

Key risks and mitigations

This section explains how we control and manage the risks in our business. It outlines key risks, how we mitigate them and our assessment of their potential impact on our business in the context of the current environment.

Managing risk

The Board is accountable for risk and the oversight of the risk management process. It 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 with respect to standards of integrity, financial reporting, risk management and internal control.

It is the responsibility of all employees to uphold the control culture of Schroders. We therefore embed risk management within all areas of the business. Members of the GMC have risk management responsibility for their respective business areas and we expect individual behaviours to mirror the culture and core values of the firm.

The Chief Executive and the GMC, as the principal executive committee with responsibility for the monitoring and reporting of risk and controls, review regularly the key risks facing the Group.

The executive oversight of risk is delegated by the Chief Executive 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 Group Risk Committee (GRC), which meets ten times a year, and more frequently if required, and is attended by the heads of the control functions, being Group Risk, Finance, Compliance, Legal and Internal Audit, the Chief Operating Officer, the Head of Investment and senior managers from Distribution and Wealth Management. The GRC supports the Chief Financial Officer and the GMC in discharging their risk responsibilities. 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. The GRC and the newly formed Wealth Management Audit and Risk Committee receive reports in respect of risk from the Wealth Management Executive Committee.

Lines of defence

The first line of defence against undesirable outcomes is the business function and the respective line managers, across Investment, Distribution, Wealth Management and Infrastructure. Business heads take the lead role with respect to implementing and maintaining appropriate controls. Line management is supplemented by oversight functions, such as Group Risk, Finance, Compliance and Legal, which constitute the second line of defence. The compliance monitoring programme reviews the effective operation of our processes in meeting regulatory requirements.

Group Internal Audit provides retrospective, independent assurance over the operation of controls and is the third line of defence. The internal audit programme includes reviews of risk management processes and recommendations to improve the control environment. External reviews from the Group's auditors provide a fourth line of defence.

Schroders also maintains comprehensive insurance cover.

2014 developments

Upholding high standards of conduct and focusing on clients' interests and outcomes is fundamental to our business. We have reviewed and formalised our approach in this regard, taking into account the increasing expectations of clients and regulators. We have also taken steps to enhance our client-centric processes and communications, building on our established culture and values.

In 2013, we implemented a new operational risk system to support our firm-wide risk and control assessments and in 2014 we continued to invest in technology to enhance our risk management capabilities and manage our investment risks.

Information security has been an area of specific attention in response to the increasing prevalence of cyber-crime and related fraud within our industry.

Following the integration of Cazenove Capital, our Wealth Management division is now substantially larger. In recognition of this, we established a separate Wealth Management Audit and Risk Committee which provides reports to the Board Audit and Risk Committee, and provides non-executive oversight of the Wealth Management business.

New instruments and strategies are important for the growth of our business and we have continued to invest in investment risk management systems to reflect both the level of growth and the complexity of the strategies we use.

Mapping our key continuing risks

The key continuing risks outlined below have been assessed in the light of the current environment as summarised in the following diagram.

The horizontal axis shows whether the risk is stable or heightened reflecting current market conditions. The vertical axis shows the potential financial impact to the firm. The Group undertakes additional work to address those risks that it considers to be potentially heightened or more costly.

This year we have made the following changes to the presentation of our key risks:

- A new category for Business risks has been included which sets out the risks that are material to our business, but against which we are not required to hold regulatory capital;
- The Market, Investment Performance and Liquidity category has been renamed as Market, Credit and Liquidity risk;
- Distribution risk, Geographical diversity risk and Conduct risk have been renamed Business concentration risk, International business risk and Conduct and regulatory risk to align better to the nature of the risks presented;
- Integration risk has been removed as a key risk following the successful integration of Cazenove Capital; and
- Fraud risk has been separately identified given the growing focus on fraud prevention across financial services.

1. Reputational risk
2. Investment performance risk
3. Product risk
4. Business concentration risk
5. International business risk
6. Market risk
7. Credit risk
8. Liquidity risk
9. Conduct and regulatory risk
10. Legal risk
11. Process risk
12. Fraud risk
13. Technology and information security risk
14. People and employment practices risk
15. Third-party service provider risk



Reputational risk

The reputation of Schroders is of paramount importance. In the asset management industry, our reputation can be impacted by an adverse risk event of various types.

Description of key risk	How we manage risk
<p>Reputational risk</p> <p>Reputational risk impacts Schroders' brand, reliability and relationship with clients and shareholders. This may arise from poor conduct or judgements, or from negative financial or operational events as a result of weaknesses in systems and controls.</p> <p>Reputational risk may also arise from taking on inappropriate client relationships or mandates which may have adverse implications for the Group.</p>	<p>High standards of conduct and a principled approach to regulatory compliance are integral to our culture and values. We consider key reputational risks when initiating changes in strategy or operating model.</p> <p>In addition, we have a number of controls and frameworks to address other risks that could affect our reputation including: conduct risk, financial crime, investment risk and client take-on and product development.</p>

Business risks

Business risk can be influenced by both internal and external factors. A risk can materialise due to suboptimal business execution or a failure to respond appropriately to internal or external factors. Business risk can impact our earnings.

Description of key risk	How we manage risk
<p>Investment performance risk</p> <p>The management of investment performance risk is a core skill of the Group. This is the risk that portfolios will not meet their investment objectives or that there is a failure to deliver consistent and above-average performance.</p>	<p>We have in place clearly defined investment processes designed to meet investment targets within stated risk parameters.</p> <p>The Group's Investment Risk Framework provides review and challenge of investment risks, independent of our fund managers, across all asset classes. Individual portfolio performance, valuations and risk profiles are monitored by fund managers and asset class management on a regular basis, as well as by Pricing and Valuation Committees, Asset Class Risk Committees and the GMC.</p> <p>Recognising that products will not outperform all of the time, we offer a diversified product set which reduces our dependence on the performance of any one fund or asset class.</p> <p>Key to this performance is our ability to attract and retain talented people (see People and employment practices risk for further information).</p>

<p>Product risk</p> <p>Product risk arises from product complexity and the risk that products do not meet their objectives.</p> <p>Product risk can also arise from capacity constraints where the size of assets under management in a particular asset class or strategy makes it more difficult to trade efficiently in the market.</p>	<p>To manage product risk we conduct quantitative analysis on a product by product basis to confirm that products are performing as expected and meeting the needs of our clients. If the results do not meet our benchmarks, we assess the qualitative aspects and, if appropriate, the product strategy is reassessed.</p> <p>New fund proposals are evaluated by the Product Development Committee which considers the risk management approach, potential investor profiles and distribution channel to ensure these are both suitable and commercially viable. New investment propositions and strategies are reviewed by the Product Strategy Committee.</p> <p>We monitor potential capacity constraints and may mitigate them by hard or soft closing products to new investment. The Product Development Committee considers the interests and needs of potential investors in our funds.</p>
<p>Business concentration risk</p> <p>Business concentration risk arises from concentration in a small number of distribution channels or products or when a small number of clients are concentrated in a specific product or market.</p>	<p>The broad range of distribution channels that we have established mitigates the concentration risk we have and the dependency on any single sales channel. No client accounts for more than two per cent. of revenues.</p> <p>We aim to ensure client concentrations in any particular market or channel do not become excessive.</p>
<p>International business risk</p> <p>Our business is broadly diversified by region. Whilst this mitigates our aggregate risk profile it introduces additional risks in terms of operating cross-border and in multiple environments as a result of complexity, local laws, regulations, business customs and traditions.</p>	<p>We aim to employ people with local expertise who ensure the business and operations conform to local requirements as well as Group standards. In addition, we seek the advice of local experts (for example, in the areas of tax, regulatory and legal) where appropriate. Furthermore, our employees are trained in relation to local requirements and are able to share their knowledge through international secondments across the Group.</p> <p>Our international operations are regularly reviewed by Internal Audit.</p> <p>The GRC receives reports from line management regarding matters giving cause for concern and recommendations for appropriate remedial action.</p>

Market, credit and liquidity risks

We face market, credit and liquidity risks from movements in the financial markets in which we operate, arising from holding investments both as principal and agent.

Description of key risk	How we manage risk
<p>Market risk</p> <p>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 in the agency business.</p> <p>Operating capital, net fee income and expenses related to the Group's overseas subsidiaries are denominated in local currencies and are therefore subject to exchange rate risk.</p>	<p>Our geographically-diversified, broad product range enables us to provide clients with solutions in a variety of market conditions and serves to diversify individual market dependencies.</p> <p>The Group Capital Committee, chaired by the Chief Financial Officer, regularly reviews all principal assets held for investment or seed capital purposes. The Group's seed capital investments are usually hedged in respect of market risk and currency risk. The Wealth Management Executive Committee monitors and manages market risk in the Group's banking businesses.</p> <p>We use forward foreign exchange contracts to mitigate transactional and investment exposure to currency movements.</p>
<p>Credit risk</p> <p>We face credit risk as a result of counterparty exposure with respect to client, principal and derivative exposures.</p> <p>We also face credit risk through Wealth Management lending activities, in addition to transactional counterparty risk.</p>	<p>To manage this risk we assess counterparty creditworthiness and set appropriate limits for both our principal and agency counterparties.</p> <p>The creditworthiness of the counterparties and borrowers are monitored as is usage against the relevant credit limits. We seek to diversify our exposure across different counterparties.</p> <p>In Wealth Management, we seek to mitigate credit risk within the lending activities as appropriate through collateralisation in the form of cash, portfolio investments or real estate. Credit risk is monitored and managed against limits and collateral.</p>
<p>Liquidity risk</p> <p>Liquidity risk in relation to client portfolios is the risk that funds are not readily available to meet redemptions or other obligations as they arise.</p> <p>Liquidity risk is also the risk that the Group or any of its subsidiaries cannot meet its contractual or payment obligations in a timely manner.</p>	<p>To mitigate this risk within client portfolios we seek to match, where possible, the liquidity of a portfolio's underlying investments with the anticipated redemption requirements. We pay particular attention when we offer funds with daily liquidity that the assets they hold are liquid. We actively monitor markets for indicators of a decline in liquidity. We also review products and portfolios to identify capacity constraints.</p> <p>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.</p> <p>In Wealth Management in London, we operate an Individual Liquidity Adequacy Assessment (ILAA) process.</p>

Operational risks

Operational risk arises in our investment management and banking activities, distribution activities, product development and in our IT and operational infrastructure. Line management is responsible for operational risk controls. The second line of defence teams develop and deploy the risk framework and monitor its implementation and operation.

Description of key risk	How we manage risk
<p>Conduct and regulatory risk</p> <p>The risks of client detriment arising from inappropriate conduct, practice or behaviour and failing to meet client needs, interests or expected outcomes.</p> <p>The risks of money laundering, bribery, fraud or market abuse shortcomings on the part of fund investors, clients or our employees.</p> <p>The risk of fines, penalties, censure or other sanctions arising from failure to identify or meet regulatory requirements.</p> <p>The risk that new regulation or changes to existing interpretation has a material effect on the Group's operations or cost base.</p>	<p>We promote a strong compliance culture and we value good relationships with our regulators. Our Compliance function supports management in identifying and meeting our regulatory obligations with relevant training and procedures. Compliance with relevant regulatory requirements is monitored in accordance with a risk-based programme.</p> <p>Our approach to encouraging appropriate conduct is set out in our conduct risk framework, and is built on culture and values, supported by appropriate governance and reporting. This includes:</p> <ul style="list-style-type: none"> • A culture in which all employees are encouraged and supported to 'do the right thing'; • A long-term approach to creating value and good outcomes for our clients, fund investors and shareholders; • A focus on products that meet the needs of our clients and investors; and • Strong controls, governance, training and risk management processes. <p>Regulatory and legal change is monitored by the compliance, legal and public policy teams. Key regulatory and tax risks are identified below. We engage with our regulators and participate in representative industry organisations so that we are informed about, and involved in, potential changes.</p>
<p>Legal risk</p> <p>The risk that Schroders or its counterparties, clients or suppliers with whom we contract fail to meet their legal obligations and the risk of legal proceedings and loss.</p> <p>The risk that client expectations and obligations with respect to our own and third-party responsibilities under investment management and other agreements will not be met, with a revenue or contingent liability impact.</p>	<p>We rely on our employees, with support from our Legal function, to consider the obligations we assume across the Group and our compliance with them. Our policies and procedures across the Group are developed having regard to recognised legal risks.</p> <p>Confirmations are obtained from representatives around the Group that actual or potential disputes or claims have been brought promptly to the attention of the General Counsel.</p> <p>We have an escalation process for areas of identified material risk.</p>

<p>Process risk</p> <p>The risk of failure of significant business processes, including for example mandate compliance, client suitability checks and asset pricing.</p>	<p>Risk and Control Assessments are used to identify and assess key operational risks. Associated controls are assessed with regard to their design and performance. Where required, processes and controls are enhanced to improve the control environment.</p> <p>We manage risk events through identification, reporting and resolution with the aim of preventing risk events from recurring.</p>
<p>Fraud risk</p> <p>Fraud could arise from either internal or external parties who attempt to defraud the firm or our clients by circumventing our processes and controls.</p>	<p>We operate a system of processes and controls to aid prevention and detection of attempted fraud. In addition, we have a governance framework through which all types of fraud, including cyber-crime, are monitored. The framework includes the use of fraud risk assessments to identify potential risks and to ensure appropriate controls are in place.</p>
<p>Technology and information security risk</p> <p>Technology and information security risk relates to the risk that our technology systems and support are inadequate or fail to adapt to changing requirements; that our systems are penetrated by third parties; and that data is held insecurely.</p>	<p>Schroders actively engages with regulators and intelligence services to understand and take action against potential cyber threats.</p> <p>An information security strategy has been established and is overseen by the Information Security Council which provides executive oversight. We maintain explicit cover for cyber-crime as part of the Group's insurance protection.</p>
<p>People and employment practices risk</p> <p>Talented people may be targeted by competitors seeking to build their businesses.</p> <p>In addition, people and employment practices risk relates to the risk that our employment practices do not comply with local legislation, such as equal opportunities, human rights or the safety and wellbeing of employees when at work.</p>	<p>We have competitive remuneration and retention plans, with appropriate deferred benefits targeted at key employees. We seek to build strength in depth and to put in place sustainable succession and development plans. We also operate from many international centres, which reduces our reliance on single pools of talent. Clear objectives are set for employees and success is measured in the annual review process, allowing us to identify motivational development initiatives.</p> <p>We have policies and procedures in place to manage employment issues appropriately and handle them consistently, fairly and in compliance with local legislation.</p>
<p>Third-party service provider risk</p> <p>We have a number of outsourced supplier relationships as part of our business model, particularly in respect of information technology, fund administration and transfer agency services.</p> <p>Third-party service provider risk relates to the risk that suppliers may not be able to meet their agreed service level terms.</p>	<p>Our outsourcing policy sets out key considerations when appointing and managing a third-party service provider, including due diligence and regular reviews of providers' performance against agreed service levels.</p> <p>Exit plans are considered prior to appointment and provide a framework for transitioning business from one service provider to another should the quality fall below the agreed service level.</p> <p>On an annual basis, the GRC reviews all outsourced relationships covered by the Group Policy, focusing on significant aspects such as service quality and risks.</p>

Mapping key emerging risks

Emerging risks are those with uncertain impact, probability and time frame that could impact the Group. These are the hardest to define. 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 and potential timing of these risks. The estimated likelihood may change as circumstances evolve and mitigation plans are developed. Regulatory and tax related risks are mapped below.

1. Eurozone crisis
2. Major bank failure
3. Market liquidity crisis
4. Margin pressure
5. Geopolitical events (for example Ukraine, Middle East, oil price)
6. Clearing house failure
7. Cyber-crime
8. Terrorism
9. UK exit from the European Union



Mapping key regulatory and tax related risks

The extent of regulatory and tax change facing our industry has increased significantly. This poses both risks and opportunities for our business. The diagram below combines known and emerging regulatory and tax change initiatives, to identify both the likely timing and estimated impact of regulatory change on our business. New initiatives which arose during 2014 are highlighted in orange.

1. Strengthening accountability in UK banking: the new regulatory framework
2. Markets in Financial Instruments Directive II (MiFID II) and Regulation (MiFIR) implementation
3. Undertakings for Collective Investments in Transferable Securities (UCITS) Directive V implementation
4. Anti-money laundering, bribery and corruption developments
5. UK Client Assets rules revision
6. Market Abuse Directive II (MAD II) and Regulation (MAR) implementation
7. Remuneration and employee incentivisation reform
8. Derivatives clearing and reporting globally
9. EU money market funds proposals
10. EU Recovery and Resolution Directive implementation
11. Data and privacy protection reform
12. EU Solvency Directive II implementation
13. EU Packaged Retail and Insurance based Investment Products Regulation
14. Regulatory scrutiny of systemic risks in asset management
15. EU Shareholder Rights proposal
16. European Long Term Investment Funds
17. EU Capital Markets Union proposals
18. Asian mutual fund recognition initiatives
19. SEC focus on US mutual funds
20. UK Fair and Effective Markets Review
21. Review of EU Capital Requirements Directive IV implementation
22. FATCA reporting
23. OECD base erosion and profit sharing tax initiative
24. EU VAT changes
25. OECD common tax reporting standard
26. EU Financial Transaction Tax

