

Understanding Collective Trusts

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Introduction

Cohen Fund Audit Services

- PCAOB Registered Public Accounting Firm
 - Specializing in providing audit, tax and consulting services to the investment industry
 - Mutual funds, hedge funds, collective investment trusts, broker/dealers, and investment advisors
- Client base includes over 250 funds with over \$20 billion in assets
- Over 25 professional staff dedicated solely to servicing clients in the investment industry

Pinnacle Financial Partners, Inc.

- Pinnacle Financial Partners, Inc. (Pinnacle) is a Nashville, TN based bank holding company established in 2000
 - Approximately \$5 billion in assets
 - 31 offices and 820 associates
 - Member of Standard and Poor's SmallCap 600; symbol: PNFP
 - Ranked first among large businesses in Business TN magazine's Best Employers list
 - Ranked by Sandler O'Neill among the nation's 33 best-performing (out of 574) small cap institutions based on growth, profitability, asset quality, and capital strength
- Pinnacle operates Pinnacle National Bank, which serves as the trustee for its collective investment funds

Overview of Collective Trusts

Legal Structure

- Collective trust funds are bank-administered trusts that hold commingled assets that meet specific criteria established by 12 CFR 9.18
- Funds used for collective investment are generally divided into two categories:
 - Common Trust Funds (A1 Funds)
 - Commingled vehicle for fiduciary accounts held by a financial institution as trustee, executor, administrator, or guardian
 - Collective Investment Funds (A2 Funds)
 - Commingled vehicle for tax-qualified retirement plans

Regulation

- Collective investment funds fall within the purview of bank regulators
 - The Office of the Comptroller of the Currency (OCC) in the case of national banks
 - State banking regulators in the case of state-chartered banks and trust companies
- Collective funds are not required to be registered with the SEC under an exemption granted under the Securities Act of 1933 and an exclusion provided in Investment Company Act of 1940, if:
 - Funds are “maintained” by a bank or trust company that demonstrates “exclusive management” of the fund; trustee demonstrates “substantial investment responsibility” in SEC parlance
 - Funds are established for a fiduciary purpose as opposed to an investment purpose

Features

- Collective funds possess a number of features that have enhanced their viability
 - Ability for trustee to engage institutional investment management firms as sub-advisers
 - Inherent initial and ongoing expense advantage relative to registered products
 - Trade and transfer via NSCC
 - Flexibility to customize fees
 - Relatively short time to bring fund to market
 - Trustee oversight
 - Emergence of dedicated collective fund databases

Restrictions

- In addition to the “maintenance” requirement, collective funds must also restrict investment to certain eligible investors in order to avoid SEC registration
 - Only qualified employee benefit plans are eligible for investment in A2 funds
 - 401(k) plans
 - Defined benefit plans
 - Taft Hartley plans
 - Certain 457 plans
- “Marketing” of collective funds is limited
 - No mass print/TV marketing
 - No open websites
 - Password protected content okay

Comparison with Other Pooled Investment Vehicles

Comparison with Other Pooled Investment Vehicles

- Collective funds available to qualified retirement plans offer an attractive array of features relative to other investment choices

Comparison of Investment Vehicles					
Features	Retail Mutual Fund	Institutional Mutual Fund	Collective Trust Fund	Limited Partnership	Separate Account
Daily Valuation	✓	✓	✓	Generally No	✓
Daily Liquidity	✓	✓	✓	Generally No	✓
Cost	Generally High	Generally Moderate	Generally Low	Generally Low	Generally Low
Fund Fact Sheets	✓	✓	✓	Generally No	✓
Morningstar Rating	✓	✓	✓	X	✓
NSCC Trading	✓	✓	✓	X	X
Investment Guidelines Determined By	Mutual Fund Board	Mutual Fund Board	Trustee	General Partner	Plan Sponsor
Transparency of Holdings	Quarterly	Quarterly	Custom	Custom	Daily
Regulatory Oversight	SEC	SEC	OCC	-	-
Limitations on Investment	None	Minimum Account Size	Type of Investor	Number of Investors	Minimum Account Size

Distribution Channels and Market Trends

Distribution Channels

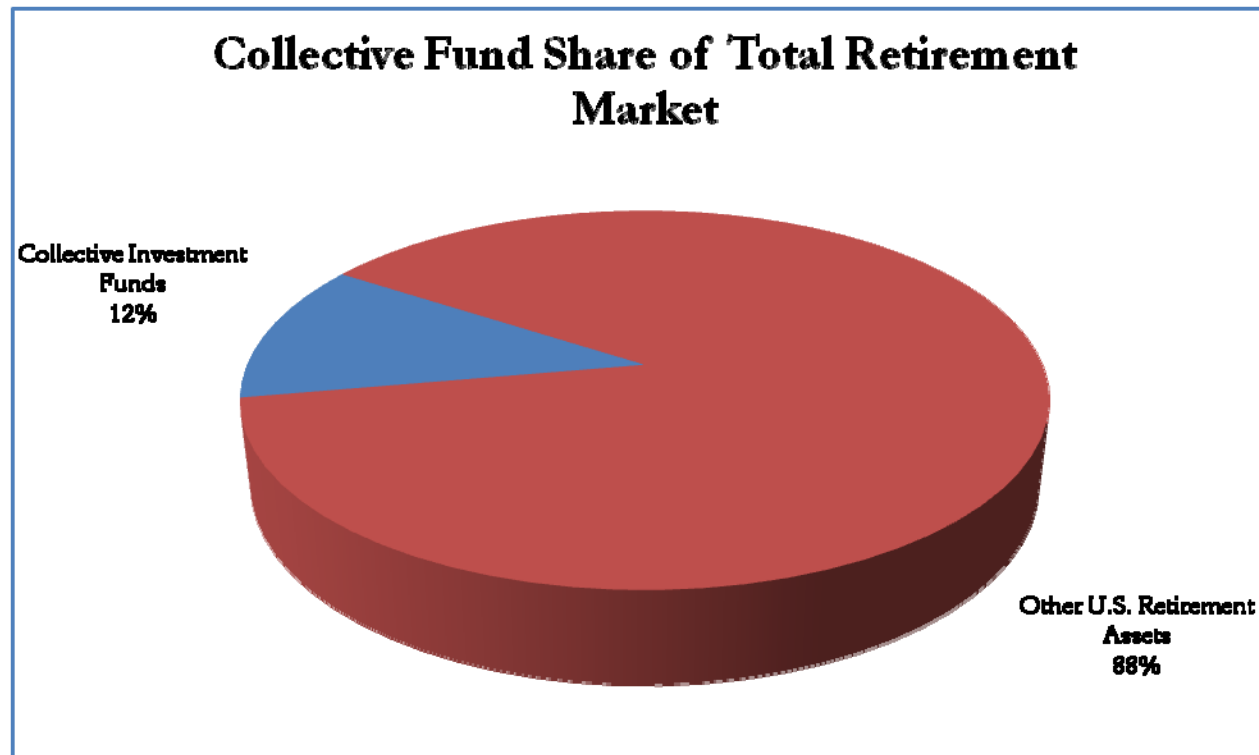
- Increased visibility and NSCC trading has helped collective trusts gain increasing acceptance in a variety of channels
 - Large Plan Sponsors
 - Institutional Consulting Firms
 - Financial Intermediary Service Providers
 - Independent RIAs and Registered Reps
 - Providers of Correspondent Banking Services

Market Trends

- Collective trusts in the qualified plan space have seen tremendous growth due to legislation, such as the Pension Protection Act of 2006, and increased awareness by plan sponsors regarding investment performance and fees
 - 2003 – Approximately 32% of 401(k) plans offered collective funds
 - 2007 – Approximately 45% of 401(k) plans offered collective funds
 - This figure increases to 70% for plans with over 1,000 employees
- Recent litigation regarding fees borne by 401(k) participants at large employers has prompted many plan sponsors to opt for collective funds
 - Caterpillar, as part of a \$16.5 million settlement, agreed to add collective funds to its plan

Market Trends

- Despite recent growth, collective funds still represent a relatively small percentage of the \$13 trillion retirement market



Process for Establishing a Collective Trust Fund

Fund Operating Model

- Successful operation of a collective fund requires coordination from all involved parties
 - Fund Trustee
 - Sub-Adviser
 - Custodian
 - Fund Accountant/Administrator
 - Transfer Agent
 - Auditor

Role of Sub-Adviser

- With a few exceptions, the collective fund allows the sub-adviser to operate the account much like an ordinary institutional account
 - Complete request for proposal provided by fund trustee
 - Agree to terms of investment policy statement and sub-adviser agreement
 - Sub-advise fund in compliance with policy and procedures established by trustee with regard to pre-clearance of securities not on Approved List, proxy voting, and broker/dealer selection
 - As requested, although generally quarterly, provide trustee with updated firm and fund information and analysis via completion of a questionnaire and participation in a conference call

Role of Sub-Adviser

- The collective fund structure provides a number of benefits to investment management firms that enter the market
 - Low start-up and operating costs relative to other pooled investment vehicles
 - Access to growing retirement plan market, which is trending toward lower cost vehicles
 - Ability to bring new strategies to market with minimal lead time
 - Ability to private label or co-brand
 - Minimal client service effort
- However, it is important to note a few eccentricities
 - Participating investors (plan sponsors) become clients of the trustee
 - As trustee of each collective fund, the trustee may replace the sub-adviser

Role of Trustee

- As the fiduciary, the trustee is ultimately responsible for all aspects of each collective fund
 - Create plan of operation for each fund within the construct of a master trust established by the bank
 - Establish investment policy statement and sub-adviser agreement with investment management firm
 - Provide or select business partners to provide fund services
 - Custodian
 - Fund accountant
 - Transfer agent
 - Auditor
 - Evaluate eligibility of each plan that signs a participation agreement requesting investment in a given fund or funds

Role of Trustee

- Importantly, the trustee must operate each collective fund in strict compliance with relevant regulations in order to ensure the funds maintain their exemption from registration
 - Comply with OCC requirements associated with establishment and ongoing administration of collective funds
 - Demonstrate “exclusive management” of each collective fund, including establishment of an Approved List of securities for each collective fund, and a process for pre-clearance of securities not on the Approved List
 - Perform due diligence on all aspects of fund, including investment performance, and maintain fund Watch List to identify issues
 - Understanding the trustee’s investment and oversight philosophy is of paramount importance

Questions

Thank You