

WHAT IS A WHITE LABEL FUND?

As defined contribution (DC) plan sponsors warm to the idea of incorporating illiquid investments into investment strategies offered on their menus, DCREC offers an explanation of the vehicle largely facilitating this shift—the white label fund.

The majority of DC plan sponsors that incorporate daily valued private real estate funds require them to be embedded within a multi-asset strategy such as a white label fund. Participant contributions are invested directly into the white label fund, rather than directly into any one of the underlying investment managers' funds. Participant contributions are aggregated by a custodian to create a net cash flow into or out of the white label fund. The net cash flow is prorated among the underlying investment managers as per the white label fund's allocation policy. The following brief will further clarify white label funds and how they operate.

What is a White Label Fund?

A white label fund is a professionally managed, multi-asset (and/or multi-manager) structure.

Although this paper focuses on the multi-manager structure, an investor can create a white label fund with a single manager. A multi-manager structure is commonly used when incorporating private investments, including real estate.

There are four ways to create a white label fund:

- 1) a model portfolio
- 2) unitized separate account
- 3) a custom investment trust ("CIT") or
- 4) custom mutual fund

In practice, unitized separate account or custom CIT methodologies are most prevalent. Model portfolios generally require investment funds used to create the model are individually accessible on the plan menu, which most private real estate investment managers don't allow participant directed investments. Mutual funds are limited to 15% exposure to illiquid securities introducing additional management constraints.

The manager of a white label fund can be a fiduciary committee (typically with help of a nondiscretionary consultant), a discretionary consultant, a financial intermediary or an investment management company. The white label fund can invest in a wide range of assets, such as cash, bonds, stocks, public and private real estate, private equity, etc., to create a specific investment profile (i.e., target date fund ("TDF"), real asset fund, inflation hedge fund) for any desired investment objective.

Regarding private real estate, there are two primary benefits in using a white label, multi-manager structure. First, the structure allows the white label fund manager to invest in less liquid private real estate to diversify the overall risk-adjusted profile of the fund. Second, this structure helps mitigate liquidity concerns. The following example will illustrate these two primary benefits.

Although other white label fund structures exist, we will focus this example on the custom target date fund ("cTDF"). A cTDF invests in multiple asset classes, which historically have included cash, bonds, and stock, all of which are traded daily and fully liquid. A typical cTDF will generally invest with 10 to 15 investment funds across all asset classes.

For liquidity management, the cTDF manager would likely use one of two approaches. The first uses a private real estate fund that includes a liquidity sleeve of daily-traded securities, primarily cash and REITs. These funds are considered packaged or off-the-shelf products. These daily-valued, private real estate funds allow for a certain amount of daily liquidity subject to the specific fund's liquidity caps, which differ from fund to fund. Since most of these types of funds are structured as CITs, they generally clear daily trades through the National Securities Clearing Corp. (NSCC). In this operational environment, aggregate net cash flows in or out of the cTDF would be prorated among all of the underlying investments including the private real estate fund as per preset percentage allocations. In using this approach, monitoring the level of cash flows into and out of the daily valued, private real estate fund is important to avoid a breach in the fund's specific liquidity rules.

In a second approach, assuming a 10% allocation to private real estate, the cTDF manager can direct aggregate net cash flows into or out of the fully liquid investments of the cTDF (the other 90%), while keeping the private real estate fund constant. In our example, if there was a net outflow of \$1 million (a redemption), the entire \$1 million would be redeemed from the 90% of investment managers that invest in cash, bonds and stocks. This approach gives the white label fund manager multiple options:

- 1) Direct management of cash flows into and out of the packaged private real estate fund to avoid tripping periodic liquidity limits.
- 2) Direct investment into an open-end, private real estate fund with 100% exposure to private real estate. The cTDF manager has the additional flexibility to take the real estate fund's dividend in cash or reinvest it.



Custodians have long tenures of experience in handling cash flow management for fixed income and equity white label funds. Most custodians are able to accommodate an operational approach, as long as rules are established at the start of an investment with written documentation and clear policies. Each custodian's process may be unique. As such, white label managers should clearly communicate with the custodian about their intentions to add a private real estate investment well in advance of implementation to confirm the custodian can accommodate the asset class, determine the cash flow process as well as necessary documentation. It's also important that there be open lines of communication after implementation between all parties involved (i.e. client, manager, custodian) for ongoing liquidity management of the structure.

A Final Thought on the White Label Fund Construct:

Each white label fund should have its own investment guidelines document. This document should at the very least include the fund's allocation to each underlying asset class and manager, with appropriate ranges for each, and instructions for how daily net flows (in and out) should be invested or redeemed among the underlying investment managers.

About the Defined Contribution Real Estate Council (DCREC)

The Defined Contribution Real Estate Council was formed in 2012 to promote the inclusion of investments in direct commercial real estate and real estate securities, including REITs, within defined contribution plans. Its goal is to improve participant outcomes by furthering education about, advocacy for, and best practices of such investments. Members include many of the leading providers of real estate investment products to the defined contribution marketplace.

More information can found be at www.dcrec.org.

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