Risk Appetite Statement – Schroder Investment Management Australia Ltd

January 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 intermediated business. 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 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 neither possible nor necessarily desirable to eliminate 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 management 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 Corporate Governance and Finance. The Head of Corporate Governance and Finance 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.

4.1 Strategic Risks

The risk of our strategy failing to deliver the expected outcomes, earnings, and profitability can be influenced by both internal and external factors.

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.

  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.

- **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.

4.2 Business Risks

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

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. 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 and suffer prolonged underperformance. We have clearly defined investment processes designed to meet investment targets within stated risk parameters, which are subject to independent review and challenge.

Tolerance – SIMAL has a low tolerance for managing portfolios outside their stated investment process and investment guidelines. 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. Product risk also arises from product or service viability, and from the risks arising through product and 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.

  SIMAL follows the Schroders Group Product Development Policy. All new products are approved by SIMAL's management committee and Schroders Group's Product Development Committee (whose membership includes the Group's Head of Risk).

  Tolerance – 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.

- **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 range and scale of products, distribution and investment channels.

4.3 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.

4.4 Operational Risks

Operational risks are inherent in all activities and processes we perform within SIMAL. To manage and mitigate these risks, the second line of defense provides oversight and challenge to the business through a Group operational risk framework. Tools to manage this include risk and control assessments (RCAs), risk event management processes and new product approval processes. 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 impacting on client outcomes, or of failing to respond appropriately to regulatory changes.

  Tolerance – SIMAL promotes and requires high standards of conduct and compliance and has a low tolerance for conduct and regulatory risk. It also has no tolerance for a lack of integrity from our employees.

  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 SIMAL, its counterparties, clients, suppliers or other third parties with whom we contract fail to meet their legal or regulatory obligations and that SIMAL takes on obligations that it did not intend to assume with a revenue or contingent liability impact and the risk of legal claims and loss. SIMAL's internal Legal team supports the business to identify and appropriately manage legal risk.

  Tolerance – We have zero tolerance for contractual disputes with clients or other third parties or regulatory sanctions, as evidence of unplanned liabilities where legal advice might have been incomplete or incorrectly implemented. 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; 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 and change Risk** – Process risk is defined as the risk of failure of significant business processes resulting in financial or reputational loss throughout the client lifecycle, from sales and marketing, through client take on, portfolio management and dealing, operations and reporting. This could arise through business as usual activities or linked to change activities such as new product development or process re-design.

  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.

  Tolerance - 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 a preference to seek direct exposure to assets over synthetic exposure. Derivatives are used predominately for efficient portfolio management. SIMAL has zero appetite to develop new products which cannot be supported by effective systems, process and controls.

- **Fraud Risk** – Fraud could arise from either internal or external parties who attempt 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).

  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.

  Tolerance – 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** – Talented employees may be targeted by competitors seeking to build their businesses. This is particularly important for key revenue generators in Investment given the potential impact their departure could have on SIMAL's financial position. SIMAL also needs to attract new employees for new business activities or strategic initiatives that require different skills to those that currently exist within the business. 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 also aim to maintain high rates of employee retention.

- **Third-party Service Provider Risk** - Third-party service provider risk relates to the risk that outsource providers may not be able to meet their agreed service level terms. SIMAL has a number of outsourced supplier relationships (internally within the Group as well as externally) 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.

- **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 risks and is supported by the Global Technology to manage IT problems and incidents, change/ projects and IT strategy and architecture. Key IT risk metrics are monitored via the Global Technology Risk Committee.

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

  Tolerance – SIMAL has a low appetite for threats arising from external cyber-attacks. 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 through the Group Information Security Risk Oversight Committee. The Group holds insurance to cover certain losses in respect of cyber risks. Security awareness training has been deployed across the Group.

5. Implementation of SIMAL's Risk Appetite

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

5.1 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.

5.2 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 board 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.