

# ICI Webinar

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Intermediary Oversight  
March 11, 2009

# Introduction

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- Investment Company Institute  
Don Boteler
- Capital Bank and Trust Company  
Tom Hamblin

# Intermediary Oversight

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- Welcoming Remarks
- Webinar Preview and Objectives
- Speaker Introductions

# Intermediary Oversight

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- ICI Working Group Formation and Composition
  - National Accounting Firms
  - Fund Representatives
- Established to understand and improve the existing approaches to the oversight of third party intermediary account servicing and processing

# Intermediary Oversight

- Goals
  - Define an intermediary oversight approach that would be unified and consistent.
  - Define an oversight framework that could be relied upon by all industry participants, promoting a common use, understanding and trust.
  - Promote widespread acceptance of the oversight framework
  - Reduce redundant on-site exams/increase efficiency

# Deloitte – Tim O’Sullivan

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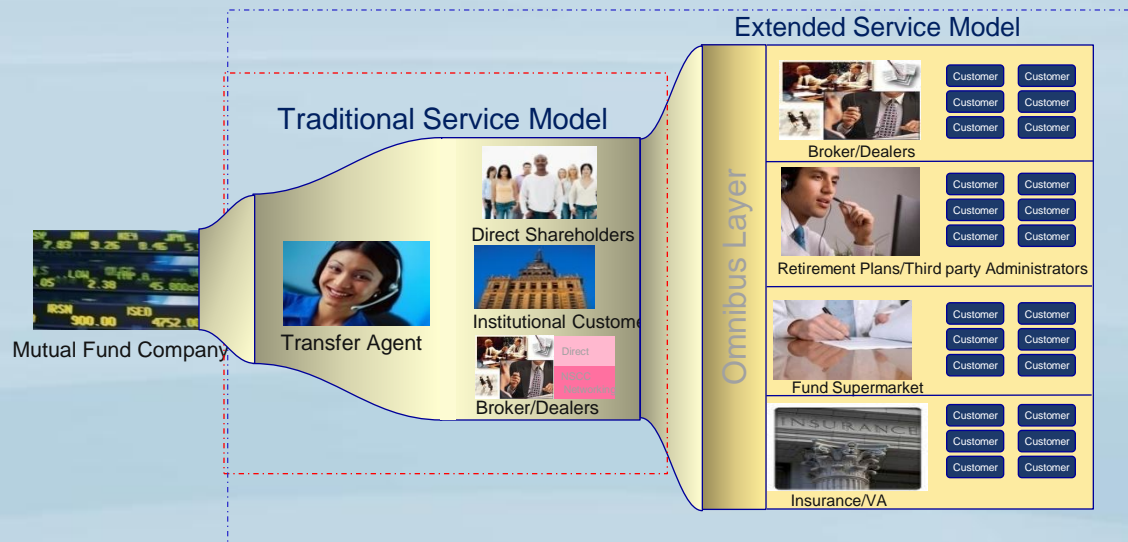
- An Industry Historical View: How we got here

# Paradigm Shift in the Industry

- History
  - The Mutual Fund industry's push toward expanded distribution channels has resulted in a paradigm shift in the conventional transfer agent shareholder servicing model.
  - Roles and responsibilities traditionally reserved for the transfer agent are continuing to be pushed outside the walls of the mutual fund complex and into the hands of distribution partners through the expanded use of omnibus accounting practices.

# Paradigm Shift in the Industry

- As the number of omnibus relationships grows, funds must increasingly rely upon the integrity of a growing number of external systems and service operations to deliver customer service and comply with industry rules.





# Increased Pressure for Risk and Oversight Enhanced Oversight and Risk Management

- Market events as well as regulatory mandates continue to place pressure on mutual fund boards and fund companies to reassess compliance and risk management as it applies throughout their extended enterprise.
- This has prompted many fund companies to increase their scrutiny beyond the confines of their own operations and consider the potential impact that their business partners may have on them.

# Increased Pressure for Risk and Oversight Enhanced Oversight and Risk Management

- For many fund companies, this broader risk perspective is beginning to extend to the review of the compliance controls of the broker-dealers, fund supermarkets, and other financial intermediaries that hold clients' mutual fund investments.
  - **Additional Drivers**
    - **Shifting Fees**
    - **Increased Regulatory Compliance**
    - **Board Responsibility**
    - **Data Sharing**

# Search For A Common Solution

- Growing level of oversight and due diligence being performed by funds
- Varying practices ranging from questionnaires, certifications, monitoring, site-visits, third party reports
- Concern regarding cost, discipline and effectiveness



# Search For A Common Solution

- ICI Working Group Solicits input from National Accounting Firms on Audit Solutions
  - Initially explored in 2005 – Parallels to 38a-1 challenges and related AICPA efforts identified
  - Statement of Position (SOP) 07-02 issued Fall 2007
  - Working group reconvenes with National Accounting Firms in December 2007 to explore applicability to Intermediary Oversight
    - Planning sessions
    - Socialization and industry vetting
  - Press Release issued in November 2008

# KPMG – Mark Twerdok

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- Differences Between and Primary Users of the Following Reports

# Statement on Auditing Standards No. 70 (SAS 70)

- Overview
  - Examination of internal controls at service organization over controls related to financial statement reporting of customers (user organizations).
  - Provides user auditors with information about controls at the service organization that may affect assertions in the user organizations' financial statements.
  - Type 1 vs. Type 2 examination.

# Statement on Auditing Standards No. 70 (SAS 70)

- Report Format
  - A Service Auditor conducts an examination and issues an Independent Service Auditor's Report covering the presentation, design and, in a Type 2 examination, the effectiveness of the service provider's controls.
  - Typically comprised of four sections – Independent Service Auditor's Report; Description of Relevant Controls; Control Objectives, Related Controls, and Tests Of Operating Effectiveness; and Other Information.

# Statement on Auditing Standards No. 70 (SAS 70)

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- Report Format
  - Details control objectives, control procedures, tests, and results.
  - No predetermined set of control objectives or control activities that service organizations must achieve. Customized control objectives and criteria for each engagement may be selected from authoritative sources.



# Statement on Auditing Standards No. 70 (SAS 70)

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- Intended Audience / Distribution
  - Restricted to service organizations, user organizations and auditors of the user organizations. The report cannot be shared with non customers.

# Agreed-Upon Procedures (AUP)

- Overview
  - Independent Auditor conducts predefined procedures agreed to by specific parties and reports findings.
  - Designed to meet the information requirements of specific parties.
  - Form of attestation report.

# Agreed-Upon Procedures (AUP)

- Report Format
  - Independent Auditor issues an Independent Accountants' Report on Applying Agreed-Upon Procedures. The report does not provide an opinion on the presentation, design and effectiveness of the service provider's controls.
  - Detailed procedures and findings report.
  - No predetermined set of criteria that service organizations must achieve. Predefined procedures are agreed to by parties based on informational needs.

# Agreed-Upon Procedures (AUP)

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- Intended Audience / Distribution
  - Report is available for use by any party that agrees to the procedures performed and takes responsibility for the sufficiency of the procedures.

# Other Reports

- WebTrust and SysTrust
  - Examination of documentation, processes and controls at service organization in place to meet defined criteria for Security; Availability; Confidentiality; Privacy; and Processing Integrity.
  - WebTrust and SysTrust share a common set of criteria. WebTrust is intended for online/e-commerce systems where as SysTrust can apply to any system.

# Other Reports

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- BITS FISAP
  - The BITS Financial Institution Shared Assessments Program is a process by which user organizations obtain detailed information on a service provider's Information Technology controls (Focusing on Security; System development and maintenance; and Business continuity). It introduces uniform assessment criteria and a consistent service provider questionnaire.
  - The FISAP consists of the two complementary components - The Supplemental Information Gathering (SIG) questionnaire and a set of Agreed-upon Procedures (AUP) achieved.

# Other Reports

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- Advisory Reports
  - Advisor conducts reviews, analyses, studies, or procedures based established standards, frameworks, and/or client requirements, and issues a report detailing findings and recommendations.
  - Designed to meet a wide variety of client information requirements.

# Financial Intermediary Controls and Compliance Assessment (SOP 07-02)

- Overview
  - Examination of internal controls at financial intermediary, focusing on controls over shareholder servicing, dividend disbursing and transfer agent services for mutual fund customers.
  - The framework describes 17 separate areas or activities where fund sponsors seek assurance.
  - Based on guidance in AICPA Statement of (SOP 07-02).



# Financial Intermediary Controls and Compliance Assessment (SOP 07-02)

- Report Format
  - An Independent Auditor assesses management's assertion, and issues an independent accountants report covering the design of the controls, and, in a type 2 examination, the effectiveness of the intermediary's controls.
  - Details control objectives and control procedures.
  - Based on a framework of control objectives that may be customized.

# Financial Intermediary Controls and Compliance Assessment (SOP 07-02)

- Intended Audience / Distribution
  - Report is for use by the board, CCO, management and auditors of the intermediary and entities that use the services of the intermediary.

# Ernst & Young – Dan New

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- Composition of the Report

# Is this Report Right for Your Organization?

- A Compliance Attestation Report would assist in the development of your overall oversight program:
  - Has your Board requested / required or inquired about such a report?
  - Have your clients or prospective clients inquired about this report?
  - In providing required assurances, would you (e.g., CCO, CRO, CFO, Chief Auditor, etc.) feel more comfortable if you were given and / or provided this report?

# Compliance Attestation Report Contents

<b><i>Auditor Compliance Attestation Report</i></b>	
<b>Contained within Attestation Report</b>	<b>Not within Attestation Report</b>
<ul style="list-style-type: none"> <li>• Managements assertions</li> <li>• An opinion on management's assertion</li> <li>• Listing of:               <ul style="list-style-type: none"> <li>▪ Control objectives</li> <li>▪ Control processes</li> <li>▪ Controls related to compliance program</li> </ul> </li> <li>• Management's response to comments (not included in report covered by auditor)</li> </ul>	<ul style="list-style-type: none"> <li>• Reporting on compliance with the federal securities laws</li> <li>• Reporting on compliance with its contractual obligations to its clients</li> <li>• Listing of applicable federal securities laws</li> <li>• Specific audit procedures and related results</li> </ul>

# Responsibilities

- *Management*
  - Understand users of report
  - Develop management assertion
  - Determine “as of” date of report
  - Identify compliance areas to be covered within report
  - Identify control objectives and related controls
- *Auditor*
  - Gain understanding of services provided and determine relevancy of control objectives
  - Test controls identified by management and obtain evidence
  - Evaluate suitability of the design and operating effectiveness of controls
  - Conclude on findings and issue opinion

# Overview of ICI Working Group

- As discussed earlier, the ICI sponsored a Committee comprised of many fund complexes and the four national accounting firms
  - Discussed 07 – 02 and uses for Intermediaries
  - Identified and prioritized 17 areas of focus
  - Developed listing of potential control objectives to be included in Fund Intermediary compliance attestation report
  - Specific controls/control considerations to be examined

# Overview of ICI Working Group

- The following table contains a few, sample control objectives developed by the ICI Working Group:

<b><i>Area of Focus</i></b>	<b><i>Sample Control Objectives</i></b>
Transaction Processing	Controls provide reasonable assurance that specified transactions and adjustments, including as-of transactions, are authorized, processed accurately and timely, and are effected at the proper share price.
Privacy	Controls provide reasonable assurance that material non-public information is restricted to the authorized individuals communicated to the Company by the client.
Anti-Money Laundering	Controls provide reasonable assurance that Information is collected from any person seeking to open an account with a mutual fund client to verify such person and the information collected is maintained.



# Value to Organization

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- Organizations which provide and/or rely upon a compliance attestation would discover immediate value:
  - Provides an independent view of the compliance program
  - Provides greater comfort to those who rely on the compliance controls and processes
  - Potentially reduces oversight performed on existing service providers
  - Allows for potential cost savings to overall organization

# Value to Organization

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- Enables firms to benefit from the industry knowledge of accounting firm who conducts compliance attestation
- Permits Fund Chief Compliance Officer to feel more confident regarding annual compliance review provided to Board of Directors
- Provides greater clarity and transparency on the processes and controls implemented by service providers

# PwC – Nick D'Angelo

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- Benefits and Uses of the Report

# Benefits

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- Common framework - a consistent, standard approach for performing the assessment
- Independent assessment - performed by an independent auditor under AICPA-approved professional standards

# Benefits

- Another tool for oversight - fund companies can use the assessment in their evaluation of financial intermediaries:
  - Helps to reduce or eliminate any gap that exists in current oversight tools (e.g. financial statements, site visits, SAS 70's etc); and
  - it does not preclude any fund from making individual decisions as to how it may use the tool or accomplish the desired compliance overviews

# Benefits

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- More efficient process – focus the efforts of financial intermediary and fund complex personnel:
  - Manage the increasing costs of oversight through a reduction in the proliferation of firm visits and other methods of oversight;
  - Ease the increasing burden on third party service providers and increase cooperation from these providers; and,
  - Identify those areas requiring additional focus from management (e.g. CCO's)

# Benefits

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- Demonstrate good “governance” – provide more transparency into the control environment

# Users of the Report

- Financial Intermediaries (Service Organizations)
  - Demonstrates confidence in the quality of business processes and information systems to:
    - Existing clients
    - Prospective clients (distribution of actual report may be limited)
  - Satisfies legal obligations
    - Some are considering inclusion of independent assessment requirement in vendor contracts



# Users of the Report

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- Mutual Fund Complex
  - One component of the diligence and oversight program for:
    - Transfer agent management
    - Chief Compliance Officers
- Fund Directors
  - Part of their oversight responsibilities on behalf of shareholders

# Question & Answer

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