

# Pillar 3 Disclosures 2020

Based on Financial Data as at 31 December 2019

## 1 OVERVIEW

### 1.1 Introduction

Hermes Fund Managers Limited ('HFML' or 'Hermes') is an asset manager with a difference. We believe that, while our primary purpose is helping beneficiaries retire better by providing world-class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial and consider the impact our decisions have on society, the environment and the wider world. Our goal is to help people invest better, retire better and create a better society for all. We pursue this goal through a holistic approach to investing that incorporates environmental, social and governance considerations into all of our investment products. We believe that our ability to mitigate ESG risks and capture investment opportunities arising from these considerations is essential to achieving consistent investment outperformance for our clients.

Federated Hermes, Inc. ('Federated') a leading investment manager publicly listed on the New York Stock Exchange ('NYSE') is the ultimate parent of Hermes. Federated is the majority owner of Hermes and all activities previously carried out by Hermes now form part of the international business of Federated and are promoted under the Federated Hermes brand. Hermes Fund Managers Limited is the legal entity of the international business of Federated Hermes. HFML is the parent company of a number of entities falling within the Hermes group.

As at 31 December 2019 Hermes had £37.1 billion assets under management and advice ('AUM'). This figure includes £6.2 billion of assets managed or under an advisory agreement by Hermes GPE LLP ('HGPE'), a wholly owned subsidiary of Federated Hermes Inc. Further, Hermes established Hermes EOS in 2004, one of the world's largest stewardship teams. At 31 December 2019 Hermes EOS advised on £662.2 billion and counts some of the world's leading pension funds as clients. Our public markets capabilities include high active share equities with regional or global exposure, specialist credit, and multi asset. In private markets our expertise includes real estate, infrastructure, private equity and private debt. Our client base and partnerships are global, including many of the world's best-known financial organisations. At 31 December 2019, Hermes managed money for more than 650 clients in 34 different locations across the world. On 1 July 2018 Federated Investors, Inc ('Federated') acquired a majority stake in Hermes, replacing the BT Pension Scheme ('BTPS') as majority shareholder. BTPS remains a key investor in Hermes products, and at the end of 2019 BTPS contributed circa 26% to AUM and 18% to total revenues.

### 1.2 Purpose of Disclosure

This Pillar 3 Disclosure statement relates to the consolidated Hermes Group, which consists of the parent ('HFML') and its subsidiaries. Regulated by the Financial Conduct Authority ('FCA') Hermes is subject to rules set out in the FCA's General

Prudential Sourcebook ('GENPRU') and Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU'). This disclosure is prepared in accordance with the Capital Requirements Directive ('CRD') III which is a common framework for implementing Basel II in the European Union. These rules consist of three pillars:

- **Pillar 1** sets out the minimum capital requirements for credit, market and operational risks;
- **Pillar 2** requires firms to assess their capital adequacy including the risks not adequately covered by Pillar 1. We undertake this assessment through the Individual Capital Adequacy Assessment Process ('ICAAP'); and
- **Pillar 3** sets out the rules for the capital and risk disclosure requirements undertaken through the Pillar 1 and Pillar 2 assessments. The disclosures are designed to promote market discipline by providing market participants with information to help them assess a firm's capital, risk exposures and processes.

### 1.3 Scope of Application

HFML and its subsidiaries form a UK Consolidation Group for regulatory purposes, which is subject to the consolidated prudential supervision. The regulatory basis of consolidation is the same as the accounting basis of consolidation, with all entities being fully consolidated. The main operating companies are:

- Hermes Investment Management Limited ('HIML');
- Hermes Alternative Investment Management Limited ('HAIML');
- Hermes Real Estate Investment Management Limited ('HREIM');
- Hermes Equity Ownership Services Limited ('HEOS'); and
- Hermes Fund Managers Ireland Limited ('HFMIIL').

HFMIIL, HIML (BIPRU 50k), and HAIML (BIPRU 125k) are separately authorised and regulated by the Financial Conduct Authority ('FCA'). For HFMIIL there is €6.0m held as capital resources in a ring-fenced bank account in Ireland. On an annual basis an ICAAP submission is made to the Central Bank of Ireland (CBI). The submission for 2019 included a capital requirement figure of €3.6m. HGPE undertakes its own ICAAP and is not in scope of these Pillar 3 Disclosures.

With effect from 4 June 2020 Hermes European Equities Limited ('HEEL') is no longer authorised to provide regulated products or services but was previously authorised by the PRA and/or FCA as BIPRU 50k firm.

### 1.4 UK Consolidation Group

The UK Consolidation Group was expanded following the transaction to acquire a majority share of HFML by Federated Hermes Inc (formerly Federated Investors Inc) on 1 July 2018. HIML, as the largest regulated entity in the UK Consolidation Group by revenues, acts as the reporting entity to the FCA. The Group consists of a number of regulated and non-regulated entities. The Group is structured under Federated International Holdings B.V. ('FIH BV'), a private holding company with limited liability organised under the laws of the

Netherlands. FIH BV is the parent and consolidation level of the regulated entities of the UK Consolidation Group and both the regulated capital and capital requirements are derived from the consolidated FIH BV position.

The entities in scope include:

- HFML and its regulated subsidiary entities, as noted above (collectively known as the "Hermes Group");
- Federated Hermes (UK) LLP ('Federated UK'); and
- Federated Investment Management Limited ('FIML').

Federated UK and FIML are authorised and regulated by the FCA and FIML is also regulated by the CBI. The UK Consolidation Group has a capital requirement of £49.5m and capital resources of £87m with a capital surplus of £37.5m. HFML has the largest contribution to this capital surplus (84.3%), followed by FIML (8%) and Federated UK (7.7%). The Federated Pillar 3 Statement is a separate document and not included in this Statement.

## 1.5 Frequency and Basis of Disclosures

Unless otherwise stated, these disclosures are available on the Hermes website and are based upon figures as at 31 December 2019. <https://www.hermes-investment.com/ukw/about-us/policies-and-disclosures/>. 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, where any material changes to the business model have taken place or where significant changes to techniques for calculating capital requirements have been made.

## 2 RISK MANAGEMENT FRAMEWORK

The Risk Management Framework sets out the overall approach at Hermes to manage the internal and external risks to which the firm is currently exposed or may be exposed to in the future. Underpinning this framework there are a number of supporting Risk Policies that describe the principles, the approach to risk management and define the content of the risk management process pursuant to the risks to which the firm is exposed. The Risk Management Framework is founded on three pillars:

- **Risk appetite:** Key parameters which set out how much risk the firm is prepared to accept;
- **Corporate governance:** The legal, organisational and management structure; and
- **Policies and standards:** The rules that determine how the firm should conduct itself. The HFML Board is ultimately responsible for ensuring that the firm operates in an effective, risk-controlled environment. Good risk management, with the backing of Hermes' strong risk culture, is the responsibility of every employee. The Risk team and Investment Risk team has been authorised by the Risk & Compliance Committee to provide oversight and independent challenge of the risk management activities undertaken in the firm.

## 2.1 Risk Appetite

The Risk Appetite for Hermes is set by the HFML Board and details the amount of risk it is prepared to accept in conducting its business and in pursuit of its strategic objectives, after consideration of risk-reward trade-offs. Risk Appetite sets the framework for the development of corporate strategy and the risk framework. The Board recognises that Hermes' long-term success and sustainability depends upon:

- Its relationship with clients, owners and regulators;
- The protection of its brand; and
- The attainment of corporate success factors.

Taking such factors into consideration as well as Hermes' values and beliefs, the Board has set an overarching Risk Appetite Statement and detailed underlying statements with tolerance limits that are monitored through key risk indicators and reported to management on a quarterly basis through the Risk MI.

## 2.2 Three Lines of Defence

Hermes uses an effective organisation structure to operate on a three lines of defence basis, whereby responsibility for Risk-related decision making and management is embedded within:

- **1st line:** business and supporting functional areas;
- **2nd line:** challenge and oversight supporting the effectiveness of risk management, compliance and governance is provided by Risk, Compliance and Legal; and
- **3rd line:** Internal Audit ensures that risk management and controls are in place and operating effectively. This includes independent assurance on the operation of the first- and second-line activities in Hermes.

## 2.3 Risk Management Methodology

The methodology employed to identify, assess/measure, monitor, manage (mitigate/control) and report risk on a continuous basis, forms the basis of the firm's risk management process, which is relevant from both a bottom-up (business/function) and top down (Hermes) perspective. The process can be applied to all types of risk but is particularly relevant for operational risk.

**Identify:** the identification of risk is the responsibility of all staff. This relates to risks that are current in nature (that have an immediate impact) and that are derived from both internal influences and external factors. Secondly, emerging risks relate to exposures that do not currently exist but may surface at some point in time in the future due to changes in the environment. Hermes uses the Risk & Control Self-Assessment ('RCSA' or 'Risk Register') to define the parameters of the firm's risk universe, and is the primary tool used to support the identification and measurement of risk.

**Measure:** risks are assessed/measured at both the inherent (pre-controls) and residual (post-controls) levels. Assessing the materiality (significance) of risk is key in determining whether matters are important enough to be brought to a decision-maker's attention and so that management can make more effective and informed business decisions.

**Monitor:** risk monitoring comprises ongoing or periodic evaluations to be completed in order to assess Hermes' risk exposures over time versus established tolerances/limits. We use tools such as key risk indicators ('KRI's), risk systems/dashboards, regular independent monitoring programmes (compliance, internal audit).

**Manage:** risk mitigation controls are used to eliminate or reduce the extent, nature and/or severity of a specific risk-related event. Four risk mitigation options are considered when managing the risks that the business faces, **Avoidance, Transfer, Reduction** and **Acceptance**. Hermes objective is not to eliminate the risks it faces completely. The challenge is to choose actions/responses that are proportionate to the risks faced, that operate efficiently to bring the risks within acceptable tolerance levels within risk appetite and that do not compromise the achievement of strategic objectives.

**Report:** all significant risk issues are required to be escalated to the Risk team and to senior management as appropriate. Where necessary, external communication (to regulators, clients, vendors etc.) will be managed in accordance with policies and procedures.

## 2.4 Conduct Risk Framework

Hermes has in place a robust Conduct Risk Framework that is founded on the identification of conduct risks relevant to the firm. Conduct risk is a factor in all aspects of our business and

the way we behave in our business relations. It is considered top-down, starting with our business strategy and business model. Further, the Firm's core value of 'responsibility' and to always put clients first is at the heart of the Framework. The Conduct Risk Framework is supported by both internal and external principles, including The Hermes Pledge, which codifies the Firm's own standards. The identification and quantification of conduct risks relevant to Hermes has been subject to rigorous review by Risk and subject matter experts from across the business. Conduct risks and supporting key controls are documented through the Risk & Control Self-Assessment ('RCSA') process and regular Risk MI is produced.

## 2.5 Governance Committees

In order to embed risk management throughout the firm, Hermes has a comprehensive risk governance structure, group-wide policies and procedures, management reporting and system controls in place to identify, mitigate and control risks. In addition, the Hermes Board ('the Board') has documented and approved the risk appetite which contains both qualitative and quantitative measures. The Board is ultimately responsible for the oversight of risk management within its subsidiary operating companies and as such is responsible for setting and periodically reviewing Hermes' risk strategy, including operational risk, counterparty credit risk and investment risk aspects. For the Board to accomplish its responsibilities it has established a governance framework consisting of the Executive Committee and the following Committees of which the members are Non-Executive Directors.



### Risk & Compliance Committee

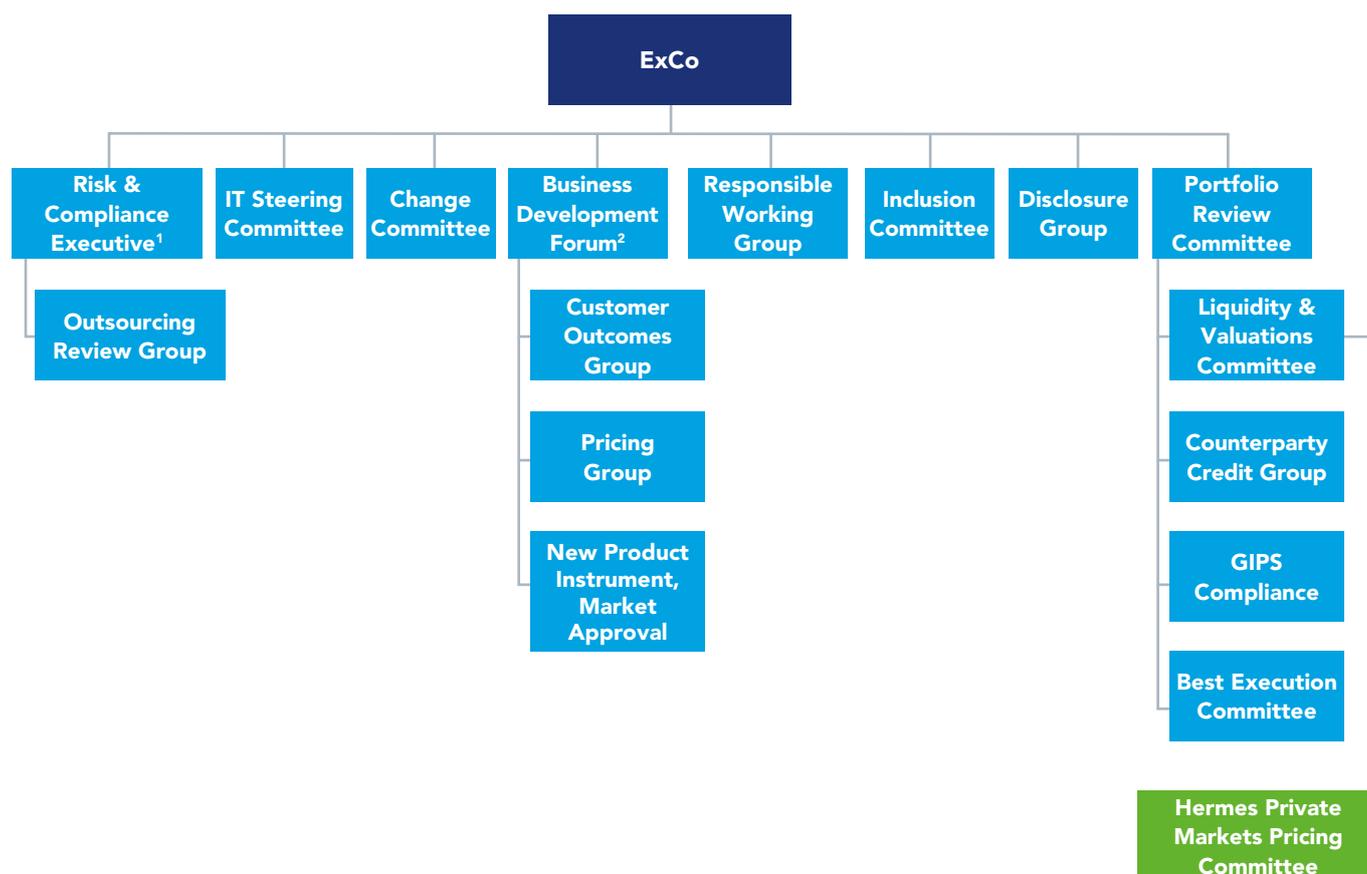
In order to ensure complete transparency and independence, the Risk & Compliance Committee ('RCC') is composed of the Non-Executive Directors of the Hermes Board with attendance from the Head of Strategic Risk & Compliance. Other staff are in attendance as required.

The Risk and Compliance Committee (RCC) is responsible for:

- Overseeing Hermes' risk management framework and the effectiveness of risk management, governance and compliance activity within the group;
- Reviewing the methodology and assumptions used in Hermes' models for determining its economic and regulatory capital and satisfying itself that the models are fit for purpose;

- Overseeing the management of relationships and registrations with regulatory authorities and to review developments and prospective changes in the regulatory environment; and
- Overseeing the development of the ICAAP and formally recommending to the Board's for approval.

Day-to-day management of the business has been delegated to the Executive Committee ('ExCo'). A number of management oversight committees/groups have been set up to support the governance framework.



<sup>1</sup> Includes Regulatory Change, Conduct Risk and Health & Safety

<sup>2</sup> Includes Capacity

Note: In addition to the above there are team meetings and other informal groups which are not part of formal governance.

### Executive Committee

The Executive Committee comprises of the Chief Executive Officer, Chief Operating Officer, Head of Business Development, Head of Private Markets, Head of Investments and the Head of Strategic Risk & Compliance. The ExCo is responsible for all significant matters relating to the overall management of the Hermes business.

### Risk and Compliance Executive

The Risk and Compliance Executive ('RCE') supports the ExCo and the RCC in the identification, measurement and monitoring of risks and controls throughout Hermes. This, in the main, consists of identifying key operational and business risks, monitoring key risk indicators across the business to ensure the effective operation of the controls framework within Hermes, ensuring compliance with regulatory requirements and making recommendations to the Hermes Board, RCC and other relevant committees for the mitigation of key risks to the business. The RCE is attended by ExCo members and representatives from Compliance, Risk, Legal and Audit.

### IT Steering Committee

The IT Steering Committee assist ExCo in ensuring that Hermes' IT Strategy is aligned with the Hermes Business Strategy. The IT Steering Committee ensures that the business units represented have ultimate oversight over larger IT strategic decisions within the sphere of their

influence; refines and aligns business solutions that leverage appropriate technology; prioritises IT projects, ensure that there is executive sponsorship and resolve conflicts in project prioritisation and resource allocation; assists in IT strategic planning and project approval.

### Business Development Forum

The Business Development Forum ('BDF') is responsible for approving or rejecting a new product as being desirable and suitable from a commercial, customer and portfolio management perspective, responding to issues and concerns raised by the New Product, Instrument & Market Approval Committee in its assessment of the suitability and appropriateness of the new product, setting fees and pricing, reviewing ongoing product and range suitability, target markets and profitability.

### Portfolio Review Committee

The Portfolio Review Committee ('PRC') supports the ExCo in the assessment and management of the investment teams, their corresponding processes and related activities.

### Responsibility Working Group

A working group which oversees the formulation and communication of the Hermes Responsibility Policy.

## 2.6 Control and Oversight Functions

On a day-to-day basis, operational and business risk oversight is the responsibility of the Risk & Compliance teams while investment risk is managed both at the investment team level and by a dedicated Investment Office. Internal Audit provides independent, objective assurance on the control framework as well as consulting activities to management. All members of staff within the control and oversight functions are suitably qualified and have extensive industry knowledge.

## 3 CAPITAL ADEQUACY

### 3.1 Capital Resources

Statutory revenue for the year ending 2019 increased to £158.2m (2018: £142.8m) driven by increased new business revenues. Assets under management increased by £3.6bn from £33.5bn to £37.1bn with management fees increasing to £158.2m (2018: £142.5m) driven by net new inflows of third party AUM. Performance fees reduced to £5.5m (2018: £6.4m). The Group continues to deliver investment performance against the continuing backdrop of a challenging economic environment.

Capital Resources		
All figures in (£'000)		
	2019	2018
<b>Core Tier 1</b>		
Share capital	83,592	83,592
Share premium	–	71,866
Retained earnings and other reserves	39,534	(57,049)
<b>Audited Year End Profit</b>	<b>123,126</b>	<b>98,409</b>
<b>Deductions from total of Tier 1</b>		
<b>Material holdings</b>	(18,085)	(8,868)
<b>Available Capital</b>	<b>105,041</b>	<b>89,541</b>

The capital resources of HFML have increased during 2019, primarily as a result of the inclusion of the audited statutory profits. The material holdings deduction rose in the year as the Company seeded a number of new funds. Capital resources are comprised of only Tier 1 capital. The Board concludes that the Group is well capitalised, as it holds significant capital resources of £105m, after deduction of material holdings, as at 31 December 2019. The Company has sufficient liquidity and the outlook for 2021 suggests that it will further increase its strong capital position.

### 3.2 Individual Capital Adequacy Assessment Process (ICAAP)

The Board ensures that Hermes maintains sufficient levels of capital to meet its regulatory requirements and to mitigate the key risks present in both its current business and future strategy. Risk management and capital management is an ongoing process within Hermes. The process involves various activities, these include:

- Monthly and quarterly Risk MI reporting to senior management and governance committees which includes an escalation process for significant risks and issues;

- Capital requirements and financial forecasts are assessed quarterly by the ExCo;
- Semi-annual risk assessments which are carried out across the organisation, both top-down and bottom-up, and are assessed by the relevant business heads and senior management on a regular basis;
- Regular review of risk appetite and tolerances;
- Stress and scenario analysis, reverse stress testing, and wind-down analysis; and
- Risk and capital is considered when change occurs.

Example of this include:

- If significant changes to the corporate structure occur;
- During considerations of M&A or disposal activity;
- When developing new products, instruments, distribution strategies;
- In response to material changes in regulatory requirements;
- In times of crisis;
- During times of significant market turbulence; and
- When material changes are made to the Hermes risk assessment.

The Board considers if more capital needs to be set aside against increasing and/or emerging risks. The Board may also consider reductions in capital if appropriate.

The ICAAP is seen as a business as usual process within Hermes, with the Executive Committee and the Board involved in ongoing discussions and challenge. The ICAAP report is formally reviewed and approved on an annual basis, or more frequently should a material change arise.

### 3.3 Key Risk Exposures

As an asset manager Hermes is primarily exposed to operational and business risks. For the purpose of ICAAP the following risks are assessed:

#### OPERATIONAL RISK

The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. There are several subcategories of operational risk at Hermes including: regulatory, legislative, reputational, operating model, change, employee, outsourcing, fraud, technology, information security and data protection, business continuity, and product risk.

Hermes maintains a measured approach to operational risk. The Board is not willing to accept excessive risk taking which leads to unexpected, adverse consequences. However, the Board acknowledges that prudent and calculated risk taking is inevitable if Hermes is to achieve its strategic objectives. It is also recognised that risks cannot always be eliminated completely. In many cases, they must be managed or mitigated through transfer or controls in accordance with the risk management methodology.

The key risks affecting Hermes which form the basis of the Pillar 2 capital calculation are classified as operational risks. Operational risk covers a range of underlying risks including reputational risk and regulatory risk. Hermes uses a statistical simulation approach to assess the Pillar 2 operational risk capital requirements. This process is built around the development of 'what if' scenarios with input and approval of subject matter experts across the business and incorporates internal and external operational risk data, this includes, RCSA, error events, regulatory implications and infrastructure spend. Using assumptions such as the typical and worst-case loss estimate, probability, and a correlation coefficient, these scenarios are modelled through a simulation tool multiple times at a given level of confidence. The output is reviewed and challenged throughout the process with final approval provided by the Hermes Board.

## BUSINESS RISK

The risk of the possibility the firm will have lower than anticipated profits or Hermes experiences a loss. Business risk is influenced by numerous factors, including people, sales volume, per-unit price, input costs, competition, the overall economic climate and government regulations. For Hermes this risk also includes poor investment performance and heightened client concentration. Business risks are used for the purpose of scenario stress testing.

## MARKET RISK

The risk of loss arising from assets, liabilities, or the mismatch between all assets and liabilities, due to market fluctuations or from economic change. As the Hermes companies do not trade on their own account, Hermes does not have any significant market risk exposure. The main source of market risk is exposure to changes in foreign exchange ("FX"), which arises as a result of income and expenses in foreign currencies. In order to meet operational expenses in foreign currency Hermes holds a sufficient level to meet its working capital requirements. To the extent that holdings in any currency is greater than the working capital requirements, these amounts are converted into Sterling to minimise the FX exposure. In addition, Hermes has taken out FX forwards to mitigate revenue exposure from FX movements. The hedging strategy is reviewed and approved by the Board and implemented by the Finance department. In terms of other investments, there is some market risk arising from asset/fund price movements.

- Discretionary bonus payments that are linked to the performance of Hermes' funds (commonly known as Collective Investment Undertakings). Some staff are obligated to notionally invest a portion of their bonus from a selection of Hermes' funds. The market risk therefore relates to an increase in the value of the fund(s) by the end of the vesting period that is paid to the employee. Hermes mitigates this risk through co-investments in the fund(s), of an equal amount to the bonus amount to be paid to the employee, which act as a hedge on the valuation movement of the bonus.

- Investment of cash in a Liquidity Fund. As a money market investment vehicle, the market risk volatility is extremely low.
- Seed capital invested in Hermes' funds.
- Hermes is indirectly exposed to market risk as its fee revenue is based on the underlying value of the portfolios that it manages for its clients. A decrease in the market value of these portfolios, due to a market fall for example, would result in a decrease in revenues.

Hermes has elected to adopt the standardised approach to market risk. Under this approach the market risk capital requirement is calculated as 8% of the Group's total risk weight exposures. The following table summarises the Pillar 1 market risk assessment:

Pillar 1 Market Risk (All figures £'000)		
	Amount	8% RWE*
Net Foreign currency receivables	14,203	1,136
Cash	33,344	2,668
Investments	7,329	586
Derivatives – Forward FX	50,966	4,077
Other	1,872	150
<b>Total Market Risk</b>	<b>107,714</b>	<b>8,617</b>

\*Risk weighted exposure

## CREDIT RISK

The risk of loss if another party fails to perform on its obligations or fails to perform them in a timely fashion. It is also known as default risk. Credit risk can be classified into counterparty credit risk and issuer risk. Counterparty credit risk arises from a counterparty failing to settle an open or unsettled transaction. Issuer risk arises where the issuing party defaults on repayment. Hermes has exposure to counterparty credit risk in relation to its own balance sheet, specifically:

- Exposures to market counterparties (e.g. banks) where Hermes cash is held or through deposits. This risk is currently minimised as Hermes only uses highly rated counterparties for its banking relationships;
- Fee receivables from clients or platforms;
- Subscriptions into the UCITS funds. Subscription orders received from investors are executed on trade date (T) for settlement (T+3) on the understanding that the payments will be received into the funds dealing account by the settlement date. Hermes (on behalf of the UCITS funds) bears the non-settlement risk; and
- FX forward contracts taken out to hedge USD and EUR fee receivables/income in these currencies. To the extent that the counterparty fails to deliver its obligation at the time of settlement Hermes is exposed to counterparty credit risk. Hermes has elected to adopt the standardised approach to credit risk. Under this approach the credit risk capital requirement is calculated as 8% of the Group's total risk weight exposures. Hermes uses the simplified method of calculating risk weights and applies the risk weightings from BIPRU 3.5.5.

The following table summarises the Pillar 1 credit risk assessment:

Pillar 1 Credit Risk (All figures £'000)	Amount	Risk weight %	RWE*	8% RWE
Sterling bank accounts	7,228	20%	1,446	116
Liquidity fund & money market funds	75,511	50%	37,756	3,020
Foreign bank accounts	7,155	100%	7,155	572
Equity Investments	26,530	150%	39,795	3,184
Tangible assets	7,001	100%	7,001	560
Deferred Tax	18,779	100%	18,779	1,502
Derivatives	510	50%	255	20
Other receivables	45,833	100%	45,833	3,667
Total Assets	188,547		158,019	
<b>Total Credit Risk</b>				<b>12,642</b>

\*Risk weighted exposure

### 3.4 Capital requirements

The Hermes Board has assessed the required level of capital for the period ended 31 December 2019 in order to mitigate potential future risk exposures that may arise in pursuit of achieving the firm's strategic objectives during 2020. The capital requirement for 2020 is £44.9m, the highest of Pillar 1 (£28.6m), Pillar 2 (£44.9m) and the cost of wind-down (£28.4m). Hermes has £105m of capital resources, resulting in a capital surplus of £60.1m.

Hermes' ICAAP calculations (All figures £'000)	2019 ICAAP (As at 31 Dec 2019)	2018 ICAAP (As at 31 Dec 2018)	Change	Change %
Pillar 1 Capital Requirement	£28,557	£25,401	£3,156	+12.42%
Pillar 2 Capital Requirement	£44,929	£35,636	£9,293	+26.08%
Orderly Wind-Down	£28,389	£28,199	£190	+0.67%
<b>Higher of Pillar 1, Pillar 2 or Wind-Down</b>	<b>£44,929</b>	<b>£35,636</b>	<b>£9,293</b>	<b>+26.08%</b>
Total Capital Resources	£105,041	£89,541	£15,500	+17.31%
<b>Capital Surplus</b>	<b>£60,112</b>	<b>£53,905</b>	<b>£6,207</b>	<b>+11.51%</b>

Overall, the increase in the capital requirement is justified as the business continues with the development of the growth strategy. Specifically, this can be attributed to expanding relationships to third party clients, the development of the operating model, and advancements with the distribution and the product development strategy. The Pillar 1 calculation has increased from the previous year in line with business growth despite a reduction in audited expenditure and variable expenditure. The Pillar 2 analysis shows that the risk profile of the Firm (£44.9m) has increased on the previous year (£35.6m). Breaking this down the contribution from Operational Risk is £23.7m (2019: £21.1m), Market Risk is £8.6m (2019: £6.1m) and Credit Risk is £12.6m (2019: £8.5m). The approach to the Pillar 2 calculation is the same as the previous year. The Wind-Down cost (£28.4m) has increased marginally from last year (£28.2m).

## 4 REMUNERATION POLICY STATEMENT (RPS)

### 4.1 Introduction

CRD requires certain disclosures to be made which enable market participants to assess information on the firm's risks, capital and risk management procedures. One subset of these disclosures relates to remuneration practices. Certain FCA rules apply to staff that have a material influence on the risk profile of the Company. These are called 'Remuneration Code staff'. Remuneration Code staff comprise categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same bracket as senior management, whose professional activities have a material impact on the firm's risk profile. The aggregate information about remuneration shown below relates to our Remuneration Code staff only. This information relates to the year ending 31 December 2019.

### 4.2 Application to proportionality

Given the Company's size, structure, and organisation applying the Principle of Proportionality to disapply the full payout rules is a prudent approach. The current arrangements described ensure rigour and discipline are applied through the remuneration processes. Further, the arrangements support the objectives of the Code.

### 4.3 Remuneration Policy

We ensure remuneration policies are in line with business strategy, objectives, values and long-term interests on the following basis:

- Basic purpose: to provide competitive total compensation opportunities, designed to attract, retain, motivate and reward employees to deliver outstanding performance;
- Alignment with business strategy: remuneration philosophy is aligned with business strategy, objectives, values and the long-term interests of Hermes and its clients; and
- Remuneration and link to performance: performance management is operated to support achievement of the overall business strategy, and to ensure remuneration is linked to business and personal performance.

The policy principles are:

- To be aligned with business strategy, objectives, values and the long-term interests of Hermes and its clients as reflected in the Hermes Pledge;
- To provide competitive total remuneration potential, designed to attract, retain, motivate and reward employees to deliver outstanding investment and operational performance;
- To promote sound and effective risk management;
- To ensure remuneration is linked to investment, business and personal performance measured over the short, medium and long term;
- To differentiate and reward high performance and to proactively manage poor performance;

- To deliver reward programmes which are transparent, simple to administer and affordable to the business; and
- To deliver compensation and benefit strategies which have the oversight and approval of our Remuneration Committee. There are no minimum or maximum ratios.

#### 4.4 Remuneration Committee

The Remuneration Committee ('RemCo') is formed by the Chairman of Hermes and other directors who appointed in line with the business needs of the Group. The primary focus of the Committee continues to be centred on advising the Hermes Board on remuneration matters. This advice takes shape through policies and plans that are designed to motivate and retain high calibre executive directors, senior management and staff.

The Remuneration Committees responsibilities include:

- To determine and agree with the Board the broad remuneration policy and framework for the remuneration of Hermes Fund Managers Limited;
- To approve the annual remuneration (salary and bonus awards) of the members of the Executive Committee and to have oversight of the remuneration and performance rating proposals for the top 50 employees as measured by total remuneration and all current employees identified as Senior Managers and Code Staff during the performance year;
- Ensuring compliance with the FCA and other regulators' rules with regards to remuneration; and
- Director remuneration is reviewed by the Chairman and Hermes' Chief Executive and implemented, where appropriate, following approval of the CEO and Compensation Committee of the Board of Directors of Hermes' majority owner, Federated Hermes, Inc.

#### 4.5 Bonus and Incentive Schemes

**Bonus Scheme – Discretionary Bonus Scheme:** The purpose of the discretionary bonus scheme is to encourage all employees to deliver high levels of performance and demonstrate behaviours that are in line with the corporate values. The scheme has a co-investment/deferral structure. The level of deferral is dependent on the quantum of the bonus; all participants are put through the same deferral table. The award vests in equal tranches over 3 years. While the deferred element is notionally co-invested such that it tracks the performance of certain funds. Investment Professionals are required to notionally co-invest at least 50% of their deferred bonus against the funds they manage thereby aligning their interests to those of the shareholders and investors. The remaining percentage will be invested in the Company Managed funds. Non-investment Professionals notionally co-invest 100% of their deferred bonus against Company-managed funds.

**Executive Incentive Scheme 1 – Long Term Incentive Plan (LTIP):** The Long-Term Incentive Plan offers selected employees the chance to acquire beneficial ownership of ordinary shares in the Company. This plan was introduced in

2018 as a result of the acquisition of a 60% majority ownership in the business by Federated Hermes Inc. with the intention of retaining key senior employees and to align long-term interests of senior employees with clients and stakeholders.

#### CEO Scheme – Bonus Restricted Stock (Deferred Bonus):

The purpose of this award is to align interests of the CEO of Hermes with that of the majority shareholder, Federated Hermes Inc.

**CEO Scheme – Stock Incentive Plan:** The purpose of this award is to align interests of the CEO of Hermes with that of the parent company, Federated Hermes Inc.

#### 4.6 Decision-making Process

We ensure that remuneration decisions take into account the implications for risk and risk management of the firm, on the following basis.

The Heads of Legal, Risk & Compliance and Internal Audit provide the Risk & Compliance and the Audit Committee's with regular updates on any errors or breaches that may have occurred throughout the performance period. At the end of the period, the Control Functions are re-engaged by HR to ensure that any errors or breaches have been taken into account for making remuneration decisions. Where appropriate, a report of errors or breaches is provided to the RemCo for consideration in remuneration proposals.

The RemCo have the ability to apply discretion to adjust the bonus pool and any individual payments including those paid out in individual incentive schemes. The RemCo challenge bonus recommendations and are empowered and charged to approve or not approve recommendations put before them.

#### 4.7 Link between Pay and Performance

Below sets out a high-level description of our approach to measuring the performance of individuals including both financial and nonfinancial metrics, and explains how this assessment influences an individual's remuneration:

- The Performance Management Process requires all managers to review the performance and behaviours of their employees and to assign a rating to reflect their contribution throughout the year. The rating scale is 1-4 for performance and A-D for behaviour; A1 being highest. Both performance and behaviour are equally weighted;
- All roles are benchmarked against the market to ensure that their remuneration is comparable; and
- A rigorous review is undertaken to ensure a strong correlation between positive assessments and positive awards; and negative assessments and negative awards.

Throughout the different remuneration processes, there are layers of signoff and review, which include the Executive Committee and RemCo. The elements of compensation support the objectives – balancing risk with reward; and these discussions are underpinned by a robust assessment process; which is done on an individual, team and firm-wide basis.

#### 4.8 Remuneration Code Staff

We identify Code staff as follows:

- 1 **Executive and non-executive members of the management body** – This translates as the board members for each regulated entity;
- 2 **Senior Management** – We consider ExCo members as Senior Management;
- 3 **Control Functions** – Heads of Risk, Compliance, Audit, Legal and Finance;
- 4 **Staff responsible for heading investment management, operations, marketing and human resources** – Heads of Investments, Marketing, HR, Operations;
- 5 **Other Risk Takers** – Those roles who have a material impact on the funds are to be included under this such as Portfolio Managers, Traders, Sales and Investment Committee members where key decisions are taken or vetoed.
- 6 **Quantitative criteria** – Any staff member earning a total remuneration higher than that of those captured using the criteria above are to be looked at however if their role does not pose any material risk they can be excluded but only after proper rationale and evidence is collected and presented to RemCo for approval.

Once the list is established, it is reviewed by the Head of Compliance following which it is presented to RemCo for approval showing changes to previous year. 26 employees have been identified.

The aggregate annual remuneration of senior management who have a material impact of the risk profile of the firm is £6,830,570 in respect of the 2019 performance year. This is made up of fixed pay and variable pay for Senior Management.

The aggregate annual remuneration of other staff who have a material impact of the risk profile of the firm is £16,193,569 in respect of the 2019 performance year. This is made up of fixed pay and variable pay for Risk Takers and Control Functions.



## Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes. Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new strategies from the entire group.

## Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

For more information, visit [www.hermes-investment.com](http://www.hermes-investment.com) or connect with us on social media:

