Schroders

Schroder Investment Management Australia Ltd

Risk Appetite Statement

November 2020

Introduction

This statement considers the most significant risks to which Schroder Investment Management Australia Limited (SIMAL) is exposed and provides an outline of the approach to mitigate these risks. Whilst not exclusively institutional, the vast majority of business is either serviced through institutional relationships and/or intermediary business with plans to also increase the direct to consumer presence. This does influence the nature of risks SIMAL is exposed to and how it manages and mitigates these risks.

General Statement of Appetite

SIMAL is exposed to a variety of risks as a result of its business activities. These risks include those resulting from its responsibilities in the areas of investment management, providing financial product advice, product development, operating registered managed investment schemes and listed ETFs (including internal market making) and day to day operational activities.

SIMAL has a low tolerance for risks that will adversely affect its business. As such, active and effective risk management is a core competence and we actively monitor the potential impact of current and emerging risks. SIMAL places significant focus on the integrity and good conduct of employees and the risk management framework is underpinned by a strong ethical culture.

On our investment capabilities, SIMAL accepts that our investments are exposed to market fluctuations, credit and liquidity risk impacts. These risks are mitigated through stringent Group risk frameworks and global policies that SIMAL is subject to, as well as a strong three lines of defense model, which ensures that risk tolerances and limits are monitored and adhered to.

In terms of operational issues, SIMAL has a low risk appetite and history of a low number of risk events and significant breaches reportable to ASIC under SIMAL's licence. SIMAL accepts that it is not possible to eliminate all risks inherent in its activities. Acceptance of some residual risks is necessary to facilitate efficiencies within the business.

The Risk Management Framework

The Board is accountable for risk and oversight of the risk management process and will consider the most significant risks facing SIMAL. It is the responsibility of all employees to uphold the control culture of Schroders, which leads to embedded risk management culture across all areas of the business. This allows risks to be identified top down and bottom up within SIMAL.

The Chief Executive and the GRC Committee, as the principle executive committee with responsibility for the monitoring and reporting of risk and controls, regularly review the key risks facing SIMAL.

The executive oversight of risk is delegated by the Chief Executive to the Head of Finance and Governance. The Head of Finance and Governance has responsibility for the risk and control framework of SIMAL and independent monitoring and reporting of risks and controls is supported by the Group Risk function in its capacity as second line of defense.

Coverage

SIMAL's attitude towards its key strategic, business, investment and operational risks is described below.

Strategic Risks

These risks relate to our strategy and the environment in which we operate. If these risks are not carefully managed, our AUM may be lowered and likewise the income we receive may decrease. Our business plans seek to address these risks by responding to the challenges faced.
SIMAL's Executives meet regularly to discuss any major initiatives. A governance framework is in place to ensure that these initiatives are prioritised appropriately and that the associated risks are well managed and reported on.

SIMAL's Strategic Risks include:

- **Changing Investor Requirements** – Client requirements are evolving rapidly. Failing to adapt or evolve our business model and product range to reflect changing investor requirements could lead to a drop in assets under management. This includes index tracking products or certain products where SIMAL does not currently offer the investment capability. Larger industry-wide shifts, including larger clients bringing investment management in-house. ESG is a material part of our client considerations and we expect Client Change risk to feature more heavily in future investment requirements and offerings.

  Tolerance - SIMAL has a low appetite for threats to the effective and efficient delivery of any strategic initiatives. SIMAL will continuously monitor internal and external environments to identify new and emerging risks

  Our value proposition is based on our strategic capabilities, focusing attention where we believe we are able to make a significant difference for our clients or where we have current or emerging capabilities.

- **Market Returns** – Our income is derived from the assets we manage. A considerable and sustained decline in markets is outside our control but may contribute to a significant fall in revenue.

  Tolerance - SIMAL has a low appetite for risks that can be managed internally. Fund managers will ultimately invest where they believe the returns best compensate for the risks being taken on and actively manage the risks through client communications. We are also introducing a Private Assets product range to allow us to have a broader range of income streams which are less directly linked to public markets.

- **Regulatory Landscape** – Australian regulators are facing ongoing scrutiny over their own performance, following independent reports such as the Hayne Royal Commission. Regionally and globally regulators are under pressure to meet minimum regulatory standards set elsewhere, for instance AML/KYC, privacy etc. SIMAL, being a wholly owned subsidiary of a UK headquartered fund manager is indirectly impacted by UK and European regulations. The growing scope and complexity of regulation is placing an increasing burden on regulated entities both in terms of resources and costs.

  Tolerance – SIMAL has a low appetite for threats to the effective and efficient delivery of any regulatory obligations. SIMAL will continuously monitor the local and global regulatory landscape to identify new and emerging regulatory trends. SIMAL is an active participant with our local industry body, the Financial Services Council (FSC) in providing feedback on regulatory changes that impact SIMAL.

- **Fee attrition** – Continued reduction of fees due to the current market environment and pricing pressures and a move towards vertical integration could impact our revenues.

  Tolerance – Fees have a direct impact on the viability of our business. SIMAL is increasing focus on solutions and outcome-oriented strategies and private assets to diversify fee income. We are also increasingly diversifying our product offering, supporting long-term profitability.

- **Business model disruption** – Our business model could be disrupted by a range of external factors including technology changes, product evolution and market participants.

  Tolerance – It is of utmost importance that we ensure the long term viability of our business model in tandem with the changing industry and market landscapes. We are increasing our delivery of efficiencies and insights through technology. Digital initiatives are in progress to improve client experience, engagement and servicing. We are investing in our technology platform to support scalability, agility in our product offering and our new Private Assets business.

Business Risks

In executing our strategy, a number of key risks arise that could impact our ability to attract and retain clients. By evolving our product offering and delivering good investment performance, we have the best opportunity to be selected by clients when allocating assets. A failure to achieve these could lead to a decrease in AUM.SIMAL's Business Risks include:

- **Reputational Risk** – Reputation risk may arise from poor conduct or judgments or risk events due to weaknesses in systems of controls. The reputation of SIMAL can be impacted by any of our key risks.

  Tolerance – SIMAL has a low tolerance for taking risks with its reputation. SIMAL seeks to minimise the impact of events that can damage its reputation through its crisis management processes and scenario planning. We do not seek short-term profits at the expense of our long-term reputation and consider reputational risks when initiating changes to our strategy or operating mode. Also, our employees are to adhere to high standards of conduct with a principled approach to regulatory compliance, which are integral to our culture and values.

- **Investment Performance Risk** – This is the risk that portfolios will not meet their investment objectives or that there is a failure to deliver consistent performance, resulting in clients moving assets away from SIMAL, or a failure to attract new assets..

  Tolerance – SIMAL has a low tolerance for managing portfolios outside their stated investment process and investment guidelines. We have clearly defined investment processes which seek to meet investment objectives within stated risk parameters. Oversight of both risk and performance is embedded in our business processes and governance. Whilst the management of investment portfolio risk and maintaining portfolio risks within given parameters is a core skill of the business, the risk that investment portfolios may not always meet client objectives cannot be eliminated.

- **Product Risk** – Product risk can arise if our product offering is not suitably diversified or does not provide access to strategies that will help investors to meet their objectives, and from the risks arising through product or service complexity. Product risk can also arise from capacity constraints where the size of assets under management in a particular asset class or strategy can make it more difficult to trade efficiently in the market and deliver out-performance.

  Tolerance – SIMAL has low tolerance for product risk which may result in potential client harm. SIMAL adopts the Schroders Group Product Development and Lifecycle Policy. All new products are approved by SIMAL's management committee and Schroders Group's Product Development Committee. SIMAL's product team focuses on strategy, innovation and changing investor requirements. SIMAL has a low tolerance for compromising its investment performance through the over-estimation of product capacity. Products are assessed for capacity at launch, and on an ongoing basis, and potential capacity constraints are mitigated by hard or soft closing products to new investment.

  SIMAL also has a low tolerance for failure to meet client redemption requests in normal business conditions with appropriate disclosure and legal protection within the governing documentation. Procedures and controls are in place to ensure that funds' and clients' investments are suitably liquid.

- **Climate change risk -** In terms of the assets we manage, this is the risk of a failure to understand the pricing of assets affected by climate change due to declining cash flows from industries or those with a lower demand from investors. This may lead to poor investment decisions and more volatile pricing as asset prices adjust to reflect the increasing regulation. Our business may also be negatively impacted if we fail to incorporate climate change risk in our investment process as this may impact our performance, brand and reputation.

  Tolerance – As a corporate citizen, Schroders is strongly committed to supporting the objectives of the 2015 Paris Agreement in which global leaders agreed to an international target to limit global warning to well below 2°C above pre-industrial levels. We are aiming to reduce the gross carbon emissions of our global operations year on year from their peak in 2015. This is to be achieved by greater efficiency in Scope 1, 2 and 3 emissions. A substantial proportion of scope 3 emissions result from business travel.

As well as limiting our gross carbon emissions, we are committed to running our global operations on a carbon-neutral basis from 1 January 2020. This will be achieved through a carbon offsetting programme investing in projects which act as natural carbon sinks.

At a global level, we have developed a range of tools to better understand the impacts of climate change on the portfolios we manage, including a physical risk model and a transition risk model and we are working to apply these models to assess climate change risk across our local investment portfolios. We assess our corporate exposure to physical climate change risks and that of our supply chain. We actively monitor our emissions and have adopted targets to reduce our carbon footprint.

We are actively educating clients on this complex topic and evolving products to meet their needs and those of new investors. We are also scaling up our engagement activity on the topic climate change with both investee companies and policymaker. We aim to stay ahead of fast moving expectations in this area and to share our experience of building effective analytical tools and investment solutions.

We are committed to reporting in accordance with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations and have also signed up to a Global Investor Statement on Climate Change. We are also involved with a number of investor groups focused on collective engagement with high emitting companies such as Climate Action 100.

- **Business concentration risk** – Business concentration risk arises from insufficient diversification in distribution channels, products, clients, markets, or income streams.

  Tolerance – SIMAL has a preference for a diversified product set which reduces our dependence on the performance of any one fund or asset class. We have a broad and increasing range and scale of products, distribution and investment channels.

Market, credit, liquidity and capital risks

SIMAL faces market, credit, liquidity and capital risks from the instruments we manage as part of our assets under management.

Descriptions of these risks as well as the appetites are described below:

- **Market Risk** – Market risk arises from market movement, which can cause a decline in the value of the assets under management. The Schroders Group’s Investment Risk Framework provides second line review and challenge of market risks.

  Tolerance – SIMAL has a low tolerance for risk taking beyond Tracking Error limits (including high and low risk taking).

- **Credit Risk** - SIMAL faces credit risk as a result of counterparty exposure arising from client investment holdings, including derivative exposures.

  Tolerance - SIMAL has a conservative appetite for credit risk and so uses a small number of high creditworthiness counterparties, where possible, across the business and secures credit exposures against collateral, where possible. An extensive counterparty list is not possible in the Australian market if we are to secure best execution with counterparties who dominate venue flows and market liquidity.

  SIMAL seeks to minimise concentrations in its business where possible, within the constraints of the type and geographic nature of the business. Where concentrations do exist, they are mitigated by the use of high-quality counterparties and credit exposures secured by readily realisable collateral. In line with industry practice SIMAL has implemented the trading of OTC instruments on a cleared basis rather than via bi-lateral exchange of collateral.

- **Liquidity Risk -** Liquidity risk is the risk that SIMAL cannot meet its contractual or payment obligation in a timely manner. Liquidity risk in relation to client portfolios may arise in difficult market conditions from the inability to sell the portfolio's underlying investments for full value, or at all. This could affect performance and also prevent cash or other assets from being readily available to meet redemptions or other obligations.

  Tolerance - SIMAL has no appetite for failure to adequately disclose liquidity constraints in risk disclosures / offer documents. It also has no appetite for products to deviate from their liquidity profile as disclosed in their legal documentations (Investment policy and redemption terms). Where appropriate provision is provided in Pools for staggered redemptions and/or in-specie transfers whilst segregated mandates have client specified investment restrictions and client appointed custodians.

- **Risk of insufficient capital** - The risk of insufficient capital would arise if SIMAL did not comply with its requirements under its Australian Financial Services Licence (AFSL) and the relevant ASIC regulatory guides. The capital requirements are in place to ensure that SIMAL has sufficient financial resources to conduct our financial services business in compliance with the Corporations Act and a sufficient buffer to protect our investors.

  Tolerance - SIMAL has zero tolerance for insufficient capital. On a quarterly basis Finance prepares a report showing compliance with SIMAL's capital requirements which is provided to the SIMAL Board and GRC Committee.

Operational Risks

Operational risks are inherent in all activities and processes. They exist in the normal course of business and are sometimes heightened when we implement changes to our organisation. When Operational risk events occur, this may impact our clients and our ability to serve them. We may be liable for financial losses or fines, which could affect our business performance and may weaken our standing with stakeholders.SIMAL manages risk events through identification, reporting and resolution in order to prevent risk events from recurring.

The material operational risks that SIMAL faces are described below:

- **Conduct and Regulatory Risk** – The risks from inappropriate conduct, conflicts management, practice or behaviour resulting in detriment and client harm, or market abuse, or of failing to meet regulatory requirements and changes.

  Tolerance – SIMAL has a low tolerance for conduct and regulatory risk and accepts that these risks may be present in the normal course of business and as a result of standard market practices. We promote and require high standards of conduct and compliance without exception with regard to the lack of integrity from our employees. We promote a strong compliance culture among all our staff through communication of our Group's purpose and values, policies and procedures, appropriate governance, monitoring and assurance activities, staff training, appropriate remuneration structures and the annual appraisal process.

  SIMAL Compliance function supports management in identifying our regulatory obligations and enabling these to be met through relevant training and procedures. Compliance with regulatory requirements is monitored in accordance with a risk-based programme. SIMAL recognises and accepts that higher compliance risks arise from certain aspects of its business model and activities and has designed its compliance arrangements to mitigate those risks.

- **Legal Risk –** The risk that we, our clients, our suppliers or other third parties fail to meet or record legal or regulatory obligations, and related disputes..

  Tolerance – We have zero tolerance for contractual disputes with clients or other third parties or regulatory sanctions. We have a low tolerance for claims against SIMAL which could lead to financial loss and potentially regulatory damage.

- **Tax risk –** SIMAL and its managed funds are exposed to tax compliance and reporting risks, which include submission of late or inaccurate tax returns, the failure to submit claims and elections on time or where finance or operational systems and processes are not sufficiently robust to support tax compliance and reporting requirements; transactional risks, where actions being taken without appropriate consideration of the potential tax consequences or where tax planning is not correctly implemented; and reputational risks, which cover the wider impact that our conduct in relation to our tax affairs can have on our relationships with our stakeholders.

- **Tolerance** – Local management, with oversight from our Group tax function, is generally responsible for identifying and managing the tax position of our managed funds, with the assistance of third party service providers. There is no appetite for the submission of late or inaccurate returns. There is low appetite for transactional risks, which would include actions being taken without appropriate consideration of the potential tax consequences. At a corporate level SIMAL's position is to at all times comply in spirit and practice with the expectations of SIMAL's tax authority.

- **Process Risk** – Process risk is defined as the risk of failure of significant business processes, such as mandate compliance, client suitability checks, financial crime risk management and asset pricing.

  Tolerance - SIMAL's preference is to run its business on core systems that support all aspects of their operation. This may not always be possible for new business where either the market or the business has not developed the critical mass to support full systems automation. Where this is the case, the business must be managed using a suitably robust infrastructure.

  SIMAL's processes and controls must be suitably designed and operated to ensure that its customer transactions, financial records and other critical business activities are processed accurately, robustly and securely. SIMAL must ensure that its control objectives with regard to these processes are identified and actioned and ensure that any risks are mitigated to within accepted levels. SIMAL has zero appetite to develop new products which cannot be supported by effective systems, process and controls.

  Our key business processes are regularly reviewed and the risks assessed through the Risk and Controls Assessment (RCA) process. When we undertake change, such as acquisitions, we assess new processes that may arise.

- **Fraud Risk** – Fraud could arise from either internal or external parties attempting to defraud SIMAL or its clients by circumventing our processes and controls, including those operated by our third party providers (e.g. within our outsourced activities).

  Tolerance – SIMAL has a commitment to high ethical standards and a desire to prevent and deter harm to its clients or staff interests. It seeks to limit the reputational and financial risks associated with fraud, particularly internal fraud. SIMAL has zero appetite for any fraud which may:

  - Lead to reputational damage to SIMAL and/or damage our image with our clients.

  - Lead to regulatory action or censure.

  - Lead to significant losses or represent a significant control deficiency.

- **People and Employment Practices Risk** –. The risk that SIMAL is unable to attract, retain or develop key employees to support our business, offer an attractive value proposition under remuneration regulations or maintain high standards in employment practices. Additionally, people and employment practices risk incorporates the risk that our employment practices do not comply with local legislation, such as equal opportunities, human rights or the work health and safety (WHS).

  Tolerance – SIMAL aims to manage employment issues appropriately and handle them consistently, fairly and in compliance with Australia regulations. We have sustainable succession and employee development processes and recruit selectively through our entry-level and experienced hire programmes. We have competitive remuneration, which is designed to encourage retention, and we build depth and strength in our workforce.

- **Business services resilience risk** – The risk that we are unable to operate critical business services, this includes our third parties' readiness to manage. SIMAL has a number of outsourced supplier relationships (both external and internal within the Group) as part of our business model, particularly in respect of fund administration, custody and transfer agency services.

  Tolerance – SIMAL seeks to minimise the impact of risk caused by third party service provider arrangements through documenting all service levels into contractual arrangements as well as initial and ongoing due diligence programs and regular reviews of performance against agreed service levels. Relevant processes, procedures and plans are tested to ensure we can maintain service, respond or recover.

- **Technology Risk** – Technology risk relates to the risk that a change or failure in technology could pose a risk to the integrity or availability of the services provided by SIMAL.

  Tolerance – SIMAL has a low appetite for technology risk. Policies and technical standards are deployed, together with robust project and change management processes, which cover the assessment of business requirements, risk and scalability.

- **Information Security Risk** – This is the risk that arises if our technology is compromised or inadequate, resulting in the confidentiality, integrity or availability of our clients' and our own data or SIMAL's services being negatively impacted.

  Tolerance – SIMAL has a low appetite information security risk. To address this risk, SIMAL aims for strong internal control processes and the development of robust technology solutions. Formal governance over information security risks has been established across the three lines of defense and is monitored by the Group Information Security Risk Oversight Committee. The Group holds insurance to cover certain losses in respect of cyber risks.

5. Implementation of SIMAL's Risk Appetite

All Heads of Department are responsible for the implementation of, and compliance with, this Statement.

Risk Assessments

Each department undertakes a Risk and Controls Assessment (RCA) and maintains a Risk Register of the business risks it faces in its day-to-day operations and the control framework which is in place to mitigate risks. These RCAs are updated when there are key changes in policies, structures or functions.

All risks which are assessed as unacceptable at departmental level are reported in the RCA which is tabled at the SIMAL Board and action plans to reduce these risks to acceptable levels are recorded.

Departments are required to manage their specific operational risks in a manner which is consistent with this Statement and to manage and address any risks outside appetite or agreed tolerance levels.

Reporting & Monitoring

This Statement is complemented by a number of specific risk reports which assist management in assessing whether outcomes are consistent with SIMAL's risk appetite. A risk report is presented at each of SIMAL's quarterly GRC Committee meetings.

6. Review

This Risk Appetite Statement is reviewed annually, or whenever there is a significant change to SIMAL's operating environment. This review is coordinated by the Risk Department. Proposed changes to the Risk Appetite Statement are endorsed by the SIMAL Board following review by the local Management Committee.