

FSC Standard No. 5



Operational Capability

July 1999

Main features of this Standard are:

- **Specification of the Standards to be adopted by a Member in the operation of its business;**
- **Guidance in the interpretation and application of those Standards; and**
- **A note to Members of the relevant regulation that is applicable in the operation of their businesses.**

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1 Title

- 1.1 This Standard (the “Standard”) may be cited as FSC Standard No. 5 ‘Operational Capability’.

2 Standards and Commentary

- 2.1 The standards set out in this Standard are shown in bold print. Commentary is shown in normal print immediately after the standard to which it relates, as an aid to interpretation of the standard.

3 Date of Issue

- 3.1 19 July 1999

4 Effective Date

- 4.1 This Standard should be applied in relation to a Member’s operations on or after 1 August 2000. Earlier application of this Standard is permitted and encouraged.

5 Application

- 5.1 This Standard applies to all Schemes offered by a Scheme Operator, whether by public subscription or otherwise. Equally, this Standard applies to Schemes managed by Associates of FSC Members. The exception to this requirement is the instance where an FSC Member is unable to influence the operations of the Associate.
- 5.2 Members should ensure that an Associate will comply with the Standards described in this Standard before recommending investment of Scheme assets in a Scheme managed by the Associate. A Member should also ensure that an Associate complies with the Standard during the period in which the investor Scheme holds interests in the investee Scheme.
- 5.3 Where there is a conflict between the requirements of this Standard, applicable legislation, and the constituent document of a Scheme, the requirements of this Standard should, having regard to the purpose of the Standard, be modified appropriately so that, as far as is practicable, the Scheme Operator complies with the requirements of this Standard.

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6 Statement of Purpose

6.1 The purpose of this Standard is:

- to specify Standards to be adopted by a Member in the operation of its business;
- to provide guidance and clarification of the interpretation and application of those Standards; and
- to highlight to Members where relevant legislation and regulation is applicable.

6.2 Because of the significance of the managed investments industry within the Australian economy, Scheme Operators should meet a high standard in relation to their operations. A variety of regulators impose requirements to meet objectives that are deemed important in legislation or the related regulatory environment. Entry into the managed investments industry is closely monitored as is the on-going conduct of participants' business operations.

6.3 However, experience has shown that, in addition to meeting regulatory requirements, there are other business principles and practices that should be followed in maintaining a high standard of conduct in the operation and management of a Members' Scheme.

6.4 Whilst regulators (such as the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority) have their own objectives in setting operational Standards with which a Scheme Operator must comply, the purpose of this Standard is to provide guidance in a single, cohesive document in relation to the application of regulatory requirements as well as to provide guidance in areas which are not specifically addressed by the regulations.

6.5 This Standard examines some, but not all, aspects of operational capability necessary to prudently manage a Scheme. Since an FSC Member must comply with the regulations imposed upon it by the applicable regulator(s), this Standard does not cover all aspects of operational capability. Neither is it intended that this Standard represents a checklist of all the obligations that are required to be met by a Member. This Standard will, however, assist a Member Scheme Operator in the identification and monitoring of its obligations in relation to a Scheme managed by the Member.

6.6 This Standard recognises that a Scheme Operator shares responsibility for the operational efficiency of the managed investments and life insurance industry. The

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efficient functioning of the industry requires all Scheme Operators to have confidence in each other's stability and ability to operate responsibly.

7 Application of Materiality

7.1 The standards in this Standard should apply to a Scheme where such application is of material consequence. Failure by a Scheme Operator to adopt or implement a standard is material if such failure has the potential to adversely affect:

- an investor's equitable interest in the Scheme assets;
- other users of Scheme prices;
- a proper assessment of the investment performance of the Scheme;
- a decision by an investor to allocate scarce resources.

7.1.1 In deciding whether an item is material, its nature and amount usually need to be evaluated together.

8 Definitions

8.1 In this Standard:

- 'Associate' - has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions';
- 'Approved deed' has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions';
- 'Scheme Holder' has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions';
- 'Investors' has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions';
- 'Member' refers to a 'Full Member' as defined in FSC's Articles of Association;
- 'Operator', has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions';
- 'Public Unit Trust' has the same meaning as in FSC Guidance Note No. 5 'Industry Terms and Definitions';

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- **‘Scheme’ has the same meaning as in FSC Guidance Note No. 5 ‘Industry Terms and Definitions’.**

9 Principles of Operational Capability

9.1 Operational Capability should be such that a Member can comply with the FSC Code of Ethics and Code of Conduct, FSC Standards and where applicable, relevant FSC Guidance Notes and legislation.

9.1.1 The operational functions of a Member should be carried on with fidelity to the interests of Scheme Holders, prospective investors, and other interested parties.

9.1.2 A Member should ensure that at all times it is able to meet its financial and non-financial obligations to Scheme Holders and other interested parties.

9.1.3 A failure by a Member to meet its obligations to Scheme Holders and others may result from a wide range of events, some of which have been identified in this Standard. Compliance with this Standard requires a Member to assess the adequacy of all aspects of operational capability relevant to their individual circumstances.

10 Application of Operational Capability Principles

10.1 Business Continuity and Disaster Planning

10.1.1 A Member should assess the business continuity risks applicable to its business and should have in place an appropriate business continuity plan that will enable the key elements of its operations to continue with the minimum amount of disruption. The business continuity plan should be subject to regular, at least annual, review to ensure adequacy.

10.1.2 A business continuity plan incorporates, but is much more than, a disaster recovery plan devised to, for example, cover the effects of a fire at the premises of a Member. A Member should as part of its business continuity plan have in place an appropriate and properly documented disaster recovery plan.

10.1.3 Where records are computerised, back-up and storage procedures should be documented, as should procedures for preventing data corruption.

10.1.4 Scheme Operators regulated by Chapter 5C of the Corporations Act 2001 (Managed Investments Schemes) and related ASIC Regulatory Guides are currently required

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to have a business continuity plan in place at the time of licensing. This will be reviewed by ASIC on an ongoing basis.

10.2 Insurance

10.2.1 A Member should have in place insurances that it considers appropriate to its operations.

10.2.2 The following types of insurance cover should be considered for a Member's operations:

- fidelity guarantee;
- fire and other specified perils;
- directors' and officers' liability;
- public liability;
- professional indemnity; and
- loss of profits.

This list is not exhaustive, other types of insurance may be appropriate for a Member's business.

10.2.3 A Member should ensure that the insurance cover taken out and maintained is of a kind and amount that is adequate having regard to the nature and extent of the Member's operations and the responsibilities and risks assumed, or which may be assumed, by the Member in connection with those operations.

10.2.4 Operators regulated by Chapter 5C of the Corps Act 2001 (Managed Investment Schemes) and related ASIC Regulatory Guides are required to have professional indemnity insurance.

10.3 Systems and Controls

10.3.1 Members should ensure that they have appropriate control systems in place, and that those systems are properly supervised and enforced. Systems and controls, including the assignment of responsibilities, should be appropriately and clearly documented.

10.3.2 The prime responsibility for the prudent management of a Scheme Operator's operations rests with its board of directors. It is the responsibility of the management

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of the Scheme Operator to design, establish and maintain appropriate control systems to ensure that a Scheme is properly and efficiently managed.

- 10.3.3 In assessing the adequacy of its control systems, the board of directors should identify those aspects of its operational capability in which a failure could cause a breach of its obligations to Scheme Holders and others. Appropriate arrangements should then be put in place to manage that risk.
- 10.3.4 A Scheme Operator's control systems should convey all relevant information on a timely basis and in a clear and comprehensible manner to the directors and senior management of a Scheme Operator.
- 10.3.5 The control systems adopted by a Scheme Operator should be specific to the business of the Scheme Operator and address the operational risks that the Scheme Operator faces in meeting its obligations to Scheme Holders and others. Control Systems should therefore be designed to allow a Member to avoid contravention of the laws and regulations applicable to the Scheme Operator and to ensure the proper protection of Scheme Holders.
- 10.3.6 It is a requirement of Chapter 5C of the Corps Act 2001 (Managed Investment Schemes) that Managed Investments Schemes have a compliance plan that identifies a Scheme's control structure, systems and processes. The requirements of this FSC Standard will be satisfied by the compliance plan of a Member's Scheme. Compliance plans are required to be reviewed on an annual basis by both an external auditor and by ASIC. It is also a requirement of the Superannuation Industry (Supervision) Act that a Scheme Operator has a Disaster Recovery Plan.

10.4 Audit Function

10.4.1 Members should have effective compliance and appropriate internal or independent audit functions to ensure that its control systems operate properly and efficiently.

10.4.2 To be effective, these compliance functions should have appropriate terms of reference, be independent from operational personnel and management, be adequately staffed by employees with appropriate qualifications, and have a direct line of responsibility to senior management and directors.

10.5 Capacity to Meet Operational Obligations

10.5.1 A Member should have sufficient resources - both financial and otherwise - to properly fulfil its obligations to Scheme Holders, prospective investors and others.

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10.5.2 A Member's resources should be sufficient to maintain operational capability with reference to product range under current conditions. Allowance should also be made for the effects of technological, legislative, economic and environmental change. Members should, as part of their control systems, draw up forecasts and business plans that allow the early identification of possible limitation to capacity to meet operational obligations. A Member's capabilities must be appropriate for the launch of future products.

10.5.3 Where a Member is regulated by ASIC/APRA, the adequacy of resources is assessed as part of the Scheme Operator licensing process and again in the ongoing monitoring process.

10.5.4 A Member's employees should be appropriate in number and capability to properly service the Member's operations.

10.5.5 A Member should ensure that its employees are adequately trained and properly able to fulfil the tasks expected of them. A Member should identify 'core competencies' relative to each category of employee. Such 'core competencies' could include:

- general and technical knowledge;
- application skills;
- ethical standards; and
- management skills.

10.5.6 Members should provide appropriate training to ensure that employees are aware of the obligations and operations of the Scheme Operator. Members should ensure that their employees and prospective employees are of good character, and likely to act in an honest, efficient and fair manner.

10.6 Outsourcing of Operational Capability

10.6.1 Members should take particular care in assessing operational capability where part of that operational capability is provided by a parent company, an Associate, a related party, or by a third party.

10.6.2 It is becoming increasingly common for a Scheme Operator to outsource certain business requirements to various specialist providers. Functions, including investment management, registry maintenance, and investment accounting and valuation, previously provided in-house may now be provided by specialist organisations.

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10.6.3 Where a Member outsources a part of its operational capability, at least some element of control over its operational capability will be relinquished. In such circumstances, a Scheme Operator should:

- specify the services to be provided;
- ensure that the provider of operational capability has the capacity to provide the required services at an appropriate level, both currently and in the future;
- satisfy itself that the provider of operational capability is contractually obliged to provide the required services; and
- ensure that the service provider complies with this Standard.

10.6.4 The Scheme Operator should monitor the ongoing capacity of the provider to deliver the contracted services and take steps to ensure the delivery of those services, should circumstances indicate that the provider is experiencing difficulty in delivering the requisite services.

10.7 Dispute Resolution

10.7.1 A Member should set up and operate a formal system of recording, handling and resolving disputes with Scheme Holders.

10.7.2 To meet its obligations to Scheme Holders and other interested parties, FSC considers that each Member should develop and maintain a formal system for dispute resolution.

10.7.3 Members should carefully monitor the level of disputes and complaints received from investors in a Scheme since the level (and type) of complaint may be indicative of significant operational problems. A Scheme Operator should appoint a person of appropriate seniority (with access to senior management, and with responsibility to the board of directors) to be responsible for monitoring the level (and type) of complaints received.

10.7.4 Members regulated by ASIC/APRA and certain industry bodies are currently required to participate in an external complaints resolution scheme or to have in place arrangements for Scheme Holders to make an inquiry into or a complaint about the management of a Scheme.