

# Schroders plc

Pillar 3 Disclosures as at 31 December 2011

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## Schroders plc

### Pillar 3 disclosures

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# 1 Overview

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## 1.1 Introduction

The Capital Requirements Directive (CRD) is the framework for implementing Basel II in the European Union. Basel II requires a risk sensitive framework for the calculation of regulatory capital.

The CRD consists of three 'pillars': Pillar 1 sets out the minimum capital requirements that entities are required to meet for credit, market and operational risk. For Pillar 2, firms and supervisors take a view on whether a firm should hold additional capital against risks not covered in Pillar 1 and to take action accordingly within the Internal Capital Adequacy Assessment Process (ICAAP). Pillar 3 complements the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2) with the aim of improving market discipline by requiring firms to publish certain details of their risks, capital and risk management.

In the United Kingdom, the Financial Services Authority (FSA) introduced Pillar 3 by duplicating the CRD articles and annexes to create Chapter 11 – Disclosure (Pillar 3) of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU).

## 1.2 Basis of disclosures

In accordance with the requirements of Chapter 11 of BIPRU, the disclosures included in this document relate to the Schroders Group (for further details of Schroders Group subsidiaries covered by these disclosures see page 10). References to Schroders shall mean either Schroders plc or the Group. The disclosures cover both the qualitative and quantitative requirements.

## 1.3 Frequency of disclosures

The disclosures are required to be made on an annual basis at a minimum and if appropriate some disclosures will be made more frequently. Schroders plc has an Accounting Reference Date of 31 December. These disclosures are made as at 31 December 2011.

## 1.4 Verification, media and location

These disclosures have been compiled to explain the basis of preparation and disclosure of certain capital requirements and provide information about the management of certain risks and for no other purposes. These disclosures are not subject to audit; they do not constitute any form of audited financial statement and have been produced solely for the purposes of satisfying Pillar 3 requirements. They should not be relied upon in making any judgment about the financial position of the Group or any purpose other than that for which they are intended.

The Schroders plc Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system can provide only reasonable and not absolute assurance against material financial misstatement or loss and is designed to mitigate, not eliminate, risk.

These disclosures are published on the Schroders plc corporate website ([www.schroders.com](http://www.schroders.com)).

## 2 Risk management framework

Schroders believes that active and effective risk management is a business imperative and it is regarded as a core competence by clients, consultants, regulators, counterparties and other interested parties.

### 2.1 Approach to risk management

Schroders' approach to risk management builds on the following core principles.

#### Key Principles of the Governance Risk Framework

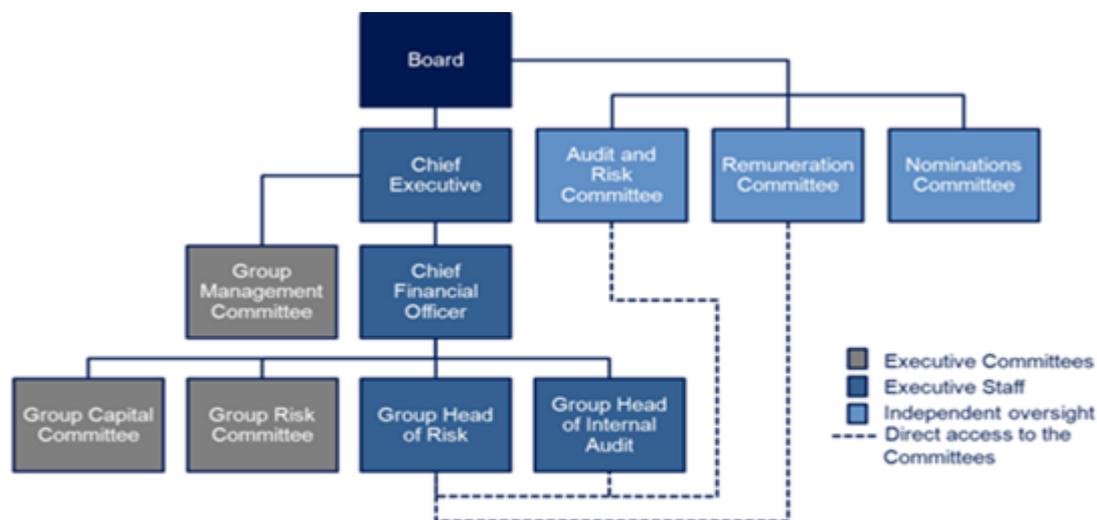
- Authority to manage the business, including internal controls and risk, is delegated from the Schroders plc Board to the Chief Executive;
- The Chief Executive delegates primary responsibility for the risk and controls framework within the Group and the independent monitoring and reporting of risk and controls to the Chief Financial Officer (CFO);
- The Group Risk Committee (GRC) supports the CFO and is the principal committee for the monitoring and reporting of risks and controls;
- The key issues covered by the GRC are included in the suite of reports provided regularly to the Board Audit and Risk Committee; and
- Significant risk and control issues are reported to the Chief Executive and Group Management Committee either by the relevant business head or by the CFO.

Underpinning the Schroders' philosophy is the principle of individual responsibility and accountability across the firm, supported by guidance and training as required. This is subject to independent challenge and oversight via risk specialists, the Group Head of Risk and the Chief Financial Officer. This approach is independently tested through the monitoring provided by Group Internal Audit.

The Group's corporate governance structure supports this framework, as outlined in the following diagram. This includes line management responsibility for the management of risk in the execution of strategy supported via the Group Management Committee and independent oversight of risk management supported by the Group Risk Committee and Board Audit and Risk Committee.

Schroders' credit rating of A+ reflects its strong and conservative risk culture. It has a well diversified investment management business, sound capitalisation and cash generation, and no leverage.

#### Schroders' Governance Structure



The Board consists: Chairman, Five executive directors, Six non-executive Directors (five considered independent)

## Core Governance Committees

### Schroders plc Board

The Board delegates the executive management of the Schroders Group's business to the Chief Executive with the exception of specific matters reserved for the Board which include:

- Maintenance of a framework of prudent and effective financial, operational and compliance controls and risk management systems;
- Approval of the Group's Internal Capital Adequacy Assessment Process;
- Determination of the Company's corporate governance arrangements, including the review of risk management and control structures (subject to the recommendations of the Board Audit and Risk Committee).

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system can provide only reasonable and not absolute assurance against material financial misstatement or loss and is designed to mitigate, not eliminate, risk.

### Group Management Committee (GMC)

The Group Management Committee, chaired by the Chief Executive of Schroders plc comprises all members of senior management and responsibilities include reviewing the work undertaken by the Group Risk Committee using the draft reports to be submitted formally to the Board Audit and Risk Committee.

### Board Audit and Risk Committee (BARC)

The main role of the Board Audit and Risk Committee, a committee of the Board of Schroders plc composed entirely of independent Non-executive Directors, is to encourage and safeguard the highest standards of integrity, financial reporting, risk management and internal control. In doing this the principal responsibilities of this Committee include:

- Monitoring the integrity of the financial statements of the Group;
- Monitoring and reviewing the arrangements for ensuring the objectivity and effectiveness of the external and internal audit functions;
- Recommending to the Board of Schroders plc the appointment, re-appointment or removal of the external auditors;
- Reviewing the effectiveness of the Group's internal controls and risk management systems; and
- Reviewing and monitoring the Group's ethical standards, procedures for ensuring compliance with regulatory and financial reporting requirements and its relationship with the relevant regulatory authorities.

### Group Risk Committee (GRC)

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.

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 the Retail Distribution Review; the Japanese earthquake business continuity plan; and policy reviews such as brand protection, information assurance, procurement and corporate residence.

The GRC 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. The Group has increased the sophistication of statistical modelling of risk outcomes which has resulted in improved quantification of Pillar 2 regulatory capital.

## 2.2 Risk management systems and techniques used

### Risk Assessment and Identification

Change in every aspect of the business and the external environment is a key driver of risk. Change may impact the potential occurrence or potential magnitude of events relating to existing risks or may result in new or emerging risks. Different approaches may be used for the assessment of risk depending on the type of risk faced and the evidence available to assess the risk. These approaches may be used in combination or isolation and include qualitative and quantitative assessments.

### Risk Mitigation

Like any Asset Management business the Group is exposed to a range of risks. These risks, if not managed properly, increase the possibility of the Group not being able to meet its objectives.

There are a variety of techniques that are used to mitigate risks, which may be used in isolation or in combination depending on the nature of the risk. These techniques include use of controls, outsourcing, contingency planning, insurance and capital allocation.

### Risk Monitoring and Reporting

Risks are managed in a variety of different ways, depending on the nature of the risk and the areas potentially affected, to ensure that wherever appropriate the consequences are mitigated.

Monitoring and communication are key to an effective risk management framework. Significant risk matters are reported through the management chain and ultimately to the Group Management Committee and Board where significant. The Group risk function undertakes independent review and oversight work, reporting to the Group Risk Committee and Board Audit and Risk Committee in accordance with the governance structure outlined above.

## 2.3 Key risks faced

The key risk types faced which are relevant to this Pillar 3 disclosure are as follows:

### 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

##### 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 funds under management.

#### How we manage the 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.

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 liquidity requirements. We actively monitor the market 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 on 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.

We face credit risk as a result of counterparty exposure.

In order to manage this risk we actively monitor counterparty creditworthiness and operate within 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 through the investment process, 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.

### 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 commencement, maintains a programme of assessment against the agreed service levels.

### Distribution risk

Distribution risk arises from relationship management and concentration across different distribution channels and products. We distribute 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.

We have a dedicated product development team and a new product approval and review procedure.

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.

### **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 on-going basis.

Continuity and business resumption planning is in place across the business.

### **People risk**

Our business is heavily dependent 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. We also operate from several international centres, which reduce 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 expect our employees to behave with integrity, which is one of our core values.

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 Schrodgers 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.

### 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



## Internal Capital Adequacy Assessment Process (ICAAP)

The ICAAP is updated quarterly, and formally reviewed by the Board on at least an annual basis, with more frequent reviews if there is a fundamental change to our business or the environment in which we operate. This assessment draws on the results of existing risk management techniques and reporting. Scenario analysis and stress testing are performed to assess Schroders' exposure to extreme events and to ensure that appropriate mitigating factors are in place. Any residual risk is then mitigated by setting aside capital to meet the worst case potential impact calculated at a confidence level agreed by the Board. Each of the core risk types are assessed and further holistic analysis is performed to challenge the output.

### Operational risk

The operational risk analysis focuses on statistical modelling of key risk scenarios for the Group, with additional stress testing of the output. This includes consideration of the potentially increased likelihood of further related risk events on occurrence of a single event. Further analysis is performed to assess the potential revenue impact of additional key risk scenarios.

### Credit risk

Scenarios based on key risks currently faced are assessed against the capital requirement under Pillar 1. In addition further stress testing is performed both on the scenarios and the Pillar 1 output considering both principal book and Private Bank lending exposures.

### Market risk

Schroders exposure to market risk under Pillar 2 is assessed via scenario analysis and stress testing of the exposure in the Group's capital portfolios as well as the asset and liability management exposures in the Private Banks.

### Pension obligation risk

The risk of deficit in the defined benefit section of the Schroders Retirement Benefit Scheme ("the Scheme"), which was closed to future accrual on 30 April 2011, is assessed via stress tests of the key liability factors inherent in the valuation of the Scheme as well as consideration of stresses on asset value. Scenarios based on a combination of factors are also considered in establishing the capital requirement for this risk. Under current regulations, we are only required to assess pension obligation for risk to the Private Bank in our ICAAP estimate of capital requirements. We do, however, consider the full extent of our potential exposure to the Scheme when stress testing the adequacy of our capital resources.

### Liquidity risk

Schroders uses a range of liquidity risk assessments and stress tests to assess our ability to always meet our obligations as they fall due

### Business risk

Business risk is assessed through consideration of the threat to Schroders capital base and strategic plans of a severe, sustained recession.

In addition to the individual assessments of capital required for specific risk types, further holistic scenarios are considered to challenge the overall level of capital required. This includes consideration of emerging risks currently being monitored by the Group Risk Committee. In accordance with current best practice, there is also an assessment of the capital required to ensure an orderly wind-up of the Group if it is no longer viable.

## 3 Scope of application

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### Basis of consolidation

#### 3.1 Accounting consolidation

The consolidation of the financial statements is based upon the inclusion of all entities controlled by Schroders plc prepared to 31 December each year. Control is achieved where Schroders has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. The consolidated statutory financial statements include all subsidiary undertakings which, in the opinion of the Directors, principally affect the consolidated profits or assets of the Group. A list of these principal Group subsidiaries can be found in **Note 33 of the 2011 Annual Report and Accounts**.

#### 3.2 Regulatory consolidation

The consolidation for regulatory purposes is on the same basis as above, although certain entities are excluded from the regulatory consolidation for reasons outlined below.

#### Entities excluded from the regulatory consolidation:

##### Insurance related subsidiaries

Insurance and the broking of insurance are not financial activities for the purpose of regulatory consolidation, and are subject to the FSA's Prudential Sourcebook for Insurers (INSPRU) and not BIPRU. As a result the following two companies are excluded. Although our insurance wrapped asset management business is excluded from these disclosures, the business is subject to the same risk management framework as the rest of the Group:

Schroder Pension Management Limited  
Burnaby Insurance (Guernsey) Limited

##### Immaterial entities

Those subsidiaries which otherwise would be consolidated, but have a combined balance sheet total lower than the lesser of Euro 10 million and 1% of the balance sheet total of total Group net assets. The entities excluded from the regulatory consolidation on this basis are:

Asia Venture Managers Inc.  
Blitz 06-953 GmbH  
CM Komplementar 06-379 GmbH & Co.  
Columbus Capital Management LLP  
Columbus UK GP Limited  
J Henry Schroder & Co. AG (in liquidation)  
J.H.S.C. Management Limited  
Newsphere Trading Company Limited  
NFCP Consulting S.L  
OPUS (Cayman) Limited  
Schroder Investment Company (Switzerland) AG  
Schroder Investment Management (Guernsey) Limited  
Schroder Investment Management (Ireland) Limited  
Schroder Nominees Limited  
Schroder Pension Trustee Limited  
Schroder Property Investment Management (France) Sarl  
Schroder Property Investment Management (Italy) SRL  
Schroders Corporate Secretary Limited  
Schroders India Private Limited  
Schroders Chile SpA  
Schroders, S.A. de CV Distribuidora de Acciones de Sociedades de Inversion (SIM Mexico)  
SIM Nominees Limited

SITCO Nominees Limited  
Thornbury Company Limited

The investment in those entities which are not included in the consolidation for regulatory purposes, is deducted from the sum of Tier 1 and Tier 2 capital (see section 4, capital resources).

There is no current or foreseen material, practical or legal impediment to the prompt transfer of capital resources from parent undertakings to their subsidiary undertakings.

## 4 Capital resources

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### Tier 1 capital

Tier 1 capital is the highest ranking form of capital. Eligible Tier 1 capital consists of two classes of ordinary share capital, of which voting shares account for 80% of the total ordinary share capital. The premium on ordinary shares also qualifies for inclusion as Tier 1 capital. The non-voting ordinary shares carry the same rights as ordinary shares except that they do not confer the right to attend and vote at any general meeting of Schroders plc, and that on a capitalisation issue they carry the right to receive non-voting ordinary shares rather than ordinary shares. Also included in Tier 1 capital are retained profits and other reserves.

Deductions in arriving at total Tier 1 capital as at 31 December 2011 include intangible assets of £144.1m, which consist mainly of goodwill of £120.4m. Goodwill includes £51.7m in relation to the acquisition of NewFinance Capital Holdings Limited in 2006; £24.3m on the acquisition of Swiss Re AM; £13.6m on the acquisition of Aareal Asset Management GmbH during 2007; and £4.0m on the acquisition of a Singapore private client advisory business during 2008.

### Tier 2 capital

Tier 2 capital is a firm's supplementary capital and consists of revaluation reserves, general provisions and some classes of subordinated debt. As at 31 December 2011, the Group held revaluation reserves consisting of unrealised gains of £34.4m in respect of the fair valuation of securities held in the available-for-sale financial assets category, which is classified as Tier 2 capital.

The investment in associates and joint ventures has been deducted 50% from Tier 1 and 50% from Tier 2 capital.

### Tier 3 capital

Tier 3 brings together shorter term debt capital and less permanent reserves and may only be used to meet regulatory capital requirements arising from market risk in the trading book.

The Group did not hold any Tier 3 capital as at 31 December 2011.

As at 31 December 2011 the capital resources of the Schroders Group were as follows:

<b>Tier 1</b>	<b>£m</b>
Permanent share capital	282.5
Share premium account	87.8
Profit and loss and other reserves	1,496.9
<b>Total</b>	<b>1,867.2</b>
<b>Deductions from Tier 1</b>	
Goodwill	(120.4)
Intangible assets	(23.7)
Material holdings	(29.2)
Other supervisory deductions *	(17.9)
<b>Tier 1 after deductions</b>	<b>1,676.0</b>
<b>Tier 2</b>	
Revaluation reserves	34.4
<b>Deductions from Tier 2</b>	
Material holdings	(29.2)
<b>Total capital resources</b>	<b>1,681.2</b>

\* Investment in entities excluded from the regulatory consolidation.

During the year to 31 December 2011 the Group, and all regulated entities within the Group (including those excluded from the regulatory consolidation), complied at all times with all of the externally imposed regulatory capital requirements.

## 5 Capital adequacy

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As part of the assessment of the adequacy of its capital, the Group considers its risk appetite, the key risks facing the Group and the management strategies in place for dealing with such risks. This is included within the Group's Internal Capital Adequacy Assessment Process which is reviewed by the Schroders plc Board. The capital adequacy at an individual company level is also regularly reviewed.

It is the Group's policy that all entities within the Group have sufficient capital to:

- meet regulatory requirements;
- keep an appropriate credit standing with counterparties; and
- maintain sufficient liquid funds to meet working capital requirements.

### Calculation of the Group's capital resources requirement

The capital resources requirement of the Schroders Group for regulatory reporting purposes is the sum of the credit risk, market risk and operational risk capital requirements.

#### Credit risk

Schroders has elected to adopt the standardised approach for credit risk to calculate the minimum credit risk capital requirement under Pillar 1 of the Capital Requirements Directive. Under the standardised approach firms must calculate the minimum credit risk capital requirement as 8% of the total risk weighted exposures.

#### Market risk

Schroders has adopted the commodity simplified approach for calculating the commodity position risk requirement. The commodity simplified approach is to sum the following:

- (a) 15% of any net position multiplied by the spot price for the commodity; and
- (b) 3% of the gross position (long plus short, ignoring the sign) multiplied by the spot price for each commodity.

#### Operational risk

Schroders has adopted the standardised approach for calculating the Pillar 1 capital requirements for operational risk therefore the operational risk capital requirement is calculated as the three year average of gross revenues per the consolidated income statement, multiplied by a beta factor of 12%.

**As at 31 December 2011, the total consolidated capital resources requirement of the Group under Pillar 1 was £309.3m**

<b>Credit risk exposure class</b>	<b>£m</b>
Institutions	34.3
Central government and central banks	-
Corporate/Private clients	36.4
Other items (i)	25.4
Regulatory high-risk categories (ii)	37.8
Claims secured by mortgages on residential property	4.0
Claims secured by mortgages on commercial real estate	4.9
<b>Total credit risk capital requirement</b>	<b>142.8</b>
<b>Market risk</b>	
In respect of commodity option contracts	0.1
In respect of foreign exchange (iii)	6.1
<b>Total market risk capital requirement</b>	<b>6.2</b>
<b>Operational risk</b>	
Calculated in accordance with the Standardised Approach	<b>160.3</b>
<b>Total capital requirement Pillar 1</b>	<b>309.3</b>

(i) Other items include accrued income, fee debtors, settlement accounts, tax, prepayments and other debtors.

(ii) As defined by the FSA high risk exposures include those arising out of venture capital business (whether or not the firm itself carries on the venture capital business) and those in a Collective Investment Undertaking which is considered as high-risk.

(iii) Calculated as per BIPRU 7.5.19

## 6 Credit risk & dilution risk

### Past due and impaired

A financial asset is past due when the counterparty has failed to make a payment when contractually due. An exposure is classified as impaired (the carrying value exceeds the amount to be recovered through use or sale) or non-performing when the principal, interest or fees remain unpaid more than 90 days after the due date when, following review, there are indications that the likelihood of full repayment is in doubt. These indications of impairment may include, but not be restricted to: non-payment of interest, a fall in credit worthiness, a reduction of cover/collateral below the covenanted minimum.

### 6.1 Provisions against lending arrangements

The Group makes bad debt provisions which fall into two categories:

#### (i) Lending arrangements

Lending arrangements principally arise in certain of the Group's Private Banks\*. The relevant Private Bank Credit Committee will determine whether it is necessary to make a provision against a credit exposure. Non-performing exposures (where there has been non-payment of principal, interest or fees for a period exceeding 90 days) will not automatically merit the creation of a provision. Impaired exposures will always require the creation of an appropriate provision.

The decision to create or write back a provision is undertaken on a case-by-case basis, reviewed by the relevant Credit Committee and approved by the Board of the appropriate subsidiary. Any such provisions created are advised to Group Finance and Tax. Where interest has not been received for 90 days or more (though this period may be reduced if required), its accrual for income purposes is suspended, and cash accounting adopted.

For the period to 31 December 2011, a doubtful debt provision of £0.2m had been charged to the income statement in respect of loans and advances to customers.

Movement in provisions during the year:	£m
Opening balance as at 1 January 2011	17.4
Bad and doubtful debts charged	0.2
Foreign exchange	1.2
	<b>18.8</b>

#### (ii) Other debtors

Other debtors consist mainly of fee debtors which arise principally within the Group's institutional business and amounts are monitored regularly by local offices. Although the Group is usually managing client cash representing a large multiple of the amount owed to the Group by the client, the Group does not hold any of the assets it invests on behalf of its clients as collateral in relation to its fees.

The Group's fee debtors that are past due (i.e. items that are past their contractually agreed settlement date) but are not considered to be impaired as at 31 December 2011 are presented below. The majority of these were settled by the 4 January 2012. Factors considered in determining whether impairment has taken place include how many days past the due date a receivable is, deterioration in the credit quality of a counterparty, and knowledge of specific events that could influence a debtor's ability to repay an amount due.

	£m
Up to and including 3 months	33.9
Over 3 months up to 1 year	2.3
	<b>36.2</b>

\* Schroder & Co Ltd, London, Schrodgers (C.I.) Ltd, Guernsey and Schroder & Co Bank AG, Zurich

## 6.2 Analysis of credit risk exposures

The following table is an analysis by exposure class of the Group's credit risk exposure as at 31 December 2011.

<b>Exposure class</b>	<b>£m</b>
Institutions	2,197.6
Central government and central banks	960.7
Corporate/Private clients	910.0
Other items	481.6
Regulatory high-risk categories	319.7
Claims secured by mortgages on residential property	139.6
Claims secured by mortgages on commercial real estate	64.4
<b>Total</b>	<b>5,073.6</b>

The tables over the page provide further breakdown by geographic region, counterparty type and residual maturity.

## Exposure by geographic distribution

Exposure class £m	UK	Continental Europe	Asia Pacific	Americas	Total
Institutions	890.4	1,075.2	205.4	26.6	2,197.6
Central governments and central banks	647.4	302.8	10.5	-	960.7
Corporate/Private clients	440.3	459.1	7.8	2.8	910.0
Other items	214.7	148.2	81.8	36.9	481.6
Regulatory high-risk categories	107.7	170.7	5.5	35.8	319.7
Claims secured by mortgages on residential property	101.9	37.7	-	-	139.6
Claims secured by mortgages on commercial real estate	36.9	27.5	-	-	64.4
<b>Total</b>	<b>2,439.3</b>	<b>2,221.2</b>	<b>311.0</b>	<b>102.1</b>	<b>5,073.6</b>

## Exposure by counterparty type

Exposure class £m	Banks	Non-banks	Investments	Other	Total
Institutions	2,093.9	-	103.7	-	2,197.6
Central governments and central banks	441.0	-	519.7	-	960.7
Corporate/Private clients	-	691.3	218.7	-	910.0
Other items	-	-	0.0	481.6	481.6
Regulatory high-risk categories	-	-	319.7	-	319.7
Claims secured by mortgages on residential property	-	139.6	-	-	139.6
Claims secured by mortgages on commercial real estate	-	64.4	-	-	64.4
<b>Total</b>	<b>2,534.9</b>	<b>895.3</b>	<b>1,161.8</b>	<b>481.6</b>	<b>5,073.6</b>

## Exposure by residual maturity

Exposure class £m	<3 months	3m – 1 year	1 year – 5 years	> 5 years	Total
Institutions	1,954.2	206.4	32.3	4.7	2,197.6
Central governments and central banks	771.2	109.1	78.9	1.5	960.7
Corporate/Private clients	199.8	135.1	244.0	331.1	910.0
Other items	292.5	115.2	2.0	71.9	481.6
Regulatory high-risk categories	-	-	-	319.7	319.7
Claims secured by mortgages on residential property	5.6	55.7	68.9	9.4	139.6
Claims secured by mortgages on commercial real estate	-	7.8	47.7	8.9	64.4
<b>Total</b>	<b>3,223.3</b>	<b>629.3</b>	<b>473.8</b>	<b>747.2</b>	<b>5,073.6</b>

## 7 The Standardised approach to credit risk

The External Credit Assessment Institution (ECAI) used by the Group is Fitch. Fitch Ratings are recognised by the Financial Services Authority (FSA) as an eligible ECAI and are used to assess the credit quality of all exposure classes, where applicable, using the credit quality assessment scale that is set out by the FSA in BIPRU 3 – the standardised approach to credit risk.

The Group currently use Fitch to rate exposure classes for Institutions and Sovereigns and daily alerts of rating changes from Fitch are used to update existing ratings as appropriate.

The following table gives details of the exposure value before and after credit risk mitigation (after application of BIPRU 5.4) associated with each credit quality assessment step.

The main types of collateral taken by Schroders are:-

- Financial collateral including cash and client portfolios to support client lending. Financial collateral is marked to market daily and compared to loans outstanding.
- Other assets such as property and guarantees. Other assets are valued less often depending on the type of assets held and property is valued according to the requirements of BIPRU 3.4.66.

Credit quality step	Credit Rating	Exposure before eligible financial collateral (£m)	Exposure after eligible financial collateral (£m)
1	AAA to AA-	1,692.1	641.0
2	A+ to A-	1,220.2	735.5
3	BBB+ to BBB-	24.2	4.4
4	BB+ to BB-	-	-
5	B+ to B-	19.8	19.8
6	CCC+ and below	-	-
unrated *		2,117.3	1,687.6
<b>Total</b>		<b>5,073.6</b>	<b>3,088.3</b>

\* unrated includes loans to individuals, seed capital and equity investments plus other balance sheet exposures not subject to credit rating such as trade and other receivables, tax balances and fixed assets.

The unrated exposures can be analysed as follows:

	£m
Loans and advances to customers	797.0
Financial assets	423.5
Trade and other receivables	346.5
Cash and Cash Equivalents	196.0
Seed capital	104.8
Tax balances	63.4
Retirement benefit scheme surplus	55.7
Undrawn commitments	54.8
Other Derivatives	30.3
Guarantees	26.4
Fixed assets	16.2
Letters of Credit	2.7
<b>Total</b>	<b>2,117.3</b>

## 8 Interest rate risk in the non-trading book

Interest rate risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market interest rates.

### *Private Banking activities*

In Private Banking, interest rates are monitored against policies and limits set by the relevant risk committee.

Private Banking's treasury policy is to hedge fixed-rate assets and liabilities beyond one year back to the floating rate; outright interest rate risk arises mainly from the decision to allow a limited amount of mismatch between the related cash inflows and outflows associated with interest.

Within Private Banking, there are sensitivity-based and stress-based models used for monitoring interest rate risk. These involve assessing the impact on the Group's net worth against a prescribed basis point rise in interest rates with extreme scenarios for the stress tests. The impact is calculated regularly for each currency and in aggregate.

### *Other activities*

Cash held by the other operating companies is not normally placed on deposit for longer than three months.

The Group's capital includes investments in government bonds managed by the Group's fixed income fund managers. These investments are managed to a maximum average duration of two years and are concentrated in UK and US issues. Government bonds issued by selected AAA rated countries can also be held. The fund managers may reduce the average duration with the use of future contracts at their discretion.

### *Sensitivity analysis*

At 31 December 2011, if interest rates had been 50 basis points higher / nil basis points lower with all other variables held constant, the Group estimates that post-tax profit for the year would have increased by £3.4 million, mainly as a result of higher interest income on the Group's floating rate debt securities and cash; other components of equity would have been unaffected.

The following are underlying assumptions made in the model used to calculate the effect on post-tax profits and other components of equity:

- The fair values of assets and liabilities will not be affected by a change in interest rates.
- Within Private Banking, the fixed rate financial assets will be rebalanced to the higher/lower market interest rates.
- Within other operating entities, funds would be reinvested in similar variable interest-bearing debt securities on maturity.

The analysis by currency is reflected in the table below:

<b>Currency</b>	<b>Increase in rates by 0.5%</b>
	<b>Post tax profit £m</b>
GBP	2.0
EUR	0.3
USD	0.2
CHF	0.4
Others	0.5
<b>Total post tax profit</b>	<b>3.4</b>

## 9 Non-trading book exposure in equities

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An overview of the accounting techniques and valuation methodologies used, as required by BIPRU 11.5.15(1), is included in **Note 11 within the 2011 Annual Report and Accounts** and is not repeated here. An overview of how capital is managed, and with what objectives, can be found within **Note 20(a) of the 2011 Annual Report and Accounts**.

The balance sheet value and the fair value of non-trading book equities as at 31 December 2011 was £501.4m, analysed as follows:

<b>Type</b>	<b>Listed</b>	<b>Unlisted</b>	<b>Total</b>
Seed capital and hedge funds	36.5	115.6	152.1
Third party hedge funds	-	92.6	92.6
Private Equity Investments	50.3	14.5	64.8
Property funds	-	28.0	28.0
Others	59.8	104.1	163.9
<b>Total</b>	<b>146.6</b>	<b>354.8</b>	<b>501.4</b>

The cumulative realised gains from sales / liquidations during the year were £11.5m. Total unrealised gains were £6.8m which have been included in Tier 2 capital resources.

## 10 Remuneration

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The following disclosures are required by the FSA's Handbook for banks, building societies and investment firms (BIPRU) 11.5.18.

These disclosures should be read in conjunction with the Remuneration Report in the 2011 Annual Report & Accounts (available on the Group's website - [www.schroders.com](http://www.schroders.com)), which provides more information on the activities of our Remuneration Committee and our remuneration principles and policies.

Details of the FSA's Remuneration Code can be found at [www.fsa.gov.uk](http://www.fsa.gov.uk).

### **Decision-making process for determining the remuneration policy**

Schroders has an established Remuneration Committee whose responsibilities include setting the Group's policy on remuneration, overseeing the remuneration governance framework and ensuring that remuneration arrangements are consistent with effective risk management. The role and activities of the Remuneration Committee and their use of advisors are further detailed in the Remuneration Report and the Remuneration Committee's Terms of Reference (both available on the Group's website).

### **Code Staff criteria**

The following groups of employees have been identified as meeting the FSA's criteria for Code Staff:

- Directors of Schroders plc;
- Members of the Group Management Committee;
- Staff performing a Significant Influence Function within the Group;
- Employees in key control function roles; and
- Employees who have approval authorities such that their decision-making could have a material impact on the Group's Income Statement.

The categories above include all senior management, those responsible for the management of the main businesses and control function heads.

### **Link between pay and performance**

The overall size of the annual pool for variable performance-related pay is a material component of our total remuneration expense and is set by the Board and the Remuneration Committee by reference to a bonus to pre-bonus profit before tax and exceptionals ratio, which we report to shareholders. This ensures that the aggregate spend on variable performance-related pay directly reflects the Group's performance.

Remuneration at Schroders is made up of fixed pay and variable performance-related pay.

Fixed pay is principally comprised of salaries but includes appropriate employee benefits. All Code Staff receive either a salary (for employees) or fees (for non-executive directors) that reflect their talent, skills, competencies and contribution to the Group relative to the market for their roles. Schroders salaries are sufficient to cover employees' key financial needs.

Variable performance-related pay is principally comprised of bonus awards. Non-executive directors do not receive variable performance-related pay. Code Staff who are permanent employees are eligible to be considered for a bonus award annually. Bonuses for all employees take account of overall Group, team and individual performance against agreed objectives and, in this context, performance typically includes financial and non-financial measures, risk performance and any other relevant factors. For senior management and employees receiving larger bonus awards a significant proportion of their bonus award is deferred into Schroders shares and funds, vesting after three years.

The pay-outs from these deferred awards are directly determined by the performance of the Company and the Group's performance managing funds for our clients.

Additionally senior employees are eligible to participate in our Long-Term Incentive Plan (LTIP) which is comprised of deferred awards of Schroders' shares that vest after four years to the extent that performance conditions are achieved.

In addition to providing retention incentives, a primary purpose of our deferred awards (deferred bonuses and LTIP) is to support our performance culture where employees recognise the importance of sustainable Group, business and individual performance and their responsibilities in delivering value for clients and shareholders over the longer-term.

Further details of our remuneration structures, our deferred award arrangements and LTIP performance conditions are provided in the Remuneration Report.

### Quantitative Remuneration Disclosures

81 employees have been identified as Code Staff, 26 of whom are classified as Senior Management. Those individuals employed either by the Group or by our Nissay Schroders joint venture and who are regarded as Code Staff in respect of those joint ventures are included within these quantitative disclosures. Aggregate remuneration for Code Staff was as follows:

	Senior Management (£'000)	Rest of Group (£'000)
Fixed Remuneration	4,809	7,286
Variable Remuneration	36,698	20,137
<b>Aggregate Remuneration</b>	<b>41,507</b>	<b>27,423</b>

Aggregate remuneration expenditure for Code Staff by business area was as follows:

Investment (£'000)	Distribution (£'000)	Rest of Group (£'000)
30,837	13,821	24,272

Aggregate remuneration disclosed includes:

- Non-executive director fees for 2011
- Annual base salaries as at 31 December 2011
- Cash bonus awards for the 2011 performance year
- Deferred awards for 2011 (LTIP awards at 50% of award value and other awards at award value)
- Any other awards or payments for new hires or leavers

In addition, Code Staff who are permanent employees are eligible to receive various employee benefits (e.g. private health care, pension) on the same basis as other employees.