EDUCATING A FUND BOARD TO INFORM ITS DECISION-MAKING PROCESS

A Barrington Partners *Case Study*
July 2019

SCENARIO

A client wanted to educate its Funds' Board of Trustees about industry best practice to inform its decision-making process on a particular issue. To do so, the client asked us to provide a written report and make an in-person presentation to their Board utilizing the findings from one of Barrington's industry benchmarking surveys complemented with follow-up interviews. The Board found that this was a beneficial process.

BACKGROUND

Last fall Barrington conducted its fourth Intermediary Oversight Survey ('Survey').[1] The diverse mix of 47 unique participants during the tenure of the Survey has created a comprehensive and dynamic representation of the trends shaping oversight.

One underpinning has not wavered during the tenure of the Survey – how we define intermediary oversight or subject to oversight. The term means any intermediary to which a service fee[2] is paid. In the 2018 Survey, our 20 participants had intermediated assets of $1.6 trillion, of which a hefty 90% were subject to oversight.

Each Survey has covered a range of topics[3] which are always selected with the guidance of a Steering Committee of 'front line' oversight personnel. (This same approach is used for all our benchmarking surveys.)

BARRINGTON'S BENCHMARKING SURVEYS

2020

Intermediary Fees Survey seeks to establish 'market rates' for the payments of 12b-1, sub-TA and revenue sharing within each platform of five intermediary distribution channels

Transfer Agency P&L Survey addresses the revenues, expenses and profitability of a transfer agency operated by a fund company (applicable to firms that still operate their own transfer agency and/or have a large direct book of accounts

Intermediary Oversight Survey focuses on benchmarking how firms manage their intermediary oversight responsibilities and sub-accounting activities, and the ways their oversight programs are evolving.

2021

Fund Audit Fees Survey uses our pioneering methodology to determine if overall audit fees for a fund company are within a reasonable range based on a relative complexity factor.

Fund Accounting & Administration Cost Survey asks the question, "How do a fund company's overall fund accounting and administration costs compare to what others are paying given the complexity of the funds' portfolios?"

2021

Private Funds Audit Fees Survey addresses the differing realities facing private funds, including Hedge Funds, Private Equity Funds, Hybrid Funds (HF holdings with PE structure), Illiquid or Real Asset Funds, Alternative fund of funds, and ERISA only funds. (3-Year Schedule)

Among the issues explored in the 2018 Survey, we wanted to gain a better understanding of how fund companies most effectively interact with intermediaries from an oversight perspective in face-to-face settings. In order to assess the prevalence of standalone oversight visits exclusively focused

[1] The Surveys have been run in 2013, 2014, 2016 and 2018.

[2] The terms *service fee, sub-TA fee* and *recordkeeping fee* have similar meanings and may be used interchangeably in this paper.

[3] Our white paper entitled *Intermediary Oversight: The ongoing evolution of Barrington's survey,* January 2019, elaborates on the topics covered in the 2018 Survey. The white paper can be obtained through our website at www.barringtonp.com.

on the oversight program ('Oversight Visits'), the Survey distinguished between Oversight Visits, back office/ operational reviews ('Operational Visits'), and relationship visits.

EVOLUTION OF THE OVERSIGHT PROGRAM

Since the inception of oversight programs, the most crucial change has been intermediary adoption of the FICCA with its many standard controls tested by a third-party audit firm, complemented with the SOC-1/SSAE-18 auditor reports. These independently created documents now provide the underpinnings of the oversight program.

The increasingly preeminent role of audited documents in an oversight program may have accelerated the jettisoning of Oversight Visits as a program element.

- Greater Transparency – The FICCA provides transparency not otherwise available to most fund companies in an Oversight Visit.
- Eliminating Unique Fund Company Oversight Visits – A driver in the adoption of the FICCA by intermediaries as a reporting/information dissemination tool was to reduce the 'traffic jams' of individual fund companies at the intermediary's offices – each with their individualized questionnaires and data requests. The FICCA has provided a credible, far-reaching replacement.
- Auditor Credibility – The FICCA has immediate credibility because it incorporates an independent opinion about the control environment.

Because the FICCA – and the controls tested – are not fund company-specific, we explored with 2018 Survey participants how they become comfortable with the relevance of the FICCA results for their firm. The responses could be distilled to a common refrain – transparency not otherwise available to a fund company.

CHRONOLOGY OF OVERSIGHT VISITS

In 2013 – the first year of the Survey – almost 25% of firms decided that they would not conduct Oversight Visits, and an additional 43% were only *considering* this program element. Just one year later, 58% of Survey participants indicated that they conducted no Oversight Visits. Since 50% of the 2014 participants also participated in the 2013 Survey, this confirmed that they were steadfast in their initial *no visit* decision.

The following table shows the trend in Oversight Visits:

TRENDS IN DEDICATED OVERSIGHT VISITS

Survey Year	Yes	As Needed	Considering	Implementing	No Visits	Total
2013	4	2	9	1	5	21
2014	4	5	5	1	9	24
2016	6	2	0	1	11	20
2018	2	2	0	0	16	20

What was particularly interesting was that five firms originally responded in the affirmative about conducting Oversight Visits in 2018.[4] Based on subsequent discussions with those participants, it turned out that five became two (in terms of Oversight Visits) and in reality, two became one. Among the common refrains were:

- Reserved for high risk relationships, but no relationships carry that designation
- No longer primary to oversight program
- Fewer visits due to intermediary unwillingness; more use of conference calls

From the get-go, the majority of Survey participants have instead elected to employ *operationally focused* visits that emphasize operational dialogues and operational relationship building. Those Operational Visits are being leveraged to address specific oversight topics that may not have been resolved by calls or emails. Adoption of that alternative quickened in the subsequent 2016 and 2018 Surveys. In the 2018 Survey, participants were asked to indicate the importance and time allocated to various potential oversight program elements, and Operational Visits outpaced Oversight Visits when measured by importance and time allocation scores.

[4] One firm was counted as 'No Visits' since it had eliminated Oversight Visits and replaced them with calls.

UNDERSTANDING THE MERITS OF OVERSIGHT VISITS AND OPERATIONAL VISITS

In order to understand why Operational Visits have become such an effective successor to (or replacement for) Oversight Visits, we reached out to half the participants in the 2018 Survey, including several that had initially claimed to be conducting Oversight Visits as well as many others that employ Operational Visits. The interviews used a pre-designed questionnaire that addressed topics such as meeting driver, frequency, attendees, protocol, meeting prioritization, duration and intermediary reaction.

One important takeaway was that the right to conduct Oversight Visits was held in reserve. Even though Oversight Visits had never been utilized, firms could employ them tactically as needed.

We found remarkable consistency in the goals, structure and 'workings' of these Operational Visits. The sole exception was in the identification of targeted intermediaries, which is explained by their different priorities in establishing targets, such as risk ranking results, service fees paid, AUM, or changes in business model, to cite just a few examples.

Below is a summary of the feedback we received from these interviews.

ISSUE	RATIONALE
Goals: Build and maintain operational relationship/partnership; informational exchange; collaboration	Associating name and face builds/enhances the relationship for routine questions, challenges or issues
Approach: Two-way feedback; spirit of partnership	Facilitates optimal operating environment between intermediary and fund company; complements other elements of oversight program
Meeting Tenor: Cooperative	Collaboration helps facilitate optimal operating environment
Role of the FICCA: Helps change nature and type of dialogue with intermediary	Most information that *might* be gathered in Oversight Visit is resident in FICCA.
Intermediary Willingness to Hold Operational Visit: Never refused (scheduling may be a challenge)	Meeting nomenclature makes a difference. (If the term 'oversight visit' is used, the response is likely to be 'no availability'.)
Meeting Frequency: Most commonly on annual basis, but often is less frequently (for example, when there is a low risk ranking). Another driver is budget, so Operational Visits may be limited to proximate intermediaries or to multiple firms in a single visit.	Discussion optimized in face-to-face meetings.
Meeting Duration: Typically 1-1.5 hours	Extensive audited documentation substantially reduces in-person time.
Meeting Agenda: Commonly used; sent out 1-2 weeks in advance	Intermediary has 'voice' in suggesting agenda topics; gives intermediary time to prepare/identify
Use of Additional Meeting: When an issue crops up between meetings, any/all of email, phone call and additional meeting(s) may be utilized.	By having built relationships with counterparts, issues can be quickly resolved in an optimal communications means.
Follow-up: Notes of the meeting are prepared and shared with key internal fund company colleagues (e.g., legal, compliance, distribution relationship manager)	Creates a 'trail' and to-do list, including further outreach to the intermediary, and fosters internal collaboration.
Topics Covered • Specific operational challenges • Areas of concern noted in review of FICCA and other materials • Operating concerns flagged by fund company personnel • Industry themes (e.g., 30e-3); upcoming fund company initiatives • Review of fund company policies/procedures; understanding of controls (without testing by the fund company) • Feedback about improvements in FICCA language to clarify a control • Sharing of contacts at fund company and intermediary. • Discussions about fees are deliberately excluded.	While oversight issues are addressed, the discussion spans an array of topics that are of interest to both the fund company and the intermediary.

Several firms also noted that they provide PowerPoint decks that may include (but are not limited to) a high-level review of their due diligence on the intermediary, risk ranking, and third-party audit evaluation.

FINAL THOUGHTS

Attendees at these Operational Visits further reinforce the intent of the sessions. Fund company attendees typically include operations personnel, operations relationship management team and/or oversight personnel depending on the organizational structure of the fund company. If others such as a national account manager or sales team representative attends, they participate as observers. Based on the topics to be covered, which is another advantage of agreeing on an agenda in advance, typically the relationship manager, day-to-day operational contacts and the head of operations will serve as representatives of the intermediary.

For more information on Barrington Partners' research capabilities and our broad range of services, please contact Judy Benson (jbenson@barringtonp.com or 617.482.3303).