PILLAR 3 DISCLOSURES
MERCER UK

OCTOBER 2018

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Background

The purpose of this document is to set out the Pillar 3 disclosures of Mercer Limited and its regulatory consolidation group (‘the Group’ or, together, ‘Mercer’)) as at 31 December 2017.

The Capital Requirements Directive (CRD) for the financial services industry is a supervisory framework in the European Union which reflects the Basel II and Basel III rules on capital measurement and capital standards. The capital framework consists of three Pillars:

- Pillar 1 determines the minimum capital requirements of firms to cover credit, market, and operational risk. These comprise: base capital resources requirements; credit risk and market risk capital requirements; and the fixed overhead requirement.

- Pillar 2 requires firms to analyse the risks to the business and then consider whether the risks are mitigated to an appropriate standard. If the firm feels that the risks are not adequately mitigated then they should allocate capital against those risk. Stress and scenario tests are conducted to ensure that the processes, strategies and systems are comprehensive and robust and that the allocation of capital is sufficient.

- Pillar 3 complements Pillars 1 and 2 and improves market discipline by requiring firms to disclose information on their capital resources and requirements, risk exposures and their risk management framework.

The CRD came into effect on 1 January 2007, establishing a revised regulatory capital framework governing the amount and type of capital that must be maintained by credit institutions and investment firms based on the provisions of the Basel II Capital Accord.

CRD IV, effective from 1 January 2014, implements the Basel III agreement in the European Union. It was designed primarily for credit institutions and banks but is also applicable to certain investment firms. Mercer Limited does not fall into this category and remains subject to the CRD III legislation.

The CRD is implemented in the United Kingdom by the UK Regulators, The Prudential Regulatory Authority (PRA) and The Financial Conduct Authority (FCA).

1.1 Basis of Disclosures

Mercer's Pillar 3 disclosures are set out in this document as required by the FCA's Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU), specifically BIPRU 11.3.3R.

Unless otherwise stated, all figures are based on the audited Annual Reports of the entities in the Group for the year ended 31 December 2017.

1.2 Frequency of Publication

The disclosures will be reviewed at least annually and, if appropriate, more frequently. Disclosures will be published as soon as practicable after the publication of the Annual Reports and the finalisation of Mercer's Internal Capital Adequacy Assessment Process (ICAAP).

1.3 Verification

The information contained in this disclosure has not and is not required to be audited by the Group's external auditors and does not constitute any form of financial statement. The information should not be relied on in making any judgement on the Group.

1.4 Media & Location of Publication

The disclosures are published on the Mercer UK corporate website.

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Scope and application of directive requirements

The Group is headed by Mercer Limited, an FCA regulated entity that is categorised as a BIPRU firm and meets the definition of an EEA parent institution. The other entities falling within the Group are listed below and are fully consolidated for regulatory purposes:

- Jelf Financial Planning Limited, an FCA regulated entity, categorised as an Article 3 MiFID exempt firm.

- Thomsons Online Benefits Limited, an FCA regulated entity, categorised as an Article 3 MiFID exempt firm.

- The Benefit Express Holdings Limited, an unregulated holding company.

- The Benefit Express Limited, an unregulated trading company and holding company.

- Thomsons Online Benefits Limited, an FCA regulated entity, categorised as an Article 3 MiFID exempt firm.

- Sedgwick Noble Lowndes Group Limited, a non-trading and unregulated entity.

- Sedgwick Noble Lowndes (UK) Limited, a non-trading and unregulated entity.

Marsh & McLennan Companies, Inc. (MMC) is the ultimate parent of the Group, and all entities within the Group are wholly owned by MMC. The Group is exempt from the obligation to prepare and deliver group accounts (Companies Act 2006, section 401).

The Boards do not currently foresee any material practical or legal impediment to the prompt transfer of capital resources or the repayment of liabilities between the legal entities within the Group (aside from limits associated with regulatory capital requirements).

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Management objectives and policies

The Group's risk management objectives and policies are supported by a risk management framework which establishes the governance arrangements and the principles of how risk is to be identified, assessed, quantified, monitored and controlled. The key risk management responsibilities are allocated as shown below:

3.1 Governance Arrangements

Boards of Directors

The responsibility for the framework of risk governance and management lies with the Boards of Directors. The Mercer Limited Board is responsible for agreeing risk appetite on both a solo and a consolidated basis; and ensuring that risk is monitored and controlled effectively. The Mercer Limited Board is supported by the Risk Committee which provides more detailed oversight across all risks faced by Mercer Limited and the Group as a whole. Similarly, the Mercer Limited Board is supported in fulfilling its supervision and monitoring responsibilities in respect of the internal control system by the Audit Committee.

Risk Committee

The Risk Committee supports the Mercer Limited Board in ensuring that it has an adequate understanding of the material risks, overseeing the proper management of these risks, and ensuring the adequacy of Mercer's capital relative to these risks. The Risk Committee makes recommendations to the Board on the risk appetite and related risk management policies and evaluates whether the risk associated with new services is acceptable. The Risk Committee works closely with the risk owners to understand risk triggers, tolerances, and necessary actions on the part of management to control risk. Ultimately, the Risk Committee is responsible for executing mitigating action where the risk appetite is exceeded.

Audit Committee

The Audit Committee reviews the quality and effectiveness of the procedures and structures under which risks are managed and oversees the performance of the internal control system, including monitoring the effectiveness of the Internal Audit programme.

Risk owners

The day to day management of risk lies with the individual risk owners. The risk owners are accountable for all risks assumed in their area of responsibility and for promoting an appropriate risk management discipline. The risk owners regularly report to the Risk Committee on the status of their risks, escalating any breaches of the risk tolerance and executing remediation action to bring the risk within acceptable levels.

Risk control functions
Independent assessment and monitoring of risk is provided by various risk control functions including: Finance; Legal; Compliance; Human Resources; MMC Internal Audit; MMC Business Resilience; and MMC Risk Management. The control functions play a role in supporting the operational areas to manage their risks effectively.

3.2 Risk Management Framework

The Group's risk management framework is composed of six pillars:

- **Strategy pillar**: defines Mercer's risk appetite statement.
- **Governance pillar**: determines responsibilities for risk management aimed at clear accountability and delegation of authority. It defines the roles of the different parts of the organisation in the risk management process.
- **Identification and assessment pillar**: identifies, categorises, describes, assesses and prioritises risks.
- **Quantification pillar**: quantifies the impact of specific risks using data from a range of internal and external sources.
- **Mitigation pillar**: establishes and coordinates the policies and actions aimed at reducing the likelihood of risks crystallising and reducing their impact.
- **Monitoring and reporting pillar**: defines the key risk indicators (KRIs) used to monitor risks and establishes the form, timing, and governance of reporting.

The framework ensures that management resource is directed towards those risks which pose the greatest threat at any one time.

The Group seeks to manage all the major risks that arise from its operations.

For the purpose of this disclosure, all the major sources of risks referred to in GENPRU 1.2.30(2) R have been considered. Only operational risk, business risk, pension obligation risk, credit risk and group risk are considered major. All of the remaining categories are either not applicable to the Group or, in the case of liquidity risk and market risk, are not considered to be major.

The ways in which the five major categories of risk manifest themselves, and the policies and practices in place to manage them is described below.

3.3 Operational Risk

The majority of the risk management efforts are focused on operational risk. Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Group sub-divides the operational risk category by event type: employee practices and workplace safety; clients, products and business practices; execution, delivery & process management; and internal and external fraud.

A variety of techniques are used to manage operational risk, including monitoring key risk indicators and internal controls and the analysis of historical loss events. The Group maintains a comprehensive insurance programme to cover the risks associated with business interruption; casualty; workers' compensation; directors and officer's liability; and professional indemnity exposures. Specialist support functions provide expertise in risk mitigation focusing on areas such as information security; health & safety; compliance; legal; and business continuity management. The key operational risks are developed into scenarios for capital modelling purposes as part of the Pillar 2 assessment.

3.4 Pension Obligation Risk

Mercer Limited is exposed to financial risk through its obligations under the group defined benefit (DB) pension scheme, which is now closed to future benefit accrual. There is a risk that the funded status of the scheme may deteriorate due to a number of factors including increased life expectancy; lower interest rates; lower equity returns; changes to investment strategy; or salary inflation for those with benefits accruing pre April 2006.

The Board of Mercer Limited regularly considers the outcome of value at risk modelling which analyses the economic risks in the pension scheme at a 99.5% confidence level, and the management actions which could be implemented to mitigate the effects of such deterioration in the funding status.

3.5 Business Risk

Business risk is the risk caused by uncertainty in the macroeconomic environment, impacting the Group's ability to carry out its business plan or desired strategy. The Group adopts conservative assumptions in all its business planning. There is a business approval process for new service offerings and senior management regularly review client won/lost data. Business risk includes damage to physical assets; business disruptions and system failures. Scenario testing is used to assess Mercer's vulnerabilities to a downturn in revenue and to consider the mitigating actions which could be implemented to reduce the effects on the Group's capital adequacy.

3.6 Credit Risk

Credit risk is defined as the current or prospective risk to earnings and capital arising from an obligor's failure to meet its contractual obligations. The Group is exposed to two types of credit risk: counterparty credit risk and credit concentration risk.

The Group’s counterparty credit risk arises primarily from its cash deposits with financial institutions and from its trade receivables. The risk is managed through adherence to global treasury guidelines which include the selection of a diversified number of high quality credit institutions, and through operating active client approval and credit control processes. All client receivables are aged and, where appropriate, provisions for debts that are not expected to be collected in full are made in accordance with accounting standards.

Credit concentration risk is a component of credit risk, arising from an exposure to a counterparty (or group of connected counterparties) that is so large that it could threaten the solvency of the institution if the counterparty were to encounter repayment problems. The risk is mitigated by a well-diversified client base meaning there is no significant exposure to any one individual client or group of clients. The Group’s participation in the MMC cash pooling arrangement does create a concentration risk by virtue of the exposure to other MMC entities. The exposure has various mitigating controls in place which are considered in the quantification of the Pillar 2 assessment, including guarantees by Marsh and McLennan Companies Inc.

3.7 Marsh & McLennan Companies Group Risk

The Group comprises entities which are wholly owned subsidiaries of Marsh & McLennan Companies Inc. There is a risk that an event elsewhere in the MMC Group could impact the Group’s operations in the UK, either through reputational or financial contagion factors. The risk may manifest in three primary ways: brand contagion, and through shared MMC wide arrangements for pooling cash and insurance coverage. These exposures are minimised by effective management at MMC Board level, including stringent policies and analysis of current market trends and threats to achieving the global MMC strategy.

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Capital resources

The Group's consolidated capital resources at 31 December 2017 are shown below. These comprise predominately Tier 1 capital. The Group has no innovative Tier 1 instruments.

	Notes	£000s
Core tier 1 capital		
Permanent share capital	1	225,105
Share premium	2	94,322
Audited reserves	3	315,508
Less: Dividends		(30,000)
Less: Pension Asset	4	(167,510)
Less: Intangible Assets	5	(274,874)
Tier 1 capital		162,551
Tier 2 capital		
Other reserves	6	30,583
Tier 1 & 2 capital		**193,133**
Tier 3 capital		
Short term subordinated debt		0
Total capital resources		**193,133**

Notes

1. Share capital is the permanent, allotted, called up and fully paid ordinary share capital.
2. Share premium account relates to Sedgwick Noble Lowndes Group Limited (non-trading), Jelf Financial Planning Ltd and Thomsons Online Benefits Ltd.
3. The audited reserves also include the profit & loss account and the carried forward losses from the non-trading Sedgwick entities and Jelf Financial Planning Ltd.
4. Relating to the Group's participation in the MMC UK Pension Fund.
5. Intangible Assets represent amounts calculated upon the acquisitions of ORC, Leadership Development, Kepler Associates Limited, The Positive Ageing Company and The Benefit Express Holding Limited.
6. The revaluation reserve relates predominately to a capital contribution in respect of the funding of the ultimate parent company share schemes.

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Compliance with rules in BIPRU and the Pillar 2 rule requirements

5.1 Capital Adequacy

Mercer Limited is categorised as a BIPRU firm. In accordance with GENPRU 2.1.45R (calculation of variable capital requirement for a BIPRU firm), the Group's Pillar 1 capital resources requirement is determined as the higher of (i) the sum of the credit and market risk capital requirements and (ii) the fixed overhead requirement. The Pillar 1 capital requirement is the fixed overhead requirement, £81.5 million.

The Group's Pillar 2 capital requirement is assessed as part of the Internal Capital Adequacy Assessment Process (ICAAP) described in the paragraph below. The current Pillar 2 requirement has been determined as being lower than the Group's Pillar 1 minimum capital requirement and, for this reason; the Pillar 1 minimum requirement is adopted as the Group's current capital requirement.

The ICAAP is Mercer Limited Board's assessment of the Group's required level of capital, consistent with its risk appetite and business plans. The assessment focuses on the major risks faced by the Group and on the behaviour of those risks under stressed scenarios. For each major risk, an assessment is made of the potential loss it could cause were it to materialise under a severe scenario. The assessment is performed gross and net of mitigating systems and controls, and after incorporating the effects of insurance. A variety of techniques are used to support the potential loss figures, including value at risk modelling and historic loss experience. Stress and scenario tests are used to consider the impact based on a variety of events.

The Group's capital adequacy position is monitored by the Group's Finance function and reported to the FCA on a quarterly basis. Based on these reviews, the Mercer Limited Board is able to consider the need to change any capital forecasts and plans accordingly. The ICAAP is formally reviewed on an annual basis or more frequently if there is a material change in the internal or external business environment.

The following shows the Group's capital requirement and capital adequacy at 31 December 2017:

	£000s
Credit risk (standardised approach)	42,173
Market risk	-
Sum of credit risk and market risk	42,173
Fixed overhead requirement	81,494
Pillar 1 capital requirement (higher of (1) and (2))	81,494
Total capital resources	193,134
Surplus capital resources	**111,640**

5.2 Credit and Market Risk

The Group's overall minimum capital requirement for credit risk under the standardised approach is expressed as 8% of the risk weighted exposure amounts for each of the applicable standardised credit risk exposure classes.

Exposure class	Exposure value	Risk weight	Risk weighted exposure amount
Institutions	202,035	20%	40,407
Corporates	208,754	100%	208,755
Past due items[1]	14,489	100%	14,489
Other items	309,645	100%	309,645
Guarantee on cash pool	170,242	100%	170,242
Total			743,538
Credit risk capital component (8% of risk weighted exposure)			**59,483**

Specific disclosures in relation to market risk are considered immaterial under BIPRU 11.3.5R (Exemption from disclosure: Materiality), as the Group does not undertake any principal trading on its own account, is not exposed to any material foreign exchange risk, does not have any external debt, and does not rely on interest income to fund its operations.

[1] An asset is classified as past due when the counterparty has failed to make a payment for more than 90 days.

5.3 Remuneration

The Group is subject to the FCA's BIPRU Remuneration Code. This section provides further information on the Group's remuneration policies and governance, as well as quantitative information on remuneration.

Decision making process for determining remuneration policy

The Remuneration Committee of the Group meets regularly throughout the year and, inter alia, is responsible for:

- Determining, and agreeing with the Boards, the policy for the remuneration of the Group's employees that: is consistent with and promotes effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk; is in line with the business strategy, objectives, values and long-term interests of the Group; and includes measures to avoid conflicts of interest.

- Undertaking a periodic review, at least annually, of the remuneration policy and the list of FCA BIPRU Remuneration Code Staff.

- Approving the broad policy and framework for variable remuneration plans, including share incentive programmes and extraordinary pension arrangements (but not including matters normally reserved for the trustees such as ill health).

- Approving the remuneration packages of all FCA BIPRU Remuneration Code Staff annually. No individual is involved in determining or approving their own remuneration. This includes base salary, bonuses and performance-related payments, discretionary payments, long-term incentive awards, share options and pension contributions.

Composition of the Remuneration Committee

The membership of the Remuneration Committee includes two independent non-executive directors.

The Remuneration Committee is supported, where appropriate, by the UK Chief Executive Officer, the UK Human Resources Director and the EuroPac Head of Reward. In addition, the Remuneration Committee will consider advice from the UK Chief Compliance Officer in setting individual remuneration awards where there may be concerns about the behaviour of the individuals concerned or the riskiness of the business undertaken.

Link between pay and performance

Mercer's discretionary bonus award annually rewards and incentivises excellent performance and aligns the success of Mercer with that of the employee. Bonuses are intended to reflect contribution to the overall success of Mercer and to recognise employees who take a long-term view of Mercer's development.

Employees are assessed throughout the year and rated based on business performance and their individual performance and behavioural and technical competencies, and relative to their peers, against their goals and business performance. Mercer uses a 'Balanced Scorecard' approach to setting and measuring remuneration against performance goals. The goal setting framework covering: Clients, Financials and People ensures a holistic approach to measuring and rewarding performance.

Where other sales incentive plans are applicable to employees, high standards of individual behaviour and compliance act as a 'gate' through which individuals must pass before becoming eligible to receive incentives under these plans. These behavioural gates are in place for all sales incentive plans that Remuneration Code Staff participate in. Remuneration Code Staff who are eligible for such incentive schemes do not provide services to retail clients.

The Remuneration Committee annually reviews the balance between fixed and variable pay for executive roles. Executive Code Staff receive a salary and Non-Executive Code Staff receive fees.

The table below provides an analysis of the remuneration provided to the 18 employees that were categorised as Code Staff for the group during 2017 (for the period they were categorised as Code Staff during the year).

	Code Staff £m	**Total £m**
Fixed remuneration[2]	4.0	162.3
Variable remuneration[3]	4.0	30.1
Total	8.0	192.4

[2] Includes base salary, other cash payments (excluding variable pay) and employer pension contributions earned during 2017.

[3] Includes total bonus and long term incentive awards granted in 2018, in respect of the 2017 financial year and quarterly sales bonuses earned during 2017.

MAKE TOMORROW, TODAY

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