Key risks and mitigations

This section provides a summary of our control of risk. It sets out how we manage the risks in our business and how we have developed risk management during 2011, including a summary of the work of the Group Risk Committee. It then provides a summary of the key continuing risks, how we mitigate them and our assessment of their potential impact on our business in the context of the current economic and geopolitical environment. Finally, it provides an overview of the impact and indicative timescales of emerging risks.

Managing risk

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

The Board retains 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. The non-executive oversight of the risk management process lies with the Audit and Risk Committee.

The Chief Executive and Group Management Committee review the key corporate risks facing the Group. Individual risks are managed in different ways depending on the nature of the risks and their potential impacts so as to mitigate adverse consequences. We group the risks we face into market, 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 Group Risk Committee, which includes, as well as the control functions, senior representatives from each business segment and division, including the Chief Investment Officer, Chief Operating Officer and the Group Head of Private Banking. As the principal management committee for the monitoring and reporting of risks and controls, the Group Risk Committee 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 Group Management Committee have risk management responsibility within their respective business areas. The senior management team takes the lead role with respect to appropriate controls across the business to maintain the quality standards expected by clients and regulators.

Line management is supplemented by oversight functions 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.

2011 developments

During the year, we worked to increase the awareness of individuals' responsibility for the control of risk. For example, we prepared a bespoke film for the 2011 global management meeting focusing on external risks faced by the Group. We drew not only on internal views but included perspectives from other leading financial institutions and regulators.

We have also worked to increase the sophistication of our risk controls. There have been three notable automations: the installation of a global treasury system; the development of transparent look-through reporting of Group capital holdings providing detailed analyses of combined exposures; and a consolidated daily report of counterparty exposures.

The Group Risk Committee's work in 2011 included emerging risk identification; complex product development reviews; preparations for the implementation of the UK Bribery Act; the approval of client take-on procedures; preparations for regulatory developments such as Dodd-Frank, FATCA, UCITS IV and RDR; the Japanese earthquake business continuity plan; and policy reviews such as brand protection, information assurance, procurement and corporate residence.

We devoted resources to the management of risks associated with Eurozone instability and the weak economic environment, establishing a team to monitor, pre-empt and react to developments. Its work continues.

We have increased the sophistication of statistical modelling of risk outcomes which has resulted in improved quantification of Pillar 2 regulatory capital. The Financial review in the Annual Report covers this in more detail.

We have extended the Group Risk Committee's attendees to include all members of the Group Management Committee on a quarterly basis.

Key risks

The following tables summarise key business risks. The list is not exhaustive but aims 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 as both principal and agent. We have principal exposure in the life company in Asset Management where we hold 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 this 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.	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. Group management 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.
Shareholders' funds, net fee income and expenses of the Group's overseas subsidiaries are denominated in local currencies and are therefore subject to exchange rate risk.	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.
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. A team reporting directly to the Group Head of Risk provides further independent oversight and challenge to this process. We adhere to a clearly defined investment process which seeks 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, allowing issues to be identified and mitigated. Recognising that not all products will outperform all 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 performance risk management process.

Liquidity risk Liquidity risk is the risk that cash flows 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.	To mitigate this risk within client portfolios, we seek to match, where possible, the liquidity of a portfolio's underlying investments with its 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 in our assets for our anticipated needs, taking account of the risks we face. We monitor Private Banking liquidity against the regulatory requirements in the jurisdictions concerned. In the UK, this includes the maintenance of an Individual Liquidity Adequacy Assessment that monitors liquidity against a range of stress scenarios.

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 this 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 financial metrics. We actively monitor market data and rating agency outputs in assessing counterparties. Collateral is taken in some cases.
We also face credit risk through lending by Private Banking.	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 channels, product development and the operation of our infrastructure and as a consequence of our diversified business model. Local management is responsible for operational risk controls.

Description of key risk	How we manage this risk
Operational risk Operational risk could arise from the failure of significant business processes undertaken by Schroders.	All new business processes are subject to review in order to identify a suitable suite of 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.	Prior to entering outsourcing arrangements, the Group undertakes due diligence and, prior to engagements, maintains a programme of assessment against agreed service levels.

Distribution risk Distribution risk arises from relationship management and concentration across different distribution channels and products. We access clients through three channels: 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 one per cent. of total revenue.
Product risk Product risk arises from complexity and the development of new products to meet changes in client demand. 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 have a dedicated product development team and a product approval and review procedure. We actively monitor potential capacity constraints and may mitigate them by closing products to new investment in certain circumstances.
Technology risk We rely on technology and qualified professionals to maintain our infrastructure.	Our technology is partly outsourced and our platform utilises well established, tested technology from outsource partners assessed 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.

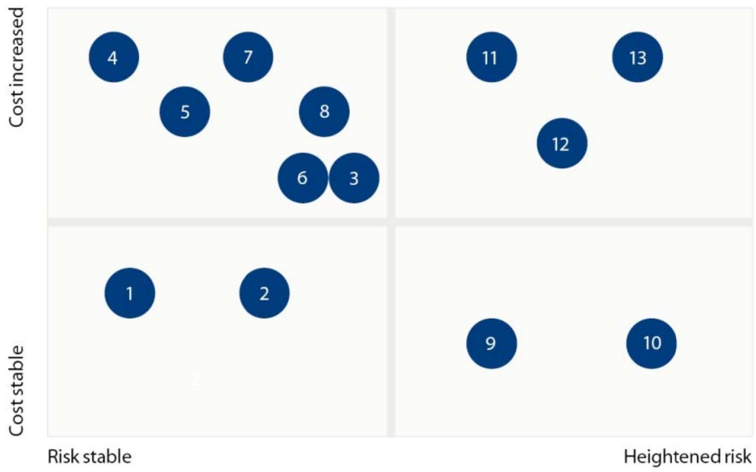
People risk Our business depends on people. We ensure we employ people with skill sets appropriate to our changing business needs. We expect our employees to behave with integrity, which is a core value.	We recruit and develop specialist skills as the range of our product offerings deepens and our investment and distribution strategies develop into new areas. To mitigate people risks, we have competitive remuneration plans, with appropriate deferred benefits, targeted at key employees. We also operate from many international centres, which reduces reliance on single pools of talent and individual country stability. Clear objectives are set for employees and we measure success in the annual review process. This allows us to identify employee development initiatives which can be motivational and increase the retention of talented people. We actively promote ethical standards and train our employees accordingly.
Geographical diversity risk Our business is broadly diversified by region which, whilst mitigating aggregate risk, introduces local risks as a result of local laws, regulations, business customs and traditions.	We employ local people with local expertise and also move employees internationally around 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 international regulation relevant to them, particularly extra-territorial legislation which typically emanates from the UK, Europe and the US. 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.
Legal risk The risk that Schroders or counterparties fail to meet their legal obligations and the risk of legal proceedings.	We rely on our employees, with support from our legal team, to consider carefully the obligations we assume and our compliance with them. Semi-annual confirmations are obtained from representatives around the Group that any dispute or potential 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 arrangements across our global offices, through which our Compliance function supports business management in meeting its obligations. Compliance with relevant regulatory requirements is monitored.

Current assessment of 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 considers if the probability of each key risk is heightened due to current market conditions. The vertical axis considers whether the potential cost of the key risk 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 change regularly. We analyse each risk and, if needed, develop and apply mitigation and management plans. The external emerging risks and key regulatory changes 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.

1. Double dip recession
2. Eurozone crisis
3. Major bank failure
4. Market liquidity crisis
5. Investment performance
6. Financial Services Compensation Scheme review
7. Vickers report impact
8. Capital controls in the Eurozone
9. AIFMD impact
10. Financial transaction tax
11. Basel III impact
12. MiFID II/PRIPS/UCITS V impact
13. RDR impact
14. Dodd-Frank, EMIR (OTC market reform)
15. Terrorism