Mutual Fund Directors Digest

The emergence of financial Intermediary controls and compliance assessments: An additional tool to evaluate omnibus subaccounting services

Background

Earlier this year, the staff of the U.S. Securities and Exchange Commission (SEC) indicated that omnibus intermediaries and related oversight practices are a current priority in fund inspections.[1] Intermediary relationships also remain a key topic for fund directors. With the continuing migration toward intermediaries being a primary provider of shareholder services, the fund industry has sought to refine its oversight of the intermediary population.

Over the last year, increasing attention has been given to the use of Financial Intermediary Controls and Compliance Assessments, or the so-called FICCA, as a means of enhancing fund oversight of intermediary relationships. FICCA was developed by the fund industry, in coordination with the "Big 4" accounting firms and the Investment Company Institute. It is an independent internal controls attestation report that covers key focus areas relative to intermediary subaccounting services, such as transaction processing, reconciliations, and fee calculations by way of examples.

To complete a FICCA, an intermediary engages an independent accounting firm to examine its internal controls relating to specific service areas. The FICCA engagement is performed under existing American Institute of Certified Public Accounting standards, similar to an SSAE 16 Report[2] (formerly a SAS 70). The FICCA results in the issuance of a report that includes the accounting firm's opinion on the design, implementation and operating effectiveness of the internal controls as well as a description of those controls and related control objectives provided by the intermediary. The FICCA is designed specifically for dissemination to fund sponsors that rely on the intermediary's services.

While the FICCA has value for all intermediaries, it is particularly well suited for larger institutions that provide shareholder servicing for multiple fund companies, primarily due to the costs and effort involved. The benefits of the FICCA include:

- An independent view of the intermediary's compliance program and internal controls
- Greater transparency on the design and effectiveness of the intermediary's internal controls; and
- Enhanced overall fund oversight, potentially reducing the need for other oversight activities

Additional details regarding intermediary sub-accounting, view our publication "The Omnibus Revolution"

Questions for fund directors to consider

For directors, intermediary relationships typically warrant periodic discussion with fund management. In light of the continuing shift towards intermediary subaccounting and the SEC's focus in this area, directors may want to ask fund management if—as well as how—it has adapted to the changing landscape. Specific questions that fund directors may wish to consider include:

1. What activities are being employed by management to oversee fund intermediaries?

2. Which intermediaries currently providing subaccounting services for the funds are supplying a FICCA report and, if a FICCA is available, does the scope include the relevant control areas?

[1] U.S. Securities and Exchange Commission, National Exam Program, Exam Priorities for 2013, February 21, 2013 http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2013.pdf.

[2] In 2011, Statement on Standards for Attestation Engagements No.16 (SSAE 16) replaced Statement on Auditing Standards No.70 (SAS 70) as the professional standard for service organizations that perform processing on behalf of other entities, such as fund transfer agents, to obtain an independent assessment about the effectiveness of internal controls that are relevant to their customers' financial statement audits. The SSAE 16 report, which can be distributed to specified interested parties, has become an accepted means for assessing controls at a service organization around specific services.

3. For those intermediaries that are not supplying a FICCA report:
   a. Has fund management requested one?
   b. Has the intermediary indicated why it does not plan to provide such a report?

4. Is there an opportunity to enhance the content and/or timing of existing board reporting with the inclusion of a FICCA report?

In closing

We expect the scrutiny of intermediary subaccount servicing to continue. A periodic reassessment of the funds' oversight framework, including both internal activities and external reports, can be a useful risk management tool. Such efforts may result in enhancements that can mitigate potential financial, regulatory or reputational harm in connection with intermediary relationships.

Our Deloitte professionals are happy to answer questions and provide more information regarding this important topic.

Accurate and appropriate fee calculations can be a complex area due to, among other things, the different types of fees charged, variances in the amount of applicable fees and multiple class structures. A fee calculation control objective within a FICCA can help give assurance to fund complexes that their intermediaries are meeting contractual obligations, complying with regulations, and adhering to the terms of fund disclosure documents.

Sample control objective	Points to consider
Controls provide reasonable assurance that: • Sales charges (e.g., initial and contingent deferred) have been calculated and applied in accordance with prospectus and statement of additional information guidelines • Redemption fees have been calculated and applied in accordance with prospectus and statement of additional information guidelines	Control descriptions should address the process for: • Capturing all fee types from the prospectus and other sales documents (e.g., taking into account class of shares, rights of accumulation, letters of intent, account aggregation, concurrent purchases, waivers, "free shares," share aging, lot tracking and reinvested shares) • Verification of fee amounts • Comparing and agreeing intermediary information to the underlying fund books and records • Grouping of fee types (i.e., asset based, account based), if applicable • Management monitoring

Source: Investment Company Institute Financial Intermediary Controls and Compliance Assessment, November 2012, Section 15; http://www.ici.org/pdf/12_draft_inter_assessment.pdf.

Contact:

Elizabeth Krentzman
U.S. Mutual Fund Leader
Deloitte & Touche LLP
+1 202 370 2330
ekrentzman@deloitte.com

Krissy Davis
Partner
Deloitte & Touche LLP
+1 617 437 2648
kbdavis@deloitte.com

Timothy O'Sullivan
Director
Deloitte & Touche LLP
+1 617 437 3251
tiosullivan@deloitte.com

Peter Poulin
Partner
Deloitte & Touche LLP
+1 617 585 5848
pepoulin@deloitte.com

James Nee
Senior Manager
Deloitte & Touche LLP
+1 617 437 3921
jnee@deloitte.com