

## **Stewardship Code**

**1.0 Introduction and background:** Institutional shareholding in companies has increased in the past few years as mutual funds, insurance companies, pension funds, banks, provident funds and foreign portfolio investors have increasingly become important investors in the Indian equity markets. Some of these investors like Mutual Funds are managing third party funds and as such have a fiduciary duty to their investors. Such institutional investors are expected to shoulder greater responsibility towards their unitholders by greater engagement and monitoring of investee companies. These activities are referred to as stewardship responsibilities. Stewardship is the responsibility attributed to an institutional investor to monitor, oversee and manage the capital invested in companies in order to create long term value for its investors. A formally documented stewardship code will act as a set of guiding principles to be followed by an institutional investor to fulfil its fiduciary responsibility towards its investors.

**2.0 SEBI Circular on Stewardship Code:** SEBI has asked institutional investors to further deepen their stewardship responsibilities and increase engagement and monitoring with the investee companies. This deeper engagement is expected to lead to better corporate governance in companies and to improved investor protection. In this regard, it has issued a circular (No. CIR/CFD/CMD1/168/2019, dated December 24, 2019) which lays down specific responsibilities on institutional investors with respect to their stewardship roles. This circular lays down six principles which are briefly listed as below:

- a. Institutional investors should formulate a comprehensive policy on the discharge of their stewardship responsibilities and publicly disclose it
- b. Institutional investors should have a clear policy on how they manage conflicts of interest, if any, in fulfilling their stewardship responsibilities and publicly disclose it
- c. Institutional investors should monitor their investee companies
- d. Institutional investors should have a clear policy on intervention in their investee companies. They should also have a clear policy for collaboration with other institutional investors where required, to preserve the interest of the ultimate investors. Such policies should also be disclosed
- e. Institutional investors should have a clear policy on voting and disclosure of voting activity
- f. Institutional investors should report periodically on their stewardship activities

**3.0 Stewardship Code:** We propose the following stewardship code for adoption and implementation from April 1, 2020, or such other date as permitted by SEBI. The code is based on principles stated in above referred SEBI circular dated December 24, 2019.

The Stewardship Code has been approved by the Board of Principal AMC and Principal Trustee Company, Trustees to Principal Mutual Fund at their respective meetings held on 25/05/2020 and 26/05/2020.

The usage of words “us”, “we”, “our”, “Company”, “Principal AMC”, “AMC” refers to Principal Asset Management Private Limited (PAMC).

The stewardship code is applicable in respect of equity shareholding across schemes of Principal Mutual Fund. The code is not applicable to debt securities investments of the schemes.

Chief Investment Officer of PAMC will be the owner of the Stewardship Code.

The Code shall act as guidance to us for discharging the stewardship responsibility, however, this code is not intended to curtail / restrict the fund management activities of the AMC. The investment team shall always be at liberty to decide their dealing strategies, keeping in mind the investment objectives of the scheme.

A Stewardship Committee comprising of Chief Investment Officer, Head Equities and Head - Compliance will be formed to look into aspects of Training requirements as felt necessary of the Investment Team, Conflict of interest etc. The Committee, if it feels the need to do so, may seek views from the Group Chief Compliance officer on any of these matters.

The Committee may set a threshold level primarily based on the materiality of the issue and the size of schemes' exposure to the individual investee company, beyond which the exposure to the investee company will be deemed to be 'meaningful'. The threshold level will help in determining the level of engagement, monitoring and intervention with the investee company. The Committee is empowered to modify the meaningful threshold level, as deemed appropriate. (Details in Clause 4.1)

3.1 Key Stewardship Responsibilities: As managers of third-party monies, we have a fiduciary responsibility to investors in our schemes. We realise that companies which are well governed create value for investors in schemes of Principal Mutual fund. While engaging with companies/ voting on resolutions, our overarching philosophy is to give our views/ take such actions in terms of voting etc. as are in the interest of minority shareholders. In line with this, we propose the following:

- a. As an institutional investor we recognise our responsibility towards monitoring and actively engaging with the investee companies on various matters including performance (operational, financial, etc.), company strategy, corporate governance, capital structure etc. In the investment process, in addition to metrics regarding financial and operational parameters, we will also take into consideration the company's governance practices, with special focus on its treatment of minority shareholders. We shall also monitor the company's practices on environmental and social factors.
- b. We shall vote and engage with investee companies in a manner consistent with the best interest of its minority shareholders/ investors
- c. While engaging with investee companies, we shall advocate for responsible corporate governance practices as a driver of value creation
- d. We shall pay particular attention to related party transactions, merger and acquisitions, disposal of undertaking, substantial diversification etc. while analysing and voting in resolutions in case of investee companies.
- e. In addition to voting on board or shareholder resolutions, we shall discharge our stewardship responsibilities through discussions with the management to convey the view of minority shareholders where appropriate.
- f. The discharge of stewardship responsibilities would be implemented through and be subject to the resources, rights and influence available at our disposal.

- g. The AMC may use services of advisors in discharge of stewardship activities. Under such circumstances, the AMC will disclose the nature and extent of its relationship, if any, with such advisors. However, such engagement of advisors does not amount to delegation of fiduciary responsibilities towards the fund's investors.

3.2 Managing conflict of interest: A conflict of interest may arise where the interests or benefits of the Asset Management Company conflict with the interest or benefits of minority shareholders in an investee company, and by extension, of its unitholders. We will be guided by the principles provided in the Code, however if there is conflict between discharge of the stewardship responsibilities and the Investment team's normal fund management activity, the Investment team shall always ensure that they act in the interest of the investors.

CIO and Head of Equity will be responsible for identification of conflict and bringing it to the Stewardship committee.

A conflict of interest may be said to arise in the following instances:

3.2.1 Potential conflicts of interest

- a. The Mutual Fund and the investee company are associates, joint venture partners or are part of the same group
- b. The investee company is a client of the fund
- c. There is a common non-independent director between the Asset Management Company/ Trustee Company and the investee company
- d. The investee company is a material\* distributor for the mutual fund / its associate company(ies)
- e. The investee company is a company providing material critical\*\* services to the fund

\* On list of Top 5 distributors based on gross commission paid to them in the previous financial year

\*\* List of critical service providers will be as per BCP policy

3.2.2 Managing conflicts of interest while implementing the stewardship policy

- a. As stated above, the Stewardship Committee will deal with issues involving Conflict of Interest relating to the stewardship activities.
- b. We shall not vote on resolutions in respect of investee companies where the investee company is an associate, joint venture partner or is part of the same group as the AMC
- c. There shall be a clear segregation of the voting function and client relations/ sales function. Whether an investee company is a client of the fund or not would not be allowed to influence the voting decision. Resolutions where the fund has voted in respect of companies where the investee company is a client / material distributor/ providing material services to the fund shall be put up to the stewardship committee for their information and review
- d. AMC will make its best efforts to avoid such conflicts, where possible and ensure that any votes cast are in the best interests of unit holders.

- e. The voting decision will be guided by the approved Proxy voting policy, which is published on our website.
- f. In a situation wherein the conflict of interest is not covered by the voting policy, decision will be taken on case to case basis.
- g. Minutes of the discussions and decisions at the Stewardship Committee meetings relating to conflict of interest will be maintained.

4.0 Institutional investors shall monitor their investee companies: Ongoing monitoring of investee companies and dialogue with management of companies are fundamental of the AMC's investment approach. As part of the investment process, the portfolio managers/ research analysts track the performance of investee companies using publicly available information on the company, published quarterly/ annual results, sell side research, engagement with the management, industry reports etc. As part of the investment process, the portfolio managers/ research analysts may hold review meeting with the management of investee companies. However, this monitoring will not be necessary in case of companies where the holding of the fund is only in passive funds.

Specifically, the portfolio managers/ research analysts will track:

- a. Operational and financial performance of the company
- b. Company strategy and execution
- c. Corporate governance at the company, specifically with respect to related party transactions, mergers and acquisitions, material divestitures, compensation of senior management etc.
- d. Treatment of minority shareholders

The AMC has adopted policies in compliance with regulations to prohibit insider trading. Further, there is a policy governing trading by employees of the AMC to avoid any misuse of the information received.

4.1 Level of monitoring and engagement: The fund has holdings across a number of companies in its portfolio across all schemes. Given the limited resources, and the need to focus our energies, the AMC may prioritise monitoring and engagement activities based on various parameters including size of its holding in the investee company. Specifically, the AMC will prioritise monitoring (including quarterly review, periodic active engagement with the management of the company, review of corporate governance etc.) in respect of companies where

- a. the holding in the company is more than 5% of a scheme's assets
- b. the fund holds more than 2% of a company's paid up share capital across all its schemes.

If equity in a company is held only in the passive funds, then active monitoring of such companies may not be needed. However, the fund will vote in respect of all its holdings, including where the holding is held only in the passive strategy.

5.0 Institutional investors should have a clear policy on intervention in their investee companies. They should also have a clear policy for collaboration with other institutional investors where required, to preserve the interest of the ultimate investors, which should be disclosed:

5.1 Circumstances for active intervention: Active intervention with the company will be appropriate in the event of consistent poor financial performance, poor corporate governance related practices, specifically with respect to treatment of minority shareholders, related party transactions, various Environmental, Social and Governance (ESG) risks involved in the company, material litigation etc.

5.2 Manner of Intervention and ongoing assessment: The members of the investment team may identify companies where engagement is needed based on the above listed factors, or other factors that they believe calls for an active engagement with the company. It may be an event-driven incident or to address a company specific or a broader industry issue. The engagement approach will depend on a number of factors including but not limited to, the nature and severity of the issue, the size of our investment position, and the responsiveness of the investee company.

Our preferred approach is an open, constructive dialogue with the management of the investee company. The focus would be to engage with the management to convey the point of view of minority shareholders and the need for management action for shareholder value creation.

While we believe that open, constructive dialogue is the preferred way to engage with the companies, in select cases where we believe it is appropriate and necessary to protect shareholder interests, the fund may engage publicly with the company, including bringing our concern to the notice of the regulators.

The AMC may also collaborate with other institutional investors directly or under a common umbrella of Association of Mutual Funds of India (AMFI) in engaging with companies, if it believes that doing so is likely to protect investor interests, and is consistent with and permissible under the relevant laws and regulations.

5.3 Escalation of intervention: We will primarily engage with the management of the investee company in the initial stages. However, depending upon the severity of the issue and the need for intervention, we may escalate matters to the Board of the investee company, collaborate with other investors, vote against the proposal, make public disclosure of issues, and report to the relevant regulator.

Finally, the fund recognises, that in certain cases, it may be worthwhile to simply sell and exit its holding in a company, rather than undertaking a lengthy engagement with the company.

6.0 Institutional investors should have a clear policy on voting and disclosure of voting activity. The AMC has a Proxy voting policy to enable the schemes to exercise votes on resolutions proposed by the investee companies.

The objectives underlying casting a vote are:-

1. To favour such proposals that tend to maximize a Company's shareholders' value; and
2. To ensure that the decision taken to cast a vote is not influenced by conflict of interest

The aforesaid objectives would help to create a framework within which a Company can be managed in the best interests of its shareholders. This, in turn, would help generate better returns for the unit

holders under the various Schemes of the Fund. The said objectives may not direct a particular voting outcome, but instead help identify factors which should be considered in determining how the vote should be cast.

The principles and positions reflected in AMC's Proxy Voting Policy are designed to guide AMC in casting votes, and not necessarily in making investment decisions. The Investment Team base their decision of whether to invest in a particular company on a variety of factors, and while corporate governance may be one such factor, it may not be the only primary consideration.

In order to discharge its obligations under this policy, the AMC accesses and utilizes research on management performance and corporate governance issues, drawn inter alia from its in-house research team. As per the proxy voting guidelines, AMC would support resolutions that promote the functioning of boards in best interests of shareholders. Specific decision on a particular resolution i.e. to support, oppose or abstain from voting, shall be taken on a case-to-case basis placing focus on the potential impact of the vote on shareholder value and interests of the unitholders of the Schemes at large. The AMC reserves the right to vote against any resolution that goes against the interest of its unit holders. AMC may also at its discretion choose to abstain from participating in any resolution and hold a neutral stance, should the concerned issue either be of no major relevance for the shareholder value and/or unitholder interest or involve potential conflict of interest. The ultimate decision as to the manner in which votes will be cast, rests with CIO, keeping in view at all points of time the best interest of unitholders of the schemes of PMF.

The CIO may base his decision on the recommendation of the Fund Manager of the concerned Scheme. Where a decision on a resolution is reached a suitable delegation shall be organized by the AMC in favour of any identified authorized AMC official or in favour of an authorized representative from within the Custodian to cast a vote on behalf of the scheme(s) holding the said security.

When considering investments in Group Companies / Company(ies) that have subscribed to the Units of the Schemes of PMF, the AMC inter alia ensures that (a) investments in such companies are in line with the Scheme specified Investment Objective/ Asset allocation and the Investment Policy in place; (b) such transactions are for pure commercial consideration; after having evaluated the same on merits; (c) such transactions are at arm's length with no consideration of any existing / consequent investments by an Investor/group of investors.

Further, when deciding on a stance (to vote for or against or abstain) vis-a-vis any resolution proposal by any such issuer that has subscribed to the Units of the Schemes of PMF, the concerning Fund Manager/CIO shall confirm that no special consideration has been accorded vis-a-vis such proposals/issuers and that the decision to vote on the concerned proposals have been arrived at in line with the process specified in above clauses.

As per the requirement of the SEBI Circular dated March 15, 2010, this general policy and procedure for exercising voting rights in respect of shares held by the AMC is disclosed. The same has also been set forth in the annual report distributed to the unitholders from the Financial Year 2010-11 onwards.

Further as prescribed in the referred Circular; disclosure has been made on AMC's website as well as in the Annual Report distributed to the unitholders from the Financial Year 2010-11 onwards, to indicate the actual exercise of the proxy votes in the AGMs/EGMs of the investee companies in respect of all resolutions including the following matters:-

- a. Corporate governance matters, including changes in the state of incorporation, merger and other corporate restructuring, and anti-takeover provisions;
- b. Changes to capital structure, including increases and decreases of capital and preferred stock issuances;
- c. Stock option plans and other management compensation issues;
- d. Social and corporate responsibility issues;
- e. Appointment and Removal of Directors; and
- f. Any other issue that may affect the interest of the shareholders in general and interest of the unit-holders in particular.

7.0 Institutional investors should report periodically on their stewardship activities: As an institutional investor, the fund is committed to following the stewardship code and publicly disclosing how it has fulfilled its stewardship responsibilities.

Further, we are aware that compliance with the aforesaid stewardship principles does not constitute an invitation to manage the affairs of the company. These principles above also do not preclude our decision to sell a holding when it is in the best interest of our unitholders.

The fund shall report on its stewardship activities as prescribed in the following manner:

- a. A report may be placed on the website for implementation of every principle
- b. Different principles may be disclosed with different periodicities.

<u>Principle</u>	<u>Periodicity</u>
Principle 1: Stewardship Policy	Annually.
Principle 2: Conflict of Interest	Annually.
Principle 3: Monitoring of Investee Companies	Annually.
Principle 4: Intervention by institutional investors	Annually.
Principle 5 : Voting Policy	Annually

8.0 Periodicity of Review: The Stewardship Code shall be reviewed every year and changes, as considered appropriate, may be carried out in accordance with any change in the applicable regulations or otherwise as may be felt necessary. The updated code shall be disclosed on AMC's website for the information of the unitholders.

