
Collective Investment Trusts and indexes – a growth story

Deeper knowledge about how indexes work can drive
better retirement plan outcomes



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RUSSELL**
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Contents

01. Introduction	4
02. What is an index?	5
03. Indexes as a basis for Collective Investment Trusts	7
04. The key to an index-based collective investment trust's power? An "investable" index	9
05. CIT ecosystem	11
06. Common CIT considerations	12
07. About FTSE russell	14
08. Find out more	20



All of your clients want positive outcomes

But each client has unique challenges — from a Defined Benefit (DB) plan with a low funding status, to a Defined Contribution (DC) plan with mostly older participants — that need to be addressed.

How can you improve outcomes for a wide segment of clients and gain a competitive advantage?

A better understanding of indexes and passive strategies can help.

Indexes are driving the growth of Collective Investment Trusts (CITs), and all indexes are not created equally.

Passive is going massive

When constructing DB plan portfolios, or DC plan investment menus, retirement plan sponsors rely on passive strategies both for their ability to accurately capture targeted exposures and for their cost-efficiency. However, there are many different passive strategies to choose from, where it is important to have an understanding of how the underlying index is constructed.

% OF DEFINED CONTRIBUTION PLANS UTILIZING CITs*



53% of DC ppts offered at least one passive core menu option**

73% of DC ppts offered at least one passive core menu option**

* Source: Callan Associates: 2019 Defined Contribution Trends Survey

** Source: Vanguard "How America Saves" Trends Survey (passive core is defined as a comprehensive set of low-cost index options that span the global capital markets).

Understanding how indexes work reveals the capabilities of CITs

Helping your clients achieve their goals requires time and research. That hard work is easier when you can apply an understanding of how indexes work—allowing you to make smarter portfolio choices.

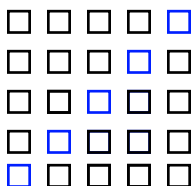
When you know a CIT is based on a FTSE Russell index, that tells you a lot about how accurately that index underlying the CIT represents the selected market, as well as the investment features of the index.

First, a quick primer:

What is an index?

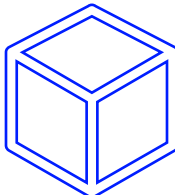
Generally speaking, an index is an indicator or measure of something. In simple terms, in the world of investing, an index is a hypothetical portfolio of securities designed to represent an asset class, market, or market segment.

KEY TERMS



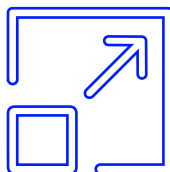
Basket

The exact compilation of securities in an index



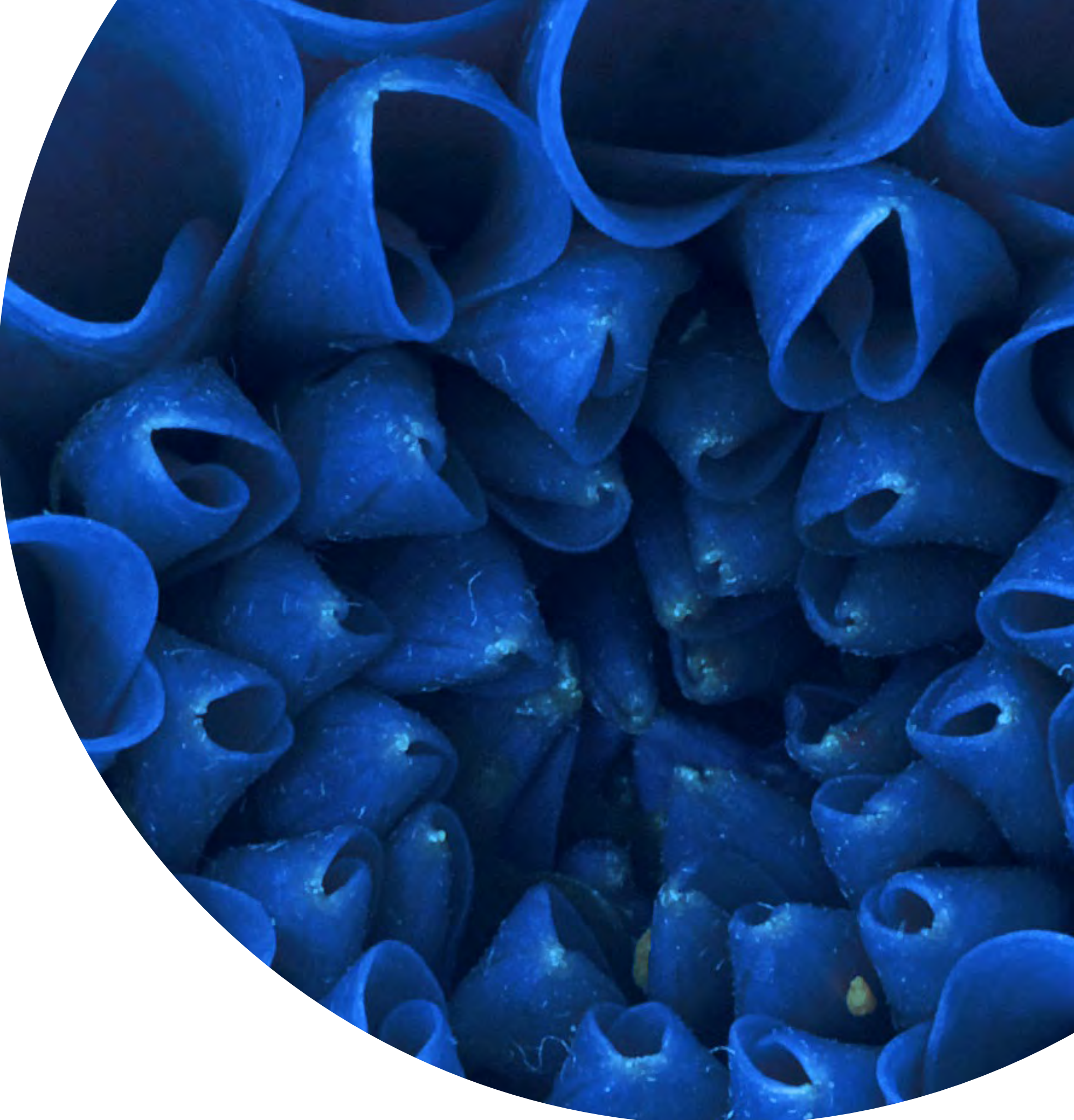
Weighting

The proportion of the index that each individual security comprises



Value

A single number that, when referenced to a starting value (or level), describes how the index has performed over time



Why indexes?

Markets or individual market sectors can be enormous, including hundreds and even thousands of securities.

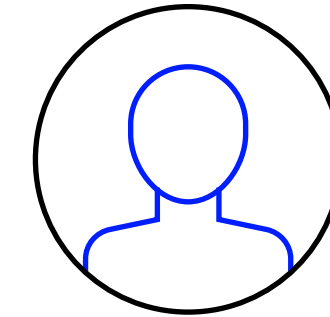
Buying all these securities just to access one market or trend can be expensive and time-consuming. And it can be ineffective. That approach inevitably would include securities with negligible influence on the portfolio.

Indexes are comprised of only the securities most relevant to their investment theme, which allows you to follow market trends without having to track the entire available universe of securities. Essentially, an index acts as a measuring stick to capture representative exposure to a particular market or sector.

LARGE CAP GLOBAL STOCKS	NORTH AMERICAN OFFICE REITs
EMERGING MARKETS BONDS/ DEBT	AND MORE...

Chances are, if you can imagine it, there's an index for it. And you can use it in a variety of ways:

Plan Sponsor



- Assess a given market's performance
- Gauge how well an active strategy is working
- Serve as the foundation for CITs, mutual funds, or Separately Managed Accounts (SMAs)
- Evaluate a market's risk profile or its diversification benefits
- Measure factor risk premia

Indexes as a basis for

Collective Investment Trusts

Because an index is a hypothetical basket of securities, it cannot be invested in directly. However, indexes are widely licensed by fund managers as the basis for CITs, as well as other investment vehicles, including:



Let's say you feel strongly that large-cap US equities are going to outperform small-cap US equities over the long term. You may then seek exposure to only the large-cap US equities market segment.

Rather than purchasing each US large cap stock individually, you adopt a passive strategy. You choose an investment product that tracks an index designed to precisely represent just the US large-cap equities market.



Choosing passive investment products

While some investors prefer actively managed investments, which rely on a manager’s stock selection skills, others turn to passively managed investment products for the following reasons:

Representation



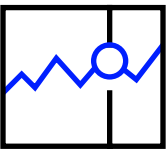
Since the goal of the investment vehicle is to target a particular market or market segment, the chosen index should be as representative of this market segment as possible.

Objective and transparent



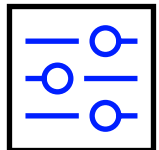
When an investment vehicle is replicating the index, it’s important that the index’s rules and calculation methodology are published openly. You should be able to understand and anticipate changes to the index.

Simplicity



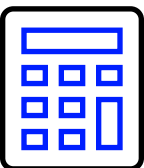
Passively managed index products are comprised of the same securities and at the same weights as the index on which they are based. That makes it easy to track and measure performance.

Investable



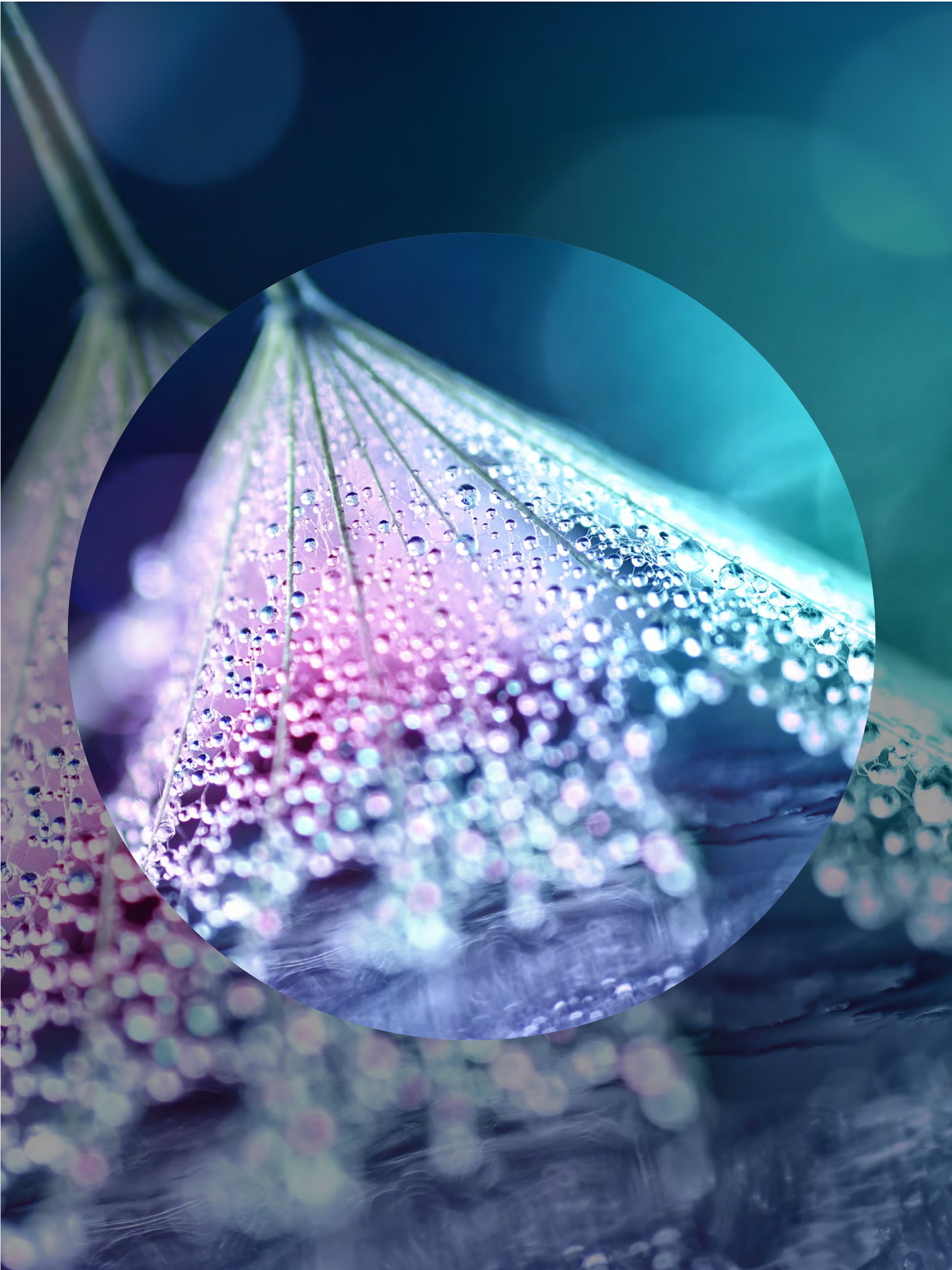
The index should only include securities that are freely available for purchase by average investors, rather than those held by employees or other investors who are restricted from selling their shares. Otherwise, replicating the index can be difficult, and unnatural stock price volatility can occur.

Lower cost



Passively managed investments that track equity indexes typically cost less than their actively-managed counterparts thanks to lower fees vs. a manager to make investment decisions based on expertise, opinions, and analysis.

As index solutions continue to expand and evolve, you can rely on us to deliver tools designed to help you achieve your investment goals.



The key to an index-based CIT's power? An “investable” index

It is imperative that CIT product developers, as well as fund selectors and retirement plan sponsors, grasp how index selection/construction can impact an investment product's ability to meet its objectives.

What makes an index investable?

Before embarking on any journey for a collective investment trust, providers must consider core index construction tenets that serve as a strong foundation for investability.

- | | | | | |
|---|--|---|--|--|
| 1
Start with clear objectives | 2
Accurate representation improves investability | 3
Diversification mitigates concentration risks | 4
Design methodology can make a big difference | 5
Replicability is key for investability |
|---|--|---|--|--|

1 Start with clear objectives

From the outset, CIT providers must define a clear vision of their goals, such as an enhanced return index vs. a market cap weighted index, lowering volatility, or achieving targeted factor exposure(s). Then product providers and index engineers work together to map all the requirements and characteristics of an underlying index. Best practice is to design the index with a long view toward investability, ensuring the original objectives can be maintained over time.

EXAMPLE

The Russell 1000 Index has the objective of tracking the top 1,000 US equities by market cap

When designing an index, practical, real-world implementation issues must be considered. It has to be investable, meaning an investment product replicating the index can be traded in the market efficiently, and at a high capacity.

2 Accurate representation improves investability

It is important to assess indexes from multiple angles—not just market performance. An index that effectively represents a market does so by delivering an unbiased, complete view of the market or market segment it is designed to measure. This is only accomplished through the application of objective, transparent construction methodology. Arbitrarily excluding opportunities available to market participants can impact the weights of index members. Differences in weights and returns can impact index performance.

The introduction of constraints can be a useful safeguard against any unwanted extreme positions. In other words, an investable index must be “true-to-label.”

EXAMPLE

The Russell 3000 Index represents the top 3,000 investable stocks in the US stock market

3 Diversification mitigates concentration risks

To achieve the original objectives, any index runs the risk of becoming overly concentrated. Naturally, its design can get biased toward a style resembling active management relative to the market capitalization of the benchmark. Ensuring appropriate levels of diversification within an index can mitigate potential sector, country, or stock-specific concentration risks.

EXAMPLE

FTSE Global RIC Capped Indexes were built to help investors meet concentration and diversification requirements

4 Design methodology can make a big difference

Index providers differ in their build methodologies. Each brand brings their own toolkit to design for particular objectives. In the process, trade-offs are made along the way: targeted factor exposure vs. diversification, simplicity vs. complexity, etc.

Investability relies on the most efficient methodology that most closely meets the stated objectives.

EXAMPLE

FTSE Fixed Income Indexes are designed to appeal to a broad range of market participants and are widely followed by the investment community

5 Replicability is key for investability

A popular criticism of the latest generation of indexes (e.g. smart beta) is they rely on theoretical academic analysis and on back-tested data to simulate attractive performance outcomes. Investability relies on practical, real-world implementation issues; i.e., an investment product replicating the index can be traded in the market efficiently, and at a high capacity. Index design addresses many questions, such as: Can the fund manager trade the number of stocks? Is that market segment liquid enough? What's the turnover and likely trading costs? The most investable indexes are tempered by reality.

EXAMPLE

The Russell 2000 Index aims to accurately measure the performance of the small cap segment of the US equity market

Three essential groups and roles

Do you have the tools and information you need to consider all of your opportunities across markets, asset classes, styles or strategies? As indexes and portfolio strategies continue to evolve, you need an index provider who helps you stay well-informed. FTSE Russell is an integral part of the CIT industry, providing indexing and data solutions to a wide variety of market participants.

Index providers

Key services: indexes, benchmarks, and asset class proxy

Index data is licensed to a CIT sponsor who then replicates the index into a CIT

CIT sponsors

Manage and promote CITs

CIT administrators

Day-to-day operation of the CIT

OCC, IRS, SEC, CFTC and DOL

Monitor, report, and investigate all aspects of the CIT ecosystem

Distributors

Increase the availability of CITs to investors

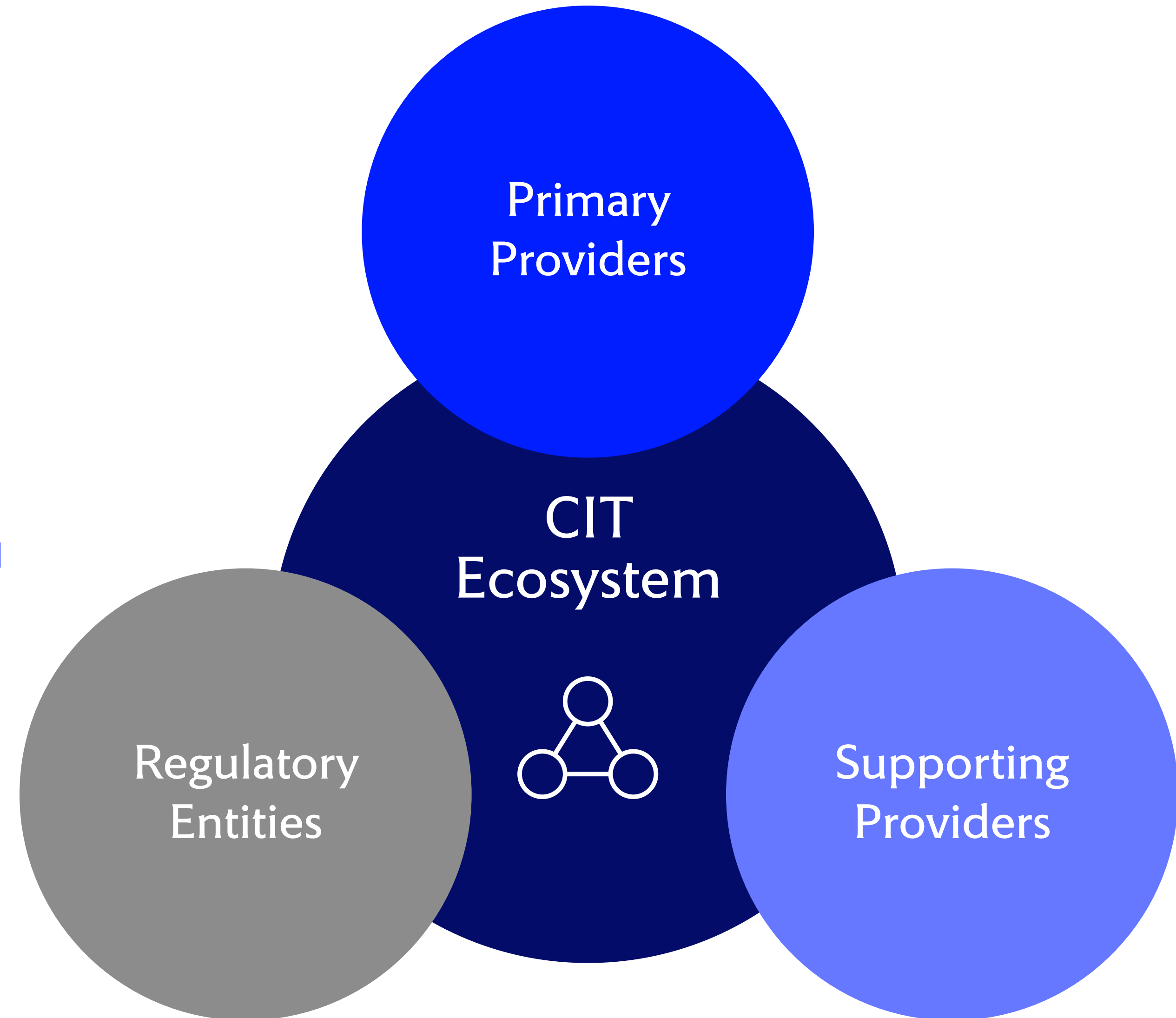
Auditors

Audit for accounting and regulatory requirements

Fund counsel

Consultants

Provide CIT investment advice to plan sponsors directly



Common CIT considerations

Up to this point you've been learning about index basics. Now, here is a brief overview of how understanding those basics gets put into action within retirement plans.

The growing devotion to CITs is in large part due to their ability to cater to a wide variety of investment objectives and risk profiles in a cost-effective manner. The dual benefits of low cost and flexibility are key reasons why plan sponsors and portfolio managers employ CITs in the construction of portfolios, sometimes alongside active strategies.

8 out of the top 10

CIT issuers work with
FTSE Russell

\$3.0 T

Industry wide

CITs HAVE GROWN IN NUMBER AND AUM:

\$1.1 T

2008

2018

Source: Cerulli Associates



Typically, retirement plan sponsors utilize CITs in three ways.

There are many reasons why retirement plans utilize CITs in DB portfolios or DC core menu and white label fund construction. Those reasons dictate the balance of active and passive strategies in that investment approach.

The top three considerations are:

PORTFOLIO ALLOCATION

PASSIVE

1

PRIMARY VEHICLE FOR MARKET EXPOSURE

A DB portfolio, or DC plan menu with a majority of passive investments, looks to utilize a mix of CITs to keep costs and cash drag low.

2

UP TO HALF OF A PORTFOLIO'S BETA

A blend of passive and active investments in a portfolio takes advantage of CITs' efficient factor exposure and lower costs, balanced with expectations for a more active role in risk management and performance beta.

ACTIVE

3

MINORITY POSITION FOR TACTICAL EXPOSURE

A portfolio consisting mostly of active with a small percentage of passive investments is likely to concentrate on a specific tilt or factor while utilizing CITs for cost-efficient exposure.

The process

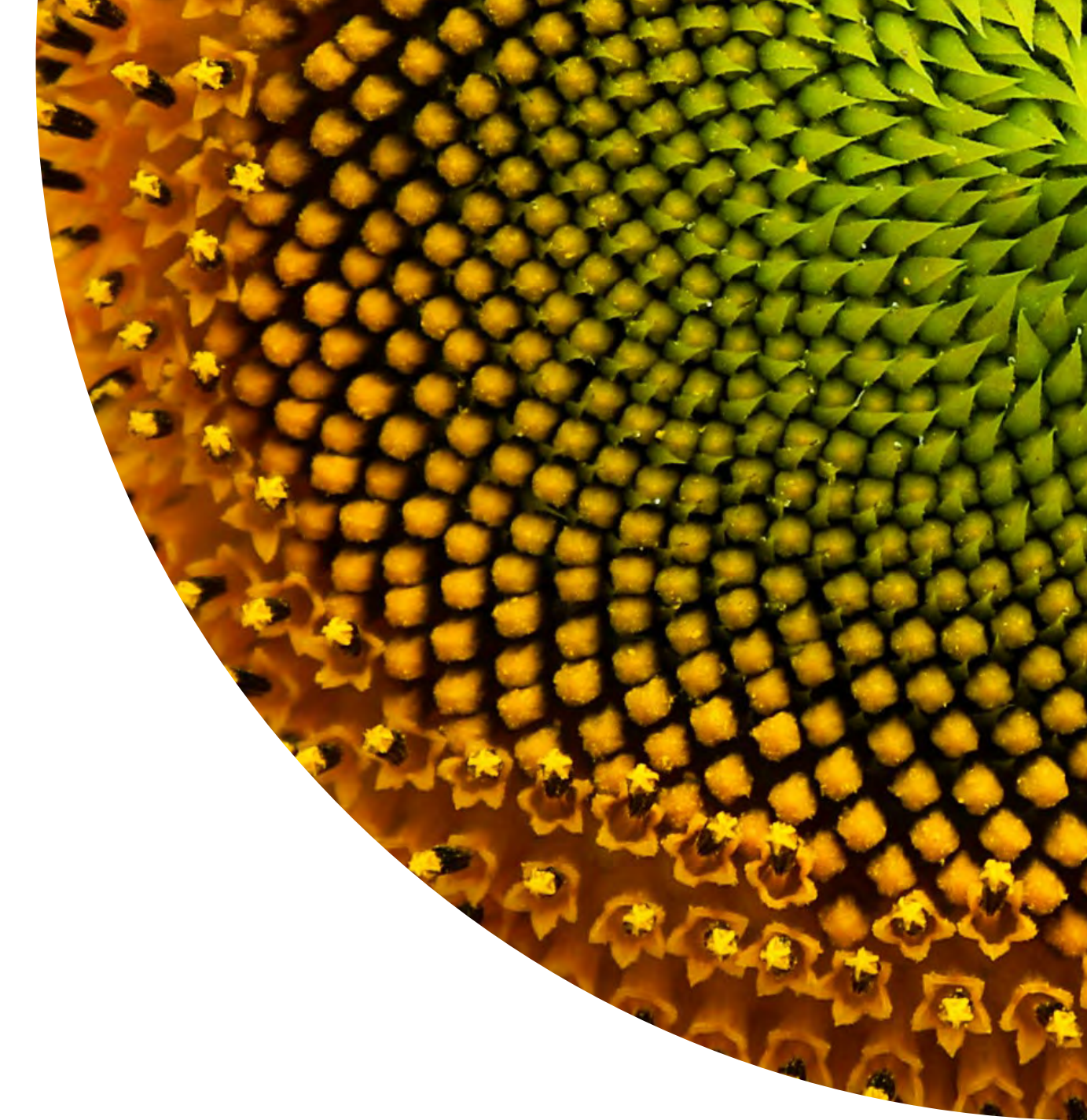
CITs aim to replicate an underlying index or benchmark. Index providers license an index to an CIT issuer or asset manager.



The CIT issuer or asset management company will replicate the index in a CIT, usually by buying the index's constituents.



This results in a CIT being "benchmarked" to that index.



We build the indexes that

Help retirement plan sponsors focus on participant goals

More than \$3T of investment product assets passively track FTSE Russell indexes. Institutional investors around the world select these investment products to build portfolios that meet their clients' specific investment objectives. Analytics tools designed for retirement plan sponsors support proportional allocation to asset classes and potentially improve risk-adjusted returns, along with simple portfolio-level performance reporting and customizable capabilities like ESG ratings.

*Data as of December 31, 2019 as reported on April 1, 2020 by eVestment for institutional assets, Morningstar for retail mutual funds, insurance products, and ETFs, and additional passive assets directly collected by FTSE Russell. AUM data includes blended benchmarks and excludes futures and options. AUM data will not include active and passive assets not reported to a 3rd party source or FTSE Russell. Passive assets directly collected by FTSE Russell have been removed from third party sources to prevent double counting. No assurances are given by FTSE Russell as to the accuracy of the data.

**Global
provider**

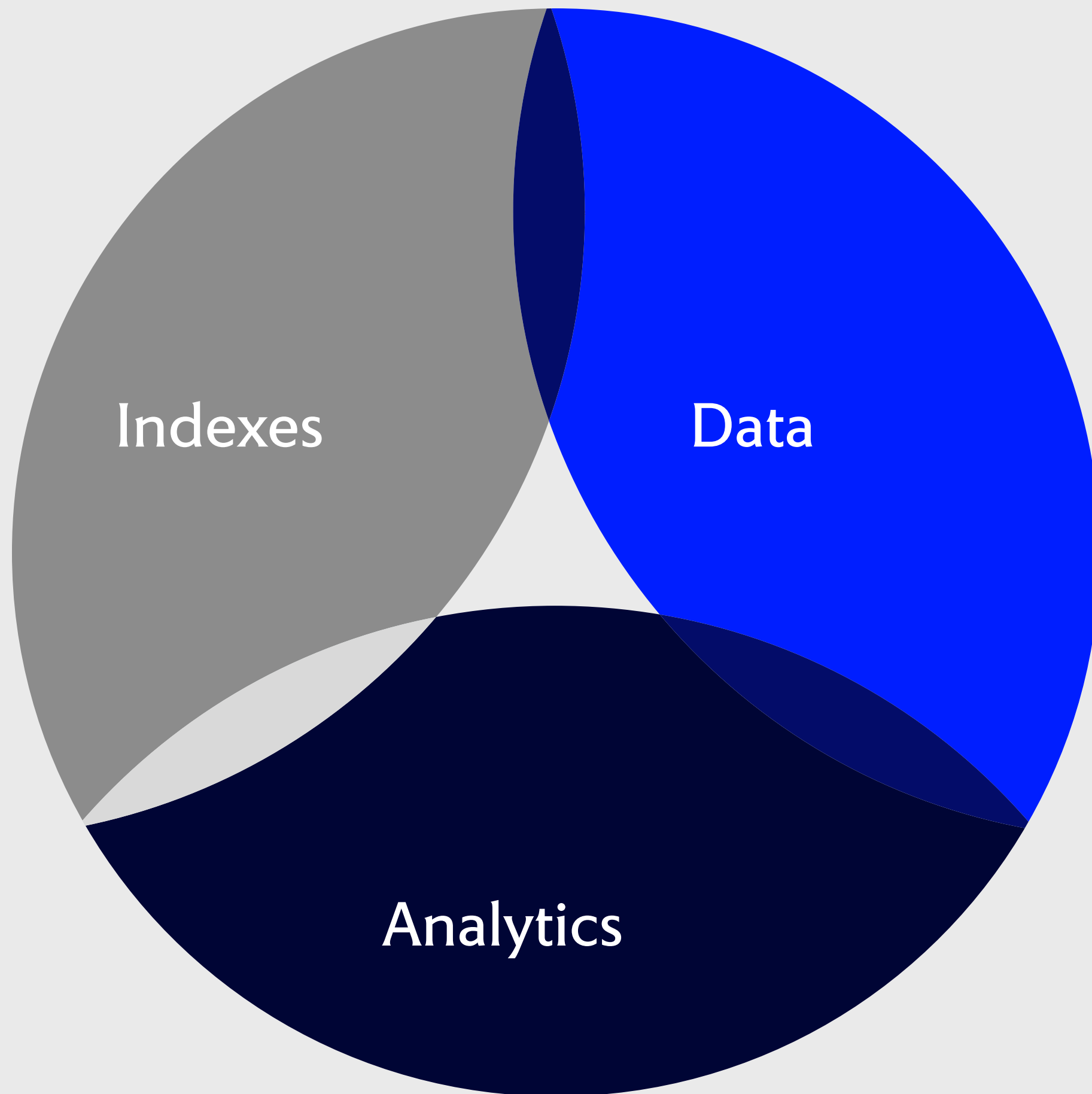
to the world's top asset
owners, asset managers,
and investment banks

**30+
years**

multi-asset
experience

**\$16
trillion***

benchmarked to
our indexes



-
- Basis of investable products
 - Performance measurement
 - Investment analytics
 - Risk management
 - Asset allocation
 - Research

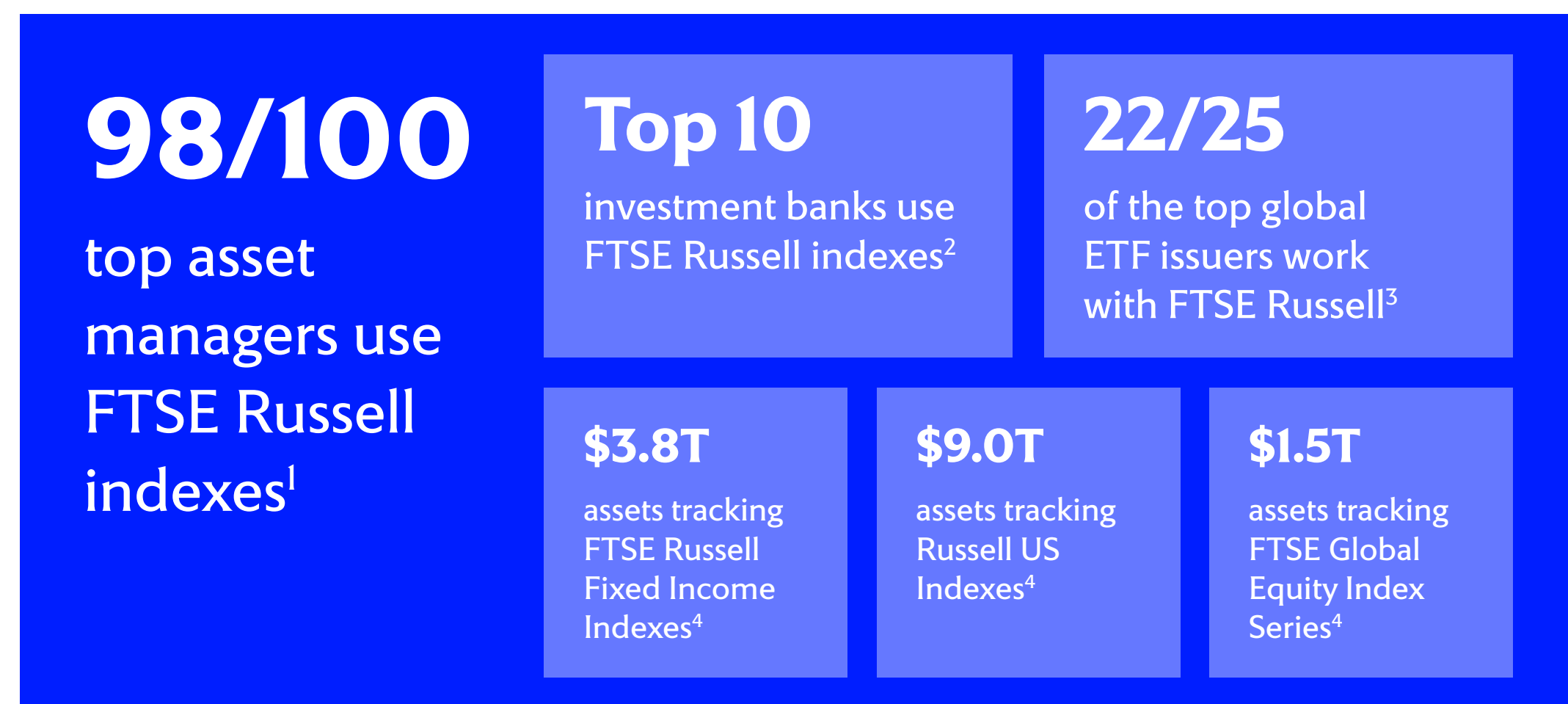
-
- Insights for better decision making
 - Examine global market conditions
 - Uncover risks and opportunities
 - Identify trend inflection points
 - Power investment strategies
 - Risk management

-
- Uncover risks and opportunities
 - Inform corporate strategies
 - Support trading, tracking and reporting
 - Insights for better decision making
 - Research

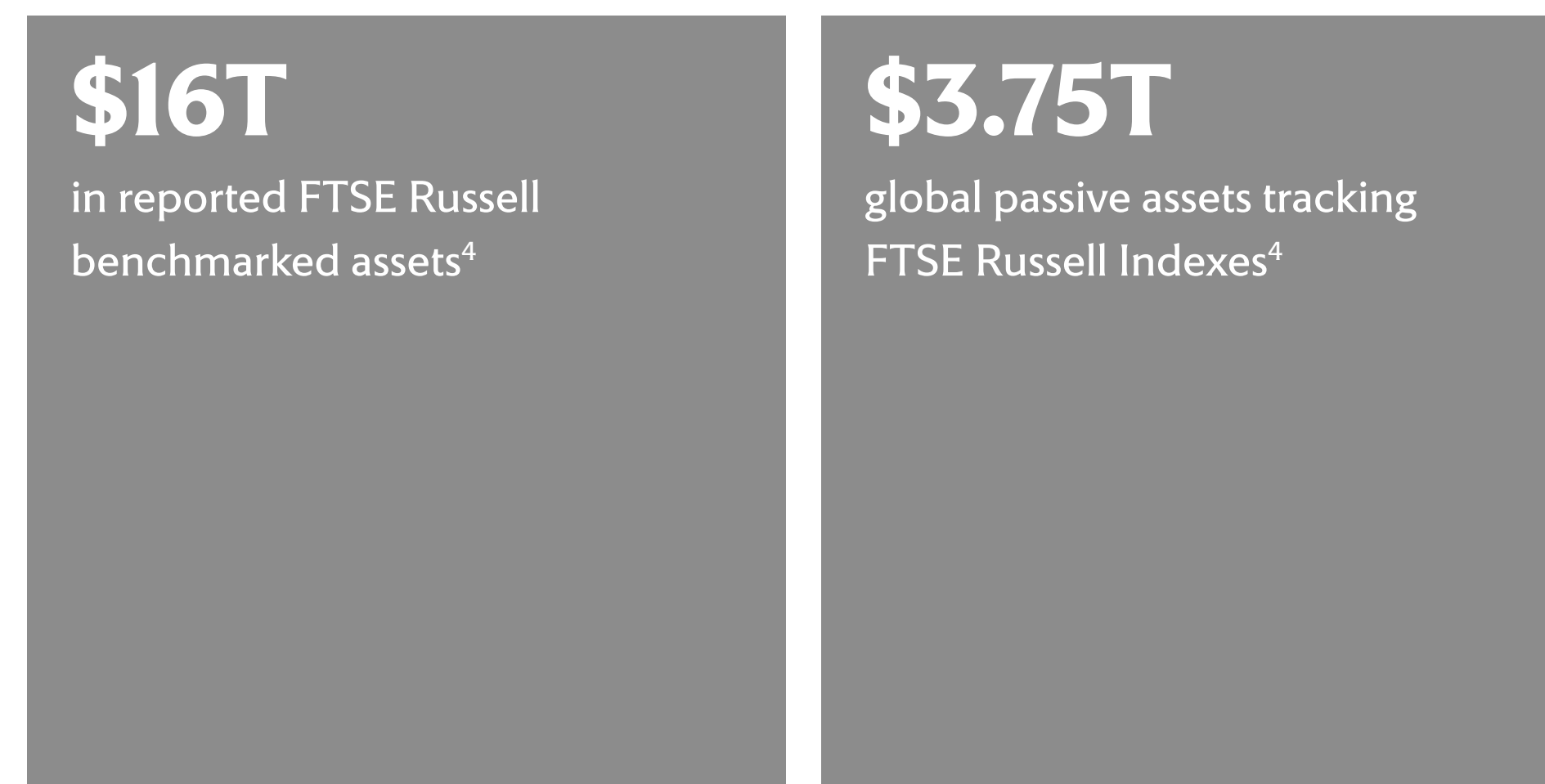


We're a different kind of index provider

Provider to top investors and issuers around the world



Global benchmarked assets



NOTE: All data in the table above are estimated by FTSE Russell

1 Based on FTSE Russell clients as of April 2019 and Pension & Investments list of top 100 worldwide asset managers.

2 Based on FTSE Russell clients as of April 2019 and Dealogic list of top 10 investment banks.

3 Morningstar, December 31, 2019.

4 Data as of December 31, 2019 as reported on April 1, 2020 by eVestment for institutional assets, Morningstar for retail mutual funds, insurance products, and ETFs, and additional passive assets directly collected by FTSE Russell. AUM data includes blended benchmarks and excludes futures and options. AUM data will not include active and passive assets not reported to a 3rd party source or FTSE Russell. Passive assets directly collected by FTSE Russell have been removed from third party sources to prevent double counting. No assurances are given by FTSE Russell as to the accuracy of the data.

FTSE Russell index series

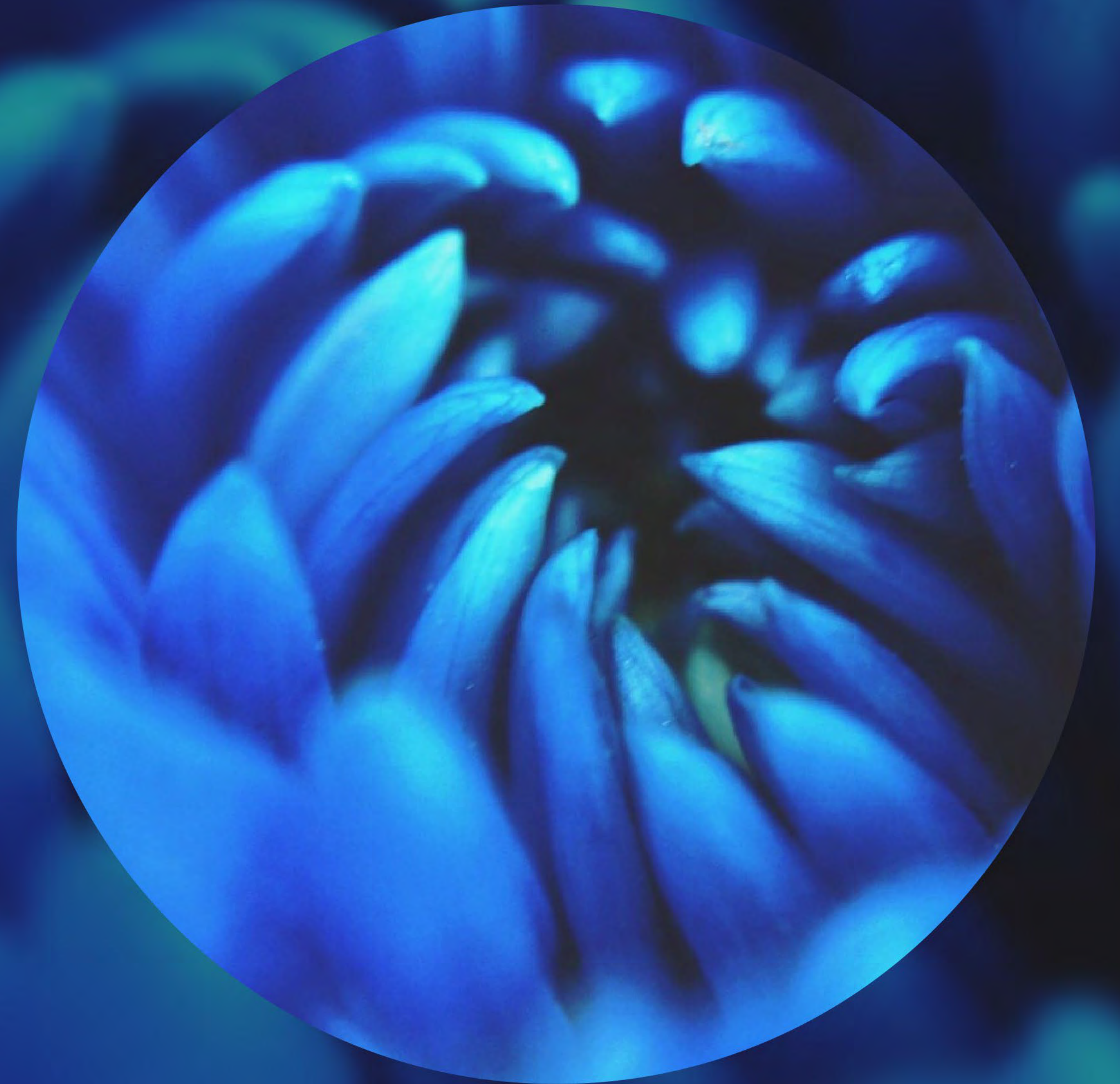
We calculate indexes across a vast variety of asset classes and markets. Here are some examples:

FTSE GLOBAL FACTOR

Single and multi-factor indexes. FTSE Russell is renowned for its proprietary Target Exposure methodology.

FTSE FIXED INCOME

Committed to best practices in governance and design.



Our commitment

To help our clients capture opportunity, manage risk, and find a competitive advantage

Quality

We provide global multi-asset solutions with a focus on quality, timeliness, and precision

Reliability

We deliver resilient solutions underpinned by a robust governance framework that comprises indexes, analytics, technology, and operations

Pioneering

We want to help our clients become future-ready, and we continually innovate to grow our industry and shape its future

Responsive

We create agile, client-centric solutions that evolve to meet changing market needs

Transparent

We take pride in fostering transparency throughout the investment process

Partnership

We partner with industry thought leaders and clients to embed innovation and trust

Service

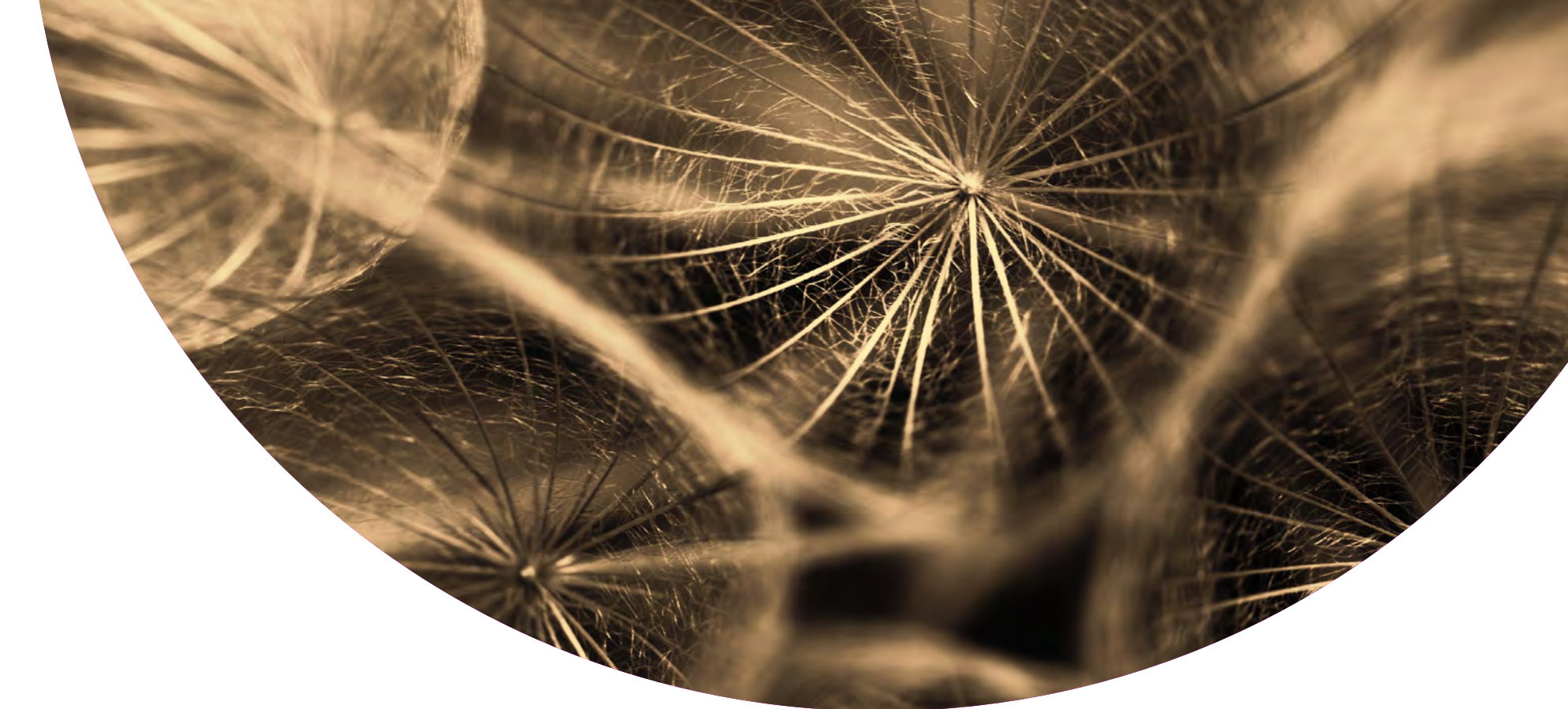
We have a global team of experts dedicated to meeting our clients' needs

Accessible

We partner with distributors around the world to ensure easy access to our data

Global and local

We combine global perspective with local knowledge. We are sensitive to market needs





Find out more


Visit lseg.com/ftse-russell; email info@ftserussell.com;
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Additional education

Recent publications on indexes



Innovation Lab | Subcategory

**Target Exposure:
Investment
applications and
solutions**

February 2020

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Market participants look to us for our expertise in developing and managing global index solutions across asset classes. Asset owners, asset managers, ETF providers and investment banks choose FTSE Russell solutions to benchmark their investment performance and create investment funds, ETFs, structured products, and index-based derivatives. Our clients use our solutions for asset allocation, investment strategy analysis and risk management, and value us for our robust governance process and operational integrity.

For over 35 years we have been at the forefront of driving change for the investor, always innovating to shape the next generation of benchmarks and investment solutions that open up new opportunities for the global investment community.

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