



## **FSC Standard 23: *Principles of Internal Governance and Asset Stewardship***

**July 2017**

<b>Relevance and purpose of this draft Standard:</b>	This Standard has been drafted to provide guidance to FSC Members who undertake the role of Asset Managers in setting and achieving best practice in fulfilling their fiduciary responsibility as custodians of one of the largest pools of managed funds in the world.
<b>Date of this Standard</b>	July 2017
<b>Next Review Date</b>	By June 2021
<b>Commencement:</b>	<p>This Standard commences from 1 January 2018, with a 6 month transition period.</p> <p>The Standard is mandatory for FSC Full Members from 1 July 2018. Accordingly FSC Full Members must provide sign-off on compliance with this Standard for the FSC Compliance Year 1 July 2018 to 30 June 2019 (such sign-off being due around September 2019).</p> <p>Earlier compliance is encouraged.</p>
<b>Application of this Standard:</b>	The Standard has been prepared for FSC Members who as Asset Managers (also known as Investment Managers or Fund Managers) undertake the role of institutional investors of assets.
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### Definitions

In this Standard:

- **Asset Manager** (also known as Investment Managers or Fund Managers) refers to FSC Full Members who manage, or who have been appointed to manage, the investment of funds by clients of the Asset Manager.
- **Member** means full member of the Financial Services Council Limited (FSC), which usually would be the Australian domiciled Asset Manager, operating in Australia.

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## **PART ONE – DEVELOPMENT OF THE STANDARD**

### **1.1 Executive Summary and Key Principles**

The FSC Standard: Principles of Internal Governance and Asset Stewardship has been developed for FSC Asset Manager Members in order to:

- encourage higher standards of internal governance and stewardship practices;
- provide better information for clients and other stakeholders; and
- raise the quality and standing of Australia’s financial services internationally.

Asset Managers are in a key position, as they undertake their role as custodians of significant amounts of capital on behalf of their clients, to ensure that responsible management and robust corporate governance practices form the basis of both their internal and external stakeholder interactions.

Although stewards codes have been developed in a number of overseas jurisdictions, we believe it is important not only to adopt high standards consistent with other leading capital markets, but that by instilling broader and deeper governance principles, it will be possible to strengthen consumer confidence in Australian financial services and ensure long term sustainability of the industry.

The Standard requires a non-prescriptive disclosure for best practice, utilising a ‘comply or explain’ rationale, where Asset Managers will, where relevant within their business practices, be required to either describe the policy underlying their practices or explain why they are not relevant to them.

This disclosure will be readily available in one location on the Asset Manager’s public website.

As is the case with all FSC Standards, compliance will be mandatory for all FSC Asset Manager Members and those undertaking asset management activities.

### **The Key Principles of the Standard**

#### **1. Organisational and Investment Approach**

Asset Managers should clearly state the purpose, values and underlying investment philosophy or approach of their organisation. Asset Managers should be transparent about their organisation’s ownership, structure, internal governance and experience and competencies of its key staff [See 2.3.1.]

#### **2. Internal governance**

Asset Managers should either publicly disclose their policies or provide a clear description of their approach to key aspects of internal governance and management of business activities which could impact client assets [See 2.3.2.]

#### **3. Asset Stewardship**

Asset Managers should provide a description of their approach to asset stewardship and exercise effective asset stewardship on behalf of their clients.

Asset Managers should encourage the companies in which they are invested to meet the highest standards of governance, as well as ethical<sup>1</sup> and professional practices. They should provide a description of their approach to monitoring and engaging with investee companies and the connection between monitoring, engagement, proxy voting and investment decision-making.

Asset Managers should endeavour to hold boards and management accountable where they fail to maintain acceptable standards [See 2.3.3.]

## 1.2 Effective date

The effective date of this Standard will be 1 January 2018 from which time compliance with this Standard will commence with a transitional period of 6 months. The Standard will then become mandatory from 1 July 2018 and be subject to annual FSC compliance certification. However, earlier compliance with this Standard is permitted and encouraged.

A complete version of The FSC Standard: *Principles of Internal Governance and Asset Stewardship* document (the “**Principles**”) will be required to be published on the Asset Manager website by no later than 1 July 2018.

## 1.3 Application of this Standard – when FSC Member undertakes asset management

In this Standard, “**Asset Manager**” (also known as Investment Managers or Fund Managers) is a term used to describe an institution which has responsibility for managing, or overseeing the management of assets of clients. This Standard applies to any FSC Member who is an Asset Manager or undertakes asset management activities. Below is a table summarising when this Standard applies and when it does not.

While this Standard is mandatory for asset managers as set out below, the FSC encourages other institutional investors including superannuation funds and ‘manager of managers’ to also disclose in accordance with the Standard to the extent that it applies to them. For example where they have assumed the proxy voting rights from their asset managers, where they conduct direct engagement activities or in the appointment of investment managers or other third parties to conduct stewardship activities on their behalf.

This Standard also applies to FSC Members in their capacity as responsible entities of registered managed investment schemes or trustees of unregistered schemes where the FSC Member in that capacity undertakes asset management (or asset management of part of the assets of the scheme or trust) (that is, the responsible entity or trustee undertakes asset management itself rather than out-sourcing all asset management of the scheme/trust to another entity). The Standard applies in this case as the responsible entity/trustee is in that capacity, an Asset Manager. The internal governance of the Asset Manager refers to the governance and management of the Australian domiciled Asset Manager, operating in Australia.

This Standard **does not** apply to the “Client” of the Asset Manager or the “Asset Owner” where they have out-sourced **all of** the investment management/asset management to the Asset Manager (other than currency hedging/overlay and interest rate hedging). This may include APRA regulated entities (such as RSE Licensees (superannuation) or life insurance companies) or ‘manager of manager’ investment strategies. This is the case even if the Client is an FSC member. In this case, the

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<sup>1</sup> Please see ASX Corporate Governance Principles and Recommendations (3<sup>rd</sup> edition) definition of ‘acting ethically’ under Principle 3.

intention is that the Asset Manager, who has control of investment decisions, will be bound by this Standard.

However, asset owners can and do undertake Stewardship either directly, by assuming proxy voting responsibilities or conducting direct company engagement, or indirectly through the appointment of managers and other services providers. We would encourage asset owners to disclose in accordance with this Code to the extent that it is relevant to them so that the ultimate beneficiaries can better understand how stewardship is conducted for their assets. If an asset owner undertakes internal investment management activities, they should comply with the Standard for at least those assets.

### Application of this Standard: Summary table

Below is a summary table of when this Standard applies or does not apply:

FSC Member/Entity	How is Asset Management performed	Does this Standard apply to that Entity
Asset Manager managing assets for clients of the Asset Manager.	By the Asset Manager.	If the Asset Manager is an FSC Member, then this Standard applies to the Asset Manager.
<b>(Asset Management outsourced by a responsible entity/trustee):</b> Responsible entity of a registered scheme or trustee of an unregistered scheme/ wholesale trust	The responsible entity/trustee appoints an external Asset Manager or a number of external Asset Managers to manage <b>all</b> of the assets of the Scheme/trust (other than currency management/ overlay or interest rate hedging). The responsible entity/trustee does not itself undertake any asset management (other than currency management/ overlay or interest rate hedging).	This Standard <b>does not</b> apply to the responsible entity/trustee in its capacity as responsible entity/trustee of the registered scheme/trust.  While not mandated for these entities, the FSC encourages these entities to disclose in accordance with the Standard to the extent that it is relevant.  If the <u>external</u> Asset Manager(s) appointed by the responsible entity/trustee is an FSC Member, then this Standard applies to the Asset Manager.
<b>(Asset Management In-sourced – in whole or part):</b> Responsible entity of a registered scheme or trustee of an unregistered scheme/ wholesale trust	The responsible entity/trustee undertakes some (or all) of the asset management activities of the registered scheme/trust (in addition to currency management/overlay or interest rate hedging).	If the responsible entity/trustee is an FSC Member, then this Standard applies to the responsible entity/trustee in its capacity as responsible entity/trustee of the registered scheme/trust. In this case, the responsible entity/trustee is an Asset Manager.
<b>(“Platform”/“Investment Wraps”):</b> Responsible Entity of an IDPS-like Scheme or an IDPS	The responsible entity is the responsible entity of an IDPS-like Scheme but the responsible	If the responsible entity of the IDPS-like Scheme (or the IDPS Operator) <b>does not</b> undertake

Operator	entity <b>does not</b> undertake discretionary investment management as the investment instructions are provided to the responsible entity by the client/member of the IDPS-like Scheme. Similarly for an IDPS Operator which does not undertake discretionary investment management.	discretionary investment management because the client/member of the IDPS-like scheme (or client of the IDPS Operator) provides the investment instructions to the responsible entity (or IDPS Operator), then this Standard does not apply to the responsible entity/IDPS Operator.
RSE Licensee (superannuation)	This Standard does not apply to RSE Licensees who outsource all of their investment management activities.	This Standard does not apply to RSE Licensees who outsource all of their investment management activities. If the RSE Licensee is an FSC Member, then the RSE Licensee must comply with FSC Standard 20 <i>Superannuation Governance Policy</i> .  While not mandated for these entities, the FSC encourages these entities to disclose in accordance with the Standard to the extent that it is relevant.  If an asset owner (RSE licensee) undertakes internal investment management activities, they should comply with the Standard.
Life insurance company	This Standard does not apply to life insurance companies.	This Standard does not apply to life insurance companies.

This Standard applies to FSC Members (other than RSE Licensees (superannuation) who outsource all of their investment management activities or life insurance companies) who undertake institutional investment or are Asset Managers in relation to their own operations. The Standard establishes a formal framework for a sound approach to internal governance and asset stewardship.

The Standard adopts a non-prescriptive ‘comply or explain’ approach. The Financial Services Council acknowledges that some Asset Managers may have circumstances within their business practices where disclosure for certain elements of this Standard will simply take the form of reference to their current practices, or reference as to why those particular elements are not relevant to their business practice. In these circumstances, disclosure should take the form of a direction to the reader to a particular section of the Asset Manager’s website and should clearly explain the Asset Manager’s policy in regard to that element.

For this reason, the Principles will take different formats for each Asset Manager. However, it must be published on the Asset Manager's website and have each relevant area outlined, explained or linked in one document or webpage.

## **PART TWO – THE PRINCIPLES**

### **2.1 Statement of purpose**

As the peak representative body for the Australian financial services industry, the Financial Services Council (**FSC**) sets standards of best practice for the industry.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds as well as financial advisory networks, life insurers, trustee companies and public trustees.

Asset Managers in Australia have an obligation to operate to a standard that is deserving of the right to manage client assets. Asset Managers must operate to governance standards that are not dissimilar, in principle, to the standards that are expected of investee companies. In demonstrating that they do, Asset Managers should abide by certain principles of internal governance and oversight and manage their own affairs accordingly.

In addition, as stewards of client capital, Asset Managers must exercise their ownership rights and responsibilities including monitoring company performance, engaging with companies and voting proxies. Clients and investee companies have a right to know how Asset Managers approach these important issues.

The FSC Standard: *Principles of Internal Governance and Asset Stewardship* has been developed to:

- encourage higher standards of internal governance and stewardship practices;
- provide better information for clients and other stakeholders; and
- raise the quality and standing of Australia's financial services internationally.

### **2.2 Context and rationale**

Stewardship is the careful and responsible management of something entrusted to one's care. The first formal asset management stewardship code appeared in the UK in 2010. Since its launch a wide-ranging debate regarding asset managers' role as stewards and the subsequent evolution of codes of practice has occurred across the globe.

Stewardship codes exist in other jurisdictions including the Netherlands, Switzerland, South Africa, Singapore, Japan and across Europe as articulated in the EFAMA Code for External Governance. As well, a number of other markets outside Australia are formulating their own codes.

The FSC Standard: *Principles of Internal Governance and Asset Stewardship* replaces FSC Guidance Note No 2: "The Blue Book" Corporate Governance: A Guide for Fund Managers and Corporations. The Standard has been designed to encourage the adoption of high standards that are consistent with other leading capital markets. However, unlike other stewardship codes which focus on asset stewardship and conflicts of interest, the FSC Standard takes a broader view and also includes the internal governance of the Asset Manager.

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The FSC has taken this broader approach because our members believe that the careful and responsible management of clients' assets requires foundations built on good practices and robust internal governance. This code is therefore split into the following sections:

1. organisational and investment approach;
2. internal governance; and
3. asset stewardship.

The Standard is essentially a disclosure based standard which requires FSC Members to bring together or disclose in a single concise place, their approach to internal governance and asset stewardship. The Standard is related to other FSC Standards, namely FSC Standard 1: *Code of Ethics and Code of Conduct*, FSC Standard 13: *Voting Policy, Voting Records and Disclosure* and FSC Standard 20: *Superannuation Governance Policy*.

Like Stewardship Codes in other countries and the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, this Standard uses a 'comply or explain' approach, where Asset Managers will, where relevant within their business practices, be required to either describe their practices or explain why they are not relevant to them. In their disclosure, Asset Managers are able to refer to other public documents by providing links to their website.

Rather than adopting a prescriptive disclosure approach the Standard requires a principles-based disclosure for best practice. Rather than dictate the way in which Asset Managers should discharge their stewardship obligations, the Standard instead sets out 'markers of good practice' that Asset Managers should use to describe their approach. By making these disclosures public we believe good practice will develop organically and change over time as the market evolves.

## **2.3 Scope of the Principles**

### **2.3.1 Organisational and Investment Approach**

Clients of Asset Managers should understand the purpose and values, including the underlying investment philosophy or approach, of the Asset Managers to whom they entrust capital. A clear statement in this regard will allow clients to assess the actions of their manager against their stated purpose.

Asset Managers should be transparent about the organisation's ownership, structure, internal governance and the experience and competencies of its key personnel. Asset Managers should also clearly articulate how they manage conflicts of interests and ensure ongoing alignment with clients' interests.

Material changes to these structures or key personnel should, as soon as practicable, be communicated to clients and updated in the firm's governance and stewardship disclosure.

#### ***Appropriate disclosure should include, but is not limited to:***

1. A description of the distinguishing features of the Asset Manager and how these features are directed towards achieving client objectives;
2. An explanation of how the Asset Manager aligns its purpose and values with its duty to clients;
3. An overview of the ownership, management and governance structures of the organisation;



4. An overview of the key management and investment personnel within the organisation; and
5. Explain how the Asset Manager ensures client assets are managed in accordance with their investment strategies and how conflicts of interest are managed.

### **2.3.2 Internal Governance**

Governance is the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations and the mechanisms by which the organisation and its people are held to account. While stewardship is often focused on the corporate governance of entities that the Asset Manager is invested in, effective internal governance and stewardship requires the Asset Manager to also have robust internal governance practices to ensure they always act responsibly, act in clients' interests and treat clients fairly.

Asset Managers should provide a publicly available and concise description of their approach to the following areas of their business. If any of the following are not applicable, the Asset Manager should explain why that is the case. Asset Managers should refer to other publicly available information (e.g. policies) in their disclosure.

Asset Managers should either publicly disclose their policies or provide a clear description of their approach to managing business activities which could impact client assets. Disclosure is not expected to be to the extent that proprietary information or intellectual property is released but rather a description of the Asset Manager's approach to governance.

Asset Managers should outline their policy position in regard to their business activities.

*Appropriate disclosure should include, but not be limited to:*

1. ethical conduct and professional practice;
2. personal trading;
3. management of conflicts of interest to ensure client interests take priority (including gifts and entertainment);
4. risk management and compliance;
5. error correction policy;
6. brokerage and commissions;
7. equitable asset valuation and pricing;
8. best execution and trade allocation;
9. remuneration policy
10. whistle-blower protection policy;
11. training and development; and
12. complaints and dispute resolution.

### **2.3.3 Asset stewardship**

Asset Managers should exercise effective asset stewardship on behalf of their clients.

They should encourage the companies in which they are invested to meet the highest standards of governance, as well as ethical<sup>2</sup> and professional practices. Asset Managers should use the tools available to them to encourage improving practices and endeavour to hold boards and management accountable where they fail to maintain acceptable standards.

Asset Managers should provide a description of their approach to asset stewardship which includes monitoring and engaging with investee companies and the connection between monitoring, engagement, proxy voting and investment decision-making.

Disclosure should include the Asset Manager's approach where relevant to the following stewardship activities and the governance and oversight associated with each one:

1. monitoring of company performance on financial and non-financial matters;
2. engagement with company management and the board (as appropriate) and escalation of issues in instances where initial engagements have not been adequately responded to;
3. approach to considering Environmental, Social and Governance factors (risks and opportunities) and whether these considerations influence investment decision-making and company engagement;
4. proxy voting (see FSC Standard 13);
5. collaborative engagement with other investors including involvement with industry groups and associations;
6. principles used for policy advocacy including participation with industry groups and associations; and
7. the approach to client engagement, education and communication regarding asset stewardship.

## **2.4 Compliance with this Standard**

- 2.4.1 Compliance with this Standard by FSC Full Members must be certified annually in accordance with FSC Standard No 1.
- 2.4.2. The Standard is mandatory for FSC Full Members from 1 July 2018. Accordingly, FSC Full Members must provide sign-off on compliance with this Standard from the FSC Compliance Year 1 July 2018 to 30 June 2019 (such sign-off being due around September 2019). A complete version of the FSC Standard: *Principles of Internal Governance and Asset Stewardship* document (the "Principles") will be required to be published on the Asset Manager website by no later than 1 July 2018. Earlier compliance with this Standard is encouraged.

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<sup>2</sup> Please see ASX Corporate Governance Principles and Recommendations (3<sup>rd</sup> edition) definition of 'acting ethically' under Principle 3.

## **PART THREE**

The FSC Standards and Guidance Note below are available on the Financial Services Council website at [www.fsc.org.au](http://www.fsc.org.au)

### **ANNEXURE A**

#### **FSC Standards**

FSC Standard No. 1: *Code of Ethics and Code of Conduct*

FSC Standard No. 13: *Voting Policy, Voting Record and Disclosure*

FSC Standard No 20: *Superannuation Governance Policy*

### **ANNEXURE B**

#### **FSC Guidance Notes**

Guidance Note 30: *ESG Reporting Guide for Australian Companies*