Schroders

Pillar 3 disclosures as at 31 December 2015

Schroders

Contents

Overview 2
Regulatory framework 3
Risk management framework 4
Capital management and regulatory own funds 7
Capital resource requirements 9
Credit risk 10
Market risk 14
Operational risk 16
Other risks 17
Remuneration disclosures 18
Appendix I – Credit risk adjustments 21
Appendix II – Asset encumbrance 22

Overview

Purpose

This document sets out the Pillar 3 disclosures on capital and risk management for the Schroders plc Group (Schroders or the Group) as at 31 December 2015.

This document fulfils the regulatory disclosure requirements of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) referred to collectively as CRD IV. CRD IV has the effect of implementing the international Basel III framework in the European Union. This regulatory framework is supplemented by a number of technical standards issued by the European Banking Authority that have been adopted by the Group where relevant. CRD IV applies to all EU financial institutions, except for insurance companies, which are covered under a separate directive.

The capital and risk disclosures required under Pillar 3 are required to be produced at least annually and published at the same date as the Schroders plc Annual Report and Accounts 2015 (Annual Report and Accounts). Schroders plc has an accounting reference date of 31 December and these disclosures are made for the Group as at 31 December 2015. These disclosures are not subject to audit and have been produced solely for the purposes of satisfying the Pillar 3 regulatory requirements.

Additional relevant information can be found in the Annual Report and Accounts 2015 which is available on the Schroders corporate website (www.schroders.com/ir).

Summary capital position and requirements

Schroders' total regulatory capital consists entirely of common equity tier 1 capital. The Group's total capital ratio is calculated as the total regulatory capital divided by the total risk exposures and must be greater than 8 per cent. The Group's key regulatory metrics are shown below.

	Total regulatory capital £m	Total risk exposure £m	Total CET1 capital ratio %	Total capital ratio %
2015	2,067.0	5,349.1	38.6	38.6
2014	1,826.9	4,843.1	37.7	37.7

The tables below show the Group's capital requirement by risk exposure.

Risk weighted exposures	2015 £m	2014 £m
Credit risk	2,328.6	2,097.9
Market risk	85.0	115.7
Operational risk	2,932.6	2,626.3
Credit valuation adjustment	2.9	3.2
Total	**5,349.1**	**4,843.1**

Capital required	2015 £m	2014 £m
Credit risk	186.3	167.8
Market risk	6.8	9.3
Operational risk	234.6	210.1
Credit valuation adjustment	0.2	0.3
Total	**427.9**	**387.5**

These disclosures are published on the Schroders plc corporate website (www.schroders.com/ir).

Regulatory framework

Regulatory supervision

The Group is supervised on a consolidated basis in the United Kingdom. The Group includes a subsidiary with a UK banking licence so the lead regulator is the Prudential Regulation Authority (PRA). The PRA receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Certain subsidiaries are directly regulated by their local supervisors including the Financial Conduct Authority for certain UK subsidiaries, who set and monitor the local capital adequacy requirements.

Regulatory framework

The Group's regulatory capital is assessed under the Basel Committee's framework which comprises three pillars:

– Pillar 1 sets rule-based minimum capital standards;

– Pillar 2 sets requirements for supervisory review and the setting of individual capital requirements for firms, taking into consideration the firm's own assessment of capital requirements; and

– Pillar 3 sets disclosure requirements.

The aim of Pillar 3 is to produce disclosures which allow market participants to assess the capital position, risk exposures, risk management processes, and hence capital adequacy of financial institutions. Pillar 3 disclosures are required to include all material risks, enabling a comprehensive view of the Group's risk profile.

Basis of consolidation

The Pillar 3 disclosures presented in this document relate to the Group consolidated on a regulatory basis. Information about the Group's subsidiaries, including the regulated entities, is provided in note 37 of the Annual Report and Accounts.

The regulatory basis of consolidation differs from the accounting basis of consolidation because it excludes the Group's insurance entities; Schroder Pension Management Limited and Burnaby Insurance (Guernsey) Limited. Insurance entities are subject to a separate regulatory framework and are therefore outside the scope of CRD IV. The Group's insurance entities are included in the Group's overall risk management framework.

Table 1: Reconciliation of accounting balance sheet to regulatory balance sheet

	31 December 2015 (audited) £m	Deconsolidation of the insurance related subsidiaries £m	Regulatory balance sheet £m
Assets			
Cash and cash equivalents	3,019.0	(9.0)	3,010.0
Trade and other receivables	526.8	(44.2)	482.6
Financial assets	2,446.7	(22.7)	2,424.0
Associates and joint ventures	109.2	-	109.2
Capital invested in insurance entities	-	29.8	29.8
Property, plant and equipment	41.8	-	41.8
Goodwill and intangible assets	467.4	-	467.4
Deferred tax	53.7	-	53.7
Retirements benefit scheme surplus	115.4	-	115.4
Assets backing unit-linked liabilities	11,319.9	(11,319.9)	-
Total assets	18,099.9	(11,366.0)	6,733.9
Liabilities			
Trade and other payables	761.2	(27.5)	733.7
Financial liabilities	3,126.5	-	3,126.5
Current tax	61.8	(0.6)	61.2
Provisions	26.3	-	26.3
Deferred tax	0.4	-	0.4
Retirement benefit scheme deficits	8.2	-	8.2
Unit-linked liabilities	11,319.9	(11,319.9)	-
Total liabilities	15,304.3	(11,348.0)	3,956.3
Net assets	2,795.6	(18.0)	2,777.6
Equity	2,795.6	(18.0)	2,777.6

Risk management framework

Risk management

The Group is exposed to a variety of risks as a result of its business activities. As such, active and effective risk management is a core competence and we actively monitor the potential impact of current and emerging risks. The Group places significant focus on the integrity and good conduct of staff and the risk management framework is underpinned by a strong ethical culture. Schroder plc's credit rating of A+ from Fitch reflects this strong and conservative risk culture.

The Group has a diversified business, a strong capital position and is cash generative. The key risks to which the Group is exposed are summarised below together with an overview of relevant capital considerations. Further detailed information about the Group's key risks and mitigations is provided on pages 36 to 43 of the Annual Report and Accounts.

Reputational risk

Reputational risk impacts Schroders' brand, reliability and relationship with clients and shareholders. Reputational risk can be impacted by adverse risk events arising from any of our key risks. We do not hold regulatory capital directly against reputational risk but may consider it when assessing the risks listed below.

Further detail on how the Group manages this risk can be found in the Annual Report and Accounts on page 38.

Business risks

The Group's key business risks are identified as:

- Investment performance risk;
- Product risk;
- Business concentration risk; and
- Global business risk.

These risks are material to our business and exist in relation to all of our business activities. We are not required to hold regulatory capital against these risks. The Group's approach to managing these risks is detailed on page 39 of the Annual Report and Accounts.

Credit risk

The Group's approach to credit risk management is set out on page 10 of this report.

Market risk

The Group's approach to market risk management is set out on page 14 of this report.

Liquidity risk

The Group's approach to liquidity risk management is set out on page 17 of this report.

Risk of insufficient capital

Maintaining a strong capital base is important to our business and is a core part of our strategy. The risk of insufficient capital would arise if the Group was unable to support its strategic business objectives beyond its minimum regulatory capital requirements. The Group sets and maintains a prudent level of capital, which includes a buffer over the minimum regulatory capital requirement that allows us to effectively conduct our business in the markets in which we operate and to invest in new business opportunities that may arise. This Pillar 3 document outlines the Group's capital position with reference to the minimum requirements with which we are required to comply.

Operational risk

The Group is exposed to a number of key operational risks:

- Conduct and regulatory risk;
- Legal risk;
- Tax risk;
- Process risk;
- Fraud risk;
- Technology and information security risk;
- People and employment practices risk; and
- Third party service provider risk.

The Group's approach to operational risk management is set out on page 16 of this report.

Approach to risk management

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

- Authority to manage the business is delegated from the Schroders plc Board of Directors (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 Management Committee (GMC) is the principal executive committee responsible for the monitoring and reporting of risks and controls;
- The Group Risk Committee (GRC) reviews and monitors the adequacy and effectiveness of the Group's risk management framework, including relevant policies and limits and supports the CFO and the GMC in discharging their risk management responsibilities; and
- The key issues covered by the GRC are included in the reports provided regularly to the Audit and Risk Committee, a committee of the Board.

Underpinning Schroders' approach to risk management is the principle of individual responsibility and accountability across the firm, supported by guidance and training as required. It is the responsibility of all employees to uphold the control culture of Schroders and we embed risk management within all areas of the business as part of our three lines of defence framework. The first line of defence is subject to independent challenge and oversight by risk specialists, the Group Head of Risk and the CFO. The overall approach is independently tested through the monitoring provided by Group Internal Audit.

The Group's corporate governance structure supports this risk management framework, and is outlined in the Annual Report and Accounts on page 52. This includes line management responsibility for the management of risk in the execution of strategy supported through the GMC and independent oversight of risk management supported by the GRC and Audit and Risk Committee.

The Annual Report and Accounts include further detailed information in respect of the Group's risk management and governance policies and processes.

Pillar 2 and ICAAP

The Group identifies and assesses the risks it faces through both structured and ad hoc processes. The structured processes are principally operated through the Group's Internal Capital Adequacy Assessment Process (ICAAP) and risk and control assessments (RCA) completed in each business area.

The ICAAP is the means by which the Group assesses the level of capital that adequately supports all of the relevant current and future risks in its business. The ICAAP focuses on the principal risks to the consolidated financial position and examines each risk category to identify exposures that could put the Group's equity capital at risk. Risks are assessed using the most appropriate technique; the outputs from which are measured and monitored as part of the risk management and oversight process.

The ICAAP is integrated with the RCA process, which focuses on operational risks and controls. Line management is responsible for identifying and assessing the risk and controls in their units and the outputs from the RCAs support the operational risk capital assessment within the ICAAP. The Group also operates on-going processes to identify and assess risks that are less easy to quantify such as reputational, conduct, regulatory and legal risks. The results of these processes are overseen by the GRC and GMC.

The ICAAP is updated, and formally reviewed by the Board on at least an annual basis, with more frequent reviews in the event of a fundamental, or anticipated, change to our business or the environment in which we operate. The ICAAP assesses the capital required to meet unexpected losses over a one-year horizon, calculated at a confidence level specified by the Board. In addition, the Group operates processes to identify and assess emerging risks, including geopolitical events, cyber risk and terrorism. These are also overseen by the GRC and GMC.

Risk mitigation

A variety of techniques are used to mitigate risks, depending on the nature of the risk. These include the use of controls, outsourcing, contingency planning, insurance, capital allocation and collateral.

Stress testing

Stress testing is an important element of the Group's planning and risk management processes, helping us to identify, analyse and manage risks within our business. Capital planning forms part of the ICAAP and a range of stress tests and scenario analysis are used. In addition, stress testing is conducted for liquidity purposes and stress testing also supports the Recovery Plan and reverse stress test scenarios. Together with the Group's business plan, the risk management processes support the Group's Viability Statement (see page 37 of the Annual Report and Accounts).

Board risk management declaration

The Board is responsible for the risk management framework of the Group as detailed in the Annual Report and Accounts on page 36.

Further information on risk management and governance

The Annual Report and Accounts include further detailed information in respect of the Group's risk management and governance policies and processes.

Capital management and regulatory own funds

Capital management

The Group aims to maintain a strong financial position to support the long-term future of the business and takes a long-term view in its strategic and operational planning.

The Group's capital comprises Operating capital, Investment capital, Seed capital and other items.

	2015 £m	2014 £m
Operating capital	**906**	**957**
Investment capital	942	725
Seed capital	229	163
Other items	719	693
Total capital	**2,796**	**2,538**

Operating capital is the capital required to meet regulatory and working capital requirements. Each subsidiary manages its own operating capital with consideration of local regulatory capital requirements, the economic and commercial environment and other relevant considerations. Capital generated by subsidiaries in excess of their individual operating capital requirement is returned to the Group by way of dividends and subsequently managed as part of the Group's investment capital. The ability of companies to pay dividends is dependent on their local regulatory capital requirements, statutory reserves, financial and operating performance and strategic plans. In addition, where appropriate, the liquid resources of individual subsidiaries are also managed centrally by Group Treasury.

Investment capital represents shareholders' investible equity and is used to support strategic investments. Investment capital is managed by the Group Capital Committee and Group Treasury with the objective of achieving an appropriate return with low volatility. It is mainly held in government and government-guaranteed bonds, investment grade corporate bonds and Schroders' funds.

Seed capital represents capital invested to support new investment strategies, co-invest selectively alongside our clients and finance growth opportunities. Seed capital is deployed principally to support the growth of Asset Management and, where practical, the market risk on seed capital investments is hedged. Surplus capital is deployed in accordance with limits approved by the Board.

Other items comprise assets that are not investible or generally available to support the Group's operating activities. Other items include assets that are actually or potentially inadmissible for regulatory capital purposes, such as goodwill, intangible assets, pension surpluses, other associates and joint ventures and deferred tax.

Regulatory own funds

Regulatory capital is categorised as either tier 1 or tier 2 depending on the characteristics of the capital items. Certain capital deductions and regulatory adjustments are made against these capital items reflecting the different regulatory treatment for capital adequacy purposes. Capital deductions include deductions for goodwill, intangible assets and the defined benefit pension surplus. Regulatory adjustments are required where certain thresholds are exceeded including adjustments for deferred tax assets and holdings of tier 1 instruments of financial sector entities. The Group capital after capital deductions and regulatory adjustments represents the Group's regulatory own funds for capital adequacy purposes.

CRD IV allows for certain regulatory adjustments to be implemented on a gradual basis to 1 January 2018. The PRA has decided not to implement these transitional provisions. Schroders' regulatory capital is therefore calculated on a fully phased in or end point basis.

Tier 1 capital

Tier 1 capital is the going concern capital which allows a firm to continue its activities and helps prevent insolvency. Tier 1 can be sub-divided into Common Equity Tier 1 (CET1) and Additional Tier 1 (AT1). The highest form of Tier 1 capital is CET1 capital because it is the most effective at absorbing losses.

Schroders regulatory capital consists entirely of CET1 capital. The Group's CET1 capital consists of two classes of shares: ordinary shares; and non-voting ordinary shares. Non-voting ordinary shares carry the same rights as ordinary shares except that they do not confer the right to attend or vote at any general meeting of Schroders plc and on a capitalisation issue they carry the right to receive non-voting ordinary shares rather than ordinary shares. Ordinary share capital accounts for 80 per cent. of the Group's total share capital with the remaining 20 per cent. represented by non-voting ordinary share capital.

CET1 capital includes share premium, retained profits and certain other reserves.

Regulatory adjustments

Certain deductions are required to be made to capital in determining the Group's total regulatory capital. In calculating CET1 capital as at 31 December 2015, deductions have been made for the Group's intangible assets of £456.6 million (including £359.1 million of goodwill), primarily relating to the acquisition of Cazenove Capital in 2013, the Group defined benefit pension surplus of £94.6 million and its' own shares held to hedge employee share schemes of £175.5 million.

Table 2: Composition of regulatory capital

	31 December 2015 £m	31 December 2014 £m
Shareholder equity per the regulatory balance sheet[1]	2,777.6	2,537.8
Adjustment for foreseeable dividends	(158.0)	(147.0)
Common Equity Tier 1 (CET1) capital before regulatory adjustments	**2,619.6**	**2,390.8**
Common Equity Tier 1 (CET1) capital: regulatory adjustments		
Intangible assets (net of related tax liability)	(456.6)	(460.2)
Defined-benefit pension fund assets (net of related tax liability)	(94.6)	(76.7)
Additional value adjustments	(1.4)	-
Transitional adjustments	-	(27.0)
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(552.6)**	**(563.9)**
Total Common Equity Tier 1 Capital	**2,067.0**	**1,826.9**
Total Capital	**2,067.0**	**1,826.9**

[1]Shareholder equity per the regulatory balance sheet includes the deduction for direct holdings of own CET1 instruments.

Capital resource requirements

The Group's Pillar 1 capital requirement is calculated as the total of the credit risk, market risk, operational risk and the credit valuation adjustment requirements as set out in CRD IV.

The table below summarises the Group's Pillar 1 capital resource requirement by risk area.

Table 3: Total consolidated capital resources requirement of the Group under Pillar 1

	31 December 2015 £m	31 December 2014 £m
Credit risk		
Central governments or central banks	-	-
Institutions	40.6	28.6
Corporates	102.9	86.5
Retail	0.5	0.5
Secured by mortgages on immovable property	5.2	5.8
Items associated with particular high risk[1]	3.9	19.0
Other items[2]	33.2	27.4
Total credit risk capital requirement	**186.3**	**167.8**
Market risk		
In respect of foreign exchange	6.8	9.3
Total market risk capital requirement	**6.8**	**9.3**
Operational risk		
Calculated in accordance with the Standardised approach	234.6	210.1
Total operational risk capital requirement	**234.6**	**210.1**
Credit valuation adjustment		
Calculated in accordance with the Standardised approach	0.2	0.3
Total credit valuation capital requirement	**0.2**	**0.3**
Total Pillar 1 capital requirement	**427.9**	**387.5**

[1]High risk exposures include private equity.
[2]Other items as per CRR article 134 include accrued income, fee debtors, settlement accounts, tax, prepayments and other debtors.

Certain subsidiaries of the Group are also required to meet certain local regulatory capital requirements. During the year ended 31 December 2015 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.

Leverage ratio

CRD IV requires firms to calculate a non-risk based Leverage Ratio, to supplement risk-based capital requirements. The leverage ratio measures the relationship between capital resources and total assets. The purpose of monitoring and managing this metric is to enable regulators to constrain the build-up of excessive leverage.

The leverage ratio is calculated based on the Group's capital divided by exposures which are defined as the total of on and off balance sheet exposures less the deductions applied to Tier 1 capital.

The Basel Committee has implemented a monitoring period which runs to January 2017, during which time a minimum leverage ratio of 3 per cent. should apply. This limit will be reassessed in 2017 before becoming mandatory in 2018.

As at 31 December 2015 Schroders leverage ratio was 34 per cent. (2014: 32 per cent.).

Credit risk

Overview

Credit risk is the exposure to loss arising from a counterparty's failure to meet its contractual obligations, either as a result of business failure or intentional withholding of amounts due. The Group is exposed to credit risk in relation to its loans and advances to customers, cash held on deposit with banks, cash held on deposit with central banks, fixed income investments, trade and other receivables including balances subject to settlement risk, derivatives arising from interest rate and market risk management.

Credit risk management

The Group employs a range of techniques to assess credit risk both in terms of counterparties and the lending activities within the Wealth Management business.

The Group has policies in place and sets appropriate limits for both our principal and agency counterparties taking into consideration both the large exposure requirements and where appropriate the use of External Credit Assessment Institutions (ECAI) supplemented by internal assessments. The creditworthiness of the counterparties is monitored regularly, as is usage against the relevant credit limits. We seek to diversify our exposure across different counterparties.

In Wealth Management, we seek to mitigate credit risk within lending activities through collateralisation, where appropriate collateral takes the form of cash, portfolio investments or real estate. Client portfolios held as collateral are marked to market daily and compared to the outstanding loan balance. Other assets, such as Real Estate are valued less frequently but in accordance with the requirements of CRR article 208.

Wealth Management credit risk is monitored and managed against internally set limits, including consideration of capital.

Credit risk measurement

Schroders has elected to adopt the standardised approach to credit risk. Under the standardised approach, a credit risk capital requirement is calculated as 8 per cent. of the Group's total risk weighted exposures. The calculation requires the Group to first determine the total credit risk exposures and then apply a risk weighting to calculate the total risk weighted exposure.

Calculating the credit risk exposure

The Group's credit risk exposure before credit risk mitigation is calculated based on the accounting value of the relevant instruments adjusted for regulatory valuation adjustments together with an add-on for the potential future exposure of derivatives. Off-balance sheet exposures are also considered and where relevant these exposures are included within the overall credit risk exposure through the use of credit conversion factors (CCFs).

The table below shows the Group's total credit risk exposure by asset class.

Table 4: Credit risk exposure value

	Regulatory balance sheet £m	Regulatory Adjustments and balances adjusted directly through capital[1] £m	Regulatory Exposure value of IFRS off balance sheet items post CCFs £m	Derivative add-on £m	Exposure value before credit risk mitigation 31 December 2015 £m	Exposure value before credit risk mitigation 31 December 2014 £m
Assets						
Cash and cash equivalents	3,010.0	-	-	-	3,010.0	3,340.9
Trade and other receivables	482.6	-	-	-	482.6	513.3
Financial assets	2,424.0	(1.4)	28.8	10.8	2,462.2	1,761.5
Associates and joint ventures	139.0	-	-	-	139.0	92.6
Property, plant and equipment	41.8	-	-	-	41.8	29.9
Goodwill and intangible assets	467.4	(467.4)	-	-	-	-
Deferred tax	53.7	-	-	-	53.7	47.8
Retirements benefit scheme surplus	115.4	(115.4)	-	-	-	-
Total assets	**6,733.9**	**(584.2)**	**28.8**	**10.8**	**6,189.3**	**5,786.0**

[1]Includes adjustments to account for items treated as regulatory capital deductions and other adjustments to balances determined in accordance with International Financial Reporting Standards as prescribed by CRD IV. Approaches to assessing potential credit risk adjustments for the prudential valuation adjustment, past due and impaired financial assets and calculating provisions are detailed in appendix I to this document.

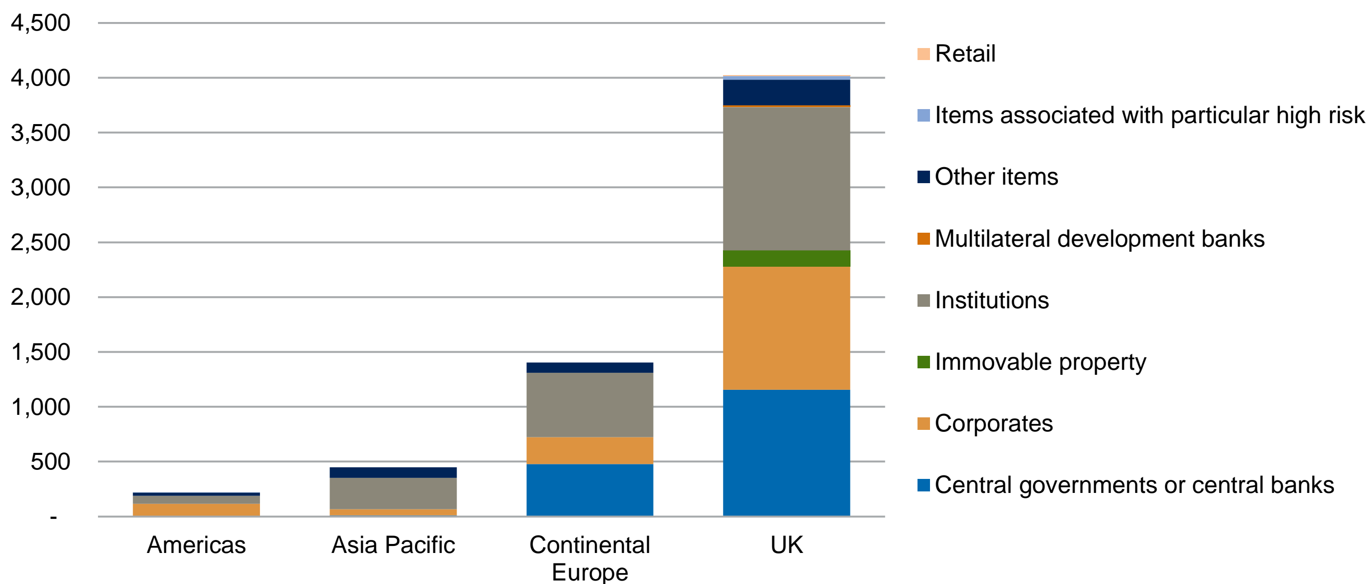
Each risk exposure is assigned to an exposure class as defined in article 112 of the CRR and set out in the table below.

Table 5: Credit risk exposure before credit risk mitigation by exposure class

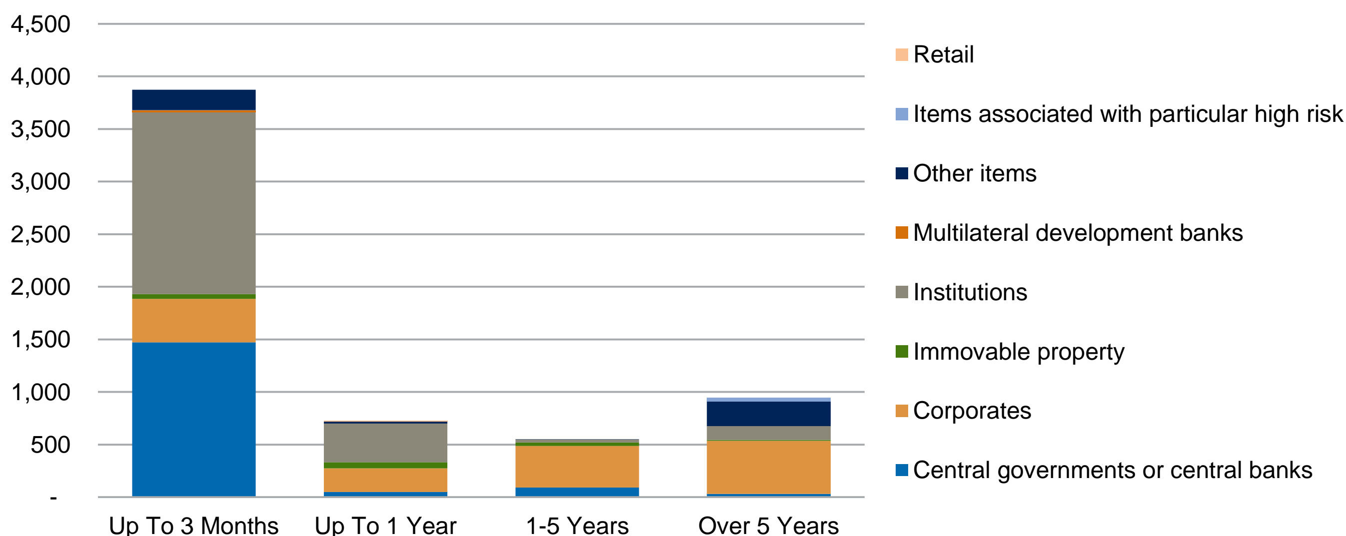
	31 December 2015 Exposure value £m	31 December 2014 Exposure value £m
Central governments or central banks	1,648.8	1,843.0
Multilateral development banks	18.0	24.8
Institutions	2,349.7	1,843.1
Corporates	1,534.3	1,336.6
Retail	8.6	9.1
Secured by mortgages on immovable property	147.0	154.3
Items associated with particular high risk	32.3	158.1
Other items	450.6	417.0
Total exposure value	**6,189.3**	**5,786.0**

Further detail in relation to the Group's credit risk exposure by geographic region, counterparty type and residual maturity is provided below.

Graph 1: Exposure by counterparty and geographic distribution (£m)



Graph 2: Exposure by counterparty and residual maturity (£m)



Credit risk mitigation

The Group applies credit risk mitigation techniques mainly consisting of financial and non-financial collateral to mitigate credit risks to which it is exposed.

The Group has detailed policies in place to ensure that credit risk mitigation is appropriately recognised and recorded. The recognition of credit risk mitigation is subject to a number of considerations, including ensuring the legal certainty of enforceability and effectiveness, ensuring the valuation and liquidity of the collateral is adequately monitored and ensuring the value of the collateral is not materially correlated with the credit quality of the counterparty, using the credit quality assessment scale that is set out in Title 2 Chapter 2 Section 3 of the CRR ("Use of ECAIs").

The main types of collateral taken by the Group are:

– Financial collateral including cash and client portfolios to support client lending. Bonds are held to collateralise reverse re-purchase agreements (Reverse Repos). Financial collateral is marked to market at least daily and compared to loans and Reverse Repos 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 CRR article 208(3).

The following table gives details of the exposure value before and after credit risk mitigation (after application of CRR Title II Chapter 4) associated with each credit quality assessment step.

Table 6: Detail of the exposure value before and after credit risk mitigation at 31 December 2015

Credit quality step	Credit rating	Exposure before credit risk mitigation £m	Exposure after credit risk mitigation £m
1	AAA to AA-	2,111.5	2,056.2
2	A+ to A-	1,628.6	1,248.6
3	BBB+ to BBB-	325.3	325.3
4	BB+ to BB-	13.8	13.8
5	B+ to B-	10.0	10.0
6	CCC+ and below	2.6	2.6
Unrated*		2,097.5	1,527.1
Total		**6,189.3**	**5,183.6**

*Unrated exposures include 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 are risk weighted based on exposure class.

Calculating the risk weighted exposure

The Group's risk-weighted exposure is calculated by applying risk weightings to all credit exposures, after credit risk mitigation, based on the exposure class to which the exposure is assigned and the credit quality of the relevant counterparty.

The Group assesses the credit quality of its counterparties with reference to credit assessments conducted by ECAI's. The ECAI used by the Group is Fitch. Fitch ratings are recognised as an eligible ECAI by the PRA and are used to assess the credit quality of all exposures, where available. If a Fitch rating is unavailable, a rating from an alternative ECAI is used, which may include Moody's or Standard & Poor's.

Each exposure is mapped to one of six credit quality steps based on its credit rating. A risk weighted percentage is then applied to the exposure based on the credit quality step, exposure class and maturity. The risk weighted percentage applied is specified in Title 2 Chapter 2 of the CRR. Where no credit rating can be obtained from an endorsed ECAI the exposure is categorised as unrated.

Table 7: Risk-weighted assets

	31 December 2015	31 December 2014	31 December 2015	31 December 2014
	Risk-weighted assets		Capital requirement	
	£m	£m	£m	£m
Central governments or central banks	0.7	-	-	-
Multilateral development banks	-	-	-	-
Institutions	508.0	357.2	40.6	28.6
Corporates	1,285.7	1,081.0	102.9	86.4
Retail	6.2	5.8	0.5	0.5
Secured by mortgages on immovable property	64.5	73.7	5.2	5.9
Items associated with particular high risk	48.4	237.1	3.9	19.0
Other items	415.1	343.1	33.2	27.4
Total	**2,328.6**	**2,097.9**	**186.3**	**167.8**

Market risk

Overview

Market risk is the risk that market movements, including foreign exchange rates, interest rates, equity prices, credit spreads and commodity prices, cause a reduction in the Group's equity or otherwise reduce the Group's profits. The Group's primary exposures to market risk arise from holdings of principal investments; foreign currency positions as a result of overseas operations; and certain off balance sheet items. The Group has a second order exposure to market risk through its investment management activities as the income earned from this agency business will vary dependent on the value of assets under management. This second order exposure does not give rise to a capital requirement.

Market risk management

For its principal investments, the Group has an investment framework in place which includes a risk appetite, risk measures and prescribed limits which are approved by the Board. The currency risk associated with non-sterling investments is hedged, where appropriate, using short-dated forward foreign exchange contracts. The Group aims to hedge the market risk exposure in the seed capital investments where possible and where this is not possible the risk must be approved by the Group Capital Committee.

The Wealth Management Executive Committee monitors and manages market risk in the Group's banking businesses, which is primarily interest rate risk in the banking book. This process includes monitoring the sensitivity of the balance sheet to moves in yield curves and assessing any mismatch between interest rate sensitive assets and liabilities.

Foreign exchange position risk

The Group is exposed to foreign exchange risk as a result of transactional foreign exchange exposures in its operating entities. Transactional foreign exchange exposures arise as a result of a position held in a currency other than the functional currency of the transacting entity. The Group seeks to minimise its exposure to transactional foreign exchange by converting foreign currency position to the functional currency of the transacting entity as soon as practical. Certain investments within the investment capital and seed capital portfolios are held in currencies other than sterling and these are hedged where appropriate.

The Group is exposed to structural foreign exchange risk as a result of its net investment in overseas subsidiaries and branches which contribute to its capital resources. These investments are recorded in the functional currencies of the individual entities and subsequently translated to the Group's presentational currency (sterling). Foreign exchange differences arising on the translation of the foreign operations are recorded in the net exchange differences reserve through other comprehensive income and give rise to movements in the Group's CET1 capital. The Group manages its exposures to translational foreign exchange by returning surplus capital to the ultimate parent of the Group as soon as practical.

Market risk measurement

The Group calculates its own funds requirement for market risk in accordance with Title IV of the CRR. In determining its Pillar 1 capital requirement, the Group is required to consider whether its exposure to market risk arises from trading or non-trading activities. The Group does not generally hold positions with trading intent or to hedge positions held with trading intent, except for certain positions within the Wealth Management business held to facilitate client participation. Financial instruments that make up the Group's investment capital and seed capital are considered to be non-trading as they are not managed on a short term basis and do not form a trading book. We apply a range of value at risk methodologies to assess the profile of the non-trading book. Consequently, the Group's trading book is small.

Non-trading positions, in addition to the Group's investment capital and seed capital, consist of financial assets within the Group's operating capital that are held to meet the operational, regulatory and liquidity needs of our operating entities around the world. Operating capital in the Wealth Management business includes the financial assets that support the Group's banking book.

As the Group's trading book is small, the Group applies the derogation allowed under Article 94 of the CRR. The Group is therefore not required to calculate an own funds requirement based on the equity position risk of its trading book. The exposures arising as a result of the Group's limited trading activities are considered as part of the Group's credit risk exposure along with other non-trading exposures. The Group's own fund requirement for market risk required under Article 92 of the CRR is therefore calculated based on the Group's exposure to foreign exchange risk, settlement risk and commodities risk. The Group applies the standard rules to determine its own funds requirement for these exposures.

Foreign exchange position risk measurement

The Group considers Article 352 of the CRR when calculating its overall net foreign exchange position. The net open positions in each currency are assessed to determine an overall net foreign exchange position, which is then multiplied by 8 per cent. to calculate the Group's own funds requirement. As at 31 December 2015 the own funds requirement for market risk calculated in respect of foreign exchange position exposures was £6.8m.

Interest rate risk

Interest rate risk is the exposure of the Group's balance sheet to adverse movements in interest rates, i.e. the risk that the fair value of future cash flows of financial instruments will fluctuate due to changes in market interest rates. The largest exposure to interest rate risk that the Group faces is to duration risk that arises from timing differences in the maturity (for fixed-rate) and repricing (for floating-rate) of bank assets, liabilities and off-balance sheet positions.

The sensitivities to interest rate risk analysed by currency for a 0.75 per cent. increase in interest rates as at 31 December 2015 is shown in table 8.

Table 8: Interest rate sensitivity: analysis by currency of 0.75 per cent. increase in interest rates

	31 December 2015 £m	31 December 2014 £m
GBP	3.0	2.4
EUR	0.7	0.7
USD	0.1	-
Others	1.3	1.4
Total	**5.1**	**4.5**

Operational risk

Overview

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. Operational risk arises in our investment and banking activities, distribution activities, product development and in our IT and operational infrastructure.

Operational risks include:

- Conduct and regulatory risk;
- Legal risk;
- Tax risk;
- Process risk;
- Fraud risk;
- Technology and information security risk; and
- People and employment practices risk.

Operational risk is a significant risk for the Group, and makes up 55 per cent. of the total capital requirement.

Operational risk management

Line management is responsible for operational risk controls throughout the Group's business and for promoting and overseeing high standards of conduct in accordance with our values and conduct framework.

The operational risk framework requires risk and control assessments (RCAs) which identify and assess key operational risks to be completed by each business area at least annually and also when significant changes occur. The RCA documents set out relevant risks and the controls and supervision practices that have been implemented by management to mitigate and monitor risks and controls. Group Risk oversee the completion of RCAs and report to the GRC on key findings including high risk areas for which risk mitigation plans are required to be completed by management.

Further information on the key operational risks and how those risks are managed can be found in the Annual Report and Accounts on pages 41 to 42.

Operational risk measurement

Schroders has adopted the standardised approach to calculating the Pillar 1 capital requirements for operational risk. Under the standardised approach institutions calculate an average relevant indicator over the past three years. The Group's relevant indicator is based on revenues, including the sum of interest receivable and similar income, interest payable and similar charges, income from shares and other variable/fixed-yield securities, commissions/fees receivable, commissions/fees payable and other operating income. The relevant indicator is divided into certain business lines, each with a relevant beta factor ranging from 12 to 15 per cent. The average of the relevant indicators over the past three years, for each business line is then multiplied by the relevant beta factor to give an operational risk capital requirement.

Table 9: Calculation of the relevant indicator

Relevant indicator elements	2015 £m	2014 £m	2013 £m	Average £m
Fee income	2,007.2	1,889.1	1,780.8	1,892.4
Net banking interest income	15.5	14.6	13.6	14.6
Net gains on financial instruments and other income	31.4	45.6	29.6	35.5
Net finance income	12.7	10.5	11.7	11.6
Total	**2,066.8**	**1,959.8**	**1,835.7**	**1,954.1**

As at 31 December 2015 the own funds requirement for operational risk was £234.6m.

Other risks

Non trading book exposures in equities

An overview of the accounting techniques and valuation methodologies used, as required by Article 447 of the CRR, is included in note 10, Financial Assets, within the Annual Report and Accounts. An overview of how capital is managed, and with what objectives, can be found within note 19 of the Annual Report and Accounts.

The balance sheet value of non-trading book equities held as at 31 December 2015 was £574.7m based on the regulatory consolidation. This reflects investments held for the purposes shown below.

Table 10: Analysis of the balance sheet value and fair value of non-trading book equities

	31 December 2015			31 December 2014		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Seed capital and hedge funds	76.2	9.8	86.0	102.4	10.4	112.8
Private equity investments	18.7	12.6	31.3	33.0	19.7	52.7
Property funds	-	3.3	3.3	-	8.3	8.3
Others	453.3	0.8	454.1	248.2	64.8	313.0
Total	**548.2**	**26.5**	**574.7**	**383.6**	**103.2**	**486.8**

The cumulative realised gains from sales or liquidations during the year were £24.2m. Total unrealised losses in the year were £10.5m which are included in other reserves.

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 through the use of stress tests which consider the impact of possible alternative assumptions on the valuation of the Scheme liabilities as well as consideration of stresses on asset values. Stress tests are performed in line with the PRA's Supervisory Statement PS17/15, dated July 2015. The pension obligation risk capital requirement is an add-on to the Group's minimum capital requirement.

Liquidity risk

Liquidity risk is the risk that a firm, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost. The Group has a Liquidity Risk Management Framework (LRMF) which applies to the Group, including its subsidiaries. The LRMF consists of the following elements:

– Liquidity Risk Tolerance Statement;

– Liquidity Management Policy;

– Liquidity Stress Test; and

– Contingency Funding Plan.

In accordance with the LRMF, the Group holds liquidity resources to meet expected contractual obligations and some discretionary obligations as they fall due, both under normal conditions and severe yet plausible potential stresses. The Group uses a range of liquidity risk assessments and stress tests to assess its ability to meet its obligations as they fall due. The Group's liquidity stress tests are in addition to the stress tests that are applied by each of the Wealth Management entities in assessing their own individual liquidity.

Procedures and controls are also in place, which seek to ensure that funds managed by the Group and other client investments are suitably liquid.

Asset encumbrance

Certain of the Group's assets are encumbered by way of commitments, guarantees or other charges. Further details of the Group's encumbered assets are provided in appendix II to this document.

Remuneration disclosures

The following disclosures are required under the Capital Requirements Regulation (CRR) Part 8 (Article 450).

These disclosures should be read in conjunction with the Remuneration report on pages 68 to 86 of the Annual Report and Accounts, which provides further information on the activities of our Remuneration Committee and our remuneration principles and policies.

Details of the UK Remuneration Code can be found at www.fca.org.uk and information on the remuneration part of the PRA Rulebook can be found at www.prarulebook.co.uk.

Decision-making process for determining the remuneration policy

Schroders has an established Remuneration Committee consisting of independent non-executive Directors of Schroders plc. The Committee met four times during 2015. Their responsibilities include recommending to the Board the Group's policy on Directors' remuneration, overseeing the remuneration governance framework and ensuring that remuneration arrangements are consistent with effective risk management. The role and activities of the Committee and their use of advisors are further detailed in the Remuneration report and the Committee's Terms of Reference (both of which are available on the Group's website).

The Remuneration Committee developed the Group's remuneration policy with a number of principles in mind. The overall policy is designed to promote the long-term success of the Group. It is:

– Aligned with clients: A proportion of key employees' variable remuneration is deferred and delivered as Fund Awards, which are notional investments in funds managed by the Group, thereby aligning the interests of employees and clients.

– Aligned with shareholders: A proportion of variable remuneration is deferred and delivered in the form of deferred awards over Schroders' shares, thereby aligning the interests of employees and shareholders. In addition, the executive Directors of Schroders plc and other members of the GMC are required, over time, to acquire and retain a holding of Schroders' shares or rights to shares equivalent in value to 300 per cent. of annual base salary.

– Aligned with financial performance: Total variable compensation is managed as a percentage of pre-bonus profit before tax and exceptional items, determined by the Remuneration Committee and recommended to the Board. The total spend on compensation is managed as a percentage of net revenue. This approach aligns compensation with financial performance.

– Designed to encourage retention: Deferred variable compensation does not give rise to any immediate entitlement. Awards normally require the participant to be employed continuously by the Group until at least the third anniversary of grant in order for the award to vest in full.

– Competitive: Employees receive a competitive compensation and benefits package, which is reviewed annually and benchmarked by reference to the external market. It allows us to attract and retain the best talent, who know that good performance will be rewarded.

Code staff criteria

The Group's Code Staff are individuals in roles which can materially affect the risk of the Group. Subject to proportionality considerations, the list of individuals reviewed in determining those who are Code Staff includes:

– Directors of Schroders plc and certain key operating subsidiaries;

– Non-executive directors of Schroders plc and certain key operating subsidiaries;

– Members of the Group Management Committee;

– Employees in key control function roles;

– Other employees who the Group deems may have a material impact on the firm's risk profile through their professional activities; and

– Employees who are remunerated at the same levels as senior management and material risk takers identified above, if their role has a material risk impact.

The Schroders Code Staff population has been determined in accordance with technical standards issued by the European Banking Authority with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile. In determining whether or not someone who meets the quantitative criteria in the technical standard should be included as Code Staff, the professional activities of the role were assessed for their impact on the ICAAP risks as identified by the Group. Control frameworks and relevant committee terms of reference were also taken into account. The approach taken was submitted jointly to the PRA and FCA and regulatory approval is still pending.

Link between pay and performance

Employee remuneration is comprised of fixed pay and variable performance-related pay.

Fixed pay is principally comprised of salaries or fees. All Code Staff receive either a salary (for employees) or fees (for non-executive Directors) that reflect their responsibilities and the level of experience and expertise needed to undertake their roles. Fixed pay also includes appropriate pensions and benefits in kind to enable employees to undertake their role by ensuring their wellbeing and security.

Variable performance-related pay is principally comprised of annual bonus awards. Non-executive directors do not receive variable performance-related pay. The overall size of the annual pool for variable performance-related pay is a material component of the Group's total remuneration expense. It is set by the Board and the Remuneration Committee by reference to two ratios: 1) bonus charge to pre-bonus profit before tax and exceptional items; and 2) total compensation to net revenue ratio, both of which are reported to shareholders. This ensures that the aggregate spend on variable performance-related pay is directly linked to the Group's performance.

Code Staff who are permanent employees are eligible to be considered for an annual bonus award each year. Bonuses for all employees take account of overall Group, team and individual performance against agreed objectives. In this context, performance typically includes financial and non-financial measures. We believe that a discretionary incentive approach is preferable to the use of formulaic arrangements, to ensure that good conduct and behaviours in line with our values are rewarded, to avoid reinforcing or creating conflicts of interest and to encourage a one team attitude.

Deferral of incentive awards is a key mechanism to retain talent, primarily through the use of the Equity Compensation Plan (ECP) for bonus deferrals. For senior management and employees receiving larger bonus awards, a significant proportion of their annual bonus award is deferred under the ECP. ECP awards vest over three years. ECP Share awards are conditional rights to acquire shares in the Group at nil cost. ECP Fund awards are conditional rights to receive a cash sum based on the value of a notional investment in a range of Schroders investment products. The pay-outs from ECP Fund Awards are directly determined by the Group's performance managing funds for our clients. For awards in respect of performance-year 2014, the Remuneration Committee approved an increase in the use of Fund Awards and this continued for awards in respect of 2015, thus strengthening the alignment with client outcomes for more employees. At the same time, the Group ensured that at least 50 per cent. of each employee's deferred remuneration was in Share awards, to retain an appropriate level of shareholder alignment. The Equity Incentive Plan (EIP) is an additional deferred remuneration plan, used to recognise sustainable performance and potential, and to increase the alignment of employee interests with the interests of shareholders and clients. EIP awards operate in a similar way to ECP awards but vest after five years, and are normally in the form of Share awards.

In March 2015, executive Directors of Schroders plc were eligible to be considered for an award under the 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 (ECP 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.

Deferred remuneration awards made under the ECP since May 2011, EIP awards made since October 2013 and LTIP awards made at any time may be reduced or lapsed in the event of a material misstatement of the Group's financial results or individual misconduct, under 'malus' terms. Amounts that have been paid or released from ECP, EIP or LTIP awards made since October 2013 may be recovered for a period of 12 months from the date of payment or release in the event of individual misconduct, under 'clawback' terms. For the executive Directors, for performance-year 2015 onwards, similar clawback terms also apply to any cash bonus award for 12 months from the date of payment.

Further details of our remuneration policy, our deferred remuneration arrangements and LTIP performance conditions are provided in the Remuneration report.

Quantitative remuneration disclosures

Ninety five individuals have been identified as Code Staff, of which twenty five are classified as Senior Management.

Table 11: Total remuneration expenditure for Code Staff split by Senior Management and other Code Staff

	Senior Management (£'000)	Other Code Staff (£'000)
Fixed Remuneration	6,611	13,479
Variable Remuneration	41,276	18,231
Total Remuneration	**47,887**	**31,710**

Table 12: Aggregate remuneration expenditure for Code Staff by business area

Asset Management (£'000)	Wealth Management (£'000)	Rest of Group (£'000)
44,270	**10,501**	**24,826**

The remuneration disclosed above includes:

– Non-executive Director fees for 2015;

– Annual base salaries as at 31 December 2015 (or actual salary paid during 2015 for leavers);

– Cash bonus awards for the 2015 performance year;

– Deferred awards (ECP, EIP and LTIP) for 2015 based on the value at award date. LTIP awards are subject to performance conditions, which can result in the portion of the award that is ultimately released ranging from 0 to 100 per cent. The figures above assume 50 per cent. vesting; and

– Any other awards for new hires and any bonus payments made to leavers.

In addition, Code Staff other than non-executive Directors are normally eligible to receive employee benefits, such as private health care and pension, on the same basis as other employees. One of the non-executive Directors of Schroders plc also receives private health care and medical benefits, which is included in the disclosures above.

Appendix I – Credit risk adjustments

Credit risk adjustments are all amounts by which capital has been reduced in order to reflect losses exclusively related to credit risk under IFRSs, resulting from impairments, value adjustments or provisions for off-balance sheet items that are recognised in the profit or loss account.

Value adjustments

A value adjustment is a deduction from common equity tier 1 capital where the prudent value of financial assets measured at fair value is materially lower than the fair value recognised in the financial statements. The valuation adjustment is calculated based on the fair value of items having an impact on own funds. As at 31 December 2015 the value adjustment was £1.4m.

Provisions against lending arrangements

The Group makes specific impairment provisions for potential recoverability of debts from lending arrangements and other debtors.

Lending arrangements principally arise in the Group's Wealth Management business. The relevant Wealth Management Credit Committee determines whether it is necessary to make a provision against a credit exposure. Non-performing exposures will not automatically merit the creation of a provision.

The decision to create or write-back a provision is undertaken on a case-by-case basis, reviewed by the relevant Wealth Management Credit Committee and approved by the Board of the appropriate subsidiary.

Table 13: Movement in provisions during the year

	31 December 2015 £m	31 December 2014 £m
At 1 January	0.1	13.0
Bad and doubtful debts credited	-	(12.2)
Reclassifications	-	-
Foreign exchange	-	(0.7)
Total	**0.1**	**0.1**

Past due and impaired financial assets

A financial asset is past due when the counterparty has failed to make a payment when contractually due. An exposure is classified as impaired when the carrying value exceeds the amount expected to be recovered through use or sale or as non performing when the principal interest on fees remain unpaid for more than 90 days after the due date. The Group assesses its financial assets for indication of impairment at each reporting date. Indicators of impairment may include, but are not restricted to: non-payment of interest; a fall in credit worthiness or a reduction of cover/collateral below the required minimum.

Other debtors consist mainly of fee debtors that arise principally within the Group's Asset Management business and amounts are monitored regularly by local offices. Although the Group manages client assets which represent a large multiple of the amount owed to the Group by the client, the Group does not generally 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 2015 are presented in table 14. Factors considered in determining whether impairment should be recorded 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.

Table 14: Fee debtors that are past due but not impaired

	31 December 2015 £m	31 December 2014 £m
Up to and including 3 months	14.3	8.9
Over 3 months up to 1 year	3.0	4.5
Total	**17.3**	**13.4**

Appendix II – Asset encumbrance

Asset encumbrance arises from collateral pledged against secured funding and other collateralised obligations. The following tables disclose the balance sheet value of encumbered and unencumbered assets as at 31 December 2015 based on the requirement in Part Eight of the Capital Requirements Regulation and in the related Guideline issued by the European Banking Authority.

Table 15: Assets

	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
Assets of the reporting institution	**40.8**		**6,733.9**	
Equity instruments	-	-	578.0	578.0
Debt securities	35.9	35.9	954.4	954.4
Other assets	4.9		5,201.5	

Table 16: Collateral received

	Fair value of encumbered collateral received or own debt securities issued £m	Fair value of collateral received or own debt securities issued available for encumbrance £m
Assets of the reporting institution	**-**	**517.8**
Equity instruments	-	-
Debt securities	-	517.8
Other collateral received	-	-
Own debt securities issued other than own covered bonds or ABSs	-	-

Table 17: Encumbered assets/collateral received and associated liabilities

	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	-	-