Schroders

Key risks and mitigations

This section summarises how we control risk. It sets out how we manage the risks in our business and how we have developed risk management. It summarises the role of the Group Risk Committee (GRC) and outlines key risks, how we mitigate them and our assessment of their potential impact on our business in the context of the current economic and political environment. Finally, it provides an overview of the impact of emerging risks.

Managing risk

It is the responsibility of all employees to uphold the control culture of Schroders and we embed risk management within the business.

The Board also has accountability for risk management. It regularly considers the most significant risks facing the Group and uses quantitative exposure measures, such as stress tests, where appropriate. Non-executive oversight of the risk management process is exercised through the Audit and Risk Committee.

The Chief Executive and Group Management Committee (GMC) regularly review the key risks facing the Group. Individual risks are managed in accordance with the risks and their potential impacts, so as to mitigate adverse consequences. We group the risks we face into market risks, investment performance and liquidity risks, credit risks, operational risks, and emerging risks.

We continually upgrade our risk control processes and technological support tools to increase their effectiveness. The Chief Executive has delegated the executive oversight of risk to the Chief Financial Officer. The Chief Financial Officer has responsibility for the risk and control framework of the Group and the independent monitoring and reporting of risks and controls.

The Chief Financial Officer is supported by the Group Head of Risk and chairs the GRC. The Committee meets ten times a year. As well as the executive Directors, the heads of the control functions and the Chief Operating Officer, meetings are attended by GMC members consistent with the quarterly cycle of reviewing individual businesses. As the principal executive committee for the monitoring and reporting of risks and controls, 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 exceptions in the most significant risk exposures.

Three lines of defence

The first line of defence against unexpected outcomes lies with line managers, whether they are in Investment, Distribution, Private Banking or Infrastructure. Members of the GMC have risk management responsibility for their respective business areas. The senior management team takes the lead role with respect to implementing controls across the business to maintain the quality standards expected by clients and regulators.

Line management is supplemented by oversight functions (i.e. Group Risk, Financial Control, Compliance and Legal) that provide a second line of defence.

Group Internal Audit provides retrospective independent assurance over the operation of controls and is the third line of defence against unexpected outcomes. The internal audit programme includes reviews of the risk management process and advice and recommendations to improve the control environment. Schroders also carries a comprehensive insurance programme, providing further assurance.

2012 developments

The membership of the GRC was expanded during the year to include all GMC members. Agendas are tailored to Investment, Distribution and Infrastructure on a sequential quarterly cycle and GMC members attend the meetings relevant to their responsibilities. In order to simplify agendas, sub-committees comprising Group policy reviews, credit reviews, financial crime and Private Banking have been established. They report to the GRC.

During 2012, we continued to devote resources to the management of risks associated with potential Eurozone instability and the weak economic environment. A crisis management exercise was held during the year to consider our response to Eurozone risks, which led to the delivery of a Eurozone crisis management plan to the GMC.

We revised our assessment of operational risk controls during the year, piloting the approach successfully in seven business areas and across a variety of supporting systems. A number of new operational 'key risk indicators' were introduced to monitor potential risks such as unauthorised trading.

In addition, we reviewed the operation of the Investment Risk team, changing the reporting line to make it fully independent of Investment.

The GRC's work in 2012 also included emerging risk identification; hard to value and illiquid instruments; mandate breaches; taxation; Private Banking specific risks; preparations for regulatory developments including Client Asset Sourcebook (CASS) revision; Recovery and Resolution Plans; Anti-Money Laundering and market abuse developments; and policy reviews such as Group pricing, personal account dealing and Group order management and execution.

Key risks

The following tables summarise key business risks. These are not exhaustive but aim to provide information on the risks that are currently considered to be most relevant to our business.

Market, investment performance and liquidity risks

We face risks from movements in the financial markets in which we operate, arising from holding investments both as principal and agent. We have principal exposure in the Life Company in Asset Management which holds investments in funds; in our Private Banking business, where we hold bank paper and government securities; and through the Group's investment capital, where we hold bank paper, government and corporate bonds, equities, funds of hedge funds, property and private equity. There is agency exposure in Asset Management and Private Banking in respect of the assets we manage on behalf of our clients.

Description of key risk	How we manage risk
Market risk 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. Equity, net fee income and expenses of the Group's overseas subsidiaries are denominated in local currencies and are therefore subject to exchange rate risk.	Our geographically-diversified, broad product range enables us to provide clients with solutions tailored to a variety of market conditions and serves to diversify individual market dependencies. The Group Capital Committee regularly reviews all holdings within Group capital. All principal investments are managed within approved limits. The Group's seed capital investments may be hedged in respect of market risk and currency risk. These decisions are taken by the Group Capital Committee, chaired by the Chief Financial Officer. Income and expenses are, where possible, matched in the currency of individual subsidiaries. We also use forward foreign exchange contracts to mitigate transactional and investment exposure to currency movements. In Private Banking, market risk is monitored and managed at a local level and by the Private Banking Risk Committee.

Description of key risk	How we manage risk
Investment performance risk The management of investment risk is a core skill of the Group. This is the risk that portfolios will not meet their investment objectives. This can adversely affect levels of net new business.	The Schroder Investment Risk Framework provides review and challenge of investment risks across each of the asset classes managed by the Group. The Investment Risk team is independent of the Investment function. We adhere to clearly-defined investment processes which seek to meet investment targets within stated risk parameters. Individual portfolio performance, valuations and risk profiles are monitored by fund managers and management on a regular basis, as well as Pricing and Valuation Committees, allowing issues to be identified and mitigated. Recognising that products will not outperform all of the time, we offer a diversified product set which reduces the concentration of risk on the performance of any one fund or asset class. Investment performance is monitored as part of our investment risk management process.
Liquidity risk Liquidity risk in relation to client portfolios is the risk that funds cannot be generated to meet redemptions or other obligations as they arise. Liquidity issues can arise as a result of market conditions or through inherently illiquid investments. Liquidity risk also applies to the Group's own capital position.	To mitigate this risk within client portfolios, we seek to match, where possible, the liquidity of a portfolio's underlying investments with the anticipated liquidity requirements. We actively monitor markets for indicators of declines in liquidity. We also review products and portfolios to identify capacity constraints. Each of our regulated subsidiaries, and the Group as a whole, meet regulatory capital requirements. In addition, we maintain sufficient liquidity for our anticipated needs, taking account of the risks we face. We have developed a new Individual Liquidity Analysis Assessment (ILAA) and implemented improved liquidity analysis and reporting in Private Banking in London.

Credit risk

We face risks from the default of counterparties to our principal financial transactions. Our clients also face counterparty risk in relation to the financial transactions in their portfolios and funds. Private Banking additionally faces principal credit risk on its lending activities.

Description of key risk	How we manage risk
Credit risk We face credit risk as a result of counterparty exposure.	In order to manage this risk we actively monitor counterparty creditworthiness with limits expressed in terms of value and term to maturity. The Group sets overall limits in respect of both principal and agency counterparty risk. Where possible, we seek to diversify our exposure across different counterparties. All counterparties are reviewed on a regular basis and limits are amended following changes to their financials. We actively monitor market data and rating agency outputs in assessing counterparties. Collateral is taken in most cases.
We face credit risk through Private Banking lending activities.	In Private Banking, we mitigate credit risk where possible through collateralisation in the form of cash, portfolio investments or property. Credit risk is monitored and managed against the performance of the collateral.

Operational risk

Operational risk arises in our investment management activities, distribution activities, product development and the operation of our IT and operations infrastructure. Local management is responsible for operational risk controls.

Description of key risk	How we manage risk
Operational risk Operational risk could arise from the failure of significant business processes undertaken by Schroders, including mandate compliance and suitability.	All business processes are subject to review in order to identify suitable operational controls to mitigate potential risks.
We have a number of outsourced supplier relationships that are an important part of our business model, particularly in respect of fund administration services.	Before entering outsourcing arrangements, we undertake due diligence on third-party suppliers. We then maintain a programme of regular assessment against agreed service levels.
Distribution risk Distribution risk arises from relationship management and concentration across different distribution channels and products. We have three broad client groups: institutional clients, often advised by consultants; retail clients, intermediated through banks, brokers and independent advisers; and private clients.	The broad range of distribution channels mitigates against a key dependency on any sales channel. No single client accounts for more than two per cent. of total revenue.
Product risk Product risk arises from product complexity and the risk these products do not meet their performance objectives or are unsuitable for certain clients.	We have a dedicated Product Development team and a product approval and review procedure. We consider carefully the suitability of products for clients and where possible, monitor the way products are sold.
Product risk can also arise from capacity constraints where the size of assets under management in a particular asset class makes it more difficult to trade efficiently in the market.	We actively monitor potential capacity constraints and may mitigate them by closing products to new investment in certain circumstances.

Description of key risk	How we manage risk
Technology risk We rely on technology and qualified professionals to maintain our infrastructure, and we invest in information technology projects with long lead times.	We regularly review the progress of major information technology projects and new projects are subject to rigorous testing before approval. Our technology is partly outsourced and our platform uses well-established, tested technology from outsource partners which we assess to be financially stable and able to provide the required level of service. Outsource partners are an important part of our business model and we work with them to maintain the quality and continuity of service. Due diligence is undertaken before entering into new arrangements and performance is reviewed on an ongoing basis. Continuity and business resumption planning is in place across the business globally.
People risk Our business depends on people. We ensure we employ people with skill sets appropriate to our changing business needs.	We recruit and develop specialist skills as the range of our product offerings deepens and our investment and distribution strategies develop into new areas. To mitigate people risks, we have competitive remuneration plans, with appropriate deferred benefits, targeted at key employees, and we seek to build strength in depth and put in place sustainable succession plans. We also operate from many international centres, which reduces reliance on single pools of talent and individual country stability.
We expect our employees to behave with integrity, which is one of our core values.	Clear objectives are set for employees and we measure individual success in the annual review process. This allows us to identify motivational employee development initiatives, which helps to retain talented people. We demand high ethical standards and train our employees accordingly.
Geographical diversity risk Our business is broadly diversified by region which, whilst mitigating aggregate risk, introduces risks as a result of complexity, local laws, regulations, business customs and traditions.	We employ local people with local expertise and also second employees internationally within the Group. The Group Risk Committee receives reports from line management regarding matters giving cause for concern and recommendations for appropriate remedial action. We keep our employees up-to-date on relevant international regulation. An independent team, reporting to the Group Head of Risk, is responsible for assessing the impact of material issues and implementing appropriate and timely risk mitigation. All our overseas operations are regularly reviewed by Internal Audit.

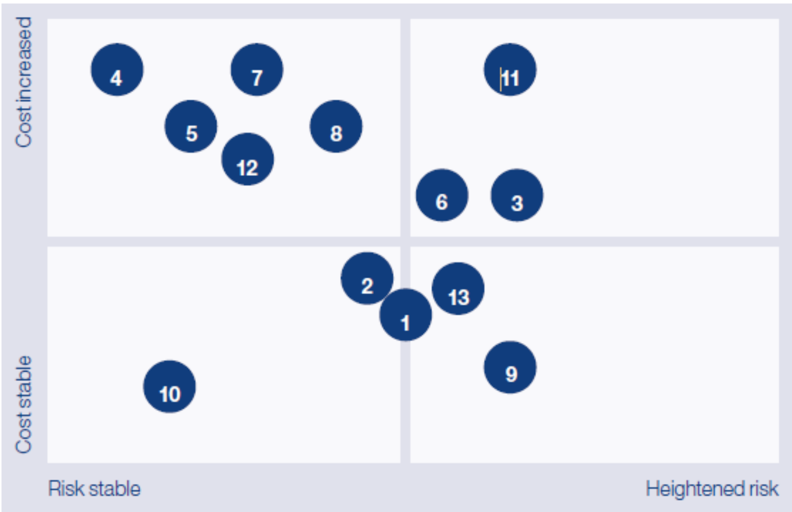
Description of key risk	How we manage risk
Legal risk The risk that Schroders or its counterparties fail to meet their legal obligations and the risk of legal proceedings.	We rely on our employees, with support from our Legal function, to consider carefully the obligations we assume and our compliance with them. Confirmations are obtained from representatives around the Group that any actual or potential dispute or claim has been brought promptly to the attention of the General Counsel.
Regulatory and compliance risk The risk of loss arising from failure to meet regulatory requirements in those jurisdictions in which the Group operates.	We maintain compliance procedures across our global offices, and our Global Compliance function supports business management in meeting its obligations. Compliance with relevant regulatory requirements is monitored continuously.

Key continuing risks

The key continuing risks outlined above have been assessed in the light of the current economic and geopolitical environment as summarised in the diagram below.

The horizontal axis shows whether risk is stable or heightened in current market conditions. The vertical axis shows whether the potential cost of the key risk is stable or has increased due to current market conditions. The Group undertakes additional work to address those risks that it considers to be potentially heightened and/or more costly.

1. People risk: Employment practices and workplace safety
2. Geographical diversity: Disasters and public safety
3. Regulatory and compliance risk
4. Operational risk: Distribution risk
5. Operational risk: Clients, products and business practices
6. Legal risk
7. Operational risk: Technology and infrastructure failures
8. Operational risk: Execution, delivery and process management
9. Counterparty credit risk
10. Credit lending risk
11. Liquidity risk
12. Investment performance risk
13. Market risk



Emerging risks

Emerging risks are those with uncertain impact, probability and timeframe that could cause risk to the Group. These are the hardest to define and may change in nature. We analyse each risk and, if needed, develop and apply mitigation and management plans. The external emerging risks that are currently our focus of attention are set out below. The diagram indicates our assessment of the likelihood, timeframe and impact on our business. The estimated impact and likelihood may change as circumstances change and mitigation plans are developed. Regulatory risks are reported on the following page.

1. Eurozone crisis
2. Major bank failure
3. Market liquidity crisis
4. Margin pressure
5. Investment performance
6. Negative real interest rates
7. LIBOR
8. Oil price shock
9. Argentina
10. Financial transaction tax
11. Corporate bond fund liquidity
12. Terrorism

Key regulatory change risks

The extent of regulatory change facing the asset management and private banking industries has increased significantly in recent years. As part of our risk reporting, we have introduced the following diagram that combines both known and emerging regulatory change risks, to identify both the likely timing and estimated impact of regulatory change on our business.

1. Financial Services Compensation Scheme levy
2. Vickers report impact
3. AIFMD impact
4. Basel III/Capital Requirements Directive (CRD) IV
5. MiFID II
6. UCITS V
7. Anti-Money Laundering (AML)
8. Client Asset Sourcebook (CASS) revision
9. Solvency II client reporting
10. Market Abuse Directive (MAD) II
11. Remuneration policies
12. Dodd-Frank OTC
13. European Banking Authority's common regulatory reporting framework (COREP)
14. RDR for platforms
15. EU Securities Law
16. Private Banking Recovery and Resolution Plans
17. Group Recovery and Resolution Plans
18. European market Infrastructure Regulation (EMIR – OTC market reform)
19. Asia OTC
20. Dodd-Frank commodities
21. Data protection
22. UCITS VI
23. Solvency II
24. FSA change to FCA/PRA