

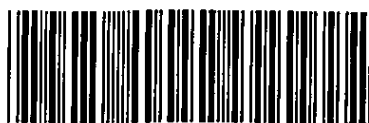
DIRECTORS' REPORT AND FINANCIAL STATEMENTS

HERMES FUND MANAGERS LIMITED

31 DECEMBER 2008

Registered No: 1661776

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HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW

Overview of Hermes

During 2008 Hermes continued the implementation of the strategic decision to separate risk management and advice for its owner and principal client, the BT Pension Scheme (BTPS), from the continuation of the development of an asset manager built around specialist investment partnerships managing assets for BTPS and other clients.

These activities were performed against the backdrop of unprecedented market volatility, sharp falls in the value of most asset classes, a banking crisis constraining credit availability, increasing counterparty risk and a global recession. Hermes approach to managing its business to respond to these challenges is detailed in this review.

The entity acting as the executive arm of BTPS is Hermes Pension Fund Management Limited (HPFM).

The investment management group manages funds on behalf of BTPS and other clients and operates through several key subsidiary entities. Their activities in the year are dealt with in this review.

Hermes Board

The key Board change in the year was the appointment of Glyn Jones on 25 July 2008 to succeed Richard Bernays who retired as Chairman of Hermes on the same date. Glyn brings a wealth of relevant experience having previously been CEO of Thames River Capital and, prior to that, CEO of Gartmore Investment Management and CEO of the Coutts Group. Glyn is also Chairman of UK wealth manager Towry Law Group and Chairman of Aspen Insurance Holdings, a New York-listed speciality insurer and re-insurer.

The Board records its thanks for the contribution that Richard Bernays made to the development of the business in his tenure as Chairman.

Review of the Year

Although, inevitably, given the continuing extreme market conditions we have had a number of strategies that have been adversely affected, Hermes overall performance was extremely positive. Our investment activities delivered our clients in excess of £1 billion of outperformance against benchmark during the year. Group profit before interest and tax rose by 57% to £16 million.

These results were achieved through dedicated hard work across the business, a characteristic which will continue to be needed in the current year and next as further change is driven through the organisation against the backdrop of a difficult financial market environment.

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Review of the Year (continued)

1. General

The extreme market volatility and falls experienced in 2008 took centre stage across Hermes activities in the year. In particular, the following points should be noted.

- An equity de-risking strategy was put into place over the course of 2007 and early 2008 by HPFM for BTPS and this proved extremely valuable.
- The Counterparty Credit Risk Group met very frequently in the latter half of the year to assess counterparty risk and adjust interactions on behalf of clients accordingly.
- The value based style of investing in several Hermes mandates, in particular the European Focus Funds, proved very challenging in this environment and led to a fall in performance fees from previous levels.
- Hermes management fees are mostly linked to the value of funds under management. They came under pressure particularly in the latter part of 2008 and the effect will be most felt in 2009.
- Mandates with gearing, such as the BTPS Real Estate mandate which includes the corporate ownership of MEPC, suffered as asset values fell.

2. Financial Performance

Against this backdrop the financial performance of the group remained healthy. Turnover rose from £108 million to £109 million and profit before interest and tax also increased from £10 million in 2007 to £16 million. The assets of the group increased from £89 million to £94 million.

The FRS 17 deficit of the company's defined benefit pension scheme (HGPS), net of deferred tax, rose from £8 million to £18 million reflecting the fall in asset values in the pension fund at the balance sheet date. The triennial actuarial valuation of HGPS is due effective 31 December 2008. Hermes is engaging with the Trustees of HGPS to ensure that any deficit calculated, and the associated recovery plan, meet the requirements of both HGPS and Hermes.

3. Operating Model and Re-engineering

To underpin the strategic development of both parts of the business, a comprehensive program (named 'Genesis') to re-engineer the operating model commenced late in 2007. Genesis is a two to three year program of significant investment in systems and processes with the aim of delivering a platform that will support the ambition and requirements of both HPFM and the investment 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 April 2009 the program remains broadly on time and on budget and has delivered on key milestones including the following.

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Review of the Year (continued)

3. Operating Model and Re-engineering (continued)

- Outsourcing of fund administration and custody services to Northern Trust.
- Launch of five equity funds and two hedge fund-of-funds in Dublin in December 2008.
- Implementation of an operational risk system.
- Implementation of a new front office order management system, initially to process foreign exchange trades.

Further developments planned for the remainder of the programme are outlined in the section on the future.

4. Review of Key Subsidiaries

4.1 Hermes Pension Fund Management Limited (HPFM)

HPFM was established in 2008 as the executive arm of BTPS and is headed by Nigel Labram. The activities performed for BTPS are governed by a master services agreement completed in February 2009. HPFM became FSA regulated in February 2009. Key activities include the following.

- Risk management of BTPS assets and liabilities.
- Implementation of scheme level investment strategies.
- Advice on the Strategic Asset Allocation of BTPS assets.
- Managing a Tactical Asset Allocation mandate within defined parameters.
- Selection and monitoring of the Scheme's investment managers.
- Scheme administration.

The improved clarity and focus that the establishment of HPFM has provided was very beneficial in 2008 and the risk rebalancing and Tactical Asset Allocation strategies performed very strongly in the year. Performance for BTPS is now 1% above benchmark and 0.8% above the peer group annualised over the last ten years.

Hermes remains committed to investing in HPFM and growing its resources to become best in class in all aspects of its operations.

4.2 Hermes Real Estate Investment Management Limited (HREIM)

In absolute terms, HREIM's real estate portfolios have fallen given the rapid decline in property values. However, HREIM continued to provide sound performance relative to benchmark for clients on the underlying property assets within the portfolios managed. The Hermes Property Unit Trust, where HREIM acts as investment manager, remains in the upper quartile of performance for funds in its sector. However, the BTPS mandate suffered in the year from having gearing in excess of the benchmark and, although this was mitigated as far as possible, underperformed accordingly.

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Review of the Year (continued)

4. Review of Key Subsidiaries (continued)

HREIM continued to invest in people and systems in 2008 in support of both UK and the growing international mandates.

4.3 Hermes Investment Management Limited (HIML)

The strongest performing area in HIML in 2008 was Smaller Companies where the UK and US funds produced outperformance against their benchmarks. European portfolios fared less well with some underperformance.

The Emerging Market business unit had a steady year in conditions of extreme market volatility and produced performance very close to benchmark.

In the Fixed Income business unit some mandates performed well but the investment grade credit positions in the largest mandate were poorly positioned to cope with the market downturn, financial services in particular, and underperformed. Hermes and HIML have addressed this following the year end by taking the following action.

- Restructuring the mandates across the whole Fixed Income business unit.
- Redefining the investment grade mandate for BTPS and transferring it to an external manager to be run on a very low-risk / return tolerance.
- Strategically seeking the acquisition of new teams or entities to transform the capability, investment performance and marketability of the businesses unit. The focus of the area will move to active management of fixed income assets across the global credit markets.

4.4 Hermes Equity Ownership Services Limited (HEOS)

Responsible and long-term investing is at the heart of what Hermes does in both areas of its business. At the forefront of this is HEOS which, on behalf of over 20 clients, provides stewardship for the shareholdings of long-term investors and seeks to bring about corporate change through a focussed and value oriented approach.

During the year HEOS continued to extend its client base and now advises on over £50 billion of assets. HEOS is uniquely placed to assist owners in the engagement they need to undertake which is particularly relevant in the new environment that is emerging with its increased focus on effective governance and engagement.

4.5 Hermes Focus Asset Management Limited and Hermes Focus Asset Management Europe Limited (HFAM/E)

2008 was a year of unprecedented declines in markets and these led to huge challenges for managers with a value style of investing and concentrated portfolios, including HFAM/E. The UK Specialist Focus Fund (previously called the UK Small Companies Focus Fund) performed strongly in the year but the UK and European Large Cap Focus Funds had poor years. Hermes has responded to these issues through the following actions.

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Review of the Year (continued)

4. Review of Key Subsidiaries (continued)

- A comprehensive review of performance, investment process, engagement activity and personnel was undertaken to clearly understand any underlying issues and how they could be averted in the future. A number of people and process changes have resulted.
- The UK Large Cap Focus Funds were closed at 30 September 2008 and positions have been liquidated over the period since then.
- The former UK Small Cap Focus Funds benchmark has been changed to allow engagement in larger entities and has been renamed the UK Specialist Focus Fund.
- With effect from 1 April 2009, the European Focus Funds have been split between an ongoing fund and funds to be liquidated and monies returned to clients.

Engagement with companies on behalf of long-term owners remains fundamental to the Hermes vision and Hermes is confident that the changes made in the funds have positioned HFAM/E well for a recovery.

4.6 Hermes Private Equity Limited (HPE)

During 2008 HPE continued its two main activities on behalf of clients of direct investment in mid market buy-out opportunities and Fund of Funds investing. Following a strategic review of the activities of HPE, Hermes decided to exit the direct private equity investment activity and pursued an opportunity to sell this business and transfer its employees to Bridgepoint Capital. Bridgepoint were judged by HPFM to be the best custodians of the existing direct investments. This transaction remains subject to regulatory approval and is noted as a non-adjusting post-balance sheet event as indicated in note 29 to the financial statements.

The Fund of Funds business is an important part of Hermes strategic vision and resource has been added during the year to strengthen the team.

4.7 Hermes BPK Partners LLP (HBPK)

In December 2008, Hermes recruited a Hedge Fund of Funds team which was incorporated as Hermes BPK Partners LLP. The team have launched their first two funds in Dublin, the Hermes BPK Fund and the Hermes BPK Restructuring Fund.

The team acquired has had a long association and a very successful track record of both investment performance and client acquisition and servicing. The team meets the investment needs of BTPS in this important investment area and is well positioned to emerge from the current market turmoil as a highly credible offering to long-term investors.

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

The Future

The performance of Hermes in future years will continue to depend on the quality of advice given to BTPS and the investment performance generated for BTPS and other clients by our specialist investment teams.

The current economic environment and, in particular, the impact on Hermes management fees raises challenges which management is well aware of and responding to as shown below.

- Close monitoring and maintenance of both cash flow and the significant cash balances in the Group.
- Implementing best value procurement practices including the recent key hire of a Head of Procurement.
- Tight control over areas of discretionary spending including pay rises and bonuses.
- Continuing to seek to grow and diversify revenue streams as described elsewhere in the review.

HPFM is committed to continuing to develop best in class ability in its advice and risk management of BTPS. Further high-quality professionals will be added in 2009, in particular to advise on mitigating the risks impacting the future liabilities of BTPS.

The investment management business will continue to grow existing successful capabilities and seek to acquire additional high performing teams and/or entities that will provide new or enhanced investment offerings. To facilitate this Hermes has employed skilled internal and external resource to identify and screen opportunities leading to selection and implementation of those that are best suited to adding investment excellence.

Underpinning the above ambition is the continuation and completion of the re-engineering of the operating model to provide a flexible, leading edge platform capable of supporting both principal activities. The key features to be implemented in 2009 are as follows.

- Outsourcing of Investment Operations to Northern Trust.
- A new front office order management system.
- A sophisticated risk management system for HPFM.
- A new portfolio performance and risk solution.
- A new client reporting solution.

In addition, Hermes sales and distribution capability will continue to be enhanced to facilitate offering products to target clients through a range of distribution channels.

Key Risks and Capital Requirements Directive Pillar III Disclosure

Overview

Under Pillar III of the Capital Requirements Directive (CRD), firms are required to make certain disclosures in relation to risk management techniques and capital requirements. These disclosures are designed to promote market discipline by providing market participants with information to help them assess a firm's risk exposures and processes.

HERMES FUND MANAGERS LIMITED**BUSINESS REVIEW (continued)****Key Risks and Capital Requirements Directive Pillar III Disclosure (continued)**

The intention of Pillar III is to complement the minimum capital requirements of Pillar I and the supervisory review processes of Pillar II.

Frequency and Basis of Disclosures

Unless otherwise stated, these disclosures are based upon figures as at 31 December 2008.

After considering the operations and complexity of Hermes, the Directors do not consider it necessary to make disclosures more frequently than annually, with the exception of any material changes to the business model and to permissions or techniques for calculating capital requirements.

Future disclosures will be published annually, and contained in the Financial Statements.

Scope of Application

Hermes Fund Managers Limited (HFML) is the parent company of a number of companies falling within the Hermes Group. The main operating companies within Hermes are Hermes Investment Management Limited (HIML), Hermes Administration Services Limited (HASL), Hermes Real Estate Investment Management Limited (HREIM), Hermes Focus Asset Management Limited (HFAM), Hermes Focus Asset Management Europe Limited (HFAME), Hermes UOB Capital Management Limited (HUCM), Hermes Private Equity Limited (HPE), Hermes Pension Fund Management Limited (HPFM) and Hermes BPK Partners LLP. All of the above named companies (with the exception of Hermes Real Estate Investment Management Limited and Hermes BPK Partners LLP) are separately authorised and regulated by the Financial Services Authority. Further information on all subsidiaries, associates and joint ventures within Hermes can be found in Note 22 to the financial statements.

There are no material restrictions that currently affect the transfer of capital within Hermes.

These disclosures have not been subject to separate external audit, except as appropriate as part of the Business Review.

Risk Management

As a general philosophy, Hermes is cautious and risk averse. It is, however, a feature of any business such as that undertaken by Hermes that risks exist and cannot always be completely mitigated. Hermes is primarily exposed to operational and reputational risk but other risks are also covered in this statement.

In order to embed risk management throughout the firm, Hermes has a comprehensive governance structure, Group-wide policies and procedures, effective management reporting and system controls in place to identify, mitigate and control risks.

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Key Risks and Capital Requirements Directive Pillar III Disclosure (continued)

Whilst the Board is ultimately responsible for risk management, day-to-day responsibility is delegated to the Operating Executive and the Risk and Control Executive. The Risk and Control Executive is the primary committee for risk management within Hermes. The Risk and Control Executive reports directly to the Operating Executive which, via the CEO, reports to the Board. Further sub committees of the Operating Executive include:

- Derivative Governance and New Product/New Instrument Approval Group
- Valuations Committee
- Outsourcing Review Group
- Counterparty Credit Risk Group

The Risk and Control Executive is chaired by the Chief Risk Officer and has senior management representation. It receives regular management reporting including any material errors or breaches. Any significant risks are escalated to the Operating Executive, Audit Committee and Board where necessary.

The Operating Executive acts as a forum to support and advise the Hermes Chief Executive on significant matters relating to the overall management of the Hermes business, to ensure that it achieves its strategic objectives. This includes significant client issues, business development, human resources, finance, risk, compliance and legal, and IT and operations.

Hermes has a range of policies and procedures covering its activities which are designed to help manage and control its day-to-day operations.

Principal Control Functions

Set out below is a description of the role and activities of each of the principal control functions:-

- Operational Risk

Operational Risk undertakes the oversight of the Group's risk management arrangements.

Areas of potential risk or vulnerability are identified by the Risk team working with management and associated controls and mitigating actions are considered. The existence of risks and recommendations for their management or control are made. This is achieved by regular risk reviews at Group level. Furthermore, risk and control self assessments (RCSA's) are being rolled out across all areas within Hermes as part of the implementation of a new operational risk system. Additionally, key performance and risk data is gathered and monitored on a regular basis.

Regular reports are provided to the Group's management and advice on risk identification and controls is given.

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Key Risks and Capital Requirements Directive Pillar III Disclosure (continued)

- Compliance

Compliance is responsible for monitoring and advising senior management on regulatory risk.

This is primarily achieved through testing the Group's procedures and practices for adherence to the highest regulatory standards and best business practice.

Compliance provides guidance on anti-money laundering legislation and is the conduit for reporting to the authorities any money laundering suspicions. There have been no reports made in the period covered by the financial statements.

Any areas of weakness which are identified in the regulatory control environment are reported to a variety of relevant senior management bodies along with recommendations to strengthen the regulatory control environment. This process aims to mitigate the regulatory risks faced by the Group appropriately and consequently help Hermes achieve its regulatory obligation to its conduct of the business and its staff.

- Internal Audit

Internal Audit performs an independent appraisal role reviewing the internal control system across the organisation. This is achieved by regular internal audit reviews and spot checks supplemented by ad-hoc investigations and advice in response to operational issues and new products and procedures. Reports on findings and issues arising are issued to management as well as to the Hermes and BTPS Audit Committees and to the Hermes Risk and Control Executive.

Key Risks and Mitigating Actions

The following areas discuss the key risks and mitigating actions that relate to Hermes.

Credit Risk

Credit risk is the potential for loss caused by a counterparty failing to meet their obligations as they become due. Hermes is not exposed to high levels of credit risk, as it does not undertake any principal trading in relation to its own balance sheet, other than placing cash on deposit. Hermes only places cash out on deposit with a select list of highly rated counterparties.

Hermes acts as agent on behalf of its clients when executing trades in the markets for the portfolios that it manages. Credit risk does exist within the portfolios managed by the Group. These credit exposures are either *issuer* risk, where a position has settled but the issuer has defaulted e.g. bonds, or *counterparty* risk where the trade has yet to settle and the counterparty defaults e.g. FX forwards. Clients may set applicable limits within the investment restrictions of each portfolio.

HERMES FUND MANAGERS LIMITED**BUSINESS REVIEW (continued)****Key Risks and Mitigating Actions (continued)**

Hermes has processes in place to approve and monitor exposures to counterparties including periodic reviews of each counterparty. Hermes has an approved counterparty list, counterparty limits and dealer limits. These are monitored within Hermes' trading systems. The new Counterparty Credit Risk Group has also drafted a new counterparty credit risk policy to further strengthen controls and improve the review process further. This Group met far more frequently in 2008 in order to respond to the challenges imposed by extreme market events.

Market Risk

Market risk arises from adverse changes to the values of positions or portfolios arising from changes in exchange rates, interest rates and market prices.

As noted above, Hermes does not undertake any principal trading for its own account. As a result, it is not exposed to any significant market risk which would arise from such. Investment objectives and restrictions are agreed with clients and, save breaches from those guidelines, the market movement risk affecting portfolios lies with Clients; Hermes does not guarantee returns on portfolios. However, Hermes revenue is affected by the value of assets under management.

To generate long-term performance for clients, contrarian investment positions are sometimes taken. By definition, this will mean that over some periods of time there will be underperformance against the market. However, Hermes aims to have staff, processes and structures which will generate performance over the long-term horizons that the clients require.

Operational Risk

The majority of the risks affecting Hermes can be classified as operational risks. Operational Risk occurs in all areas of the Company's activities. Risk assessments are carried out and considered by the Hermes Audit Committee. The Hermes Board is also advised of any significant errors or omissions that have occurred.

The operational risk team undertakes the oversight of Hermes' risk management arrangements.

Areas of potential risk or vulnerability are identified and associated controls and mitigating actions are considered. The existence of risks and recommendations for their management or control are made.

Hermes also has insurance arrangements in place to mitigate operational risks.

Regular reports are provided to the Group's management and advice on risk identification and controls is given.

The operational risk team are involved in all major change programmes and the Chief Risk Officer is a member of the Hermes Operating Executive.

HERMES FUND MANAGERS LIMITED**BUSINESS REVIEW (continued)****Key Risks and Mitigating Actions (continued)**

Key Operational risks considered are:

- **Investment Performance**

Hermes primary focus is the delivery of investment performance for clients. Hermes has a range of reporting in place to provide investment managers, committees and Boards with the required information. Hermes Investment Committee meets regularly to consider performance against benchmarks and any response necessary. As described elsewhere in this review Hermes took decisive action in both European Focus Funds and Fixed Income where performance fell below the level required. Hermes is committed to providing the people, processes and systems necessary to underpin the provision of investment performance for clients.

- **Internal Controls**

Recent examples of 'rogue traders' accumulating unauthorised market positions have brought operational risk to the fore. These highly public examples of the failing of risk management processes and internal controls at major institutions have placed an onus on the industry to review current practices and procedures. Hermes is diligent in undertaking regular assessments of its risk and control processes and, as such strives to evolve and improve its risk management framework continuously. These risk assessments are regularly reviewed and challenged by the Audit Committee and Boards within the Group.

- **Key Clients**

There are two reasons why clients might be lost. First, Hermes may fail to generate the investment performance they expect. This is discussed above. Second, their needs or investment structure may change such that Hermes role is no longer required. Hermes seeks to mitigate this risk in two ways: by staying in close contact with clients such that their changing needs and how to service them are understood; and also by diversifying the client base to reduce the impact if any client is lost.

- **Key Staff**

Fund management is a people business with company performance dependent on investment performance generated by individuals, teams and the structures around them. If Hermes fails to attract and retain key staff, the business could be significantly impaired. Hermes maintains its good staff retention through a culture which bolsters team-working and a communal spirit, encourages an appropriate work-life balance and offers significant training and development opportunities. Furthermore, under the business strategy outlined earlier, changes to the structure of remuneration will ensure the alignment of client, shareholder and the long-term interests of employees. At the same time it will provide a competitive advantage versus other investment managers to enable the retention of existing staff and the attraction of key individuals and teams into the company.

HERMES FUND MANAGERS LIMITED

BUSINESS REVIEW (continued)

Key Risks and Mitigating Actions (continued)

- Business Disruption

The business might be disrupted for a number of different reasons that are out of Hermes immediate control. This is mitigated by having a business continuity framework that is tested on a regular basis. Space is rented at an alternative site to which key staff can go to maintain core operations in the short-term until business returns to normal. This site now provides mirrored systems and provides rapid point of failure recovery.

- Regulatory Requirements

Hermes has experienced, professionally staffed Compliance, Risk, Legal and Audit functions which advise the business on key regulatory issues and recommend appropriate actions to ensure regulatory compliance.

Ethical, Social and Environmental Risks

- Social – staff retention and satisfaction

Discussed above.

- Environmental – direct impacts

As a company operating from a single site, direct impacts are limited. These are controlled with housekeeping measures minimising the use of power for lighting and computers, encouraging minimal paper usage and offering recycling facilities.

- Ethical – maintenance of high compliance standards

A robust compliance culture is maintained to avoid the risk that regulatory failings might lead to penalties and/or reputational damage. This is discussed in more detail above under Principal Control Functions.

- Social, Environmental & Ethical – indirect impacts

These impacts are potentially more significant than the above: as an investment institution with interests in companies all around the world, Hermes has influence over the social, environmental and ethical footprints of the globe's leading companies. Hermes seeks to use this influence through the HEOS business and through co-operation with other institutions, to ensure that investee companies appropriately manage their own risks. Hermes is also among the leading players in carrying out socially responsible investment within the real estate market.

We are signatories to, active supporters of and participator in the activities of the UN Principles for Responsible Investment (UNPRI), the leading international vehicle for institutional investors actively to seek to manage the environmental, social and ethical impacts of their investments.

HERMES FUND MANAGERS LIMITED**BUSINESS REVIEW (continued)****Capital Resources**

At 31 December 2008	<u>£000</u>
<u>Tier 1 Capital</u>	
Called up share capital	30,000
Retained earnings	63,361
Other reserves	98
Minority interests	167
Tier 1 Capital	93,626
Tier 2 and 3 Capital	-
<u>Deductions from Total Capital</u>	
Material holdings	88
Total capital resources	93,538

Information on Capital Resources and Deductions**1. Ordinary Share Capital**

Ordinary share capital is permanent share capital subscribed for by the parent of Hermes, the BT Pension Scheme. Its purpose is to fund the ongoing capital and working capital needs of the Group.

2. Retained Earnings

Retained earnings are audited profit and loss reserves retained by the business. These reserves form a permanent capital base to be used by the Group for the same purposes as the ordinary share capital subscribed, as indicated above.

3. Other reserves

Other reserves consist of a Non-distributable capital reserve. This amount is permanent capital held to fund future capital needs of the Group.

HERMES FUND MANAGERS LIMITED**BUSINESS REVIEW (continued)****Information on Capital Resources and Deductions (continued)****4. Minority Interests**

The minority interest is the 40% shareholding in Hermes UOB Capital Management Limited owned by UOB Capital LLC. This shareholding is in the form of subscription for ordinary shares and a 40% share of audited retained earnings. It is held to fund the ongoing capital and working capital needs of Hermes UOB Capital Management Limited on a permanent basis.

5. Material holdings

Material holdings comprise the following associate companies of the Group:

	<u>£000</u>	<u>% of net assets held by Hermes Group</u>
Hermes UOB Asia	88	40

Capital Adequacy

The main operating companies within Hermes are BIPRU limited licence firms. They have adopted the simplified standardised approach to credit risk.

Approach

For all companies in the Group, the Fixed Overhead Requirement is in excess of the sum of the Pillar II Requirement. The Group Capital Requirement is therefore the sum of group shares of each company's Fixed Overhead Requirement.

Both Credit Risk Requirement and Market Risk Requirement are considered immaterial.

The Group Fixed Overhead Requirement as at 31st December 2008 was:

	<u>£000</u>
Fixed Overhead Requirement	<u>18,819</u>

Group Capital Resources were in excess of this amount, leaving a surplus of own funds and Group solvency ratio as follows:

Group Capital Resources	<u>93,538</u>
Surplus of own funds	<u>74,719</u>
Solvency ratio	<u>497%</u>

HERMES FUND MANAGERS LIMITED**BUSINESS REVIEW (continued)****Internal Capital Adequacy Assessment Process**

Hermes undertakes an Internal Capital Adequacy Assessment Process (ICAAP). This internal assessment is formally carried out on an annual basis, 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.

HERMES FUND MANAGERS LIMITED

DIRECTORS' REPORT

Directors:	G P Jones	(Chairman – appointed 25 July 2008)
	R Bernays	(Chairman – resigned 25 July 2008)
	R J Clarke	(Chief Executive)
	R M Gray	
	N Labram	(appointed 01 January 2008)
	M M Webb	(appointed 01 January 2008)
	D R Barford	(Non executive)
	J A Biles	(Non executive)
	D W Davies	(Non executive)
	R D Kent	(Non executive - appointed 01 January 2008)

Secretary: M S Green

Registered Office: Lloyds Chambers, 1 Portsoken Street, London E1 8HZ.

The directors submit their report and the audited financial statements for the year ended 31 December 2008.

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

During the year the directors had no interests in the shares of the Company or any other Group company.

ELECTIVE RESOLUTIONS

The Board of Hermes Fund Managers Limited has used the written resolution procedures pursuant to S381A of the Companies Act 1985 to pass the following elective resolutions:

- a) that pursuant to S366A of the Companies Act 1985, the Company has elected to dispense with the holding of Annual General Meetings (until the election is revoked);
- b) that pursuant to S252 of the Companies Act 1985, the Company has elected to dispense with the laying of accounts and reports before the Company in general meeting; and
- c) that pursuant to S386 of the Companies Act 1985, the Company has elected to dispense with the obligation to appoint auditors annually. Therefore, Deloitte LLP are deemed to continue as auditors.

HERMES FUND MANAGERS LIMITED

DIRECTORS' REPORT (continued)

FINANCIAL INSTRUMENTS

Group operations are primarily financed from retained earnings and a loan from the BT Pension Scheme, the Group's ultimate parent.

The Group also has other financial instruments such as 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, interest rate risk and currency 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.

RESULTS

The results for the year are shown on the attached consolidated profit and loss account. The directors do not recommend the payment of a dividend (2007 - £nil).

Included within the results are profits before dividend of £807,000 (2007 - £1,120,000) relating to Hermes Assured Limited which ceased trading on 13 December 2007.

The directors consider the results of the Group and Company to be satisfactory and that the Company is well placed to take advantage of future opportunities.

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

In November 2008 the Financial Reporting Council published guidance notes in relation to going concern and liquidity risk to address the challenges arising from current economic conditions. In accordance with these guidance notes it is now considered best practice that annual accounts include a statement that the company/group is a 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. The Group has returned an operating profit for the year of £14.8m (2007 - £9m) and a total net gain for the year of £4.6m (2007 - £18.2m). The Group's financial position is healthy. Net assets have increased by 5% over the year and total £93.6m at year-end (2007 - £89.0m). Current assets exceed current liabilities by a ratio of 3.2:1 at year-end with liquid cash reserves comprising 82% of total current assets, demonstrating the ability of the Group to meet its current liabilities as they fall due in the ordinary course of business. The Group has £131.5m of cash reserves at year-end (2007 - £127.9m) and a large profit and loss reserve of £62.9m (2007 - £58.2m). Given the nature of the business, trade debtors are collectable within a short timescale. The Group maintains capital resources significantly in excess of its regulatory capital requirement (refer to the Capital Adequacy section in the Business Review). The Group has access to further capital if required, with a level of authorised share capital of £100m, only £30m of which has been called up by year-end. In addition, HFML has a loan facility of £50m with its parent, of which £10m has been drawn down to date.

HERMES FUND MANAGERS LIMITED**DIRECTORS' REPORT (continued)****RESULTS (continued)**

The current economic environment and in particular its impact on fee income poses a challenge for the Group, but, having made all reasonable enquiries and having respect to the nature of the Group and its activities, the Directors are satisfied based on the information available to them at the present time, that it is appropriate to adopt the going concern basis in preparing the financial statements and, after due consideration, the Directors consider that the Group is able to continue in the foreseeable future.

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.

STATEMENT ON DISCLOSURE OF INFORMATION TO AUDITORS

Under Section 234ZA of the Companies Act 1985 the directors, having made enquiries of fellow directors, management and the Company's auditors, confirm 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 s234ZA of the Companies Act 1985.

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



Director

| May 2009

HERMES FUND MANAGERS LIMITED

REPORT OF THE AUDIT COMMITTEE

MEMBERSHIP

The Audit Committee currently comprises three non-executive directors, John Biles (Chairman), David Davies and David Barford (appointed 16 April 2008). Members of the Committee are appointed by the Board following recommendations from the Nominations Committee.

Each member of the Committee brings relevant financial experience from senior executive levels. The Committee Chairman, John Biles is 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.

SUMMARY OF TERMS OF REFERENCE

1. To review and challenge, where appropriate, the actions and judgements of management in relation to the company's financial statements, business review and any related formal statements before submission to, and approval by, the Board.
2. To review management's and the internal auditor's reports on the effectiveness of the systems for internal financial control and financial reporting in relation to the Annual Report and Accounts.
3. To review, and challenge where appropriate, the risk management framework, systems, processes, procedures and controls in relation to all investment management activity and other services that Hermes has contracted to provide to its clients.
4. To assess the scope, effectiveness, and integrity of the systems established by management to identify, assess, manage and monitor the risk inherent in its investment management and administration activities.
5. To approve the appointment or removal of the Chief Risk Officer, Head of Compliance and Head of Audit.
6. To review and approve the HFML internal audit programme and ensure that the internal audit function is adequately resourced and has appropriate standing within the company.
7. To receive reports on the results of the internal auditor's work on a periodic basis and to review and monitor management's responsiveness to internal audit findings and recommendations.
8. To consider, and make recommendations on the appointment, re-appointment and removal of the external auditor in relation to HFML, and in the case of BTPS in relation to the external auditors of all companies within the BTPS Group with the exception of BriTel Fund Trustees Limited and BT Pension Scheme Trustees Limited.
9. To review with the external auditors the findings of their work including any major issues that arose during the course of the audit which have been resolved and those which remain unresolved; key accounting and audit judgements; levels of errors identified during the audit and obtaining, where necessary, explanations of why any errors have remain unadjusted.

HERMES FUND MANAGERS LIMITED**REPORT OF THE AUDIT COMMITTEE (continued)****SUMMARY OF TERMS OF REFERENCE (continued)**

10. The Committee shall annually review its Terms of Reference and its own effectiveness and recommend any necessary changes to the Board.

In addition the Committee reports to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

WORK OF THE COMMITTEE DURING 2008

During the year the Committee considered the Master Services Agreement between BTPS and Hermes that was eventually signed in February 2009. The Committee specifically reviewed the implications for the work of the Committee and its terms of reference. The terms of reference were revised accordingly.

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 advisors 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 three non-executive directors, David Davies (Chairman), Roderick Kent and Glyn Jones (appointed 25 July 2008). Richard Bernays, having served on the committee during the year, resigned on 25 July 2008.

SUMMARY OF TERMS OF REFERENCE

The Remuneration Committee shall be responsible for and shall have authority to take decisions in relation to the following:

1. To determine and agree with the Hermes Board the framework for the remuneration of the Chief Executive Officer ("CEO"), the Chairman and other Designated Persons (executive directors of Hermes Fund Managers Limited and senior managers of the Hermes group of companies with total remuneration exceeding an agreed specified figure).
2. To provide oversight in respect of ensuring appropriate terms are established for Designated Persons service contracts.
3. To set targets for performance-related pay schemes, determine whether targets have been met and make appropriate and relevant awards as the Remuneration Committee deems fit.
4. To determine policy for and scope of pensions arrangements for Designated Persons.
5. To ensure that contractual terms on termination and payments made for Designated Persons are fair and to mitigate any damage payments.
6. To determine the total individual remuneration packages for Designated Persons.
7. To approve major changes in employee benefit structures throughout Hermes.

WORK OF THE COMMITTEE DURING 2008

During the year the Committee received and approved following challenge fundamental changes to the structure of Hermes remuneration plans in particular:

- Revisions to annual bonus plans to drive them from a combination of performance fees and profit excluding performance fees.
- 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.
- 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.

HERMES FUND MANAGERS LIMITED**REPORT OF THE REMUNERATION COMMITTEE (continued)****WORK OF THE COMMITTEE DURING 2008 (continued)**

The Committee believes these plans together provide an alignment of management, shareholders and clients and are in accordance with best practice.

The Committee reviewed and endorsed salary and bonus awards for 2008 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
- The financial and investment performance of Hermes in 2008

Accordingly the awards were significantly lower than the previous year.

DIRECTORS' EMOLUMENTS

Details of 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 five non-executives, Glyn Jones (Chairman, appointed 25 July 2008), David Barford, John Biles, David Davies and Roderick Kent, together with the Chief Executive, Rupert Clarke. Richard Bernays served on the committee as Chairman during the year but resigned on 25 July 2008.

SUMMARY OF TERMS OF REFERENCE

1. Identifying and nominating for the approval of the Board, candidates to fill Hermes Board vacancies as and when they arise.
2. To evaluate the balance of skills, knowledge and experience on the Hermes Board in order to prepare a description of the role and capabilities required for a particular appointment.
3. To review annually the time required from a non-executive director.
4. To give full consideration to succession planning.
5. To regularly review the structure, size and composition of the Hermes Board and make recommendations to the Board with regard to any changes.
6. To keep under review the leadership needs of Hermes, both executive and non-executive.
7. To keep under review the performance of the non-executive directors of the Company.
8. To keep under review the performance of the Chief Executive Officer of the Company.
9. To review annually the Nomination Committee's effectiveness and its terms of reference and make any proposals for change to the Hermes Board.
10. To ensure that on appointment to the Hermes Board, non-executive directors receive a formal letter of appointment setting out what is expected of them.
11. To approve the appointment of any director to the board of a subsidiary operating company of Hermes.

WORK OF THE COMMITTEE IN 2008

During the year the Committee approved the appointment of Glyn Jones as Chairman and also approved a number of appointments to the Board of subsidiary operating companies.

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). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the Group as at the end of the financial year and of the profit or loss of the Group for that period.

In preparing those financial statements, the directors are required to:

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

The directors are responsible for keeping proper accounting records that 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 1985. 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.

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

We have audited the Group and parent company financial statements of Hermes Fund Managers Limited for the year ended 31 December 2008 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. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's member, as a body, in accordance with section 235 of the Companies Act 1985. 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

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This information comprises only the Directors' Report and the Business Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF HERMES FUND MANAGERS LIMITED (CONTINUED)**Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the parent Company's affairs as at 31 December 2008 and of the Group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.



Deloitte LLP
Chartered Accountants and Registered Auditors
London

1 May 2009

HERMES FUND MANAGERS LIMITED**CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2008**

	Notes	2008 £'000	2007 £'000
TURNOVER			
Continuing operations (including joint ventures' share)	1	109,162	101,804
Discontinued operations	1	1,023	7,264
Less: share of joint ventures' turnover	1	(830)	(661)
GROUP TURNOVER		<u>109,355</u>	<u>108,407</u>
Administrative expenses		<u>(94,527)</u>	<u>(99,427)</u>
OPERATING PROFIT			
Continuing operations		14,305	8,949
Discontinued operations		523	31
GROUP OPERATING PROFIT		<u>14,828</u>	<u>8,980</u>
Share of net operating profit of joint ventures	2	200	478
Share of net operating profit of associates	2	227	260
Dividends receivable		-	50
Realised currency gain		18	82
Profit on disposal of assets/liabilities on discontinued operations		-	4
Profit on disposal of investments	2	<u>240</u>	<u>-</u>
PROFIT ON ORDINARY ACTIVITIES BEFORE INTEREST AND TAXATION		<u>15,513</u>	<u>9,854</u>
Interest receivable and similar income	3	5,982	4,891
Other finance income	16	300	400
Interest payable and similar charges	3	<u>(865)</u>	<u>(742)</u>
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		<u>20,930</u>	<u>14,403</u>
Tax on profit on ordinary activities - Group	6	(6,125)	276
- Joint ventures	6	(111)	(143)
- Associates	6	<u>(69)</u>	<u>(93)</u>
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		<u>14,625</u>	<u>14,443</u>
Equity minority interests	26	<u>(14)</u>	<u>(10)</u>
RETAINED PROFIT FOR THE FINANCIAL YEAR	18	<u><u>14,611</u></u>	<u><u>14,433</u></u>

HERMES FUND MANAGERS LIMITED**CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
FOR THE YEAR ENDED 31 DECEMBER 2008**

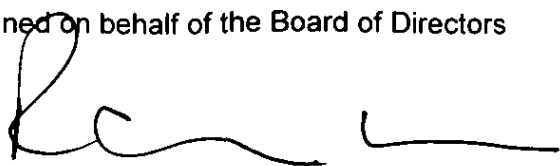
	Notes	2008 £'000	2007 £'000
Retained profit for the financial year		<u>14,611</u>	<u>14,433</u>
Defined Benefit Pension Scheme – Actuarial (loss)/gain on assets	16	(20,727)	900
Defined Benefit Pension Scheme – Actuarial gain/(loss) on liability experience	16	300	(100)
Defined Benefit Pension Scheme – Actuarial gain on change in assumptions	16	8,800	4,800
Deferred tax credit/(charge) – attributable to net actuarial gain/(loss)	6	<u>1,652</u>	<u>(1,814)</u>
Total recognised gains relating to the year	18	<u>4,636</u>	<u>18,219</u>

HERMES FUND MANAGERS LIMITED**CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2008**

	Notes	2008 £'000	2007 £'000
FIXED ASSETS			
Intangible assets – goodwill	9	-	3,714
Tangible assets	10	12,697	8,773
Investments – associates	11	1,067	1,295
Joint ventures – share of gross assets	11	672	661
– share of gross liabilities	11	(483)	(327)
Investments – other	11	58	58
		<u>14,011</u>	<u>14,174</u>
CURRENT ASSETS			
Debtors	14	28,725	33,265
Cash at bank	21	131,512	127,886
		<u>160,237</u>	<u>161,151</u>
CREDITORS - amounts falling due within one year	15	<u>(52,425)</u>	<u>(64,694)</u>
NET CURRENT ASSETS		<u>107,812</u>	<u>96,457</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		121,823	110,631
CREDITORS - amounts falling due after more than one year	15	<u>(10,372)</u>	<u>(13,953)</u>
NET ASSETS EXCLUDING PENSION LIABILITIES		111,451	96,678
Net pension deficit	16	<u>(17,825)</u>	<u>(7,702)</u>
NET ASSETS INCLUDING PENSION LIABILITIES		<u>93,626</u>	<u>88,976</u>
CAPITAL AND RESERVES			
Called up share capital	17	30,000	30,000
Non-distributable capital reserves	18	98	98
Capital contribution from parent company	18	510	510
Profit and loss account	18	62,851	58,215
SHAREHOLDER'S FUNDS		<u>93,459</u>	<u>88,823</u>
Minority Interest	26	<u>167</u>	<u>153</u>
TOTAL CAPITAL EMPLOYED		<u>93,626</u>	<u>88,976</u>

These financial statements were approved by the Board of Directors and authorised for issue on 1 May 2009

Signed on behalf of the Board of Directors



Director

HERMES FUND MANAGERS LIMITED**COMPANY BALANCE SHEET AS AT 31 DECEMBER 2008**

	Notes	2008 £'000	2007 £'000
FIXED ASSETS			
Tangible assets	10	12,697	8,773
Investments	11	26,775	26,775
		<u>39,472</u>	<u>35,548</u>
CURRENT ASSETS			
Debtors	14	33,636	30,148
Cash at bank		17,364	29,185
		<u>51,000</u>	<u>59,333</u>
CREDITORS - amounts falling due within one year	15	(37,307)	(37,121)
NET CURRENT ASSETS		<u>13,693</u>	<u>22,212</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		53,165	57,760
CREDITORS - amounts falling due after more than one year	15	(8,713)	(10,158)
NET ASSETS EXCLUDING PENSION LIABILITIES		44,452	47,602
Net pension deficit	16	(17,825)	(7,702)
NET ASSETS INCLUDING PENSION LIABILITIES		<u>26,627</u>	<u>39,900</u>
CAPITAL AND RESERVES			
Called up share capital	17	30,000	30,000
Capital contribution from parent company	18	510	510
Profit and loss account	18	(3,883)	9,390
SHAREHOLDER'S FUNDS		<u>26,627</u>	<u>39,900</u>

These financial statements were approved by the Board of Directors and authorised for issue on 1 May 2009

Signed on behalf of the Board of Directors



Director

HERMES FUND MANAGERS LIMITED**CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008**

	Notes	2008 £'000	2007 £'000
NET CASH INFLOW FROM OPERATING ACTIVITIES	20	4,921	36,837
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		5,981	4,837
Interest paid		(865)	(740)
Dividends received from associates/joint ventures		426	225
NET CASH INFLOW FROM RETURNS ON INVESTMENTS AND SERVICING OF FINANCE		5,542	4,322
TAXATION			
Corporation tax received/(paid)		828	(5,905)
TAX RECEIVED/(PAID)		828	(5,905)
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT			
Payments to acquire tangible fixed assets	10	(7,861)	(4,581)
Purchase of investments		-	(44)
Sale of investments		-	4
NET CASH OUTFLOW FROM CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT		(7,861)	(4,621)
ACQUISITIONS AND DISPOSALS			
Disposal of associates		396	-
Investment in joint ventures		(200)	-
NET CASH INFLOW FROM ACQUISITIONS AND DISPOSALS		196	-
INCREASE IN CASH	21	3,626	30,633

HERMES FUND MANAGERS LIMITED

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008

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 except for fixed asset investments which are held at directors' valuation and on the going concern basis as described on pages 17-18 in the Directors' Report.

b) Turnover

Turnover is recognised on an accruals basis.

c) 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 in accordance with the provisions of FRS 6.

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 the 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 1985 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.

d) Discontinued Operations

Following the cessation of trade within Hermes Assured Limited, turnover and operating profit have been disclosed separately to the continuing operations in accordance with the provisions of FRS 3.

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.

HERMES FUND MANAGERS LIMITED**NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008****ACCOUNTING POLICIES (continued)****f) 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.

g) 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.

h) 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.

i) Tangible fixed assets

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	-	4 to 5 years
Leasehold improvements	-	Period of the lease

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.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

ACCOUNTING POLICIES (continued)

j) Financial assets and liabilities

The following policies applied principally to the trading business of Hermes Assured Limited. This trade ceased during 2007, hence there are no related assets or liabilities on the balance sheet in the current or prior year. Fair value movements through profit and loss impact the 2007 year.

Investments are recognised and derecognised on a trade basis where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into the following specified categories: financial assets as 'at fair value through profit or loss' (FVTPL) or 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised on an effective interest basis for debt instruments other than those financial assets designated as at FVTPL.

Financial assets at FVTPL

Financial assets are classified as at FVTPL where the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is held for trading if:

It has been acquired principally for the purpose of selling in the near future; or

It is a part of an identified portfolio of financial instruments that the Company manages together and has a recent actual pattern of short-term profit-taking; or

It is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

ACCOUNTING POLICIES (continued)

j) Financial assets and liabilities (continued)

The financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Company's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or

It forms part of a contract containing one or more embedded derivatives and FRS 26 permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset.

Cash and deposits are valued at actual amounts with consideration made with regard to any possible impairment.

Loans and receivables

Trade receivables, loans and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised costs using the effective interest method less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables where the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

If, in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment was reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

ACCOUNTING POLICIES (continued)

j) Financial assets and liabilities (continued)

Other financial liabilities

Other financial liabilities including borrowings are initially measured at fair value net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method with interest expenses recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or where appropriate, a shorter period.

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

Pension benefits under the Group's defined benefit scheme are funded over the employees' periods of service. The Company's contributions are based on the most recent actuarial valuation of the fund as at 30 June 2006. Pension benefits are accounted for in accordance with FRS17 as disclosed in note 16.

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.

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 balance sheet date.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

1. TURNOVER

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

	2008 £'000	2007 £'000
Continuing operations:		
Investment management services (including share of joint venture)	108,452	101,189
Miscellaneous fees	710	157
Recharge to associate	-	458
Less: Share of joint venture	(830)	(661)
	<u>108,332</u>	<u>101,143</u>
Discontinued operations:		
Income from assurance activities	1,023	7,264
	<u>1,023</u>	<u>7,264</u>
TOTAL GROUP TURNOVER	<u>109,355</u>	<u>108,407</u>

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.

Hermes Assured Limited (HAL), a wholly owned subsidiary, was an authorised life insurance company authorised by the Financial Services Authority. On 12 July 2007, following a strategic review of the business announced on 21 February 2007, the Company decided to withdraw from the provision of index-tracking services. An arrangement to provide index tracking was made with a leading index fund manager and all client index tracking funds have been transferred out of the Company. The Company ceased trading on 13 December 2007 and was deregistered by the FSA on 11 April 2008.

HAL continues to be wound down and its results are shown as discontinued operations.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

2. JOINT VENTURES AND ASSOCIATES

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

	2008 £'000	2007 £'000
Joint ventures:		
50% share of Logistics Management Limited	371	478
50% share of Perception UK LLP	(171)	-
	<u>200</u>	<u>478</u>
Associates:		
40% share of UOB Hermes Asia Management Pte	30	21
33% share of Nippon Life Investments Europe	197	241
25% share of Activa	-	(2)
	<u>227</u>	<u>260</u>
	<u>427</u>	<u>738</u>

Note 22 provides further information on subsidiaries, associates and joint ventures.

The Company had the following interests in the performance and position of its joint ventures and associates at 31 December 2008:

Logistics Management Limited	2008 £'000	2007 £'000
Turnover	505	661
Profit before tax	387	478
Tax	(111)	(143)
Profit after tax	276	335
Fixed assets	-	-
Current assets	608	661
Current liabilities	(248)	(327)

Hermes UOB Asia Limited

	2008 £'000	2007 £'000
Turnover	369	287
Profit before tax	30	21
Tax	(3)	(2)
Profit after tax	27	19
Fixed assets	-	-
Current assets	92	61
Current liabilities	(4)	(3)

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

2. JOINT VENTURES AND ASSOCIATES (continued)

NLI Investments Europe Ltd	2008	2007
	£'000	£'000
Turnover	798	837
Profit before tax	233	276
Tax	(66)	(86)
Profit after tax	167	190
Fixed assets	-	-
Current assets	1,099	1,262
Current liabilities	(120)	(291)

Activa Capital	2008	2007
	£'000	£'000
Turnover	-	753
Profit before tax	-	7
Tax	-	(5)
Profit after tax	-	2
Fixed assets	-	85
Current assets	-	318
Current liabilities	-	(256)

The company disposed of its investment in Activa Capital during the year, resulting in a realised gain of £239,484.

Perception UK LLP	2008	2007
	£'000	£'000
Turnover	325	-
Loss before tax	(171)	-
Tax	-	-
Loss after tax	(171)	-
Fixed assets	1	-
Current assets	65	-
Current liabilities	(236)	-

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

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

	2008 £'000	2007 £'000
Interest receivable and similar income in respect of:		
Bank deposit balances	5,929	4,837
Joint ventures	17	-
Associates	36	54
	<u>5,982</u>	<u>4,891</u>
Interest payable and similar charges in respect of:		
Bank interest	147	-
Loan from ultimate parent	718	740
Associates	-	2
	<u>865</u>	<u>742</u>

Interest payable to the ultimate parent relates to the loan from the BT Pension Scheme as indicated in Note 15 – Creditors.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

4. PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2008 £'000	2007 £'000
Profit on ordinary activities before taxation is stated after charging:		
Depreciation of tangible fixed assets	3,937	3,583
Impairment of goodwill	3,714	795
Rentals under operating leases:		
- Charges	1,615	1,330
- Receipts	(125)	(216)
Auditors' remuneration:		
Audit fees - Group	197	220
- Company	46	33
Regulatory reporting	15	15
Other services		
- Group Tax services	235	145
Management consultancy	-	187
Further assurance work	245	26
- Company Tax services	-	70

No fees were payable to the company's auditors and their associates in respect of associated pension schemes during the year (2007 - £8,410).

5. INFORMATION REGARDING DIRECTORS AND EMPLOYEES

The total emoluments paid and payable to the directors during the year were £3,507,950 (2007 - £2,286,639), of this amount £98,500 (2007 - £1,188,145) was deferred.

The total emoluments paid and payable to the directors during the year in respect of long-term incentive plans were £nil (2007 - £707,250).

Four (2007 - two) of the directors are accruing benefits under the Hermes Group Pension Scheme, which is a defined benefit scheme, in respect of their services to the group.

The total emoluments paid and payable to the highest paid director during the year were £1,228,700 (2007 - £972,317). The accrued pension benefit of the highest paid director at 31 December 2008 was £11,212 (2007 - £49,460).

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

5. INFORMATION REGARDING DIRECTORS AND EMPLOYEES (continued)

	2008 No.	2007 No.
Average number of persons employed by the Group and Company in the year:		
Investment management	216	189
Administration	154	155
	<u>370</u>	<u>344</u>
	2008 £'000	2007 £'000
Staff costs during the year in respect of these directors and employees were:		
Wages and salaries	39,297	51,827
Social security costs	5,030	5,890
Pension cost related to Group scheme (see Note 16)	5,200	5,600
Unfunded pension costs	-	(35)
	<u>49,527</u>	<u>63,282</u>

The unfunded pension figure relates to a reduction in the year in the Company's liability to pay a pension in excess of that provided by the Hermes Group Pension Scheme.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

6. TAX ON PROFIT ON ORDINARY ACTIVITIES

	2008	2007
	£'000	£'000
a) Profit and loss account		
UK corporation tax at 28.5% (2007 – 30%)	2,800	720
Share of tax charge in joint venture and associates	180	236
Adjustment in respect of prior periods	(84)	(949)
	<u>2,896</u>	<u>7</u>
Deferred tax:		
Timing differences, origination and reversal	2,164	(998)
Adjustment in respect of prior periods	1,245	951
Tax on profit on ordinary activities	<u>6,305</u>	<u>(40)</u>
Statement of total recognised gains and losses		
Deferred tax:		
Timing differences, origination and reversal	(1,652)	1,814
Adjustment in respect of prior periods	-	-
Total deferred tax	<u>(1,652)</u>	<u>1,814</u>
Total tax on items in statement on total recognised gains and losses	<u>(1,652)</u>	<u>1,814</u>
b) The tax charged in the period differs from that resulting from applying the standard rate of corporation tax in the UK of 28.5% (2007 - 30%). The differences are explained below:		
	2008	2007
	£'000	£'000
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 28.5% (2007 - 30%)	5,964	4,320
Non-taxable income, such as UK dividends	(2,429)	(4,951)
Non-deductible expenses	2,301	409
Capital allowances in excess of depreciation not provided for in deferred tax	(285)	(537)
Movement in unprovided deferred tax	(657)	(295)
Short term timing differences not provided for in deferred tax	(1,878)	1,535
Adjustment in respect of prior periods	(84)	(949)
Deferred tax rate change	(36)	475
	<u>2,896</u>	<u>7</u>

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

6. TAX ON PROFIT ON ORDINARY ACTIVITIES (continued)

	2008 Provided £'000	2008 Unprovided £'000	2007 Provided £'000	2007 Unprovided £'000
c) The Group				
Deferred tax asset				
Accelerated capital allowances	1,612	1	1,962	2
Tax losses	357	138	306	463
Short-term timing differences	76	232	3,270	657
	<u>2,045</u>	<u>371</u>	<u>5,538</u>	<u>1,122</u>
The Company				
Deferred tax asset				
Accelerated capital allowances	1,622	-	1,962	-
Short-term timing differences	3,006	-	3,162	-
	<u>4,628</u>	<u>-</u>	<u>5,124</u>	<u>-</u>

The deferred tax assets of £2,045,000 (2007 - £5,538,000) have been recognised in 2008 as there is sufficient certainty of recovery of those assets within a relatively short period of time. Deferred tax assets totalling £371,000 (2007 - £1,122,000) 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.

	Group £'000
d) Movement on Deferred Tax	
1 January 2008	5,538
Profit and loss charge	(3,409)
Offset against pension creditor	(84)
31 December 2008	<u>2,045</u>

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)**7. CAPITAL STATEMENTS AND CAPITAL MANAGEMENT****a) Objectives, policies, and processes for managing capital – continuing operations**

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 for its continuing operations.

The Group maintained monthly checks to ensure that the 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.

b) Objectives, policies, and processes for managing capital – discontinued operations

Hermes Assured Limited is a wholly-owned, discontinued insurance business. The entity ceased trading on 13 December 2007, was de-registered from the FSA on 11 April 2008 and is in the process of being wound up. As a result, there is no longer a requirement to maintain a level of capital in accordance with the regulations of the FSA.

As the company is in the process of being wound up the intention is that the capital will be returned to the shareholder.

8. PROFIT OF THE PARENT COMPANY

As permitted by Section 230 of the Companies Act, the profit and loss account of the parent Company is not presented as part of these accounts. The parent Company's loss for the year amounted to £3,298,000 (2007 – profit of £5,382,000).

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

9. INTANGIBLE FIXED ASSETS

	Goodwill £'000
The Group	
Cost	
At 1 January 2008 and 31 December 2008	<u>8,614</u>
Accumulated amortisation	
At 1 January 2008	4,900
Impairment charge	<u>3,714</u>
At 31 December 2008	<u>8,614</u>
Net book value	
At 31 December 2008	<u>-</u>
At 31 December 2007	<u>3,714</u>

Goodwill of £3,714,000 relating to Hermes Focus Asset Management Limited was written off during the year.

10. TANGIBLE FIXED ASSETS

	Leasehold improvements £'000	Fixtures, Fittings and equipment £'000	Total £'000
The Group and the Company			
Cost			
At 1 January 2008	5,773	13,311	19,084
Additions	-	7,861	7,861
Disposals	-	(2,876)	(2,876)
At 31 December 2008	<u>5,773</u>	<u>18,296</u>	<u>24,069</u>
Accumulated depreciation			
At 1 January 2008	2,929	7,382	10,311
Charge for the year	260	3,677	3,937
Disposals	-	(2,876)	(2,876)
At 31 December 2008	<u>3,189</u>	<u>8,183</u>	<u>11,372</u>
Net book value			
At 31 December 2008	<u>2,584</u>	<u>10,113</u>	<u>12,697</u>
At 31 December 2007	<u>2,844</u>	<u>5,929</u>	<u>8,773</u>

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (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 2008	334	1,295	58	1,687
Share of retained profit for the year	26	39	-	65
Additions	(171)	-	-	(171)
Disposals	-	(267)	-	(267)
At 31 December 2008	189	1,067	58	1,314

The Group has applied the provisions of FRS 29 and has applied the relevant accounting policy in considering the value of each class of asset. There was no financial impact on the figures provided above as a result of this exercise.

Additions relate to the investment in Perception UK LLP during the year. Disposals relate to the sale of Activa Capital during the year. Unlisted investments are valued at cost.

Investments in joint ventures and associates comprise:

2008
£'000

Joint ventures:Logistics Management Limited

Share of net assets 360

Perception UK LLP

Share of net liabilities (171)

Associates:NLI Investments Europe Limited

Share of net assets 979

Hermes UOB Asia

Share of net assets 88

The Company

2008
£'000

Shares in subsidiary and associate undertakings

At 1 January 2008 and 31 December 2008 26,775

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

12. INCOME AND EXPENDITURE OF DISCONTINUED LIFE BUSINESS

The Group

Hermes Assured Limited is a wholly owned subsidiary of the Company that ceased trading on 13 December 2007.

At 31 December 2008 and 2007 following the cessation of trade and the subsequent asset transfer, the Company held no insurance assets attributable to unit-linked policyholders.

At 31 December 2008, the summarised income and expenditure account of the discontinued Life business comprised:

	2008 £'000	2007 £'000
Unrealised gains	-	21
Realised gains	244	631,995
Investment income receivable	779	433,077
Other technical income	-	7,264
Change in technical provisions for linked liabilities	-	(1,065,090)
Net operating expenses	(500)	(7,232)
Balance on long term business technical account	<u>523</u>	<u>35</u>

13. CHANGE IN VALUE OF TECHNICAL PROVISIONS

The Group

	2008 £'000	2007 £'000
Opening technical provision for linked liabilities	-	22,091,679
Change in technical provisions	-	1,065,090
Cash inflows arising from investment contracts	-	225,211
Cash outflows arising from investment contracts	-	(23,381,980)
	<u>-</u>	<u>-</u>

Hermes Assured Limited ceased trading in the prior year.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

14. DEBTORS

	2008		2007	
	Group £'000	Company £'000	Group £'000	Company £'000
Due within one year				
Owed by subsidiaries	-	18,292	-	12,753
Owed by associates	143	36	322	124
Owed by parent	14,445	10	2,600	165
Trade debtors	2,197	27	8,952	222
Taxation	4,131	5,360	10,879	8,832
Other debtors	2,073	2,025	4,058	411
Prepayments and accrued Income	5,736	2,886	6,454	2,491
	28,725	28,636	33,265	24,998
Due after one year				
Subordinated loan – subsidiary	-	5,000	-	5,000
Loan to associate	-	-	-	150
	28,725	33,636	33,265	30,148

15. CREDITORS

	2008		2007	
	Group £'000	Company £'000	Group £'000	Company £'000
Amounts falling due within one year:				
Owed to parent	10,000	10,000	10,000	10,000
Other creditors	5,070	4,924	7,370	3,424
Unfunded pension liability	773	773	922	922
Accruals and prepaid income	36,582	21,610	46,402	22,775
	52,425	37,307	64,694	37,121
Amounts falling due after more than one year:				
Other creditors	10,372	8,713	13,953	10,158
	10,372	8,713	13,953	10,158

The amount owed to parent represents a loan from the BT Pension Scheme which is repayable on demand. The interest on the loan is calculated and paid quarterly at LIBOR + 1%.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

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 £103,869 during the year (2007 - £nil).

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 2008 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 throughout the year were 16.5% of pensionable payroll, in line with the Schedule of Contributions. Members of the Scheme contribute 5% of pensionable earnings. An additional contribution of £1.33m was made during the year. The contributions of the Company have increased to 18.7% from 1 January 2009. The amounts recognised in the balance sheet are as follows:

	2008 £m	2007 £m
Present value of funded Scheme obligation	(79.1)	(78.6)
Fair value of Scheme assets	56.6	67.9
Deficit	(22.5)	(10.7)
Related deferred tax asset	4.7	3.0
Net liability	(17.8)	(7.7)

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

	2008 £m	2007 £m
Current service cost (charged to Operating profit)	5.2	5.6
Interest on Scheme obligation (included in Other finance income)	4.8	3.9
Expected return on Scheme assets (included in Other finance income)	(5.1)	(4.3)
Total	4.9	5.2
Actual return on plan assets	(15.6)	5.2

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

16. PENSION COMMITMENTS (continued)

Analysis of the actuarial (loss)/gain recognised in the statement of total recognised gains and losses:

	2008 £m	2007 £m
Actual return less expected return on Scheme assets, i.e. (loss)/gain	(20.7)	0.9
Experience gains and losses arising on Scheme liabilities, i.e. gain/(loss)	0.3	(0.1)
Changes in assumptions underlying the present value of Scheme liabilities, i.e. gain	8.8	4.8
Actuarial (loss)/gain	<u>(11.6)</u>	<u>5.6</u>

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

	2008 £m	2007 £m
Opening Scheme obligation	78.6	74.1
Current service cost	5.2	5.6
Interest cost	4.8	3.9
Actuarial gains	(9.1)	(4.7)
Scheme participants' contributions	1.4	1.2
Benefits paid	(1.4)	(1.1)
Administrative expenses paid	(0.4)	(0.4)
Closing Scheme obligation	<u>79.1</u>	<u>78.6</u>

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

16. PENSION COMMITMENTS (continued)

Changes in the fair value of Scheme assets are as follows:

	2008 £m	2007 £m
Opening fair value of Scheme assets	67.9	59.3
Expected return	5.1	4.3
Actuarial (losses)/gains	(20.7)	0.9
Contributions by employer	4.6	3.7
Scheme participants' contributions	1.4	1.2
Benefits paid	(1.4)	(1.1)
Administrative expenses paid	(0.3)	(0.4)
Closing fair value of Scheme assets	56.6	67.9

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

	2008 %	2007 %
Equities	87	78
Bonds / Gilts	8	11
Other	5	11

Principal actuarial assumptions at the balance sheet date:

	2008 %	2007 %
Discount rate at 31 December	6.4	5.8
Expected return on plan assets at 31 December	7.1	7.4
Future salary increases	3.1	3.4
Future increases to pensions in payment (pensioners)	3.3	3.4
Future increases to pensions in payment (non-pensioners)	3.1	3.4
Deferred pension revaluation (HGPS members)	3.1	3.4
Deferred pension revaluation (HPS members)	3.3	3.4

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

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:

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Scheme obligation	(79.1)	(78.6)	(74.1)	(67.4)	(54.6)
Scheme assets	56.6	67.9	59.3	50.8	39.9
Deficit	(22.5)	(10.7)	(14.8)	(16.6)	(14.7)
Experience adjustments on Scheme assets	(20.7)	0.9	2.0	6.3	1.5
Experience adjustments on Scheme liabilities	0.3	(0.1)	3.4	(0.2)	0.0

17. CALLED UP SHARE CAPITAL

	2008 £'000	2007 £'000
Authorised: 100,000,000 (2007: 100,000,000) ordinary shares of £1 each	100,000	100,000
Called up, allotted and fully paid: 30,000,000 (2007: 30,000,000) ordinary shares of £1 each	30,000	30,000

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

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

The Group	2008 Called up Share Capital £'000	2008 Non- distributable capital reserves £'000	2008 Contribution from parent company £'000	2008 Profit and loss account £'000	2008 Total £'000	2007 Total £'000
At 1 January	30,000	98	510	58,215	88,823	70,604
Profit for the financial year	-	-	-	14,611	14,611	14,433
Defined Benefit Pension Scheme						
- Actuarial gain/(loss) on liability experience	-	-	-	300	300	(100)
Defined Benefit Pension Scheme						
- Actuarial (loss)/gain on assets	-	-	-	(20,727)	(20,727)	900
Defined Benefit Pension Scheme						
- Actuarial gain on change in assumptions	-	-	-	8,800	8,800	4,800
Deferred tax credit/(charge) on pension liabilities	-	-	-	1,652	1,652	(1,814)
At 31 December	30,000	98	510	62,851	93,459	88,823

The Company	2008 Called up share capital £'000	2008 Capital contribution from parent £'000	2008 Profit and Loss Account £'000	2008 Total £'000	2007 Total £'000
At 1 January	30,000	510	9,390	39,900	30,732
(Loss)/profit for the financial year	-	-	(3,298)	(3,298)	5,382
Defined Benefit Pension Scheme					
- Actuarial gain/(loss) on liability experience	-	-	300	300	(100)
Defined Benefit Pension Scheme					
- Actuarial (loss)/gain on assets	-	-	(20,727)	(20,727)	900
Defined Benefit Pension Scheme					
- Actuarial gain on change in assumptions	-	-	8,800	8,800	4,800
Deferred Tax credit/(charge) on Pension Liabilities	-	-	1,652	1,652	(1,814)
At 31 December	30,000	510	(3,883)	26,627	39,900

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

19. COMMITMENTS UNDER OPERATING LEASES

The Group and Company annual commitments for the year to 31 December 2008 under operating leases are as follows:

	2008 Land and buildings £'000	2008 Other £'000	2007 Land and buildings £'000	2007 Other £'000
Operating Leases which expire within:				
1 year	-	-	-	14
2 - 5 years	-	40	-	29
Over 5 years	1,630	-	1,287	-
	<u>1,630</u>	<u>40</u>	<u>1,287</u>	<u>43</u>

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 PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2008 £'000	2007 £'000
Operating profit	14,828	8,980
Realised currency gain	18	82
Difference between pension contributions and charge against operating profit	531	1,900
Depreciation	3,937	3,583
Amortisation/impairment	3,714	795
(Increase)/decrease in debtors	(2,339)	22,117,517
Decrease in creditors	(15,768)	(22,096,020)
Net cash inflow from operating activities	<u>4,921</u>	<u>36,837</u>

21. RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS

	2008 £'000	2007 £'000
Increase in cash in year	<u>3,626</u>	<u>30,633</u>
Movement in net funds in year	3,626	30,633
Net funds at beginning of year	<u>127,886</u>	<u>97,253</u>
Net funds at end of year	<u>131,512</u>	<u>127,886</u>

Net funds at 31 December 2008 comprised cash of £131,512,000 (2007 - £127,885,700).

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

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 or 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 Assured Limited (discontinued)	Life assurance (discontinued)
Hermes UOB Capital Management Limited	Investment management
Hermes Equity Ownership Services Limited	Investment management
Hermes Private Equity Limited	Investment management
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
NLI Investments Europe 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, which is owned as to 60% of ordinary share capital and Hermes BPK Partners LLP which is owned as to 61.5% of issued units.

All subsidiaries have been consolidated in the accounts. All are incorporated in Great Britain and registered and operate in England and Wales apart from two subsidiaries not disclosed above, Hermes UOB GP Limited and Hermes UOB SLP GP Limited, which are incorporated, registered and operate in Scotland.

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 Pte Ltd is owned as to 40% of ordinary share capital and is incorporated, registered and operates in Singapore.

NLI Investments Europe Limited is 33% owned and is incorporated in Great Britain and registered and operates in England and Wales.

Logistics Management Limited is 50% owned and is incorporated in Great Britain and is registered and operates in England and Wales.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

23. LIMITED PARTNERSHIPS

As described in accounting policy c) 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.

24. FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY

Following the cessation of trade in Hermes Assured Limited the principal risk exposures of the Company and the Group have changed. The risk policies applicable whilst Hermes Assured Limited undertook active operations as well as those applicable at the balance sheet date are set out below. The principal risk exposures of the Company and the Group at the balance sheet date relate to operational, liquidity and credit 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 investment transactions within the funds 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.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

24. FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY (continued)

Credit Risk (continued)

At 31 December 2008, the Company and the Group's financial assets exposed to credit risk amounted to the following:

Financial assets	2008 £'000		2007 £'000	
	Group	Company	Group	Company
Cash at bank and in hand	131,512	17,364	127,886	29,185
Owed by Subsidiaries	-	18,292	-	12,753
Trade Debtors and Accrued Income	7,933	2,913	15,406	2,713
Taxation Debtor	4,131	5,360	10,879	8,832
Owed by Parent	14,445	10	2,600	165
Other Debtors	2,216	2,061	4,380	535
Subordinated loan - subsidiary	-	5,000	-	5,000
Loan to associate	-	-	-	150
	<u>160,237</u>	<u>51,000</u>	<u>161,151</u>	<u>59,333</u>

Cash at bank is held with the Royal Bank of Scotland or put on deposit with highly rated counterparties. Bankruptcy or insolvency of the bank may cause the Company's rights with respect to the cash held by the bank to be delayed or limited. The bank has a Fitch Credit rating of F1+ and its credit rating is monitored by management by reference to reputable rating agencies such as Standard & Poor's, Moody's or Fitch. If the bank's financial position were to materially deteriorate then the cash holdings would be moved to another bank.

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 counterparties is regularly reviewed.

As at the year end, within the Company, £nil of trade debtors were past their due date. Within the Group £2,128,766 of trade debtors were past their due date at the year end. Of these, £38,042 were greater than 60 days past their due date at the year end. Of the £2,128,766 due at the year end, only the £38,042 is still outstanding. This is due from a customer that has gone into administration. Recent correspondence from the company's administrator indicates that this amount will shortly be received, and therefore it is deemed not to be impaired.

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.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

24. FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY (continued)

Liquidity Risk (continued)

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

Liabilities	Maturity	2008 £'000		2007 £'000	
		Group	Company	Group	Company
Owed to parent	< 12 months	10,000	10,000	10,000	10,000
Other creditors < 12 months	< 12 months	5,070	4,924	7,370	3,424
Unfunded pension liability	< 12 months	773	773	922	922
Accruals and prepaid income	< 6 months	36,582	21,610	46,402	22,775
Other creditors >12 months	> 12 months	10,372	8,713	13,953	10,158
		<u>62,797</u>	<u>46,020</u>	<u>78,647</u>	<u>47,279</u>

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

The Business Support Committee of the Company is assured, on a monthly basis, that day-to-day regulatory solvency has been maintained. The Company retains a high level of liquidity to ensure that regulatory solvency requirements are continuously met. There is a funding arrangement in place with the ultimate parent organisation, the BT Pension Scheme, should this be required at any point.

Operational Risk

Operational Risk occurs in all areas of the Group's activities. Risk assessments are carried out quarterly and considered by the Board. The Board is also advised of key performance indicators and made aware of any significant errors or omissions that have occurred on a quarterly basis.

Insurance Risk

The type of business operated by the Group indicates that there is no insurance risk. The Group does not operate guaranteed or with profits policies and policy cash inflows are reviewable and may vary in size. Policy fees were set at a level above the marginal cost of operating the funds.

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 significant interest receipts. The Group has a treasury department that serves to mitigate the interest rate risk by continually monitoring the cash position of the Group and seeking the optimal return given the Groups liquidity requirements.

If the average rate of interest was 2% higher during the year based upon the year-end cash position an additional £2,630,232 interest would have been received. If interest rates were 2% lower on average, ceteris paribus, it would have resulted in an equal but opposite effect.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

25. 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 the BT Pension Scheme in respect of the Trustees' services to the BT Pension Scheme.

	2008 £'000	2007 £'000
R Kent (Chairman)	110	-
Sir Tim Chessells	-	75
C N J Long	23	23
D M MacDonald	21	21
H Marchant	24	24
W McClory	21	21
D R Barford	30	30
L Cullen	40	40
Total fees	<u>269</u>	<u>234</u>

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.

Parent Undertaking

The Company is a wholly-owned subsidiary and 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 subsidiaries as it is taking advantage of the exemption in FRS8.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

25. RELATED PARTY TRANSACTIONS (continued)

Hermes UK Focus Funds

The Hermes UK Focus Funds are partnerships investing in UK equities. 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 £3,851,094 (2007 - £4,977,933) from the UK Focus Fund 1, £986,043 (2007 - £1,390,846) from the UK Focus Fund 2 and £631,444 (2007 - £1,377,209) from the UK Focus Fund 3 as profit share.
- HFAM recharged £80,822 (2007 - £73,722) of expenditure to the UK Focus Fund 1, £26,388 (2007 - £25,230) to the UK Focus Fund 2 and £12,872 (2007 - £16,399) to the UK Focus Fund 3. This expenditure represented the direct costs of the partnerships.

UK Small Companies Focus Fund 1, 2 (renamed the Hermes Specialist Focus Funds) and Side Pocket Fund 1, 2:

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

- HFAM received £1,609,301 (2007 - £2,448,403) from UKSCFF 1, £321,242 (2006 - £77,688) from UKSCFF 2, £58,474 (2007 - £61,542) from the UK Small Companies Side Pocket Focus Fund 1 and £17,752 from the UK Small Companies Side Pocket Focus Fund 2 (2007 - £nil), as profit share.
- HFAM recharged £61,400 (2007 - £30,700) of expenditure to UKSCFF 1. This expenditure represented the direct costs of the partnership.

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.

- HFAM is a general partner of the European Focus Funds. During the year HFAM received £129,515 as a general partner's profit share (2007 - £141,567).
- HFAME received £9,034,586 (2007 - £9,780,167) from the European Focus Fund I and £934,433 (2007 - £1,054,252) from the European Focus Fund II and £1,029,795 (2007 - £1,154,971) from European Focus Fund III as profit share.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)

25. RELATED PARTY TRANSACTIONS (continued)

European Focus Funds I, II and III (continued)

- HFAME recharged £35,666 (2007 - £41,867) of expenditure to the European Focus Fund I, £35,666 (2007 - £41,867) of expenditure to the European Focus Fund II and £35,666 (2007 - £41,867) of expenditure to the European Focus Fund III. This expenditure represented the direct costs of the partnerships.

26. MINORITY INTEREST - EQUITY

The minority interest of £167,000 (2007 - £153,435) included within the consolidated balance sheet and the £14,000 (2007 - £9,929) included within the consolidated profit and loss account relates to the 40% shareholding of Hermes UOB Capital Management Limited (HUCM) owned by UOB Global Capital LLC.

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

In the prior year it was disclosed that an action had been brought against Hermes Investment Management Limited (HIML) in South Korea in respect of the actions of a former fund manager and alleged breaches of the South Korean Securities and Exchange Act. It was disclosed that HIML was found not guilty by the Korean High Court and Court of Appeal and cleared of all charges. The South Korean authorities subsequently exercised their right to appeal to the Supreme Court which upheld the not guilty verdict of the Korean High Court and Court of Appeal. HIML was cleared of all charges during the year, which brings the matter to an end as the Korean Prosecutor has no further rights to appeal the decisions of the Korean Courts.

In the prior year financial statements it was disclosed that an action for damages had been brought against Hermes Focus Asset Management Europe Limited ("the Company"), filed before the Court of Parma, Italy, where it was alleged that the Company wrongfully cooperated in conduct which delayed the filing for bankruptcy by a company in which funds managed by the Company had invested. The plaintiff in this action ("P") has for some years been a defendant in legal action taken by the Company on behalf of the Hermes European Focus Fund I, II and III Limited Partnerships in both the United States and in Italy. A settlement agreement has been entered into during the year in respect of the class action taken by the Company in the U.S., a provision of which is that the parties will cause that all other actions pending between P and the Company, including the action brought by P against the Company before the Parma Court, be dismissed with prejudice. The settlement agreement has been approved by the Court in the US and the order is subject to appeal. The Directors consider the likelihood of the Parma Court finding against the Company to be remote.

NOTES TO THE ACCOUNTS - YEAR ENDED 31 DECEMBER 2008 (continued)**29. POST BALANCE SHEET EVENT**

The Group announced post year-end that contracts had been exchanged to appoint Bridgepoint Capital as the manager of two Hermes direct private equity investment vehicles. As part of this agreement, the Hermes direct private equity investment team will transfer to Bridgepoint Capital. The transaction is subject to UK Financial Services Authority and European Commission mergers approvals as at the date of these financial statements, and accordingly the results for 2008 have been included in continued operations.