Collective Investment Trusts (CITs) 101

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CCIT—Who We Are

• Formed in 2012, the Coalition of Collective Investment Trusts (CCIT) is a group of fund sponsors and money managers active in the collective investment trust industry. With approximately 40 member companies, the Coalition collectively represents a sizeable presence in the industry.

• The primary goals of the group are:
  – to serve as a forum for discussing and developing best practices for legal and operational issues relating to collective trust funds;
  – to provide regular updates with respect to legal and regulatory matters affecting collective trust funds; and
  – where desired by the members, to express opinions (e.g., by filing comment letters) on matters of interest to collective fund sponsors.

• For more information, visit us online: www.ctfcoalition.com
Overview of collective investment trusts

The Myths and The Facts

Top 5 reasons for selecting collective investment trusts

Summary

Q&A
Plan fiduciary considerations when selecting an investment vehicle

- Are the fees appropriate for plan size and strategy?
- Is there an opportunity to customize fees based on plan needs?
- What type of reporting will be available to the plan/participants?
- Are there any liquidity boundaries, trading issues, operational considerations?
- Given all available information, is the investment vehicle the best fit for the plan participants?
Overview of collective investment trusts

• Common Trust Fund
  – Bank must serve as trustee, executor, administrator, conservator or guardian to invest in a common fund
  – Investors are normally personal trust or foundation and endowments

• Commingled Trust Fund
  – Investors consist of qualified retirement plans that are exempt from federal income tax
<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1927</td>
<td>CITs first introduced</td>
</tr>
<tr>
<td>1936</td>
<td>CIT use expanded in DB plans when Congress amended the Internal Revenue Code to provide tax-exempt status to certain bank-maintained CITs</td>
</tr>
<tr>
<td>1955</td>
<td>CIT use expanded further with the Federal Reserve authorization for banks to combine funds from pensions, profit sharing and stock bonus plans, and the IRS determination that such CITs could be tax-exempt</td>
</tr>
<tr>
<td>2000</td>
<td>CITs began trading on the NSCC’s Fund/SERV® platform</td>
</tr>
<tr>
<td>2012</td>
<td>DOL required all investment option providers to standardize risk, performance and expense disclosures</td>
</tr>
</tbody>
</table>
Eligibility

• Qualified Retirement plans subject to ERISA include:
  – 401k plans
  – Money purchase plans
  – Pension plans/defined benefit plans
  – Profit sharing plans
  – 457 government plans
  – Taft-Hartley (union) plans

• Types of plans not eligible for CITs include:
  – 403(b) plans
  – IRAs
  – Health and welfare benefit plans
  – VEBAs
  – Non-qualified deferred compensation plans
Regulatory

• Primary regulator:
  – Office of Comptroller of the Currency OR State Banking Examiners

• Collective investment trusts must also follow certain regulations from:
  – U.S. Department of Labor (DOL)
  – Internal Revenue Service (IRS)
  – U.S. Securities and Exchange Commission (SEC)
  – Financial Industry Regulatory Authority (FINRA)
  – Commodities Futures Trading Commission (CFTC)
Common Myths and the Facts
Common Myths and the Facts

• **Myth: CITs are significantly different than mutual funds**
  – Though there are important differences, CITs are similar to mutual funds in many respects
    • CITs tend to be more cost-effective and may offer flexible pricing
    • Typically, CITs have lower costs associated with compliance, administration, marketing and distribution¹

• **Myth: CITs don’t have documents like a mutual fund prospectus, so the investor cannot make an informed decision**
  – A CIT is established and governed by its Declaration of Trust, which set forth the fund’s terms and conditions (e.g., investor eligibility, valuations, subscriptions and redemptions)
  – Most CIT providers also prepare a fund offering document that further describes, among other things, the fund’s material terms, investment objective and strategy, policies, fees/expenses and risk characteristics

¹ Cerulli’s Institutional Markets 2013
Common Myths and the Facts

- **Myth: CITs have high account minimums**
  - Many CITs, especially if traded through Fund/SERV®, may have small minimum investment requirements
  - Recordkeepers may offer omnibus structures for smaller plans to access CITs with little or no minimum

- **Myth: Large plans prefer separately managed accounts**
  - Many large plans prefer CITs to separate accounts to escape the added administration necessary to maintain a separate account
  - Separate accounts may also incur additional legal costs associated with the review and negotiation of required documents
Common Myths and the Facts

- **Myth: CITS only have a limited selection of asset classes to choose from**
  - New strategies are available and continue to be added
  - A wide variety of asset classes now exist in CITs, including domestic equity, international equity, fixed income and alternatives
  - Popularity increasing for use in glide path/target-date funds (TDFs)

- **Myth: CITs don’t have the same level of reporting as mutual funds**
  - While reporting can vary by provider, most leading CIT providers offer similar reporting to mutual funds
Common Myths and the Facts

• **Myth: CIT information, including pricing, holdings and commentary, is not readily available**
  – Prices are updated on many fund company websites daily
  – Participant account values are updated on recordkeeping systems daily
  – Many CIT providers maintain websites that are designed to furnish investors with detailed information similar to mutual funds

• **Myth: CITs are not daily valued or daily traded, making it difficult to add to a plan’s investment lineup**
  – The vast majority of CITs are priced daily, with NAVs available by 6:00 PM, the same time as mutual funds
  – Most CITs are traded daily via Fund/SERV®, the industry standard platform that mutual funds use, making it easy for recordkeeping platforms to include alongside mutual funds
Common Myths and the Facts

• **Myth: CITs are more expensive than mutual funds**
  – On average, CIT fees can be 25 to 40 basis points less than mutual fund fees
  – CITs do not pay 12b-1 fees and have limited marketing and distribution costs
  – For many CITs, operating expense ratios decrease as assets under management increase, resulting in lower overall costs for investing plans

• **Myth: Fee flexibility is only available in mutual funds**
  – Many CIT providers now offer a variety of fee structures that are included in the net asset value (NAV) of each share
  – A plan may negotiate management fees on certain types of share classes
Common Myths and the Facts

• **Myth: Fees for CITs aren’t as transparent as mutual funds**
  – 408(b)(2) Covered Service Provider Disclosure
    • Provides the covered service provider 408(b)(2) disclosure
    • Easy to read and understand
  – 404(a)(5) Participant Disclosure
    • Provides full 404(a)(5) support
    • Some providers offer 404(a)(5) data files to third parties
    • Some providers offer 404(a)(5) compliant participant fact/data sheets
  – Schedule C Form 5500 Compensation Disclosure
    • Provides assistance with form 5500 Schedule C through disclosure of all
direct and indirect expenses
Common Myths and the Facts

- **Myth:** Third party data providers don’t have information used to monitor and analyze CITs
  - The gap is closing between data support for mutual funds and CITs
  - Since 2006 Morningstar has increased the number of CITs it tracks by 55%
  - More third-party providers and plan consultants are creating and maintaining robust CIT databases
    - eVestment
    - Callan
    - Cambridge
    - Rogers Casey
    - Zephyr
    - Other institutional databases
How does a CIT stack up to a mutual fund?

<table>
<thead>
<tr>
<th>Feature</th>
<th>Collective Investment Trust</th>
<th>Mutual Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fee Flexibility</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Transparency of Holdings</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Monthly Portfolio Holdings available online</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Institutional Quality Quarterly Reports</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Online Account Web Access</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Daily Priced/Traded</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Traded on NSCC Fund/SERV® Platform</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Fee Transparency</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Comply with DOL 5500 Reporting</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment Guideline Transparency</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Detailed Investment Guidelines</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monthly Portfolio Characteristics</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Quarterly Fund Fact Sheet</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Investor Familiarity</td>
<td>Maybe</td>
<td>Yes</td>
</tr>
<tr>
<td>Investor Limitation</td>
<td>Qualified Retirement Plans Only</td>
<td>Open to all investors</td>
</tr>
</tbody>
</table>

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Why use collective investment trusts?
Top 5 reasons
Top 5 reasons for qualified plans to use collective investment trusts

1. Low Cost
   - May be less expensive than institutional share class of mutual funds
   - Typically have lower compliance, administration, marketing and distribution costs
   - Cost savings associated with a CIT are passed on to plan sponsors and participants

2. Customized Fees & Optional Revenue Sharing
   - CITs offer more pricing flexibility
   - Share classes may be available with zero revenue sharing and others with multiple levels of revenue sharing
   - Customizable fees can be negotiated for larger plans with economies of scale
   - Share classes available where all fees and expenses are netted from the daily traded net asset value (NAV)
## Top 5 reasons for qualified plans to use collective investment trusts

<table>
<thead>
<tr>
<th></th>
<th>Efficiencies</th>
<th></th>
<th>Speed to Market</th>
<th></th>
<th>Flexible Investment Strategies</th>
</tr>
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<tbody>
<tr>
<td>3</td>
<td></td>
<td></td>
<td></td>
<td>4</td>
<td></td>
</tr>
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<td></td>
<td><strong>Flexible Investment Strategies</strong></td>
</tr>
<tr>
<td></td>
<td>- Exclusive to qualified retirement plan investors — performance issues due to retail cash flows is mitigated</td>
<td></td>
<td>- Portfolio manager has more flexibility to fully implement the strategy</td>
<td></td>
<td>- Act as an underlying sleeve in TDFs due to lower cost and ability to customize the management fees outside of the fund — no “double layer” of fees to participants</td>
</tr>
<tr>
<td></td>
<td>- Sub-custodian, futures and derivatives agreements contracted by the trustee and fund — not the plan</td>
<td></td>
<td>- Not subject to lengthy registration process required under 40 Act</td>
<td></td>
<td>- Access to alternatives—can fully implement strategies and are not restricted by retail guidelines such as limitations on leverage and use of derivatives</td>
</tr>
</tbody>
</table>
Summary

• What you should remember about CITs
  – CITs are available only for qualified retirement plan investors
  – A wide range of strategies are offered now, not just stable value
  – The majority of CITs are daily valued and daily traded
  – Costs for CITs are equal to or lower than mutual funds
  – Fees can be customized to fit plan needs
  – Robust reporting is available on most CITs
  – CITs are regulated and comply with ERISA and various disclosure requirements
Questions?

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