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### Managing Fund Compliance Across the Distribution Chain

*How transfer agents can help fund companies better position themselves for compliance with the states and an increased SEC presence*

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Of late, there have been a number of high profile enforcement actions by the SEC. These cases have generated considerable attention, signaling the SEC's intent to focus on oversight. But such "headline" events aren't the only ones gaining the SEC's attention. In an October speech at the Securities Enforcement Forum, SEC chairman Mary Jo White noted the agency's plan to address a wide array of violations as part of an overall enforcement strategy.

"One of our goals is to see that the SEC's enforcement program is – and is perceived to be – everywhere, pursuing all types of violations of our federal securities laws, big and small," White said. She went on to explain that the SEC's approach would parallel the "broken windows" strategy used by the New York Police Department in the 1990s to fight crime. White explained, "The theory is that when a window is broken and someone fixes it, it is a sign that disorder will not be tolerated." Such comments are widely interpreted as putting fund companies on notice that infractions of technical rules could lead to full enforcement cases.

In addition, the SEC just issued its examination priorities for 2014, which highlights those areas they perceive to have heightened risk and where they will be focusing their attention.

With this backdrop, asset management firms of all sizes are tightening their compliance efforts and more actively examining their oversight processes. By reviewing and testing controls across the front-, middle- and back-office, fund companies can better prepare themselves for a heightened SEC presence.

#### Core Transfer Agency Capabilities

Shareholder and intermediary practices are a large part of a Fund's compliance review process. Some well-established compliance obligations – monitoring prospectus rules, late trading and marketing timing – are regularly completed by the Fund's transfer agent. Robust technology and integrated data processing assist with daily reviews of shareholder and trading data. Similarly, AML and CIP testing is generally an automated part of shareholder recordkeeping platforms. These are core reporting obligations that should be easily handled by a reputable transfer agent.

Yet, with the adoption of the omnibus model by financial intermediaries and requirements like Blue Sky state-level reporting obligations, compliance for fund companies is more complex than ever.

## Blue Sky Laws and Financial Intermediary Oversight

Blue Sky is one area where keeping up with the multitude of state rules can be a significant undertaking for Funds. Without a strong program in place, a fund company's ability to grow assets under management, while maintaining the appropriate level of registration in each state, can be limited. Recognizing a need in this area, Boston Financial has developed a specific Blue Sky administration offering to assist. Boston Financial brings together significant industry and compliance expertise with leading technology to help fund companies comply with the varying registration mandates for every state.

Another emerging area of focus is oversight of financial intermediaries. Shareholder data from intermediaries is usually held in an omnibus account, which inhibits the Fund from having visibility at the shareholder level. The intermediary is responsible for ensuring compliance with a fund's prospectus. However, unlike accounts held at the transfer agent, the Fund has added complexity in monitoring these accounts for prospectus compliance.

In addition, the fund company frequently pays compensation to the financial intermediary for these servicing activities. A contractual agreement between the Fund and the financial intermediary details the services to be performed and the fees that the Fund will pay for them. Fund companies must work closely with intermediaries to define program parameters and monitoring obligations, and then conduct reviews to test the effectiveness of such programs. Fund companies can also seek regular attestation on a financial intermediary's overall oversight through a specific due diligence questionnaire. The ability to successfully complete these tasks is weighing on the minds of asset management professionals.

## Managing Intermediary Compliance Risk

A recent Boston Financial survey found that over 96% of respondents thought their fund company's need to manage financial intermediary oversight will increase over the next three years<sup>1</sup>. Further, nearly all respondents (97%) identified legal/regulatory risk related to intermediary oversight as a key concern. In light of Chairwoman White's comments, this is clearly an area where fund companies can – and should – be focusing.

Fortunately, some fund companies have already recognized the need for greater oversight and tools to monitor financial intermediary activity. Boston Financial, with robust data management platforms and deep shareholder servicing experience, has introduced intermediary specific offerings that help with many of the critical compliance tasks. From operational reviews, to supporting fund company due diligence programs, to tracking and validating fee payments, fund companies have strong solutions available to them that can help protect against the risks of non-compliance.

## Going Forward

As the states get more aggressive and the SEC continues to identify potential infractions – both small and large – asset managers can protect themselves against the financial and reputational risks associated with non-compliance. Particularly with the help of an established transfer agent like Boston Financial, some of the more challenging compliance oversight tasks can be addressed and managed more effectively.

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<sup>1</sup> Boston Financial 2013 Financial Intermediary Administration Survey

