

## 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 economic and political 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 and we embed risk management within the business. Members of the Group Management Committee (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 review the key risks facing the Group regularly as the principal executive committee with responsibility for the monitoring and reporting of risk and controls. These include reputational, market, investment performance and liquidity risks, credit risks, operational risks including legal, regulatory and compliance, people and conduct risk, and emerging risks.

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, which meets 10 times a year, and more frequently if required, and is attended by the heads of the control functions, the Chief Operating Officer, the Global Head of Equities and senior managers from Distribution. The Group Risk Committee supports the Chief Financial Officer and the GMC in discharging these risk responsibilities. It 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. There is also a dedicated Wealth Management Risk Committee, which reports into the Group Risk Committee.

### Lines of defence

The first line of defence against unexpected outcomes lies with line managers, whether they are in Investment, Distribution, Wealth Management or Infrastructure. The senior management team takes the lead role with respect to implementing and maintaining appropriate controls across the business to ensure the quality standards expected by clients and regulators. Line management is supplemented by oversight functions, such as Group Risk, Finance, Compliance and Legal, which provide the second line of defence. The Compliance monitoring programme reviews the effective operation of our processes to meet regulatory requirements.

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. External assurance can provide a fourth line of defence.

Schroders also has a comprehensive insurance programme, providing substantial financial assurance.

### 2013 developments

During the year, we reviewed and re-emphasised the role of the GMC as the principal executive committee with responsibility for risk as well as the responsibility of line management in embedding appropriate risk management throughout the firm. We continued to devote resources to the management of risks associated with the external market environment, including instability in the Eurozone although this risk decreased as the year progressed.

Investment risk was another area of focus, reflecting the growth in funds and assets under management. We introduced a new operational risk system, 'Archer', to support a revised, firm-wide 'Risk and Control Assessment' approach.

The focus on Wealth Management-specific risks continued in 2013, particularly investment risk and the risks associated with the integration of the acquisition of Cazenove Capital. The risks associated with the integration of STW and our relationship with Secquaero were also reviewed regularly. The implications of business integration on our IT and Operations functions was considered, with regular assessments of project prioritisation and resource allocation.

Updates were made to a number of Group policies, including conflicts of interest and anti-bribery and corruption to reflect new regulatory guidance in these areas; institutional client take-on procedures; investment model governance; and the acceptance of contingent liabilities and other non-standard commitments. We reviewed our approach to conduct risk recognising its importance to our clients and regulators.

## Key risks

The following tables summarise key business risks currently considered most relevant to our business.

### Reputational risk

**In the asset management industry, reputational risk can arise from any of the key risks outlined below. Reputation risk relates to the Schroders brand, as well as ethics, trust, relationships with stakeholders, conduct and the overall culture and values of our firm.**

Description of key risk	How we manage risk
<b>Reputational risk</b> This can arise from financial or operational events or failing to meet stakeholders' expectations.	Integrity, appropriate conduct and a principled approach to regulatory compliance, including treating customers fairly, are integral to Schroders' culture. We engage in proactive communications with all stakeholders and monitor media coverage to understand how our reputation is perceived.

### 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 our Wealth Management business, where we hold bank paper and government securities; and through the Group's investment capital, where we hold cash and certificates of deposits, government and corporate bonds, equities, funds of hedge funds, property, private equity and catastrophe bonds. We also have principal exposure in the Life Company in Asset Management which holds investments in funds but this exposure is transferred to third-party investors in the Life Company's product and therefore is comparable to the agency exposure in both segments in respect of the assets we manage on behalf of our clients.**

Description of key risk	How we manage risk
<b>Market risk</b> 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.  Operational capital, net fee income and expenses related to the Group's overseas subsidiaries are denominated in	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, chaired by the Chief Financial Officer, regularly reviews all holdings within Group capital. All principal investments are managed within approved limits. The Group's seed capital investments are usually hedged in respect of market risk and currency risk.  Income and expenses are, where possible, matched in the currency of individual subsidiaries. We also use forward foreign exchange contracts to mitigate

local currencies and are therefore subject to exchange rate risk.	transactional and investment exposure to currency movements. In Wealth Management, a Wealth Management Risk Committee has been established to monitor and manage market risk at a local level.
<b>Investment performance risk</b> 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. This can adversely affect levels of net new business.  In Wealth Management, this also includes the risk of inappropriate advice and unsuitable investment portfolios in relation to clients' investment objectives.	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 by Pricing and Valuation Committees, Asset Class Risk Committees and the GMC, 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.  A dedicated Investment Risk Committee for Wealth Management was established in 2013, following the acquisition of Cazenove Capital and the growth of our Wealth Management business.
<b>Liquidity risk</b> 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 holdings of inherently illiquid investments. Liquidity risk also applies to the Group's own financial obligations.	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 actively monitor markets for indicators of a decline 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.  In Wealth Management in London, we operate an Individual Liquidity Analysis Adequacy (ILAA) process.

## 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. Wealth Management additionally faces principal credit risk on its lending activities.**

Description of key risk	How we manage risk
<b>Credit risk</b> We face credit risk as a result of counterparty exposure.  We face credit risk through Wealth	In order to manage this risk we 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. Counterparties are reviewed on a regular basis and limits are amended following changes to their financial condition. We monitor market data and rating agency outputs in assessing counterparties.  In Wealth Management, we mitigate credit risk, where possible, through

Management lending activities.	collateralisation in the form of cash, portfolio investments or property. Credit risk is monitored and managed against the performance of the collateral.
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## Operational risk

**Operational risk arises in our investment management activities, distribution activities, product development and the operation of our IT and operations infrastructure. Line management is responsible for operational risk controls. We also face integration risk when consolidating acquired businesses into the Group.**

Description of key risk	How we manage risk
<b>Process risk</b> Operational risk could arise from the failure of significant business processes undertaken by Schroders, including for example mandate compliance, client suitability checks and asset pricing.	Business processes are reviewed to identify suitable operational controls to mitigate potential risks.
<b>Third-party service provider risk</b> We have a number of outsourced supplier relationships as part of our business model, particularly in respect of fund administration and transfer agency services.	Before entering into outsourcing arrangements, we undertake due diligence on third-party suppliers. We then maintain a programme of regular assessment against agreed service levels.
<b>Integration risk</b> Integration risk arises on the acquisition of a business that may have a significant impact on the risk exposure and risk management strategies of the combined business.  It also includes transaction-specific risks, such as the impact of competing demands on IT and Operations from system integration, loss of clients or key employees.	Risk management considerations are evaluated prior to any acquisition and an integration plan, including risk management, as well as steps to address transaction specific risks, is developed and implemented post-acquisition. The GMC, supported by the Group Risk Committee, monitors integration progress against planned targets.  Group Risk considers the risk resources available to support newly acquired businesses and appropriate risk resource with experience of the relevant business area is identified and developed.
<b>Distribution risk</b> Distribution risk arises from 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 and	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.

charities.	
<p><b>Product risk</b></p> <p>Product risk arises from product complexity and the risk that these products either do not meet their performance objectives or are unsuitable for certain clients.</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>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.</p> <p>We monitor potential capacity constraints and may mitigate them by hard or soft closing products to new investment in certain circumstances.</p>
<p><b>Technology and security risk</b></p> <p>The risks that our technology systems and support are inadequate or fail to adapt to changing requirements; that our systems are vulnerable to third-party penetration; and that data is held insecurely.</p> <p>We rely on technology and qualified professionals to maintain our infrastructure, and we invest in information technology projects with long lead times.</p>	<p>The UK Government and Bank of England have highlighted cybercrime as an issue across the financial and broader commercial sectors and we are engaging in a Bank of England exercise to address our response to potential threats. A Head of Information Security has joined the Group and we have updated the Group's insurance cover for cybercrime to include more explicit coverage in the terms and conditions.</p> <p>We regularly review the progress of major information technology projects and new systems 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.</p> <p>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.</p>
<p><b>People risk</b></p> <p>Talented people may be targeted by competitors seeking to build their businesses.</p>	<p>To mitigate people risks, we have competitive remuneration and retention plans, with appropriate deferred benefits targeted at key employees, and 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 reliance on single pools of talent and individual country stability. Clear objectives are set and success is measured in the annual review process, allowing us to identify motivational development initiatives.</p>
<p><b>Conduct risk</b></p> <p>The risks of client detriment, particularly with respect to retail fund distribution and Wealth Management, and market integrity, money laundering and bribery and corruption.</p>	<p>This is managed through a conduct risk framework focusing on enhancements to risk identification, mitigation, management information and reporting in conjunction with line management and Human Resources.</p> <p>Our client take-on programmes are designed to confirm clients' status, risk appetite and requirements.</p>

<p>We face the possible risk of inappropriate conduct or actions by individuals or a group of employees.</p>	<p>We expect our employees to behave with integrity, which is one of our core values. We promote our cultural values throughout the firm and demand high ethical standards and train our employees accordingly.</p>
<p><b>Legal, regulatory and compliance risk</b></p> <p>The risk that Schroders or its counterparties or clients fail to meet their legal obligations and the risk of legal proceedings and loss. The risk that client expectations and obligations with respect to our own and third-party responsibilities under their investment management and other agreements will not be met with a revenue or contingent liability impact.</p> <p>The risk of legal or regulatory action resulting in fines, penalties, censure or other sanction or legal action arising from failure to identify or meet regulatory and legislative requirements in those jurisdictions in which the Group operates.</p> <p>The risk that new regulation or changes to the interpretation or implementation of existing regulation affects the Group's operations and cost base.</p>	<p>We rely on our employees, with support from our Compliance and Legal functions, to consider carefully the obligations we assume and our compliance with them.</p> <p>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.</p> <p>We maintain compliance procedures across the Group, and our Compliance and Legal functions support business management in meeting its obligations. Compliance with relevant regulatory requirements is monitored in accordance with a risk-based programme.</p> <p>Regulatory and legal change is monitored by the Compliance and Legal functions. Key regulatory change risks are identified on page 34. We maintain good working relationships with our regulators and participate in industry representative organisations globally to ensure we are informed of potential changes in regulations.</p> <p>With the introduction of central clearing for derivatives we are revising our credit and operational due diligence processes.</p>
<p><b>Geographical diversity risk</b></p> <p>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.</p>	<p>We employ local people with local expertise and also second employees internationally within the Group.</p> <p>The Group Risk Committee receives reports from line management regarding matters giving cause for concern and recommendations for appropriate remedial action.</p> <p>We keep our employees up-to-date on relevant international regulation.</p> <p>An independent team, reporting to the Group Head of Risk, is responsible for assessing the impact of material risk issues and events across the offices of the Group and implementing appropriate and timely risk mitigation.</p> <p>Our overseas operations are regularly reviewed by Internal Audit.</p>

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

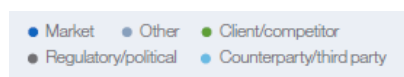
1. Reputational risk
2. Market risk
3. Investment performance risk
4. Liquidity risk
5. Credit risk
6. Process risk
7. Third-party service provider risk
8. Integration risk
9. Distribution risk
10. Product risk
11. Technology and security risk
12. People risk
13. Conduct risk
14. Legal, regulatory and compliance risk
15. Geographical diversity risk



## Key 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, and potential timing of those risks. The estimated 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. US debt crisis
6. Clearing house failure
7. Cyber-crime
8. Fund liquidity
9. Terrorism
10. UK exit from the European Union





## Key regulatory change risks

The extent of regulatory change facing our industry has increased significantly in recent years. The following diagram combines known and emerging key regulatory change risks, to identify both the likely timing and estimated impact of regulatory change on our business. New risks in 2013 are highlighted in grey.

1. Consumer rights bill
2. Banking reform Act
3. AIFMD
4. Capital Requirements Directive IV
5. MiFID II
6. UCITS V
7. Anti-Money Laundering Directive IV
8. Client asset reform
9. Market Abuse Directive II
10. Remuneration regulation
11. EU common regulatory reporting framework
12. Retail Distribution Review
13. EU securities law reform
14. Shadow banking/money market funds reform
15. Non-bank Recovery and Resolution requirements
16. Derivative regulation – US, Europe, Asia
17. Data protection regulation
18. Solvency II
19. Packaged Retail Investment Products Directive
20. Dealing commission reform

