Pillar 3 Disclosure for Hewitt Risk Management Services Limited

March 2018

Prepared for

Board of Directors – Hewitt Risk Management Services Limited

Prepared by

Philip Kelley and Carl Giles

Empower Results®

Table of Contents

1	**Executive Summary**	**2**
2	**Background and Scope**	**1**
3	**Approach to Risk Management**	**1**
4	**Risk Identification and Assessment**	**2**
5	**Risk Monitoring and Reporting**	**3**
6	**Stress Testing and Scenario Analysis**	**4**
7	**Capital Resources**	**5**
8	**Contingency Funding**	**7**

1 Executive Summary

Purpose

All Financial Conduct Authority (FCA) regulated firms within the scope of the Capital Requirements Directive (CRD), are required to undertake an Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP serves to validate the appropriateness of the firm's regulatory capital requirement, to ascertain if its capital resources are sufficient in relation to the risk profile of the business and to assess the appropriateness of the firm's framework for managing risk. Hewitt Risk Management Services Limited (HRMSL) embraces these concepts as they fit comfortably with the firm's approach to regulatory issues and risk management.

This Pillar 3 Disclosure for HRMSL effectively makes the key findings of the ICAAP and the thought processes behind the document, publicly available.

2 Background and Scope

HRMSL is wholly owned by Aon Hewitt Limited (AHL). HRMSL is subject to the CRD and, as such, it has produced its ICAAP in accordance with the relevant prudential rules for banks and investment firms (‘BIPRU’). HRMSL is a BIPRU ‘Limited License’ 50k firm and therefore calculates its Pillar One capital requirement as the greater of its fixed overhead requirement (plus its PII Cover Requirement) and the sum of its credit and market risk requirements. HRMSL is an AIFMD firm.

It calculates its overall capital requirement figure as being the larger of its Pillar one figure, its Pillar 2 figure and its wind down requirement figure (see section 6 for more details in this regard).

HRMSL was originally established with the sole purpose of providing fiduciary management services to UK pension funds. As a consulting firm with a long heritage of providing investment advice to pension funds, Aon Hewitt recognised that many trustees of pension schemes found the governance burden of managing the investments of their scheme efficiently, dealing with multiple fund managers, assessing new asset classes and implementing changes when necessary, too onerous, leading to many schemes adopting 'simple' but less than optimal investment strategies. HRMSL was set up as a fund management business specifically to address the need for pension schemes to have more holistic management of assets and liability risks. HRMSL is therefore the Aon business in the UK that has the regulatory permission to manage investments.

It should be noted that this disclosure relates to HRMSL only and not to any other part of the Aon group of companies in the UK.

HRMSL is not part of a UK consolidation group and this disclosure is therefore made on an individual basis.

3 Approach to Risk Management

The Board is responsible for defining the HRMSL strategy and its appetite for risk. The maintenance of a strong capital base is considered essential by HRMSL.

HRMSL has an appetite for risk that varies from very low to medium depending on the nature of the risk concerned and how central it is to the firm's operations. Generally speaking, it has a low or very low risk appetite in areas that are fundamental to the firm's business model - the investment process, client service and regulatory compliance. It is more accepting of risks – for example, risks relating to product development plans - where the overall effect, though potentially significant, is likely to be short to medium term, given its belief that continuing to focus on the fundamentals will deliver long-term success.

When addressing its risk appetite, the Board gave due consideration to its business strategy, objectives and goals in the context of its current business model, which it has no plans to alter in the longer term. That is, it intends to continue being a provider of solutions to a range of clients and client types primarily via the use of specialist underlying investment managers in each asset class.

The Board retains control of key decisions that could directly impact its risk profile and specifically the financial assumptions on which its business plan is based. Key decisions include, for example:

- Approval of the assumptions contained within the financial forecast models to predict business growth plans
- Approval of the annual operating and capital expenditure budgets (and any material changes thereafter)
- Approval of the firm's three year vision and annual business plan
- Approval of the ICAAP

The Board also receives independent reporting from the Compliance, Risk, Finance and Operations teams which assist in enabling it to assess the risks relative to its stated appetite.

4 Risk Identification and Assessment

HRMSL undertakes regular risk assessments which comprise the following:

- Every Quarter a full risk assessment takes place reviewing both newly noted and existing risks. The assessment is attended by HRMSL's CRO, the Global CRO, Head of Operational Monitoring, Head of Infrastructure and also representatives from HRMSL's Board This forum formally scores newly identified risks and re-scores existing risks where needed in terms of both impact and probability.
- The output from the Quarterly risk assessment is provided to HRMSL's Executive, HRMSL's Compliance Risk and Audit Committee, HRMSL's Board and, on request, Aon Hewitt's Enterprise Risk Committee.

Risks are entered in to HRMSL's risk system, Risk Console, which is used to enable a control oversight of the risks and facilitate ongoing dialogue with the risk owners in terms of the applicable controls, mitigants and the status of ongoing actions.

Risk assessment are also completed twice yearly on each internal team within the HRMSL business. The output from these assessments is also logged within Risk Console and takes the form of a dialogue with the area concerned in terms of what are their key risks, what are the controls in place to mitigate, how effective are the controls, what additional actions are required? A bespoke risk register is produced for each assessment and circulated to the area concerned. Each area is also asked what they consider to be the top key risks affecting the business as a whole such that the Operational Risk Committee can have a broader sweep of views and more comprehensive information when compiling the risk register.

5 Risk Monitoring and Reporting

- The business is responsible for ensuring, on an ongoing basis, that risks are appropriately identified and managed. As such, it employs a full time Operational Monitoring Team; the role of this team is to monitor the performance of HRMSL's key controls on an ongoing basis, and where exceptions are found, to help implement improved procedures and controls to prevent recurrence.

- Management information on operational processes, errors, breaches and losses is analysed for trends. HRMSL uses a risk system, Risk Console, which is used by the business to facilitate the collation of such information.

- Compliance is responsible for coordinating a monitoring programme throughout the year. The HRMSL Compliance Officer is located within the HRMSL team and has regular dialogue with the Non-Exec Director and Board but reports in to Aon's Central Compliance Team.

- The compliance programme is designed to ensure that controls are operating effectively, remain appropriate to the nature, scale and potential impact of the risk, and to identify areas of non-compliance with the Group's ethos and culture of risk appetite and risk management.

- The CRO is responsible for providing oversight and, where necessary, challenge to the process. The CRO is also responsible for the following activities with regard to the AIFs managed by HRMSL:

  – Implementing the risk policy and risk management;

  – Monitoring the risk limits which have been established and which are documented in the Risk Policy.

  – Reporting on a regular basis to senior management and the Board.

- In addition to the activities of the CRO, HRMSL employs a Portfolio Risk Team which assesses various risk matrices largely on a client as opposed to an AIF basis.

- Errors and other exceptions identified in the monitoring programme are analysed in detail, discussed with the business and, where appropriate, reported to the Enterprise Risk Committee for appropriate remedial and corrective action.

- Internal Audit undertakes its own audit programme which has involved reviewing HRMSL on several occasions during the last few years.

6 Stress Testing and Scenario Analysis

An assessment takes place of the Group's potential risks as determined by the "Risk Identification and Assessment" process in section 4. The assessment takes the form of stress testing, scenario analyses and consideration of their impact on future revenues and costs. It is carried out on at least an annual basis and incorporates the effects of both wider macroeconomic issues and more local HRMSL specific ones. The financial impact of risks crystallising is considered against both the liquidity of the business and its capital adequacy.

The results of the above stress testing identified that in the extreme case of a number of separate eventualities occurring simultaneously a capital requirement figure of £5,198,000 was applicable. This is the firm's Pillar 2a capital requirement. As the Pillar 1 figure is projected to be £6,290,000 by the end of 2018, HRMSL's overall requirement figure is therefore its Pillar 1 figure which will fluctuate on an ongoing basis so should not be regarded as always being the figure stated above.

Although the necessity for winding up HRMSL is considered extremely unlikely, consideration of the operational and financial process in winding up the business has been considered in addition to the above stress tests. The conclusion was that the wind up cost would not exceed the Pillar 2a or Pillar 1 capital requirement figure.

7 Capital Resources

Risk type	Total (000)
Balance Sheet risk (Credit risk & Market risk)	3,221
Fixed Overhead Requirement (FOR)	4,756
PII Cover Requirement	1,534
Aggregated Result*	**6,290**
Current capital resource available	22,630
Capital surplus	**16,340**

Based on projection for year ending 31 December 2018

*Aggregated result is the higher of Balance sheet risk and FOR plus PII cover requirement.

Requirement	Total (000)
Pillar 2a Requirement	**5,198**
Capital resource available	22,630
Capital surplus	17,432

HRMSL's Pillar one requirement is £6,290,000

HRMSL's Pillar 2a requirement is £5,198,000

HRMSL's overall requirement figure is therefore currently its Pillar 1 figure which will fluctuate on an ongoing basis so should not be regarded as being the figure stated above.

HRMSL had capital resources of £22,630,000 as at the end of 2017 and therefore maintains a surplus of £16,340,000 which represents a significant buffer over the capital requirement and within the firm's risk appetite. This is considered sufficient for the time being, but will be kept under regular review by the business.

These conclusions may be seen as a reflection of the underlying strength of the business and also of the nature of the investment management industry in general, which is not balance sheet-driven in the same way as deposit-taking financial institutions are.

HRMSL has no direct exposure to market movements, as it is does not trade on its own account. The primary risk is volatility of earnings in respect of assets under management. This risk is mitigated by the variability of the cost base, and, given the relatively low level of the fixed costs, it is unlikely that net losses would result even in strongly adverse circumstances. Hence there is little chance of the capital base being eroded by negative earnings.

8 Contingency Funding

During the early part of HRMSL's existence it was totally reliant on its parent company for funding. As the business grew, this reliance was eradicated and HRMSL is now self sufficient and profit making,

In the longer term, the business has been designed as one that can continue to be financially self-supporting. It needs external services (such as medium term asset allocation advice, manager research, risk/liability modeling and swaps) that, while currently being supplied by AHL, could as easily be supplied by any other provider. This means that if AHL or AHL's parent decide on a different strategic direction, the business model is one that, given time to arrange the provision of these services from a third party or bring them in-house, could survive on its own.

Ultimately, the level of capital held under the Pillar 1 requirement figure is sufficient for an orderly wind down if such a situation was necessary.