Defined Contribution
Institutional Investment
Association

Multi-Asset, Multi-Manager, and White Label Investment Options

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Defined Contribution Institutional Investment Association

Multi-Manager Strategies: Decision and Implementation Process

DEFINITIONS

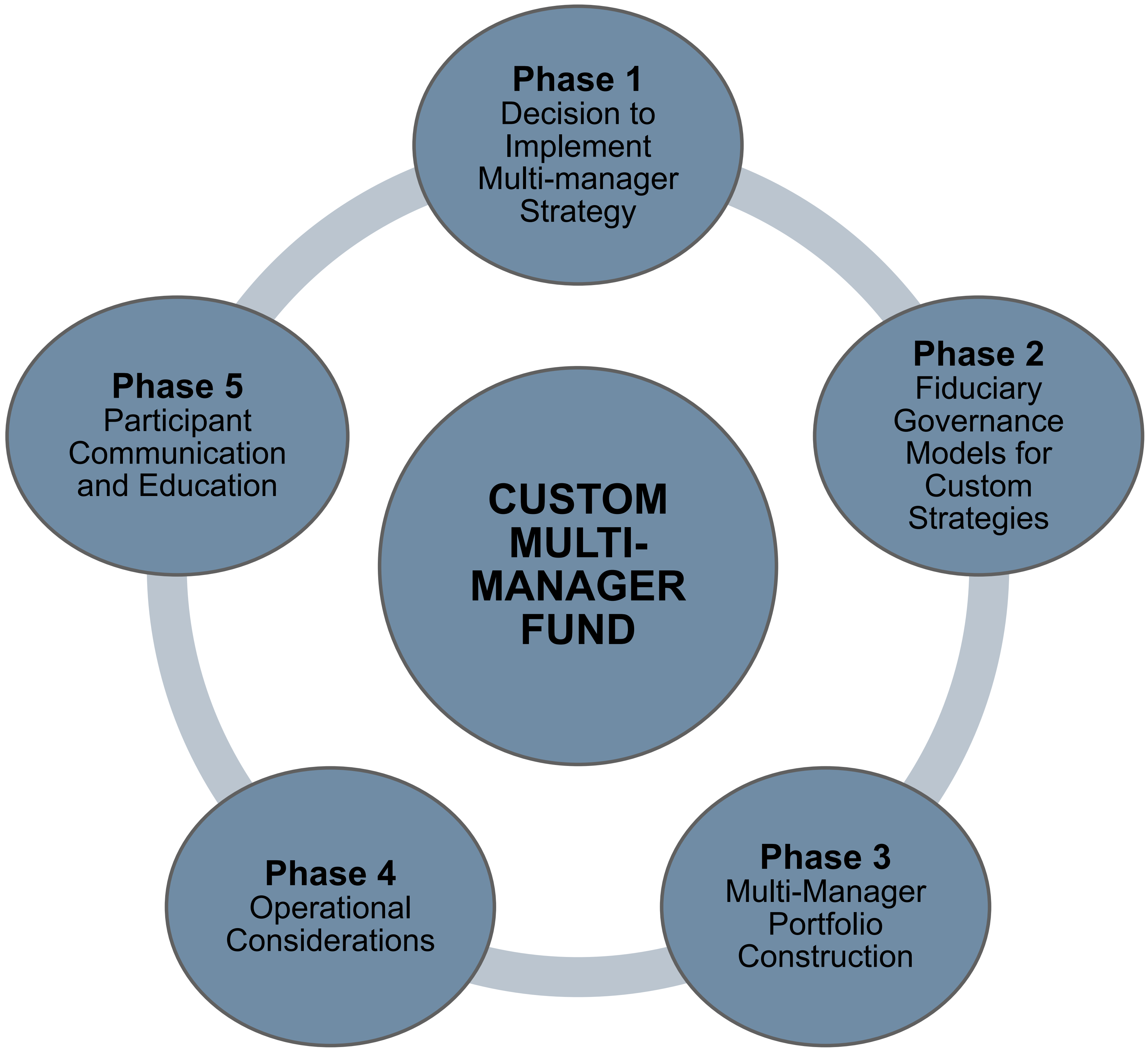
Custom multi-manager option

- Built with two or more underlying portfolios
- Unitized to be a single investment option with a single price (NAV) through a separate account, custom collective trust or custom mutual fund structure
- Underlying portfolios may be a mix of mutual funds, collective investment trusts, and separate accounts
- Plan Sponsor or designated fiduciary manager selects and manages the underlying investment manager portfolios, asset allocation, and rebalancing frequency

Off-the-shelf multi-manager option

- Built with two or more underlying portfolios
- Packaged in a CIT or mutual fund vehicle with a single price (NAV) and offered as a single investment option
- Strategy provider selects underlying portfolios, asset allocation, and rebalancing frequency

Sample Custom Fund Implementation Process



Phase 1 - Decision to Implement Multi-Manager Strategies

Multi-Manager Investment Option Decision: Custom or Off-the-shelf?

Custom Multi-Manager Option:

- Plan sponsor and/or delegated fiduciary manager are responsible for:
  - Portfolio manager or fiduciary manager selection
  - Defining the investment objective for the option
  - Asset allocation
  - Underlying investment manager selection
  - Rebalancing
  - Investment vehicle service provider
  - Custodian
- A more detailed discussion of the duties of the plan sponsor or duties delegated to a fiduciary manager are covered in the following pages

Off-the-shelf Multi-Manager Option:

- Plan sponsor or designee responsible for:
  - Selecting an investment provider that is responsible for asset allocation, manager/strategy selection, and rebalancing
  - Plan sponsor will need to decide whether to white label
  - May not require material changes to IPS or record-keeper processes
- Provide access to a multi-manager solution where there are limited plan assets
- Typically has an existing fund track record
- Off-the-shelf option will have communication and education materials for participants

Phase 1 - Decision to Implement Multi-Manager Funds

Consideration for Custom Multi-Manager Funds

Plan's service providers

- ❑ Can custodian/trustee and record keeper integrate a custom strategy?
- ❑ Will existing agreements need to be amended?
- ❑ Evaluate impact on fees and expenses

Core menu structure

- ❑ Will all or some menu options be multi-manager strategies?
- ❑ How will the options be named?
- ❑ Mapping and black-out dates

Communications and education

- ❑ Initial and ongoing communications
- ❑ Fact sheets, website data availability, performance track records
- ❑ Annual regulatory reporting requirements
- ❑ Evaluate impact on costs

Plan's existing documents

- ❑ Investment Policy Statement
- ❑ Trust documents and/or other governance documents

Fiduciary Assistance for Plan Investment Menu Decision Making – Role of an investment consultant

Advice - A traditional 3(21) investment consultant can advise plans on the construction of a custom approach including asset allocation and investment manager recommendations or recommend off-the-shelf multi-manager options

Delegated Fiduciary Manager - A 3(38) discretionary investment manager has the ability to implement, monitor and replace off-the-shelf multi-manager solutions on a delegated basis for the plan sponsor

Retention of an investment consultant or delegated manager is not mandatory, but is a common practice for plan sponsors.

Phase 2 – Fiduciary Governance Models for Multi-Manager Funds

	Plan Fiduciary	3(21) Consultant	3(38) Delegated Fiduciary	3(38) Off-the-shelf Funds
Selection & Replacement Process	Plan fiduciary responsible	Plan fiduciary is responsible with non-discretionary assistance from consultant	Discretionary manager responsible for decisions and plan sponsor retains responsibility for selecting and monitoring discretionary manager	OTS investment manager is responsible for all underlying manager decisions and plan sponsor retains responsibility for selecting and monitoring OTS manager
Investment Monitoring Process	Typically quarterly	Typically quarterly	Agreed upon by plan fiduciary and delegated fiduciary. Typically daily.	Typically daily
Fiduciary Accountability	Plan fiduciary	Plan Sponsor and Consultant as "co-fiduciaries"	Discretionary Manager. Plan fiduciary has a more limited role	OTS Investment Manager. Plan fiduciary is primarily responsible for the OTS product and its manager
Complexity Level for Plan Fiduciary	High. Do It Yourself, no delegation	Medium. External fiduciary assistance. Plan fiduciary retains decision authority.	Low. Full delegation that may include the use of OTS Funds	Low. Full delegation to OTS fund manager for underlying fund investments

Fiduciary Models – Benefits and Challenges

Plan Fiduciary Builds

- Benefits– plan sponsor controls design, implementation, and monitoring; potential for consistency and scale across various plans
- Challenges–higher level of complexity requiring significant breadth and depth of internal resources, experience, and assets; greater fiduciary responsibility

3(21) Non-discretionary Consultant Assists

- Benefits– consultant can assist with selection of an off-the-shelf strategy or with the creation of a plan fiduciary - built strategy; breadth and depth of consultants' resources, experience, and fiduciary support can be leveraged
- Challenges– final decisions rest with plan fiduciary

3(38) Delegated Fiduciary Manager (custom strategies)

- Benefits– breadth and depth of managers' and plan's resources, experience, and assets can be leveraged; higher level of customization as compared to an off-the-shelf approach; maximized fiduciary support for the plan fiduciary
- Challenges –investment minimums may be high

3(38) Multi-Manager ("off-the-shelf" strategies)

- Benefits– Access to the breadth and depth of managers' resources, experience, and assets; maximized fiduciary support; lower level of complexity for plan fiduciary
- Challenges –low level of customization; legal documents may not be negotiable

Phase 3 – Multi-Manager Portfolio Construction

If selecting an **off-the-shelf** strategy, the strategy provider will be responsible for constructing the portfolio.

If selecting a **custom** implementation, portfolio construction steps may include:

- Defining the investment objective
- Establishing the investment policy
- Permitted asset classes, investment vehicles and strategies
- Asset allocation ranges
- Monitoring and replacement process for underlying managers
- Rebalancing process
- Liquidity management
- Selecting and organizing underlying investment portfolios and managers
- Negotiating and evaluating fees and fee breakpoints

Phase 3 – Multi-Manager Portfolio Construction

Evaluation of Fees

It is important to note that plans need <u>not</u> seek to implement the "lowest cost" option, but rather should make decisions based on the relative value of services provided.

<u>Relevant costs to evaluate may include:</u>

- Record keeping
- Trustee/custodial services
- Consulting
- Communications
- Legal support
- Investment management
- Internal resources and staff
- Performance attribution

Plan sponsors may be able to leverage their size and scale and/or existing relationships to reduce overall fees. Additionally, implementing institutional vehicles may provide potential cost reductions.

Phase 3 – Multi-Manager Portfolio Construction

Rebalancing Methodology

- A custom strategy is rebalanced in accordance with its adopted rebalancing procedures
- Quarterly rebalancing is most common
- Technology is available to automatically rebalance to strategic asset allocation bands
- Asset allocation bands can be set at the asset class and/or investment manager level
  - Establish acceptable “bands” around the desired strategic asset allocation which dictate the point at which rebalancing is desired
    - Example: A Large Cap Equity strategy is 15% large cap momentum growth strategy, rebalancing band of +/- 3% from strategic target

Special Considerations for Multi-Manager strategies that include illiquid assets

- Need to understand liquidity restrictions and costs, such as “gates”, or if daily liquidity is not available
- Liquidity constraints may require broader strategic asset allocation bands
- Consider if illiquidity may trigger redemption “gate” violation resulting in a failed rebalance transaction
- Entry and redemption transaction timing for underlying investments

Phase 4 – Operational Considerations

Comparison of Multi-Manager Packaging

- The majority of custom multi-manager funds are constructed as unitized separate accounts or custom collective investment trusts (CITs).
- Off the shelf funds are typically offered as mutual funds or CITs.
- Unitized separate accounts offer the highest level of customization, but also have the highest level of involvement for the plan fiduciary or their fiduciary designee

Vehicle Type	Unitized Separate Account	CIT	Mutual Fund
Customization	Yes	Not typical	Not typical
Level of Third Party Fiduciary Governance	High (If Outsourced to a 3(38))	High (Trust Company Investment Committee)	High (Fund Board of Directors)
Access to Data	Yes	Often negotiable	Dictated by Investment Company Act of 1940
Investment Fees	Negotiable	Often negotiable	Typically non-negotiable
Custody and Administration Costs	Variable (minimum fee may apply)	Fund level, not direct plan expense	Fund level, not direct plan expense
Regulatory Investment Restrictions (i.e., use of leverage or illiquid assets)	Flexible	Moderate	Restrictive
Operational Requirements/Complexities	Varies (depending on level of outsourcing)	Low	Low
Minimum $ Investment	Often higher than other vehicles	Varies (typically low)	Low
Participant Access to Information	Customized	Good	Good
Rebalancing Responsibility	Plan Fiduciary or designee	Fund Fiduciary Manager	Portfolio Manager/multi-manager provider

PHASE 4 – OPERATIONAL CONSIDERATIONS

Unitized Separate Account

Typically, custom multi-manager strategies are implemented using the Trust Unitization approach although some large plans have utilized collective trust and, less commonly, custom mutual fund structures

Trust Unitization Approach

- Individual accounts are typically open for each underlying portfolio within the strategy, then consolidated to create an aggregate market value.
- Individual accounts allow for reporting at the investment manager level, as well as applying manager specific fee schedules to the appropriate balances.
- Individual accounts provide the manager with a record of their data (trades, holdings, etc.) and facilitate manager specific performance calculations.

The unitization of the strategy is accomplished by taking the aggregate, fully accrued market value of the individual accounts and dividing it by the outstanding units of the pool. From there, the unit value (Net Asset Value or NAV) can be applied as a stand alone investment option.

* For more information on implementing the different vehicle types, please see Appendix slides 59-61.

Phase 4 – Operational Considerations

Sample Players and Key Roles for Custom Strategies*

Consultant

- Provide asset allocation
- Define rebalancing rules
- Analyze exchange/mapping rules

Record-Keeper

- Receive Net Asset Value (NAV) from Custodian
- Rebalancing and liquidity management
- Trading protocol
- Create fact sheets
- Participant communications and performance reporting
- Exchange/map participant records

Custodian

- Unitize the multi-manager strategy and strike daily NAV
- Rebalancing and liquidity management

* For more detailed information please See Appendix slides 62 and 63

Phase 4 – Operational Considerations

Managed Account Compatibility

Managed account providers can use custom or off-the-shelf multi-manager strategies in their asset allocation models similar to the way traditional DC investment options are utilized

Managed account providers typically consider the following elements when constructing their models:

- fees
- portfolio turnover
- historical manager performance
- active risk
- risk factor exposures
- portfolio holdings history

Additional information may be needed for custom multi-manager strategies. Examples include:

- composite performance for the underlying funds/strategies
- asset allocation policy targets

Phase 5 – Participant Communication and Education

Multi-manager strategies can streamline communications and reporting

Consider the impact on your initial and ongoing communications in the following areas:

- ❑ Strategy descriptions and names
- ❑ Fact sheets
- ❑ Performance reporting
- ❑ Direct disclosures, risk disclosures
- ❑ Website reporting
- ❑ Documents to be available
- ❑ Coordination with SEC disclosures, if applicable
- ❑ Required ERISA disclosures
- ❑ Black-out notices and fund mapping

Make sure to coordinate across providers

Consider the impact to your participants in the following areas:

- ❑ Core options that are not "branded"
- ❑ Core options that include the Plan or company name

Phase 5 – Participant Communication and Education

Sample Communication Plan for a Menu Redesign

Scope
Have a clear investment menu design and strategy to map current assets

Tasks
Identify the participants affected by the investment menu redesign
Create a communications strategy on how and when to inform participants

- What is changing?
- When is it changing?
- What are the options?
- Remind participants at regular intervals prior to the change
- Announce that the change was completed

Review with service providers to create a message that helps participants appreciate the added value and benefits

Potential Misperceptions to Address
If employer-branded:

- The offerings may be seen as managed by the employer instead of the fiduciary manager
- Removing familiar brand names may upset some participants and be perceived as taking something away