

# PILLAR 3 DISCLOSURES

as at 31 December 2016



## 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."

As at 31 December 2016 Hermes had £28.5 billion assets under management and advice (AUM). This figure includes £5.4 billion of assets managed or under an advisory agreement by Hermes GPE LLP (HGPE), a joint venture between Hermes Fund Managers Limited and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. Further, Hermes established Hermes EOS in 2004, one of the world's largest stewardship teams. Today Hermes EOS advises on £261.3 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 2016, Hermes managed money for more than 479 clients in 22 different locations across the world. Hermes is ultimately owned by the Trustees of the BT Pension Scheme (BTPS), which is also a major client of Hermes. As at the end of 2016, BTPS contributed circa 49% to AUM and 40% 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)**;
- **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 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 2016. <https://www.hermes-investment.com/>

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.

### 1.4 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 European Equities Limited (HEEL)
- Hermes Equity Ownership Services Limited (HEOS)

HIML and HEEL (BIPRU 50k) and HAIML (BIPRU 125k) are separately authorised and regulated by the Financial Conduct Authority (FCA). HGPE undertakes its own ICAAP and is not in scope of these Pillar 3 Disclosures.

## 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.
- **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-taking 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.
- **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 (KRIs), 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. The following four risk mitigation options are considered to manage the risks that the business faces, namely **Avoidance, Transfer, Reduction and Acceptance**.
- **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

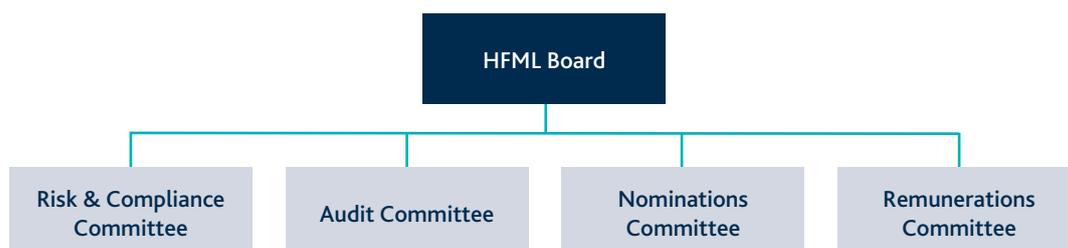
Hermes has implemented a bespoke Conduct Risk Framework which provides the formal structure ensuring that the Firm continues to keep pace with the increasing expectations for good conduct. Further, the Firm's core value of 'responsibility' and to always put clients first is at the heart of the Framework. 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.

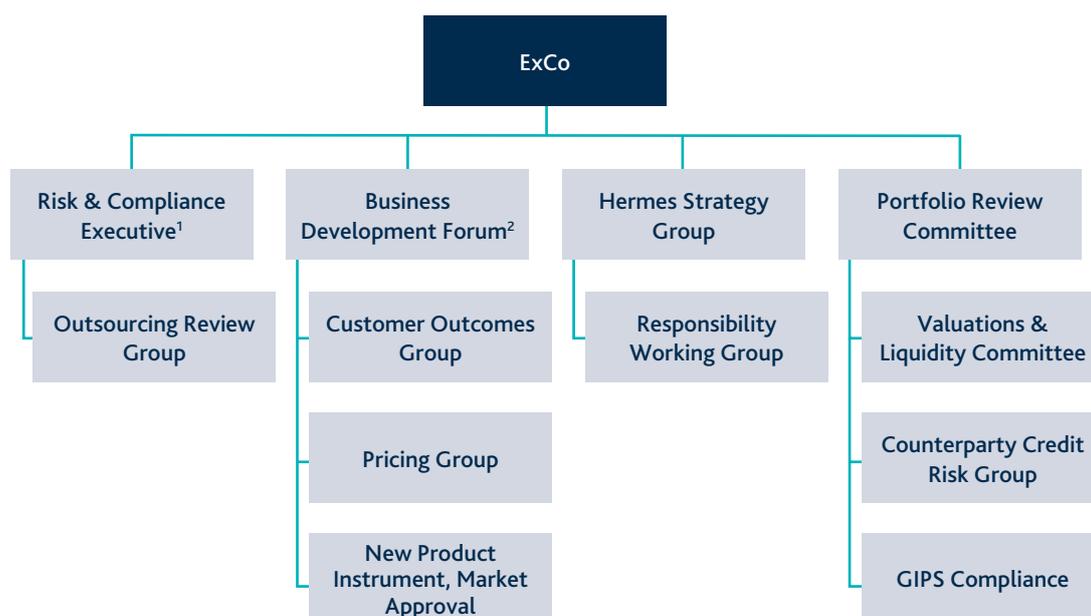


The Risk and Compliance Committee (RCC) is responsible for:

- 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.
- 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 RCC is composed entirely of non-executive directors of the Hermes board with attendance from the Strategic Risk & Compliance Director. Other staff are in attendance as required.

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

ExCo consists of the Chief Executive Officer, Chief Operating Officer, Head of Business Development, Head of Private Markets and the Strategic Risk & Compliance Director. 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 and reporting 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 Board, RCC and other relevant Committees for the mitigation of key risks to the business. RCE is attended by ExCo, Compliance, Risk, Legal and Audit.

### ■ 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 and, reviewing ongoing product and range suitability, target markets and profitability.

### ■ Hermes Strategy Group

Hermes Strategy Group is made up of senior members of the firm and is a discussion forum.

### ■ 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.

## 2.6 Control and Oversight Functions

On a day-to-day basis, business and firm risk is managed within Hermes by Risk and Compliance. 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 2016 decreased marginally to £104.0m (2015: £105.5m) primarily due to an increase in repeatable management fees offset by a reduction in performance fees. Assets under management increased by £5.5bn from £23.0bn to £28.5bn with management fees increasing to £95.7m (2015: £82.6m) driven by net new inflows and investment performance. Performance fees decreased to £6.5m (2015: £19.7m) as significant non-repeatable performance fees were generated in 2015 following the closure of the Hermes China strategy. The Group continues to deliver investment performance against the continuing backdrop of a challenging economic environment.

Capital Resources (All figures in £'000)	2016	2015
<b>Core Tier 1</b>		
Share capital	62,458	52,458
Retained earnings and other reserves	(17,333)	(18,021)
Audited Year End Profit	9,686	20,082
	54,811	54,519
<b>Deductions from Tier 1</b>		
Intangible assets	(735)	(1,103)
<b>Total Core Tier 1</b>	54,076	53,416
<b>Tier 2 Capital</b>		
Lower tier 2 capital	1,750	2,750
	1,750	2,750
<b>Deductions from total of Tier 1 and 2 Capital</b>		
Material holdings	(7,932)	(9,557)
Defined benefit pension asset	–	(1,844)
	(7,932)	(11,401)
<b>Capital Resources</b>	47,894	44,765

The commercial success at Hermes in 2016 provides the backdrop for the improved capital position. Capital resources are comprised of Tier 1 and Tier 2 capital. Tier 1 capital mainly comprises share capital and retained earnings. Tier 2 capital comprises a subordinated loan issued to HFML by its parent, BTPS.

The Board concludes that the firm is well capitalised, as it holds a significant capital resources of £47.9m (after deduction for goodwill and material holdings) as at 31 December 2016 and has sufficient liquidity. This figure is up from £44.8m as at the end of 2015. The outlook for the 2017-2021 plan suggests that the firm will maintain 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, for example:

- 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 Executive Committee;
- 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;
- Risk and capital is considered when change occurs. For example when 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 (e.g. MiFID II, SMCR, remuneration requirements), should a crisis occur, during times of significant market turbulence, if the HGPS pension deficit materially deteriorates; and when material changes are made to the Hermes risk assessment – considering if more capital needs to be set aside against increasing and/or new 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 sub-categories of operational risk at Hermes including: regulatory, legislative, reputational, operating model, change, employee, outsourcing, material (investment) breach or error, cyber risk, business continuity, data protection, 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 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.

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 the aid of subject matter experts across the business and incorporates internal and external operational risk data (e.g. RCSA, error events, regulatory implications, infrastructure spend, etc.). Using assumptions such as the typical and

worst case loss estimate, probability, and a correlation coefficient, these scenarios are run and the simulation multiple times at a given level of confidence. The output is reviewed and challenged throughout the process with approval provided by the HFML Board.

## BUSINESS RISK

The possibility the firm will have lower than anticipated profits or experience a loss rather than making a profit. Business risk is influenced by numerous factors, including key people risks, 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 Group 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 the 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 a USD/GBP and EUR/GBP FX forward to mitigate revenue exposure from FX movements. The hedging strategy is reviewed and approved by the HFML Board and implemented by the Finance department. In terms of other investments, there is some market risk arising from asset/fund price movements. The risk exposure is, however, nominal.

- 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.
- Nominal 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 in £'000)	Amount	8% RWE
Other receivables	6,093	487
Cash	2,492	200
Derivatives – Forward FX	23,000	1,840
<b>Pillar 1 Market Risk</b>		<b>2,527</b>

## 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.
- Fees receivables from clients or platforms.
- 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 in £'000)	Amount	Risk weight %	RWE	8% RWE
Sterling bank accounts and liquidity fund	67,358	20%	13,472	1,078
Foreign bank accounts	2,493	100%	2,493	199
Collective Investment Undertakings	10,049	150%	15,074	1,206
Other receivables	32,379	100%	32,379	2,590
Total Assets	112,279			
<b>Pillar 1 Credit Risk</b>				<b>5,073</b>

## 3.4 Capital Requirements

The Hermes Board has assessed the required level of capital for the period ended 31 December 2016 in order to mitigate potential future risk exposures that may arise in pursuit of achieving the firm's strategic objectives.

The capital requirement for 2017 is £24.7m, the highest of Pillar 1 (£19.7m), Pillar 2 (£24.7m) and the cost of wind-down (£23.4m). Hermes has £47.9m of capital resources, resulting in a capital surplus of £23.2m.

Hermes' ICAAP calculations (All figures in £'000)	2017 ICAAP (As at 31 Dec 2016)	2016 ICAAP (As at 31 Dec 2015)	Change	Change %
Pillar 1 Capital Requirement	19,731	16,384	3,347	20.4%
Pillar 2 Capital Requirement	24,741	20,544	4,197	20.4%
Orderly Wind-Down	23,438	17,120	6,318	36.9%
<b>Higher of Pillar 1, Pillar 2 or Wind-Down</b>	<b>24,741</b>	<b>20,544</b>	<b>4,197</b>	<b>20.4%</b>
Total Capital Resources	47,894*	44,766*	3,129	7.0%
<b>Capital Surplus</b>	<b>23,153</b>	<b>24,222</b>	<b>(1,069)</b>	<b>(4.4%)</b>

\* Included within this amount is a drawn down subordinated loan amount of £5m from BTPS, which is being amortised over 5 years in line with GENPRU 2.2.196 and has a value of £1.75m for regulatory capital purposes as at 31 December 2016. This loan qualifies as a lower tier 2 capital instrument. The subordinated loan is repayable over a five year period from date of draw down on a 5% fixed rate basis.

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 as overall repeatable Fixed Overheads have increased. Audited expenditure in 2016 has increased in comparison to 2015 as a function of the growing business.

The **Pillar 2** analysis shows that the risk profile of the firm (£24.7m) has increased on the previous year (£20.5m). The approach to the Pillar 2 calculation has changed since the previous year with the calculation now based around a statistical model that uses advanced Monte Carlo techniques to quantify risk scenarios derived from the firm's top risks.

The **Wind-Down** number (£23.4m) has increased from 2016 (£17.1m). The increase is primarily due to the analysis of staff costs at a team level which has resulted in more staff retained during wind-down.

## 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 2016.

### 4.2 Application to Proportionality

Given the 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.
- 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, motivate 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 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 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 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. 23 employees have been identified.

The aggregate annual remuneration of senior management who have a material impact of the risk profile of the firm is £6,318,700 in respect of the 2016 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 £9,284,136 in respect of the 2016 performance year. This is made up of fixed pay and variable pay for Risk Takers and Control Functions.

## HERMES INVESTMENT MANAGEMENT

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries 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.

### Our investment solutions include:

#### Private markets

Infrastructure, private debt, private equity, commercial and residential real estate

#### High active share equities

Asia, global emerging markets, Europe, US, global, and small and mid cap

#### Credit

Absolute return, global high yield, multi strategy, global investment grade, real estate debt and direct lending

#### Multi asset

Multi asset inflation

#### Stewardship

Active engagement, advocacy, intelligent voting and sustainable development

### Offices

London | New York | Singapore

The value of investments and income from them may go down as well as up, and you may not get back the original amount invested.

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