# Key risks and mitigations

We are exposed to a variety of risks as a result of our business activities. Effective risk management is a core competence and we actively monitor the potential impact of current and emerging risks. We place significant focus on the integrity and good conduct of employees and doing the right thing for our stakeholders. Our risk management framework is underpinned by a strong control culture with clear oversight responsibilities.

## Managing risk

The Board is accountable for risk and oversight of the risk management process. It assesses the most significant risks facing the business and also uses quantitative exposure measures, such as stress tests, where appropriate to understand the potential impact on the business. Non-executive oversight of the risk management process with respect to standards of integrity, risk management and internal control is exercised through the Audit and Risk Committee.

It is the responsibility of all employees to uphold the control culture of Schroders. We embed risk management within all areas of the business at a Group and legal entity level. The Group Chief Executive and Group Management Committee (GMC), as the principal executive committee, have responsibility for regularly reviewing the key risks we face. This includes ensuring that their respective business areas in all legal entities are monitoring and reporting relevant risks and controls. They are also responsible for monitoring individual behaviours, ensuring that they mirror the culture and core values of the business.

The executive oversight of risk is delegated by the Group Chief Executive to the Chief Financial Officer (CFO). The CFO has responsibility for the risk and control framework of the Group. Independent monitoring and reporting of risks and controls at a Group and legal entity level is supported by the Group Head of Risk.

The CFO chairs the Group Risk Committee (GRC), which meets ten times a year. The GRC supports the CFO and the GMC in discharging their risk management responsibilities. The committee is attended by the heads of the control functions (Group Risk, Compliance, Legal and Internal Audit) along with chief operating officers from across the business and senior managers from Distribution, Product and Wealth Management. Other GMC members regularly attend. The GRC reviews and monitors the adequacy and effectiveness of the Group's risk management framework, including relevant policies and limits. It also reviews trends and current exposures to our key risks and considers issues as they arise. The GRC and the Wealth Management Audit and Risk Committee (WMARC) receive reports relating to the risk profile of Wealth Management.

Our Business Issues and Conflicts Committee supports the GRC and GMC in identifying and managing conflicts that may arise from time to time in our diversified business.

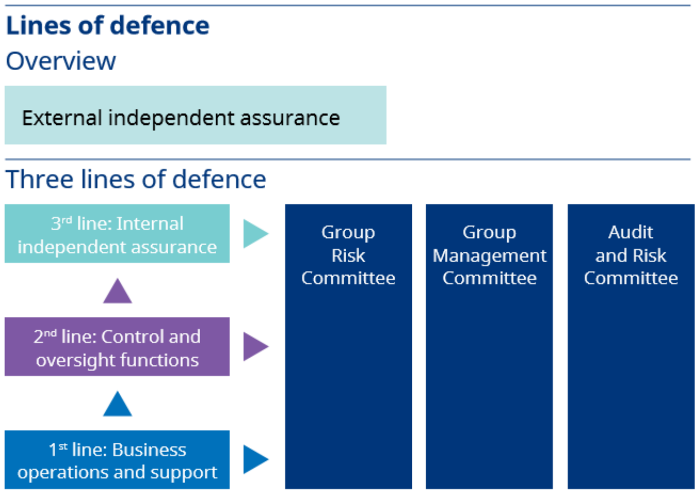
## Lines of defence

The first line of defence against undesirable outcomes is the business functions themselves and the line managers across Asset Management, Wealth Management and Infrastructure. Heads of each business area take the lead role with respect to identifying potential risks in their area and implementing and maintaining appropriate controls to manage these risks.

Line management is supplemented by the control and oversight functions, including Group Risk, Compliance, Legal, Governance, Finance, Tax and Human Resources, which constitute the second line of defence. The compliance monitoring programme reviews the effective operation of relevant key processes against regulatory requirements.

Internal Audit provides retrospective, independent assurance over the operation of controls and forms the third line of defence. The internal audit programme includes reviews of risk management processes and recommendations to improve the control environment, supplemented by external assurance from the Group's auditors. The team also carries out thematic compliance monitoring work.

We maintain comprehensive insurance cover with a broad range of policies covering a number of insurable events.




## 2018 developments

Management of our key risks has remained a priority throughout 2018. In particular, we have focused on embedding our risk framework within the businesses we have acquired and new business relationships we have established. We have also managed the risks involved in transitioning to our new front office technology platform.

Specific initiatives were undertaken that covered a wide range of activities across the Group and are covered below:

- Group Risk has been actively and extensively engaged in the implementation of our strategic projects: notably our new front office technology platform, our move to a new London headquarters, transition to S3 (a new virtual desktop technology) and in establishing material new business relationships with Lloyds Banking Group.
- Our Operational Risk teams have supported the implementation of our new front office technology platform across each of our global locations, so that risks are clearly assessed, understood and controlled by management. Where necessary, action plans to mitigate risk were formulated and put into action.
- The design and implementation of our new front office technology platform has improved our capabilities in the management and oversight of investment risk. It has provided a broad suite of integrated metrics that can be monitored centrally on a more frequent basis. Group Risk deployed portfolio-level stress testing across our client mandates and funds, which allows us to develop a better understanding of how our client portfolios perform under adverse market conditions relative to their portfolio objectives.
- A number of thematic investment risk reviews were conducted to support the oversight and challenge of risk taking. These included themes such as consideration of active risk levels, performance relative to benchmarks and fund liquidity.
- As an integral part of the corporate investment process, Group Risk worked alongside business teams performing due diligence on opportunities to assess the risks.
- Group Risk has worked to integrate the risk framework across new business areas, including Schroder Adveq, Benchmark Capital and Algonquin. This included the deployment of policies, alignment of governance and escalation, and reporting across various legal entities.
- Ongoing monitoring of our risk appetite measures and metrics was performed. In certain areas these were enhanced, most notably in the ongoing priority of information security, which is overseen by our Information Security Risk Oversight Committee.

- The Audit and Risk Committee reviews a comprehensive dashboard of metrics for key risks on a quarterly basis.
- Further work has been undertaken to assess model risk and to manage user-developed tools to reduce risks from changes to software.
- A new approach was developed to assess the risks when we deploy robots as part of our robotics program.

The risk and control assessment (RCA) process continues to be a key part of our risk management framework and is summarised in the diagram below. In 2018, we completed an upgrade of our technology to manage our operational risk framework, including RCAs, issues, events and data loss management.

**Risk and control assessment process**


## Key risks

### Assessment of key risks

We have identified 22 key risks across strategic, business, operational and financial instrument risk categories, as shown on the following page.

These risks have been assessed in light of the current environment, taking into consideration the views of subject matter experts and risk owners within the firm, geo-political risks that may impact our clients, market conditions and the ability of our employees to operate in local offices around the world. Regulatory sentiment, changes within the business and threats with uncertain impact, probability and timeframe could impact the Group. We continuously monitor internal and external environments to identify new and emerging risks. We then analyse each risk and, if needed, develop and apply mitigation and management plans.

The Group determines which key risks it considers to be heightened, for example those that are more costly if they materialise. We then undertake further work to manage these actively. When considering these risks, we also take account of the objectives of regulators to ensure market integrity, appropriate consumer protection and promotion of competition within the industry. The diagram on the following page illustrates the relative likelihood and impact of our risks and is an outcome of our assessments.

We remain vigilant in considering the impact of Brexit on our business model and have described this further at the end of this section.

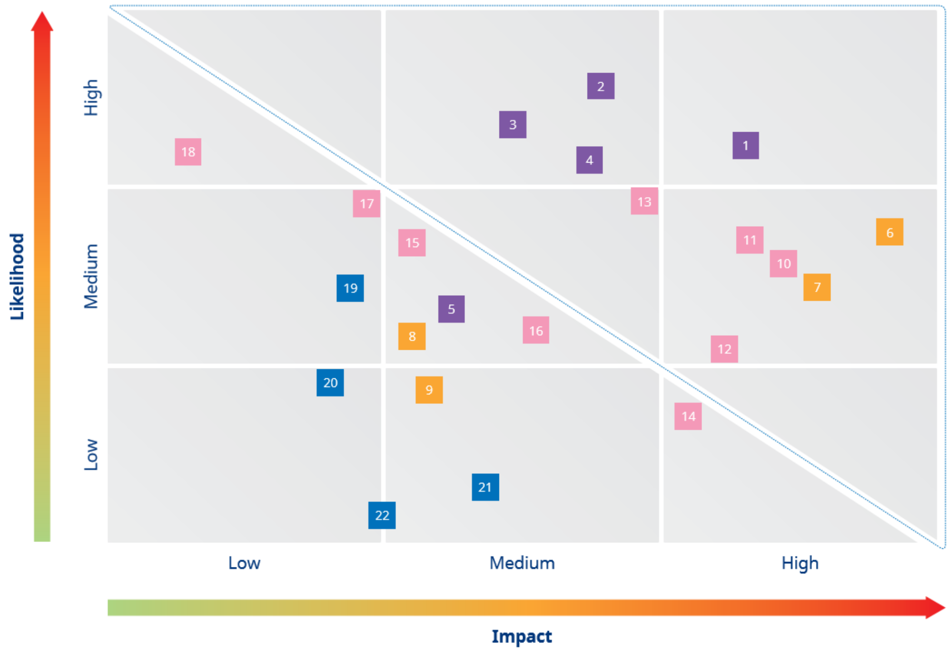
### Reporting on our material risks

The diagram below shows our key risks. The horizontal axis illustrates the impact of a key risk if it were to materialise and the vertical axis illustrates the likelihood of this occurring. The scales of each axis are set on a relative basis between each risk and are based on the residual risks.

The risks that we consider to have either a higher likelihood of impacting the organisation, or with a higher likelihood of occurring, are shown above the diagonal line.

Details of how we manage our risks are described in the tables on the following pages.

**Risk impact matrix, based on residual risk assessment (after controls)**




**Strategic risks**

1. Changing investor requirements
2. Fee attrition
3. Business model disruption
4. Market returns
5. Regulatory landscape change

**Business risks**

6. Reputational risk
7. Investment performance risk
8. Product risk
9. Business concentration risk

**Operational risks**

10. Conduct and regulatory risk
11. Third-party service provider risk
12. Information security risk
13. Process risk
14. Fraud risk
15. Technology risk
16. Legal risk
17. Tax risk
18. People and employment practices risk

**Financial instrument risks**

19. Credit risk
20. Market risk
21. Risk of insufficient capital
22. Liquidity risk

## Key risks

### (a) Strategic risks

Impact for Schroders: These risks relate to our strategy and the environment in which we operate. The impact of these risks, if not carefully managed, is to lower our AUMA and the income we therefore receive. Our business plans seek to address these risks by responding to the challenges faced and growing our assets and earnings.

| Higher-rated key risks | Description | How we manage risk |
|---|---|---|
| 1. Changing investor requirements | Client requirements are evolving rapidly. Failing to adapt or evolve our business model and product range to reflect changing investor requirements could lead to a drop in AUMA. This includes index tracking strategies, such as passive funds. | We have a dedicated Product and Solutions function that focuses on developing our product strategy. We continue to expand our capabilities into new areas, including private assets, and commit seed capital to developing solutions. We carefully manage our cost base to reflect our clients' changing asset allocation requirements. |
| 2. Fee attrition | Continued reduction of fees due to the current market environment and pricing pressures and a move towards vertical integration could impact our revenues. | We are increasing our focus on solutions and outcome-oriented strategies and private assets, which diversify our fee income. We are also increasingly diversifying our product offering, supporting long-term profitability. |
| 3. Business model disruption | Our business model could be disrupted by a range of external factors including technology advancements, product evolution and market participants. Good progress in managing this risk has lowered the impact. | We are increasing our effort to deliver efficiencies and insights through technology. Digital initiatives are in progress to improve client experience, engagement and servicing. We are investing in our technology platform to support scalability, agility in our product offering and our expanding private assets and alternatives businesses. |
| 4. Market returns | Our income is derived from the assets we manage and administer. Falling markets could reduce AUMA and cause a fall in revenues. | We have diversified income streams across a range of markets to mitigate falling markets in any one area. |
| **Lower-rated key risk** | **Description** | **How we manage risk** |
| 5. Regulatory landscape change | The risk that we do not respond appropriately to regulatory changes such as MiFID II, BEAR, GDPR or SMCR, or other events such as Brexit. | Regulatory and legal change is monitored by the Compliance, Legal and Public Policy teams. We engage with regulators globally on potential or planned regulatory changes and in response to Brexit. |

## Key risks

### (b) Business risks

Impact for Schroders: In executing our strategy, a number of key risks arise that could impact our ability to attract and retain clients. By evolving our product offering and delivering investment performance, we have the best opportunity to be selected by clients when allocating assets. A failure to achieve this could lead to a decrease in AUMA.

| Higher-rated key risks | Description | How we manage risk |
|---|---|---|
| 6. Reputational risk | This may arise from poor conduct, judgement or risk events due to weaknesses in systems or controls. The reputation of Schroders can be impacted by any of our key risks. | We consider reputational risks when initiating changes to our strategy or operating model and maintain high standards of conduct. |
| 7. Investment performance risk | There is a risk that portfolios may not meet their investment objectives or that there is a failure to deliver consistent performance. | We have clearly defined investment processes designed to meet investment targets within stated parameters, which are subject to independent review and challenge. |
| **Lower-rated key risks** | **Description** | **How we manage risk** |
| 8. Product risk | There is a risk that our product offering is not suitably diversified, or does not provide access to strategies that will help investors to meet their objectives. | Our dedicated Product and Solutions function focuses on strategy, innovation and changing investor requirements. |
| 9. Business concentration risk | Insufficient diversification in distribution channels, products, clients, markets, or income streams could pose a risk to our business. | We have a broad range and scale of products, distribution and investment channels and our development of strategic relationships and acquisitions enables further diversification of income streams. |

### (c) Operational risks

Impact for Schroders: Operational risks are inherent in all activities and processes. They exist in the normal course of business and are heightened when we undertake changes to our organisation. When operational risk events occur, this may affect our clients and our ability to serve them. We may be liable for financial losses or fines, which could affect our business performance and may weaken our standing with stakeholders.

| Higher-rated key risks | Description | How we manage risk |
|---|---|---|
| 10. Conduct and regulatory risk | The risk of inappropriate conduct, conflicts management practice or behaviour impacting on client outcomes, or of failing to respond appropriately to regulatory changes. | We promote a strong compliance culture and seek to maintain good relationships with our regulators. We also encourage appropriate conduct via our conduct risk framework and culture assessment, supported by compliance monitoring and surveillance programmes. |
| 11. Third-party service provider risk | The risk that suppliers may not meet their agreed service level terms. | We have policies in place to govern our approach to appointing, managing and reviewing third-party providers. |
| 12. Information security risk* | The risk that our technology is compromised or inadequate, resulting in the confidentiality, integrity or availability of our data or Schroders' services being negatively impacted. | Formal governance of information security (cyber) risks exists across the three lines of defence and is monitored by the Information Security Risk Oversight Committee. |

## Key risks

(c) Operational risks (continued)

| Higher-rated key risks | Description | How we manage risk |
|---|---|---|
| 13. Process risk** | The risk of failure of significant business processes, such as mandate compliance, client suitability checks, financial crime risk management and asset pricing. | Our key business processes are regularly reviewed and the risks assessed through the RCA process. When we undertake change, such as acquisitions, we assess new processes that may arise. |
| **Lower-rated key risks** | **Description** | **How we manage risk** |
| 14. Fraud risk | Fraud could arise from any attempt to defraud the firm or our clients by circumventing our processes and controls. | Controls are in place, which are assessed as part of the RCA process. We have applied particular focus to our payment processes. |
| 15. Technology risk | A change or failure in technology could pose a risk to the integrity or availability of the services we offer. | Policies and technical standards are deployed, together with robust project and change management processes, which cover the assessment of business requirements, risk and scalability. |
| 16. Legal risk | The risk that we, our clients, suppliers or other third parties fail to meet or record legal or regulatory obligations. | Our policies and procedures consider legal risk as part of their design. We have an escalation process for the areas of material risk and our Legal function supports our employees and the business. |
| 17. Tax risk | We and the funds we manage are exposed to tax compliance and reporting risks, which include the submission of late or inaccurate tax returns. We have further reviewed the impact and updated our risk position. | Our tax strategy sets out our approach to managing our tax affairs, underpinned by a governance framework and supported by the Tax function, which works with management and advisers to monitor our position and relevant tax changes. |
| 18. People and employment practices risk | The inability to attract, retain or develop key employees to support our business or maintain high standards in employment practices. | We have competitive remuneration and retention plans and build depth and strength in our workforce. We have sustainable succession and employee development processes and recruit selectively through our entry-level and experienced hire programmes. |

* Separated from technology risk.
** Change risk has been removed.

## Key risks

### (d) Financial instrument risks

Impact for Schroders: We face market, credit, liquidity and capital risks from the instruments we manage as part of our AUM, as well as those arising from holding investments where we act as principal. The impact of financial instrument risks on our business may negatively affect our earnings or ability to invest in our business.

| Lower-rated key risks | Description | How we manage risk |
|---|---|---|
| 19. Credit risk | Exposure to counterparty risk from clients, principal investment holdings and in the assets we manage. Our wealth management lending activities also face credit risk exposure. | We assess counterparty creditworthiness and set limits for both principal and agency counterparties. In Wealth Management, credit risk is monitored and managed against approved limits and where collateral is taken. |
| 20. Market risk | Market movements may cause a fall in the value of principal investments and a decline in the value of our proprietary assets. | The Group Capital Committee (GCC) regularly reviews all principal assets held for investment or seed capital purposes. The Group's seed capital investments are hedged in respect of market risk and currency risk, where practical. The Wealth Management Executive Committee monitors and manages market risk in the Group's Wealth Management business. |
| 21. Risk of insufficient capital | The risk that the Group is unable to support its strategic business objectives due to its minimum regulatory capital requirements. | The Group and its legal subsidiaries maintain an appropriate level of capital, including a significant buffer over the minimum regulatory capital requirements, which allows us to conduct business and invest in new business opportunities as they arise. |
| 22. Liquidity risk | The inability to meet our contractual or payment obligations in a timely manner and, in relation to client portfolios, the inability to sell the underlying investments for full value or at all. | The GCC reviews the Group's liquidity needs, considering the current liquidity position, future cash flows, regulatory requirements and potential stress scenarios. The Wealth Management Executive Committee monitors and manages liquidity risk in the Group's banking businesses. We have established processes to assess and monitor the liquidity risk profile of funds on an ongoing basis. |

## Our business model and Brexit

On 29 March 2017, the British government gave notice under Article 50 of the Lisbon Treaty that the UK would leave the European Union (EU) on 29 March 2019. Negotiations continue but uncertainty remains and there is a range of possible outcomes and timeframes for many aspects of the UK's exit from the EU.

Uncertainty with respect to the terms on which the UK will leave the EU has impacted some of the markets in which we invest our clients' assets. We have taken this into account as events have developed over the year, particularly with respect to European-invested strategies with a UK weighting, and have made adjustments accordingly.

Schroders is well-positioned to manage the challenges that arise as a result of Brexit. Our diversified business model and significant presence in the EU27 mean that we are well-placed to continue to service our clients and grow our business.

We have a long-standing commitment to continental Europe, with a substantial presence involving more than 750 employees across nine offices. In Luxembourg, we have around 250 employees in a wide range of functions and from there distribute funds across borders within the EU as well as more widely around the world. We have also obtained additional permissions to ensure we can continue to offer services, including segregated mandates, to European institutional clients where they wish, or need, to contract with an EU27 entity. We delegate portfolio management to a number of jurisdictions including the UK and welcomed the announcements by the UK and other European regulators that they had agreed the necessary cooperation agreements to allow the delegation of portfolio management to the UK to continue.

Globally, our two largest fund ranges are in the UK and Luxembourg. The UK range is not actively marketed outside the UK. Investors in the Luxembourg range are predominantly comprised from the EU27 and elsewhere in the world. The UK government has introduced a regime to allow EU27-based funds to continue to be offered to clients based in the UK in the period immediately after Brexit.