

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

### E1: Income statement for asset management operations

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

Asset management in the UK and Europe is undertaken through M&G which is made up of three distinct businesses being Retail, Institutional and Finance. M&G's investment expertise covers all key asset classes, equities, fixed interest and commercial real estate, and includes a number of specialist fixed income and real estate strategies. M&G manages its own retail fund operations, funds for pensions, insurance companies and third-party entities.

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

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

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

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

	2012 £m				2011 £m
	M&G	US	Eastspring Investments note (iii)	Total	Total
Revenue (excluding revenue of consolidated investment funds and NPH broker-dealer fees)	1,234	296	282	1,812	1,583
Revenue of consolidated investment funds <sup>note(i)</sup>	(11)	–	–	(11)	9
NPH broker-dealer fees <sup>note(i)</sup>	–	435	–	435	405
Gross revenue*	1,223	731	282	2,236	1,997
Charges (excluding charges of consolidated investment funds and NPH broker-dealer fees)	(713)	(257)	(207)	(1,177)	(1,147)
Charges of consolidated investment funds <sup>note(i)</sup>	11	–	–	11	(9)
NPH broker-dealer fees <sup>note(i)</sup>	–	(435)	–	(435)	(405)
Gross charges	(702)	(692)	(207)	(1,601)	(1,561)
<b>Profit before tax</b>	<b>521</b>	<b>39</b>	<b>75</b>	<b>635</b>	<b>436</b>
Comprising:					
Operating profit based on longer-term investment returns	371	39	75	485	461
Short-term fluctuations in investment returns <sup>note(ii)</sup>	93	–	–	93	(29)
Shareholder's share of actuarial gains and losses on defined benefit pension schemes	15	–	–	15	4
Gain on dilution of Group's holdings	42	–	–	42	–
<b>Profit before tax</b>	<b>521</b>	<b>39</b>	<b>75</b>	<b>635</b>	<b>436</b>

\* For 2012, gross revenue includes the Group's share of results from the associate PPM South Africa. In prior years, PPM South Africa was treated as a subsidiary and accounted for accordingly.

#### Notes

- (i) Under IFRS, disclosure details of segment revenue are required. The segment revenue of the Group's asset management operations are required to include two items that are for amounts which, reflecting their commercial nature, are also wholly reflected as charges within the income statement. After allowing for these charges, there is no effect on profit from these two items which are:
  - (a) Investment funds which are managed on behalf of third parties and are consolidated under IFRS in recognition of the control arrangements for the funds. The gains and losses of these funds are non-recourse to M&G and the Group; and
  - (b) NPH broker-dealer fees which represent commissions received, that are then paid on to the writing brokers on sales of investment products.
 The presentation in the table above shows the amounts attributable to these two items so that the underlying revenue and charges can be seen.
- (ii) Short-term fluctuations in investment returns for M&G are primarily in respect of unrealised fair value movements on Prudential Capital's bond portfolio.
- (iii) Included within Eastspring Investments revenue and charges are £42 million of commissions (2011: £44 million).

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## b M&amp;G operating profit based on longer-term investment returns:

	2012 £m	2011* £m
Asset management fee income	728	662
Other income	6	4
Staff costs	(289)	(270)
Other costs	(147)	(134)
Underlying profit before performance-related fees	298	262
Share of associate results	13	26
Performance-related fees	9	13
Operating profit from asset management operations	320	301
Operating profit from Prudential Capital	51	56
Total M&G operating profit based on longer-term investment returns	371	357

\* Following the divestment in the first half of 2012 of M&G's holding in PPM South Africa from 75 per cent to 49.99 per cent and its treatment from 2012 as an associate, M&G's operating income and expense no longer include any element from PPM South Africa, with the share of associates' results being presented in a separate line. The table above reflects the retrospective application of this basis of presentation for the 2011 results. Total profit remains the same.

The difference between the fees and other income shown above in respect of asset management operations, and the revenue figure for M&G shown (excluding consolidated investment funds) in the main table primarily relates to the total revenue of Prudential Capital (including short-term fluctuations) of £218 million (2011: £96 million) and commissions which have been netted off in arriving at the fee income of £728 million (2011: £662 million) in the table above. The difference in the presentation of commission is aligned with how management reviews the business.

**E2: Statement of financial position for asset management operations**

Assets, liabilities and shareholders' equity included in the Group consolidated statement of financial position in respect of asset management operations are as follows:

	2012 £m			2011 £m	
	M&G note(iii)	US	Eastspring Investments	Total	Total
<b>Assets</b>					
Intangible assets:					
Goodwill	1,153	16	61	1,230	1,230
Deferred acquisition costs and other intangibles assets	10	2	2	14	16
Total	1,163	18	63	1,244	1,246
Other non-investment and non-cash assets	901	174	83	1,158	1,129
Associate investments accounted for using the equity method	41	–	–	41	–
Financial investments:					
Loans <sup>note(i)</sup>	1,199	–	–	1,199	1,256
Equity securities and portfolio holdings in unit trusts	50	–	20	70	594
Debt securities <sup>note(ii)</sup>	1,839	–	7	1,846	1,842
Other investments	38	6	–	44	78
Deposits	3	33	48	84	89
Total investments	3,170	39	75	3,284	3,859
Cash and cash equivalents	909	48	126	1,083	1,735
<b>Total assets</b>	<b>6,143</b>	<b>279</b>	<b>347</b>	<b>6,769</b>	<b>7,969</b>
<b>Equity and liabilities</b>					
<b>Equity</b>					
Shareholders' equity	1,545	124	268	1,937	1,783
Non-controlling interests	–	–	–	–	5
Total equity	1,545	124	268	1,937	1,788
<b>Liabilities</b>					
Core structural borrowing of shareholder-financed operations	275	–	–	275	250
Intra-group debt represented by operational borrowings at Group level <sup>note(iv)</sup>	2,084	–	–	2,084	2,956
Net asset value attributable to external holders of consolidated unit trusts and similar funds	162	–	–	162	678
Other non-insurance liabilities <sup>note(v)</sup>	2,077	155	79	2,311	2,297
Total liabilities	4,598	155	79	4,832	6,181
<b>Total equity and liabilities</b>	<b>6,143</b>	<b>279</b>	<b>347</b>	<b>6,769</b>	<b>7,969</b>

**Notes**

## (i) Loans

The M&G loans relate to loans and receivables managed by Prudential Capital. These assets are generally secured but most have no external credit ratings. Internal ratings prepared by the Group's asset management operations as part of the risk management process are:

	2012 £m	2011 £m
Loans and receivables internal ratings:		
A+ to A-	–	129
BBB+ to BBB-	836	1,000
BB+ to BB-	339	89
B+ to B-	24	38
Total M&G loans	1,199	1,256

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

### E2: Statement of financial position for asset management operations continued

(ii) Debt securities  
Of the £1,846 million total debt securities at 31 December 2012 (2011: £1,842 million) for asset management operations, the following amounts were held by M&G.

	2012 £m	2011 £m
M&G:		
AAA to A- by Standard & Poor's or Aaa rated by Moody's	1,493	1,547
Other	346	287
<b>Total M&amp;G debt securities</b>	<b>1,839</b>	<b>1,834</b>

(iii) The M&G statement of financial position includes the assets and liabilities in respect of Prudential Capital.

(iv) Intra-group debt represented by operational borrowings at Group level

Operational borrowings for M&G are in respect of Prudential Capital's short-term fixed income security programme and comprise:

	2012 £m	2011 £m
Commercial paper	1,535	2,706
Medium-Term Notes	549	250
<b>Total intra-group debt represented by operational borrowings at Group level</b>	<b>2,084</b>	<b>2,956</b>

(v) Other non-insurance liabilities consists primarily of intra-group balances, derivative liabilities and other creditors.

### E3: Regulatory and other surplus for asset management operations

Certain asset management operations are subject to regulatory requirements. The movement in the year of the surplus regulatory capital position of these operations, combined with the movement in the IFRS basis shareholders' funds for unregulated asset management operations, is as follows:

	Asset management operations				2011 £m
	2012 £m				
	M&G	US	Eastspring Investments	Total	Total
<b>Regulatory and other surplus</b>					
Beginning of year	156	129	127	412	432
Gains during the year	356	8	52	416	326
Movement in capital requirement	(3)	–	6	3	(14)
Capital injection	–	–	9	9	8
Distributions made	(254)	(8)	(56)	(318)	(342)
Exchange movement	–	(5)	(4)	(9)	2
<b>End of year</b>	<b>255</b>	<b>124</b>	<b>134</b>	<b>513</b>	<b>412</b>

The movement in the year reflects gains driven by profits generated during the year and also changes in regulatory requirements.

Distributions consist of dividends paid up to the parent company.

The M&G figures include those for Prudential Capital.

**E4: Sensitivity of profit and shareholders' equity to market and other financial risk****i Currency translation**

Consistent with the Group's accounting policies, the profits of Eastspring Investments and US asset management operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. The rates for the functional currencies of most significant operations are shown in note B4.

A 10 per cent increase in the relevant exchange rates would have reduced reported profit before tax attributable to shareholders and shareholders' equity, excluding goodwill attributable to Eastspring Investments and US asset management operations, by £10 million (2011: £9 million) and £29 million (2011: £30 million) respectively.

**ii Sensitivities to other financial risks for asset management operations**

The principal sensitivities to other financial risk of asset management operations are credit risk on the bridging loan portfolio as described in note E2 of the Prudential Capital operation and the indirect effect of changes to market values of funds under management. Due to the nature of the asset management operations there is limited direct sensitivity to movements in interest rates. Total debt securities held at 31 December 2012 by asset management operations were £1,846 million (2011: £1,842 million), the majority of which are held by the Prudential Capital operation. Debt securities held by M&G and Prudential Capital are in general variable rate bonds and so market value is limited in sensitivity to interest rate movements and consequently any change in interest rates would not have a material impact on profit or shareholders' equity. The Group's asset management operations do not hold significant investments in property or equities.

**E5: Other operations**

Other operations consist of unallocated corporate activities relating to Group Head Office and the Asia regional head office, with net expenditure for the year of £498 million (2011: £483 million) as detailed in note B1. An analysis of the assets and liabilities of other operations is shown in note B5.

The Group holds certain derivatives that are used to manage foreign currency movements and macroeconomic exposures. The fair value of these derivatives is sensitive to the combined effect of movements in exchange rates, interest rates and inflation rates. The possible permutations cover a wide range of scenarios. For indicative purposes, a reasonably possible range of fair value movements could be plus or minus £17 million.