

DC Insights

What's behind your collective trust fund?

Collective trust funds are more than investment objectives and portfolio results. They are complex vehicles which require a strong operational backbone to function seamlessly, particularly in defined contribution plans. As a collective trust leader, we felt compelled to document our practices, our industry observations, and our experience with these DC funds. What follows is a review of our recently published piece, *Collective trust funds: A practice guide for defined contribution plans*.

Interest in collective trusts by the defined contribution (DC) industry is booming. Recent data from the National Securities Clearing Corporation (NSCC), the clearinghouse for daily valued, pooled vehicles, shows a dramatic rise in collective trusts trading volume, and experts predict it will only increase. Plan sponsors have historically been drawn to collective trusts' attractive and flexible fee structure, and have typically offered these investment vehicles through their stable value option. However, recent fee regulation and litigation have made collective trusts even more attractive for all asset classes of DC plans.

Collective trusts are pooled investment vehicles offered by a bank or a trust company and are available to qualified plans, such as 401(k) plans and certain governmental plans, including 457(b) plans. They are not available to retail investors. They fit well into many DC plans with benefits that include: competitive and generally transparent costs, tighter investment guidelines, flexible fee arrangements for recordkeeping offsets or pass-throughs, the ability to lower fees as assets rise, and an operational similarity to daily valued mutual funds, with seamless integration with DC recordkeepers and platforms.

Capital Guardian started its first collective trust more than 30 years ago and has been offering them in daily valued form since 1993. Naturally, we have been watching the dramatic rise in DC collective trust activity with interest, and believe this movement is warranted. However, we think it is important plan sponsors understand that not all collective trusts are created equally. We can tell you from experience that they need to be well researched from both an investment and operational standpoint to ensure they are suitable for a DC plan. Thus in September 2008 we released *Collective trust funds: A practice guide for defined contribution plans*. It offers a timely look at our thoughts.

In this guide, we look at 12 important elements that contribute to the success of collective trusts as well as several developing regulatory items that may impact these investment vehicles and DC plans in the future. A full list of topics covered in the guide is available on Capital Guardian's DC website (www.capitalguardian.com/definedcontribution). Copies of the guide can be obtained through your Capital Guardian relationship manager.

Four questions to ask your collective trust provider

How are fees charged?

Fees are a top concern in the DC industry, and are one of the main drivers behind the interest in collective trusts. It is important to become aware of the variety of possible fee arrangements and their potential impact on the overall structure of a DC plan.

Capital Guardian offers unit class structures that provide plans with flexible pricing arrangements and fee structures to best meet your needs. We offer four standard vehicles with flat management and operating fees but with varying levels of third-party pass-throughs at 0, 10, 15, 25 basis points. This system operates very much like a mutual fund with all management, custody and trustee fees and expenses charged directly to the fund, with a daily NAV net of all fees.

We also offer collective trust funds with tiered fee schedules, in which management fees fall as a client's assets rise. In order to support fee levels of different clients, management fees are charged outside the fund. This type of collective trust allows for fee aggregation based on the total assets invested with Capital Guardian, not just one specific mandate. Creating a daily valued, net-of-fee vehicle does require daily reunitization by an outside custodian or trustee; however, management costs can be driven down with a larger asset base.

How do participants get fund information?

Traditionally, the availability of fund information for participants was a drawback for collective trusts. Today, collective trusts can use CUSIP numbers as unique identifiers, allowing standardized and efficient sharing of data, which can be accessed in quarterly statements and online. These enhancements and advances in collective trusts enable the timely delivery of comprehensive data to the recordkeeper, which can then be easily delivered to participants.

Standard collective trust fund

Recordkeeper pass-through
(option of 0, 10, 15, 25 bps)

Investment management fees
and operating expenses

Daily NAV

- Daily NAV is net of fees and expenses — all fees accrued within NAV
- Constant expense ratio (including operational and investment management fees) regardless of account size
- Four different unit classes available
- CUSIP assigned to each unit class
- A structure that is similar to a mutual fund with share classes

Tiered-fee collective trust fund

Recordkeeper or other service
fees (optional)

Not built into offering
by Capital Guardian

+

Investment management fees

Tiered and charged
outside NAV

+

Operating expenses

Daily NAV

- Capital Guardian does not offer recordkeeper pass-through fees built into this vehicle
- Custodian/trustee can include specified recordkeeper or other service fees if re-unitizing NAV

At Capital Guardian, we work closely with recordkeepers to deliver comprehensive, timely and accurate data about our investment strategies through quarterly fact sheets, electronic delivery of collective trust data, and population of commonly used external data services. Recordkeepers can easily filter our information into a plan's web-based benefits page, fact sheets or other materials for access by plan participants.

Is the fund set up for automated trading?

Collective trusts trading via the NSCC — the main provider of centralized information services and money settlement for mutual funds — gain simplified and automated processes, reduce time, costs and risk. Without NSCC trading, funds must trade manually. NSCC trading helps to consolidate communication, and centralizes and facilitates money settlement. As a member of NSCC, Capital Guardian is able to assign CUSIPs to all of our collective trust funds. We think NSCC trading is imperative for any collective trust provider.

What is the fund's frequent trading policy?

Collective trusts are not mandated by a regulatory or governing body that might impose specific measures to prevent frequent trading.

At Capital Guardian we believe in protecting shareholders as long-term investors. Through our frequent-trading policy, we take steps to curb trading behavior that may be disruptive to the fund and that may disadvantage participants. We actively survey for frequent entries and withdrawals in fund units at the plan level, and work with recordkeepers to implement our policies at the participant level. In addition to our standard frequent-trading policy, we can also work with a plan sponsor to develop a policy to meet their needs.

Worth the research

The appeal and success of collective trust funds in a defined contribution setting makes sense: collective trusts have competitive and flexible fee arrangements and are well suited for today's highly scrutinized marketplace. However, it is important to recognize the differences that may exist between these investment vehicles and then gauge the impact these differences can have on plans and their participants. We encourage you to consider these areas when evaluating your current plans and before selecting future collective trusts. Please ask your relationship manager for a copy of *Collective trust funds: A practice guide for defined contribution plans* or go to www.capitalguardian.com/definedcontribution for more information. ■

This discussion focuses on collective trusts designed for use by U.S. retirement plans.

The statements expressed herein are informed opinions, are as of the date noted, and are subject to change at any time based on market or other conditions. This publication is intended merely to highlight issues and is not intended to be comprehensive or to provide advice.