Primer on Bank Collective Funds

Investors, especially institutional investors, have a substantial number of investment options available to them. In addition to deciding what asset class to invest in (equities, bonds, commodities), an investor must choose the investment managers (investment advisers, banks or insurance companies) and the form of the investment. The form of investment can be a bank-maintained collective investment fund, a registered investment company (mutual funds or exchange-traded funds), an unregistered private fund, or a separately managed account. Investors typically consider cost and flexibility when deciding on the form of the investment.

Bank collective investment funds (CIFs or collective funds) are specifically designed under banking and tax laws for qualified tax-exempt retirement plans and are not offered to the retail market. Retirement plan sponsors and their record keepers are increasingly choosing these funds, because CIFs are less costly and offer more investment options for 401(k) and similar defined contribution plans that can be specifically customized.

What are Bank Collective Investment Funds?
Collective investment funds are bank-maintained trusts that combine and collectively invest the assets of multiple qualified tax-exempt retirement plans. CIFs are highly regulated under several regulatory and statutory regimes, including federal or state banking laws and regulations, and the Employee Retirement Income Security Act of 1974 (ERISA). CIFs must also comply with federal tax laws that limit the eligible investors to U.S. tax-qualified retirement plans and U.S. governmental retirement plans. In addition, CIFs must meet specific bank management standards and investor eligibility restrictions to qualify for securities law exemptions.

Many banks offer CIFs in a wide range of asset classes and types, including domestic equity, international equity, domestic fixed income, international fixed income, stock/bond blend, target date funds, and short term investment funds. Banks may offer CIFs as passively managed (indexed) or actively managed funds. Because of the investor eligibility restrictions, banks market CIFs to a focused segment of institutional investors (i.e., employers, plan sponsors and fiduciaries, and their record keepers) rather than to the retail public.
In the CIF, the bank acts as both trustee/fiduciary and manager, holding legal title to the assets within the trust. The participating retirement plans are the beneficial owners of units of the CIF, holding an undivided interest in the total assets of the CIF. Fiduciary standards are established by common law on trusts, federal and state banking laws, and ERISA.

**How Are Collective Funds Subject to Regulatory Oversight?**

Banks and their CIFs are subject to examination and oversight by federal and state banking regulators. Depending on the bank’s charter, the regulator could be one or more of the following: the Office of the Comptroller of the Currency; the Federal Reserve Board; the Federal Deposit Insurance Corporation; or a state banking regulator.

Bank regulators conduct periodic on-site examinations, during which they review and test bank policies, procedures, systems, and risk management, as well as an institution’s compliance with the applicable banking and other regulations and laws governing its trust activities, including the management of its CIFs.

**How Do the Securities Laws and ERISA Apply to Collective Funds?**

In recognition of the existing comprehensive banking regulatory framework under which banks and their CIFs had been supervised and examined since the first CIF was established in 1927, Congress exempted bank-managed collective investment funds from registration under the Investment Company Act of 1940 and further defined interests in CIFs as “exempt securities” under the Securities Act of 1933 and the Securities Exchange Act of 1934. Congress has repeatedly recognized the fact that, unlike mutual funds, CIFs are not offered to the retail public, but are only available to investors who have a trust, custody, investment management, or agency relationship with the bank. Although interests in CIFs are exempt from registration under federal securities laws, they are still subject to broad securities law anti-fraud requirements.

The assets in CIFs are considered retirement plan assets, and therefore are subject to the requirements of ERISA. The bank as trustee and manager of the CIF is a fiduciary under ERISA and subject to ERISA’s comprehensive set of fiduciary requirements including the prohibitions
on self-dealing and conflicts of interest. Bank regulators examine CIFs for compliance with ERISA and other fiduciary rules and look closely at decisions where potential conflicts could arise. The Department of Labor (DOL) may also conduct reviews of banks and their CIFs for ERISA compliance. In contrast, retirement assets invested in mutual funds are not considered “plan assets” under ERISA, and the investment adviser to a mutual fund is not an ERISA fiduciary.

**What are the Key Regulatory Requirements for Collective Funds?**

*The Collective Fund Trust’s Written Plan*

Banking regulations require collective investment fund trusts to be established through a written plan that must include provisions on the bank’s operation of the fund, including the bank’s investment powers and policies, fee and expense information, the fund’s allocation of income, profits and losses, and the terms and conditions governing admission and withdrawal of participating accounts, among other things. A bank must make this information available to CIF participating accounts or trusts, its beneficial owners, upon request.

*Valuation of Assets and Annual Audits*

For CIFs that are used for 401(k) plans or that participate in the National Securities Clearing Corporation’s trading system, valuations are generally done on a daily basis so participant orders can be processed daily. Banking regulations require that CIFs be subject to an annual audit conducted by an independent auditor who is selected by the Board of Directors of the bank. The CIF’s annual audited financial statements contain a list of investments in the fund showing the cost and current market value of each investment.

*Why Are Collective Fund Expenses Comparatively Low?*

Pooling of assets typically lowers the operational and administrative expenses of investment management. CIFs have lower costs than mutual funds because they do not incur the costs associated with retail investment offerings, such as retail distribution and advertising. Further, the flexibility that CIFs have in how they charge investment management fees permits more tailoring of investment fees paid by CIF participants, often resulting in a lower cost for all. Similarly, CIFs have more flexibility than mutual funds in establishing recordkeeping and other
service arrangements and fees, which gives the plans greater ability to customize plan participant recordkeeping arrangements and fees.

**What Fee Structures Do Collective Funds Employ?**

Banking regulations and tax rules allow CIFs to vary the advisory fees charged to different retirement plans in the same CIF so long as the fee is reasonable based on the services provided. For example, banks may impose advisory or other types of fees, such as recordkeeping, at the CIF level or by plan at the plan account level. This greater flexibility and customization on a plan-by-plan basis helps keep the fees competitively low. Whether the fees are charged at the CIF level or plan level, the fees are transparent to retirement plan sponsors. In addition, when fees are charged at the plan level, the plan sponsor has the flexibility to decide whether to subsidize some or all of the costs or have the plan participants pay for them.

**What Disclosures Are Provided by Collective Funds?**

Various disclosures made available to retirement plan sponsors include the CIF written plan and any material updates to it, the annual audited financial statements for the CIF, and any other reports as agreed between the bank and the sponsor. The CIF manager also provides plan sponsors with information about the particular investment strategy, including investment guidelines and investment performance. In addition, ERISA regulations require the disclosure of detailed information on fees and expenses of the CIF, as well as the compensation of the CIF trustee.

The plan sponsor, administrator, or record keeper can customize this information for delivery to plan participants to fit the plan’s and participants’ particular needs and cost structure. For example, this information may be delivered in the form of “fund fact sheets,” as part of quarterly plan participant statements, or on a website hosted or maintained by any of the plan’s service providers. Accordingly, this information can be specific to each plan, reflecting the actual, all-in costs to the plan participants (and not just the internal fees and expenses of the CIF or mutual fund).