Understanding FICCA Reports – Their Use and Application in Financial Intermediary Oversight

By Mary C. Moynihan

Introduction

Over the past decade, the mutual fund industry has changed in myriad ways. A once stodgy industry, with relatively little innovation in marketing or product line, has begun to experience and respond to significant disruption. New products and strategies, such as index funds, ETFs, alternatives and smart beta have dramatically changed the offerings available to investors. At the same time, the internet, apps and emerging AI technologies have vastly changed how funds are distributed and sold to investors. These two trends have put an ever greater spotlight on the legal issues associated with the relative lack of transparency around the fees charged and the services provided by players in the distribution chain. In 2008 industry participants made a significant effort to shed light on these issues, when the Investment Company Institute introduced the Financial Intermediary Controls and Compliance Assessment Framework (FICCA)[1]. For the first time, FICCA offered the mutual fund industry a standardized assessment framework through which fund complexes could monitor the operations of financial intermediaries responsible for selling and servicing fund shares.

This article discusses the regulatory and operations issues that use of FICCA can help to address. It also discusses the impediments to widespread acceptance of FICCA and the progress that has been made, as well as alternatives for oversight. Finally, the article looks ahead to how the market may evolve and regulatory changes that may allow for more rationality and transparency in this murky corner of the mutual fund industry.

Background

How Funds are Sold

Even seasoned practitioners can lose their way in the arcane jargon of mutual fund distribution. Thus, it is useful to begin with a primer on how the process works. For this purpose, mutual fund complexes are often referred to as manufacturers. They produce the mutual funds, which are products that, like all products, must be sold. Also,

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like many products, mutual funds are sold through different distribution "channels." Different financial institutions and players participate in these different channels, selling to differing types of customers, who are purchasing the shares for various purposes (retirement savings, investment, college plans, etc.). The different players define the particular channels. The firms that distribute the shares through the different channels and provide services to shareholders are called financial intermediaries. There is an assumption that different investors purchasing through different types of financial intermediaries will require different sets of shareholder services from the financial intermediaries resulting in different fee structures for the different channels. This structure is why mutual funds are often referred to as "intermediated" and it also explains a common industry phrase that "mutual funds are sold, not bought."

In a simple example, an individual investor may have a relationship with a registered investment adviser (RIA). The RIA recommends mutual funds for the account of the investor. The investor will have no direct relationship with the mutual fund complex, but will have an account with the RIA holding the mutual fund shares. Account information, such as account balances and purchases and sales, as well as information for shareholders from the mutual funds owned, such as prospectuses and shareholder reports, would all be furnished to the investor through the RIA. Not unsurprisingly, this channel is referred to as the RIA channel. In another example, an investor may open an account with a large broker-dealer and make individual decisions to buy and sell mutual funds that are offered on the platform of that broker-dealer. Mutual fund complexes vie to have their funds included on the platform. This channel is referred to as the supermarket channel, because the various fund offerings available on the platform resemble products in a supermarket.[2] The table below shows the principle channels through which mutual fund shares are distributed.

Regulatory Issues

While distribution and shareholding modalities have changed dramatically over the past 20 years, the laws that govern them have remained largely unchanged,[3] although various guidance has been offered on the topic by the U.S. Securities and Exchange Commission ("SEC").[4] The regulatory system is based on an older sales model, in which individual investors purchased shares directly from the mutual fund. As discussed below, full compliance with these rules can be challenging, given the lack of transparency in the distribution channels. It is this problem that FICCA is designed to address.

On the "manufacturing" or mutual fund side of the equation, the players have stayed largely the same as they were in 1940. An investment adviser sponsors the formation of a mutual fund and provides investment advisory services to the fund for a fee. The funds themselves are series of a trust or corporation which has a board of trustees or directors. Under the Investment Company Act of 1940, as amended ("1940 Act"), the board is charged with a variety of oversight

TABLE 1. DISTRIBUTION CHANNELS

Broker/Dealer	These are typically firms (including wire houses) that distribute through commission-based brokerage or banks, fee-based advisors and retail self-directed assets.
Supermarket/Registered Investment Adviser (RIA)	These are platforms that provide multiple fund choice options from multiple fund families. The platforms may be either NTF, meaning no transaction fee is charged, or TF, meaning a transaction fee is charged. It includes RIAs, i.e., independent, typically fee-only advisors, who primarily access mutual funds through supermarket platforms.
Insurance	This involves insurance companies that offer variable insurance products, for which mutual funds are the underlying investments.
Retirement/Record-keepers/Third-Party Administrators	This channel is for employee-sponsored retirement plans and applies to the record-keepers and third-party administrators who service the plans. Also includes IRA rollovers.
Bank	This channel is for retail/branch banking customers, trust companies and private wealth accounts.
Direct	This channel comprises direct sales by the mutual fund to its shareholder and is fully disintermediated.

functions primarily designed to protect shareholders and the assets of the fund from the various conflicts of interest that are inherent to the industry.[5] The fund is required to have a federally registered transfer agent, whose job is to maintain the shareholder records. In addition, because shares of mutual funds are securities within the meaning of the federal securities laws, the shares must be sold by a limited purpose registered broker dealer called a distributor. Before the advent of intermediation, funds largely sold their shares directly to the public. The sale was effected by the distributor. The transfer agent recorded the shareholder as the owner of the shares and, under a contract with the fund, ensured that account statements and fund documents were provided to the shareholder of record. Most contracts governing mutual fund service provider arrangements continue to reflect these basic relationships.

FICCA is a framework for assessing the internal controls and compliance of financial intermediaries.

Over the past decades, however, fewer and fewer shareholders have purchased their shares directly from the fund.[6] Instead, as described above, shareholders are offered multiple different ways to buy shares. They may invest through retirement plans, broker-dealers, RIAs or supermarkets. As shareholders found new ways to invest and technology advanced, it forced significant change on the industry. The customer relationship shifted from one between the fund and its shareholder to one between the investor and the financial intermediary, i.e., the shareholder had an account with the financial intermediary not the fund. Financial intermediaries wanted to protect their customer relationships and become the primary party with whom the customer interacted. This meant that the financial intermediaries sought to become the single point of contact and did not want to share the customer's information, causing shareholder information and related shareholder servicing to shift from the fund's transfer agent to the financial intermediary. This led first to networking, a process in which the fund's transfer agent and the financial intermediary establish duplicate accounts to allow for the transfer of certain transactional information. In a networked arrangement, the transfer agent has no information on individual shareholders, who are customers of the financial intermediary. In this model, the financial intermediary increasingly provided shareholder services directly to its customers. From networking, the next step was omnibus accounts, which now dominate the industry. In an omnibus account relationship, the transfer agent records only an omnibus account for the financial intermediary. All individual shareholder sub-accounts are maintained by the financial intermediary and the financial intermediary provides all shareholder services to the shareholders.

Despite this migration to omnibus accounts, mutual funds continue to have specific obligations to shareholders under the federal securities laws and the underlying contracts, for example, shareholder communications, recordkeeping, information security, privacy and anti-money laundering and assessment of sales charges as set forth in the prospectus. In response, fund complexes entered into so-called sub-transfer agent agreements, under which the financial intermediaries undertook to provide the required shareholder services to the fund's shareholders. When a financial intermediary serves in this capacity it is referred to as a sub-TA.[7] The difficulty is that while the mutual fund complex continues to own the legal compliance obligations, the customer service relationship through which many of those obligations must be carried out is "owned" by the financial intermediary.

Parallel to these arrangements for shareholding, are the arrangements for distribution – or the sale of fund shares. With shareholders no longer purchasing direct from the funds, the distributor had to enter into selling agreements with financial intermediaries (often the same or related intermediaries as were serving as sub-TAs) for sale of the fund's shares.

Distribution places even more complicated regulatory obligations on mutual funds. Under Section 12(b) of the 1940 Act, a mutual fund may not pay the costs of distribution of its shares, except pursuant to a plan adopted by the board in compliance with Rule 12b-1 under the 1940 Act. Many funds have adopted Rule 12b-1 Plans, which allow them to pay a fee to the distributor for the services it provides to sell the fund's shares. The distributor in turn will typically pay some or all of this fee to the financial intermediaries through which the funds are sold.

As mutual funds began to be sold increasingly through financial intermediaries, however, those intermediaries controlled more market power and sought increased payment for their sales services, often in amounts that exceeded fees payable under the Rule 12b-1 Plan. To cover this gap, one traditional source of distribution financing has been the profits of the investment adviser. In its 1980 adopting release for Rule 12b-1, the SEC clarified that such payments, typically called revenue share, were permissible, "to the extent that such profits are "legitimate" or "not excessive"", stating that "[p]rofits which are legitimate or not excessive are simply those which are derived from an advisory contract which does not result in a breach of fiduciary duty under section 36 of the Act."[8]

In this landscape, the conflicts of interests and areas for potential mischief are obvious.

- Mutual funds are no longer in control of their customer relationships, making it challenging to ensure compliance with legal requirements relating to matters as diverse as shareholder communications, privacy and anti-money laundering and assessment of sales charges as set forth in the prospectus.[9]
- Advisers may, either through carelessness or deliberately to avoid having to make payments from their own pockets, pay for distribution out of fund assets by disguising distribution payments as payments for sub-TA services.

Overlying all of this is the role of the mutual fund board, which must oversee many of the compliance obligations of the funds.[10] In particular, a mutual fund board must approve the expenses incurred under the Rule 12b-1 Plan based upon the conclusion "in the exercise of reasonable business judgment and in light of their fiduciary duties under state law and under sections 36(a) and (b) [of the 1940 Act], that there is a reasonable likelihood that the plan will benefit the company and its shareholders."[11] The board must also oversee annually the fees paid to the adviser and distributor under Section 15(c) of the 1940 Act. Boards that authorized payment of sub-TA fees were faced with considerable difficulty in assuring that the fees were reasonable, and that the services contracted for were properly provided. Most importantly, as the practices grew up, it was not always possible to clearly distinguish between fees paid for sub-TA services and fees paid for distribution. In many cases, the underlying contracts did not clearly delineate what fees were being paid for which services or clearly prohibit the use of fund assets to pay for distribution related services outside of the Rule 12b-1 Plan.

The Role of FICCA

Background – the Early Days

As intermediary arrangements became the norm, funds, their advisers, and fund boards were faced with three problems

- It was increasingly difficult to penetrate the lack of transparency to ensure that fund intermediaries were providing the levels of services that the funds were paying for and complying with applicable law, in particular, with respect to distribution of prospectuses, assessment of appropriate sales charges and applicable waivers.
- Fund boards were increasingly challenged in arriving at appropriate fee levels for shareholder servicing payments from fund assets, overseeing compliance with shareholder servicing requirements and ensuring that fund assets were only used to pay for distribution under a Rule 12b-1 Plan.
- It was essential to ensure that fees paid for shareholder services were not distribution in guise.

FICCA was first launched in 2008, by the Investment Company Institute (ICI), working with the big four accounting firms.[12] It has since been revised in 2014 and again in 2015. As its name makes clear, FICCA is a framework for assessing the internal controls and compliance of financial intermediaries. The purpose of the report is to provide a level of transparency to funds and their service providers with respect to issues for which the funds and their direct service providers may have specific legal obligations, for example, shareholder communications, recordkeeping, sub-accounting services (such as fee calculations and transaction processing), information security and privacy and anti-money laundering. The financial intermediaries obtain the FICCA report by engaging an independent accounting firm to examine the internal controls of the financial intermediary as they relate to particular services provided by the intermediary. The review is performed under American Institute of Certified Public Accounting (AICPA) attestation standards. When the examination is completed, the accounting firm produces a report that is intended to be provided to third parties, including mutual funds, their boards and their service providers. The report includes an opinion of the accounting firm 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 management of the financial intermediary.

When FICCA was first rolled out, it was not warmly embraced by the intermediaries responsible for obtaining the reports. In the first place, the expense of obtaining a FICCA report and the work involved in bringing internal controls up to standard fell on the financial intermediaries, who enjoyed significant market power and felt no pressing need to expend the cost or effort. In addition, while the issues that pointed to the need for the FICCA framework or a similar oversight mechanism were becoming clear, there was little regulatory push. The complexity and rapid change in distribution also meant that many compliance officers and legal counsel had not yet grasped the significance of the issues or the potential compliance problems created by the emerging market practices.

Distribution-in-Guise

All of that changed in 2013, when the SEC staff announced that omnibus oversight and practices would be a focus of examinations by the SEC Office of Compliance Inspections and Examinations.[13] Dubbed "distribution-in-guise" the SEC staff stated that the exam program would focus on:

> [T]he wide variety of payments made by advisers and funds to distributors and intermediaries, the adequacy of disclosure made to fund boards about these payments, and boards' oversight of the same. These payments go by many names and are purportedly made for a variety of services, most commonly revenue sharing, sub-TA, shareholder servicing, and conference support. The staff will assess whether such payments are made in compliance with regulations, including Investment Company Act Rule 12b-1, or whether they are instead payments for distribution and preferential treatment.

In a broad sweep, the SEC staff collected data from mutual complexes across the country, including the selling agreements and sub-TA agreements that governed distribution and sub-TA arrangements. To the dismay of many industry participants, even those who had engaged law firms to review the agreements, the SEC identified numerous instances of questionable wording and payments.[14] The terrain changed, and both service providers and boards began to demand more transparency from financial intermediaries in omnibus relationships.

The regulatory drumbeat reached a crescendo in January 2016, when the SEC issued guidance on Mutual Fund Distribution and Sub-Accounting Fees (Guidance).[15] In the Guidance, the SEC set forth its views:

> … on issues that may arise when registered open-end investment companies ("mutual funds" or "funds") make payments to financial intermediaries that provide shareholder and recordkeeping services for investors whose shares are held in omnibus and networked accounts maintained with mutual funds. In particular, the guidance addresses whether a portion of those payments are being used to finance distribution and therefore, if paid by a fund, must be paid pursuant to rule 12b-1 under the Investment Company Act ….

Among other matters, the Guidance required that:

> … boards of directors have a process in place reasonably designed to assist them in evaluating whether a portion of fund-paid sub-accounting fees, if paid to intermediaries that distribute fund shares, is being used to pay directly or indirectly for distribution. Considering that the mutual fund's adviser and other relevant service providers are typically involved in recommending that sub-accounting fees be instituted or increased, and thus may be subject to conflicts of interest if they reduce payment obligations that the adviser or its affiliates might otherwise bear, the staff also recommends that advisers and relevant service providers provide or arrange for the provision to boards any necessary information to assist boards in this evaluation process.

The best defense to the SEC staff's regulatory onslaught was a good offense, which meant the development of robust oversight programs over payments to financial intermediaries. As compliance and operations professionals began to redouble their efforts to design oversight programs that would identify and deter improper payments, an obvious tool was the FICCA framework. At the time, to the extent compliance officers and operations staff had an oversight program in place, it generally consisted of sending questionnaires, obtaining certifications or making due diligence visits to intermediaries, but the distribution-in-guise sweeps made clear that a more structured framework for oversight would be beneficial. As discussed below, even in cases where not all of a funds' financial intermediary counterparts are willing to provide a FICCA report, the framework can be valuable in designing a solid oversight program.

What Exactly Does FICCA Assess?

The FICCA document itself, available through the ICI, includes a variety of tools that are helpful in understanding how the framework operates and is a useful reference for compliance professionals seeking to understand FICCA and/or to design an oversight program. These include a Glossary of Terms and a FICCA Mapping Template for Control Reports that helps in understanding the relationship of a FICCA report to a SSAE 16 (SOC1) or (SOC 2).

At its core, the FICCA framework covers 17 control focus areas, each of which is a core function either performed by the financial intermediary or relevant to its general control environment. The focus areas are as follows:

1. Management Reporting (Quality Control)
2. Risk Governance Program
3. Third-Party Oversight
4. Code of Ethics
5. Information Security Program
6. Anti–Money Laundering (AML) and the Prevention of Terrorist Financing Program
7. Document Retention and Recordkeeping
8. Security Master Setup and Maintenance
9. Transaction Processing – Financial and Nonfinancial (e.g., Account Setup and Maintenance)
10. Cash and Share Reconciliations
11. Lost and Missing Security Holders
12. Shareholder Communications
13. Subaccount Billing, Invoice Processing
14. Fee Calculations
15. Information Technology (Including Internet and VRU)
16. Business Continuity/Disaster Recovery Program
17. State of Sale Reporting (for Blue Sky purposes)

For each control focus area, the FICCA matrix identifies specific testing and controls that are useful to the operation of the function. For example, it is important to know that a financial intermediary has appropriate controls around anti-money laundering (control focus area 6). For this item, the FICCA matrix identifies the following management controls testing:

Controls provide reasonable assurance that the company's Anti–Money Laundering and Terrorist Financing Prevention Policy has been:

- Formally documented;
- Approved by the board (or other appropriate governing body);
- Communicated to, and acknowledged by, employees in a timely manner;
- Monitored by the compliance department (or other similar internal organization); and
- Designed to identify, research, and report exceptions, and that any resolution is documented in a timely manner.

The document goes on to identify "points to consider," as follows:

The company should have an Anti–Money Laundering (AML)/Prevention of Terrorist Financing Policy that contains provisions in accordance with applicable regulatory requirements and following the globally recognized four principles for compliance risk management and oversight:

- Firm-wide approach to BSA/AML/OFAC compliance risk management and oversight;
- Independence of compliance staff;
- Compliance monitoring and testing; and
- Board and senior management responsibilities for compliance risk management and oversight.

This level of detail provides a robust framework for evaluation of the proper operation of the anti-money laundering function. For each of the 17 control focus areas, the FICCA framework provides a similar level of detail with respect to controls testing and points to consider.

In addition to the detailed information on each area of focus, the FICCA matrix also identifies so-called "Reporting Mechanisms", which detail other controls reports that may address areas of focus in the FICCA matrix and form the basis for conclusions regarding the control environment. For example, it is possible that SSAE 16 (SOC 1) or (SOC 2) reports prepared by the financial intermediary or by a third-party vendor to the financial intermediary may provide comfort with respect to elements of the area of focus. For each area of focus, the FICCA matrix indicates which reporting mechanism may be applicable. In this regard, it is helpful to understand that other types of controls reporting, such as a SSAE 16 (SOC 1), (SOC 2) or an attestation engagement may be viewed as nested within the FICCA framework. Thus, to the extent indicated under Reporting Mechanisms, these other forms of controls testing may be relied upon as a basis for the FICCA report.

What does a FICCA Report Look Like?

The exact language of a FICCA report will vary and the reports are subject to professional standards applicable to the form and content of audit reports.

Management is responsible for the control objectives and the related controls relating to each of the 17 areas of focus described in the FICCA matrix. Management is required to describe the control objectives and related controls in a document referred to as the Management Description. As with audit reports generally, management is also required to make certain assertions, which relate in this case, to (i) its establishment of control objectives, (ii) the related controls, (iii) whether the controls were suitably designed as of the specified period end to provide reasonable assurances that the control objective would be achieved and (iv) whether the controls were operating effectively, such that the control objectives were met.

The FICCA framework covers 17 control focus areas, each of which is a core function either performed by the financial intermediary or relevant to its general control environment.

The auditor in turn expresses an opinion as to whether management's assertion is fairly stated based on the specific control objectives. To arrive at its opinion, the audit firm seeks to obtain an understanding of and to evaluate the suitability of the design and operating effectiveness of the controls. A summary of the specific controls tested and the results of those tests accompanies the FICCA report. As noted above, financial intermediaries engage the audit firm and the auditor report is addressed to management of the financial intermediary, but will typically provide that it may be used by the mutual fund complexes that have retained the financial intermediary to provide shareholder servicing and record-keeping.

FICCA reports are subject to the standard litany of limitations typically found in audit reports, including the possibility that error or fraud may occur, but not be detected.

How do FICCA Reports Fit into an Overall Oversight Program?

As mutual fund complexes design their overall financial intermediary oversight program, the FICCA report can be extremely helpful, although other elements are important to an effective program. Ideally, an oversight program will involve multiple levels of testing and review. These can and should include a thorough inventory of all financial intermediary relationships and a robust program for payment and invoicing that clearly distinguishes and processes different types of payments, e.g., shareholder servicing or sub-TA fees, Rule 12b-1 fees and revenue sharing. Agreements with financial intermediaries should also be thoroughly scrubbed to ensure that they correctly reflect the services being performed. While it may not always be possible (or desirable, given market pressure) to renegotiate selling and servicing agreements, if possible, there should be a separate agreement in place, covering either sub-TA or distribution, as applicable. Agreements should clearly list services to be performed. All new selling agreements should expressly state that fund assets may only be applied to distribution expenses in compliance with Rule 12b-1. Similarly, sub-TA agreements should make clear that no distribution services are being contracted for. Generally, there should be clear demarcation of duties, and salespeople should not be involved in the documentation process.

Once those or similar arrangements are in place, compliance professionals will typically seek to design a program for testing and oversight. FICCA reports can play a central role in that process. Broker-dealers have been at the forefront of performing FICCA engagements, and to the extent these are available, the mutual funds oversight program should include requesting and receiving FICCA reports. Other financial intermediaries have been slower to engage with the FICCA process, but bank trust departments, retirement record-keepers, third-party administrators and RIA and supermarket platforms can and should be encouraged to perform FICCA engagements to evaluate their internal control environments. In particular, in cases where compliance lapses have occurred (for example inaccurate transaction processing), it may be particularly important to seek to require the financial intermediary to perform a FICCA engagement. Boards of directors may also consider requiring the investment adviser or other service providers to use best efforts to obtain FICCA reports from financial intermediaries in exchange for payment of sub-TA fees or in connection with their reviews of intermediary payments as required under the Guidance.

Nonetheless, although the FICCA framework has been more broadly adopted, many financial intermediaries still do not provide FICCA reports. In those cases, important oversight tools include a risk-based program for onsite due diligence visits and questionnaires. The great strength of the FICCA framework is that it can provide a useful guide to structure a questionnaire or other inquiry in circumstances where the compliance officer (or other professional tasked with oversight) is not able to obtain a FICCA report from the financial intermediary. In this respect, even when financial intermediaries do not provide an actual FICCA report, the FICCA framework can be very useful in designing an oversight program. For example, the FICCA matrix provides a ready list of areas to focus on that can be useful both for a questionnaire and onsite visits. In cases where financial intermediaries are able to provide other controls reporting, such as SSAE 16 (SOC 1) or (SOC 2) reports, the FICCA matrix provides guidance as to how those reports can be used in assessing different control objectives. In addition, the Items to Consider listed in the FICCA matrix with respect to each area of focus can form the basis for questionnaires or for discussion at onsite visits. Thus, all compliance professionals tasked with financial intermediary oversight should familiarize themselves with the FICCA framework and use it as a tool in their oversight toolbox.

What to Expect in the Near Future

The need to oversee financial intermediaries is an imperative that will not go away. Thus, in all likelihood, the future will bring broader adoption of FICCA reporting by financial intermediaries. Once financial intermediaries become familiar with the process, it provides them with a standardized means of responding to multiple customer demands for greater transparency. In fact, many compliance professionals who were once rebuffed as they sought information from financial intermediaries are now finding that almost all financial intermediaries will respond and provide information needed by mutual fund complexes as part of their oversight obligation.

In addition, two recent regulatory developments suggest a slim chance that in the future there may be some migration towards a more logical and transparent structure for payments to financial intermediaries. The DOL Fiduciary Rule[16], although its future is in doubt, has opened the industry to more daylight with respect to intermediary payments. In addition, partly in response to the DOL Fiduciary Rule, in January 2017, the SEC staff issued a no-action letter to Capital Research and Management Company.[17] The no-action letter provided that the restrictions of Section 22(d) under the 1940 Act do not apply to classes of shares of a fund that are offered without any front-end loads, deferred sales charge or other asset-based fees for sales or distribution. The effect of the staff's position is to permit certain types of broker-dealers to create their own commission and transaction fee schedule based on the services the broker-dealer provides to the shareholder. This, in fact, more accurately represents the economic transaction that is occurring, but the SEC's failure to adopt reforms to Rule 12b-1, has blocked the market from moving in this direction.[18] In other words, in reality, customers of broker-dealers are choosing and buying services from the entity with whom they have the customer relationship – the broker dealer. But under current law and practice, the cost of the services being purchased is cloaked in obscurity and paid from fund assets. If shareholders themselves negotiated and paid for shareholding services and distribution costs, market pressures might reduce those costs and in any event would reduce the need for oversight by mutual fund complexes. A wholesale change would require multiple related regulatory changes and is unlikely. However, a general shift towards greater transparency seems inevitable.

Conclusion

FICCA reports are very valuable in overseeing the labyrinth of financial intermediaries involved in shareholder servicing and distribution of mutual fund shares. While early adoption of the FICCA framework was slow, increased regulatory pressure has speeded its broader adoption. In particular, as more mutual fund complexes demand accountability from financial intermediaries, the intermediaries themselves have begun to recognize the value of a single reporting framework through which they can respond to the mutual fund industry's demand for increased accountability and transparency. Even where a financial intermediary does not provide a FICCA report, the framework itself can be helpful in designing questionnaires and other tools for financial intermediary oversight programs.

ENDNOTES

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1 Financial Intermediary Controls and Compliance Assessment Engagements, released December 14, 2015, available at ici.org.

2 Letter from Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Management to Craig S. Tyle, Esq., General Counsel, Investment Company Institute, SEC No-Action Letter (pub. avail. Oct. 30, 1998).

3 *See*, Proposed Rule: Mutual Fund Distribution Fees; Confirmations, Release Nos. 33-9128, 34-62544, IC-29367 (July 21, 2010), available at http://www.sec.gov/rules/proposed/2010/33-9128.pdf ("Proposing Release"). The Proposing Release provides an exhaustive history of Rule 12b-1 under the 1940 Act; the rule as proposed was never adopted.

4 Bearing of Distribution Expenses by Mutual Funds, Investment Company Act Release No. 11414 (Oct. 28, 1980) [45 FR 73898 (Nov. 7, 1980)].

5 Under the 1940 Act, boards of directors of mutual funds are specifically charged with, among other matters: fair valuation determinations for certain securities held by the fund; voting of proxies for the fund's portfolio securities; oversight of compliance under Rule 38a-1; fund disclosures; and oversight of fund performance, risk management, custody of assets, prohibitions against money laundering, data security, and shareholder services.

6 According to industry data, in 2015, over 60% of total transfer agent charges reported were associated with non-direct shareholding arrangements, including omnibus, retirement and record-keeping.

7 The SEC refers to these services as "sub-accounting." *See*, IM Guidance Update No. 2016-01, "Mutual Fund Distribution and Sub-Accounting Fees," U.S. Securities and Exchange Commission, Division of Investment Management (January 2016).

8 *Supra* note 4.

9 Not unsurprisingly, the SEC and FINRA have been active in policing the area and have brought numerous enforcement actions against market participants. *See*, Fifteen Firms to Pay Over $21.5 Million in Penalties to Settle SEC and NASD Breakpoints Charges, available at https://www.sec.gov/news/press/2004-17.htm; FINRA Fines Merrill Lynch $8 Million; Over $89 Million Repaid to Retirement Accounts and Charities Overcharged for Mutual Funds, available at https://www.finra.org/newsroom/2014/finra-fines-merrill-lynch-8-million-over-89-million-repaid-retirement-accounts-and.

10 Rule 38a-1 under the 1940 Act.

11 *Supra*, note 4.

12 A working group of ICI member firms, representatives of the national accounting firms, and financial intermediaries was formed and met in 2013 and again in 2015 to review and update the 2008 FICCA framework.

13 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.

14 In the Matter of First Eagle Investment Management, LLC and FEF Distributors, LLC, Investment Advisers Act Release No. 4199 (September 21, 2015).

15 *Supra*, note 4.

16 The rule can be found at: http://www.dol.gov/ebsa/regs/conflictsofinterest.html.

17 SEC Guidance, Capital Group Companies, Inc., Response of the Office of Chief Counsel Division of Investment Management (pub. avail. Jan. 11, 2017).

18 The SEC last attempted to address Rule 12b-1 in a 278-page release in 2010. Since then, no progress has been made.