Schroders plc

Pillar 3 Disclosures as at 31 December 2012

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Schroders plc

Pillar 3 disclosures

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1 Overview

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

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

In the United Kingdom, the Financial Services Authority (FSA) introduced Pillar 3 by duplicating the CRD articles and annexes to create Chapter 11 – Disclosure (Pillar 3) of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU). On 1 April 2013 the FSA was abolished and the majority of its functions, including Pillar 3 requirements, transferred to the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

1.2 Basis of disclosures
In accordance with the requirements of Chapter 11 of BIPRU, the disclosures included in this document relate to the Schroders Group (for further details of Schroders Group subsidiaries covered by these disclosures see page 12). References to Schroders shall mean either Schroders plc or the Group. The disclosures cover both the qualitative and quantitative requirements.

1.3 Frequency of disclosures
The disclosures are required to be made on an annual basis at a minimum and, if appropriate, some disclosures will be made more frequently. Schroders plc has an Accounting Reference Date of 31 December. These disclosures are made as at 31 December 2012.

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

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

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

2 Risk management framework

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

2.1 Approach to risk management

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

Key Principles of the Governance Risk Framework

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

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

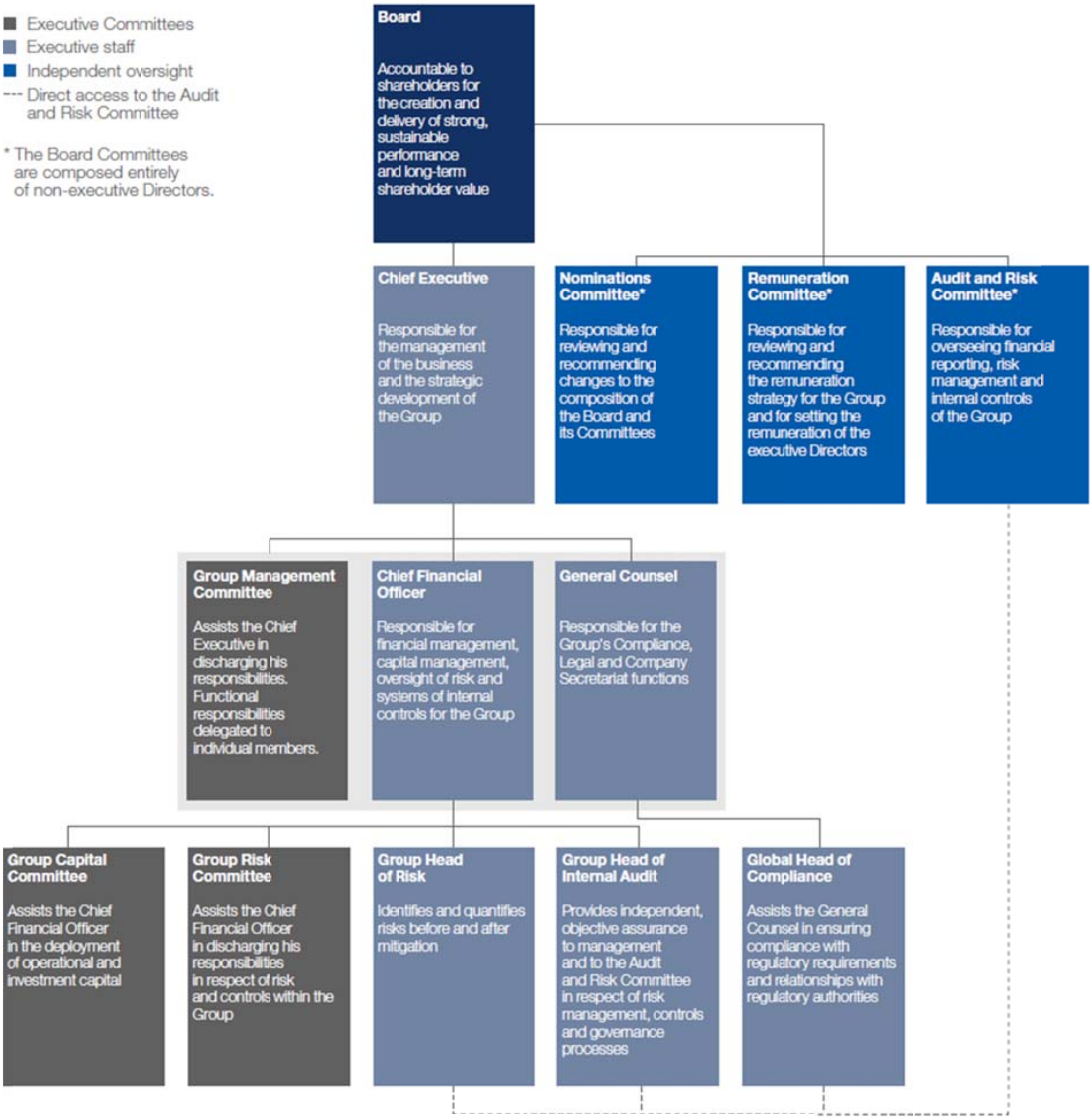
The Group's corporate governance structure supports this framework, as outlined in the following diagram. This includes line management responsibility for the management of risk in the execution of strategy supported via the GMC and independent oversight of risk management supported by the GRC and BARC.

Schroders' Fitch credit rating of A+ reflects its strong and conservative risk culture. It has a well diversified investment management business, plus sound capitalisation and cash generation.

Key Principles of the Governance Risk Framework (continued)

Schroders' Governance Structure

Governance Framework



Core Governance Committees

Schroders plc Board

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

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

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

Group Management Committee (GMC)

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

Board Audit and Risk Committee (BARC)

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

Audit and operational 'business as usual' risks

- Monitoring the content and integrity of financial reporting;
- Reviewing the appropriateness of accounting judgements;
- Reviewing the Group's risk and control framework;
- Reviewing the Group's regulatory reporting procedures and relationships with regulators;
- Reviewing the external auditors; and
- Reviewing the Group's internal audit function

'Forward-looking' emerging and thematic risks

- Considering emerging and thematic risks which may have a material impact on the Group's operations in the future

Group Risk Committee (GRC)

The Chief Financial Officer is supported by the Group Head of Risk and chairs the Group Risk Committee (GRC). The Committee meets ten times a year. Meetings are attended by the heads of the control functions, the Chief Operating Officer, and by GMC members consistent with the quarterly cycle of renewing their areas of responsibility. As the principal executive committee for the monitoring and reporting of risks and controls, the GRC reviews and monitors the adequacy and effectiveness of the Group's risk management framework, including relevant policies and limits. It also reviews trends and exceptions in the most significant risk exposures.

In order to simplify agendas, sub-committees comprising Group policy reviews, credit reviews, financial crime and Private Banking have been established. They report to the GRC.

Group Risk Committee (continued)

During 2012, we continued to devote resources to the management of risks associated with potential Eurozone instability and the weak economic environment. A crisis management exercise was held during the year to consider our response to Eurozone risks, which led to the delivery of a Eurozone crisis management plan to the GMC.

We revised our assessment of operational risk controls during the year, piloting the approach successfully in seven business areas and across a variety of supporting systems. A number of new operational key risk indicators were introduced to monitor potential risks such as unauthorised trading.

In addition, we reviewed the operation of the Investment Risk team, changing the reporting line to make it fully independent of Investment.

The GRC's work in 2012 also included emerging risk identification; hard to value and illiquid instruments; mandate breaches; taxation; Private Banking specific risks; preparations for regulatory developments, including Client Asset Sourcebook (CASS) revision; Recovery and Resolution Plans; Anti-Money Laundering and market abuse developments; and policy reviews such as Group pricing, personal account dealing and Group order management and execution.

2.2 Risk management systems and techniques used

Risk assessment and identification

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

Risk mitigation

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

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

Risk monitoring and reporting

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

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

2.3 Key risks faced

The key risk types faced which are relevant to this Pillar 3 disclosure are described below.

Market, investment performance and liquidity risks

We face risks from movements in the financial markets in which we operate, arising from holding investments both as principal and agent. We have principal exposure in the Life Company in Asset Management which holds investments in funds; in our Private Banking business, where we hold bank paper and government securities; and through the Group's investment capital, where we hold bank paper, government and corporate bonds, equities, funds of hedge funds, property and private equity. There is agency exposure in Asset Management and Private Banking in respect of the assets we manage on behalf of our clients.

Key risk	Description	How we manage risk
Market risk	Market risk arises from market movements, which can cause a fall in the value of principal investments and a decline in the value of assets under management. Equity, net fee income and expenses of the Group's overseas subsidiaries are denominated in local currencies and are therefore subject to exchange rate risk.	Our geographically-diversified, broad product range enables us to provide clients with solutions tailored to a variety of market conditions and serves to diversify individual market dependencies. The Group Capital Committee regularly reviews all holdings within Group capital. All principal investments are managed within approved limits. The Group's seed capital investments may be hedged in respect of market risk and currency risk. These decisions are taken by the Group Capital Committee, chaired by the Chief Financial Officer. Income and expenses are, where possible, matched in the currency of individual subsidiaries. We also use forward foreign exchange contracts to mitigate transactional and investment exposure to currency movements. In Private Banking, market risk is monitored and managed at a local level and by the Private Banking Risk Committee.
Investment performance risk	The management of investment performance risk is a core skill of the Group. This is the risk that portfolios will not meet their investment objectives. This can adversely affect levels of net new business.	The Schroder Investment Risk Framework provides review and challenge of investment risks across each of the asset classes managed by the Group. The Investment Risk team is independent of the Investment function. We adhere to clearly-defined investment processes which seek to meet investment targets within stated risk parameters. Individual portfolio performance, valuations and risk profiles are monitored by fund managers and management on a regular basis, as well as Pricing and Valuation Committees, allowing issues to be identified and mitigated. Recognising that products will not outperform all of the time, we offer a diversified product set which reduces the concentration of risk on the performance of any one fund or asset class. Investment performance is monitored as part of our investment risk management process.

Market, investment performance and liquidity risks (continued)

Key risk	Description	How we manage risk
Liquidity risk	Liquidity risk, in relation to client portfolios, is the risk that funds cannot be generated to meet redemptions or other obligations as they arise. Liquidity issues can arise as a result of market conditions or through inherently illiquid investments. Liquidity risk also applies to the Group's own capital position.	To mitigate this risk within client portfolios, we seek to match, where possible, the liquidity of a portfolio's underlying investments with the anticipated liquidity requirements. We actively monitor markets for indicators of declines in liquidity. We also review products and portfolios to identify capacity constraints. Each of our regulated subsidiaries, and the Group as a whole, meet regulatory capital requirements. In addition, we maintain sufficient liquidity for our anticipated needs, taking account of the risks we face. We have developed a new Individual Liquidity Adequacy Assessment (ILAA) and implemented improved liquidity analysis and reporting in Private Banking in London.

Credit risk

We face risks from the default of counterparties to our principal financial transactions. Our clients also face counterparty risk in relation to the financial transactions in their portfolios and funds. Private Banking additionally faces principal credit risk on its lending activities.

Key risk	Description	How we manage risk
Credit risk	We face credit risk as a result of counterparty exposure.	In order to manage this risk we actively monitor counterparty creditworthiness, with limits expressed in terms of value and term to maturity. The Group sets overall limits in respect of both principal and agency counterparty risk. Where possible, we seek to diversify our exposure across different counterparties. All counterparties are reviewed on a regular basis and limits are amended following changes to their financials. We actively monitor market data and rating agency outputs in assessing counterparties. Collateral is taken in most cases.
	We face credit risk through Private Banking lending activities.	In Private Banking, we mitigate credit risk where possible through collateralisation in the form of cash, portfolio investments or property. Credit risk is monitored and managed against the performance of the collateral.

Operational risk

Operational risk arises in our investment management activities, distribution activities, product development and the operation of our IT and operations infrastructure. Local management is responsible for operational risk controls.

Key risk	Description	How we manage risk
Operational risk	Operational risk could arise from the failure of significant business processes undertaken by Schroders, including mandate compliance and suitability. We have a number of outsourced supplier relationships that are an important part of our business model, particularly in respect of fund administration services.	All business processes are subject to review in order to identify suitable operational controls to mitigate potential risks. Before entering outsourcing arrangements, we undertake due diligence on third-party suppliers. We then maintain a programme of regular assessment against agreed service levels.
Distribution risk	Distribution risk arises from relationship management and concentration across different distribution channels and products. We have three broad client groups: institutional clients, often advised by consultants; retail clients, intermediated through banks, brokers and independent advisers; and private clients.	The broad range of distribution channels mitigates against a key dependency on any sales channel. No single client accounts for more than two per cent of total revenue.
Product risk	Product risk arises from product complexity and the risk these products do not meet their performance objectives or are unsuitable for certain clients. Product risk can also arise from capacity constraints where the size of assets under management in a particular asset class makes it more difficult to trade efficiently in the market.	We have a dedicated Product Development team and a product approval and review procedure. We consider carefully the suitability of products for clients and, where possible, monitor the way products are sold. We actively monitor potential capacity constraints and may mitigate them by closing products to new investment in certain circumstances.
Technology risk	We rely on technology and qualified professionals to maintain our infrastructure, and we invest in information technology projects with long lead times.	We regularly review the progress of major information technology projects and new projects are subject to rigorous review before approval. Our technology is partly outsourced and our platform uses well-established, tested technology from outsource partners which we assess to be financially stable and able to provide the required level of service. Outsource partners are an important part of our business model and we work with them to maintain the quality and continuity of service. Due diligence is undertaken before entering into new arrangements and performance is reviewed on an on-going basis. Continuity and business resumption planning is in place across the business globally.

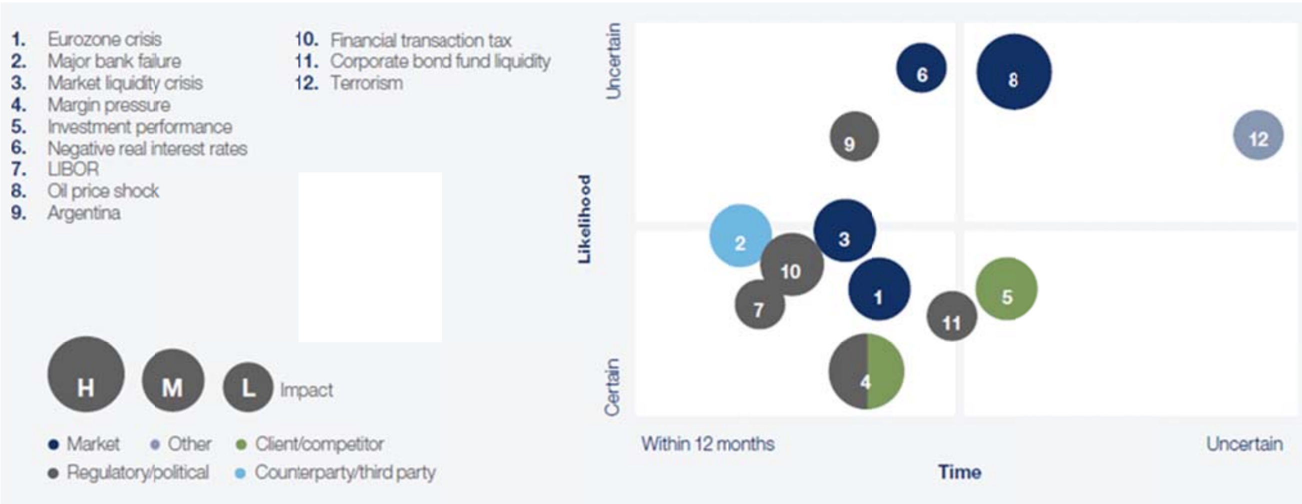
Operational risk (continued)

Key risk	Description	How we manage risk
People risk	Our business depends on people. We ensure we employ people with skill sets appropriate to our changing business needs.	We recruit and develop specialist skills as the range of our product offerings deepens and our investment and distribution strategies develop into new areas. To mitigate people risks, we have competitive remuneration plans, with appropriate deferred benefits targeted at key employees, and we seek to build strength in depth and put in place sustainable succession plans. We also operate from many international centres, which reduces reliance on single pools of talent and individual country stability. Clear objectives are set for employees and we measure individual success in the annual review process. This allows us to identify motivational employee development initiatives, which helps to retain talented people.
	We expect our employees to behave with integrity, which is one of our core values.	We demand high ethical standards and train our employees accordingly.
Geographical diversity risk	Our business is broadly diversified by region which, whilst mitigating aggregate risk, introduces risks as a result of complexity, local laws, regulations, business customs and traditions.	We employ local people with local expertise and also second employees internationally within the Group. The Group Risk Committee receives reports from line management regarding matters giving cause for concern and recommendations for appropriate remedial action. We keep our employees up-to-date on relevant international regulation. An independent team, reporting to the Group Head of Risk, is responsible for assessing the impact of material issues and implementing appropriate and timely risk mitigation. Our overseas operations are regularly reviewed by Internal Audit.

Legal risk	The risk that Schroders or its counterparties fail to meet their legal obligations and the risk of legal proceedings.	We rely on our employees, with support from our Legal function, to consider carefully the obligations we assume and our compliance with them. Confirmations are obtained from representatives around the Group that any actual or potential dispute or claim has been brought promptly to the attention of the General Counsel.
Regulatory and compliance risk	The risk of loss arising from failure to meet regulatory requirements in those jurisdictions in which the Group operates.	We maintain compliance procedures across our global offices, and our Global Compliance function supports business management in meeting its obligations. Compliance with relevant regulatory requirements is monitored in accordance with a risk-based programme.

Emerging risks

Emerging risks are those with uncertain impact, probability and timeframe that could cause risk to the Group. These are the most difficult to define and may change in nature. We analyse each risk and, if needed, develop and apply mitigation and management plans. The external emerging risks that are currently our focus of attention are set out below. The diagram indicates our assessment of the likelihood, timeframe and impact on our business. The estimated impact and likelihood may change as circumstances change and mitigation plans are developed. Regulatory risks are reported on the following page.



Internal Capital Adequacy Assessment Process (ICAAP)

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

Operational risk

The operational risk analysis focuses on statistical modelling of key risk scenarios for the Group, with additional stress testing of the output. This includes consideration of the impact of multiple risk events. Further analysis is performed to assess the potential revenue impact of additional key risk scenarios.

Credit risk

Pillar 2 credit risk capital requirements are assessed using a combined internal ratings and risk-weighted approach. In addition further stress testing is performed considering both principal book and Private Bank lending exposures.

Market risk

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

Pension obligation risk

The risk of deficit in the defined benefit section of the Schroders Retirement Benefit Scheme ("the Scheme"), which was closed to future accrual on 30 April 2011, is assessed via stress tests of the key liability factors inherent in the valuation of the Scheme as well as consideration of stresses on asset value. This is performed in line with the Prudential Regulation Authority's Supervisory Statement LSS6/13, dated April 2013.

Liquidity risk

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

Business risk

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

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

Basis of consolidation

3.1 Accounting consolidation

The consolidation of the financial statements is based upon the inclusion of all entities controlled by Schroders plc prepared to 31 December each year. Control is achieved where Schroders has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. The consolidated statutory financial statements include all subsidiary undertakings which, in the opinion of the Directors, principally affect the consolidated profits or assets of the Group. A list of these principal Group subsidiaries can be found in **Note 32 of the 2012 Annual Report and Accounts.**

3.2 Regulatory consolidation

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

Entities excluded from the regulatory consolidation:

Insurance related subsidiaries

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

Schroder Pension Management Limited
Burnaby Insurance (Guernsey) Limited

Immaterial entities

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

Asia Venture Managers Inc.
Blitz 06-953 GmbH
CM Komplementar 06-379 GmbH & Co.
Columbus UK GP Limited
Gresham Founder (CIP) Limited
J Henry Schroder & Co. AG (in liquidation)
J.H.S.C. Management Limited
NewFinance (Cayman) Limited
Newsphere Trading Company Limited
NFCP Consulting S.L
OPUS (Cayman) Limited
Schroder Asian Property Managers Limited
Schroder Capital Investments Fund
Schroder Eurologistik Fonds Verwaltungs GmbH
Schroder Finance (Bermuda) Limited
Schroder Investment Company (Netherlands) B.V.
Schroder Investment Company (Switzerland) AG (in liquidation)
Schroder Investment Management (Guernsey) Limited
Schroder Investment Management (Ireland) Limited
Schroder Nominees Limited
Schroder Pension Trustee Limited
Schroder Property Investment Management (France) S.à.r.l

Schroder Property Investment Management (Italy) SRL
Schroder Property Investment Management (Luxembourg) S.à.r.l.
Schroder Services (Mexico) S.A. de C.V.
Schroders Corporate Secretary Limited
Schroders India Private Limited
Schroders, S.A. de CV Distribuidora de Acciones de Sociedades de Inversion
SITCO Nominees Limited
Thornbury Company Limited

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

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

4 Capital resources

Tier 1 capital

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

Deductions in arriving at total Tier 1 capital as at 31 December 2012 include intangible assets of £142.1m, which consist mainly of goodwill of £117.2m. Goodwill includes £49.5m in relation to the acquisition of NewFinance Capital Holdings Limited in 2006; £23.7m on the acquisition of Swiss Re AM in 2008; £22.1m on the acquisition of Beaumont Capital Management in 2001; £13.2m on the acquisition of Aareal Asset Management GmbH during 2007; and £4.1m on the acquisition of a Singapore private client advisory business during 2008.

Tier 2 capital

Tier 2 capital is a firm's supplementary capital and consists of revaluation reserves, general provisions and some classes of subordinated debt. As at 31 December 2012, the Group held revaluation reserves consisting of unrealised gains of £25.4m in respect of the fair valuation of securities held in the available-for-sale financial assets category, which is classified as Tier 2 capital.

Any investment in associates and joint ventures should be deducted 50% from Tier 1 and 50% from Tier 2 capital. As a 50% deduction for December 2012 is greater than the total Tier 2 capital, the residual balance has been deducted from Tier 1.

Tier 3 capital

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

The Group did not hold any Tier 3 capital as at 31 December 2012.

As at 31 December 2012 the capital resources of the Schroders Group were as follows:

Tier 1	**£m**
Permanent share capital	282.5
Share premium account	90.1
Profit and loss and other reserves	1,671.9
Total	**2,044.5**
Deductions from Tier 1	
Goodwill	(117.2)
Intangible assets	(24.9)
Material holdings	(54.0)
Other supervisory deductions *	(20.5)
Tier 1 after deductions	**1,827.9**
Tier 2	
Revaluation reserves	25.4
Deductions from Tier 2	(25.4)
Total capital resources	**1,827.9**

* Investment in entities excluded from the regulatory consolidation.

During the year to 31 December 2012 the Group, and all regulated entities within the Group (including those excluded from the regulatory consolidation), complied at all times with all of the externally imposed regulatory capital requirements.

5 Capital adequacy

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

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

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

Calculation of the Group's capital resources requirement

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

Credit risk

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

Market risk

Schroders calculates its market risk capital requirement for Pillar 1 as per BIPRU chapter 7 and as at 31 December 2012, had a foreign currency position calculated as per BIPRU 7.5.19R.

Operational risk

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

As at 31 December 2012, the total consolidated capital resources requirement of the Group under Pillar 1 was £323.3m

Credit risk exposure class	**£m**
Institutions	35.9
Central government and central banks	-
Corporate/Private clients	59.6
Regulatory high-risk categories (i)	23.1
Claims secured by mortgages on residential property	3.4
Claims secured by mortgages on commercial real estate	3.6
Other items (ii)	11.9
Total credit risk capital requirement	**137.5**
Market risk	
In respect of foreign exchange (iii)	**7.6**
Operational risk	
Calculated in accordance with the Standardised Approach	**178.2**
Total capital requirement Pillar 1	**323.3**

(i) As defined by the PRA/FCA high risk exposures include those arising out of venture capital business (whether or not the firm itself carries on the venture capital business) and those in a Collective Investment Undertaking which is considered as high-risk.
(ii) Other items include accrued income, fee debtors, settlement accounts, tax, prepayments and other debtors.
(iii) Calculated as per BIPRU 7.5.19

Past due and impaired

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

6.1 Provisions against lending arrangements

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

(i) Lending arrangements

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

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

For the period to 31 December 2012, a doubtful debt provision of £2.6m had been charged to the income statement in respect of loans and advances to customers.

Movement in provisions during the year:	**£m**
Opening balance as at 1 January 2012	18.8
Bad and doubtful debts charged	2.6
Reclassifications	(4.9)
Foreign exchange	(0.3)
	16.2

(ii) Other debtors

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

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

	£m
Up to and including 3 months	11.2
Over 3 months up to 1 year	1.4
	12.6

*Schroder & Co Ltd, London, Schroders (C.I.) Ltd, Guernsey, Schroder & Co Bank AG, Zurich and Schroder & Co. (Asia) Limited

6.2 Analysis of credit risk exposures

The following table is an analysis by exposure class of the Group's credit risk exposure as at 31 December 2012.

Exposure class	£m
Institutions	2,316.4
Central government and central banks	943.4
Corporate/Private clients	1,151.5
Regulatory high-risk categories	203.7
Claims secured by mortgages on residential property	123.0
Claims secured by mortgages on commercial real estate	48.4
Other items	335.0
Total	5,121.4

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

Exposure by geographic distribution

Exposure class £m	UK	Continental Europe	Asia Pacific	Americas	Total
Institutions	1,106.5	936.8	243.5	29.6	2,316.4
Central governments and central banks	402.1	528.2	13.1	-	943.4
Corporate/Private clients	615.3	442.3	65.2	28.7	1,151.5
Regulatory high-risk categories	134.1	24.9	6.1	38.6	203.7
Claims secured by mortgages on residential property	83.5	39.5	-	-	123.0
Claims secured by mortgages on commercial real estate	30.9	17.5	-	-	48.4
Other items	-	17.2	130.8	187.0	335.0
Total	**2,372.4**	**2,006.4**	**458.7**	**283.9**	**5,121.4**

Exposure by counterparty type

Exposure class £m	Banks	Non-banks	Investments	Other	Total
Institutions	2,004.4	311.0	1.0	-	2,316.4
Central governments and central banks	1.5	941.9	-	-	943.4
Corporate/Private clients	-	381.1	770.4	-	1,151.5
Regulatory high-risk categories	-	203.7	-	-	203.7
Claims secured by mortgages on residential property	-	-	123.0	-	123.0
Claims secured by mortgages on commercial real estate	-	-	48.4	-	48.4
Other items	-	-	-	335.0	335.0
Total	**2,005.9**	**1,837.7**	**942.8**	**335.0**	**5,121.4**

Exposure by residual maturity

Exposure class £m	<3 months	3m – 1 year	1 year – 5 years	> 5 years	Total
Institutions	1,935.6	332.6	35.1	13.1	2,316.4
Central governments and central banks	819.0	-	124.4	-	943.4
Corporate/Private clients	414.8	103.8	466.6	166.3	1,151.5
Regulatory high-risk categories	4.3	-	13.1	186.3	203.7
Claims secured by mortgages on residential property	39.9	55.2	27.9	-	123.0
Claims secured by mortgages on commercial real estate	-	15.2	33.2	-	48.4
Other items	109.2	142.2	1.5	82.1	335.0
Total	**3,322.8**	**649.0**	**701.8**	**447.8**	**5,121.4**

7 The Standardised approach to credit risk

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

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

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

The main types of collateral taken by Schroders are:-

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

Credit quality step	Credit Rating	Exposure before eligible financial collateral (£m)	Exposure after eligible financial collateral (£m)
1	AAA to AA-	1,680.1	337.1
2	A+ to A-	1,660.3	1,446.2
3	BBB+ to BBB-	94.1	7.1
4	BB+ to BB-	-	-
5	B+ to B-	-	-
6	CCC+ and below	-	-
unrated *		1,686.9	1,305.9
Total		**5,121.4**	**3,096.3**

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

The unrated exposures can be analysed as follows:

	£m
Loans and advances to customers	707.2
Financial assets	262.6
Trade and other receivables	378.1
Cash and Cash Equivalents	9.2
Seed capital	113.0
Tax balances	59.1
Retirement benefit scheme surplus	67.2
Undrawn commitments	39.1
Other Derivatives	14.4
Guarantees	19.3
Fixed assets	15.0
Letters of Credit	2.7
Total	**1,686.9**

8 Interest rate risk in the non-trading book

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

Private Banking activities
In Private Banking, interest rate risk is monitored against policies and limits set by the relevant risk committee on a daily basis.

Private Banking's treasury policy is to manage its interest rate risk by matching funded asset positions and the use of interest rate swaps.

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

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

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

Sensitivity analysis
At 31 December 2012, if interest rates had been 50 basis points higher / nil basis points lower with all other variables held constant, the Group estimates that post-tax profit for the year would have increased by £3.7 million, mainly as a result of higher interest income on the Group's floating rate debt securities and cash; other components of equity would have been unaffected.

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

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

The analysis by currency is reflected in the table below:

Currency	**Increase in rates by 0.5%**
	Post tax profit £m
GBP	2.8
EUR	0.2
USD	0.3
CHF	0.1
Others	0.3
Total post tax profit	**3.7**

9 Non-trading book exposure in equities

An overview of the accounting techniques and valuation methodologies used, as required by BIPRU 11.5.15(1), is included in **Note 11 within the 2012 Annual Report and Accounts** and is not repeated here. An overview of how capital is managed, and with what objectives, can be found within **Note 20(a) of the 2012 Annual Report and Accounts**.

The balance sheet value and the fair value of non-trading book equities as at 31 December 2012 was £357.2m, analysed as follows:

Type	Listed	Unlisted	Total
Seed capital and hedge funds	53.7	60.8	114.5
Third party hedge funds	7.1	2.0	9.1
Private Equity Investments	27.7	6.6	34.3
Property funds	-	25.0	25.0
Others	9.5	164.8	174.3
Total	**98.0**	**259.2**	**357.2**

The cumulative realised gains from sales / liquidations during the year were £21.4m. Total unrealised gains were £11.6m which have been included in Tier 2 capital resources.

10 Remuneration

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

These disclosures should be read in conjunction with the Remuneration Report in the 2012 Annual Report & Accounts (available on the Group's website - www.schroders.com), which provides more information on the activities of our Remuneration Committee and our remuneration principles and policies.

Details of the FCA's Remuneration Code can be found at www.fca.gov.uk.

Decision-making process for determining the remuneration policy

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

Code Staff criteria

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

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

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

Link between pay and performance

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

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

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

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

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

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

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

Quantitative Remuneration Disclosures

34 employees have been identified as Code Staff, 27 of whom are classified as Senior Management. Aggregate remuneration for these Code Staff was as follows:

	Senior Management (£'000)	Rest of Group (£'000)
Fixed Remuneration	4,690	1,215
Variable Remuneration	24,911	2,521
Aggregate Remuneration	**29,601**	**3,736**

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

Investment (£'000)	Distribution (£'000)	Rest of Group (£'000)
10,783	8,694	13,860

Aggregate remuneration disclosed includes:

- Non-executive director fees for 2012
- Annual base salaries as at 31 December 2012
- Cash bonus awards for the 2012 performance year
- Deferred awards for 2012 (LTIP awards at 50% of award value and other awards at award value)
- Any other awards or payments for new hires or leavers

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