

ANNUAL REPORT AND FINANCIAL STATEMENTS

HERMES FUND MANAGERS LIMITED

31 DECEMBER 2017



Registered No: 1661776

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HERMES FUND MANAGERS LIMITED ABOUT US

We are 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.

Key facts

We manage £33.0bn on behalf of institutional and retail investors based in 24 countries around the world. Our investment capabilities span public and private equity and debt, infrastructure, real estate and multi asset solutions.

We help asset owners and asset managers actively engage on investments totalling over £336bn. These organisations collectively support more than 25 million current and future pensioners and savers.

We employ 377 talented individuals across the group, principally based in London, with other locations including Singapore and New York.

HERMES FUND MANAGERS LIMITED OUR YEAR IN BRIEF

2017 Financial and Business Highlights

Our mission is to help beneficiaries retire better. To achieve this, we aim to be the world's leading provider of long-term holistic returns for savers, thus creating value for all stakeholders in the financial system.

We understand that the way we achieve our investment objectives has an impact that is more than purely financial – it affects the world in which savers and beneficiaries live and the real value of their savings and incomes.

| OBJECTIVES | MEASURE | 2017 | 2016 | VARIANCE |
|---|---|---------------|---------------|----------|
| DELIVERING HOLISTIC RETURNS | Percentage of investment strategies with a three-year track record to beat their benchmark ¹ | 73% | 74% | ↓ |
| | Assets under management and advice ² | £33.0bn | £28.5bn | ↑ |
| | Assets under stewardship ³ | £336.1bn | £261.3bn | ↑ |
| | Number of companies engaged | 659 | 562 | ↑ |
| | Number of company and policy interactions | 1,735 | 1,691 | ↑ |
| EMPLOYEE ALIGNMENT | Employee turnover | 10.6% | 10.1% | ↓ |
| DELIVERING A SUSTAINABLE AND PROFITABLE FIRM | Statutory revenue ⁴ | £132.2m | £104.0m | ↑ |
| | Statutory profit (pre-tax) | £13.2m profit | £10.5m profit | ↑ |
| | Underlying revenue ⁵ | £136.1m | £111.8m | ↑ |
| | Underlying profit ⁵ | £28.7m | £15.5m | ↑ |
| | Third-party revenue (as a % of total revenue) | 70% | 59% | ↑ |

1 – Performance is calculated using published benchmarks for strategies. If a strategy does not have an official benchmark a performance target is used. A representative portfolio for each strategy has been used and not all portfolios are included in these calculations. It excludes private equity and infrastructure and strategies that do not have the required track record.

2 - The movement in assets under management and advice is explained in more detail on page 21.

3 - Assets under stewardship relate to Hermes Equity Ownership Services Limited (Hermes EOS).

4 - Statutory revenue represents the result as calculated in accordance with United Kingdom Generally Accepted Accounting Practice. Statutory revenue throughout the report relates to net group turnover as shown in the profit and loss account.

5 - Underlying profit and underlying revenue represents the result regularly provided to the Board as this is considered the most useful basis on which to manage the activities of the Group. The reconciliation for this is provided on page 8. Underlying revenue differs from statutory revenue due to the treatment of recharges to related entities.

HERMES FUND MANAGERS LIMITED

CHAIRMAN'S STATEMENT

Overview

2017 has been another successful year for Hermes, with long-term investment performance maintained, increasing sales and growth in both assets under management and assets for which we provide stewardship services.

Statutory profits before taxation of £13.2m were 25.8% higher than in 2016 (£10.5m), reflecting a combination of increased new business revenues and favourable equity markets.

Over 70% of our revenues are now generated from third-party clients (59% in 2016). Overall revenues were 27.1% higher at £132.2m (2016: £104.0m). Costs have increased to £124.2m (2016: £99.3m). This is due to a combination of investing in growth through recruitment, long-term incentive plan allocations, investment in systems to aid scalability and projects to meet the various structural changes we face, such as MiFID II, GDPR and, of course, Brexit.

Outlook

The political landscape has continued to be turbulent and the risks of increased protectionism that have been a feature of the last two years remain. In spite of this and the concerns of many analysts and commentators, equity markets have continued to strengthen, weathering tentative increases in interest rates in the US and UK. Valuations remain high by historical standards and volatility is likely to increase in a rising interest rate environment.

It was encouraging that the first phase of Brexit negotiations was concluded in a pragmatic fashion. While the daily flow of news, briefings and counter-briefings will continue to cause concern to many, we are cautiously optimistic that the long-term outcome will be satisfactory and of relatively low impact to our clients and our business. We are, however, planning for a range of outcomes and envisage some marginal changes to our business structure to ensure we can continue to serve all our clients effectively.

One of the most positive aspects of 2017 has been a fundamental shift in our industry towards what we call "holistic returns". The importance of considering the wider impact of investment decisions on society as a whole is becoming mainstream, whereas it was a fringe belief only a few years ago. Our growth in stewardship assets under advice for asset owners and asset managers is testimony to this, having doubled over the last 18 months.

We will continue to focus on delivering excellent long-term investment performance, sophisticated, industry-leading environmental, social and governance (ESG) integration and world-class stewardship services to our clients across the globe. The Board is confident that the business is well placed to continue delivering excellence to its clients and, with the rapidly growing demand for ESG-integrated investment strategies, accelerate its strong growth momentum.

HERMES FUND MANAGERS LIMITED CHAIRMAN'S STATEMENT (continued)

Culture

At the heart of Hermes is a deeply held belief that we have a duty to generate outcomes for savers and beneficiaries that go beyond investment performance to include the impact on companies, individuals and society as a whole. This belief permeates everything that we do as a business and is reflected in the Hermes Pledge, which you will find at the end of this report. The Pledge, which is voluntary, has been signed by 97% of our employees.

Our global leadership in ESG investing and stewardship was recognised when we won the inaugural *AsianInvestor* ESG Strategy Advisor award, one of a number of corporate and strategy-based awards we were proud to win this year.

The Board

After almost eight years' service, Kathryn Matthews stepped down from the Board at the end of January 2017. On behalf of the Board, I would like to express our sincere appreciation and gratitude for her contribution and wise counsel during her tenure.

Sally James joined the Board in April 2017. Sally served as Managing Director and General Counsel of UBS Investment Bank EMEA from 2001 to 2008. Previously she held a number of senior legal roles in investment banks in London and Chicago. She has been a Non-Executive Director of Moneysupermarket.com Group plc since April 2013, of Rotork plc since May 2012 and of Bank of America Merrill Lynch International Limited since February 2016. Sally is also a Trustee of the Legal Education Foundation.

Lastly, but most importantly, the Board would like to thank everyone at Hermes for their hard work and dedication over the last 12 months, which has led to our most successful year to date and positioned the firm strongly for the year ahead.



David Stewart
Chairman

4 April 2018

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT

Investment management is about people – it is about the clients who trust us with their investment and stewardship mandates. It is about the talented individuals who work in all areas of the business. It is about the savers and pensioners who rely on us to protect and grow their savings and pensions. It is about the people who work for the companies in which we invest, who live in the communities in which they operate and the places we help create. At Hermes, we see all these groups as equally important, hence our goal: to help people invest better, retire better and create a better society for all.

In this context, I am pleased to report that 2017 has been another successful year for Hermes.

Last year, I said I believed there was unstoppable momentum behind acceptance that asset managers had responsibilities far beyond the financial. 2017 has been the year in which this has been proved right. Across the spectrum of our industry, asset managers are emphasising their commitment to ESG and, in an increasing number of cases, asking for help through our stewardship service, Hermes EOS, to deliver effective engagement with the companies in which they invest. We are very happy to do so, and have seen stewardship assets under advice double over the last 18 months.

During the year we joined the United Nations Global Compact (UNGC). The UNGC is a call to companies everywhere to align their operations and strategies with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take actions that support societal goals as set out in the UN Sustainable Development Goals.

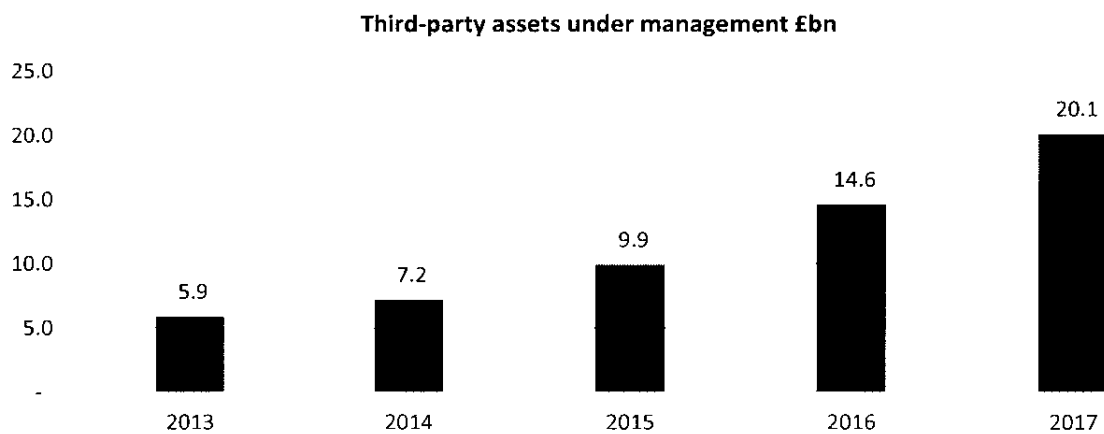
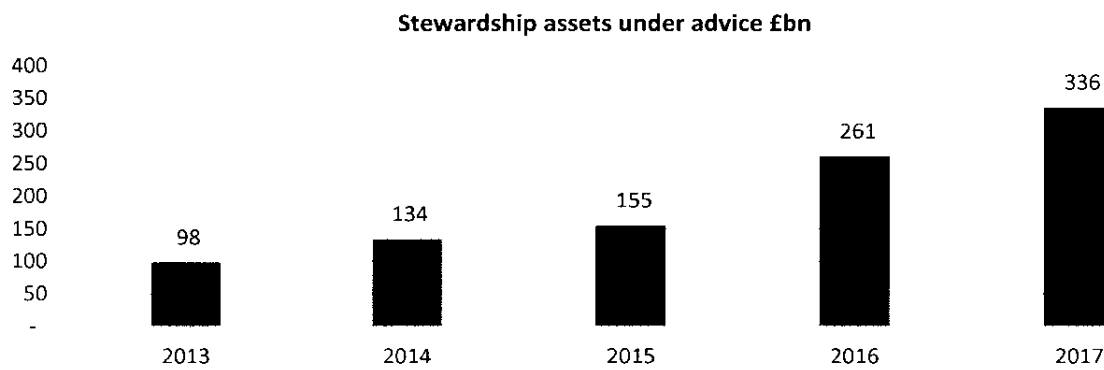
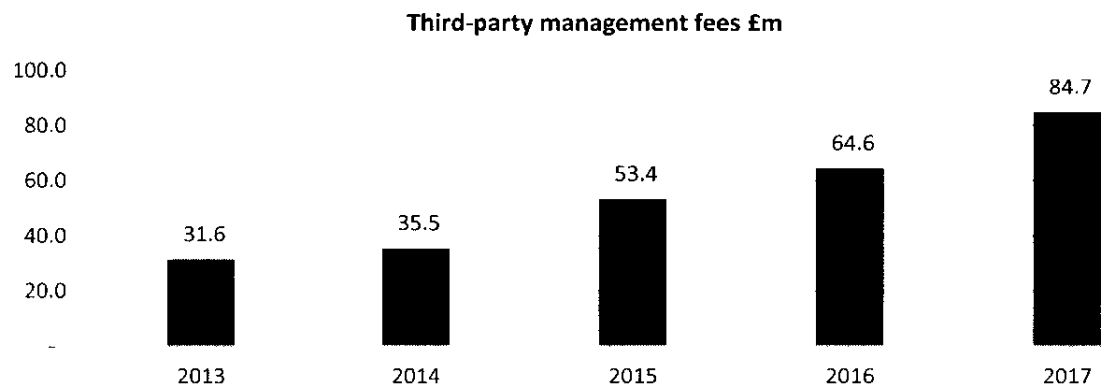
Being good is good business

In 2017, we continued to achieve strong growth in revenues, assets under management, stewardship assets under advice and profitability. Being good is, increasingly, good business.

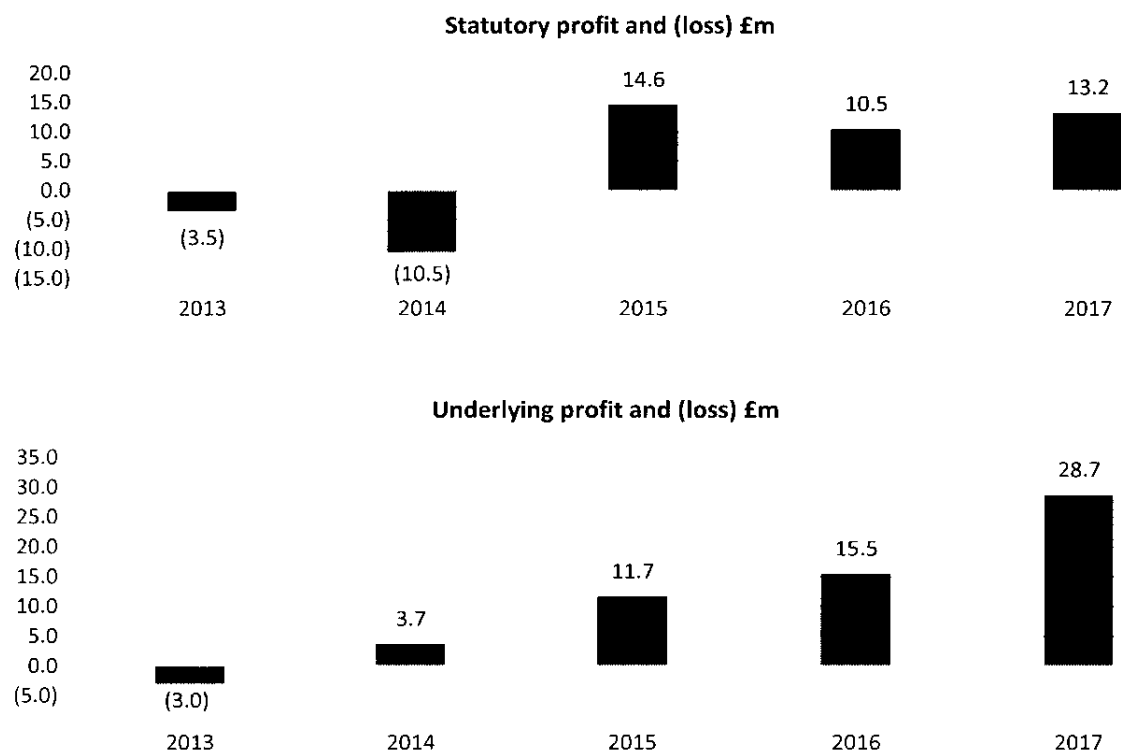
We have:

- ✓ Beaten our performance benchmarks in 80% of our investment strategies over five years to the end of December 2017
- ✓ Grown to serve more than 500 clients in 24 markets
- ✓ Increased third-party assets by 300% and third-party revenues to 70% of total revenues over the last five years
- ✓ Increased stewardship assets to £336bn – more than 100% growth in 18 months
- ✓ Engaged with companies with a combined market capitalisation of more than \$28tn on behalf of more than 25 million beneficiaries worldwide

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)



HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)



| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|-------|--------|-------|-------|-------|
| | £m | £m | £m | £m | £m |
| Statutory accounts pre-tax profit/(loss) | (3.5) | (10.5) | 14.6 | 10.5 | 13.2 |
| Add back goodwill amortisation | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 |
| Restructuring | - | 12.1 | - | - | - |
| Bonus deferral | (0.5) | 0.5 | (1.3) | (2.0) | (2.6) |
| Regulatory change costs | - | - | (3.0) | - | - |
| Non-recurring performance fee crystallisation | - | - | (3.6) | 3.6 | - |
| Other | (0.3) | 0.3 | 0.6 | (1.5) | 1.9 |
| Long-term incentive plan | - | - | 3.1 | 3.6 | 14.9 |
| Underlying pre-tax profit/(loss) | (3.0) | 3.7 | 11.7 | 15.5 | 28.7 |

Information provided to the Board is prepared on an underlying basis as this is the most useful basis on which to manage the activities of the Group. This result excludes a number of items that are not fully within the control of management. These items include goodwill amortisation, bonus deferral adjustments, long-term incentive plans, defined benefit pension charges and foreign exchange retranslation of non-sterling denominated subsidiaries.

Further information is included on page 19.

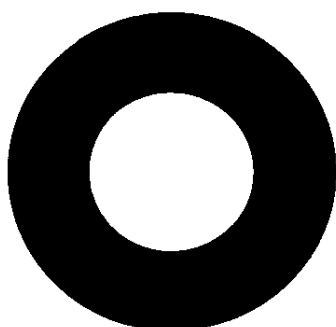
HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

At a glance

Assets

We invest across a broad range of asset classes, with equity and real estate making up the largest proportion of the Group's investments. Between all the asset classes, we currently manage £33.0bn.



- Fixed Income
- Equity
- Real Estate
- Private Equity
- Infrastructure

ALIGNED WITH THE NEEDS OF OUR CLIENTS

Underpinning our growth strategy is an intense focus on providing high value-add, sustainable investment returns, delivered holistically, with fees proportionate to performance and aligned with client objectives.

Our growth framework is structured to ensure we focus on areas where:

- There is long-term appeal from long-term investors.
- We can offer access to co-investment, club and joint venture opportunities alongside some of the world's leading institutional investors.
- We have a differentiated approach to the way we manage assets.
- We can enhance performance through the integration of ESG factors and active ownership.

Within this framework, we ensure our strategic decisions are aligned with at least one of our four growth pillars:

- Raising assets in our high conviction, high active share public market equity strategies.
- Broadening our range of benchmarked, unconstrained and multi-asset credit capabilities.
- Providing access to private market investment opportunities in infrastructure, private equity, private debt and real estate through a range of segregated, pooled and joint venture structures.
- Expanding our market-leading stewardship services and ESG-integrated investment propositions by offering clients a range of solutions for engagement, advocacy, active ownership and impact.

We believe that this combination gives us the optimum client-centric growth strategy, while enabling us to deliver the holistic outcomes that we seek.

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

Business Review

Financial highlights

Statutory profits before tax grew strongly to £13.2m (2016: £10.5m), an increase of 26%. Underlying profitability, which we regard as the better indicator of business performance, increased by 85% to £28.7m (2016: £15.5m). This was due to a combination of strong new business revenue growth and buoyant equity markets. Statutory revenues were 27% higher at £132.2m (2016: £104.0m). Underlying revenues were 22% higher at £136.1m. Over 70% of our revenues are now generated by third-party clients (59% in 2016).

Costs rose by 25% to £124.2m (2016: £99.3m) on a statutory basis. The increase was due to various projects, including MiFID II, GDPR and Brexit, and increased staff related costs including recruitment and long-term incentive plans.

Investment performance

Delivering sustained risk-adjusted outperformance is the prerequisite for gaining and retaining investment mandates, but increasingly, the ability to integrate ESG effectively has become a critical success factor in winning new business. We believe that our approach, which embeds the insights from our stewardship team, Hermes EOS, and their ability to effect change through long-term influence at board level, gives us an information advantage that is reflected in the long-term performance of our investment strategies.

At the end of 2017, 80% of our strategies had outperformed their benchmarks over five years and 92.3% had outperformed their peer group medians. Over one year, 69% of our strategies had outperformed their benchmarks and 47.6% their peer group medians. Over three years the figures are 73% and 94.1% respectively. In public markets, our active share was 85% and our asset-weighted information ratio 0.65 over a three-year period.

In our private markets strategies, our commercial real estate fund has outperformed its benchmark by an average of 2.3% over 10 years. Our primary infrastructure vehicle has generated an internal rate of return of 12.1% with a cash yield of 6.7%. Our private equity co-investment program has generated an internal rate of return of 23%.

Business development

BTPS reduced their shareholdings in a broad range of strategies by £2.1bn during the year. Net inflows from third-party clients of £3.1bn more than offset this, resulting in overall net inflows of £1.0bn including assets raised in our joint venture, Hermes GPE. On the same basis, net new third-party revenues of £36.1m represented our most successful year to date. Revenues from third-party clients have grown at an annualised compound rate of 37% inclusive of market movements for the last five years and now equate to 70% of our total revenues, compared with 59% at the end of 2016.

Our established markets of the UK and Europe continued to be the main drivers of new business, with the UK and Germany generating the highest levels of new revenues for the firm during the year. Global diversification has increased, with those markets representing 71% of new revenues in 2017, compared with 92% in 2016. This is due in part to our success in gaining new institutional mandates in North America, where our strategies screen well on consultant databases and where the ability to integrate ESG into investment is becoming more important.

HERMES FUND MANAGERS LIMITED STRATEGIC REPORT (continued)

Global diversification is also being driven by our focused Asian strategy, which resulted in 10 new mandates being awarded by sovereign, governmental and institutional clients located throughout the region, spanning our public and private equity, infrastructure and stewardship strategies.

While many of our public and private markets strategies proved popular to investors during 2017, the highest level of appeal globally was for our emerging markets capabilities, which grew strongly, with inflows from sovereign funds, public plans, corporate pension schemes, funds of funds and wealth managers. We will continue to monitor capacity in these strategies carefully to ensure that clients' interests are protected.

Our credit strategies also attracted strong flows, with the award of a High Yield ESG mandate from a leading Nordic pension scheme, a significant highlight for the year. In their words: "[Hermes'] innovative approach of pricing ESG risks in terms of spread in their fundamental credit analysis is leading in the industry." We are developing new multi-asset credit strategies for launch during 2018.

Brand recognition: Outcomes Beyond Performance

These three words are more than the headline of a marketing campaign. They are an encapsulation of our fundamental beliefs and a framework that enables us to demonstrate tangible evidence of how we go beyond the norm to deliver strong investment performance, while making a positive contribution to society as a whole. They now underpin all our brand-building activities.

Our brand is increasingly well known and regarded in Europe, thanks to our targeted, content-led sales and marketing strategy that effectively showcases our client-centric investment capabilities, brand ethos and ESG credentials.

Research from the MackayWilliams Fund Buyer Focus survey shows Hermes ranked in the top 50 asset management brands in several of our core European markets and rated as one of the most popular in the "new provider choice" category, ranking 16th across Europe and the first in the UK.

New provider choice in 2017 across Europe:

| | Ranking |
|--------------------|---------|
| All Europe | 16 |
| Belgium/Luxembourg | 12 |
| France | 15 |
| Germany | N/A |
| Italy | 8 |
| Netherlands | 17 |
| Spain | N/A |
| Sweden | 31 |
| Switzerland | 10 |
| UK | 1 |

HERMES FUND MANAGERS LIMITED STRATEGIC REPORT (continued)

Having established a strong brand in the UK and mainland Europe, we are extending our marketing and communications activities deeper into European markets where we are less well known and in Asia, using a range of traditional, digital and social communication strategies to reach diverse audiences.

Listed below are a selection of the awards we were honoured to receive in 2017.



HERMES FUND MANAGERS LIMITED STRATEGIC REPORT (continued)

Focus on placemaking

We are well known for our involvement in the transformation of King's Cross from a derelict wasteland into one of the most vibrant communities in London, delivering strong societal and financial benefits. This year has seen important milestones in three of our other regeneration projects in Birmingham, Leeds and Manchester

Paradise, Birmingham

Once known for its boarded up shops and crumbling buildings, Paradise has undergone a significant transformation in the last six years. Working alongside leading developer Argent and joint investment partners Birmingham City Council and CPPIB, this demonstrates our commitment to building long-term value and attracting subsequent global capital. The scheme has seen an upward trajectory of activity over the last 12 months with the topping out of landmark office building One Chamberlain Square, which moves one step closer to creating a leading and competitive international city.

The £700m investment at Paradise is delivering a new destination and is seen as renewing the civic pride that the city was once famed for. The creation of up to 12,000 jobs and founding of PwC's Midlands headquarters will help transform this area into a bustling commercial hub offering 10 new flagship buildings, offices, shops, bars, cafés, restaurants and a four star hotel across 17 acres upon its total completion in 2025.

Wellington Place, Leeds

A vibrant mixed-use community where over 12,500 people live and work, Wellington Place in the heart of Leeds is changing the face of the city and the way in which people work. At over an acre, it is one of the biggest public spaces in the city, with the historic Lifting Tower at its heart. Dating back to 1850, it was used to hoist wagons between the viaduct and the ground-level goods yard when the old Central Station was still in use – now it stands today as a lasting reminder of the city's industrial past.

Strategically located with exceptional transport links and offering flexible office accommodation, outstanding amenities, retail and culture facilities and open spaces, Wellington Place is a lively and distinctive destination. Standing out from the crowd, the entire development has been designed with sustainability in mind, using a low-carbon design alongside the latest technology to create energy-efficient offices that meet the growing demands of modern businesses.

Wellington Place aims to attract the best. In 2017 it was announced that 6,000 civil servants working for HM Revenue & Customs (HMRC) would relocate to a new, 378,000 sq ft state-of-the-art city centre premise in 2020, which stands as the biggest ever commercial property letting in Leeds.

Working alongside developer MEPC and a major international institution, our goal is to create a place of energy, optimism and personality, powered by people.

**HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)****NOMA, Manchester**

NOMA has seen significant improvement since its conception 10 years ago. We have played an integral role in changing perceptions of this area and have focused on employing a long-term strategy to achieve a first-class example of great placemaking.

Seen as one of the greatest drivers in creating the Northern Powerhouse, the 20 acre £800m scheme is the largest development project outside the South East of England, and puts community right at its heart. With over 6,500 people already working in the NOMA neighbourhood, there is ongoing strong demand for high-quality office space in the region and it is fast becoming one of the best-connected business destinations in the country, boasting excellent transport links. It even has its own pub, The Pilcrow Pub, which has been handcrafted by locals from the city and wider suburbs.

Upon completion the scheme will bring together homes, offices, hotels, shops, restaurants and bars to create a neighbourhood around a commercial hub that, we believe, will attract some of the biggest names in business. The development embraces the area's past and heritage by featuring a unique mix of historic and new buildings, and will provide an attractive, well-connected and sustainable environment.

Tackling modern slavery

In June 2017, we published our Modern Slavery Statement under the requirements of the Modern Slavery Act 2015 (MSA). Our objective is to ensure that there is no modern slavery or human trafficking in any of our business dealings. Due to the complexity of our supply chains, it will take time to investigate all tiers of each chain. We have therefore focused on the areas over which we have the most control: our own staff and contractors and our largest suppliers, who we are asking to sign a code of conduct committing to ending modern slavery.

We are also using our position as an active owner, both directly and on behalf of more than 25 million pension fund beneficiaries, to exert influence over other businesses.

HERMES FUND MANAGERS LIMITED STRATEGIC REPORT (continued)

In managing real estate assets, we believe that good human capital management, including the provision of fair living wages, robust health and safety practices, and investment in training and development programmes is the foundation of a stable and productive workforce and integral to businesses' social licences to operate. In 2016, we started including anti-slavery clauses in any new or renewed property management service agreements.

Since 2012, Hermes has been accredited as a Living Wage employer, affirming its commitment to provide all employees and on-site contracted staff with compensation and benefits above the London Living Wage.

Engagement, stewardship and sustainable investing

Climate change

Climate change will remain top of the investor agenda for the foreseeable future. There will be a push for more standardised disclosures, based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and increasing collaboration between investors globally in an attempt to move companies towards lowering their emissions. We will continue to engage with companies on the risks and opportunities arising from climate change and encourage them to report against the TCFD recommendations. Our own approach to carbon reduction is detailed in the Responsibility section of this report.

Diversity

The diversity of boards has caught the eye of investors over the past year. In the UK, we systematically opposed nomination committee chairs or board chairs if the proposed board composition did not meet our expectations on the representation of women directors. We will increase our efforts on diversity in 2018 by moving beyond gender and by looking at the issue below the board level.

At the same time, we recognise that we need to do better ourselves. Our gender imbalance, reflected in the gender pay gap and Women in Finance Charter, requires attention. We are putting new programs in place to address this and it will take time, but we are committed to increasing the level of female participation in investment and sales roles, which is where the greatest disparities exist.

One-share one-vote

Competition has increased between stock exchanges for initial public offerings globally. As a result, several stock exchanges, for example in Asia, have been considering whether to soften their approaches to listings of companies with differential voting rights. We have argued for adherence to the one-share one-vote principle, which is a prerequisite for effective stewardship, and will continue to do so.

Sustainable investing

In the latter part of 2017, we developed two new investment strategies that we will be marketing actively in 2018. The Hermes Impact Opportunities Fund invests in established companies that deliver positive benefits to society, aligned with the UN Sustainable Development Goals (SDGs). The SDG Engagement Fund, developed in partnership with a major global bank, is a small- and mid-cap strategy that also links to the UN SDGs, but additionally uses the willingness of the investee firm to engage and change as a fundamental part of the investment process. Both funds reflect investors' growing interest in strategies that explicitly set out to make a positive difference over and above their investment return.

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)**Investing for the future**

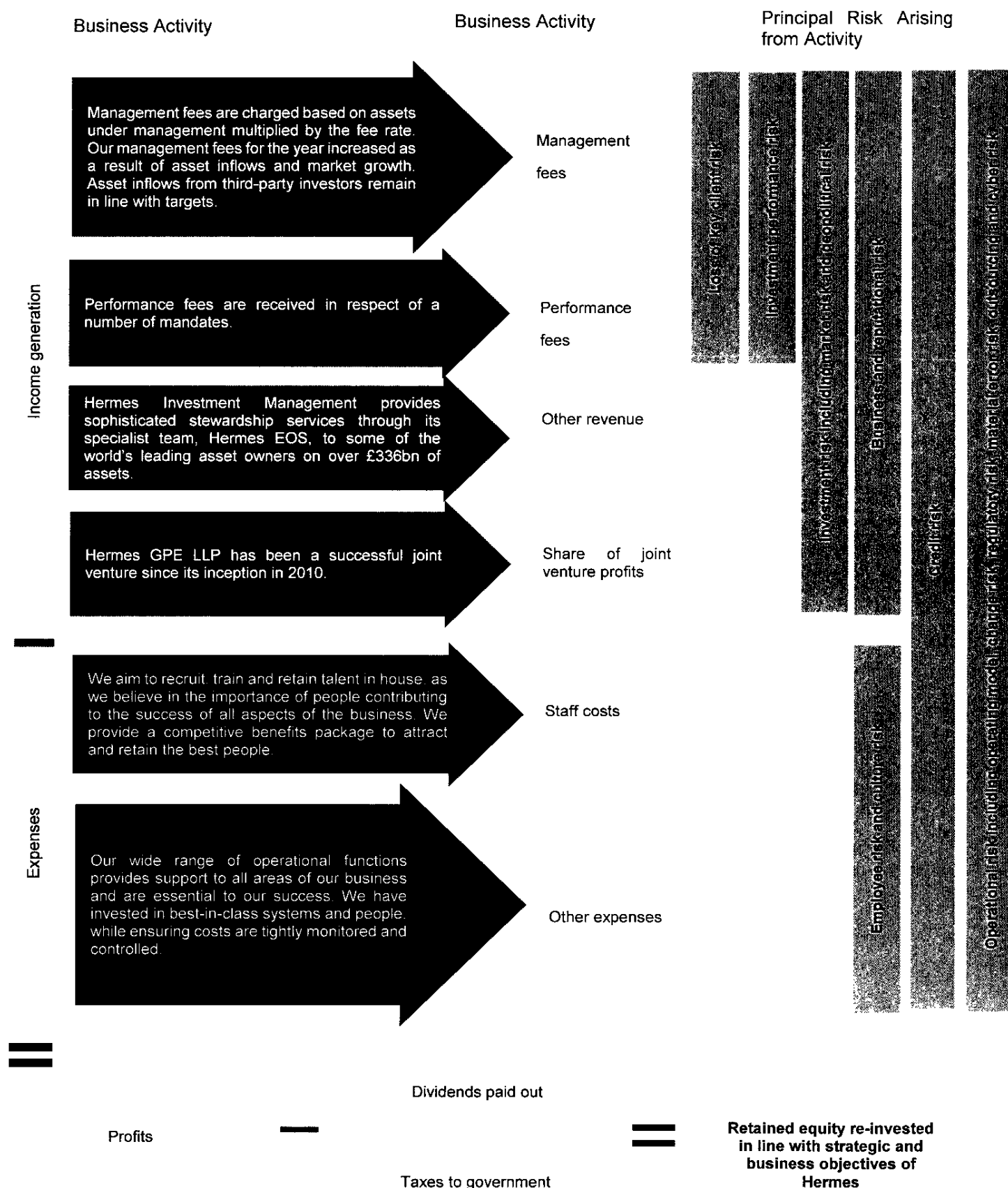
We continue to see considerable potential and will strategically invest to continue on our growth path, capitalising on the growing demand for ESG-integrated investment and stewardship. Our priorities are:

- Increasing our leadership in active ownership and stewardship, including the launch of impact and ESG engagement strategies to complement our mainstream investment capabilities, all of which integrate ESG factors and engagement.
- Expanding our credit and private markets capabilities with the launch of unconstrained and multi-asset credit strategies and an expanded direct lending platform.
- Raising assets in our high conviction, high active share public markets capabilities, while monitoring capacity levels to ensure clients' interests are protected.
- Deepening distribution relationships in our core markets of the UK and Europe.
- Continuing our growth in Asia by building on the strong relationships we have established and investing in the promotion of our brand.

At all times we will adhere to our principles of seeking holistic returns for our clients, the pensioners and savers who rely on them, and the societies in which they and we all live.

We will continue to advocate strongly for a financial industry that better serves the needs of society, and we will continue to engage with companies to improve their environmental, social and governance behaviours. In this way, we can help people invest better, retire better and create a better society for all.

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)
BUSINESS REVIEW



HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

Employees – attracting and developing talent

Hermes' success is built on strong values and the contributions of its employees. We aim to build a firm populated by excellent, motivated people, encouraging a culture of positive challenge across the business, for the benefit of our clients.

| | 2017 | 2016 |
|---------------------|------|------|
| Number of employees | 377 | 351 |

Our people make all the difference, so investing in their development is crucial to our continued success. Hermes aims to be a good employer, attracting and developing qualified and motivated people. It is the responsibility of every leader and manager throughout Hermes to create an environment where all our people can perform at the highest level, feel valued and be able to build upon their knowledge and skills.

| | 2017 | 2016 |
|-------------------|-------|-------|
| Employee turnover | 10.6% | 10.1% |

To develop future talent within the business, our Learning & Development team has created a suite of management programmes that span induction, skills and technical development, management development and professional studies.

A workplace that embraces diversity is important to ensuring that we are maximising the potential of our workforce. We recognise that diversity offers real benefits. We employ high-calibre people from many different backgrounds, combining talents and experience to deliver exceptional performance. As a forward-thinking organisation we have been active members of the 30% Club in the UK, supporting the goal of achieving a minimum of 30% women on FTSE 100 boards through our engagements with investee companies. We recognise the need to maintain the positive momentum, and to that end we were pleased to sign up to the Women in Finance Charter in 2016. As part of our commitment to the Charter, we have publicly set out gender diversity targets at multiple levels for the Group, as well as outlining a range of steps we are taking to support attainment of these targets. Importantly, we believe that diversity encompasses not only gender but also nationality, ethnicity, religion, cultural background, education, sexual orientation, personality differences, experience and skill sets.

Gender Diversity

| | 2018 target range | % female at 31 Dec 2017 |
|---|-------------------|-------------------------|
| Firm-wide | 35-50% | 39% |
| Board (including executive committee members) | 30-50% | 29% |
| Senior management level | 25-40% | 25% |

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)

Financial Review

| Statutory Accounts Pre-Tax Profit/(Loss) | 2017 | 2016 |
|---|------------------|--------------|
| | £'000 | £'000 |
| Turnover | 132,213 | 103,996 |
| Administrative expenses | (124,152) | (99,275) |
| Non-operating items | 5,111 | 5,753 |
| Statutory Group profit | 13,172 | 10,474 |
| Non-recurring performance fee adjustment | - | 3,600 |
| Goodwill amortisation | 1,334 | 1,335 |
| Regulatory change costs | 1,114 | - |
| Foreign exchange retranslation | 800 | (1,529) |
| Bonus deferral | (2,587) | (2,026) |
| Other | (10) | 56 |
| Long-term incentive plan | 14,880 | 3,634 |
| Underlying profit | 28,703 | 15,544 |
| Underlying profit margin | 22% | 15% |

Underlying performance

Information provided to the Board is prepared on both a statutory and underlying basis, however the results are reviewed primarily on an underlying basis, as this is the way in which to best manage the activities of the Group and measure the performance of the executive leadership of the business. This result excludes a number of items that are not fully within the control of management. These include goodwill amortisation, bonus deferral adjustments, long-term incentive plans and foreign exchange retranslation of non-sterling-denominated subsidiaries.

Other reconciling items include regulatory change costs relating to the implementation of MiFID II, which were recognised in full in 2015 in the management accounts, although these costs were recognised in the statutory financial statements in 2017. The charge for the year for the long-term incentive plan was £14.9m (2016: £3.6m). The increase in the charge to the profit and loss was due to the improved outlook for the group's future profitability and an increase in the share of future profits to be distributed to management.

The Group has achieved a statutory profit of £13.2m in 2017 in comparison to £10.5m in 2016. On an underlying basis the Group achieved an increase in profit to £28.7m due to the underlying revenue increase to £136.1m (2016: £111.8m). This is primarily due to higher management fees as a result of net inflows and elevated markets. The Group is now less reliant on performance fees and there are fewer mandates where such fees are earned. Assets under management and advice have increased to £33.0bn from £28.5bn in 2016. The increase is driven by the increase in third-party AUM, demonstrating the ability of the Group to deliver growth of the third-party business in line with the strategy agreed by the Board and our owner. This reconciliation is shown on page 21. The proportion of revenue from third parties has increased significantly to 70% compared to 59% in the prior year.

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

Financial Review (continued)

Operating costs increased by 25% in 2017, while the underlying profit margin has increased from 15% in 2016 to 22% in 2017.

The Group has a total tax charge of £0.6m in 2017 in comparison to a charge of £0.8m in 2016. The effective tax rate of 4.3% is lower than the UK corporation tax rate due to the utilisation of brought forward tax losses for which deferred tax had not previously been recognised. The Group has also recognised a deferred tax asset on brought forward losses of £1.8m, reflecting the fact that the Group is now profitable on a sustainable basis and is expected to have sufficient taxable profits to offset these losses in the future.

Financial position

Consolidated net assets as at 31 December 2017 were £50.9m (31 December 2016: £54.8m). The decrease is mainly due to derecognising the defined benefit pension scheme asset, which was offset by the capital contribution and the statutory profit after tax in the year. Cash balances at 31 December 2017 increased to £78.3m (2016: £69.9m) mainly due to statutory profit for the year (+£13.2m), a share capital injection (+£10m), an unsecured subordinated loan (+£20m) from our owners, and pension contributions (-£42.6m).

Hermes was the principal sponsor of the Hermes Group Pension Scheme (HGPS) until 15 December 2017. On this date, all future obligations to HGPS were transferred to BTPS by way of a Flexible Apportionment Arrangement. HGPS is a defined benefit pension scheme that was closed to new entrants in 2008 and was closed to future accrual in 2011. Hermes made a one-off additional contribution to HGPS of £35m and then derecognised the defined benefit pension asset.

The Group has both the financial strength and capital resources to support and execute its strategic plans. The Board and executive leadership remain focused on growing and developing our core business and continuing to increase third-party assets and revenues.

Regulatory capital

The Group continues to maintain a regulatory capital surplus above the capital requirement. The injected share capital of £10m and unsecured subordinated loan of £20m received from our owners form part of the year-end regulatory capital resources. Further details of the Group's approach to capital adequacy can be found on the Hermes website: <https://www.hermes-investment.com/ukw/about-us/policies-and-disclosures/>

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)

Financial Review (continued)

Tax governance

We comply fully with all relevant tax laws and regulations in all relevant jurisdictions in which the Group operates. We seek only to organise our operations, wherever they may be located, within the confines of all relevant local and international tax laws and regulations applicable. We have a transparent working relationship with HMRC and inform them of key transactions prior to implementation to gain certainty or clearance where the position may be uncertain.

The Group complies fully with all current Automatic Exchange of Information (AEOI) regulations. We will comply with any amendments to these regulations and the introduction of any new ones.

We monitor tax changes that may affect the Group and plan and prepare for changes, once full operating details have been announced, to ensure a smooth transition and continued compliance. In particular we are monitoring the OECD's Base Erosion Profit Sharing (BEPS) Action Plan and upon implementation of any of the Actions, by way of introduction into domestic legislation (in the UK or wherever the Group operates), we will comply fully with any new tax provisions that may result therefrom.

Assets Under Management and Sub-Advice (in £bn)

| | | |
|---|------------|-------------|
| At 1 January 2017 | | 28.5 |
| New funds raised | 7.2 | |
| Other redemptions, realisations and withdrawals | (6.2) | |
| | <u>1.0</u> | |
| Net new funds | | 1.0 |
| Market movement | | 3.5 |
| At 31 December 2017 | | <u>33.0</u> |
| <i>% increase in assets under management and sub-advice</i> | | 16% |

Please note the total assets under management figure above for Hermes includes assets under sub-advice of £1.6bn (2016: £1.5 bn) and includes £5.8bn of assets that are managed by Hermes GPE LLP, which is a joint venture between Hermes and GPE Partner Limited (2016: £5.4 bn).

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

Principal Risks and Uncertainties

The Group faces a number of risks in the normal course of business providing investment management and engagement services to institutional clients. These risks are managed by:

- adhering to our established business model;
- implementing an integrated risk management approach based on the concept of “three lines of defence”, which is outlined on page 32; and
- setting clearly defined risk appetites monitored with specific metrics within set limits.

The most significant risk facing the business is a downturn in economic conditions, which could impact the Group’s performance through lower demand for its investment management products, and lower investor risk appetite as a result of financial markets instability. Both would result in a decline in the value of assets under management. The majority of the Group’s activities are in specialist areas where our people have significant experience and expertise. Our commitment to our proven business model and strengthening financial position allows us to support our clients in all economic conditions. This assists us in our aim of developing long-term relationships with our clients. The Group carries out regular stress testing on its performance and financial positions to test resilience in the event of adverse economic conditions.

A summary of the principal risks and uncertainties that may impact the Group’s ability to deliver its strategy and how we seek to mitigate these risks is set out on pages 33 to 36. The risks identified remain broadly unchanged from the prior year, reflecting the Group’s consistent strategy and adherence to its established business model. The summary should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties faced by the Group but rather those risks that the Group currently believes may have a significant impact on the Group’s performance and future prospects.

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

Investment Review

Economic and market review

Central banks continue to face the challenge that the nominal growth recoveries since 2009 have primarily been output driven. Unemployment continued to decline in developed markets during 2017 yet, with output gaps slow to close and wage pressure capped, these recoveries again failed to generate enough inflation to trigger central banks' usual reactions.

Key interest rates in most advanced economies were therefore broadly maintained close to record lows. Within that, though, the US Federal Reserve was able to increase its main rate three times to 1.5%, and reinforce this effect by beginning to gradually wind down its QE-bloated balance sheet. In November, the Bank of England raised its base rate to 0.5%, reversing the reduction made following the 2016 Brexit referendum result.

In the US, real GDP stands about 14% higher than pre-crisis levels. The UK is approximately 10% higher. Yet, with the eurozone and Japan only up 5% since the crisis, the European Central Bank (ECB) and Bank of Japan maintained negative policy interest rates and continued to run their QE programmes.

Expectations that US President Trump could enact tax cuts and longer-term fiscal reform were positive for most growth assets. This helped US equity markets reach new highs, supporting global inflation expectations. This, combined with the US Federal Reserve's early attention to its balance sheet, put the near three-decade bull-run in government bonds under considerable pressure.

2018 outlook

Our macro outlook is based on five core beliefs.

First, the process of normalising interest rates will be long and slow. A decade after the crisis, central banks are loathe to lift the tide of liquidity hiding the sharp rocks beneath. With policy rates still close to the floor, "loose for longer" probably has years left to run.

Central banks consider neutral rates to be lower, meaning real rates will stay negative and peak rates will almost certainly end up below historic levels. The question is how central banks can reduce their exposure without unintended consequences, and emphasising the need to avoid taking financial markets off guard.

Second, we expect governments to offer fiscal solutions to add stimulus in order to appease disgruntled electorates. President Trump is attempting to reflate the US, and UK austerity has been deferred again. Japan still has every incentive to prolong a policy entering its twentieth year, while the ECB can taper its QE only if growing political tensions don't unravel the economic union that a monetary union demands.

Third, should protectionist forces build around the world, we expect inflation to reappear. In this scenario, we would expect it to be mainly cost-push in nature, led by tariffs, goods and labour shortages, rather than demand-pull. Central banks may then decide to take no action as economies stagflate, in the hope that inflation will then subside.

This could lead to a year polarised between the first and second halves. The initial stimulus from President Trump's proposed fiscal expansion could become muted by threats, perhaps nearer the mid-term elections, of protectionism. Congress might oppose his threatened tariffs, but he could still use Section 301 of the 1974 Trade Act to impose them without congressional or World

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)

Trade Organization (WTO) approval.

Fourth, China faces a macro dilemma of supporting growth, while minimising a boost to housing where affordability has deteriorated faster than elsewhere. President Xi will address the latter, but there is a limit to which policy will be tightened.

Lastly, for those emerging markets with high exposure to short-term external debt and foreign currency needs, the outlook in a more protectionist, strong US dollar, rising-yields scenario may be less positive. Encouragingly, most should be supported by the low level of their external debt ratios and the relatively few currency pegs in place.

By taking gradual, small steps to make monetary policy less accommodative, central banks will want back some fire power in case their economies subsequently slow. We expect that, in 2018, they will remain cautious of acting too aggressively and precipitating a downturn themselves.

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

Investment performance and stewardship

Over the longer term Hermes has continued to demonstrate its ability to deliver strong investment performance relative to both benchmark and peers.

For 2017, 69% of strategies outperformed their benchmarks. For those strategies that have a three-year track record, 73% outperformed their benchmarks as of 31 December 2017. In turn, Hermes' three-year asset weighted information ratio was 0.65.

For 2017, 24% of measurable strategies were first quartile and 48% above median. Over three years 47% were first quartile and 94% above median.

Portfolio analysis

As part of our commitment to engagement with investee companies as a means of supporting the delivery of holistic returns, we engaged with a percentage of the assets under management in the strategies listed below. This is shown in brackets after each strategy.

Asia ex-Japan

In 2017, the performance of the strategy exceeded its benchmark by 2.6%, with the since inception annualised relative return also 8.3% above benchmark. This outperformance was due to the strategy's country allocation and subsequently related currency exposure. The main detractors to performance were the negative stock selection in Taiwan and the strategy's allocation to cash. Relative to peers, the strategy has been first quartile in each year since inception (38% AUM engaged).

Global Emerging Markets

In 2017, the main strategy outperformed its benchmark by 7.5%. The annualised relative return since team inception was 4.7% above benchmark. The outperformance was driven primarily by stock selection in China, along with holdings in the United Arab Emirates, India, South Korea, Indonesia and South Africa. Relative to peers, the strategy remains first quartile over 1 year, 3 years, 5 years, and since inception (50% AUM engaged).

Global Equities

In 2017, the core Global Equity strategy exceeded its benchmark by 0.8%, with the since inception annualised return also 0.8% above benchmark. Although the Global Equity ESG and screened ESG strategies underperformed against their benchmarks for the year by 0.5%, the since inception annualised relative returns remained strong at 1.7% and 1% above benchmark respectively. In the main Global Equity strategy, key drivers of performance came from stock selection in Information Technology, Telecommunication Services, Real Estate, Financials and Health Care. These outweighed the negative stock selection in Consumer Discretionary and Industrials. Relative to peers, the main Global Equity strategy remains above median over three years, five years and since inception (73% AUM engaged).

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

Investment Review (continued)

Multi Asset

In 2017, the strategy outperformed the UK RPI by 0.3%, with the since inception annualised relative return 0.2% below benchmark. The enhancing portfolio was the main contributor to performance for the year, significantly outperforming the matching component. In terms of assets, the top contributors for the year were equities and risk factors; the main detractors were commodities, inflation break-evens and real assets. Relative to peers, the strategy ranked in the second quartile on a one-year basis.

European Equities

In 2017, the European Alpha strategy underperformed its benchmark by 2.8%, however since inception the strategy still remains 1.5% above its benchmark. Stock selection was the main driver of underperformance, particularly from the Consumer sectors and Health Care. This was partially offset by positive contributors from Industrials and Financials. The Europe ex-UK and Eurozone strategies ended 2017 outperforming their benchmarks by 6% and 3% respectively, with their since inception annualised returns 2.5% and 0.7% above benchmark. Relative to peers, all three strategies are above median on a since inception basis (69% AUM engaged).

US SMID/All Cap & Global Small Cap

In 2017, the US SMID, US All Cap and Global Small Cap strategies underperformed their benchmarks by 4.6%, 2.1% and 0.8% respectively. Since inception all three strategies outperformed their benchmarks: US SMID by 0.5%, US All Cap by 0.1% and Global Small Cap by 1.2%. For the US SMID strategy, stock selection in Producer Durables and Consumer Discretionary was the main detractor to performance, slightly offset by positive contributors from Consumer Staples and Technology. The Global Small Cap strategy, meanwhile, had a positive allocation effect that was subsequently offset by negative stock selection. Main contributors to performance came from Real Estate, Financials and Energy, while Materials, Health Care and Utilities detracted from performance. Relative to peers, all three strategies are above median on a since inception basis (24%-27% AUM engaged).

Credit

In 2017, credit markets globally continued an upward trend and subsequently resulted in positive absolute performance of our credit strategies, with High Yield returning 7.3%, Investment Grade 5.6%, Multi Strategy 5.6% and Absolute Return 3.2%. The main High Yield strategy outperformed its benchmark by 1.4% for the year, and on a since inception annualised basis was 0.5% above benchmark. Main contributors to relative performance came from Banking, Energy and Basic Industry, while Transportation, Retail and Leisure detracted. In terms of credit quality, our up in quality bias led to outperformance, and on a regional basis we saw significant outperformance from North America and Western Europe, but underperformance in our underweight in Asia emerging markets. Relative to peers, the Global High Yield strategy continues to deliver top-quartile performance over one year, three years, five years and since inception.

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)

Investment Review (continued)

Direct Lending

Since inception, on a net IRR basis, the strategy generated a return of 2.7% (versus long-term net return target of 3m LIBOR +4.5%). The positive return, below target, was driven primarily by fund establishment costs, along with the fact that the portfolio's investments have only been generating income for a limited period of time as the strategy only started in late 2016.

Real Estate

UK Core Real Estate, International Real Estate and Hermes Property Unit Trust delivered relative performance of 0.3%, -0.8% and 0.8% respectively in 2017. The Hermes Property Unit Trust continues to deliver top-quartile performance over three, five and 10 years. UK Core has also consistently outperformed its benchmark over one, three and five years. The Real Estate Debt strategy has outperformed its target three month LIBOR +2% by 0.9% for 2017 and also on a since inception annualised net internal rate of return basis. The strong performance of the strategy can be attributed to all loans achieving interest rates in excess of the target.

HERMES FUND MANAGERS LIMITED**STRATEGIC REPORT (continued)****Responsibility**

Our Responsibility Office exists to oversee the delivery of holistic returns across all aspects of the firm.

The concept of holistic returns itself was developed further in a paper entitled “The Why Question”, which we published in January 2017. This paper sought to question the purpose of the investment industry and contended that rethinking the “why” should in turn inform the answer as to “how” to reconnect capital with its underlying purpose. This challenge is one that continually informs our practices and our decisions, including the decision to absorb the costs of investment research from 2018.

We have continued to build on the good progress of past years in further embedding ESG and engagement integration across asset classes, leveraging and learning from best practice across the firm. This is illustrated by the groundbreaking research published by our Credit and Stewardship teams, which demonstrated the impact of ESG factors on credit instruments. While our Credit team has been integrating ESG considerations into their investment decisions for several years, this research is the first time a clear relationship between ESG credentials and performance has been proven from a credit perspective.

Engagement is, we believe, central to the delivery of holistic returns. During 2017, driven by the delivery of our Engagement Programme, we had 1,545 interactions with 659 companies on a range of ESG issues. During the year we also voted at 9,538 company meetings, voting against management at 55% of these meetings (as compared to 47.7% in 2016).

The introduction of stewardship codes or similar guidance around the world in recent years has, we believe, positively encouraged investors to monitor the companies they invest in, engage with them on a wider range of issues and exercise their vote. We have continued in 2017 to actively contribute to the development of stewardship codes and support their implementation, in particular in Asia. We have expanded the senior resource within our stewardship business, Hermes EOS, in order that we can cater for and support investors in fulfilling their stewardship obligations.

Climate risks and opportunity management

Since 2015 we have been continually developing our approach to managing our exposure to climate change risks and opportunities and their implementation across our investment and stewardship activities. This involves taking account of the specific challenges faced by each investment strategy and different asset classes, learning from our own experiences and industry best practice.

Our strategy has four components: Awareness, Integration, Engagement and Advocacy. They are set out in detail in our November 2017 paper, “The low carbon opportunity – and the risks of missing out”.

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

| 1 Awareness | 2 Integration | 3 Engagement | 4 Advocacy |
|--|---|--|--|
| Portfolio managers are aware of the carbon risks in their portfolios, which investments are the largest contributors and what are the associated risks and mitigation strategies | Portfolio managers integrate carbon risk considerations alongside other value and risk considerations, exploiting green investment opportunities or divesting where carbon risk alongside other factors impacts value | We act as engaged stewards of the investments we manage or represent on behalf of our clients. Where we hold assets with significant carbon risk exposure, we will manage directly-owned assets, and engage with public and private companies, to mitigate the carbon risk | We engage with public policymakers and sector organisations, nationally and internationally, to encourage policy or best practice which facilitates the transition to a low-carbon economy |

<https://www.hermes-investment.com/uki/blog/press/hermes-opportunity-knocks-thanks-need-tackle-climate-change/>

Governance and risk assessment:

We have established an internal working group to look at carbon risk and opportunity management, going beyond our current management practices and including making sense of 2-degree scenario planning as we seek to further strengthen our understanding and in turn our analysis of carbon risks and their impact on portfolios.

Managing climate risks:

Over the last three years we have been striving to make explicit our carbon risk management approach and we have been publically disclosing our activities annually. These covered 90% of our AUM as of 30 June 2017.

Our proprietary carbon footprint tool and strategy metrics go beyond portfolio-level aggregate statistics and focus on identifying patterns and outliers in our public market strategies. They form part of the risk analysis undertaken by our investment teams and our Investment Office and help investment professionals gauge the relative exposure of companies to climate change risk.

The most important finding of our public market carbon footprint analysis, given the concentration of carbon emissions in a limited number of companies, is that engagement is a powerful tool to address the risks of climate change. This year we have engaged with 51% of the Scope 1/2/3 carbon emissions in our portfolios. In addition, we recognise the importance of establishing cross-sector consensus for change and we are active among a number of sector initiatives, such as Climate Action 100+. As part of our advocacy programme we have been calling for a clear climate policy framework to enable scaling up investments, and in the last year we have worked with UK, EU and G20 policy makers.

Our real estate team has been focussed on the role of the asset class in achieving a transition to a low-carbon economy, and in particular the role it can play in scaling up finance for energy efficiency. This year represented the tenth successive year of like-for-like reductions in carbon emissions – indeed we have achieved a 14% decline in like-for-like carbon emissions across our real estate portfolio. Our annual Responsible Property Investment report continues to provide extensive detail of our approach and corresponding performance.

Hermes measures and offsets its own operational carbon emissions by working with Trees for Cities, <https://treesforcities.org/>. For every tonne of greenhouse gas emissions that Hermes generated from its day-to-day operations and its business travel during 2016, verified carbon offsets have been generated in 2017 by planting 3,159 trees in the open meadow known as Marnham Fields in Greenford.

HERMES FUND MANAGERS LIMITED**STRATEGIC REPORT (continued)****Corporate Citizenship**

At Hermes, we are particularly conscious that we should, as a company, strive to meet the expectations that we have of others. In addition to our behaviours as individual employees and the delivery of strong investment performance for our clients, we also believe we should lead by example as a firm and strive to make a difference, not only through our investment solutions, but in how we contribute to both the financial system and wider community.

In evidence of our commitment, we were proud to achieve the revised ISO 14001 requirement this year. Similarly, in recognition of the value of a diverse workforce and in line with our ongoing commitment to the Women in Finance Charter, our diversity and inclusion group, Unity, has grown in strength, delivering a timetable of events and workshops through the year. These initiatives cover a wide range of diversity, inclusion and wellbeing topics with the specific aim of promoting an open environment for people to be themselves in the workplace.

Our activities in the local community continue to be supported by our staff. These projects include a number of schools' programmes focussing on reading and numeracy, social mobility and employability skills, renovating local schools and gardens, and supporting those more vulnerable in our immediate vicinity in recognition of the huge disparities in wealth on our doorstep.

Notable partnerships include:

St Paul's Whitechapel CE Primary School

Hermes has been working in partnership with St Paul's Primary since early 2013, helping with reading, numeracy, increasing confidence and raising aspirations of the pupils.

Mosaic

Mosaic strives to inspire young people from poorer communities to realise their talents and potential. It also aims to rehabilitate young offenders in prison.

Business in the Community

Hermes is an active member of Business in the Community, the Prince of Wales' responsible business network. Members of the network tackle a wide range of issues that are essential to building a fairer society and a more sustainable future.

East End Community Foundation

The EECF has been dedicated to increasing opportunities for people living in London's East End for 25 years. Hermes is working with them on a number of initiatives to help raise educational achievement, enhance employability and increase social cohesion.

HERMES FUND MANAGERS LIMITED

STRATEGIC REPORT (continued)

Risk Management

Hermes has a strong risk culture, which emphasises the importance of rigorous controls and procedures to safeguard the interests of its clients and other key stakeholders. It is the responsibility of all employees to uphold the risk and control culture throughout all levels of the organisation.

The Role of the Board

The Board is responsible for maintaining and reviewing the effectiveness of risk management and internal controls and for determining the nature and extent of the risks it is willing to accept in achieving its strategic objectives.

For the Board to accomplish its responsibilities, it has established a governance framework consisting of the Risk and Compliance Committee, the Audit Committee, the Nomination Committee and the Remuneration Committee, all the members of which are Non-Executive Directors. Day-to-day management of the business has been delegated to the CEO, who has established an Executive Committee, as well as a number of oversight committees to support the governance framework, namely:

- Risk and Compliance Executive
- Business Development Forum
- Hermes Strategy Group
- Portfolio Review Committee

Risk Management Framework

A Group-wide risk management framework is in place to identify, measure and manage key risks and controls throughout the Group. The risk and control framework is founded on three pillars:

- Risk appetite: key parameters that set out how much risk the Group is prepared to accept
- Corporate governance; the legal, organisational and management structure
- Policies and standards: the rules that determine how the business should conduct itself

The Board regularly performs an assessment of the risks that affect the Group. Each business area is also required to perform a risk and control self-assessment specific to its own function. Business areas are required to warrant that all controls have operated effectively and to review their risk assessments semi-annually for any changes in the business, systems and processes. Risk owners assess risks in terms of impact and likelihood of the risks happening. All errors and breaches are recorded in an operational risk database, which allows for any failures in controls to be linked to the risk control self-assessment process. A suite of key risk indicators is in place to measure key risks against the risk appetite statement and the risk register.

HERMES FUND MANAGERS LIMITED STRATEGIC REPORT (continued)

Risk Management (continued)

The Three Lines of Defence

Hermes uses an effective organisation structure to operate on a three lines of defence basis, in which responsibility for risk-related decision-taking and management is embedded:

- First line: business and supporting functional areas
- Second line: challenge and oversight supporting the effectiveness of risk management, compliance and governance is provided by Risk, Compliance and Legal
- Third 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

Comprehensive insurance coverage provides an extra layer of assurance.

Capital Adequacy

The purpose of the ICAAP is to aid the Board to oversee how Hermes assesses and mitigates the key risks inherent in its daily operations and strategic pursuits and the governance frameworks that are in place to monitor those risks. Specifically, the ICAAP informs the Board of the ongoing assessment of the Group's risks, how the Group intends to mitigate those risks and how much current and future capital is required to hold against those risks. The ICAAP is formally undertaken annually, with more frequent updates made as necessary if a material change occurs. Stress and scenario testing have been developed in order to test the robustness of the Group's regulatory capital against a variety of events. Further details of the Group's approach to capital adequacy can be found on the Hermes website: <https://www.hermes-investment.com/ukw/about-us/policies-and-disclosures/>

Hermes' key risk exposures are grouped according to:

- Business risk
- Operational risk
- Market and financial risk (includes capital risk, credit risk, liquidity risk)

The following table summarises the key business risks and mitigating actions. The listing is for illustrative purposes only and is not a ranking of materiality.

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)

| Risk | Mitigants |
|--|--|
| 1 - STRATEGY (BUSINESS RISK) | |
| The risk that Hermes does not meet its long-term strategic objectives. The risk includes external threats such as technological innovation and/or new market entrants within the industry, reducing profitability and requiring fundamental change to the business model. | <p>Hermes has outlined its strategic aims, which are supported by the business operating model. Strategic planning includes an assessment of risks, client impact and consideration of risk appetite and capital. Indicators and financial metrics are in place to monitor progress against strategic objectives.</p> <p>A diversified range of products is offered, with regular new product launches to ensure that the offering remains in keeping with changing client requirements.</p> <p>A range of distribution channels mitigates against an excessive dependency on any single sales channel.</p> |
| 2 - LOSS OF KEY CLIENT / STAKEHOLDER SUPPORT (OPERATIONAL RISK) | |
| This risk relates to the loss of a key client or support from a key stakeholder (BTPS) and, therefore, having a detrimental impact on the firm. | This risk is mitigated by the firm growing its third-party offering (as demonstrated on pages 6-8) and diversifying its client base, while continuing to meet the requirements of its clients and stakeholders. |
| 3 – THE OPERATING MODEL (OPERATIONAL RISK) | |
| <p>The risk that the operating infrastructure is not fit for purpose, is inefficient or not scalable, failing to support strategic plans.</p> <p>The risks that technology systems and support are inadequate or fail to adapt to changing requirements.</p> | <p>Operational support to the business is based on middle office processes and controls that are performed in-house and back office processes undertaken by third-party service providers. The Operations department oversees that back office operations perform in accordance with expectations and to defined tolerances.</p> <p>Hermes relies on technology and qualified professionals to maintain its infrastructure and invests in IT accordingly.</p> <p>A robust governance structure exists with Board-level committees, e.g. Risk & Compliance Committee and Audit Committee, to review priorities, progress against plans, risks/issues, etc.</p> <p>Operational policies and procedures are reviewed and updated periodically and available to all staff.</p> |
| 4 – CHANGE (OPERATIONAL RISK) | |
| The risk that Hermes fails to deliver a major change initiative in a controlled manner or the risk that the initiative does not deliver expected benefits. This risk includes M&A and the failure for new ventures to align with the culture and vision of Hermes, and the organisation stress or process failures through potential demands on staff and resources. | There is in place a comprehensive change governance process including policies, procedures and senior management oversight directly and/or via applicable Board/ management committees. |
| 5 - EMPLOYEE RISK (OPERATIONAL RISK) | |
| The risk that key staff across the business leave or are not adequately motivated in their role, as well as excess reliance on a small number of key staff members (key person risk). | To mitigate people risks, the firm has competitive remuneration and retention plans in place, with appropriate deferred benefits targeted at key employees. In line with its principles, the Group puts in place sustainable succession and development plans. Clear objectives are set and success is measured in the annual review process, allowing the Group to identify motivational development initiatives for its staff including regular and sufficient training. |

**HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)**

| 6 - REGULATORY & LEGAL RISK (OPERATIONAL RISK) | |
|---|--|
| <p>The risk of regulatory or legal action resulting in fines, penalties, censure and/or legal action arising from failure to identify or meet regulatory and/or legislative requirements in those jurisdictions in which Hermes operates.</p> <p>This includes the risk that new regulations, or changes to the interpretation or implementation of existing regulations affect the firm.</p> <p>This risk includes the risk that tax requirements are not understood, implemented and complied with.</p> | <p>Hermes relies on its employees, with support from the Compliance, Risk, Finance, Tax and Legal functions, to consider carefully the obligations the Group assumes and compliance with them.</p> <p>Hermes maintains compliance procedures across the Group and compliance with relevant regulatory requirements is monitored in accordance with a risk-based programme.</p> <p>Key regulatory change risks are identified by Compliance as part of regulatory change monitoring and are also included on an emerging risks assessment where appropriate.</p> |
| 7 - MATERIAL ERROR / BREACH RISK (OPERATIONAL RISK) | |
| <p>The risk of a material error and/or investment mandate (guideline) breach.</p> | <p>A strong control environment exists at Hermes and is supported by detailed policies and procedures. Robust internal controls are in place to mitigate and monitor client and fund limits. All pre- and post-trade monitoring is automated.</p> <p>A formal errors and breaches process in place, which includes reporting and escalation, investigations, etc, to ensure that lessons are learnt/additional controls are implemented to prevent a recurrence. Root cause analysis reporting is undertaken for material matters.</p> <p>Insurance cover is in place to cover certain specified significant errors, breaches, regulatory, legal, conduct and other types of risk issues. Internal audits and external audits provide an extra layer of assurance.</p> |
| 8 - OUTSOURCING (OPERATIONAL RISK) | |
| <p>The risk that outsourcing plans are not aligned to the wider strategy or that outsourcers fail to deliver the expected benefits. The risk includes the failure of Hermes to oversee the outsourced relationship.</p> | <p>Before entering into outsourcing arrangements, the Group undertakes due diligence on outsource providers. A programme of regular oversight and assessment against agreed service levels is in place, overseen by the Outsourcing Review Group Committee.</p> |
| 9 - CYBER RISK / EXTERNAL FRAUD / BUSINESS CONTINUITY / DATA PROTECTION (OPERATIONAL RISK) | |
| <p>The risk that systems are vulnerable to third-party penetration, the risk of a payment fraud, or that the business cannot continue to operate to an acceptable standard in the event of adversity/disaster.</p> | <p>Hermes has a dedicated information security officer who ensures that robust processes are adhered to and who is responsible for monitoring cyber-crime attacks.</p> <p>Hermes has a data protection officer. As appropriate, any incident that has the potential to impact client and/or employee data is reviewed and reported.</p> <p>A business continuity programme is in place, all teams have a business continuity plan and an incident management team (IMT) has been established. Regular tests are planned in conjunction with the IMT and in accordance with the policy timeframe. A register of issues is kept and appropriate actions are taken to address matters in a timely fashion.</p> |

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)

| | |
|---|---|
| 10 – INVESTMENTS (BUSINESS RISK) | |
| <p>The risk that portfolios will not meet their investment objectives, adversely affecting levels of new business or fee income. This risk includes poor performance, liquidity, capacity and/or counterparty management subsequently impacting revenues and leading to reputational damage. The risk also includes failure to apply acceptable standards of ESG, sustainability and responsible investing.</p> | <p>The Hermes Investment Risk Framework provides monitoring and challenge of investment risks and performance across teams.</p> <p>The Hermes Investment Office independently monitors risk and ensures the rigour of team strategies. Investment teams adhere to clearly-defined investment processes.</p> <p>Various management committees such as the Valuations, Liquidity Capacity and Pricing and Portfolio Review are in place, providing an extra layer of mitigation.</p> |
| 11 – FINANCIAL SOUNDNESS | |
| <p>Risk of financial failure arising from lack of capital, liquidity or counterparty (credit) failure for the firm. This risk relates to the firm's own balance sheet and not the investment products.</p> | <p>Counterparty (credit) risk: Hermes has credit risk in relation to its own balance sheet, specifically exposures to market counterparties (e.g. banks) where Hermes cash is held and fees receivable from clients. Finance oversees regular monitoring of market counterparties and outstanding fees receivable.</p> <p>Liquidity risk: Monthly cash forecasts are prepared based on projected revenues and approved cost budgets to ensure sufficient liquidity is available at all times. Cash held on deposit is used as a liquidity source. Current assets significantly exceed current liabilities, with liquid cash reserves comprising approximately 62% of total current assets, demonstrating the ability of Hermes to meet current liabilities as they fall due in the ordinary course of business.</p> <p>Hermes maintains a high level of liquidity to ensure that the regulatory solvency requirements are continuously met. Hermes believes that a tolerance level of 1.25x current liabilities should be maintained in each entity, i.e. liquid resources are maintained at that minimum level</p> <p>Capital risk: Senior management, with support from Finance, monitors the current and projected capital resources and changing requirements. The Board maintains a level of solvency capital that meets the requirements of local regulators, including an acceptable margin of comfort above the local statutory requirements.</p> |

HERMES FUND MANAGERS LIMITED
STRATEGIC REPORT (continued)

| 12 – GEO- POLITICAL / MARKET RISK | |
|---|--|
| <p>Risks associated with political matters that could impact the governmental system and damage the economy and, therefore, impact Hermes negatively (e.g. reduced earnings). Market risk arises from market movements, which can cause a fall in the value of principal investments and a decline in the value of assets under management.</p> | <p>Hermes offers a diversified and broad product range that provides clients with solutions tailored to a variety of market conditions and serves to diversify individual market dependencies.</p> <p>Scenario analysis and impact is undertaken independently by the Investment Office to assess the performance of portfolios under a stressed environment.</p> <p>The Board has a limited appetite for market risk; therefore Hermes only holds proprietary investments for hedging purposes with the exception of nominal seed capital. These investments are only used to hedge the valuation movements on bonuses (co-invest) that are linked to the value of Hermes' funds.</p> |

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



S Nusseibeh
 Chief Executive Officer
 4 April 2018

HERMES FUND MANAGERS LIMITED

DIRECTORS

The Board comprises the following Directors:

| Name | Biography |
|--------------------------|--|
| D Stewart* (Chairman) | David is currently a Director of IMM Associates, Chairman of Caledonia Investment Trust, and a Non-Executive representative on the MacMillan Cancer Care Investment Committee. His prior experience includes nine years at Odey Asset Management, initially as CEO and latterly as a Non-Executive Director until standing down in December 2014. Before that, David's career encompassed Fidelity Investments (1994-2005), James Capel (1986-1994) and Swire Pacific Ltd, Hong Kong (1981-1986). |
| S Nusseibeh | <p>Saker is Chief Executive of Hermes, chair of its Executive Committee and an Executive Board Director. Saker joined the firm in June 2009 as Head of Investment and Executive Board Director. Saker was appointed Chief Executive in May 2012, having been acting Chief Executive since November 2011.</p> <p>Prior to joining Hermes, Saker was Global Head of Equities at Fortis Investments USA, having initially been appointed to the firm as CIO of Global Equities in 2005. Before this he was CIO of Global Equities and Head of Marketing for SGAM UK. This role followed SGAM's acquisition of Trust Company of the West (TCW), where Saker was Managing Director, running global and international strategies, as well as managing TCW's London office. He started his career at Mercury Asset Management in 1987.</p> <p>Saker is a member of the CFA Institute's Future of Finance Advisory Council, a member of the IIRC Council and Non-Executive Chairman of Carbon Tracker. He sits on the Banking Standards Board, the UK National Advisory Board on Impact Investing, and the steering committee for the United Nations Environment Programme Finance Initiative.</p> |
| S James* | Sally was appointed Non-Executive Director of Hermes in April 2017. Sally served as Managing Director and General Counsel of UBS Investment Bank EMEA from 2001 to 2008. Previously she held a number of senior legal roles in investment banks in London and Chicago. She has been a Non-Executive Director of Moneysupermarket.com Group plc since April 2013, a Non-Executive Director of Rotork plc since May 2012, and Bank of America Merrill Lynch International Limited since February 2016. She was a Non-Executive Director at Towry Holdings Limited from 2011 to 2016 and for UBS Limited from 2009 to 2015. Sally is also a Trustee of the Legal Education Foundation. |
| I Kennedy | Ian Kennedy, a chartered accountant, is Chief Operating Officer for Hermes, a member of the Executive Committee and an Executive Board Director. Ian joined Hermes in 2015, taking responsibility for Finance, IT, Legal, HR, Operations and Facilities. Prior to joining Hermes, Ian established InvestMe Financial Services LLC, a UAE-based investment advisory business in 2012. Before that, Ian held senior roles at Fortis and subsequently BNP Paribas following its acquisition of the Fortis UK wealth management and private banking division. His earlier career included roles at Dryden Wealth Management and Prudential Bache Ltd, where he started his career in 1992. |
| W McClory* | Billy was appointed Non-Executive Director of Hermes in August 2010. He was employed by Post Office Telecommunications from 1968-78 and became a National Officer of CPSA and then NCU in 1984, and CWU in 1995. At NCU he was responsible for pension matters in the Post Office and BT and he was the lead officer on pension matters for the BT Unions from 1990-97. He is a Trustee Director of the BT Pension Scheme and a member of UNITE (formerly the National Federation of Post Office & BT Pensioners). He is also a member of the Pensions Regulator's Investment Governance Group, the aim of which is to promote best practice in investment-related governance by occupational pension schemes. |

HERMES FUND MANAGERS LIMITED
DIRECTORS (continued)

| | |
|-----------|---|
| H Steel | <p>Harriet is Head of Business Development, a member of the Executive Committee and an Executive Board Director. She joined the firm in 2011 with responsibility for Sales, Client Service, Marketing, Communications and Product Strategy. Harriet was appointed to the Board of Hermes in 2013, becoming the company's first female executive director. Harriet chairs the Corporate Strategy Group, which develops the company's organic and inorganic growth plans.</p> <p>Prior to joining Hermes, Harriet led Portico Advisors, an asset raising and marketing advisory firm for alternative investment managers, including hedge funds, private equity and real estate strategies, which she founded in 2003. Her earlier career included roles in capital markets at Morgan Stanley and at Bankers Trust, where she started her career in 1990.</p> |
| D Watson* | <p>David is an Associate of the Institute of Chartered Accountants in England and Wales and was appointed Non-Executive Director of Hermes in July 2011. Currently, David is Senior Independent Director of Countrywide plc, Senior Independent Director and Chairman of the Audit Committee at TR Property Investment Trust plc, and Non-Executive Director and Chairman of the Audit and Risk Committee of Kames Capital plc. Prior to joining Hermes, David was the Chief Financial Officer (CFO) of Aviva General Insurance UK Division, and between 2003 and 2007 he was the CFO of Morley Fund Management, the asset management arm of the Aviva Group. Previous to this, he spent nine years at M&G Group Plc (now M&G Investments), where he was Group Finance Director, responsible for financial management and strategic development of the group.</p> |

* Non-Executive

| | |
|---|------------------------------|
| The following Directors were appointed to the Board during the year | S James (1 April 2017) |
| The following Directors resigned from the Board during the year | K Matthews (31 January 2017) |

Billy McClory does not meet the definition of independence in the UK Corporate Governance Code as he serves as a Trustee of BTPS, the Group's ultimate parent company; each of the other Non-Executive members of the Board and each Committee are considered independent.

HERMES FUND MANAGERS LIMITED

REPORT OF THE AUDIT COMMITTEE

STATEMENT FROM THE CHAIR OF THE AUDIT COMMITTEE

I am pleased to present the Audit Committee report for the year ended 31 December 2017.

The Audit Committee continues to be integral to Hermes' governance framework. During the year the Committee maintained its focus on assessing the integrity of the Group's financial reporting, reviewing the effectiveness of the Group's internal controls and monitoring and reviewing the activities and performance of both the Group's internal audit function and its external auditors, in particular, focussing on the transition to a new firm of auditors.



David Watson

Audit Committee Chairman

4 April 2018

MEMBERSHIP

The Audit Committee currently comprises three Non-Executive Directors: David Watson (Chairman), Billy McClory and Sally James (appointed 1 April 2017). During the year Kathryn Matthews also served on the Committee (resigned 31 January 2017). Members of the Committee are appointed by the Board following recommendations from the Nomination Committee.

Each member of the Committee brings relevant financial services experience from senior executive experience. Detailed biographies can be found on pages 37-38. David Watson, the Committee Chairman, is considered by the Board to have significant, recent and relevant financial experience.

RESPONSIBILITIES

The Committee's primary responsibilities are to assist and advise the Board. The scope includes, but is not limited to:

- reviewing and challenging, where appropriate, the actions and judgements of management in relation to the Company's financial statements, business review and any related formal statements before submission to, and approval by, the Board;
- monitoring and reviewing the activities, processes and performance of both internal and external audit;
- monitoring compliance with internal codes of conduct and other policies;
- monitoring the quality and integrity of the financial statements of the Company; and
- reviewing and challenging, where appropriate, the risk management framework, systems, processes, procedures and controls in relation to all investment management activity and administration services that the Company has contracted to provide to its clients.

HERMES FUND MANAGERS LIMITED
REPORT OF THE AUDIT COMMITTEE (continued)

An annual review of the Committee's Terms of Reference is undertaken to ensure that they are relevant and correct.

Committee attendance during 2017

| Member | Number of meetings eligible to attend | % of meetings attended |
|------------------|---------------------------------------|------------------------|
| David Watson | 5 | 100 |
| Sally James | 2 | 100 |
| Billy McClory | 5 | 80 |
| Kathryn Matthews | 1 | 100 |

WORK OF THE COMMITTEE DURING 2017

Major topics considered or activities performed by the Committee during the financial year were:

- review of the Group's financial reporting, financial statements and key accounting judgements;
- review of briefings on the latest consultation papers from regulatory and professional bodies on company stewardship and corporate governance;
- approval of new Group policies and material changes to existing policies;
- approval, monitoring and resourcing of the Internal Audit Plan;
- review and debate of issues raised in Internal Audit reports, including management responses;
- monitoring implementation of actions arising from the review of the external effectiveness of Internal Audit;
- active monitoring of the timely completion of agreed action points from past reports and escalation in the event of any material overruns, including consideration of, and if appropriate, approval of any deferral requests and related risk acceptance;
- the appointment, scope of work and findings of the external auditor and consideration of any conflicts of interest;
- consideration of the audit matters for the year and approval of actions required in respect of disclosures, statutory guarantees and deed of support from BTPS;
- consideration of the remuneration report disclosures;
- active monitoring of the defined benefit pension scheme, regulatory capital and capital funding requirements; and
- consideration of the impact of the governance matters arising at KPMG LLP South Africa in relation to the independence and suitability of the KPMG LLP UK firm.

HERMES FUND MANAGERS LIMITED

REPORT OF THE AUDIT COMMITTEE (continued)

SIGNIFICANT ACCOUNTING ISSUES

During the year the Audit Committee considered key accounting issues in relation to:

- **Premises costs:**
During 2017, the decision was made to move business premises with an intended move date of January 2018. As a result of this move, a number of accounting issues were considered and challenged by the Audit Committee, including accounting for an onerous lease, dilapidation provisions, the treatment of leasehold incentives and depreciation. The Audit Committee was in agreement that the accelerated depreciation and onerous lease provision for Lloyds Chambers should be recognised during 2017. They questioned and agreed the treatment of the dilapidation provision for the new building, 150 Cheapside. This has been capitalised as a leasehold improvement asset in accordance with FRS 102.17.10(c), and will be depreciated over the life of the lease. The lease incentive has been recorded as deferred income and the benefit of this incentive is recognised as a reduction of rental expense on a straight-line basis over the lease term.
- **Deferred tax asset:**
In the past, Hermes has not recognised a deferred tax asset in respect of brought-forward losses due to the uncertainty and timing of future profits. However, as Hermes is now sustainably profitable, the intention to recognise a deferred tax asset and its quantification was presented to the Committee. The Committee discussed the methodology of using a three-year period to forecast profits and challenged whether this was an appropriate term and whether the current forecast remained the best and most appropriate estimate of probable future taxable profits. The Committee was satisfied that this was an appropriate basis and, as a result, a deferred tax asset has been recognised in the financial statements.

EXTERNAL AUDITOR

During the year, KPMG LLP was appointed as auditor of the Hermes Group, replacing Deloitte, and this was their first year of audit.

The Group undertook an external audit tender last year, along with its parent, BTPS. Although there are no specific rules for mandatory audit rotation, the Audit Committee decided it would be good corporate governance to follow the rules applied to large PLCs requiring a tender every 10 years and to permit a maximum term of 20 years.

The Audit Committee monitors the performance, objectivity and independence of the external auditor. As it is the first year of the new auditor relationship, the Audit Committee discussed and agreed the scope of the audit plan for the full year, paying close attention to their approach to areas of judgement, significant accounting issues and to the methodology for calculating and the quantum of materiality. The Committee will carry out a further review of the effectiveness of the external audit process performed by KPMG LLP on completion of the audit.

KPMG LLP attended all Audit Committee meetings during 2017. At each meeting, they provided reports on topics such as the control environment, key accounting matters and mandatory communications.

HERMES FUND MANAGERS LIMITED

REPORT OF THE AUDIT COMMITTEE (continued)

The Committee monitors its policy on the use of KPMG LLP for non-audit services to ensure independence. KPMG LLP will only be appointed to perform non-audit work when they are best suited to do so and there is not a conflict of interest. Any non-audit work performed by KPMG LLP requires approval by the Audit Committee.

For a public interest entity, non-audit fees must not exceed 70% of the total fees following EU legislation introduced in June 2016. As Hermes does not fall within the definition of a public interest entity, it does not need to comply with this regulation, however it carefully monitors that the extent of such fees and the resulting ratio of non-audit to audit services is within the guidelines of this legislation.

The Audit Committee carefully monitored the actions taken by KPMG LLP following the widely-reported governance issues arising in South Africa and obtained written communication from KPMG LLP regarding this matter. The Committee are satisfied that this matter will not adversely impact the audit of the Hermes Group.

INTERNAL AUDIT

Internal Audit is independent of management and reports directly to the Audit Committee. The team has unrestricted access to all information as required to accomplish its audit objectives, including the permission to co-source with external advisers.

Internal Audit operates a risk-based audit cycle based on an assessment of risks within the Hermes Group. The annual audit plan is presented to the Audit Committee for approval, and for amendments where necessary.

The Head of Internal Audit has regular meetings with the Chairman of the Audit Committee and attends all meetings of the Committee to present reports on the internal audit findings and on the proposed future audits. The Audit Committee continues to monitor the internal audit plan on an ongoing basis to ensure that it remains relevant to the needs of the business and to ensure that it can be adapted or changed if required.

The Audit Committee is satisfied that the quality, experience and expertise of the Internal Audit function is appropriate for the business, and it periodically commissions external effectiveness reviews of Internal Audit in line with best practice.

EVALUATING PERFORMANCE OF THE COMMITTEE

The Board undertakes periodic self-assessments of governance, including its sub-committees.

HERMES FUND MANAGERS LIMITED

REPORT OF THE RISK AND COMPLIANCE COMMITTEE

MEMBERSHIP

The Risk and Compliance Committee ("the Committee" or "RCC") currently comprises four Non-Executive Directors: Sally James (Chair), David Stewart, David Watson and Billy McClory. During the year, the following Director also served on the committee: Kathryn Matthews (resigned 31 January 2017). The RCC, as a committee of the Board, deals with all matters that it considers appropriate. Each member of the Committee brings relevant financial services and senior executive experience.

The Strategic Compliance Director reports directly to the RCC. The Group Chief Executive Officer and/or Chief Operating Officer, Strategic Compliance Director, Head of Risk and Head of Investment attend meetings at the request of the Committee. The Chair of the Committee may also require other employees or external advisors to attend meetings as required to enable the Committee to carry out its responsibilities.

RESPONSIBILITIES

The Committee's primary responsibilities are to assist and advise the Board of Directors on:

- the Risk Management Framework and specifically the effectiveness of risk management, governance and compliance activity within the Group. The Committee will support the Board in its consideration of business activities that expose the business to material risk focusing on current and forward-looking aspects of risk exposure;
- the methodology and assumptions used in the Group's models for determining its regulatory capital, satisfying itself that the models are fit for purpose;
- ensuring adequate identification, measurement, monitoring and reporting on all types of risks including, but not limited to, business risk, operational risk (including regulatory risk), market/investment risk, credit risk, reputational risk and liquidity risk;
- ensuring that risk is properly considered in setting the overall remuneration policy for the Group and the remuneration of the Executive Directors and other senior executives;
- overseeing the management of relationships and registrations with regulatory authorities and to review developments and prospective changes in the regulatory environment; and
- any material or prospective legal actions involving the Group.

Committee attendance during 2017

| Member | Number of meetings eligible to attend | % of meetings attended |
|------------------|---------------------------------------|------------------------|
| Kathryn Matthews | 1 | 100 |
| Billy McClory | 6 | 83 |
| David Stewart | 6 | 100 |
| David Watson | 6 | 100 |
| Sally James | 4 | 100 |

HERMES FUND MANAGERS LIMITED
REPORT OF THE RISK AND COMPLIANCE COMMITTEE (continued)

WORK OF THE COMMITTEE DURING 2017

Major topics considered by the Committee during the year were:

- approval of the Risk & Compliance Plan and the Compliance Monitoring Plan;
- consideration of business continuity arrangements;
- consideration of the Money Laundering Reporting Officer's Annual Report and Risk Assessment;
- consideration of Brexit risks and planning;
- review of work on AIFMD arrangements;
- approval of the Internal Capital Adequacy Assessment Process (ICAAP) report (including risk assessment, errors and breaches, emerging risks, capital and liquidity, scenario analysis and stress testing);
- discussion of the FCA's Asset Management Market Study;
- review and discussion of the progress of the MiFID II project;
- discussion of FCA's Senior Managers and Certification Regime (SMCR) proposals and their implications;
- update on the General Data Protection Regulation (GDPR) project; and
- review, discussion and challenge of risk, compliance and investment reports and management information.

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE

MEMBERSHIP

The Remuneration Committee is constituted as a committee of the Board of Hermes Fund Managers Limited. Membership of the Remuneration Committee is formed by the Chairman of Hermes and other Non-Executive Directors who are appointed in line with the business needs of the Group.

The Remuneration Committee currently comprises four Non-Executive Directors, Billy McClory (interim Chair), David Stewart, David Watson and Sally James (appointed on 2 April 2017). Kathryn Matthews also served on the Committee until her resignation on 31 January 2017.

The primary focus continues to be centred on advising the Board of Directors 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 report continues to place an increased emphasis on remuneration disclosure in 2017, ensuring a continuous improvement in both the transparency and detail of the Group's remuneration reporting.

Transparency

The transparency of the disclosures mirrors public company disclosure, disclosing pay for executive directors and setting this in the context of the firm's performance. This aligns the principles with Hermes' recommendations for public listed companies, and this is discussed in detail in the report.

Stakeholder alignment

The Group believes that remuneration must be aligned with long-term performance, reflect strong risk management and encourage a responsible culture with regard to both investments and relationships with key stakeholders. It is important that the remuneration framework is clear, understandable and achievable in order to motivate and retain employees and ensure alignment with the strategic business targets agreed with the Shareholder. This is achieved by using a combination of fixed and variable compensation tools enabling management to encourage the right behaviours and strong performance over the short, medium and long term. Management is charged with applying their discretion as they steer the Company within a clear risk management framework. Management is supported in these responsibilities by the consistent application of the Company's performance and behaviour metrics used as part of the annual appraisal discussion. These have been reinforced by The Hermes Pledge, which underpins the importance of putting the client first and acting responsibly and transparently. An overview of how Hermes' remuneration policies align the interests of employees with the purpose is set out on the following page.

Strategy

Hermes' ongoing strategy is to build a world-class investment management business that delivers outstanding holistic return outcomes for clients and their beneficiaries, attracts strong inflows of third-party assets, and continues to meet and exceed the financial objectives. Hermes will continue to review remuneration policy in anticipation of this growth and with the changing shape of the Company. Individuals' remuneration will continue to be linked with the success and long-term growth of the Hermes Group.

HERMES FUND MANAGERS LIMITED**REPORT OF THE REMUNERATION COMMITTEE (continued)****Reward strategy principles**

As a private firm with a single shareholder, the principal-agent issues present in the public listed company sector are less prominent for Hermes. Indeed, representatives from the owner sit on the Board and the Remuneration Committee and are directly involved in developing and approving executive remuneration policy and outcomes.

Notwithstanding being a privately owned company, Hermes is aligned to those principles we have communicated to listed companies. There is a key focus on strategic delivery (we do not have a share price to distort focus) and rewarding both “the how” as well as “the what” in terms of operational and financial performance, and through representation on the Board there are clear lines of accountability to the owners.

Hermes remuneration philosophy and principles

The Group’s philosophy is to reward individual contribution, as demonstrated by the delivery of long-term sustainable results that are aligned with the business strategy, values and behaviours and that serve the best interests of clients, their beneficiaries and the owner, while enabling the business to maximize its potential.

Through focusing on long-term awards, the incentive pay strategies encourage employees to act like long-term shareholders and support the performance of the firm and its culture in order to create a sustainable business, while discouraging excessive risk taking. The risk appetite of the Group is closely monitored, and further discussed in the Risk Management section of the Strategic Report. Individual and organisational performance is transparently and rigorously assessed against a combination of financial (multi-year) and non-financial (multi-year) KPIs in order to determine the appropriate total remuneration that will attract and retain key talent.

The following page demonstrates how Hermes embodies these key principles.

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

Reward Strategy Principles (continued)

| Remuneration Principles promoted by Hermes | Specifics | How are they implemented at Hermes? |
|---|---|--|
| Shareholding Executives should make a material long-term investment in the company's shares | Long-term awards for senior management that encourage long-term success An approved ex-ante total cap on overall pay Commitment to not pay more than is necessary | Our long-term incentive plan operates as a profit-share and is designed to encourage profit growth over a four-year profile. It gives the recipients the right to share in the growth of the Group in the fourth year following the award grant. We do not operate a cap for individual pay, however the bonus pool was fixed at £37m inclusive of NI for 2017. Relative spend on pay is also monitored. Remuneration is reviewed annually and benchmarked to the external market. The Group will pay competitive and attractive, but not excessive, total remuneration in order to achieve outstanding performance. |
| Alignment Pay should be aligned to the long-term success and the desired corporate culture | Strategic performance metrics (rather than total shareholder return) to dominate incentive schemes Assessment of performance with use of relevant metrics focused towards impact on stakeholders To promote a sound and aware approach to risk management that is aligned with the firm's risk appetite, client needs and corporate objectives Tail risk built into pay structures | A proportion of key employees' deferred remuneration is delivered as fund awards, which are notional investments in funds managed by the Group, thereby aligning the short- and long-term interests of employees with our clients and stakeholders. Individuals are assessed on a combination of financial, technical and behavioural key performance indicators. Non-financial metrics include demonstration of Hermes' corporate behaviours as outlined in the Hermes Pledge. Individuals will be highly rated if they perform successfully while embodying the Hermes behaviours as conveyed in the Hermes Pledge. Further detail is discussed later in the report. The Remuneration Committee works closely with the Risk Committee to ensure that remuneration principles are governed by a sound and risk-aware management system. During the vesting period for deferred compensation, awards are subject to the malus clause in the plan rules. After vesting, awards remain subject to clawback. |
| Simplicity Pay schemes should be clear and understandable for both investors and executives | To deliver reward programs that are transparent, simple to administer and affordable to the Group | We have taken steps in recent years to simplify pay arrangements, with two complementary incentive schemes. The discretionary bonus rewards past performance and includes a deferred portion for ongoing alignment, while the LTIP provides a forward-looking motivational tool to deliver a sustainable business. |
| Accountability Remuneration committees should use discretion to ensure that awards properly reflect business performance | Ownership and accountability for pay outcomes, including greater use of discretion Publication of pay ratio | Our Remuneration Committee is consistently enhancing the disclosures we provide within the annual remuneration report. Total Variable Compensation is determined by the Remuneration Committee and recommended to the Board. Revenue and profit metrics are used for bonus pool funding. Profit acts as a hurdle that, unless cleared, will require the Remuneration Committee to review the bonus pool size – in light of its duties to the shareholder and the Board. The Remuneration Committee has overall discretion to adjust 100% of discretionary awards and has adjusted awards both up and down over recent years. We have disclosed our relative spend on pay and the ratio of total CEO pay as compared to median worker pay. Our CEO and fellow Executive committee members hold regular events in which they make themselves available to answer any questions from staff. |
| Stewardship Companies and investors should regularly discuss strategy, long-term performance and the link to remuneration | Greater quality of engagement along the ownership chain | Our owner is represented on our board and the Remuneration Committee, ensuring there is clear connection between us as a firm, our owner and our owner's underlying beneficiaries. |

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

Outline of individual pay elements of the Group

Individual pay elements support our purpose and align interests with clients and stakeholders

Fixed pay elements – base salary, retirement and other benefits

Provides competitive fixed pay at a level that reflects market compensation for the role. This applies to all employees.

- Assists employees with retirement and provides insurance coverage and other corporate benefits
- Determined by experience, duties and scope of responsibility, as well as internal and external market factors
- Reviewed annually, the Remuneration Committee considers, challenges and approves the budget requested by the Executive Committee
- Proposals are approved in accordance with the Remuneration Committee Terms of Reference

Bonus

Encourages all employees to deliver high levels of performance and demonstrate behaviours that are in line with the corporate values, thus aligning the interest of shareholders, investors and stakeholders.

Structure:

- The discretionary bonus scheme is for all eligible employees. Eligibility is based on service conditions.
- Individual awards are based on an assessment of an individual's performance and behaviours with reference to firm performance, team performance and market intelligence
- All bonus allocations are reviewed by the Executive Committee and the top 50 reviewed by the Remuneration Committee
- Based on the size of the bonus, an element is deferred and co-invested. Both the upfront and deferred elements of the bonus are delivered in cash, with the deferred portion co-invested in investment strategies to ensure alignment of interests (see next section for more detail)
- Leaver provisions: Good and Bad leaver provisions apply to the awards

Performance & Adjustment:

- The company-wide bonus pool is based purely on company performance
- Performance measures are based on revenue, profitability and margin. If the performance measures are not sufficiently met, the pool size is then determined by the Remuneration Committee's approval. Furthermore, the Remuneration Committee and Executive Committee are not obligated to fully distribute the bonus pool and should adjustments be required (risk or otherwise), they have the discretion to impose any relevant adjustments. 100% of the award is subject to adjustments
- The Risk Committee advises the Remuneration Committee about any considerations the Remuneration Committee should take into account.

Co-investment / bonus deferral

Aligns short- and long-term interests of employees with our clients and stakeholders. In particular, co-investment aligns the interests of investment professionals with those of the shareholders and investors.

Structure:

- The deferral scheme applies to all eligible employees whose bonus is £50,000 or greater
- Awards vest over three years in equal tranches (except in special circumstances) and the performance period does not restart each year
- Over the performance period, the underlying award notionally tracks fund(s) performance, and is adjusted in line with the performance of the fund(s). For the sake of clarity, it can be adjusted upward or downward
- For investment professionals at least 50% of their deferred award is notionally co-invested into the fund(s) they manage. The remaining 50% can also be notionally co-invested into the funds they manage, or the employee can choose to notionally co-invest in a basket of funds from across the Company. There is no retention period
- Non-investment professionals must notionally co-invest 100% of their deferred bonus award into a basket of funds
- During the vesting period for deferred compensation, awards are subject to malus. After the vesting, awards remain subject to clawback.
- Upon vesting, the change in performance during the performance period is applied to the vesting tranche. This mechanism is applied when performance increases, as well as decreases

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

Outline of individual pay elements of the Group (continued)

Individual pay elements support our purpose and align interests with clients and stakeholders

Long-term incentive plan (LTIP)

Aligns the interests of employees to those of the shareholder by encouraging employees to grow profits over the long term through sustained performance. The LTIP operates as a profit-share and is designed to encourage profit growth over the four-year grant period. It gives the recipients the right to share in the growth of the Company in the fourth year following the award grant.

Structure:

- Participants are selected at the discretion of the Executive Committee and approved by the Remuneration Committee on the basis of an employee's projected ability to influence the company over the performance period, and can be in any part of the Company. Eligibility is reviewed on an annual basis.
- Profitability is measured following the close of the fourth year of the award; the award is calculated on a proportional basis for all participants in that year's allocation.
- The award vests as a single amount after four years and is subject to plan rules being fulfilled.
- The vested award is delivered to the recipient as a cash payment
- Good and bad leaver provisions apply to the award
- Upon vesting, participants have no further right to the awards. There is only one annual allocation per year.

Performance & Adjustment:

- If a decision is taken by the Committee to restrict an award (to any degree), it will prevent an award from being paid to the employee.

Interim Profit Participation Plan (IPP)

Transitions participants in the previous Equity Participation Plan to the LTIP and aligns the mid-term interests of employees with clients and stakeholders. 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. This plan was closed to new participants from the 2015 performance year.

Structure:

- Participants can work in any part of the Company
- Profitability figures are measured following the close of each performance year; the award is then calculated on a proportional basis for all participants in that year's allocation
- The awards vest annually over 3 years and is subject to plan rules being fulfilled
- Upon vesting, participants have no further right to the awards. There is only one allocation.
- Good and bad leaver provisions apply to the award
- The vested award is delivered to the recipient as a cash payment

Performance & Adjustment:

- If a decision is taken by the Committee to restrict an award (to any degree), it will prevent an award from being paid to the employee

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

Assessment of performance

Below is a description of the 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 competitive without being excessive.
- A rigorous review is undertaken to ensure a strong correlation between positive assessments and positive awards, and negative assessments and negative awards.
- Non-financial metrics include demonstration of corporate behaviours, and successfully delivering agreed objectives.

Remuneration ratios

The compensation to net revenue ratio, bonus to revenue ratio and CEO to median employee ratio form part of the key remuneration measures. These measures allow us to benchmark performance against industry peers and align compensation with the Company's financial performance. For 2017, the Board and the Shareholder approved a bonus of £37m inclusive of NI for the 2017 performance year, equating to a bonus to revenue ratio of 27%.

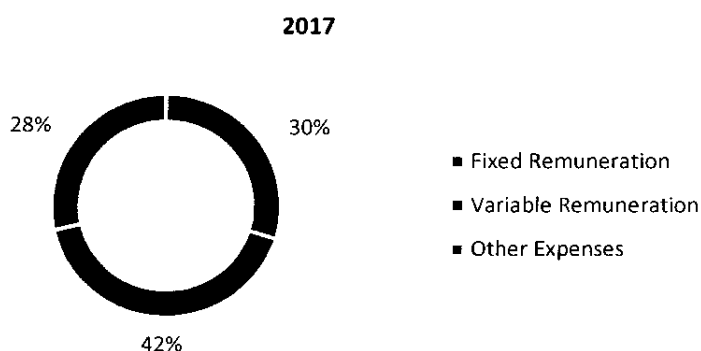
| Relative Spend on Pay | | |
|--|------|------|
| Ratio | 2017 | 2016 |
| Compensation ratio | 55% | 53% |
| Total compensation for employees /net underlying revenues | | |
| Bonus to revenue ratio | 27% | 27% |
| Bonus/Underlying Revenues *100 | | |
| CEO to median employee pay | 23x | 20x |
| Total pay for CEO/Median annual compensation for UK employees (excl. executives) | | |

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

Remuneration ratios (continued)

The charts below show the relative spend on remuneration (both fixed and variable) as a percentage of total costs of the business.



Treatment of executive incentive schemes, deferred compensation awards and LTIPs

The main sources of variable remuneration are the discretionary annual cash bonus, the co-investment/bonus deferral scheme and the long-term incentive plan. The proposed awards are presented to the Remuneration Committee by the Executive Committee, which reviews all the proposals prior to the submission to the Remuneration Committee. All the schemes are approved by the HFML Board and the Remuneration Committee, and are reviewed on an annual basis.

Any bonus pool is set as part of the strategic plan agreed between the Board and the sole shareholder, BTPS, in 2014. The Remuneration Committee and Executive Committee are charged with effectively distributing any awards across the Company on a discretionary basis. Participation in any bonus pool is limited to eligible employees only.

With regard to employees engaged in control functions, we ensure that their remuneration does not compromise their ability to objectively review the business areas they control and monitor.

Guaranteed variable remuneration

The Company will not guarantee or replace any incentive awards that would breach certain internal criteria. In limited and exceptional circumstances, the Company may agree to make an award of guaranteed variable remuneration in line with the Company policies. Replacement awards are not the Company's standard compensation practice; however, on the occasions where a replacement award is considered, the Company will take steps to determine an appropriate amount and at all times be committed to paying no more than is necessary. Retention awards are considered guaranteed variable remuneration.

Remuneration Policy Coverage

This policy covers all permanent employees of the Company, wherever based, and across all subsidiaries. We believe the current policy to be fully compliant with the requirements of both BIPRU Investment Firms (Prudential sourcebook for Banks, Building Societies and Investment firms) and Alternative Investment Fund Managers (AIFMD).

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

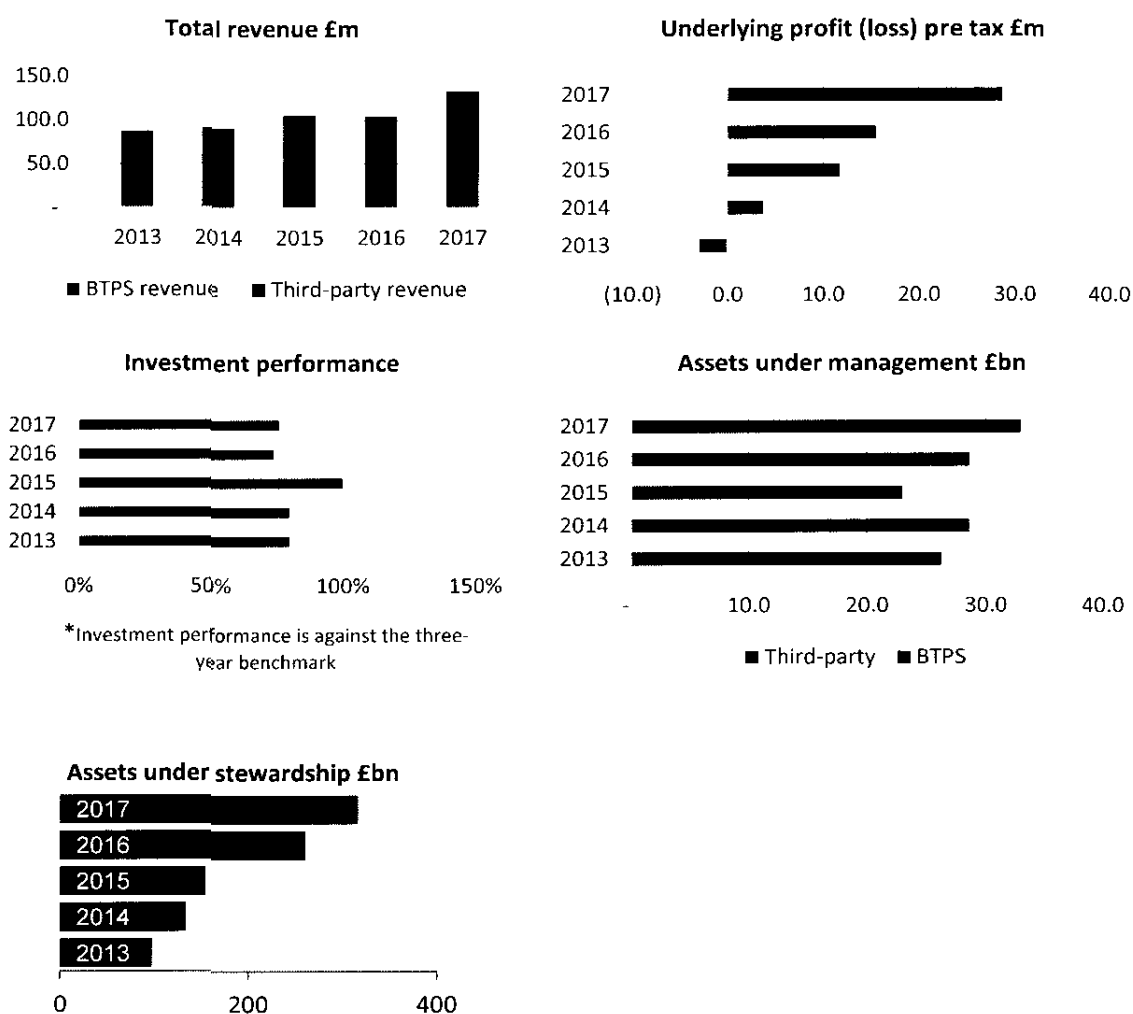
Performance and KPIs

2017 Performance and Remuneration outcomes

The Committee considered the Company's results relative to key performance indicators below and progress against its strategic objectives, as well as the personal performance of each Executive Director (further information on remuneration amounts can be found in Directors' Note 8.) This includes taking a balanced approach to growing the business profitably and in a sustainable way that encourages the longevity of client relationships, while retaining and developing the key talent critical to the long-term success of Hermes.

KPIs at a glance

The charts below provide an overview of the Group's performance over the last five years.



HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

Executive Board Directors' Remuneration v KPIs

The Executive Board of Directors for this purpose are comprised of the key management personnel, three of whom are not Directors of the company and include the Strategic Compliance Director. Key management personnel is a term used by FRS 102 for those persons having authority and responsibility for planning, directing and controlling the activities of a reporting entity, directly or indirectly, including any director (whether executive or otherwise).

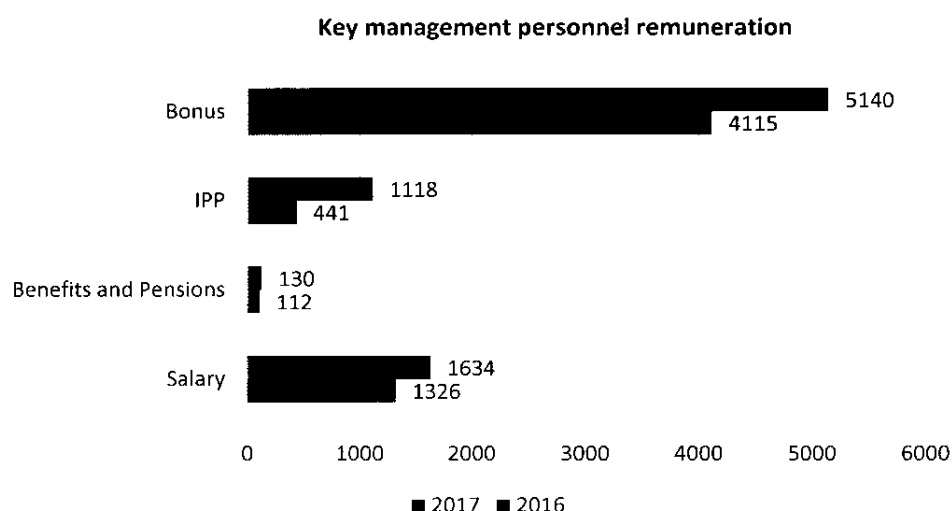
The total spend on remuneration is derived from a composite of the revenue and profit metrics discussed in more detail on the previous page. Further information on the total spend for key management personnel is detailed below.

| 2017 | 2016 |
|-------|-------|
| £'000 | £'000 |
| 8,022 | 5,994 |

Total key management personnel remuneration includes emoluments, amounts receivable under interim profit participation schemes (IPP) and company contributions to money purchase pension schemes.

Total key management personnel remuneration has increased by £2,028k from 2016 to 2017 due to an increase in the number of key management personnel to six, from five. On a per capita basis, the total key management personnel remuneration is broadly consistent with 2016. When determining key management personnel compensation for 2017, performance against agreed strategic objectives was considered.

The chart below shows the composition of remuneration for 2016 and 2017.



HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

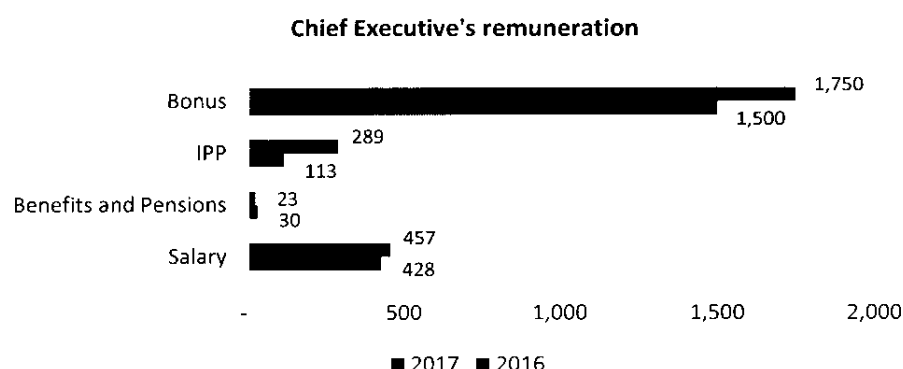
Chief Executive's remuneration

The Chief Executive's performance is formally assessed twice each year by the Chairman of the Hermes Board. Assessment is against the CEO's annual objectives and progress toward the achievement of the long-term objectives of the business.

The formal appraisal supports further discussion and deliberation by the Remuneration Committee regarding the CEO's annual cash bonus, deferred co-investment and long-term incentive pay award. This process is formally documented as part of the Committee's Terms of Reference. Hermes performance and behaviour framework applies to all staff regardless of seniority; however, specific additional competencies are assigned to those in leadership and management positions.

| 2017 | 2016 |
|-------|-------|
| £'000 | £'000 |
| 2,519 | 2,071 |

Total Chief Executive's remuneration includes emoluments, amounts receivable under interim profit participation schemes (IPP) and company contributions to money purchase pension schemes.



| Key | Key performance indicators | Key points in 2017 financial year – relevant to bonus award | Assessment |
|-----------------------------------|--|---|------------|
| Above target ✓✓✓ | Financial performance | | |
| Around target ✓✓ | Operating profit | Achieved continued growth in underlying profitability above target and in line with the strategic plan | ✓✓✓ |
| Between threshold and target ✓ | Third party growth | Consistent and material increases over 5 years in third-party assets to achieve a more sustainable firm for its stakeholders | ✓✓✓ |
| Below threshold ↓ | Cost control | Effective cost controls in place and initiatives sensitively and successfully applied across the business | ✓✓ |
| | Investment performance | 3 and 5 year investment performance – 73% (3 year) above median in 2017 and net new flows of £1.0bn -demonstrates client growth | ✓✓ |
| | Qualitative | | |
| | Ambassador for asset management industry through initiatives | Founder Chair and now member of the 300 Club. Successful fulfilment of all commitment and engagements including The 300 Club, CFA Future of Finance Advisory Council , IA, Mosaic, Banking Standards Board and lending support to CSR initiatives | ✓✓✓ |
| | Hermes Pledge and performance and behaviour framework | Clear leadership in developing, promoting and implementing Hermes' mission to deliver holistic returns, the Hermes Pledge and Hermes' performance and behaviour framework | ✓✓✓ |

HERMES FUND MANAGERS LIMITED**REPORT OF THE REMUNERATION COMMITTEE (continued)****POTENTIAL REGULATORY CHANGE**

On 21 December 2015, the European Banking Authority published its final guidelines on sound remuneration policies, which came into effect on 1 January 2017. Hermes currently applies 'Proportionality' as a Level 3 firm under the PRA's and FCA's regulations on remuneration, but in the future we may be required to make changes to the remuneration policy to remain compliant with these rules.

The Committee believes that the approach of not capping variable remuneration at an individual level is in the best interests of shareholders and clients. It allows the Group to attract, retain and motivate the best talent, who know that good performance and behaviour in line with the values will be rewarded. It also allows the base salaries to remain relatively low, controlling the fixed cost base when times are challenging. This will continue to be monitored closely and the Committee will consult with the Shareholder if a new policy is required.

The Board and Committee continue to monitor any regulatory developments and will consult with the Shareholder if a new policy is required.

HERMES FUND MANAGERS LIMITED

REPORT OF THE REMUNERATION COMMITTEE (continued)

RESPONSIBILITIES

The Committee's primary responsibilities are to assist and advise the Board of Directors regarding the following:

- agreeing the broad policy and framework for the remuneration of the Chief Executive Officer, other executive directors of the Company, and senior managers whose compensation is over a certain threshold;
- determining the overarching principles and parameters of the remuneration policy on a Hermes Group-wide basis, excluding Hermes GPE LLP, which is a joint venture;
- establishing and maintaining a competitive remuneration package to attract, motivate and retain high-calibre executive directors and senior management across the Group;
- aligning senior executives' remuneration with the interests of shareholders and relevant remuneration legislation;
- ensuring compliance with the FCA and other regulators' rules with regards to remuneration; and
- reviewing and approving the annual objectives for executive directors of the Board, in accordance with its Terms of Reference, against which their performance for remuneration purposes will be measured.

Committee attendance during 2017

| Member | Number of meetings eligible to attend | % of meetings attended |
|-----------------|--|---------------------------|
| Kathryn Mathews | 1 | 100 |
| Sally James | 4 | 100 |
| Billy McClory | 5 | 100 |
| David Stewart | 5 | 100 |
| David Watson | 5 | 100 |

HERMES FUND MANAGERS LIMITED**REPORT OF THE REMUNERATION COMMITTEE (continued)****WORK OF THE COMMITTEE DURING 2017**

During the year the Committee received and approved updates on the continued development of the Hermes remuneration policies and structure, including:

- recommending a remuneration policy and remuneration policy statement to the Board;
- continuing to apply regulations to compensation matters, and monitor developments of new regulations and government policies; and
- approving remuneration proposals across salary, bonus and LTIP.

In line with the internal changes, the Committee receives and reviews the remuneration principles for the Group as we continue to evolve. The Committee also reviewed and endorsed salary and bonuses to be awarded during 2017 under the agreed terms of reference, and reward plans in accordance with parameters previously approved by the Committee. The Committee believes that these plans, operated within the positive culture of strong performance and behaviour that exists in the business, supported by the Hermes Pledge, provide alignment between management and both the shareholder and clients, and are in accordance with the relevant legislative changes and best practice.

In setting these parameters and approving the awards, the Committee was aware of the market environment, peer group practice and the financial and investment performance of Hermes.

Non-Executive Directors

The independent Non-Executive Directors who make up the Remuneration Committee at Hermes do not have a vested interest in the amounts being paid to any employees and do not participate in any Company-based incentive schemes.

Non-Executive Director remuneration is reviewed by the Chairman and the Chief Executive and implemented, where appropriate, following approval of the ultimate parent undertaking. The fees for Non-Executive Directors are reviewed at regular intervals.

HERMES FUND MANAGERS LIMITED**REPORT OF THE REMUNERATION COMMITTEE (continued)****Independency and Objectivity of the Remuneration Committee**

The Strategic Compliance Director and Head of Internal Audit have reporting lines into the Chairman of the Audit Committee in the case of internal audit, and into the Risk and Compliance Committee in the case of Risk and Compliance. The Head of HR, although reporting internally, interfaces directly with the Chair of the Remuneration Committee. The chair of each of the committees is a Non-Executive Director.

Remuneration for the Strategic Compliance Director, Head of Internal Audit, and Head of HR is proposed by executive management but independently approved by the Remuneration Committee. It is based on a combination of individual performance and market comparison. Objectives for control functions are set and measured independent of the business areas they support. The independence ensures the discretionary award granted is reflective of the achievement of objectives, rather than business performance.

Personal Shareholding Policy

When applicable, Hermes staff undertake not to use personal hedging strategies or remuneration or liability-related contracts of insurance to undermine the risk-alignment effects embedded in their remuneration arrangements, and the Executive Committee maintains effective arrangements designed to ensure that staff comply with their undertaking.

Avoiding Conflicts of Interest

To ensure remuneration policies avoid conflicts of interests, the Company developed a Conflicts of Interest Policy in accordance with the Markets in Financial Instruments Directive (MiFID), which outlines the steps the Company has taken to identify and mitigate the types of conflict of interests that exist, or may exist.

Effective Risk Management

To ensure that remuneration decisions take into account the implications for risk and risk management of the firm, the heads of Legal, Risk, Compliance and Audit provide the Remuneration Committee 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.

Directors' Emoluments

Directors' emoluments, all of which have been approved by the Remuneration Committee, are disclosed in Note 8 to the financial statements.

HERMES FUND MANAGERS LIMITED

REPORT OF THE NOMINATION COMMITTEE

MEMBERSHIP

The Nomination Committee currently comprises all Non-Executive Directors of the Company.

RESPONSIBILITIES

The Committee's primary responsibilities are to assist and advise the Board. The scope includes, but is not limited to:

- evaluating the balance of skills, knowledge and experience of members;
- regularly reviewing the structure, size and composition of the Board;
- identifying and nominating candidates for appointment to the Board;
- considering the leadership needs of the Group and considering succession planning for Directors and other senior executives;
- assessing the contribution of Non-Executive Directors; and
- approving the appointment of any Director to the Board of a subsidiary operating company of the Group.

Committee attendance during 2017

| Member | Number of meetings eligible to attend | % of meetings attended |
|-----------------|--|---------------------------|
| Kathryn Mathews | 1 | 100 |
| Billy McClory | 4 | 100 |
| David Stewart | 4 | 100 |
| David Watson | 4 | 100 |
| Sally James | 3 | 67 |

WORK OF THE COMMITTEE IN 2017

Major topics considered by the Committee during the year were:

- the appointment of one independent Non-Executive Director;
- the appointment of a Non-Executive Director to represent Hermes on a joint venture board;
- appointments to the Boards of the main subsidiary companies of the Group; and
- approval of various committee changes.

HERMES FUND MANAGERS LIMITED**REPORT OF THE NOMINATION COMMITTEE (continued)****BOARD DIVERSITY**

We are long-standing supporters of diversity in the boardroom and we are supportive of efforts to encourage diversity in all its aspects in the boardroom and, more generally, throughout the Group. As at 31 December 2017, our Board was made up of seven directors of whom two (29%) are women. Appointments to the Board are made having considered a number of different criteria, including appropriate skill sets, experience and expertise as well as all measures of diversity. We continue to expect that long lists and short lists of possible appointments to the Board reflect this position.

HERMES FUND MANAGERS LIMITED

DIRECTORS' REPORT

Secretary: Sue Cane
 Registered Office: Sixth Floor, 150 Cheapside, London, England, EC2V 6ET
 Registered Number: 1661776

The Directors present their report on the affairs of the Group, together with the financial statements and auditor's report, for the year ended 31 December 2017. The Directors who served during the year are listed on pages 37-38.

The Chairman's statement and the Audit, Risk and Compliance, Remuneration and Nomination Committee reports form part of this Directors' report.

RESULTS AND DIVIDEND

The results for the year are shown in the Consolidated Profit and Loss Account. A detailed business review is included in the strategic report. The Directors consider that the Company is well placed to take advantage of future opportunities. The overall performance of the Group is explained in the Financial Review section of the Strategic report on pages 19-21. Further, the Group's principal risks and uncertainties are disclosed in the Risk Management section and key performance indicators are provided in the Investment Performance section of the Strategic report.

The Directors do not recommend a dividend payment in respect of 2017 (2016: £nil). During 2017 dividends have been declared and paid by subsidiaries of the Company. Dividends paid to minority shareholders are shown on page 71.

GOING CONCERN

Having made all reasonable enquiries and having regard to the nature of the Group and its activities, the Directors are satisfied at the time of approving the financial statements that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis in preparing the annual financial statements.

As part of their enquiries, the Directors have reviewed the adequacy of the Group's regulatory capital position under a number of scenarios. Accordingly, they continue to adopt the going concern basis in preparing the financial statements for the year ended 31 December 2017. Further details regarding the adoption of the going concern basis can be found in the statement of accounting policies in the financial statements.

FINANCIAL INSTRUMENTS

The Group has financial instruments including debtors, creditors, investments and cash. These mostly arise from the Group's operations. The Group has a policy of identifying and controlling the risks associated with such instruments. These risks include credit risk, liquidity risk, interest rate risk and market risk. Bearing in mind the nature of the exposure to financial instruments within the Group and the limited risks associated with them, the Directors are satisfied that there is adequate control of the risks. Note 25 presents further information on the Group's financial risk management objectives and strategy.

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

Qualifying third-party indemnity provisions, which were made during the year for the benefit of Directors, remain in force at the date of this report.

EMPLOYEE CONSULTATION

The Group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the Group and the Company.

During the year meetings are held by executive management to discuss the performance of the Group with all employees. Opportunity is given at these meetings for senior executives to be questioned about matters which concern the employees.

EQUAL OPPORTUNITIES POLICY

Hermes is committed to equality and diversity. Applications for employment are always fully considered, regardless of gender, marital status, sexual orientation, age, disability, ethnic or national origin, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and that appropriate training is given or any other reasonable arrangements are made. The Group aims to ensure that employees are treated on the basis of their merits, abilities and potential regardless of gender, marital status, disability, sexual orientation, ethnic or national origin.

SUBSEQUENT EVENTS

There were no subsequent events material to the financial statements from the balance sheet date, 31 December 2017, to the date of approval of the financial statements, 4 April 2018.

AUDITOR

KPMG LLP has indicated their willingness to continue in office as auditor and will be deemed to be reappointed at the end of the next period for appointing auditors as defined in Section 485(2) of the Companies Act 2006.

HERMES FUND MANAGERS LIMITED**DIRECTORS' REPORT (continued)****STATEMENT ON DISCLOSURE OF INFORMATION TO THE AUDITOR**

The Directors, having made enquiries to fellow Directors and the Company's auditor, can state that:

- so far as they are aware, there is no relevant audit information of which the Company's auditor is unaware; and
- they have taken all reasonable steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

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



S Nusseibeh
Chief Executive Officer

4 April 2018

HERMES FUND MANAGERS LIMITED**STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS**

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland".

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

HERMES FUND MANAGERS LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HERMES FUND MANAGERS LIMITED

OPINION

We have audited the financial statements of Hermes Fund Managers Limited ("the Company") for the year ended 31 December 2017 which comprise the Consolidated Profit and Loss Account, Consolidated Statement Of Comprehensive Income, Consolidated and Company Balance Sheets, Consolidated and Company Statement of Changes in Equity, Consolidated and Company Cash Flow Statements and related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

GOING CONCERN

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

OTHER INFORMATION

The directors are responsible for the other information, which comprises the introduction, the strategic report and the directors' report. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

**HERMES FUND MANAGERS LIMITED
INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HERMES FUND MANAGERS
LIMITED (continued)**

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

DIRECTORS' RESPONSIBILITIES

As explained more fully in their statement set out on page 64, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

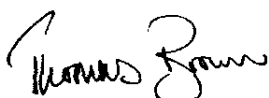
AUDITOR'S RESPONSIBILITIES

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

THE PURPOSE OF OUR AUDIT WORK AND TO WHOM WE OWE OUR RESPONSIBILITIES

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.



Thomas Brown (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London E14 5GL
4 April 2018

HERMES FUND MANAGERS LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2017

| | | 2017 | 2016 |
|---|-------|----------------|----------------|
| | Notes | £'000 | £'000 |
| Group turnover | 3 | 139,513 | 107,116 |
| Fee and commission expenses | | (7,300) | (3,120) |
| Net group turnover | | <u>132,213</u> | <u>103,996</u> |
| Administrative expenses | | (124,152) | (99,275) |
| Group operating profit | | <u>8,061</u> | <u>4,721</u> |
| Joint ventures | 4 | 3,810 | 2,305 |
| Realised currency (loss)/gain | | <u>(820)</u> | <u>1,591</u> |
| Profit on ordinary activities before interest and taxation | | 11,051 | 8,617 |
| Interest payable and similar charges | 5 | (217) | (250) |
| Interest receivable and similar income | 5 | 2,038 | 1,807 |
| Other finance income | 5 | <u>300</u> | <u>300</u> |
| Profit on ordinary activities before taxation | 6 | 13,172 | 10,474 |
| Tax on profit on ordinary activities | 9 | <u>(569)</u> | <u>(788)</u> |
| Profit on ordinary activities after taxation | | <u>12,603</u> | <u>9,686</u> |

All of the results are derived from continuing operations.

The notes to these financial statements on pages 75 to 110 are an integral part of these financial statements.

HERMES FUND MANAGERS LIMITED

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017

| | | 2017 | 2016 |
|---|-------|--------|----------|
| | Notes | £'000 | £'000 |
| Profit for the financial year | | 12,603 | 9,686 |
| Other comprehensive income/(expense) | | | |
| Remeasurement of net defined benefit liability | 17 | 7,600 | (20,000) |
| Tax (charge)/credit – attributable to net actuarial gain/(loss) | 9 | (475) | 3,656 |
| Currency translation differences on foreign currency net investments | | 778 | (1,534) |
| Other comprehensive income/(expense) | | 7,903 | (17,878) |
| Total comprehensive income/(expense) | | 20,506 | (8,192) |
| Profit for the year attributable to: | | | |
| Non-controlling interest | | 42 | 243 |
| Equity shareholders of the Company | | 12,561 | 9,443 |
| | | 12,603 | 9,686 |
| Total comprehensive income/(expense) for the period attributable to: | | | |
| Non-controlling interest | | 42 | 243 |
| Equity shareholders of the Company | | 20,464 | (8,435) |
| | | 20,506 | (8,192) |

The notes to these financial statements on pages 75 to 110 are an integral part of these financial statements.

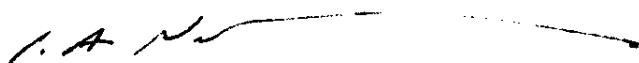
HERMES FUND MANAGERS LIMITED

CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2017

| | | 2017 | 2016 |
|--|-------|----------------|----------------|
| | Notes | £'000 | £'000 |
| Fixed assets | | | |
| Intangible assets – goodwill | 11 | 368 | 735 |
| Tangible assets | 12 | 4,762 | 1,664 |
| Joint ventures | 13 | 10,542 | 7,932 |
| Investments | 13 | 12,540 | 10,049 |
| | | <u>28,212</u> | <u>20,380</u> |
| Current assets | | | |
| Debtors | 14 | 47,513 | 33,838 |
| Cash at bank | 23 | 78,347 | 69,851 |
| | | <u>125,860</u> | <u>103,689</u> |
| Current liabilities | | | |
| Creditors – amounts falling due within one year | 15 | (48,442) | (38,045) |
| Net current assets | | <u>77,418</u> | <u>65,644</u> |
| Total assets less current liabilities | | 105,630 | 86,024 |
| Creditors – amounts falling due after more than one year | 15 | (49,208) | (17,168) |
| Provisions for liabilities | 16 | (5,558) | (3,640) |
| Net assets excluding pension liabilities | | 50,864 | 65,216 |
| Pension deficit | 17 | - | (10,405) |
| Net assets including pension liabilities | | <u>50,864</u> | <u>54,811</u> |
| Capital and reserves | | | |
| Called up share capital | 19 | 72,458 | 62,458 |
| Profit and loss account | | (21,594) | (7,886) |
| Shareholder's funds | | 50,864 | 54,572 |
| Non-controlling interest | 27 | - | 239 |
| Total capital employed | | <u>50,864</u> | <u>54,811</u> |

These financial statements were approved by the Board of Directors and authorised for issue on 4 April 2018. The notes to these financial statements on pages 75 to 110 are an integral part of these financial statements.

Signed on behalf of the Board of Directors



S Nusseibeh - Director

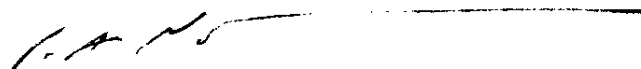
HERMES FUND MANAGERS LIMITED

COMPANY BALANCE SHEET AS AT 31 DECEMBER 2017

| | | 2017 | 2016 |
|--|-------|----------------|----------------|
| | Notes | £'000 | £'000 |
| Fixed assets | | | |
| Tangible assets | 12 | 4,762 | 1,664 |
| Investments | 13 | 47,476 | 42,400 |
| | | <u>52,238</u> | <u>44,064</u> |
| Current assets | | | |
| Debtors | 14 | 33,102 | 33,509 |
| Cash at bank | 23 | 71,948 | 67,556 |
| | | <u>105,050</u> | <u>101,065</u> |
| Current liabilities | | | |
| Creditors – amounts falling due within one year | 15 | (66,936) | (74,403) |
| Net current assets | | <u>38,114</u> | <u>26,662</u> |
| Total assets less current liabilities | | 90,352 | 70,726 |
| Creditors - amounts falling due after more than one year | 15 | (44,024) | (12,899) |
| Provisions for liabilities | 16 | (5,558) | (3,640) |
| Net assets excluding pension liabilities | | <u>40,770</u> | <u>54,187</u> |
| Pension deficit | 17 | - | (10,405) |
| Net assets including pension liabilities | | <u>40,770</u> | <u>43,782</u> |
| Capital and reserves | | | |
| Called up share capital | 19 | 72,458 | 62,458 |
| Profit and loss account | | (31,688) | (18,676) |
| Shareholder's funds | | <u>40,770</u> | <u>43,782</u> |

These financial statements were approved by the Board of Directors and authorised for issue on 4 April 2018. The notes to these financial statements on pages 75 to 110 are an integral part of these financial statements.

Signed on behalf of the Board of Directors



S Nusseibeh - Director

Registered company number: 1661776

HERMES FUND MANAGERS LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

AS AT 31 DECEMBER 2017

| | Notes | Called up share capital £'000 | Profit and loss account £'000 | Non- controlling interest £'000 | Total £'000 |
|---|-------|--|---|--|----------------|
| At 31 December 2016 | | 62,458 | (7,886) | 239 | 54,811 |
| Profit for the year | | - | 12,561 | 42 | 12,603 |
| Re-measurement of net defined benefit liability | 17 | - | 7,600 | - | 7,600 |
| Deferred tax charge on pension assets | 9 | - | (475) | - | (475) |
| Currency translation differences on foreign currency net investments | | - | 778 | - | 778 |
| Total comprehensive income | | - | 20,464 | 42 | 20,506 |
| Issue of shares | 19 | 10,000 | - | - | 10,000 |
| Dividend | | - | - | (281) | (281) |
| Derecognition of pension scheme asset | 17 | - | (39,432) | - | (39,432) |
| Tax credit on derecognition of pension | 9 | | 6,835 | | 6,835 |
| Increase in subsidiary | | - | (1,575) | - | (1,575) |
| At 31 December 2017 | | 72,458 | (21,594) | - | 50,864 |

HERMES FUND MANAGERS LIMITED

COMPANY STATEMENT OF CHANGES IN EQUITY

AS AT 31 DECEMBER 2017

| | Notes | Called up share capital £'000 | Profit and loss account £'000 | Total £'000 |
|--|-------|--|---|----------------|
| At 31 December 2016 | | 62,458 | (18,676) | 43,782 |
| Profit for the year | 10 | - | 12,460 | 12,460 |
| Re-measurement of net defined benefit liability | 17 | - | 7,600 | 7,600 |
| Deferred tax charge on pension liabilities | 9 | - | (475) | (475) |
| Total comprehensive income | | - | 19,585 | 19,585 |
| Issue of shares | 19 | 10,000 | - | 10,000 |
| Derecognition of pension scheme asset | 17 | - | (39,432) | (39,432) |
| Tax credit on derecognition of pension | 9 | - | 6,835 | 6,835 |
| At 31 December 2017 | | 72,458 | (31,688) | 40,770 |

HERMES FUND MANAGERS LIMITED

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2017

| | Notes | 2017 £'000 | 2016 £'000 |
|--|-------|-----------------|---------------|
| Net cash inflow from/(used in) operating activities | 22 | (11,047) | 8,236 |
| Cash flows from investing activities | | | |
| Receipts from sale of fixed asset investments | | 1,269 | 808 |
| Purchase of fixed asset investments | | (2,972) | (3,493) |
| Interest received | | 250 | 201 |
| Dividends received from joint venture | | 1,233 | 2,963 |
| Purchase of minority interests | | (632) | (1,192) |
| Purchase of tangible fixed assets | | (4,280) | (774) |
| Net cash flows from investing activities | | (5,132) | (1,487) |
| Cash flows from financing activities | | | |
| Proceeds on issue of share capital | | 10,000 | 10,000 |
| Proceeds from issue of long-term borrowings | | 20,000 | - |
| Repayment of long-term borrowings | | (5,000) | - |
| Dividends paid | | (281) | (327) |
| Net cash flows from financing activities | | 24,719 | 9,673 |
| Net increase in cash and cash equivalents | 23 | 8,540 | 16,422 |
| Cash and cash equivalents at beginning of year | | 69,851 | 53,360 |
| Effect of foreign exchange rate changes | | (44) | 69 |
| Cash and cash equivalents at end of year | | 78,347 | 69,851 |

HERMES FUND MANAGERS LIMITED

COMPANY CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2017

| | Notes | 2017 £'000 | 2016 £'000 |
|---|-------|-----------------|----------------|
| Net cash from/(used in) operating activities | 22 | (49,949) | (3,281) |
| Cash flows from investing activities | | | |
| Receipts from sale of fixed asset investments | | 1,269 | 808 |
| Purchase of fixed asset investments | | (1,972) | (3,495) |
| Investment in joint venture | | (1,000) | - |
| Investment in subsidiaries | | (641) | (1,192) |
| Interest received | | 250 | 184 |
| Dividends received from subsidiaries | | 35,693 | 14,385 |
| Purchase of tangible fixed assets | | (4,280) | (774) |
| Net cash flows from investing activities | | 29,319 | 9,916 |
| Cash flows from financing activities | | | |
| Proceeds on issue of share capital | | 10,000 | 10,000 |
| Proceeds from issue of long-term borrowings | | 20,000 | - |
| Repayment of long-term borrowings | | (5,000) | - |
| Net cash flows from financing activities | | 25,000 | 10,000 |
| Net increase in cash and cash equivalents | 23 | 4,370 | 16,635 |
| Cash and cash equivalents at beginning of year | | 67,556 | 51,092 |
| Effect of foreign exchange rate changes | | 22 | (171) |
| Cash and cash equivalents at end of year | | 71,948 | 67,556 |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017

1. ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable United Kingdom law and Accounting Standards. The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

a) General information and basis of accounting

The financial statements are prepared on the going concern basis as described in the Directors' Report.

Hermes Fund Managers Limited is a company incorporated in the United Kingdom under the Companies Act. The address of the registered office is given on page 61. The nature of the Group's operations and its principal activities are set out in the strategic report on pages 6 to 36.

The financial statements have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council.

The functional currency of the Company is pounds sterling because that is the currency of the primary economic environment in which the Company operates. The consolidated financial statements are also presented in pounds sterling. Foreign operations are included in accordance with the policies set out below.

b) Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and its subsidiary undertakings drawn up to 31 December each year. Acquisitions are accounted for under the acquisition method. The results of subsidiaries acquired or sold are consolidated for the period from or to the date on which control passed.

The Group has taken exemption from preparing a Company-only profit and loss account in line with Companies Act 2006.

Business combinations are accounted for under the purchase method. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

Hermes Assured Limited and Hermes Investments (North America) Limited, two wholly-owned subsidiaries, are exempt from the requirements of the Companies Act relating to the audit of individual accounts for the year ended 31 December 2017 by virtue of Section 479A of the Companies Act 2006.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

1. ACCOUNTING POLICIES (continued)

c) Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in the strategic report. The Directors' report further describes the financial position of the Group: its cash flows, liquidity position and borrowing facilities; the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

The Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

d) Turnover

Turnover is recognised on an accruals basis. To the extent that fees and commissions are recognised in advance of billing they are included as accrued income or expense. Turnover for investment management services includes performance fees based upon rolling performance periods of up to three years. These are recognised in the year the performance period ends.

Turnover from the supply of services represents the value of services provided under contracts to the extent that there is a right to consideration and is recorded at the fair value of the consideration received or receivable. Where payments are received from customers in advance of services provided, the amounts are recorded as deferred income and included as part of creditors due within one year.

Fee and commission expenses are paid to third parties for ongoing services under distribution agreements and are charged to the profit and loss account over the period in which the services are expected to be provided.

e) Goodwill

Goodwill represents any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired. Goodwill arising in respect of acquisitions is capitalised in the year in which it arises within intangible fixed assets and amortised over its useful life with a full year's charge for amortisation in the year of acquisition.

If a reliable estimate of the useful life of goodwill cannot be made, the life shall not exceed five years. Provision is made for any permanent diminution in the value of goodwill.

The recoverable amount of goodwill is derived from measurement of the present value of the future cash flows of the cash-generating units (CGU) of which the goodwill is a part. Any impairment loss in respect of a CGU is allocated first to the goodwill attached to that CGU, and then to other assets within that CGU on a pro-rata basis. An impairment loss recognised for goodwill however, shall not be reversed in a subsequent period.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

1. ACCOUNTING POLICIES (continued)

f) Financial instruments

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the instrument. Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Equity instruments issued by the Company are recorded at the fair value of cash or other resources received or receivable, net of direct issue costs.

All financial assets and liabilities are initially measured at transaction price (including transaction costs), except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value (which is normally the transaction price excluding transaction costs).

Financial assets and liabilities are only offset in the statement of financial position when, and only when, there exists a legally enforceable right to set off the recognised amounts and the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Debt instruments that are classified as payable or receivable within one year on initial recognition are measured at the undiscounted amount of the cash or other consideration expected to be paid or received, net of impairment.

Financial assets are derecognised when and only when (a) the contractual rights to the cash flows from the financial asset expire or are settled, (b) the Group transfers to another party substantially all of the risks and rewards of ownership of the financial asset, or (c) the Group, despite having retained some, but not all, significant risks and rewards of ownership, has transferred control of the asset to another party.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

The Group uses derivative financial instruments to reduce exposure to foreign exchange risk. The Group does not hold or issue derivative financial instruments for speculative purposes. Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each reporting date. The resulting gain or loss is recognised in profit or loss immediately.

g) Investments

In the Company balance sheet, investments in subsidiaries and associates are measured at cost less impairment. The impairment policy is shown below in (i).

Fair value measurement

The best evidence of fair value is a quoted price for an identical asset in an active market (Level 1). When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place (Level 2). If the market is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, the fair value is estimated by using a valuation technique (Level 3).

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

1. ACCOUNTING POLICIES (continued)

h) Joint Ventures

In the Group financial statements investments in joint ventures are accounted for using the equity method. The consolidated profit and loss account includes the Group's share of joint venture profits, less losses, clearly indicated while the Group's investment in joint ventures is shown separately in the consolidated balance sheet. Goodwill arising on the acquisition of joint ventures is accounted for in accordance with the policy for goodwill above. Any unamortised balance of goodwill is included in the carrying value of the investment in joint ventures.

In the company financial statements investments in joint ventures are accounted for at cost less impairment.

i) Impairment

Assets, other than those measured at fair value, are assessed for indicators of impairment at each balance sheet date. If there is objective evidence of impairment, an impairment loss is recognised in profit or loss as described below.

Non-financial assets

An asset is impaired where there is objective evidence that, as a result of one or more events that occurred after initial recognition, the estimated recoverable value of the asset has been reduced. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

Where indicators exist for a decrease in impairment loss, the prior impairment loss is tested to determine reversal. For all assets other than goodwill, if and only if the reasons for the impairment loss have ceased to apply, an impairment loss shall be reversed in a subsequent period. An impairment loss is reversed on an individual impaired asset to the extent that the revised recoverable value does not lead to a revised carrying amount higher than the carrying value had no impairment been recognised.

Financial assets

For financial assets carried at amortised cost, the amount of an impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost less impairment, the impairment loss is the difference between the asset's carrying amount and the best estimate of the amount that would be received for the asset if it were to be sold at the reporting date.

Where indicators exist for a decrease in impairment loss, and the decrease can be related objectively to an event occurring after the impairment was recognised, the prior impairment loss is tested to determine reversal. An impairment loss is reversed on an individual impaired financial asset to the extent that the revised recoverable value does not lead to a revised carrying amount higher than the carrying value had no impairment been recognised.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

1. ACCOUNTING POLICIES (continued)

j) Foreign exchange

Transactions denominated in foreign currencies are translated into the functional currency at the rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated at the rates ruling at that date. These translation differences are dealt with in the profit and loss account.

The results of overseas operations are translated at the average rates of exchange during the period and their balance sheets at the rates ruling at the balance sheet date. Exchange differences arising on translation of the opening net assets and results of overseas operations are reported in other comprehensive income and accumulated in equity (attributed to non-controlling interests as appropriate).

In the case of the consolidated financial statements, exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), which are recognised in other comprehensive income and reported under equity. Foreign subsidiaries are retranslated using the net investment method.

k) Tangible fixed assets

Tangible fixed assets are stated at cost or valuation, net of depreciation and any provision for impairment. Depreciation is provided on cost in equal annual instalments over the estimated useful economic lives of the assets. The estimated useful economic lives are as follows:

| | |
|----------------------------------|-----------------------|
| Fixtures, fittings and equipment | - One to five years |
| Leasehold improvements | - Period of the lease |

All tangible assets are depreciated from the point of acquisition to the point of disposal.

l) Operating leases

Rental expenses in respect of operating leases are charged to the profit and loss account on a straight line basis over the period of the lease. Rental income in respect of operating leases is recognised in the profit and loss account on a straight line basis over the period of the lease.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis over the lease term.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

1. ACCOUNTING POLICIES (continued)

m) Pension benefits

For the Group's defined benefit scheme the amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments. They are included as part of staff costs. Past service costs are recognised immediately in the profit and loss account. The net interest cost on the net defined benefit liability is shown within finance costs. Remeasurement comprising actuarial gains and losses and the return on scheme assets (excluding interest) are recognised immediately in other comprehensive income.

The Group's defined benefit scheme is funded, with the assets of the scheme held separately from those of the Group, in separate trustee-administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit credit method. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date.

For defined contribution schemes, the amount charged to the profit and loss account in respect of pension costs is the contribution payable in the year. Differences between contributions payable in the year and contributions actually paid are shown either as accruals or prepayments in the balance sheet.

n) Investment income

Income from investments is accounted for on an accruals basis.

o) Current taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Income tax is recognised in the profit and loss account for the period, except to the extent that it is attributable to a gain or loss that is recognised directly in equity. In such cases the gain or loss shown in equity is stated separately from the attributable income tax, which is also recognised directly in equity.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

1. ACCOUNTING POLICIES (continued)

p) Deferred taxation

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax balances are not discounted.

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax liabilities are recognised for timing differences arising from investments in subsidiaries and associates, except where the Group is able to control the reversal of the timing difference and it is probable that it will not reverse in the foreseeable future. Deferred tax is measured using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date that are expected to apply to the reversal of the timing difference.

Where items recognised in other comprehensive income or equity are chargeable to or deductible for tax purposes, the resulting current or deferred tax expense or income is presented in the same component of comprehensive income or equity as the transaction or other event that resulted in the tax expense or income.

q) Bonus costs

Provision is made for bonuses attributable to performance prior to the year end. Deferred bonuses subject to co-invest arrangements are accrued evenly over the period to vesting.

r) Long-term incentive plan ("LTIP")

LTIP units awarded in the year entitle the holder to a share of pre-tax profits over a four-year vesting period. The expected costs of the LTIP payment are spread over the period of vesting and recognised as a long-term liability.

s) Provisions

Provisions are recognised when the Group has a contingent or present obligation as a result of a past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

Onerous lease provisions are obligations arising under onerous contracts and are recognised and measured as provisions. An onerous contract is considered to exist where the Group has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law requires the Directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. The Group's estimates and assumptions are based on historical experience and expectation of future events and are reviewed periodically. The actual outcome may be materially different from that anticipated.

In the course of preparing the financial statements, management exercises judgement when determining the income category. Such judgement could have a significant effect on the amounts recognised in the financial statements:

Fee and commission income is recognised depending on the nature of the service provided:

- income earned from provision of services is recognised as the services are provided for example management fees; and
- income earned on the execution of a significant act is recognised when the act is completed, for example, performance fees are recognised only once they have crystallised.

The key sources of estimation uncertainty at the year-end that may have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year are:

(i) Goodwill impairment

The Directors review goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. The recoverable amounts are based on value in use calculations using management's best estimate of future cash flows and performance, discounted at a rate which the Directors estimate to be the return appropriate to the business.

(ii) Defined benefit pension plan

The valuation of defined benefit plan liabilities are determined by long-term actuarial assumptions. These assumptions include discount rates (which are based on the long-term yield of high quality corporate bonds), inflation rates and mortality rates. The Group exercises its judgement in determining the assumptions to be adopted, with input from an independent qualified actuary.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

3. TURNOVER

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

| | Group | |
|----------------------|----------------|----------------|
| | 2017 | 2016 |
| | £'000 | £'000 |
| Management fees | 122,050 | 95,724 |
| Performance fees | 5,677 | 6,490 |
| Other fee income | 11,786 | 4,902 |
| Total group turnover | <u>139,513</u> | <u>107,116</u> |

Turnover for investment management services includes performance fees based upon rolling performance periods of up to three years. These are recognised in the year the performance period ends.

4. JOINT VENTURES

Share of results of joint venture:

| | 2017 | 2016 |
|-----------------------|--------------|--------------|
| | £'000 | £'000 |
| Joint venture: | | |
| Hermes GPE LLP | <u>3,810</u> | <u>2,305</u> |
| | <u>3,810</u> | <u>2,305</u> |

Note 24 discloses additional information on principal subsidiaries and joint ventures.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

5. FINANCE INCOME/(COSTS) (NET)

| | 2017 £'000 | 2016 £'000 |
|--|---------------|---------------|
| Interest payable and similar charges | (217) | (250) |
| Interest receivable and similar income | 2,038 | 1,807 |
| Other finance income | 300 | 300 |
| | <u>2,121</u> | <u>1,857</u> |

| | 2017 £'000 | 2016 £'000 |
|--|---------------|---------------|
| Interest payable and similar charges in respect of: | | |
| Loan from ultimate parent | 217 | 250 |
| | <u>217</u> | <u>250</u> |

Interest payable to the ultimate parent relates to a loan from BTPS, as shown in Note 15.

Interest receivable and similar income in respect of:

| | | |
|--------------------------------|--------------|--------------|
| Unlisted investments (note 13) | 1,788 | 1,606 |
| Bank deposit balances | 250 | 201 |
| | <u>2,038</u> | <u>1,807</u> |

| | 2017 £'000 | 2016 £'000 |
|---|---------------|---------------|
| Other finance income: | | |
| Net interest expense on defined benefit liability | 5,000 | 5,600 |
| Net interest income on defined benefit assets | (5,300) | (5,900) |
| | <u>(300)</u> | <u>(300)</u> |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

6. PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

| | 2017 £'000 | 2016 £'000 |
|--|---------------|---------------|
| The profit on ordinary activities before taxation is stated after charging/(crediting): | | |
| Depreciation on tangible fixed assets (note 12) | 1,182 | 812 |
| Amortisation of goodwill (note 11) | 1,334 | 1,335 |
| Net loss on financial liabilities at fair value through profit and loss (note 18) | (83) | 157 |
| Foreign exchange gain/(loss) | 903 | (1,748) |
| Profit on fair value movement of investments (note 13) | (1,788) | (1,606) |
| Rental charges under operating leases | 2,721 | 1,879 |
| Rental income from operating leases | (372) | (372) |
| Auditor's remuneration: | | |
| Audit fees - Subsidiaries | 84 | 134 |
| - Company | 64 | 81 |
| | 148 | 215 |
| Non-audit fees: | | |
| Other services | 94 | 104 |
| Total fees payable to Group auditor | 242 | 319 |

Amortisation of intangible assets is included in administrative expenses. Fees payable to the Company's auditor and its associates in respect of associated pension schemes during the year were £Nil (2016: £16,710).

7. STAFF NUMBERS AND COSTS

| | | |
|--|-----------------------|-----------------------|
| Average number of persons employed by the Group and Company in the year: | 2017 No. | 2016 No. |
| Investment management | 134 | 133 |
| Business development | 66 | 57 |
| Administration | 177 | 161 |
| | 377 | 351 |
| Staff costs during the year in respect of these directors and employees were: | 2017 £'000 | 2016 £'000 |
| Wages and salaries | 75,829 | 57,245 |
| Social security costs | 9,963 | 7,006 |
| Pension cost related to Group scheme | 4,529 | 4,157 |
| Redundancy payments | 726 | 1,335 |
| | 91,047 | 69,743 |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

8. DIRECTORS' REMUNERATION AND TRANSACTIONS

| Directors' remuneration (including Non-Executive Directors) | 2017 | 2016 |
|---|--------------|--------------|
| | £'000 | £'000 |
| Emoluments | 4,627 | 4,174 |
| Amounts receivable under long-term incentive schemes | 544 | 218 |
| Company contributions to money purchase pension schemes | 55 | 59 |
| | <u>5,226</u> | <u>4,451</u> |

The Group operates co-investment/bonus deferral schemes whereby a portion of bonuses awarded in respect of the year are deferred. The full value of deferred awards granted to Executive Directors in respect of the year is £1,430,000 (2016: £1,292,500), although they will only become payable after the Directors satisfy future service conditions. Deferred awards are included in total remuneration disclosed above.

| The number of Directors who: | 2017 | 2016 |
|---|------|------|
| | No | No |
| Are members of a money purchase pension scheme | 3 | 3 |
| Had awards receivable in the form of units under a long term incentive scheme | 3 | 3 |

| Remuneration of the highest paid director: | 2017 | 2016 |
|--|--------------|--------------|
| | £'000 | £'000 |
| Emoluments | 2,211 | 1,938 |
| Company contributions to money purchase schemes | 19 | 19 |
| Amounts receivable (other than shares and share options) under long-term incentive schemes | 289 | 114 |
| | <u>2,519</u> | <u>2,071</u> |

Of this amount £785,000 (2016: £785,000) is deferred over a period of up to three years.

Details of transactions with Directors and key management personnel during the year are disclosed in note 26.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

9. TAX ON PROFIT ON ORDINARY ACTIVITIES

| a) | Analysis of tax charge/(credit) for the year | 2017 £'000 | 2016 £'000 |
|----|--|----------------|----------------|
| | Amounts recognised in profit or loss | | |
| | <i>Current tax:</i> | | |
| | UK corporation tax at 19.25% (2016: 20%) | 8,353 | 1,602 |
| | Overseas tax | - | (3) |
| | Adjustment in respect of prior periods | - | (122) |
| | Total current tax charge | 8,353 | 1,477 |
| | <i>Deferred tax:</i> | | |
| | Timing differences, origination and reversal | (7,770) | 731 |
| | Adjustment in respect of prior periods | (14) | (1,757) |
| | Effect of tax rate change on opening balances | - | 337 |
| | Total deferred tax credit | (7,784) | (689) |
| | Tax charge on profit on ordinary activities | 569 | 788 |
| | Amounts recognised in other comprehensive income | | |
| | <i>Current tax:</i> | | |
| | UK corporation tax at 19.25% (2016: 20%) | (546) | (1,600) |
| | <i>Deferred tax:</i> | | |
| | Actuarial (gain)/loss on defined benefit pension scheme | 1,021 | (2,056) |
| | Total tax on items in the statement of other comprehensive income | 475 | (3,656) |
| | Amounts recognised directly in equity | | |
| | <i>Current tax:</i> | | |
| | UK corporation tax at 19.25% (2016: 20%) | (7,583) | - |
| | <i>Deferred tax:</i> | | |
| | Tax on derecognition of defined benefit pension scheme | 748 | - |
| | Total tax credit | (6,835) | - |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

9. TAX ON PROFIT ON ORDINARY ACTIVITIES (continued)

b) Reconciliation of tax charge

The tax charged in the year differs from that resulting from applying the average rate of corporation tax in the UK of 19.25% (2016: 20%). The differences are explained below:

| | 2017 £'000 | 2016 £'000 |
|---|---------------|---------------|
| Profit on ordinary activities multiplied by the average rate of corporation tax in the UK of 19.25% (2016: 20%) | 2,536 | 2,095 |
| <i>Effects of:</i> | | |
| Non-taxable income | (80) | (252) |
| Non-deductible expenses | 608 | 404 |
| Amounts transferred to the Statement of Comprehensive Income | 234 | (344) |
| Foreign tax charge | - | (3) |
| Adjustments in respect of prior periods | (14) | (1,879) |
| Effect of differences to deferred tax rates | 374 | 1,094 |
| Deferred tax recognised | (3,595) | (399) |
| Group relief not charged for | 560 | 72 |
| Chargeable gains | (54) | - |
| Current tax charge for the year | 569 | 788 |

The effective tax rate of 4.3% is lower than the UK corporation tax rate of 19.25% for the year primarily due to the utilisation of brought forward losses for which deferred tax had not previously been provided for, and also the first time recognition of deferred tax on certain losses carried forward in the Group.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

9. TAX ON PROFIT ON ORDINARY ACTIVITIES (continued)

c) Deferred tax position

| | 2017 Provided £'000 | 2017 Unprovided £'000 | 2016 Provided £'000 | 2016 Unprovided £'000 |
|---------------------------------|---------------------------|-----------------------------|---------------------------|-----------------------------|
| The Group | | | | |
| Deferred tax (asset)/liability: | | | | |
| Fixed asset timing difference | (2,294) | - | (2,612) | (3) |
| Tax losses | (1,771) | (4,907) | - | (8,665) |
| Capital gains | 493 | - | 291 | - |
| Short-term timing differences | (9,506) | - | (4,742) | (15) |
| | <u>(13,078)</u> | <u>(4,907)</u> | <u>(7,063)</u> | <u>(8,683)</u> |
| The Company | | | | |
| Deferred tax (asset)/liability: | | | | |
| Fixed asset timing differences | (2,280) | - | (2,598) | - |
| Tax losses | - | (4,715) | - | (6,615) |
| Capital gains | 493 | - | 291 | - |
| Short-term timing differences | (8,510) | - | (3,557) | - |
| | <u>(10,297)</u> | <u>(4,715)</u> | <u>(5,864)</u> | <u>(6,615)</u> |

Deferred tax assets totalling £4,907,490 (2016: £8,683,308) have not been recognised in respect of certain trading losses as the Group is not sufficiently certain that it will be able to recover those assets within a relatively short period of time.

10. PROFIT ATTRIBUTABLE TO THE PARENT COMPANY

As permitted by Section 408 of the Companies Act 2006, no separate profit and loss account or statement of comprehensive income is presented as part of these financial statements. The parent company's profit after tax for the year amounted to £12,459,993 (2016: loss of £2,100,158).

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

11. INTANGIBLE FIXED ASSETS

| | Goodwill £'000 |
|----------------------------------|---------------------------|
| The Group | |
| Cost: | |
| At 1 January 2017 | 3,322 |
| At 31 December 2017 | <u>3,322</u> |
| Accumulated amortisation: | |
| At 1 January 2017 | (2,587) |
| Amortisation | <u>(367)</u> |
| At 31 December 2017 | <u>(2,954)</u> |
| Net book value: | |
| At 31 December 2017 | <u>368</u> |
| At 31 December 2016 | <u>735</u> |

The remaining unamortised goodwill above relates to Hermes European Equities Limited.

Unamortised goodwill of £2,903,022 (2016: £3,870,022) arising on the part-acquisition of Hermes GPE LLP in 2011 is included in the carrying value of the investment in joint ventures in accordance with the policy set out in the Accounting Policies. A total of £967,000 (2016: £967,000) was amortised during the year relating to the Hermes GPE LLP joint venture, in addition to the amortisation charge above.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

12. TANGIBLE FIXED ASSETS

| | Leasehold Improvements | Fixtures, Fittings and Equipment | Total |
|----------------------------------|---------------------------|--|---------------|
| The Group | £'000 | £'000 | £'000 |
| Cost: | | | |
| At 1 January 2017 | 5,915 | 12,281 | 18,196 |
| Additions | 3,975 | 305 | 4,280 |
| At 31 December 2017 | 9,890 | 12,586 | 22,476 |
| Accumulated depreciation: | | | |
| At 1 January 2017 | 5,344 | 11,188 | 16,532 |
| Charge for the year | 676 | 506 | 1,182 |
| At 31 December 2017 | 6,020 | 11,694 | 17,714 |
| Net book value: | | | |
| At 31 December 2017 | 3,870 | 892 | 4,762 |
| At 31 December 2016 | 571 | 1,093 | 1,664 |
| | | | |
| | Leasehold Improvements | Fixtures, Fittings and Equipment | Total |
| The Company | £'000 | £'000 | £'000 |
| Cost: | | | |
| At 1 January 2017 | 5,915 | 12,037 | 17,952 |
| Additions | 3,975 | 305 | 4,280 |
| At 31 December 2017 | 9,890 | 12,342 | 22,232 |
| Accumulated depreciation: | | | |
| At 1 January 2017 | 5,344 | 10,944 | 16,288 |
| Charge for the year | 676 | 506 | 1,182 |
| At 31 December 2017 | 6,020 | 11,450 | 17,470 |
| Net book value: | | | |
| At 31 December 2017 | 3,870 | 892 | 4,762 |
| At 31 December 2016 | 571 | 1,093 | 1,664 |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

12. TANGIBLE FIXED ASSETS (continued)

Included within leasehold improvements is an amount of £1,475,076 relating to the Company's estimate of the costs of restoring the new office, 150 Cheapside to its original state at the end of the lease.

Accelerated depreciation of £331,467 has been recognised for leasehold improvements relating to the previous office, Lloyds Chambers; this office was vacated in January 2018 before the end of the lease.

Work in progress costs of £2,419,601 relating to the fit out of 150 Cheapside have been capitalised as leasehold improvements and will be depreciated from the date the office is occupied to the end of the lease.

13. FIXED ASSET INVESTMENTS

| | Investment in Joint Ventures £'000 | Unlisted Investments £'000 | Total £'000 |
|--|---|----------------------------------|----------------|
| The Group | | | |
| At 1 January 2017 | 7,932 | 10,049 | 17,981 |
| Share of retained profit | 3,810 | - | 3,810 |
| Additions | 1,000 | 1,972 | 2,972 |
| Movement in fair value | - | 1,788 | 1,788 |
| Goodwill amortisation | (967) | - | (967) |
| Disposals | - | (1,269) | (1,269) |
| Dividends received from joint ventures | (1,233) | - | (1,233) |
| At 31 December 2017 | 10,542 | 12,540 | 23,082 |

Included within unlisted investments are investments held for the purposes of hedging liabilities on co-invest bonus arrangements that are classified as financial assets. During the year, there were additions and disposals of £2,971,597 and £1,269,025 respectively. These investments are measured at fair value through profit and loss. A fair value gain of £1,787,800 was recognised in the profit and loss during the year (2016: £1,605,567 gain).

Investments in joint ventures comprise the following share of net assets:

| | 2017 £'000 | 2016 £'000 |
|----------------|---------------|---------------|
| Hermes GPE LLP | 10,542 | 7,932 |
| Total | 10,542 | 7,932 |

The Group had no interests in associate undertakings at the balance sheet date. The companies that make up the Group are analysed in note 24.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

13. FIXED ASSET INVESTMENTS (continued)

| | Investment in Subsidiaries £'000 | Investment in Joint Ventures £'000 | Unlisted Investments £'000 | Total £'000 |
|--------------------------------------|---|---|----------------------------------|----------------|
| The Company | | | | |
| Cost: | | | | |
| At 1 January 2017 | 19,785 | 12,674 | 10,047 | 42,506 |
| Additions | 1,585 | 1,000 | 1,972 | 4,557 |
| Movement in fair value | - | - | 1,788 | 1,788 |
| Disposals | - | - | (1,269) | (1,269) |
| At 31 December 2017 | 21,370 | 13,674 | 12,538 | 47,582 |
| Provision for impairment: | | | | |
| At 1 January 2017 | 106 | - | - | 106 |
| At 31 December 2017 | 106 | - | - | 106 |
| Net book value: | | | | |
| At 31 December 2017 | <u>21,264</u> | <u>13,674</u> | <u>12,538</u> | <u>47,476</u> |
| At 31 December 2016 | <u>19,679</u> | <u>12,674</u> | <u>10,047</u> | <u>42,400</u> |

The Company recognises a provision for impairment against the investment in Hermes Investments (North America) Limited, due to the uncertain timing as to when the Company will earn a return from this investment.

During the year the Company acquired the remaining 9.51% in Hermes European Equities Limited, now a wholly-owned subsidiary.

Unlisted investments are measured at fair value through profit and loss.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

14. DEBTORS

| | 2017 Group £'000 | 2017 Company £'000 | 2016 Group £'000 | 2016 Company £'000 |
|-----------------------------|------------------------|--------------------------|------------------------|--------------------------|
| Due within one year: | | | | |
| Owed by subsidiaries | - | 16,411 | - | 16,625 |
| Owed by joint ventures | 13 | 13 | 11 | 11 |
| Owed by parent | 8,694 | - | 9,644 | 152 |
| Trade debtors | 3,148 | 48 | 2,936 | 606 |
| Deferred tax | 13,078 | 10,297 | 7,063 | 5,864 |
| Corporation tax | - | - | 61 | 5,704 |
| Other debtors | 2,174 | 1,807 | 1,570 | 1,570 |
| Prepaid and accrued income | 20,406 | 4,526 | 12,553 | 2,977 |
| | <u>47,513</u> | <u>33,102</u> | <u>33,838</u> | <u>33,509</u> |

Other debtors include £300,962 in respect of a Director's loan. The original loan was issued on 21 November 2017 for £300,000. This is disclosed further in note 26 Related Party Transactions.

15. CREDITORS

| | 2017 Group £'000 | 2017 Company £'000 | 2016 Group £'000 | 2016 Company £'000 |
|---|------------------------|--------------------------|------------------------|--------------------------|
| Amounts falling due within one year: | | | | |
| Owed to parent | 228 | - | 191 | - |
| Owed to subsidiaries | - | 39,305 | - | 54,336 |
| Other creditors | 4,455 | 4,410 | 2,467 | 2,440 |
| Corporation tax | 159 | 223 | - | - |
| Deferred income | 777 | 773 | - | - |
| Accruals and deferred income | 42,823 | 22,225 | 35,387 | 17,627 |
| | <u>48,442</u> | <u>66,936</u> | <u>38,045</u> | <u>74,403</u> |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

15. CREDITORS (continued)

| | 2017 Group £'000 | 2017 Company £'000 | 2016 Group £'000 | 2016 Company £'000 |
|--|------------------------|--------------------------|------------------------|--------------------------|
| Amounts falling due after more than one year: | | | | |
| Owed to parent | 20,048 | 20,048 | 5,822 | 5,822 |
| Other creditors | 24,005 | 18,821 | 11,346 | 7,077 |
| Deferred income | 5,155 | 5,155 | - | - |
| | <u>49,208</u> | <u>44,024</u> | <u>17,168</u> | <u>12,899</u> |

The amount owed to parent includes £20,048,284 relating to an unsecured subordinated loan with no fixed repayment date taken out on 14 December 2017. The loan accrues interest at a rate of LIBOR +5%.

Deferred income includes a lease incentive of £5,927,835. An original lease incentive amount of £6,250,000 was received in respect of the new office premises, 150 Cheapside, and is unwound on a straight-line basis over the term of the lease.

Other creditors includes deferred consideration of £600,000 in respect of the Company's repurchase of the remaining 9.51% shares in HEEL.

16. PROVISIONS FOR LIABILITIES

| | Onerous lease provision | Dilapidation provision | Total |
|--------------------------------|-------------------------------|---------------------------|---------------|
| | 2017 £'000 | 2017 £'000 | 2017 £'000 |
| The Group and Company | | | |
| At 1 January | 1,171 | 2,469 | 3,640 |
| Charged to the profit and loss | 1,085 | 1,536 | 2,621 |
| Utilisation of provision | (703) | - | (703) |
| At 31 December | <u>1,553</u> | <u>4,005</u> | <u>5,558</u> |

The onerous lease provision above relates to a liability arising from vacant space on a portion of the office property at Lloyds Chambers. This cost includes rent, service

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

16. PROVISIONS FOR LIABILITIES (continued)

charges and business rates apportioned to the vacant area. The principal assumptions include an aggregation of future costs discounted using a pre-tax risk-free rate based on a government bond rate of similar duration. During the year the Group increased its onerous lease provision to £1,552,826 due to an increase in vacant space in 2018 as a result of the office move to 150 Cheapside in January 2018.

A dilapidation provision has been recognised on the leasehold property at Lloyds Chambers, as the terms of the lease require the Company to restore the property to its original condition following changes made to the property during the period of the lease. A further dilapidation provision has been recognised in respect of works to be carried out in the new office at 150 Cheapside.

17. PENSION COMMITMENTS

The Group operates a defined benefit pension scheme, Hermes Group Pension Scheme (the "Scheme"), funded by the payment of contributions to a separately administered trust fund. Members of HGPS are entitled to pension amounts on retirement linked to their final salary (with inflationary uplift). The scheme was closed to new members on 1 July 2008. The Group closed its final salary pension scheme to future accrual with effect from 31 October 2011. Thereafter, the Company made contributions to a defined contribution scheme for all employees.

The Scheme is subject to the Statutory Funding Objective under the Pensions Act 2004. A valuation of the Scheme is carried out at least once every three years to determine whether the Statutory Funding Objective is met. As part of the process the Company must agree with the trustees of the Scheme the contributions to be paid to address any shortfalls against the Statutory Funding Objective.

On 15 December 2017, HFML entered into a Flexible Apportionment Arrangement (FAA) with BT Pension Scheme Trustee Limited (BTPSTL), following which it was agreed that the Company would have no further funding obligations and BTPSTL would take over responsibility for all the liabilities in relation to the scheme. This agreement was subject to the Company making an additional one-off contribution to the scheme of £35m. As the Company became discharged of any further liability in relation to the Scheme, the liability was derecognised on 15 December 2017.

Defined Contribution Scheme

Contributions to the defined contribution scheme amounted to £3,829,312 during the year (2016: £3,557,492). The contributions outstanding as at the year-end amounted to £Nil (2016: £Nil).

Defined Benefit Pension Scheme

Contributions to the Scheme are determined with the advice of independent qualified actuaries on the basis of triennial valuations using the Projected Unit method.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

17. PENSION COMMITMENTS (continued)

Mortality assumptions:

Investigations have been carried out within the past three years into the mortality experience of the Group's defined benefit schemes. These investigations concluded that the current mortality assumptions include sufficient allowance for future improvements in mortality rates. The assumed life expectations on retirement at 60 are:

| | 2017 years | 2016 years |
|----------------------|-----------------------|-----------------------|
| Retiring today | 27.3 | 27.6 |
| Retiring in 20 years | 29.2 | 30.0 |

The actuarial valuation was updated at 15 December 2017 by a qualified actuary using assumptions that are consistent with the requirements of FRS 102. Investments have been valued, for this purpose, at fair value. Contributions of £42.6m were made during the year into the scheme (2016: £8.3m).

The amount included in the balance sheet arising from the Group's obligations in respect of its defined benefit pension scheme is as follows:

| | 2017 £m | 2016 £m |
|---|--------------------|--------------------|
| Present value of funded scheme obligation | - | (190.7) |
| Fair value of scheme assets | - | 180.3 |
| Deficit | - | (10.4) |

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

| | 2017 £m | 2016 £m |
|----------------------------------|--------------------|--------------------|
| Administration costs | 0.7 | 0.6 |
| Interest on scheme obligation | 5.0 | 5.6 |
| Expected return on scheme assets | (5.3) | (5.9) |
| Total | 0.4 | 0.3 |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

17. PENSION COMMITMENTS (continued)

'Interest on scheme obligation' and 'Expected return on scheme assets' are disclosed net as £0.3m 'Other finance costs' in the Consolidated Profit and Loss Account (2016: £0.3m).

Analysis of the actuarial gain recognised in the consolidated statement of comprehensive income:

| | 2017 £m | 2016 £m |
|---|------------|------------|
| Actual return less expected return on scheme assets, i.e. gain/(loss) | 14.5 | 26.7 |
| Changes in assumptions underlying the present value of scheme liabilities, i.e. gain/(loss) | (6.9) | (46.7) |
| Actuarial gain/(loss) | 7.6 | (20.0) |

Changes in the present value of the defined benefit obligation are as follows:

| | 2017 £m | 2016 £m |
|---|------------|--------------|
| Opening defined benefit obligation | 190.7 | 144.0 |
| Interest cost | 5.0 | 5.6 |
| Benefits paid | (7.8) | (5.6) |
| Changes to assumptions | 6.9 | 46.7 |
| Derecognition of defined benefit obligation | (194.8) | - |
| Closing defined benefit obligation | - | 190.7 |

Changes in the fair value of the assets over the period are as follows:

| | 2017 £m | 2016 £m |
|---------------------------------------|------------|--------------|
| Opening fair value of assets | 180.3 | 145.6 |
| Interest on assets | 5.3 | 5.9 |
| Company contribution | 42.6 | 8.3 |
| Benefits paid | (7.8) | (5.6) |
| Administrative costs | (0.7) | (0.6) |
| Return on assets less interest | 14.5 | 26.7 |
| Derecognition of fair value of assets | (234.2) | - |
| Closing fair value of assets | - | 180.3 |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

17. PENSION COMMITMENTS (continued)

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

| | 2017 % | 2016 % |
|---------------------|-----------|-----------|
| Equities | - | 32 |
| Bonds / Gilts | - | 41 |
| Real estate / Other | - | 27 |

Included in the fair value of plan assets are investments in the Group's managed funds with a value of £Nil (2016: £27.3m).

Principal actuarial assumptions at the balance sheet date:

| | 2017 % | 2016 % |
|--|-----------|-----------|
| Discount rate at 31 December | N/A | 2.8 |
| Future pensionable salary increases | N/A | 2.1 |
| Future increases to pensions in payment (HGPS members) | N/A | 3.1 |
| Future increases to pensions in payment (HPS members) | N/A | 2.1 |

Pension increases in deferment are linked to Consumer Price Inflation (CPI) for both Hermes Pension Scheme (HPS) and Hermes Group Pension Scheme (HGPS) members. Pension increases in payment for HPS members are in line with CPI and pension increases in payment for HGPS members are in line with Retail Price Inflation (RPI). On 17 May 1999 all assets and liabilities of the HPS were transferred to the HGPS. The rate of return has been determined on an asset class basis reflecting factors including equity market movements, future expectations, bond yields and inflation.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

17. PENSION COMMITMENTS (continued)

Amounts for the current and previous four periods are as follows:

| | 2017 £m | 2016 £m | 2015 £m | 2014 £m | 2013 £m |
|---|------------|------------|------------|------------|------------|
| Present value of scheme obligation | - | (190.7) | (144.0) | (148.5) | (140.7) |
| Fair value of scheme assets | - | 180.3 | 145.6 | 138.8 | 118.4 |
| Surplus/(Deficit) | - | (10.4) | 1.6 | (9.7) | (22.3) |
| Experience adjustments on scheme assets – gain/(loss) | 14.5 | 26.7 | (0.4) | 10.5 | 3.4 |
| Experience adjustments on scheme liabilities – gain/(loss) | (6.9) | (46.7) | (1.5) | (0.1) | 0.2 |
| Derecognition of pension scheme | (39.4) | - | - | - | - |

18. FINANCIAL INSTRUMENTS

The carrying value of the Group's financial assets and liabilities are summarised below:

| | Notes | 2017 £m | 2016 £m |
|---|-------|----------------|---------------|
| Financial assets | | | |
| Measured at fair value through profit or loss | | | |
| Fixed asset unlisted investments | 13 | 12,249 | 9,797 |
| Measured at undiscounted amount receivable | | | |
| Trade and other debtors | 14 | 47,513 | 33,838 |
| Fixed asset investments in unlisted equity instruments | 13 | 291 | 252 |
| | | <u>60,053</u> | <u>43,887</u> |
| Financial liabilities | Notes | 2017 £'000 | 2016 £'000 |
| Measured at fair value through profit and loss | | | |
| Foreign exchange forward derivative contracts | | (83) | 157 |
| Measured at amortised cost: | | | |
| Loans payable | 15 | 20,048 | 5,822 |
| Measured at undiscounted amount payable: | | | |
| Trade and other creditors | 15,16 | 83,243 | 52,874 |
| | | <u>103,208</u> | <u>58,853</u> |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

18. FINANCIAL INSTRUMENTS (continued)

The Group enters into forward foreign exchange contracts to hedge exposure to net revenues received in foreign currency. The liability above reflects the fair value of those derivative contracts at the balance sheet date. The below shows the contracts entered into before the year end:

Liabilities as at 31 December 2017

| Sell | | Buy | | Settlement date | Fair value in £'000 |
|--------------------------|--------|----------|--------|-----------------|---------------------|
| USD '000 | 24,418 | GBP '000 | 18,000 | 2 July 2018 | 17,958 |
| USD '000 | 24,478 | GBP '000 | 18,000 | 28 Sept 2018 | 17,959 |
| Net change in fair value | | | | | (83) |

Liabilities as at 31 December 2016

| Sell | | Buy | | Settlement date | Fair value in £'000 |
|--------------------------|--------|----------|--------|-----------------|---------------------|
| USD '000 | 22,443 | GBP '000 | 18,000 | 20 Dec 2017 | 18,164 |
| EUR '000 | 5,849 | GBP '000 | 5,000 | 20 Dec 2017 | 4,993 |
| Net change in fair value | | | | | 157 |

Fair value was determined using the Level 2 measurement basis.

The Group's income, expense, gains and losses in respect of financial instruments are summarised below:

| | 2017 £'000 | 2016 £'000 |
|---|---------------|---------------|
| Interest income and (expense) | | |
| Total interest expense for financial liabilities at amortised cost | (217) | (250) |
| Fair value gains and losses | | |
| On financial assets measured at fair value through profit and loss | 1,788 | 1,606 |
| On financial liabilities measured at fair value through profit and loss | (83) | 157 |

19. CALLED UP SHARE CAPITAL

| | 2017 £'000 | 2016 £'000 |
|--|---------------|---------------|
| Called up, allotted and fully paid: | | |
| 72,458,000 (2016: 62,458,000) Ordinary shares of £1 each | 72,458 | 62,458 |
| | <u>72,458</u> | <u>62,458</u> |

On 14 December 2017, the company issued capital of £10,000,000 to its owner, BTPS.

HERMES FUND MANAGERS LIMITED
NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)
20. LONG-TERM INCENTIVE PLAN

The long-term incentive plan (LTIP) is an incentive plan designed to align an element of certain key employees' compensation to the future success of the Group.

For each award, the shares vest after four years. Each award in a particular year represents the following:

- On vesting and on the basis that there is no full sale of Hermes before that date a right to share in 30% of the pre-tax statutory profits of Hermes.
- Pre-vesting, a right to share in a proportion of the proceeds of any sale or partial sale of Hermes above the initial base value.

| | No. of units awarded 2017 | No. of units awarded 2016 |
|-----------------------|--|--|
| At 1 January | 174.5 | 95.5 |
| Issued during year | 150.5 | 94.5 |
| Forfeited during year | (3.0) | (15.5) |
| At 31 December | 322.0 | 174.5 |

The total of all awards outstanding as at 31 December 2017 is 322 units.

During the year the Company issued 150.5 units. Due to the leaver provisions, 3 of these units were forfeited during the year. The total liability recognised as at 31 December 2017 was £15,016,101 (2016: £2,972,722).

In addition to the LTIP, the Company has an interim profit participation (IPP) plan. Each IPP unit entitles the holder to a right to share in 18.5% of the pre-tax statutory profits of the Group for the years ending 31 December 2015, 2016 and 2017. The value of the IPP liability recognised as at 31 December 2017 was £2,832,184 (2016: £1,587,041).

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

21. FINANCIAL COMMITMENTS

Operating Lease Commitments

The Group and Company's total future minimum lease payments on non-cancellable operating leases are as follows:

| | Land and Buildings | Other | Land and Buildings | Other |
|--------------------------|-----------------------|-----------|-----------------------|------------|
| | 2017 | 2017 | 2016 | 2016 |
| | £'000 | £'000 | £'000 | £'000 |
| Within one year | 3,944 | 59 | 2,134 | 168 |
| Between two – five years | 11,028 | - | 1,408 | 98 |
| After five years | 7,130 | - | - | - |
| | <u>22,102</u> | <u>59</u> | <u>3,542</u> | <u>266</u> |

The UK operating lease relating to the new office, 150 Cheapside, is subject to an upwards only rent review on 21 October 2020. The Company also has an option to exit the lease on 21 October 2020 by giving 9 months' notice.

Contingent Liabilities

During the year the Company gave guarantees under Section 479C of the Companies Act 2006 to two wholly-owned subsidiary undertakings: Hermes Assured Limited and Hermes Investments (North America) Limited. As such, both subsidiaries are exempt from the requirements of the Companies Act relating to the audit of individual accounts for the year ended 31 December 2017 by virtue of Section 479A of the Companies Act 2006.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

22. RECONCILIATION OF OPERATING PROFIT TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

| | Group 2017 £'000 | Company 2017 £'000 | Group 2016 £'000 | Company 2016 £'000 |
|---|------------------------|--------------------------|------------------------|--------------------------|
| Operating profit/(loss) | 8,061 | (31,612) | 4,721 | (23,074) |
| Bank charges | - | - | (14) | (17) |
| Reversal of impairments | - | - | - | (250) |
| Adjustment for pension funding | (41,937) | (41,937) | (7,700) | (7,700) |
| Depreciation | 1,182 | 1,182 | 812 | 812 |
| Amortisation | 1,335 | - | 1,335 | - |
| Increase in provisions | 4,387 | 4,387 | - | - |
| Decrease/(increase) in debtors | (7,911) | 848 | 5,003 | (949) |
| Increase in creditors | 24,827 | 12,469 | 2,625 | 26,453 |
| Cash generated from operations | (10,056) | (54,663) | 6,782 | (4,725) |
| Interest paid | (991) | (991) | - | - |
| Tax received/(paid) | - | 5,705 | 1,454 | 1,444 |
| Net cash from/(used in) operating activities | (11,047) | (49,949) | 8,236 | (3,281) |

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

| | Group 2017 £'000 | Company 2017 £'000 | Group 2016 £'000 | Company 2016 £'000 |
|---|------------------------|--------------------------|------------------------|--------------------------|
| Net funds at beginning of year | 69,851 | 67,556 | 53,360 | 51,092 |
| Increase in cash in year | 8,540 | 4,370 | 16,422 | 16,635 |
| Effect of foreign exchange rate changes | (44) | 22 | 69 | (171) |
| Net funds at end of year | 78,347 | 71,948 | 69,851 | 67,556 |

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

24. ADDITIONAL INFORMATION ON PRINCIPAL SUBSIDIARIES AND JOINT VENTURES

The Company and the Group have investments in the following subsidiary undertakings and joint ventures that principally affect the results and net assets of the Group.

| SUBSIDIARY UNDERTAKINGS | ACTIVITY | REGISTERED OFFICE |
|--|--------------------------------------|---|
| Hermes Investment Management Limited | Investment management | Sixth Floor, 150 Cheapside, London, EC2V 6ET (Cheapside) |
| Hermes Real Estate Investment Management Limited | Investment management | Cheapside |
| Hermes European Equities Limited | Investment management | Cheapside |
| Hermes BPK Limited | Investment management | Cheapside |
| Hermes Private Equity Limited | Investment management | Cheapside |
| Hermes Alternative Investment Management Limited | Investment management | Cheapside |
| Hermes Equity Ownership Services Limited | Stewardship and corporate governance | Cheapside |
| Hermes Administration Services Limited (Dissolved 20.2.18) | Investment management | Cheapside |
| Hermes Assured Limited | Investment management | Cheapside |
| Hermes BPK Partners Inc. (Dissolved 30.1.18) | Investment management | 2711 Centerville Road, Suite 400 New York NY10017, USA |
| Hermes Investments (North America) Limited | Investment management | Cheapside |
| Hermes Fund Managers (North America) GP, Inc. | Inactive | 200 State Street, 7 th floor, Boston MA 02109-2696, USA |
| Hermes Real Estate Debt GP Limited | Investment management | Cheapside |
| Hermes Private Debt I GP Limited | Investment management | Cheapside |
| Hermes Global Funds GP Limited | Inactive | c/o Walkers Corporate Services Limited, 87 Rory Street, George Town, Grand Cayman, KY1-9005, Cayman Islands |
| Hermes BPK Coinvestment Trustees Limited | Inactive | Cheapside |
| Hermes Pension Fund Management Limited | Inactive | Cheapside |
| Hermes Secretariat Limited | Inactive | Cheapside |
| Hermes Sourcecap Limited | Inactive | Cheapside |
| Hermes Private Debt (Lux) I GP S.à.r.l. | Investment management | 51 Avenue J F Kennedy, Kirchberg, L1855, Luxembourg |
| Hermes Private Debt (Lux) II GP S.à.r.l. | Investment management | 51 Avenue J F Kennedy, Kirchberg, L1855, Luxembourg |
| JOINT VENTURES | | |
| Hermes GPE LLP | Investment management | Cheapside |
| Vista UK Residential 1 (GP) LLP | Investment management | Cheapside |
| Vista UK Residential Real Estate (GP) LLP | Investment management | Brodies LLP, 15 Atholl Crescent, Edinburgh, EH3 8HA |

Subsidiary undertakings disclosed above are wholly-owned subsidiaries. All subsidiaries disclosed above have been consolidated in these financial statements.

Hermes GPE LLP ("HGPE") is a joint venture between Hermes Fund Managers Limited and the HGPE management team through GPE Partner Limited. It is incorporated in the United Kingdom and is registered and operates in England and Wales.

Hermes BPK Limited applied for strike off on 13 March 2018 and the liquidation process is expected to complete in 2018. Hermes BPK Partners Inc. was dissolved on 30 January 2018.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

25. FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY

The Group's activities expose it to a number of financial risks. The use of financial derivatives is governed by the Group's policies approved by the Board of Directors, which provides written principles on the use of financial derivatives to manage these risks. The Group does not use derivative financial instruments for speculative purposes.

The principal financial risk exposures of the Company and the Group at the balance sheet date relate to credit, liquidity, interest rate and market risks. The Group has in place a system of controls and processes to mitigate the risks identified.

Credit Risk

Credit risk is the risk that a counterparty will be unable to meet a commitment that it has entered into with the entity. The following are credit risks relevant to the Company and the Group at the balance sheet date.

i) Fund-specific: Within a number of the funds operated by entities within the Group, investment positions are taken gaining exposure to other parties. Applicable limits are stated within the objectives and constraints of each fund. The risk is assessed by qualified and trained professionals using a range of information and tools.

ii) Transaction-related: An inevitable consequence of both investment transactions within the funds and transactions within Group entities is the involvement of counterparties, particularly brokers. A process is in place to assess the suitability of counterparties.

The carrying amounts of financial assets best represent the maximum credit risk exposure at the balance sheet date. At 31 December 2017, the Group and the Company's financial assets exposed to credit risk amounted to the following:

Financial assets

| | 2017 | 2017 | 2016 | 2016 |
|----------------------------------|----------------|------------------|----------------|------------------|
| | Group £'000 | Company £'000 | Group £'000 | Company £'000 |
| Cash at bank | 78,347 | 71,948 | 69,851 | 67,556 |
| Owed by subsidiaries | - | 16,411 | - | 16,625 |
| Trade debtors and accrued income | 23,554 | 4,574 | 15,489 | 3,583 |
| Taxation | 13,078 | 10,297 | 7,124 | 11,568 |
| Owed by parent | 8,694 | - | 9,644 | 152 |
| Other debtors | 2,187 | 1,820 | 1,581 | 1,581 |
| | <u>125,860</u> | <u>105,050</u> | <u>103,689</u> | <u>101,065</u> |

HERMES FUND MANAGERS LIMITED
NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)
25. FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY (continued)

Cash at bank is held in current accounts or placed on deposit in highly-rated liquid money-market funds or with highly-rated counterparties. Bankruptcy or insolvency of bank counterparties may cause the Company's rights with respect to the cash held by the banks to be delayed or limited. Bank credit ratings are high and are monitored by management with reference to reputable rating agencies such as Standard & Poor's, Moody's or Fitch. If the banks' financial positions were to materially deteriorate then cash holdings would be moved to other banks.

Bankruptcy or insolvency of the counterparty may cause delays in obtaining the amounts owed, or the Company may have limited rights in respect of the amounts owed. The Company manages its risk by dealing with reputable counterparties offering a low risk of default. The financial position of the counterparties is regularly reviewed.

At year-end, within the Company and the Group, an insignificant level of debt was substantially past due and the majority of debt outstanding at the balance sheet date has been received post year-end. There were no trade debtors of the Group that were more than 90 days past due at 31 December 2017 (2016: £Nil).

Liquidity Risk

Liquidity risk arises as a result of the possibility that the Company may not have sufficient cash funds to meet its liabilities as they fall due.

Below is a maturity analysis of the Group's and the Company's undiscounted liabilities at the balance sheet date:

| Financial liabilities | Maturity | 2017 Group | 2017 Company | 2016 Group | 2016 Company |
|----------------------------|-----------|---------------|----------------|---------------|---------------|
| | | £'000 | £'000 | £'000 | £'000 |
| Owed to parent | < 12 mths | 228 | - | 191 | - |
| Owed to subsidiaries | < 12 mths | - | 39,305 | - | 54,336 |
| Deferred income | < 12 mths | 777 | 773 | - | - |
| Other creditors | < 12 mths | 3,786 | 3,805 | 1,620 | 1,593 |
| Unfunded pension liability | < 12 mths | 828 | 828 | 847 | 847 |
| Accruals | < 12 mths | 42,823 | 22,225 | 35,387 | 17,627 |
| Owed to parent | > 12 mths | 20,048 | 20,048 | 5,822 | 5,822 |
| Deferred income | > 12 mths | 5,155 | 5,155 | - | - |
| Other creditors | > 12 mths | 24,005 | 18,821 | 11,346 | 7,077 |
| | | <u>97,650</u> | <u>110,960</u> | <u>55,213</u> | <u>87,302</u> |

The Company's liquidity risk relates to its cash dealings with clients, day-to-day trading activity, the funding of operational expenses and meeting solvency requirements as determined by the regulator (Financial Conduct Authority). The maintenance of liquidity is reported and monitored by senior management on a regular basis.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017 (continued)

25. FINANCIAL RISK MANAGEMENT OBJECTIVES AND STRATEGY (continued)

Interest Rate Risk

While not the primary focus of the Group, the nature of the business gives rise to large cash balances being held and consequently potentially significant interest receipts. The Group's Finance department aims to mitigate the interest rate risk by continually monitoring the cash position of the Group and seeks the optimal level of cash to place on deposit given the Group's liquidity requirements.

If the average rate of interest was 2% higher during the year based upon the year-end cash position, an additional £1.6m interest would have been earned.

Market Risk – Foreign Exchange

Market risk is the possibility for the Group to experience losses due to factors that affect the overall performance of the financial markets in which the Group is involved. One key factor is foreign currency exchange risk as the Group receives income and incurs expenses in foreign currencies.

Due to a net exposure to foreign currency movements, the Group partially hedges this exposure through the use of foreign currency forward contracts (see note 18 for further disclosures).

26. RELATED PARTY TRANSACTIONS

(a) General information and disclosure exemptions

Subsidiaries

The Company prepares Group accounts into which its subsidiaries are consolidated. The Company has not disclosed related party transactions with wholly-owned subsidiaries as it is taking advantage of the exemption in FRS 102.

Hermes Group Pension Scheme

Certain activities of the Scheme were carried out by the Hermes Group, all of the costs of which are borne by the Company. These costs have not been apportioned for accounting purposes between those attributable to the Scheme and those attributable to the Hermes Group, as functions maintained for both entities cannot be divided meaningfully between them.

HERMES FUND MANAGERS LIMITED

NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)

26. RELATED PARTY TRANSACTIONS (continued)

(b) Related-party transactions

During the year there were transactions with the following related parties:

The following fees were paid to BT Pension Scheme Management Limited (BTPSM) in respect of services provided to the Hermes Group.

| | 2017 £'000 | 2016 £'000 |
|---|---------------|---------------|
| P Spencer (Chairman & Non-Executive Director Fee) | - | 25 |
| W McClory (Non-Executive Director Fee) | - | 20 |
| Total | - | 45 |

Central allocated costs from the Company to BTPSM totalled £2,452,604 during the year (2016: £3,350,035). An amount was due to the Company from BTPSM totalling £507,132 at year-end (2016: £1,285,035).

The following transactions occurred during the year with joint ventures:

- *Hermes GPE LLP (HGPE)*

Central allocated costs from the Company to HGPE totalled £1,750,000 during the year (2016: £1,350,000). An amount was due to the Company from HGPE totalling £13,532 at year-end (2016: £11,268).

The amounts outstanding above for HEEL and HGPE are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of the amounts owed by related parties.

The following transactions occurred during the year with other related parties:

- *Directors' transactions*

During the year ended 31 December 2017 the company advanced one of the directors an unsecured loan totalling £300,000. Interest was charged at the HMRC beneficial loan rate. There were no loans to Directors in the year ended 31 December 2016.

- *Other related-party transactions*

The key management personnel are the Executive Directors and the Executive Committee.

The total remuneration for key management personnel for the period totalled £8,022,612 (2016: £5,993,866), being remuneration disclosed in note 7 of £4,964,621 (2016: £4,092,056) and remuneration provided to other key management personnel of £3,057,991 (2016: £1,901,810).

HERMES FUND MANAGERS LIMITED**NOTES TO THE FINANCIAL STATEMENTS - YEAR ENDED 31 DECEMBER 2017
(continued)****27. NON-CONTROLLING INTEREST – EQUITY**

The non-controlling interest liability of £Nil (2016: £239,000) included within the consolidated balance sheet and debit of £168,000 (2016: debit of £243,000) included within the consolidated profit and loss account relate to a 0% shareholding (2016: 9.51%) in Hermes European Equities Limited, which was owned by an individual Director of the entity. During 2017, HFML purchased all of these shares from the Director and HEEL is now a wholly owned subsidiary.

28. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

The Directors regard the BT Pension Scheme as the Company's immediate and ultimate parent and controlling entity. The financial statements of the BT Pension Scheme can be obtained at One America Square, 17 Crosswall, London, United Kingdom, EC3N 2LB.

29. SUBSEQUENT EVENTS

There were no subsequent events material to the financial statements from the balance sheet date, 31 December 2017, to the date of approval of the financial statements, 4 April 2018.

HERMES FUND MANAGERS LIMITED

Our pledge

I pledge to fulfil, to the best of my ability and judgment and in accordance with my role, this covenant:

- I will act ethically, responsibly and with integrity
- I will put the interests of our clients and their beneficiaries first
- I will encourage responsible behaviour in the firms in which we invest and on which we engage
- I will act with consideration for society and the environment both now and in the future. I will encourage others to do the same
- I will work with industry colleagues and other key stakeholders to develop and improve our industry's contribution to society
- I will treat my clients, my colleagues and all other stakeholders with respect and as I would wish to be treated
- I will deal with our regulators in an open, co-operative and timely way
- I will communicate clearly and honestly with all parties inside and outside our firm
- I will manage conflicts of interest fairly between all parties