



REVERSE inquiries

Workshop White Paper

Unit Investment Trusts

As volatility increases, unit investment trusts (“UITs”) may offer some benefits. As described in more detail below, a UIT is a pooled investment vehicle that invests in a fixed portfolio of securities for a specified period of time. The UIT is a registered investment company under the Investment Company Act of 1940 (the “1940 Act”) and has characteristics generally associated with both mutual funds and closed-end funds. A UIT issues a fixed number of redeemable securities to the public, each of which represents an undivided ownership interest in a unit of the security held by the UIT. Nearly all UITs are organized as trusts under state law, either as single trusts or series trusts, with each series constituting a different portfolio. A trust indenture governs the trust and all UIT activities, including the roles and responsibilities of the trustee, sponsor and evaluator.

According to statistics published by the Investment Company Institute, there were 115 new trusts issuing shares in December 2018. Of the 115 new trusts, 108 were equity trusts, three were taxable bond trusts and four were tax-free bond trusts. UITs had total deposits of \$3.24 billion in December 2018, an increase from \$3.23 billion in November 2018.

BENEFITS ASSOCIATED WITH UITs

UITs can offer investors transparency, liquidity, limited credit risk, diversification and access to specific investment strategies.

- **Transparency.** UITs provide transparency of holdings, fees and concessions. UITs employ a “buy and hold” strategy, which means UITs will generally maintain their original investment portfolio despite short-term market fluctuations.
- **Liquidity.** Should an investor’s needs change, investors may redeem their units on any business day at the redemption price. Section 4(2) of the 1940 Act and Rule 22c-1 thereunder require UITs to issue redeemable securities at a price based on the current net asset value (“NAV”) of such security. The term “redeemable securities” is defined in Section 2(a)(32) of the 1940 Act as “any security ... under the terms of which the holder upon its presentation to the issuer ... is entitled ... to receive approximately his proportionate share of the issuer’s current net assets, or the cash equivalent thereof.” Therefore, at the investor’s request, UITs are required to buy back the investor’s securities at NAV, which is based on the underlying securities’ current market

value, less applicable expenses, and is calculated daily. The primary purpose of Rule 22c-1 is to eliminate or reduce dilution of the value of outstanding redeemable securities of registered open-end investment companies that may occur through the practice of “backward pricing.”

- **Diversification and Access to Specific Investment Strategies.** Assets of a UIT may include stocks, bonds, preferred stock, ADRs, REITs, master limited partnerships, closed-end funds, BDCs, ETFs or other investments. UITs also may focus on outcome-driven investment objectives and/or structured payoff structures by including derivatives as part of the fixed portfolio, which results in UITs with structured product-type payoffs and which may invest in other assets, including exchange-traded options, U.S. Treasury obligations and/or cash or cash equivalents.
- **Reduced or Eliminated Credit Risk.** UITs achieve their target outcomes without the credit risk associated with structured notes. Unlike structured note offerings, where the notes are senior unsecured obligations of the issuing bank/corporation, the credit risk of a UIT depends on the assets it holds. A UIT that holds FLEX options that are issued by the OCC or U.S. Treasuries, for example, has limited credit risk.

REGISTRATION REQUIREMENTS

Initial Registration

A UIT is subject to dual registration requirements under the 1940 Act and the Securities Act of 1933 (the “Securities Act”).

	Requirements under the 1940 Act	Requirements under the Securities Act
Registration Requirement	As an issuer of securities, the UIT is required to register as an investment company with the Securities and Exchange Commission (the “SEC”) (Section 8(b) of the 1940 Act).	The offering of securities issued by the UIT is required to be registered pursuant to a registration statement deemed effective by the SEC prior to the public offer (Section 5 of the Securities Act).
Form	The UIT must file a Form N-8B-2 with the SEC to satisfy its 1940 Act filing obligations.	The UIT must file a Form S-6 with the SEC to satisfy its Securities Act filing obligations.
Review	The UIT’s 1940 Act filings are subject to review by the SEC’s Division of Investment Management.	The UIT’s Securities Act filings are subject to review by the SEC’s Division of Corporation Finance.
Disclosure	The following information is generally required in the Form N-8B-2: <ol style="list-style-type: none"> 1. a summary of the material terms of the trust indenture and other contracts into which the trust has entered; 2. a description of the securities offered; 3. a description of sales loads, fees, charges and expenses; 4. information regarding the sponsor; 	The following information is required in the Form S-6: <ol style="list-style-type: none"> 1. a summary of the material terms of the indenture and other contracts into which the trust has entered; 2. a description of the securities offered; 3. a description of all sales loads, fees and charges and expenses;

	Requirements under the 1940 Act	Requirements under the Securities Act
	5. distribution arrangements; 6. information regarding the trustee, custodian and other service providers; 7. information regarding portfolio insurance, if applicable; 8. tax information; and 9. audited financial statements.	4. information regarding the sponsor, including its history and operations, and its officers, directors and employees and their compensation; 5. any distribution arrangements; 6. information regarding the trustee, custodian and any other service providers; 7. information regarding portfolio insurance, if applicable; 8. tax consequences; and 9. audited financial statements.

Subsequent Registration

UITs may not conduct continuous or delayed offerings under Rule 415 of the Securities Act and therefore may not take advantage of the shelf registration process and must file a Form S-6 for any subsequent series of a UIT. Each series of a UIT is considered a separate registrant and must file its own registration statement on Form S-6 to register the series of the trust and the securities being offered as part of that series. After a UIT has filed a Form S-6 that was reviewed and declared effective by the SEC, the UIT may rely on Rule 487 for offerings of units of subsequent series, which may become effective immediately without affirmative action by the SEC if the series satisfies certain conditions. The Rule 487 process has the effect of permitting frequent offers by series of the UIT on an expedited basis and allows for delivery of a wide range of potential payoffs and underlyings. The procedural steps for using Rule 487 are as follows:

1. File an abbreviated Form S-6, which contains a facing sheet, a page identifying the prospectus of a previous series that the new series is relying on, and the signature page and exhibit list.
2. File a cover letter concurrently with the Form S-6 that sets forth the UIT’s intent to rely on Rule 487.
3. Distribute the marketing prospectus, which consists of the one-page prospectus of the new series followed by the prospectus of the previous series that is being relied upon.
4. File an amendment to the Form S-6 with the full prospectus for the new series and all exhibits, the requested time for effectiveness on the front cover and Rule 487 representations on the signature pages.
5. After effectiveness:
 - a. If the prospectus that will be used is not identical to the prospectus included in the Form S-6, file an additional prospectus under Rule 497(b).
 - b. If the prospectus that will be used is identical to the prospectus included in the Form S-6, file a Rule 497(j) certification in lieu of an additional prospectus filing.

Rule 487 eligibility is determined on a case-by-case basis. In order to avail itself of Rule 487, the UIT must satisfy a number of conditions: (1) identify one or more prior series of the UIT which the SEC has reviewed and declared effective; (2) represent that the securities deposited in the new series being registered do not differ materially in type or in quality from those deposited in the prior series and the disclosure in the prospectus for the new series will not differ materially from the disclosure in the prior series' registration statement; and (3) deliver a preliminary prospectus in compliance with Rule 460, which is used by the underwriting syndicate to obtain indications of interest for the units. In practice, complying with the second condition is the hardest. For example, a new series may rely on Rule 487 if the strategy of the new series is the same as the strategy of the prior series. If the new series, however, invests in a different underlying than the prior series, the new series would be materially different from the prior series and Rule 487 would be unavailable and a complete review by the SEC would be required prior to effectiveness. For example, the SEC has advised that a new series that invests in the EEM cannot rely on a prior series that invested in the SPY because there would be an additional risk factor in the prospectus related to non-U.S. companies. This additional (or different) risk factor is a material difference and prevents the use of Rule 487.

Blue Sky Requirements

The National Securities Markets Improvement Act of 1996 ("NSMIA") amended Section 18 of the Securities Act to preempt state blue sky registration and review of offerings of "covered securities." Pursuant to Section 18(b)(2) of the Securities Act, "covered securities" include securities issued by an investment company that is registered, or that has filed a registration statement, under the 1940 Act. As such, securities issued by UITs are exempt from substantive review by state authorities under Section 18(a)(1)(A) of the Securities Act. NSMIA did, however, preserve certain state rights regarding offerings of covered securities and, as a result, UITs are subject to procedural blue sky requirements, which may include notice filings, Form U-2 filings (consenting to service of process in that state), and related fees.

APPLICABLE RULES AND REGULATIONS

Ongoing Reporting Obligations. A UIT is subject to ongoing reporting obligations under the Securities Exchange Act of 1934 (the "Exchange Act"), the 1940 Act and the Securities Act. On behalf of the UIT, the sponsor, in conjunction with the trustee, prepares Form N-SAR under Rule 30a-1 of the 1940 Act within 60 days after calendar year-end to satisfy its ongoing reporting obligations under the Exchange Act. The Form N-SAR must disclose information regarding, among other things, sales during the reporting period, affiliated transactions, sales loads and other fees and expenses. Pursuant to Section 10(a)(3) of the Securities Act, the UIT's prospectus must be maintained and updated and should not include information that is more than 16 months old. In practice, the UIT's sponsor typically files post-effective amendments to the registration statement in order to comply with this requirement.

Secondary Market. The sponsor of the UIT may maintain a secondary market in, and act as a market maker for, the UIT's units. This allows investors to sell units back to the sponsor and allows other investors to buy units from the sponsor, which provides investors with enhanced liquidity and avoids depleting the UIT's assets due to sales of portfolio securities to meet redemption requests. Brokerage fees and commissions apply to purchases in the secondary market. A sponsor making a market in a UIT's securities is considered the "issuer" of those securities by the SEC and is required to keep current the registration statement in connection with any secondary market sales and must deliver a prospectus

in connection with such sales. In addition to the sponsor, any dealer in the UIT's securities must also provide investors with a current prospectus.

Exchange Listing. Because Section 22(d) of the 1940 Act and Rule 22c-1 thereunder require that an investment company's redeemable securities be sold at NAV, it is not possible to list units of a UIT on a national securities exchange due to the fact that the market price may not equal NAV. The SEC, however, has frequently granted exemptive relief to UITs, allowing UITs to list their securities on national securities exchanges. For listed UITs, investors can buy and sell on an exchange at the prevailing market price, which may be at a premium or discount to NAV, but which generally tracks the approximate value.

Advertising. The advertising materials and sales literature used in connection with a UIT by its sponsor are subject to several SEC and FINRA rules, a few of which are highlighted below:

- **Securities Act Rule 482:** applies to advertisements with respect to securities of a registered investment company that is selling securities pursuant to a registration statement that has been filed under the Securities Act. Depending upon the content of the advertisement and subject to certain required disclosures and legends, the rule allows for the inclusion of certain information in the advertisement that may not be included in the prospectus.
- **Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5:** provides that it is unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, to use sales literature which is materially misleading in connection with the offer or sale of securities issued by an investment company. Under these provisions, sales literature is materially misleading if it (1) contains an untrue statement of a material fact or (2) omits to state a material fact necessary in order to make a statement made, in the light of the circumstances of its use, not misleading.
- **Securities Act Rule 156:** prohibits the use of sales literature that is materially misleading in connection with the offer or sale of securities issued by an investment company. Determining whether or not a particular statement is materially misleading depends on an evaluation of the context in which it is made. Rule 156 provides guidance on factors that should be weighed in determining whether sales literature is misleading and sets forth (1) a few examples of general factors that could cause a statement to be misleading, (2) a non-exhaustive list of circumstances where representations about past or future performance could be misleading and (3) a few examples of where a statement involving a material fact about the characteristics or attributes of an investment company could be misleading.
- **FINRA Rule 2210:** governs communications with the public and provides for the review, record keeping, filing and content requirements applicable to advertisements used by a FINRA member, including Rule 482 advertisements.

Concentration. A UIT that concentrates in securities of issuers in a particular industry or a group of industries (i.e., invests more than 25% of its assets in a single industry or group of industries) must disclose that concentration in its principal investment strategy, as well as include applicable risk factors in the prospectus.

Naming Conventions. Section 35(d) of the 1940 Act prohibits a registered investment company from using a name that is materially deceptive or misleading. Rule 35d-1 under the 1940 Act prohibits a UIT from having a name suggesting that it focuses its investments in a particular type of investment or investments, unless: (i) the UIT has adopted a policy to invest, under normal circumstances, at least 80% of the value of its assets in the particular type of investments suggested by the UIT’s name (the “80% Policy”); and (ii) the 80% Policy is a fundamental policy under Section 8(b)(3) of the 1940 Act, or the UIT has adopted a policy to provide the its investors with at least 60 days prior notice of any change in the 80% Policy.

MECHANICS, PARTICIPANTS & GOVERNANCE

Unlike other investment companies, a UIT is not actively managed and does not have a board of directors. In lieu of a board of directors or investment adviser, a UIT employs other service providers (i.e., the sponsor (or depositor), trustee and evaluator) who are responsible for its day-to-day functions and provide minimal supervision.

Mechanics

On a certain date, the sponsor deposits the securities (or contracts to purchase securities) with the trustee in exchange for unit certificates representing shares of ownership. At the close of business on the day before the date of deposit by the sponsor, the evaluator places a value on the portfolio. The evaluator must certify that the value set forth in the prospectus and used to calculate the offering price is accurate. The evaluator must determine, in good faith and applying fair value principles, the value of securities for which market prices are not readily available. Once the sponsor receives the units, the units are then distributed to the public.

Participants

Sponsor: The sponsor, usually an investment bank or broker-dealer registered with the SEC, is responsible for organizing the UIT and establishing its investment objective and serves as the UIT’s principal underwriter. Pursuant to Section 14(a) of the 1940 Act, a UIT must have at least \$100,000 in funding prior to distributing its units and the sponsor is responsible for those initial costs, as well as for purchasing the portfolio securities. As described further below, the sponsor receives compensation based on the sales charge (load) attached to the unit sales and may also receive compensation for any additional portfolio supervisory services it provides. Depending on the valuation assigned by the evaluator, the sponsor may realize a profit or sustain a loss as a result of the difference between the price it paid for the portfolio securities and the cost of these securities on the date of deposit.

Trustee: The trustee is responsible for the possession of the UIT’s assets and, as a result, is responsible for maintaining the UIT’s assets, records of ownership, reporting to unit holders and ensuring that the UIT’s expenses are paid. Section 26 of the 1940 Act sets forth certain minimum requirements of a trustee, including that it must be a bank with at least \$500,000 of capital and that it cannot resign until the UIT (i) has been completely liquidated and the proceeds distributed to investors or (ii) a successor has been appointed. The trustee receives a fee for its services, which is typically based upon the total value of the UIT.

Evaluator: The evaluator values the UIT’s portfolio for purposes of pricing during the initial offering period, at the time of redemption and during any secondary market sales. In certain situations, the

evaluator may perform other supervisory services. The evaluator, who may be an affiliate of the sponsor, receives a fixed annual fee based on the size of the UIT or a fixed fee per evaluation.

GOVERNANCE

Written Policies and Procedures: Pursuant to Rule 38a-1 under the 1940 Act, a UIT is required to adopt and implement written policies and procedures that are reasonably designed to prevent violations of the federal securities laws. These written policies and procedures must be reviewed at least annually. The sponsor must approve and designate a chief compliance officer who is responsible for administering such policies and procedures and providing the UIT with a report of its annual review.

Written Code of Ethics: Pursuant to Rule 17J-1 under the 1940 Act, a UIT must adopt a written code of ethics that contains provisions designed to mitigate conflicts of interest between the registered investment company personnel and their funds. The sponsor is responsible for approving the UIT's code of ethics, as well as for adopting its own code of ethics.

COSTS ASSOCIATED WITH INVESTING IN UITs

Issuances may be structured for channel-specific broad syndication or multi-channel broad syndication and/or customized for limited distributions. UITs can be issued with two CUSIPs – a CUSIP for brokerage accounts and a CUSIP for fee-based accounts. There are several fees associated with UITs; the fees can include a sales charge, creation and development fees, and minimal ongoing fees for the trustee, sponsor, portfolio consultant or evaluator.

Sales Charge

A UIT may assess a front-end sales charge, a deferred sales charge or a combination of front-end and deferred sales charges. For UITs that assess a front-end sales charge, the price per unit equals its NAV plus the sales charge assessed. For UITs that assess a deferred sales charge, the collection of the charge is deferred over a period of time after the initial purchase and is deducted from the investor's distributions until the entire amount is paid. If an investor redeems its units before the entire deferred sales charge has been deducted, the balance is deducted from the investor's redemption proceeds. Since an investor may receive less than the unit's full value at redemption, UITs issuing units subject to a deferred sales charge should seek exemptive relief from the SEC.

Creation and Development Fee

Most UITs assess a creation and development fee that is designed to compensate the sponsor for creating and developing the UIT, including expenses related to preparing and printing the registration statement and organizing trust documents, registration of units and the initial audit. The creation and development fee is paid from the UIT's assets, and is generally deducted at the end of the initial offering period and computed based on the UIT's average daily NAV through the date of collection. Like all other fees, the creation and development fee is specified in the prospectus.

Ongoing Maintenance Costs

In addition to the organizational responsibilities discussed above, a sponsor typically performs ongoing services for the UIT and is generally entitled to receive a fee for providing portfolio supervisory services, maintaining unit holder records, updating the registration statement and audit services.

Annual Operating Expenses

Annual operating expenses of a UIT are paid from the assets of the UIT and typically include trustee fees and portfolio, bookkeeping, administration and other expenses. An estimate of the annual operating expenses is included in the prospectus.

Fee-Based Account Charges

Investors who own units of a UIT within a fee-based or advisory account are generally subject to an annual fee, which varies according to the investor's account size, the type of fee-based account, the securities within the account and other factors. UITs owned within a fee-based account are not assessed upfront or deferred sales charges, but are still subject to creation and development fees and operating expenses.

DISTRIBUTIONS

A UIT may distribute its income through dividends and interest payments throughout its term. Payments can occur monthly, quarterly, semi-annually or at termination. As described in more detail below, at the termination date, investors can receive cash equal to the NAV of the units, they can roll the current value of their investments into another UIT at a reduced sales charge or, in certain cases, they can receive an in-kind distribution of the portfolio of securities held by the UIT.

Like the maturity date for structured notes, UITs have a fixed termination date based on the portfolio of investments and investments goals; this date is established at the UIT's creation. At the termination date, all remaining portfolio securities are sold and redemption proceeds are then paid to investors. Depending upon the terms of the UIT, investors may have the following alternative options at termination:

- 1. Rollover:** Sponsors may offer subsequent series of UITs with the offering period for each new series coinciding with the end of the term of a prior series. This allows an investor to purchase a new series of the UIT with the same objective or strategy but with a new portfolio of securities. If a subsequent series is available, investors may exchange units for units of the sponsor's next UIT series. In the event no new series is available, an investor may have the option to rollover into other available UITs. If an investor decides to rollover, there is generally no upfront sales charge, although a deferred sales charge may apply. The rollover generally constitutes a taxable event.
- 2. Conversion:** Rather than invest in a subsequent series, investors can reinvest the proceeds from one series and invest in a different UIT. Investors may usually do this at a reduced upfront sales charge, but generally remain subject to the deferred sales charge on those units. The conversion option constitutes a taxable event.

In-Kind Distribution: Under certain circumstances, an investor may elect to receive its prorated distribution of the securities held by the UIT.

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