An Overview of the Regulatory Framework Applying to Collective Trusts
Speakers

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Introduction

- Collective investment trusts (CITs) are subject to a myriad of regulations including those administered by:
  - State and federal bank regulatory agencies, in particular the Office of the Comptroller of the Currency (OCC)
  - The U.S. Department of Labor (DOL)
  - The Internal Revenue Service (IRS)
  - The Securities and Exchange Commission (SEC)
  - Financial Industry Regulatory Authority (FINRA), to the extent the collective funds are marketed by a broker-dealer
  - The Commodities Futures Trading Commission (CFTC), to the extent the collective funds invest in futures

We outline these below.
Banking

- Federal and state banking laws
  - Practically speaking, the OCC’s collective investment regulations are the primary banking regulations relevant to collective trust funds. While the OCC’s collective investment regulations apply only to national banks that organize and maintain collective trust funds, many states apply the OCC’s rules either by statute, rule or other guidance as best practices in examining state bank collective trust activities.
  - The OCC’s collective investment regulations are codified to 12 CFR 9.18. Those regulations authorize two types of collective trust funds. The first, commonly referred to as “A1 funds,” are common trust funds. The second, “A2 funds,” are funds consisting of retirement assets and are the type of fund that is the subject of this article.
Banking

- 12 CFR 9.18 requires, among other things that:
  - The bank sponsoring a fund has “exclusive management” of the fund, subject to prudent delegation;
  - Funds are valued quarterly (illiquid assets may be valued annually), subject to market/fair valuation;
  - Management fees satisfy the limits set forth in the requirement; and
  - The funds are subject to certain risk management requirements.
Banking

- In addition to 12 CFR 9.18, the OCC has provided guidance with respect to CITs through bulletins and banking circulars, interpretative letters, and through handbooks issued by the OCC’s Asset Management Group. We reference some of this guidance below.

- OCC Bulletins and Banking Circulars
  - 2011-11 – Risk Management Elements: Collective Investment Funds and Outsourcing Arrangements
  - 2004-2 – Banks/Thrifts Providing Financial Support to Funds Advised by the Banking Organization or its Affiliates
  - Banking Circular 196 – Securities Lending (1985)
Banking

• Interpretive Letters
  - IL #1121 – CIF Distribution Delay due to Illiquid Assets (2009)
  - IL #1119 and 1120 – Withdrawal Fees and Benchmarks—Model-Driven Funds (2009)
  - IL #920 – Annual Admissions and Withdrawals (2001)
  - IL #919 – Allocation of Costs in Model-Driven Funds to Participants (2001)
Banking

• In addition, the OCC’s Asset Management Group has issued a *Collective Investment Funds* handbook (revised May 2014). Other handbooks also are relevant to CIT operations:
  - Asset Management
  - Asset Management Operations & Controls
  - Conflicts of Interest
  - Custody Services
  - Investment Management Services
  - Personal Fiduciary Services
  - Retirement Plan Services
Most CITs qualify for tax exemption as “group trusts”

- CIT is a separate taxpayer
- CIT enjoys the exemption of the plans invested in it
- CIT files Form 990 and is potentially subject to unrelated business income tax

Rev. Rul. 81-100

- Restates an IRS ruling position dating to 1956
### Eligible Investors

<table>
<thead>
<tr>
<th>Eligible Investors</th>
<th>Each investing plan/IRA must be itself tax-exempt under §408(e) or §501(a) (or treated as tax-exempt under §501(a))</th>
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<tbody>
<tr>
<td>• Section 401(a) plans</td>
<td>• §401(a)(24) governmental plan is treated as meeting this requirement if it is not subject to federal income taxation</td>
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<td>• <em>Individual retirement accounts</em></td>
<td>Group trust instrument expressly limits trust participation to eligible plan investors</td>
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<td>• Section 457(b) governmental plans</td>
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<td>• <em>Section 403(b)(7) custodial accounts</em></td>
<td>Group trust instrument expressly limits the assets that may be held by the group trust to assets that are contributed by, or transferred from, an investing plan/IRA to the group trust (and the earnings thereon)</td>
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<tr>
<td>• Only if group trust limits investments to mutual funds</td>
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<tr>
<td>• Section 403(b)(9) retirement income accounts</td>
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<td>• Section 401(a)(24) governmental plans</td>
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<tr>
<td>• Including those providing retiree welfare benefits</td>
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<td>• Commingled trust funds maintained by PBGC as statutory trustee for terminated tax-qualified plans</td>
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<td>• Puerto Rico-only qualified plans described in ERISA section 1022(i)(1)</td>
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<td>• Insurance company separate accounts limited to the above plans</td>
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<td>• Separate account must be insulated from claims of the insurer’s general creditors</td>
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<td>*Subject to securities law limitations</td>
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## Other Requirements under Rev. Rul. 81-100

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<thead>
<tr>
<th>Requirement</th>
<th>Details</th>
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<tr>
<td><strong>Situs and Structure</strong></td>
<td>Group trust must be created or organized in the U.S. and maintained at all times as a U.S. domestic trust</td>
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<td><strong>Adoption</strong></td>
<td>Group trust is adopted as a part of each plan or IRA</td>
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<td><strong>Nonassignability</strong></td>
<td>Group trust instrument must prohibit the assignment by a participating plan/IRA of any part of its equity or interest in the group trust</td>
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</table>
| **Exclusive benefit**        | • Group trust instrument prohibits violation of exclusive benefit rule  
                               • Each participating plan/IRA expressly and irrevocably prohibits in its governing document violation of the exclusive benefit rule |
| **Separate accounting**      | Group trust instrument expressly provides for separate accounting (and appropriate records) to be maintained to reflect the interest of each investing plan/IRA |
• Always ERISA “plan assets”
  - DOL Reg. §2510.3-101(h)
• Consequences
  - ERISA reporting (DFE)
  - ERISA bonding (other than for trustee)
  - ERISA indicia of ownership
  - ERISA preemption
  - ERISA fiduciary standards/prohibited transaction rules
### Applicable fiduciary compliance solutions include:

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<th>For plan investments in/out of CIT</th>
<th>ERISA §408(b)(8)</th>
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<td>For management of CIT</td>
<td>• PTE 91-38 Bank CIF</td>
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<td>• PTE 84-24 QPAM</td>
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<td>• ERISA §408(b)(17) transactions with service providers</td>
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<td>• Various exemptions for other specific transactions</td>
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<td>• Blind market transaction doctrine</td>
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<td>• PTE 97-41 In-kind conversion of CIT to mutual fund</td>
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• Securities laws

- Interests in CITs are exempt from registration under Section 3(a)(2) of the Securities Act of 1933 if the fund is “maintained by a bank” and participation in the fund is limited to certain investors.

- Most CITs avoid registration as investment companies under the Investment Company Act of 1940 (the “1940 Act” or “Investment Company Act”) by relying on an exclusion from the definition of an investment company found in Section 3(c)(11) of the Act. Section 3(c)(11) excludes, among other entities, collective trusts maintained by a bank, the assets of which consist solely of assets of certain specific types of retirement plans derived from contributions under such plans.
Section 3(c)(11) requires that a collective trust relying on the exclusion be maintained by its sponsoring bank. In a series of no-action letters, the SEC staff has required that in order for a bank to maintain a collective trust, the bank must exercise substantial investment authority over the assets of the trust.

A bank that functions in a mere custodial or similar capacity will not satisfy the “maintained” requirement. At the same time, the SEC has long held the position that a bank may hire a sub-adviser to assist it in its exercise of investment discretion. See, e.g., The Provident Bank (SEC no-action letter dated Sept. 24, 1991).
CIT interests are “exempted securities” under Section 3(a)(12) of the Exchange Act. That section, which parallels Section 3(a)(2) of the Securities Act as applied to CITs, provides broad exemptions from the requirements of the Exchange Act, including its registration provisions and the broker-dealer registration requirement.
To the extent that a CIT is marketed by a broker-dealer, FINRA rules applying to member firms’ sales of exempt securities would apply. FINRA Rule 0150 sets forth those rules that are applicable to transactions in and business activities relating to exempt securities (other than municipal securities), such as interests in CITs, conducted by member firms.
To the extent that a CIT invests in commodities, the CIT’s sponsor and adviser have to comply with applicable CFTC rules and regulations.
Questions?