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

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.

% OF DEFINED CONTRIBUTION PLANS UTILIZING CITs*

2011 2018

CITs

44% 75%

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)

Collective Investment Trusts and Indexes – A Growth Story
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.

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

- 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

Collective Investment Trusts and Indexes – A Growth Story
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:

- MUTUAL FUNDS
- ETFs/INDEX FUNDS
- SEPARATELY MANAGED ACCOUNTS
- DERIVATIVES
- STRUCTURED PRODUCTS

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:

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<tr>
<th>Representation</th>
<th>Objective and transparent</th>
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<td>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.</td>
<td>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.</td>
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<tr>
<th>Simplicity</th>
<th>Investable</th>
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<td>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.</td>
<td>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.</td>
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<tr>
<th>Lower cost</th>
<th>As index solutions continue to expand and evolve, you can rely on us to deliver tools designed to help you achieve your investment goals.</th>
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<td>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.</td>
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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.

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.”

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.

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.

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.
Collective Investment Trusts and Indexes – A Growth Story

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.

**CIT ECOSYSTEM**

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**
- Legal guidance and opinion

**Consultants**
- Provide CIT investment advice to plan sponsors directly

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Collective Investment Trusts and Indexes – A Growth Story
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

CITs HAVE GROWN IN NUMBER AND AUM:

- $1.1 T in 2008
- $3.0 T in 2018

Industry wide

Source: Cerulli Associates

Collective Investment Trusts and Indexes – A Growth Story
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**

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<th>ACTIVE</th>
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<tr>
<td>PRIMARY VEHICLE FOR MARKET EXPOSURE</td>
<td>UP TO HALF OF A PORTFOLIO’S BETA</td>
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<td>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.</td>
<td>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.</td>
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**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

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

Indexes
Data
Analytics

Collective Investment Trusts and Indexes – A Growth Story
We’re a different kind of index provider

Provider to top investors and issuers around the world

Top 10
investment banks use FTSE Russell indexes

$3.8T
assets tracking FTSE Russell Fixed Income Indexes

$9.0T
assets tracking Russell US Indexes

$1.5T
assets tracking FTSE Global Equity Index Series

Global benchmarked assets

$16T
in reported FTSE Russell benchmarked assets

$3.75T
global passive assets tracking FTSE Russell Indexes

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.
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.
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; or call your US Client Service Team +1 877 505 6437.

Dedicated US CIT team

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<tr>
<th>Name</th>
<th>Role</th>
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<tr>
<td>Alain Michnick</td>
<td>Head of Defined Contribution</td>
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<td><a href="mailto:amichnick@ftserussell.com">amichnick@ftserussell.com</a></td>
</tr>
<tr>
<td>Trenton Jenkins</td>
<td>Customer Success Manager</td>
<td>Fort Mill</td>
<td><a href="mailto:trenton.jenkins@lseg.com">trenton.jenkins@lseg.com</a></td>
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Target Exposure: Investment applications and solutions

Read about FTSE Russell’s enhanced factor replication methodology, which allows for explicit factor exposure targets.

View on our website

Investing in listed real estate

Learn more about the FTSE EPRA Nareit Index Series, which allow for easy access to exchange listed stocks of global real estate companies.

View on our website