Hermes Fund Managers Limited

Pillar 3 Disclosures as at 31 December 2015

Issued in November 2016 by Hermes Investment Management Limited.
Lloyds Chambers, 1 Portsoken Street, London, E1 8HZ. Registered No. 2466043 England & Wales.
Authorised and regulated by the Financial Conduct Authority.

Contents

1. Overview

1.1 Introduction

The Pillar 3 disclosures in this document are in relation to Hermes Fund Managers Limited ("HFML" or "Hermes").

The Capital Requirements Directive (CRD) requires firms to implement a framework which relates capital to risks and consists of 3 pillars:

- Pillar 1 sets out the minimum capital requirements for credit, market and operational risks;
- Pillar 2 requires firms and supervisors to assess the need for additional capital for risks not adequately covered by Pillar 1 by implementing an Individual Capital Adequacy Assessment Process (ICAAP). The ICAAP involves consideration of a range of risks faced by the group and determines the level of capital needed to cover these risks; and
- Pillar 3 deals with disclosure requirements and is to complement the minimum capital requirements of Pillar 1 and the risk-based processes of Pillar 2. The 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 is classified as a BIPRU firm and will not be captured by CRD IV requirements. Hermes remains subject to CRD III rules and remuneration requirements.

1.2 Frequency and Basis of Disclosures

Unless otherwise stated, these disclosures are based upon figures as at 31 December 2015.

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.

1.3 Scope of Application

Hermes is owned by the BT Pension Scheme (BTPS). Hermes has a number of companies falling within the Group, the main operating companies being:

- Hermes Investment Management Limited (HIML);
- Hermes Alternative Investment Management Limited (HAIML);
- Hermes Real Estate Investment Management Limited (HREIM);
- Hermes European Equities Limited (HEEL); and
- Hermes Equity Ownership Services Limited (HEOS).

HIML, HAIML and HEEL are separately authorised and regulated by the Financial Conduct Authority (FCA) and are limited licence BIPRU firms.

2. Risk Management

2.1 Overview and governance structure

Hermes' FCA regulated companies are all Limited Licence Firms and do not trade on their own account. Therefore they do not have any direct principal market risk (with the exception of nominal seed capital provided to the fund range). The companies' primary risk exposure is to operational and business risk.

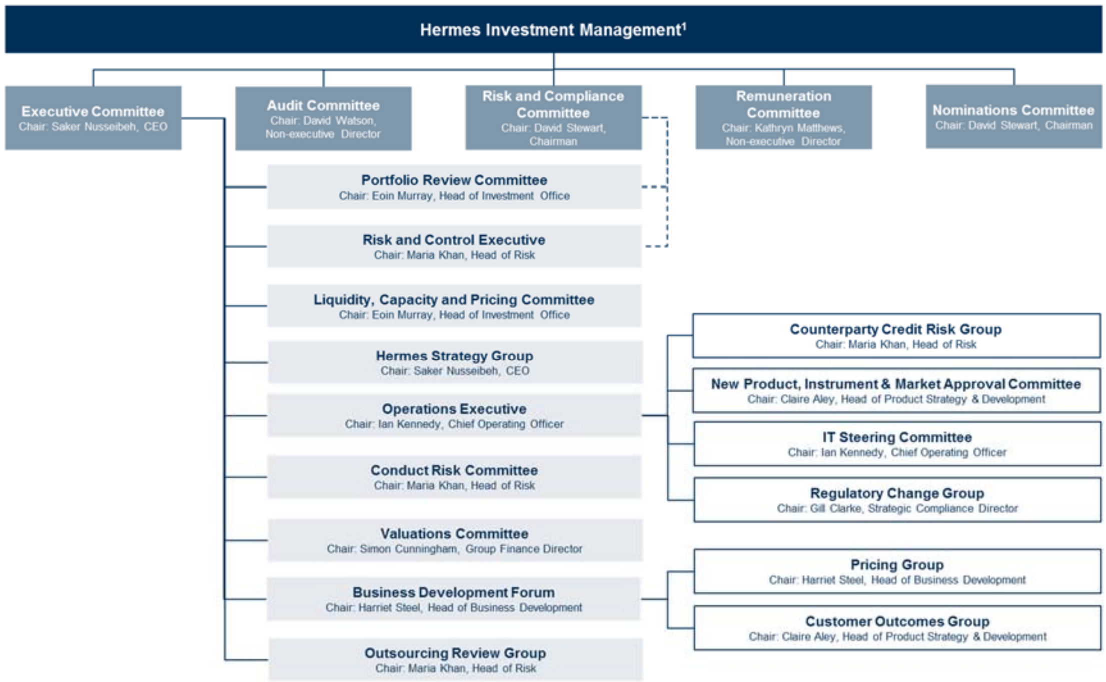
Key risks and uncertainties are managed at the Hermes Group level. Hermes' primary risk exposure is related to the possibility of a significant decrease in revenue arising from a decrease in assets under management (AUM) as a result of: a fall in market value, clients leaving or Hermes' inability to grow AUM. As Hermes' interests are closely aligned to those of clients the business strategy necessitates a conservative approach to risk. The Board has limited appetite for accepting operational risk. However, the Board recognises that no system of internal controls can fully mitigate the risk of error, loss or inappropriate activity occurring.

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

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

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

Governance Committees



[1] The legal entity Hermes Fund Managers Limited and its subsidiaries are branded for the external marketplace as Hermes Investment Management. As at 15 July 2016.

Executive Committee

The Executive Committee consists of the Chief Executive Officer, Chief Operating Officer, Head of Business Development, and Head of Private Markets – is responsible for all significant matters relating to the overall management of the Hermes business. This includes significant client issues, business development, human resources, finance, risk, compliance, legal, IT and operations.

Audit Committee

The Audit Committee is responsible for:

- reviewing and challenging, where appropriate, the actions and judgements of management in relation to the company's financial statements.
- reviewing and assessing the effectiveness of the risk management framework, systems, processes, procedures and controls in relation to the investment management activities for all portfolios, funds, and investment vehicles managed on behalf of clients. This also includes any administration services that HFML has contracted to provide.
- Reviewing and approving the HFML internal audit purpose, plan and programme and ensuring that the internal audit function is adequately resourced and has appropriate standing within the company.

- Approving the terms of engagement and the remuneration to be paid to the external auditor(s) in respect of audit services provided and monitoring / reviewing the work and output they provide.

In order to ensure complete transparency and independence, the Audit Committee is made up entirely of Non-Executive Directors, all of whom are also Board members. The Head of Internal Audit and Head of Finance are in attendance.

Risk and Compliance Committee

The Risk and Compliance Committee 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.
- Reviewing the relationships with and developments of the regulatory authorities in the UK and, where appropriate, other geographies where Hermes has a presence.
- In order to ensure complete transparency and independence, the Risk and Compliance Committee is composed entirely of non-executive directors of the Hermes board. Optional attendees include the Head of Risk and Strategic Compliance Director.

In order to ensure complete transparency and independence, the Risk and Compliance Committee is made up entirely of Non-Executive Directors, all of whom are also Board members. The Head of Risk and Strategic Compliance Director are in attendance.

Remuneration Committee

The Remuneration Committee meets approximately three times a year, with meeting frequency increasing in the run-up to the end-of-year bonus compensation period.

In order to ensure complete transparency and independence, the Remuneration Committee is made up entirely of Non-Executive Directors, all of whom are also Board members. The Chief Executive Officer is in attendance and the Head of Human Resources is an optional attendee.

Nominations Committee

The Nominations Committee meets on an ad hoc basis in order to approve any forthcoming Board appointments, as well as appointments of Executive Directors.

In order to ensure complete transparency and independence, the majority of the Nominations Committee is made up of Non-Executive Directors, with the Chief Executive Officer in attendance.

Portfolio Review Committee

The Portfolio Review Committee (PRC) supports the Executive Committee in the assessment and management of the investment teams, their corresponding processes and related activities. The committee has representatives from the Investment Office, Risk, Compliance and Client Relations. In attendance are the Head of Equities, Head of Fixed Income, Head of Private Markets and Head of Responsibility. Investment teams and representatives are in attendance as required by the PRC.

Risk and Control Executive

The Risk and Control Executive supports the Executive Committee and the Risk and Compliance Committee in the identification, measurement and monitoring of risks and controls throughout HFML. This, in the main, consists of identifying key operational and business risks to the business, monitoring key risk indicators across the business to ensure the effective operation of the controls framework within Hermes, ensuring compliance with FCA and other Regulatory requirements and making recommendations to the HFML Board and HFML Risk & Compliance Committee for the mitigation of key risks to the business.

Liquidity, Capacity and Pricing Committee

The Liquidity Capacity and Pricing Committee (LCP) supports the Executive Committee and has been established in order to regularly review the liquidity and capacity across Hermes' product range, to ensure as far as possible that Hermes is able to maintain its products' liquidity commitments to its clients.

Hermes Strategy Group

Hermes Strategy Group is responsible for helping the Executive Committee formulate and implement the long-term strategy of the firm, within the remit set out by the Board. The Group includes: ExCo, Head of Equities, Head of Fixed Income, Head of Human Resources, Head of Investment Office, Head of Marketing & Communications, Head of Responsibility and the Global Head of Stewardship. As required, invites will be extended to any of: Head of Risk, Strategic Compliance Director and Head of Internal Audit.

Operations Executive

The Operations Executive (OpEx) acts as a forum to assist and advise the Hermes Executive Committee on significant matters relating to the overall management of the Hermes business. This includes human resources (including reward), finance, legal, IT, operations or significant client issues. The OpEx ensures the delivery and coordination of support to the business areas. The OpEx has decision making authority but significant decisions affecting the business are deferred to the Executive Committee.

Valuations Committee

The Valuations Committee supports the Executive Committee and is responsible for drafting and monitoring on-going compliance with the Hermes Valuations Policy for all financial instruments and funds.

Business Development Forum

The Business Development Forum (BDF) is responsible on behalf of the Executive Committee 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 and Instrument Approval Committee in its assessment of the suitability and appropriateness of the new product; setting fees and pricing and; reviewing ongoing product and range suitability and profitability. The BDF is chaired by the Hermes CEO and has representatives from Business Development, Investment Office and Investment Solution and Product Strategy.

Outsourcing Review Group

The Outsourcing Review Group supports the Executive Committee and is responsible for reviewing all newly proposed outsourcing arrangements and for reviewing all of Hermes outsourcing arrangements to ensure compliance with Hermes outsourcing policy and regulatory requirements.

2.2 Control and oversight functions

Hermes has a number of independent control and oversight functions. On a day-to-day basis, business and firm risk is managed within Hermes via the Risk and 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.

The key responsibilities of each function are detailed below.

Risk

The Head of Risk has a reporting line to the Strategic Compliance Director with direct access to the HFML Chairman and the Chairman of the Risk and Compliance Committee.

The Risk team, together with Hermes senior management, continue to augment and embed Hermes' risk management framework, which includes:

- An ongoing assessment of the Governance Committee structure and their risk management responsibilities.
- Development of risk management metrics and risk management information to the Board and the Risk and Compliance Committee.

- The management of an operational risk system throughout Hermes in order to embed risk and control identification and assessment, together with self-certification of key controls performed by the business.
- Risk identification and control reviews to validate or challenge self-certification by the business.
- The development of new policies and improvement of existing ones where required.
- Ensuring Hermes' risk appetite is documented and cascaded to the organisation.
- Ensuring that the risks associated with new products, instruments and markets/locations are adequately considered.

Compliance

The Compliance team is responsible for ensuring that the Hermes regulated entities comply with the regulatory requirements. The Strategic Compliance Director has a reporting line to the Hermes Chief Executive Officer with direct access to the HFML Chairman and the Chairman of the Risk and Compliance Committee.

The Compliance team, together with Hermes senior management, continue to augment and embed Hermes' compliance framework, which includes:

- Act as the primary point of contact between Hermes and the regulators.
- Managing any potential conflicts of interest.
- Improving the monitoring of regulatory and client specific guidelines through the implementation of new systems.
- Ensuring that the risks associated with new products, instruments and markets/locations are adequately considered.
- Money Laundering and KYC responsibilities.
- Staff inductions and regulatory training.

Internal Audit

The Internal Audit team is independent of the day to day operations and management of the company. Internal Audit is an integral part of the Hermes internal control framework, and is fully committed to working closely with management and the Audit Committee. The Internal Audit function reports functionally to the Audit Committee and administratively to the Chief Executive Officer.

Internal Audit is responsible for providing independent, objective assurance and consulting activities to management through a systematic and disciplined risk based approach and assessment of the control framework at Hermes. This assessment is delivered through scheduled Internal Audits determined by an annual audit risk assessment process and plan, as presented to and approved by the Hermes Audit Committee. Special projects and investigations as requested by management, and approved by the Audit Committee, are also completed on key business activities.

Investment Office

The Investment Office works as an independent portfolio oversight body across all investment teams. Combining traditional fiduciary values with modern analytical techniques, it monitors fund positioning, risk and performance across the investment products. The portfolio oversight function is performed by a combination of risk and performance analysts and ex-money managers.

The Investment Office helps to ensure the delivery of sustainable risk-adjusted alpha, while providing timely warnings to the investment teams, Head of Investment and Portfolio Review Committee (PRC) when it identifies potential problem areas.

The Investment Office aims to identify the principal risks in the portfolio and the drivers of performance (both positive and negative) and relay this to the fund managers. In addition, the group monitor adherence to stated investment process and changes in decision making methodology and efficacy. It uses a combination of proprietary systems, off-the-shelf software and direct questioning to perform its duties. Where necessary, fund managers will be challenged to justify a position or view.

Should an issue be identified (such as excess concentration or factor exposure) the Investment Office will promptly discuss with the manager to manage or reduce the risk exposure, and prevent re-occurrence. If the issue cannot be resolved after discussion with the fund manager, it is escalated to the PRC. Alternatively if the issue is serious enough it will be escalated to the PRC immediately.

2.3 Hermes' key risks

The key risks that relate to Hermes are set out below. The majority of the risks affecting Hermes can be classified as operational risks, where a significant part of capital is assigned. Hermes ensures that appropriate controls are in place to manage these risks and these are monitored on a regular basis.

Operational / Business Risk - including:

- Technology, IT Security and Business Continuity Risks
- Strategy Execution Risk
- Reputational Risk
- People Risk
- Regulatory & Legal Risk
- Client Concentration Risk
- Change Risk
- Financial Promotions / Distribution Risk
- Material Error / Mandate Breach
- Unauthorised / Rogue Trading
- Outsourcing Risk
- Product / Instrument Risk

Credit Risk - Hermes acts as agent on behalf of its clients in dealing with market counterparties, and as such does not incur any credit risk to its own balance sheet or capital in relation to market trading activities. Whilst this risk rests with the clients themselves, Hermes must exercise due care, skill and diligence in its selection of counterparties as a failure to do so increases the operational risk for Hermes. Hermes will have credit risk in relation to its own funds, specifically:

- exposures to market counterparties (e.g. banks) where Hermes deposits are held; and
- fees receivable from clients.

Hermes seeks to mitigate counterparty credit risk through a number of measures, these include, settling trades on a delivery versus payment basis (equities and bonds), the use of a central clearer (futures), credit support annexes (CSA) to ISDAs (OTCs) and in relation to FX utilising Continuous Link Settlement (CLS).

Market Risk - Hermes, as investment manager, acts as agent on behalf of its clients and must manage the inherent market risk in accordance with clients risk appetite and investment parameters. Failure to have appropriate systems in place to manage client portfolios in accordance with client risk appetite and investment parameters represents an operational risk to Hermes.

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

Hermes receives income and pays expenses in foreign currency. 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 its working capital requirements, these amounts are converted into Sterling to minimise the FX exposure.

Hermes does not trade on its own account and only holds proprietary investments for hedging purposes. These investments are used to hedge the valuation movements on bonuses (Co-invest) that are linked to the value of Hermes' funds.

2.4 Individual Capital Adequacy Assessment Process (ICAAP)

Risk management and capital management is an ongoing process within Hermes. The process involves various activities, for example:

- 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 at least quarterly;
- Regular reporting to senior management and the various governance committees on the risk management process and also escalation process agreed for significant risks and issues;
- Regular review of risk appetite and tolerances;
- Stress and scenario analysis, and reverse stress testing;
- Risk and capital is considered as part of all strategic decisions;

- The Executive Committee and Board regularly review the risk assessment during their meetings and Board level agenda items are assessed against the risk assessment and capital needs of Hermes; and
- Capital requirements / financial forecasts are assessed quarterly by the Executive Committee.

The ICAAP is seen as a business as usual process within Hermes, with the Executive Committee and the Board involved in numerous ongoing discussions for review and approval. The ongoing risk management process and capital requirements are under constant review and the Hermes Executive Committee and Board actively participate in the risk workshops and review meetings. Given the structure of Hermes, the BTPS Trustees are also regularly on site so BTPS is also fully aware of the processes and requirements.

Regular risk reporting is in place, including the quarterly risk management information pack which contains an update on the capital position. The pack is discussed in detail with the Hermes Executive Committee with a summary also going to the Risk and Compliance Committee. The Hermes Board also review the financial position of the company at formal Board meetings on a quarterly basis. In addition, the Hermes Risk Appetite Statement contains key indicators for each of the risks within the Hermes risk assessment. The indicators act as an ‘early warning system’ in the monitoring of the associated risks. These are also collated within the quarterly risk management information pack to highlight any trends.

Going forward the Hermes Board will continue to formally review and approve the ICAAP on an annual basis. The Board will also revisit the ICAAP more frequently should any new material issues arise.

3. Capital Resources

3.1 Capital Resources and Capital Requirement

The majority of the operating companies within Hermes are BIPRU limited licence firms. They have adopted the simplified standardised approach to credit risk. The fixed overhead requirement forms the basis for the Pillar 1 capital requirement for Hermes, being significantly in excess of market and credit risk requirements.

A summary of Hermes’ Pillar 1 capital at 31 December 2015 is presented below. Hermes holds the largest proportion of its capital in the form of Tier 1 capital.

PILLAR 1 CALCULATION	Group Capital (£'000)
Credit Risk	4,308
Market Risk	531
Total Credit Risk + Market Risk	4,839
Operational Risk*	-
Fixed Overhead Risk (FoR)	16,384
Total Own Funds Requirement (higher of Credit + Market Risk or FoR)	16,384
PILLAR 1 TOTAL	**16,384**

* Operational risk is not applicable to the regulated entities.

In addition, Hermes also undertakes an ICAAP (see previous section) in accordance with the requirements to assess the need for additional capital to support the risks not adequately covered by Pillar 1. This process includes:

- a detailed analysis of the key risks to Hermes with input and approval from the Hermes Board and Risk and Compliance Committee; and
- stress and scenario analysis, which includes both single event and multi event scenarios.

The risks and scenarios are considered in relation to the financial forecasts, over a five year period to assess the impact.

Hermes' Pillar 2 capital requirement has been calculated to be £20,544,000.

As at 31 December 2015 Hermes' capital resources were £44,766,000 which was in excess of both the Pillar 1 and Pillar 2 assessments and the cost of orderly wind down of the business.

4. Remuneration Policy Statement (RPS)

4.1 Intro

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 2015.

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.

Rewards are set at levels such that excessive risk taking is not encouraged. Although not required, the Company has adopted many of the features of the BIPRU features for its remuneration practices such as: RemCo, deferrals, performance and risk adjustments, and risk committee input.

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.
- 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 provide competitive total remuneration potential, designed to attract, retain, motivated and reward employees to deliver outstanding investment and operational performance.
- To promote sound and effective risk management.
- To ensure remuneration if linked to investment, business and personal performance measured over the short, medium and long term.
- To be aligned with business strategy, objectives, values and the long term interests of Hermes and its clients.
- 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.
- 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 Company's Remuneration Committee (RemCo) is made up of independent non-executive directors who have the power to challenge awards that are recommended. They do not have a vested interest in the amounts being paid to any employees and do not participate in any Company-based incentive schemes.

The RemCo follows a Terms of Reference document which outlines its duties. Documentation is prepared for the RemCo in accordance with these guidelines. Information is shared between committees when it is deemed appropriate that, as it relates to remuneration, the RemCo should be aware.
The RemCo is empowered to engage external consultants for advice and these agreements are done so under terms of agreements.

The Company's policies are made available to relevant internal committees and bodies. Further, the initial drafts are supported by the external consultants and in conjunction with the FCA guidelines.

4.5 Bonus and incentive schemes

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.

Executive Incentive Scheme 1: Co-investment/Bonus Deferral Scheme

The purpose of the co-investment/bonus deferral scheme is to align short and long-term interests of employees with clients and stakeholders. It links a portion of eligible employees' discretionary bonus to the underlying performance of funds. The vehicle enables award values to increase and decrease in line with the true performance

Executive Incentive Scheme 2: Long Term Incentive Plan (LTIP)

The purpose of the LTIP is to align long-term interests of employees with clients and stakeholders. The LTIP operates as a profit-share and is designed to encourage profit growth over the 4-year profile. This strategy gives the recipients the right to share in the growth of the Company in the fourth year following the award grant.

Executive Incentive Scheme 3: Interim Profit Participation (IPP)

The purpose of the exceptional IPP is to transition participants in the previous EPP plan to the LTIP by aligning mid-term interests of employees with clients and stakeholders. The IPP operates as a profit-share and is designed to encourage profit growth over the 3-year profile. This strategy gives the recipients the right to share in the growth of the Company in each year following the award grant until the LTIP plan vests.

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 Head of Legal, Head of Risk, Strategic Compliance Director and Head of Audit provide the RemCo 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 to ensure that any errors or breaches have been taken into account for making remuneration decisions.

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 non-financial metrics, and explains how this assessment influences an individual's remuneration:

- The Company 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.
- All roles are benchmarked against the market to ensure that their remuneration is comparable.
- 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

All employees registered for a Significant Influence Functions (SIF) role and fund managers registered as CF30 who exert a significant influence over their area, plus non-UK staff who exert significant influence have been classified as Code Staff. 28 employees have been identified.