

# MFS International (U.K.) Limited

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## Pillar 3 Disclosure for the year ended 31<sup>st</sup> December 2021

### Introduction

The EU Capital Requirements Directive (CRD) introduced consistent capital adequacy standards and an associated supervisory framework in the EU. This framework consists of three pillars:

- Pillar 1 sets out minimum capital requirements for a firm;
- Pillar 2 sets out the Internal Capital Adequacy Process (ICAAP) through which a firm and the regulator satisfy themselves as to the adequacy of capital and whether additional capital needs to be held for risks not covered by Pillar 1; and
- Pillar 3 requires disclosure of certain information about a firm's capital and risk assessment process.

The Pillar 3 disclosures in this document are made in respect of MFS International (U.K.) Limited ("MIL UK" or "the Company") in accordance with the Financial Conduct Authority's (the "FCA") "Prudential Sourcebook for Banks, Building Societies and Investment Firms" (BIPRU), specifically BIPRU 11.3.3R. This will apply until the introduction of the Investment Firms Prudential Regime ('IFPR') on 1 January 2022 (discussed in further details below).

The Company will be making Pillar 3 disclosures at least annually, unless an interim update to the most recent ICAAP is issued in response to substantial changes in the nature of its operations, or material adverse market movements.

This disclosure will be published at [www.mfs.com](http://www.mfs.com)<sup>1</sup>.

The information contained herein has not been audited by the Company's external auditors, does not constitute any form of financial statement. The rules provide that one or more of the required disclosures may be omitted if the Company considers that information to be immaterial. Materiality is based on the criterion that the omission or misstatement of any information would be likely to change or influence the decision of a reader relying on the information. In addition, one or more of the required disclosures may be omitted if the Company believes that the information is proprietary or confidential. Proprietary information is that which, if it were shared, would undermine MIL UK's competitive position. Information is considered confidential where that are obligations binding us to confidentiality with our clients, suppliers and counterparties.

### Background and Scope

MIL UK is a Private Limited Company, incorporated in England and Wales. It is authorised and regulated by the Financial Conduct Authority and as such is subject to minimum regulatory capital requirements. The Company is categorised as a BIPRU €50k Limited Licence Firm by the FCA. The Company is not a member of a consolidated group for FCA reporting purposes.

MIL UK is a wholly-owned, indirect subsidiary of Massachusetts Financial Services Company, a US-based investment firm and fund manager.

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<sup>1</sup> Institutions & Consultants page of [www.mfs.com](http://www.mfs.com)

## Risk Management Framework

Business strategy is determined by senior management of the MFS Group's US based parent, Massachusetts Financial Services Company ("MFS"). Risk appetite and the corresponding risk management framework are determined by the Board. Determination of how identified risks may be mitigated and arrangements to manage those risks are considered during this process.

The governance framework of the firm deploys adequate and consistent policies, procedures and controls across its operations. This framework provides the infrastructure for managing risk. Key components of this framework include:

- MFS has in place a number of functional committees, which are responsible for the oversight of regulatory activities. These committees are comprised of MFS employees who have relevant subject matter expertise. Each committee attempts to resolve issues brought to its attention. MFS also maintains four supervisory committees, to which MFS' functional committees report relevant matters: the Employee Conduct Oversight Committee, Internal Compliance Controls Committee, the Enterprise Risk Committee and the Investment Management Committee.
- MIL UK's senior management and other personnel participate in, or are represented on, various committees, including the Policy Committee, Error Resolution Committee, Trade Oversight Committee and AML Committee. Through participation in this committee infrastructure MIL UK can ensure that key requirements are achieved.
- The Company's risk appetite is set through the MFS group-wide risk appetite statement and an extensive series of policies. MFS' conservative risk appetite is reflected in a commitment to a comprehensive and robust policy framework that defines acceptable standards across many activities. The policy framework is governed by MFS' Committee Structure.
- The Board meets on a quarterly basis and discussions include risk and regulatory capital management of the Company. The Board's process is formally documented in the Company's ICAAP at least annually. In the event that the nature of the Company's operations change substantially, or material adverse market movements limit the usefulness of the information contained in the most recent ICAAP document, the Board may issue an interim update accordingly.

## Capital Resources

The Company's capital resource position, as at 31 December 2021, is summarised as follows:

	£,000
<i>Total tier 1 capital after deductions</i>	
Permanent share capital	1,996
Retained earnings plus OCI	<u>105,401</u>
<i>Total tier 2 capital after deductions</i>	-
<i>Total tier 3 capital</i>	-
<b>Total capital after deductions</b>	<b>107,397</b>

The Company's capital resources comprise Tier 1 capital only with no Tier 2 or Tier 3 capital.

## Capital Resources Requirement

The minimum capital to be held by the Company is the higher of the requirement calculated under Pillar 1 and Pillar 2.

### Pillar 1

Investment firms such as MIL UK are required to maintain a minimum level of capitalisation in accordance with Pillar 1 of the EU Capital Requirements Directive.

MIL UK's Pillar 1 capital requirement consists of a "variable capital requirement" calculated in accordance with GENPRU 2.1.45R (Calculation of the variable capital requirement for a BIPRU firm). The variable capital requirement for a BIPRU firm is the higher of (i) the sum of the Market and Credit Risk Requirement and (ii) the Fixed Overhead Requirement (FOR). As a BIPRU Limited Licence firm, MIL UK's variable capital requirement does not include an Operational Risk element.

As at 31 December 2021, MIL UK's variable capital requirement was £18.2m driven by its credit and market risk..

#### Credit Risk:

Credit risk is the risk of financial loss if a customer or counterparty fails to meet its contractual obligations. In calculating the Company's Credit Risk Requirements, the simplified approach has been adopted.

#### Market Risk:

As MIL UK does not operate a trading book, its market risk is substantially limited to the impact of short term foreign exchange fluctuations on its non-Sterling denominated currency holdings and accounts receivable.

BIPRU 11.4 provides that firms may omit certain disclosures on the basis of materiality, to the extent their omission or misstatement would not change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

Detailed disclosure of Credit Risk and Market Risk has been excluded on the basis of materiality.

### Pillar 2

Pillar 2 requires the Company to consider whether it should hold additional capital against risk not covered in Pillar 1. This is implemented through the ICAAP. The Company's most recent ICAAP was approved by the Board on 9<sup>th</sup> December 2021.

Through the ICAAP, MIL UK senior management and the Board have undertaken an analysis of material risks typically faced by investment management firms to determine whether the Company is adequately capitalised to absorb the financial impact of such risks materialising.

The following risks were examined as part of the ICAAP process:

#### Stress tested

Business risk  
Reputational risk

Keyman risk  
Legal & regulatory risk  
Operational risk

#### Not stress tested

Credit risk  
Market risk  
Insurance risk

#### Not applicable

Pension obligation risk  
Securitisation risk  
Residual risk

Liquidity risk  
Interest rate risk

A number of specific risk scenarios were identified and modelled in the context of the risks outlined above. The projected financial impact of these risks materialising forms the basis for calculation of the Company's Pillar 2 Capital Requirement.

#### *Exclusions*

MIL UK does not rely on third party guarantors in relation to client receipts or settlements and as such, residual risk was excluded accordingly.

The Board believes that the current level of insurance coverage is adequate and is secured from strong, well-capitalised firms. On this basis, insurance risk has not been examined in the context of Pillar 2.

As MIL UK does not operate a defined benefit pension plan, or undertake any securitisation activities, pension obligation risk and securitisation risk have been excluded from this analysis.

The Board considers the current level of capitalisation sufficient to sustain the projected impact of the identified risks materialising.

As stated above, IFPR is effective from 1 January 2022. Under the new framework, all investment firms will be subject to the same key measures, in particular with regard to capital holdings, liquidity requirements, regulatory reporting, corporate governance and remuneration. The rules will be applied proportionately to MIL UK according to its size, business activities and risk profile.

For Own Funds Requirement under the new IFPR regime, the combined K-AUM and K-COH requirement (rather than the Fixed Overhead Requirement) is the binding measure with £36.4m of capital identified. As the Own Funds Requirement is higher than the Pillar 1, Pillar 2 and the cost of an orderly winddown calculations, the capital requirement for 2022 is £36.4m. As the forecast capital post-dividend is £79.3m, a surplus of £42.9m (118%) exists over the regulatory capital requirement.

#### **Remuneration Code Disclosure**

MIL UK is subject to the FCA's Remuneration Code. This document has been prepared as required and pursuant BIPRU 11.5.18 on a proportionate basis based on the size and internal organization of MIL UK and the nature, scale and complexity of its activities.

The objective of MIL UK's Remuneration Policy is to provide a reasonable and appropriate remuneration environment while ensuring that employees are not incentivised to take inappropriate risks. MIL UK emphasises its culture of compliance and ethics with its employees, and does not approve, condone or support employees taking inappropriate risks for the purpose of maximising individual bonuses.

The Company ensures that it does not remunerate or assess the performance of employees in a way that conflicts with the Company's duty to act in the best interest of its clients. In this regard, it takes steps to identify and prevent or manage conflicts of interest that could arise under its remuneration arrangements. For example:

- the Company does not operate or introduce any remuneration structures that could create a conflict of interest or incentive for an employee to favour their own interest, or that of the Company's, to the potential detriment of the Company's clients.
- the Company and MFS US have comprehensive policies that address personal trading and business conduct that require employees to place the interests of clients first and require employees to identify and escalate any appearance of, or actual, conflicts of interest including circumstances where they consider the remuneration for a particular activity may be misaligned with the duty to act in the client's best interest.

- the method of determining the compensation for employees in Compliance is independent of the profitability of the business unit they supervise and does not comprise their objectivity;
- the Company makes clear to participants in remuneration plans that (i) the respective plan contains discretions which allow the Company to reduce remuneration in the event of non-compliant sales; but (ii) in addition to any such reduction, other disciplinary consequences may also apply;
- employees in the MFS group, including the Company, are annually required to acknowledge their understanding of and compliance with the firms' Code of Ethics and related business conduct policies, which governs employees' professional behaviour. In addition, the Chief Human Resources Officer of MFS US is a member of the Ethics Oversight Committee which, among other things, ensures that compliance violations are factored into compensation decisions appropriately in collaboration with Compliance and the employee's management team. No employee of the Company is involved in any decision making related to his or her own compensation.

The MIL UK cash bonus pool is based on the overall profitability of MIL UK's parent, MFS Investment Management, an investment manager registered with the US Securities and Exchange Commission ("**MFS US**") on a consolidated basis. No individual employee's bonus is calculated by reference to the profitability of the individual employee's business activities. Consequently, individual employees do not have an incentive to take inappropriate risks to maximise the profits earned from their individual activities. By tying individual compensation to overall profitability of MFS, employees are encouraged to work cooperatively to produce the best long-term results for clients.

The firm employs a "pay-for-performance" approach to compensation to recognise employees who contribute the greatest value to the firm, considering performance (both financial and non-financial), experience and critical skills. Code Staff are assessed and compensated based on the performance of MIL UK, their business unit and their individual performance. Performance considerations also include those non-financial risks: building and maintaining positive customer relationships, reputation, achieving in line with firm strategy and values and effectiveness and operation of the risk and control environment.

In evaluating which employees are "Code Staff" for the purposes of the FCA Remuneration Code, MIL UK considers if they fall within any of the categories below:

- Senior Management Function Holders (e.g. board members of MIL UK)
- Risk takers (who have a material impact on the risk profile of MIL UK)
- Heads of control functions, support functions, significant business lines, and individuals within their control who have a material impact on MIL UK's risk profile
- Employees whose total remuneration takes them into the same remuneration bracket as senior management and risk takers, whose professional activities could have a material impact on MIL UK's risk profile.
- If an employee is based outside the UK s/he will only be identified as Code Staff if s/he is considered to be a material risk taker in respect of MIL UK. In determining this MIL UK considers the impact of the risk profile of MIL UK on the MFS Group as a whole and the role that MIL UK plays within the responsibilities of such employees.

MIL UK's incentive compensation programmes are subject to rigorous review by MFS US' Management Committee. The MIL UK's incentive compensation programmes follow the same philosophy and policies of MFS, which are reviewed and approved by the Management Resources Committee (MRC). The MRC consists of independent directors of Sun Life Financial who are also wholly independent of MIL UK and MFS US. MIL UK HR policies are also reviewed and approved by the MIL UK Board of Directors. The implementation of MIL UK's compensation programmes is subject to annual central and independent review for compliance with the compensation programmes reviewed by both MFS's Corporate Compensation and the Remuneration Committee of MFS. None of the Remuneration Committee of MFS members have day-to-day executive roles within MIL UK.

MFS engages the services of McLagan Partners to assist with conducting competitive assessments to determine any necessary changes to the remuneration policy. McLagan Partners is an AON Hewitt Company specializing in global compensation programs for asset management firms and financial services.

In addition, MFS' principal shareholder Sun Life Financial Inc. ("Sun Life"), acting through the Sun Life Board and the Management Resources Committee hire their own independent consultant to review MFS compensation programs. The firm they engage is Pay Governance, which is a nationally recognised compensation consulting firm. Sun Life appointed Pay Governance in August 2016 replacing Johnson Associates Inc.

MIL UK strives to provide superior long-term investment performance for its clients. To meet this objective MIL UK trains its investment professional staff and the staff that supports the investment function to focus on long-term performance and not on short-term opportunities. To support that objective, MIL UK's compensation practices are structured to reward long-term performance and sound risk management. This long-term focus is consistent with the historical corporate culture of MIL UK and its parent company, MFS US.

**Quantitative information for the year ending 31 December 2021**

For the year ending 31 December 2021, total remuneration for MIL UK's 12 Code Staff (most of whom are senior management but also including staff who have a material impact on the risk profile of the firm) was GBP 20,125,118.

**MFS International (U.K.) Limited**

March 2022