Collective Investment Trusts (CITs)

Use of CITs is increasingly common among defined contribution (DC) plans… and for good reason.

This material is presented in collaboration with Franklin Templeton Investments.

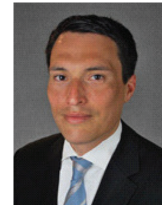
Key Points

- *CITs are specifically designed for use within defined contribution plans and can generally be offered at a lower cost than comparable mutual funds.*
- *In addition to lower overall median investment management fees, CITs also offer greater fee clarity than many mutual funds, potentially reducing burdens of fiduciary oversight.*
- *Unlike mutual funds, CITs are specifically managed to comply with ERISA fiduciary standards. CITs are also subject to various federal and state regulations, including oversight by the Department of Labor (DOL) and the Office of the Comptroller of the Currency (OCC).*
- *CITs can provide multi-manager capabilities, bringing institutional-style capabilities to a larger audience.*

Yaqub Ahmed

Senior Vice President,
Head of Defined Contribution

Franklin Templeton Investments



Rob Barnett

Administrative Vice President,
Head of Retirement Sales

Wilmington Trust, N.A.

In recent years, Collective Investment Trusts (CITs) have gained substantial traction among DC plans. As pooled investment vehicles similar to mutual funds or separately managed accounts, CITs offer a comparable investor experience. However, CITs can provide additional advantages due to their specific design for use within qualified retirement plans (e.g. 401(k) and 457 plans).

Here are six reasons why you should consider using CITs, if you aren't already doing so.

1. **Demand for CITs has increased.**
2. **CITs are subject to robust regulatory oversight.**
3. **CITs often feature lower operating expenses than mutual funds.**
4. **CITs offer greater fee clarity than many mutual funds.**
5. **CITs can provide institutional-style, multi-manager capabilities.**
6. **CITs provide transparency and convenience for DC plan participants.**

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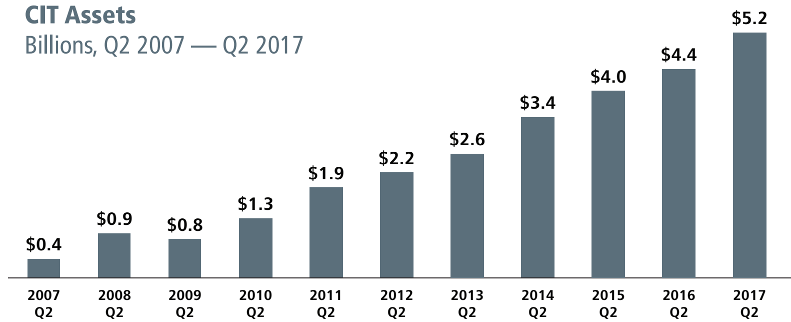
1. Demand for CITs has increased

Assets invested in CITs have grown alongside the increasing importance of DC plans as the predominant savings vehicle for many American households. As of 2016, 65% of DC plans offered a CIT within their investment option line-up[1] and overall CIT assets stand at $5.2 billion as of June 30, 2017[2].



Source: Morningstar

2. CITs are subject to robust regulatory oversight

As purpose-built qualified retirement plan investments, CITs are subject to oversight by the Department of Labor (DOL) and compliance with Employee Retirement Income Security Act (ERISA) fiduciary standards. In addition, because they are sponsored by banks and trust companies, CITs are further regulated by the Office of the Comptroller of the Currency (OCC), under the U.S. Department of the Treasury. CITs must also meet requirements set forth by IRS Revenue Ruling 2011-01 to qualify for U.S. tax exemption. This robust combination of oversight—versus singular oversight by the Securities and Exchange Commission (SEC)—is in place to best protect retirement plans and their participants.

3. CITs often feature lower operating expenses than mutual funds

Despite their widespread use and availability, mutual funds are not necessarily an ideal match for DC plans in all circumstances. Given their widespread distribution in retail markets—among everyday investors, shorter-term "traders," as well as within retirement plans—mutual funds can be subject to additional costs versus purpose-built CITs. Volatile inflows and outflows can be a drain on portfolio efficiency and—due to the way mutual fund expenses are accounted—these costs are often distributed evenly among all shareholders.

However, unlike the broader investment market where some investors try to seize momentum opportunities and rotate through “hot” sectors, DC plan investments are generally intended to be longer term. By restricting availability to DC plans, CIT providers can reduce transaction costs and liquidity drag associated with higher available cash requirements that must be met by many mutual fund managers.

"...the median fee among U.S. Fixed Income focused CITs (35 bps) is 31% lower than the median fee for comparable mutual funds (51 bps)."

In addition, although institutional-focused separately managed accounts (SMAs) can often—but not always—offer lower fees than CITs for comparable investment strategies, research shows the relative fee advantage for SMAs is often relatively small compared to the fee advantage provided by CITs versus mutual funds.

For instance, the median fee among U.S. Fixed Income focused CITs (35 basis points or bps) is 31% lower than the median fee for comparable mutual funds (51 bps). [See chart on next page.]

[1] Source: Callan Associates, 2017 Defined Contribution Trends Survey
[2] Source: Morningstar

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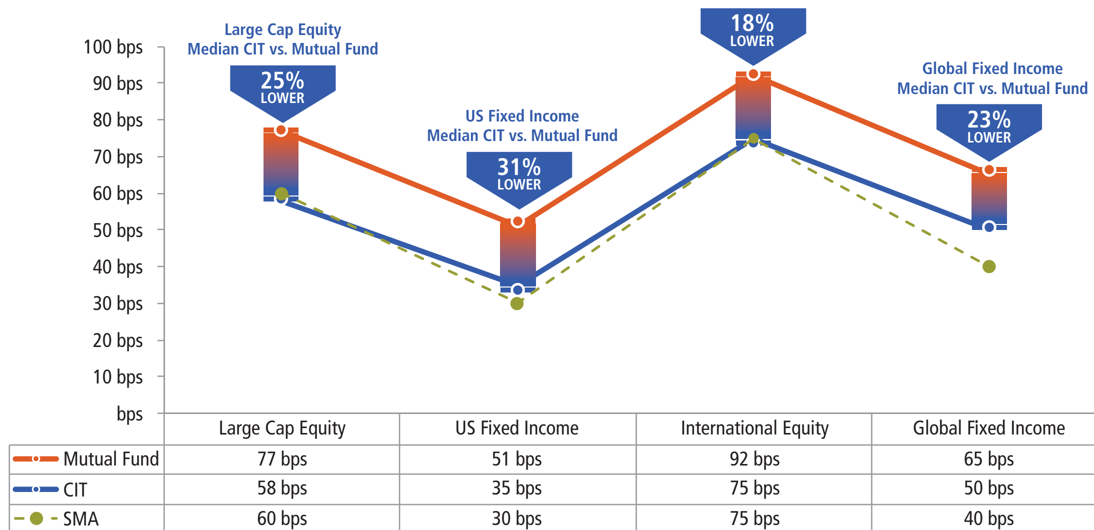
Median Fee Comparison

2017, Mandate size $25M, Sliding Scale



	Large Cap Equity	US Fixed Income	International Equity	Global Fixed Income
Mutual Fund	77 bps	51 bps	92 bps	65 bps
CIT	58 bps	35 bps	75 bps	50 bps
SMA	60 bps	30 bps	75 bps	40 bps

Source: Franklin Templeton, modified from eVestment.

4. CITs offer greater fee clarity than many mutual funds

Critics of the DC system have pointed to opaque fee sharing arrangements between mutual fund providers and plan administrators as potentially in conflict with good fiduciary practice. While often highlighted as a fundamentally flawed approach, in truth, shareholder servicing fees paid from mutual fund providers to plan administrators can be a way to refund fees for some services—for example, mutual fund marketing and transfer agency expenses—for which DC plans may already pay their plan administrator or simply do not apply in a qualified plan context.

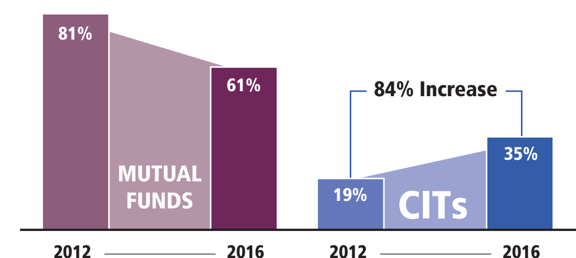
Nevertheless, plan fiduciaries have a continual responsibility to monitor all plan expenses, and the increased complexity of shareholder servicing arrangements can make it more difficult to ensure that these remunerations are appropriate and complete. Because CITs are distributed exclusively within qualified plans, there is no need for revenue exchanges or refunds between investment providers and plan administrators. The CIT simply charges a straightforward percentage fee for trusteeship, administrative, and investment management services.

5. CITs can provide institutional-style, multi-manager capabilities

While many CITs are organized to provide exposure to a single asset class and may share investment managers with similarly-labelled mutual funds, CITs can also be structured to accommodate multiple sub-advisors.

In so doing, CIT providers can assign different sub-advisors to manage single asset classes within multi-asset CITs. This is of particular interest in the construction of "open architecture" target date investments, allowing seasoned investment managers to provide focused expertise rather than taking responsibility for the management of all asset classes within the target date investment. Due in part to this flexibility, the use of target date CITs grew 84% between 2012 and 2016, whereas the use of mutual fund target date funds dropped by 25% during the same period.

Market Share of Target Date Solutions



Source: Morningstar Direct, Strategic Insight Simfund

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Multi-manager CITs also make it possible to combine the skills of different sub-advisors to manage single asset class CITs, with each providing a discrete investment style. This can include a combination of value-oriented and growth-oriented strategies or even a mix of active and passive management strategies within, for example, a single large-cap equity CIT. The appeal of this approach is to simplify a DC plan's investment menu, and make it easier for participants to get exposure to a diversified mix of investment strategies within a single allocation.

6. CITs provide transparency and convenience for DC plan participants

Long ago, when daily valuation of DC plan assets was a new phenomenon, CITs were valued infrequently (typically only once per calendar quarter) and provided investors little access to portfolio and performance data.

Today, CITs are valued daily, traded via the National Securities Clearing Corporation (NSCC), and are available for back office processing through Fund/SERV, just like mutual funds. Moreover, CIT portfolio data is typically available through both quarterly fact sheets and third-party services like Morningstar.

With the increased transparency of modern CITs, participants generally may not be concerned with the legal technicalities that differentiate CITs and mutual funds. However, they will appreciate the potential reduction in investment expenses and consequent boost in investment performance.

Basic comparison summary

CIT Attributes	Shared Attributes	Mutual Fund Attributes
• CITs are specifically designed for DC plans	• Both are daily valued, pooled vehicles	• Mutual funds are open to investment from all investors
• CITs are held to ERISA standards and bank-regulated	• Both are NSCC traded, facilitating recordkeeping and administration	• No ERISA standards apply to mutual funds; SEC regulated
• CITs generally feature lower expenses and pricing flexibility	• Both feature fund documentation, factsheets • Third-party services (including Morningstar) offer CIT databases	• Mutual funds generally feature higher expenses and no pricing flexibility

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Franklin Templeton Investments

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For additional information, please contact a Franklin Templeton DC Specialist at 800.530.2432.

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