



Investor Education

Investment Products & Strategies

UNDERSTANDING

COLLECTIVE

INVESTMENT TRUSTS

Collective Investment Trusts (CITs) offer similar benefits to mutual funds at generally lower costs, making them an attractive option for plan sponsors to consider in carrying out their fiduciary responsibilities.

An increase in interest rates will reduce the value of fixed income securities.

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

THE BASICS

A CIT is a tax-exempt, pooled investment vehicle maintained by a bank or trust company.



Total assets in CITs are now at approximately **\$2.8 trillion**.¹

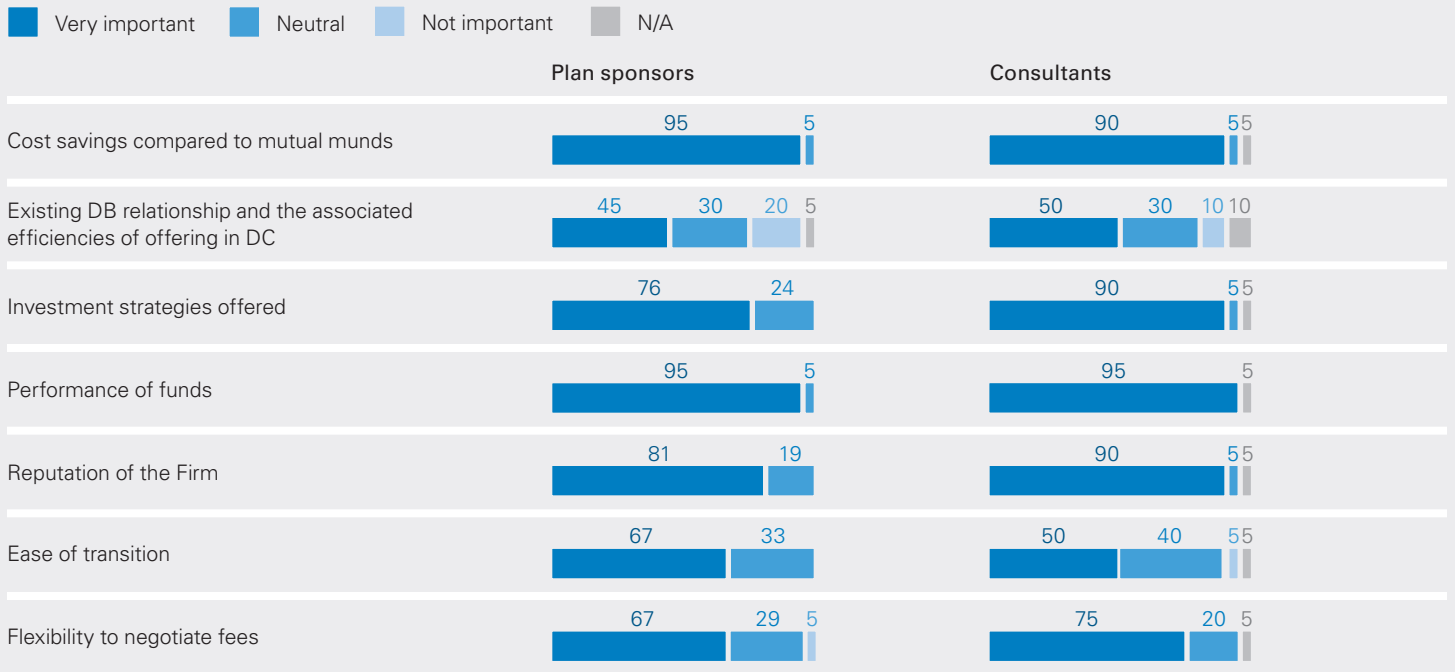
48% of large plan sponsors believe that CITs offer the best opportunity for growth.²

CITs were historically designed as investment vehicles for defined benefit plans. But they have evolved over the years. Today, CITs have become a popular choice of defined contribution (DC) plan sponsors. They are available for investment only by ERISA retirement plans and certain other types of governmental retirement plans.

The primary reason why CITs have become popular: CITs are generally less expensive than mutual funds.

Because investment-related fees and expenses are generally the most significant costs for many retirement plans, plan sponsors recognize that cost-effective investment vehicles such as CITs can mean sizable savings for their plans and their plan participants.

Importance of CIT attributes by industry participants, 2017 (%)²



Approximately 90% of consultants and 95% of plan sponsors believe the cost savings compared to mutual funds are very important attributes of CITs.

¹ The Cerulli Report "North American Institutional Markets 2017." Total Collective Investment Trust Assets and Growth, 2011-2016.

² The Cerulli Report "North American Institutional Markets 2017." Asset Managers: Importance of CIT Attributes by Industry Participant, 2017.

COMPARISONS

CITs share some similarities with mutual funds but are also different in several meaningful ways that may be important considerations for a plan sponsor when deciding whether to choose a CIT or a mutual fund for its plan’s menu of investment options.



	CITs	Mutual Funds
Operating costs	Generally lower operating costs (regulatory, administrative, distribution, marketing fees)	Generally higher operating costs (regulatory, administrative, distribution, marketing fees)
Fee structure	Flexible unit class fee structures (investment management fees can be different for different unit classes of the same CIT)	Many funds have shares classes with different fee and expense structures but investment management fees must be the same across different share classes of the same fund
Investment options	Wide range of investment choices	Wide range of investment choices
Sponsor	Offered by bank or trust company to qualified retirement plans; not available for investment by general public (retail)	Offered directly or through financial intermediaries (i.e., broker-dealers, insurance companies, banks, etc.) to public (retail), as well as institutions
Eligible investors	Eligible trusts: tax-qualified plans under Internal Revenue Code of 1986 (Code), Section 401 (corporate, Keogh [Rule 180], Taft-Hartley); eligible government plans described in Code and Securities Act of 1933, Section 3 (a)(2); other group trusts or insurance company separate accounts that consist solely of Code Section 401 plans and eligible governmental plans Generally not eligible to participate: IRAs, 403(b) plans, Church plans not qualified under Code Section 401	No limitations, subject to prospectus criteria and requirements
Investment management governance	Managed by investment managers retained by CIT trustee, subject to such trustee’s supervision and oversight	Managed by investment managers approved by a fund’s board of directors, subject to the board of directors’ supervision and oversight
Regulatory oversight	Subject to ERISA and Department of Labor (DOL) regulations and state or federal banking regulations	Subject to securities laws and regulations, including registration with the SEC
Application of ERISA	Fund assets considered “plan assets” under ERISA — subject to transaction provisions of IRC Section 4975	Fund assets not “plan assets” under ERISA
Trade settlement	FUND/SERV	FUND/SERV
Marketing limitations	Not registered under Securities Act; anti-fraud restrictions apply; marketing to eligible plan sponsors	Registered under the Securities Act of 1933. Marketing and distribution subject to FINRA requirements
Regulatory documents	Declaration of Trust and Investment Policy Statement or similar trust documentation that govern the operations and investments of a CIT; no obligation to file with a banking regulator on a regular basis	Prospectus and Statement of Additional Information (SAI), which are updated and filed with the SEC on a regular basis, govern the operations and investments of a mutual fund
Holdings information	Performance and holdings information available to plan sponsors and, in many cases, publicly on a periodic basis through website postings	Performance and holdings information publicly available and filed with the SEC, typically on a periodic basis depending on the type of fund

POTENTIAL COSTS AND BENEFITS

Typically, the fees and expenses of a CIT are lower than those of comparable mutual funds, making it an attractive alternative for plan investors.



20-25 bps

On average, CIT fees can be 20 to 25 basis points lower than mutual fund fees.⁵

Example of Mutual Fund Fees vs. CIT Fees

When a large plan and a small retail investor invest in the same mutual fund, they're both subject to the same investment management fee — even if they are investing in different share classes.⁶

However, a CIT can offer multiple classes of unit ownership⁷ subject to different investment management fees. This means that a retirement plan that is eligible to invest in a less expensive unit class — such as a large plan that is able to satisfy the investment minimum for a less expensive unit class — may be able to take advantage of lower CIT expense ratios.

One can easily see why CITs are generally more cost-effective than mutual funds.

CITs' regulatory costs are lower, because they are not subject to the extensive registration, operational, disclosure and reporting requirements of federal and state securities laws and regulations or oversight by the SEC.

Unlike mutual funds, CITs and their trustees are subject to the oversight of state banking regulators or the Office of the Comptroller of the Currency (OCC), with substantially less burdensome regulatory, operational, reporting and disclosure requirements and obligations than those applicable to mutual funds.³

Administrative, distribution and marketing costs are typically lower, too. Since CITs are offered only to retirement plans and cannot be sold to individual retail investors, they are subjected to fairly limited advertising or distribution expenses in comparison to certain classes of mutual funds.

Fees are more flexible

Simply put, CITs have greater fee flexibility than mutual funds. When a mutual fund offers multiple share classes, SEC rules dictate that the same investment management fee be charged with respect to all share classes of the fund.⁴

Not so with CITs. Many CITs offer unit classes with different investment management fees associated with each unit class typically based on the investment amount. This allows CITs to offer different pricing to retirement plans on the basis of the amount of assets that such plans invest or plan to invest in the CIT.

³ Under Section 9.18 of OCC regulations, national banks must prepare annual reports for their CITs based on audited financial statements. State-chartered banks are subject to similar reporting requirements under state law.

⁴ Rule 18f-3 under the Investment Company Act of 1940.

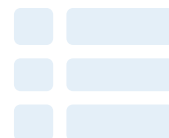
⁵ Source: "Institutional Markets," Cerulli Associates, 2014.

⁶ Although the management fee generally must be the same, different mutual fund share classes may be paying different amounts for class-specific distribution- and service-related expenses as provided under Rule 18f-3.

⁷ Ownership interests in CITs are customarily referred to as "units," rather than "shares."

INVESTMENT CHOICES

Like mutual funds, CITs may invest in a wide range of instruments and securities.



CITs may invest in the same types of instruments and securities as mutual funds, subject to their stated mandates and requirements and limitations in the governing documents. They can invest in multiple types of assets — including stocks, bonds, actively and passively managed funds and ETFs, REITs, derivatives, etc. — often as a family of CITs that offers different investment strategies and styles for investment.

CITs combine assets from eligible retirement plan investors into a single investment pool (or “fund”) with a specific investment strategy. These assets may be managed by multiple managers, who act as subadvisors to the CITs’ trustees, who have been chosen based on their specialized investment expertise. In managing the CITs, subject to some limited exceptions, such as investments that may generate Unrelated Business Taxable Income (UBTI), investment managers do not need to be concerned with the tax consequences of the CITs’ trading activities, because CITs are tax-exempt.

Valued and traded on a daily basis, CITs are accessible through 401(k) record-keeping platforms.

EXPLORING FIDUCIARY RESPONSIBILITIES

Plan sponsors have an ERISA-dictated fiduciary obligation to offer reasonably priced investment alternatives. Exploring the possibility of including CITs on a plan's menu of investment options may help satisfy this requirement.



Important note

CITs must follow ERISA regulations and are subject to the DOL rules. Under ERISA, plans must disclose their investments in CITs on their form 5500s and participants must receive, at least quarterly, statements and information about their investments, including their investments in the CITs, if any.

Since CITs are generally less expensive than mutual funds and typically offer unit classes with different pricing options depending on the amount of investment, plan sponsors may be able to significantly reduce and mitigate their fiduciary risk by exploring the possibility of including CITs on their plans' menu of investment options.

Under ERISA rules, plan sponsors must offer investors reasonably priced investment alternatives. A plan sponsor who prudently looks into CITs as a potential investment option for plan participants can help demonstrate that it is acting with the appropriate level of care. That can offer valuable protection from a fiduciary liability perspective, even if the plan sponsor ultimately decides against making the CITs available in its plan.

Of course, while CITs may offer attractive pricing, plan sponsors should consider a wide range of other factors in addition to fees and expenses in deciding what types of vehicles to make available for investment by their plan participants.

Available only from banks and trust companies

Only banks and trust companies may sponsor and maintain CITs and, as such, act as CIT trustees, including choosing and monitoring the CIT's subadvisors. Each CIT is managed and operated according to its trust's governing documents.

IMPORTANT NOTES

Although CITs offer many advantages over mutual funds, plan sponsors should also consider potential advantages of mutual funds over CITs.



Because CITs are not subject to the numerous reporting and disclosure requirements applicable to mutual funds, more public information is generally available for mutual funds, resulting in greater transparency for mutual fund investors.

Plan participants may also be less familiar with CITs, which are not available for investment by individual retail investors.

Furthermore, plan participants who take rollover distributions generally lose access to the plan's CITs, because CITs are not available to retail investors, including those investing through rollover IRAs. However, their rollover IRAs may be able to access mutual funds that are advised by the same investment managers.

In light of these potential comparative advantages for mutual funds, when evaluating CITs, plan sponsors may wish to consider CITs advised by investment managers that also advise well-established mutual funds.

Because mutual funds managed by these managers would be subject to SEC reporting and disclosure requirements, additional information about the funds and their investments and operations as well as the managers themselves would be publicly available, increasing transparency.

What plan sponsors may want to consider

If a retirement plan is currently using mutual funds as an investment option, consider whether more favorably priced CITs with comparable investment strategies are available.

When considering different CITs, consider choosing those that are advised by investment managers that also manage well-established mutual funds.


If plan sponsors need assistance with this type of due diligence, it may benefit them to work with a qualified financial advisor to help them make an informed decision.

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Clarion Partners
ClearBridge Investments
EnTrustPermal
Martin Currie
QS Investors
RARE Infrastructure
Royce & Associates
Western Asset

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Where can I find more information?

History tends to repeat itself. Legg Mason seeks to ensure that your portfolio can withstand and recover from the inevitability of market corrections and portfolio losses, with a balance of strategies that addresses your need for portfolio growth, income, capital appreciation and risk management. Talk to your financial advisor today about the right investing strategy for your situation.

What should I know before investing?

An investor's individual circumstances, long-term investment goals and risk tolerance — and especially if the investor falls between two retirement years — should all be carefully considered. These and other factors, as well as a fund's risks, should be discussed with an investor's financial professional.

Past performance is no guarantee of future results.

Legg Mason affiliated managers subadvise a number of Collective Investment Trusts created and managed by a third-party trust company.

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