTIVITY
Hermes Focus Asset Management Limited	Investment management
Hermes Focus Asset Management Europe Limited	Investment management
Hermes Investment Management Limited	Investment management
Hermes Real Estate Investment Management Limited	Investment management
Hermes Administration Services Limited	Administration
Hermes Sourcecap Limited (formerly Sourcecap International Limited)	Investment management
Hermes UOB Capital Management Limited	Investment management
Hermes Equity Ownership Services Limited	Investment management
Hermes Private Equity Limited	Investment management
BT Pension Scheme Management Limited (formerly Hermes Pension Fund Management Limited)	Pension advice
Hermes BPK Partners LLP	Investment management

ASSOCIATES AND JOINT VENTURES	ACTIVITY
Perception UK LLP	Building service provider
UOB Hermes Asia Management Pte Ltd	Investment management
X-Leisure Ltd	Investment management
Logistics Management Ltd	Investment management

Subsidiary undertakings disclosed above are owned as to 100% of ordinary share capital except for Hermes UOB Capital Management Limited (60% of ordinary share capital owned), Hermes BPK Partners LLP (61 5% of issued units owned) and Hermes Sourcecap Limited (formerly Sourcecap International Limited, 75 01% of ordinary share capital owned at the balance sheet date) All subsidiaries disclosed above have been consolidated in the accounts All are incorporated in Great Britain and registered and operate in England and Wales

Investments in associates and joint ventures relate to ordinary share capital

Perception UK LLP is 50% owned by Hermes Real Estate Services Limited and is incorporated in Great Britain and is registered and operates in England and Wales

UOB Hermes Asia Management is owned as to 40% of ordinary share capital and is incorporated, registered and operates in Singapore

22 ADDITIONAL INFORMATION ON PRINCIPAL SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES (continued)

X-Leisure Limited and Logistics Management Limited are each 50% owned by Hermes Real Estate Investment Management Limited and are incorporated in Great Britain and registered and operate in England and Wales

23 LIMITED PARTNERSHIPS

As described in accounting policy d) the results of the Hermes UOB Special Limited Partner LP and Hermes UOB General Partner LP have not been consolidated Had these been consolidated the effect on net assets, retained profit and total recognised gains and losses would have been £nil (2008 - £nil)

24 FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY

The principal financial risk exposures of the Company and the Group at the balance sheet date relate to credit, liquidity and interest rate risks

The Group has in place a system of controls and processes to mitigate the risks identified

Credit Risk

Credit risk is the risk that a counterparty will be unable to meet a commitment that it has entered into with the entity The following are credit risks relevant to the Company and the Group at the balance sheet date

i) Fund-specific – Within a number of the funds operated by entities within the Group, investment positions are taken gaining exposure to other parties Applicable limits are stated within the objectives and constraints of each fund The risk is assessed by qualified and trained professionals using a range of information and tools

ii) Transaction-related – An inevitable consequence of both investment transactions within the funds and transactions within Group entities is the involvement of counterparties, particularly brokers A process is in place to assess the suitability of counterparties

The carrying amounts of financial assets best represent the maximum credit risk exposure at the balance sheet date

24 FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY (continued)

Credit Risk (continued)

At 31 December 2009, the Company and the Group's financial assets exposed to credit risk amounted to the following

Financial assets

	2009 £'000 Group	2009 £'000 Company	2008 £'000 Group	2008 £'000 Company
Cash at bank and in hand	119,477	17,070	131,512	17,364
Owed by subsidiaries	-	47,291	-	18,341
Trade debtors and accrued income	16,225	2,421	7,933	2,913
Taxation debtor	1,659	1,972	4,131	5,311
Owed by parent	6,606	-	14,445	10
Other debtors	2,039	1,633	2,216	2,061
Subordinated loan - subsidiary	-	-	-	5,000
	146,006	70,387	160,237	51,000

Cash at bank is held in current accounts or put on deposit with highly-rated counterparties Bankruptcy or insolvency of bank counterparties may cause the Company's rights with respect to the cash held by the banks to be delayed or limited Bank credit ratings are high and are monitored by management with reference to reputable rating agencies such as Standard & Poor's, Moody's or Fitch If the banks' financial positions were to materially deteriorate then the cash holdings would be moved to other banks

Other debtors include dividends due and trade debtors Bankruptcy or insolvency of the counterparty may cause the Company's rights with respect to the amounts owed being delayed or limited The Company manages its risk by dealing with reputable counterparties offering a low risk of default The financial position of the counter-parties is regularly reviewed

As at the year end, within the Company and Group, an insignificant level of debt was substantially past due and the majority of debt outstanding at the balance sheet date has been received to date post year-end

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2009 (continued)

24 FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY (continued)

Liquidity Risk

Liquidity risk arises as a result of the possibility that the Company may not have sufficient cash funds to meet its liabilities as they fall due

Below is a maturity analysis of the Group and Company undiscounted liabilities

Financial liabilities	Maturity	2009 £'000 Group	2009 £'000 Company	2008 £'000 Group	2008 £'000 Company
Owed to parent	< 12 months	10,000	10,000	10,000	10,000
Other creditors < 12 months	< 12 months	12,086	13,742	5,070	4,924
Unfunded pension liability	< 12 months	782	782	773	773
Accruals and prepaid income	< 6 months	34,482	34,526	36,582	21,610
Other creditors >12 months	> 12 months	7,073	2,493	10,372	8,713
		64,423	61,543	62,797	46,020

The Company's liquidity risk relates to its cash dealings with clients, day-to-day trading activity, the funding of operational expenses and meeting solvency requirements as determined by the regulator (Financial Services Authority)

The maintenance of regulatory solvency is reported and monitored by senior management on a regular basis The Company retains a high level of liquidity to ensure that regulatory solvency requirements are continuously met There is a £50m loan facility in place with the ultimate parent, the BT Pension Scheme, should this be required at any point

Interest Rate Risk

Whilst not the primary focus of the Group the nature of the business gives rise to large cash balances being held and consequently potentially significant interest receipts The Group has a finance department that serves to mitigate the interest rate risk by continually monitoring the cash position of the Group and seeking the optimal level of cash to place on deposit given the Group's liquidity requirements and a treasury department which seeks to obtain the optimum return on cash deposited

If the average rate of interest was 2% higher during the year based upon the year-end cash position an additional £2 4m interest would have been earned If interest rates were 2% lower on average, *ceteris paribus*, it would have resulted in an equal but opposite effect

25 RELATED PARTY TRANSACTIONS

(a) Disclosure exemptions and further information

Parent Undertaking

The Company is a wholly-owned subsidiary and is consolidated into the accounts of the BT Pension Scheme, which are available to the public As such, the Company has not disclosed related party transactions with the BT Pension Scheme, as it is taking advantage of the exemption in FRS8 available to wholly-owned subsidiaries

Subsidiaries

The Company prepares Group accounts into which all of its subsidiaries are consolidated The Company has not disclosed related party transactions with wholly-owned subsidiaries as it is taking advantage of the exemption in FRS8

Hermes Group Pension Scheme

Certain activities of the Scheme are carried out by the Hermes Group, all of the costs of which are borne by Hermes Fund Managers Limited These costs have not been apportioned for accounting purposes between those attributable to the Scheme and those attributable to the Hermes Group as functions maintained for both entities cannot be divided meaningfully between them

(b) Related party transactions

During the year there were transactions with the following related parties

The Trustees of the BT Pension Scheme

The following fees were paid by the Hermes Group on behalf of BTPS and recharged to BTPS, in respect of the Trustees' services to the pension scheme

	2009 £'000	2008 £'000
R Kent (Chairman)	175	110
C N J Long	-	23
D M MacDonald	29	21
H Marchant	25	24
W McClory	29	21
D R Barford	50	30
L Cullen	13	40
B Shepherd	11	-
P Spencer	17	-
Total fees	349	269

25 RELATED PARTY TRANSACTIONS (continued)

(b) Related party transactions (continued)

The following transactions occurred during the year with subsidiaries that are part-owned

Hermes Sourcecap Limited (HSL, formerly Sourcecap International Limited)

The Company acquired HSL during the year The cost of investment totalled £4,376,776 as disclosed in Note 11 Additional information relating to the acquisition is disclosed in Note 12 There is a debtor due to the Company from HSL of £134,852 at year-end (2008 - £nil)

Hermes BPK Partners LLP (HBPK)

The Company provided capital investment totalling £11,000,000 to HBPK during the year (see Note 11 There is a creditor due from the Company to HBPK of £5,933,623 at year-end (2008 - £nil)

Hermes UOB Capital Management Limited (HUCM)

The Hermes UOB European Private Equity fund invests in European equities Hermes UOB GP Limited (a 100% subsidiary of HUCM) receives 61% of the profit share arising from the fund in respect of Hermes UOB GP Limited and pays a management fee to HUCM of the same amount HUCM then pays a management fee to Hermes Private Equity Limited (HPEL, a 100% subsidiary of the Company)

- During the year HUCM received £412,627 (2008 - £402,236) from Hermes UOB GP Limited in management fees and paid on £395,709 (2008 - £385,748) in management fees to HPEL

- At the year end HUCM owed £14,733 (2008 - £nil) to the Company

The following transactions occurred during the year with funds that are related to 100% owned subsidiaries of the Company

Hermes UK Focus Funds

The Hermes UK Focus Funds are partnerships investing in UK equities A 100% owned subsidiary of the Company, Hermes Focus Asset Management Limited (HFAM), is the General Partner During the year there were the following transactions between the UK Focus Funds and HFAM

- HFAM received £80,111 (2008 - £3,851,094) from the Hermes UK Focus Fund, £20,235 (2008 – £986,043) from the Second Hermes UK Focus Fund and £15,031 (2008 - £631,444) from the Third Hermes UK Focus Fund as profit share

25 RELATED PARTY TRANSACTIONS (continued)

Hermes UK Focus Funds (continued)

- HFAM recharged £nil (2008 - £80,822) of expenditure to the Hermes UK Focus Fund, £nil (2008 - £26,388) to the Second Hermes UK Focus Fund and £nil (2008 - £12,872) to the Third Hermes UK Focus Fund This expenditure represented the direct costs of the partnerships There were no outstanding balances owed to HFAM at year end (2008 - £nil)

The Hermes Specialist Focus Fund 1, 2 (formerly Hermes UK Small Companies Focus Fund 1, 2) and Side Pocket Fund 1, 2

The Hermes Specialist UK Focus Funds are partnerships investing in UK Small Company equities HFAM is the general partner During the year there were the following transactions between Hermes Specialist UK Focus Fund (HSUKFF), Hermes Specialist UK Focus Fund 2 (HSUKFF 2), the Side Pocket Fund 1, the Side Pocket Fund 2 and HFAM

- HFAM received £2,075,294 (2008 – £1,609,301) from HSUKFF, £53,056 (2008 – £321,242) from HSUKFF 2, £56,874 (2008 – £58,474) from the UK Small Companies Side Pocket Focus Fund 1 and £74,644 from the UK Small Companies Side Pocket Focus Fund 2 (2008 – £17,752), as profit share

- HFAM recharged £21,548 (2008 – £61,400) of expenditure to HSUKFF This expenditure represented the direct costs of the partnership There were no outstanding balances owed to HFAM at year end (2008 - £nil)

European Focus Funds I, II and III

The European Focus Funds are limited partnerships investing in European equities Hermes Focus Asset Management Europe Limited (HFAME) is a general partner During the year there were the following transactions between the European Focus Funds and HFAME

- HFAME received £2,753,481 (2008 – £9,034,586) from the European Focus Fund I, £188,792 (2008 – £934,433) from the European Focus Fund II and £206,482 (2008 – £1,029,795) from European Focus Fund III as profit share

- HFAME recharged £104,469 (2008 – £35,666) of expenditure to the European Focus Fund I, £4,193 (2008 – £35,666) of expenditure to the European Focus Fund II and £4,039 (2008 – £35,666) of expenditure to the European Focus Fund III This expenditure represented the direct costs of the partnerships There were no outstanding balances owed to HFAME at year end (2008 - £nil)

- In addition, HFAM is a general partner of the European Focus Funds During the year HFAM received £318,282 (2008 - £129,515) as a general partner's profit share

26 MINORITY INTEREST - EQUITY

The minority interest of £(2,022,000) (2008 - £167,000) included within the consolidated balance sheet and the £3,334,000 (2008 - £14,000) included within the consolidated profit and loss account relate to a 38 5% shareholding in Hermes BPK Partners LLP owned by nine individual members, a 40% shareholding in Hermes UOB Capital Management Limited (HUCM) owned by UOB Global Capital LLC, and a 24 99% shareholding in Hermes Sourcecap Limited (formerly Sourcecap International Limited) which is owned by a combination of two individual directors and an institutional shareholder

27 ULTIMATE PARENT UNDERTAKING

The directors regard the BT Pension Scheme as the Company's immediate and ultimate parent and controlling entity It is also the parent of the largest and smallest Group to prepare Group accounts into which the results of the Company are consolidated The accounts of the BT Pension Scheme can be obtained at Lloyds Chambers, 1 Portsoken Street, London E1 8HZ

28 LITIGATION

It was disclosed in the prior year financial statements that an action for damages had been brought against a subsidiary of the Company, Hermes Focus Asset Management Europe Limited (HFAME), filed before the Court of Parma, Italy At a hearing that took place in December 2009 the Parma Court declared that this action had been terminated, with the agreement of both the plaintiff and the HFAME

There is an ongoing dispute between certain funds managed by a subsidiary of the Company, Hermes Investment Management Limited (HIML), and the administrator of a derivative counterparty in relation to the close-out of two derivative transactions in September 2008 The claim is strongly refuted by the company who proposes to defend any claim relating to this matter There is significant uncertainty surrounding the outcome of the potential claim which is at a very early stage The directors are also of the view that to disclose an estimated value at this stage would seriously prejudice the position of the company in respect of this claim Consequently, no provision or disclosure of its estimated value has been made in the financial statements in relation to this matter Discussions with the insurers are taking place with regard to professional indemnity insurance and, as set out in note 15, a provision has been made in respect of the excess amount payable on the Group's professional indemnity insurance policy in respect of this matter

29 POST BALANCE SHEET EVENTS

On 15 January 2010, under the terms of the shareholder agreement following the Company's acquisition of Hermes Sourcecap Limited (HSL, formerly Sourcecap International Limited) in December 2009, 1,650 Ordinary 'A' shares held by the Company in the capital of HSL were transferred at par value to Ordinary 'B' shareholders and that issuance of capital altered from Ordinary 'A' to Ordinary 'B' The transfer reduces the Company's controlling shareholding in HSL from 75 01% to 58 51%

On 26 March 2010 the Company made an additional contribution of £3,000,000 to its subsidiary undertaking Hermes BPK Partners LLP (in accordance with the Limited Liability Partnership Agreement) to enable it to continue to satisfy the FSA Tier 1 regulatory capital requirements

On 1 April 2010, Hermes GPE LLP (a joint venture vehicle established by the Company and Gartmore Investment Management Limited to manage the merged Hermes and Gartmore private equity fund of funds business) replaced Hermes Private Equity Limited (HPEL) as manager of all the partnerships that HPEL managed as at the year end, other than HPEP I (the "HPE Funds") Also on that date, ownership of (i) the general partner entities of the HPE Funds (being HPE GP Limited and HPE Scotland GP Limited), and (ii) HPEL interests in Hermes UOB Capital Management Limited UOB Hermes Asia Management PTE Limited, were transferred to Hermes GPE LLP Hermes GPE LLP became authorised by the Financial Services Authority on 1 April 2010 As such, it began trading from that date

On 28 April 2010, 75 'A', 125 'B', 120 'E' and 751 'G' Growth shares of £1 each in the capital of the Company were allotted to employees, increasing the total called-up, allotted and fully paid share capital of the Company to £30,002,668

Following incorporation on 21 April 2010 and the granting of a regulatory licence on 13 July 2010, Hermes Fund Managers (Australia) Pty Limited, a 100% owned subsidiary of the Company, has commenced sales and marketing activity in Australia