

MEMO# 31466

November 1, 2018

ICI Files Comment Letter on Processing Fee Framework

[31466]

November 1, 2018 TO: ICI Members
Investment Company Directors
Operations Committee
Processing Fees Working Group
SEC Rules Committee
Small Funds Committee
Transfer Agent Advisory Committee SUBJECTS: Disclosure
Distribution
Fees and Expenses
Fund Governance
Intermediary Oversight
Operations
Transfer Agency RE: ICI Files Comment Letter on Processing Fee Framework

ICI filed the attached comment letter, responding to the SEC's request for comment on the framework for certain processing fees that intermediaries charge funds for delivering fund regulatory materials to investors that are beneficial owners of shares held in street name through the intermediary.[\[1\]](#) The SEC's release explains that, with the adoption of Rule 30e-3, the SEC believes it is appropriate to consider more broadly the overall framework for these fees.[\[2\]](#)

A short summary of the letter is as follows:

Current system lacks appropriate incentives. SEC rules require funds to reimburse intermediaries for reasonable expenses incurred in forwarding fund materials to beneficial owners of fund shares. Intermediaries generally outsource forwarding of fund materials to a fulfillment vendor that then invoices the fund to pay the expenses. This reimbursement system creates a disconnect between the party that negotiates the vendor fees (*i.e.*, the intermediary) and the party that pays the vendors' bill (*i.e.*, the fund).

Because funds bear the cost of shareholder report delivery, intermediaries have little incentive to negotiate lower delivery rates with the fulfillment vendor or otherwise control costs. To make matters worse, the lack of properly aligned incentives prevents competition and has created a near-monopoly for the predominant vendor, which now has a financial stake in keeping the status quo.

The result is higher costs to fund shareholders. This environment inevitably has led to significantly higher fees than funds pay when they select their own delivery vendor and negotiate the fee. Individuals can and do purchase fund shares directly from the fund. These shareholder accounts are held directly with the fund (“direct-held accounts”). Vendors compete to offer funds attractive pricing for delivering fund materials to direct-held accounts.

A recent ICI member survey found that the median fund pays three times as much in processing fees for mailing the same shareholder report to an intermediary-held account as compared to a direct-held account. The median fund pays five times as much to e-mail the same shareholder report to an intermediary-held account as compared to a direct-held account.

NYSE fee schedule is not suited for funds and cements higher fees. The NYSE fee schedule sets maximum rates for what constitutes “reasonable” delivery expenses (*i.e.*, “processing fees”) that funds must reimburse, in addition to actual out-of-pocket costs such as printing and mailing.

The NYSE fee framework is ill-suited to distribution of fund materials, however, and the fees that apply to funds bear little relation to the actual work and cost of distributing fund materials. As a result, fees charged pursuant to the schedule are higher than necessary to compensate for reasonable delivery expenses.

Processing fees will reduce Rule 30e-3 cost savings. The Commission recently adopted Rule 30e-3 under the Investment Company Act of 1940 to, among other things, provide cost savings to shareholders (*i.e.*, by allowing funds to mail a notice instead of the full shareholder report, which will reduce printing and mailing costs). An additional processing fee will apply to these Rule 30e-3 Notices, however, and this will greatly reduce potential cost savings. Without further SEC action, this added processing fee may largely offset the cost savings from the reduced printing and mailing costs.

SEC can facilitate greater competition. The SEC should permit funds to select the fulfillment vendor and negotiate the price for distribution of fund materials. This will realign incentives and reintroduce market competition, eliminating the need for a regulator-set fee schedule and allowing vendors to compete for funds’ business.

Two potential solutions exist for the SEC to encourage greater competition. We suggest two possible regulatory solutions that would permit funds to negotiate with vendors and eliminate the need for a fee schedule:

1. The SEC can make clear that Section 14 rules under the Securities Exchange Act of 1934 permit funds to choose how to deliver fund regulatory materials and require intermediaries to provide on request to funds or their selected agent (*i.e.*, vendor) a data file with only the shareholder information necessary for delivering these materials;
2. Or, the SEC can allow funds to choose how to deliver fund regulatory materials by not applying the objecting beneficial owner (OBO)/non-objecting beneficial owner (NOBO) distinction for the purpose of distributing fund regulatory materials.

Alternative recommendation for reforming NYSE fees. If the SEC chooses to retain the existing fee framework, it must rework the fee schedule to:

- Create a fee schedule for funds that is separate from the existing NYSE fee schedule,

recognizing that the fees for forwarding of fund materials to intermediary-held accounts are unrelated to the fees for forwarding of operating company proxy materials;

- Replace the existing fees and layered application structure with simple flat fees that reflect actual costs, using cost for direct-held accounts as a guide;
- Clarify that funds cannot be charged for managed accounts where funds are not required to forward materials;
- Eliminate unreasonable billing practices, such as remittances, that maximize intermediary and vendor profit at shareholder expense;
- Create a robust regulatory oversight framework; and
- Mandate regular independent review of fee rates and vendor billing practices.

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[Attachment](#)

endnotes

[1] See ICI memorandum no. 31243, *available* at https://www.ici.org/my_ici/memorandum/memo31243 (summarizing SEC's request for comment).

[2] *Request for Comments on the Processing Fees Charged by Intermediaries For Distributing Materials Other Than Proxy Materials to Fund Investors*, SEC Rel. Nos. 33-10505, 34-83379, IC-33114 (June 5, 2018), *available* at <https://www.sec.gov/rules/other/2018/33-10505.pdf>.