The rising popularity of collective investment trusts

In DC plans of all sizes, the use of collective investment trusts (CITs), also known as commingled funds, collective investment funds or collective trust funds, is growing.

A long-time popular choice of defined benefit (DB) plans, CITs have increasingly become a choice of defined contribution (DC) plan sponsors in recent years. As investment expense is generally the largest single expense associated with a retirement plan, lower-cost vehicles, including CITs, provide plan sponsors and participants the potential for considerable savings as the industry becomes more focused on driving down plan costs to enhance performance and avoid fee litigation.

CITs represent more than half of the investments used by the 100 largest corporate DC funds.

Investment Vehicle

<table>
<thead>
<tr>
<th></th>
<th>CIT</th>
<th>MUTUAL FUND</th>
<th>SEPARATE ACCOUNT</th>
<th>ETF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>54.3%</td>
<td>35.0%</td>
<td>10.6%</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

The potential pricing flexibility and cost advantages that CITs offer when compared with other investment vehicles are translating into greater demand in the DC market:

- CITs in DC plans have grown by 68% since 2008, with assets rising to more than $1.5 trillion by the end of 2014.1
- Of the 100 largest corporate DC funds by vehicle in 2016, CITs make up 54.3%, more than mutual funds, separate accounts and ETFs combined.2

Understanding the potential benefits of CITs, and how they differ from traditional mutual funds, can help DC plan committees determine if transitioning to CITs would be to a plan’s advantage.

CIT BASICS

CITs are tax-exempt, pooled investment vehicles maintained by a bank or trust company exclusively for qualified plans, including 401(k)s, as well as for certain types of government plans. They are similar to mutual funds, but with important differences. Like mutual funds, CITs are designed to facilitate investment management by combining assets from eligible investors into a single investment portfolio (i.e., a “fund”) with a specific investment strategy. However, collective trusts are exempt from the investment company registration requirements of the Investment Company Act of 1940 and the securities registration requirements of the Securities Act of 1933. These exemptions apply since collective trusts can only be offered by a bank to certain qualified employee retirement plans, and are not available to the general public. This does not mean that CITs are unregulated; CITs and respective bank trustees are supervised by the Office of the Comptroller.

2 Pensions & Investments, “Assets of the P&I DC 100 Increase 5.1% to $1.12 Trillion,” March 7, 2016.
of the Currency (OCC), or a state banking regulator, depending on the type of bank. CITs can include any of the investment assets that are in mutual funds, they can be actively managed or index funds, funds of funds (FOFs), or non-traditional, such as REITs. CITs are particularly useful in single-manager or multi-manager FOFs, such as asset allocation (target risk or balanced) and target date funds (TDFs). These investments are growing in popularity due to their designation as Qualified Default Investment Alternatives (QDIAs) under the Pension Protection Act (PPA). Today, the CIT structure is increasingly deployed in TDFs — often in an open-architecture approach giving plan sponsors a means of creating custom glide paths for their participant population at an affordable price.\(^3\)

Like other investment vehicles, CITs must follow ERISA regulations and are subject to rules of the Department of Labor (DOL). Each fund is managed and operated in accordance with the applicable trust’s governing documents, which generally include a declaration of trust (or plan document) and the fund’s statement of characteristics. Under ERISA, plan sponsors must disclose their arrangements with CITs on their 5500 forms and participants must receive at least quarterly notification of their positions.

FEE & FLEXIBILITY ADVANTAGES

Lower costs or fee advantages are a clear benefit of CITs over the mutual fund approach. In comparison to mutual funds, CITs typically have lower administration, marketing and distribution costs: because CITs are not subject to oversight from the U.S. Securities and Exchange Commission (SEC), they do not incur some of the expenses associated with compliance and regulatory reporting. There is no need to support the marketing and distribution of the fund into the retail space (e.g., producing prospectuses and maintaining retail call centers). Participant recordkeeping generally is at the plan level, rather than the CIT level, which can allow greater flexibility on recordkeeping structure and costs. This can all result in both lower initial and ongoing operational costs. As a result, CIT fees can be 20 to 25 basis points less than mutual fund fees.\(^5\)

Plan sponsors interested in securing lower plan fees are also attracted by an ability to negotiate investment management fees and, in most cases, plan asset (or TDF asset size) minimums. As CITs do not have 12(b)-1 fees, DC plans looking to reduce or eliminate revenue-sharing and shift to a per-person administrative fee model are gravitating to this investment vehicle option. Both factors help to drive CIT growth; according to Callan Associates, 71% of DC plans offered at least one CIT in 2015, up from 60% in 2014.\(^6\)

The shift to collective trusts offers additional benefits beyond lower fees. While CITs are by definition collective vehicles, they can be created specifically for large institutional investors. Plan sponsors also like the flexibility CITs can offer in terms of pooling together assets across multiple plans, often a common goal of large organizations with a history of M&A activity.

In comparison to mutual funds, CITs typically have lower administration, marketing and distribution costs. On average, CIT fees can be 20 to 25 basis points less than mutual fund fees.\(^9\)

---

CONSIDERATIONS

CITs continue to grow in popularity for a variety of reasons, including recordkeeper acceptance, consultant familiarity, pricing flexibility, daily valuation, NSCC Fund/SERV compatibility and improved reporting and transparency as a result of compliance with DOL disclosure requirements under ERISA. Plan sponsors also appreciate that CIT trustees are subject to ERISA fiduciary standards with respect to ERISA plan assets invested in CITs.7

Together with the plan’s advisor/consultant and ERISA attorney, plan sponsors should consider the following questions to determine whether transitioning to CITs within the plan’s investment lineup would benefit the plan and participants:

Is the plan provider’s current investment universe appropriate?

Is the cost structure appropriate given the plan size, the services provided and the scope of desired investment options?

Is there an opportunity to customize fees based on plan needs?

Would the plan benefit by switching some asset categories to CITs due to cost- or fee-adjusted performance?

What type of data and/or reporting will be supplied to the plan?

What communications, education and information will be supplied to plan participants? In what format?

Are there any liquidity boundaries, trading issues or operational considerations?

How experienced is the asset manager, and what is the firm’s reputation in the marketplace?

Given all available information, is the investment vehicle the best fit for the plan participants and their beneficiaries?

---

**Median Fee Comparison (basis points)**

<table>
<thead>
<tr>
<th>MUTUAL FUND</th>
<th>COLLECTIVE INVESTMENT TRUST</th>
<th>MEDIAN FEE DIFFERENCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>55.0</td>
<td>35.0</td>
<td>20.0 U.S. FIXED INCOME</td>
</tr>
<tr>
<td>83.0</td>
<td>60.0</td>
<td>23.0 LARGE-CAP EQUITY</td>
</tr>
<tr>
<td>125.0</td>
<td>100.0</td>
<td>25.0 EMERGING MARKETS EQUITY</td>
</tr>
<tr>
<td>105.0</td>
<td>80.0</td>
<td>25.0 ALTERNATIVES</td>
</tr>
</tbody>
</table>

Data is specific for a mandate size of $25 million and includes active and passive products. Fees are generally subject to a sliding scale. Source: Cerulli Associates, *Institutional Markets 2014: Gaining Marketshare as Shifting Portfolio Construction Presents New Opportunities and Challenges*.

---

**THE EVOLUTION OF CITs**

**Early CITs**

- Lack of pricing flexibility at the plan level
- Limited product offerings
- Quarterly valuation
- Manual processing of investor contributions and withdrawals
- Limited performance calculations based on quarterly valuations
- Limited availability of fund data
- Used almost exclusively in DB plans

**Modern CITs**

- Plan-level pricing flexibility often available
- Expanded universe of investment objectives
- Daily valuation
- Potential for more standardized and automated daily processing
- Performance generally available due to daily valuations
- Fund fact sheets and enhanced data reporting
- Used in both DB and DC plans


---

7Pensions & Investments, “Assets of the P&I DC 100 Increase 5.1% to $1.12 Trillion,” March 7, 2016.
## Stacking up
### MUTUAL FUNDS vs. CITs

<table>
<thead>
<tr>
<th>OPERATIONAL</th>
<th>SIMILARITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulated by the Securities and Exchange Commission under Investment Company Act of 1940, as amended; subject to numerous restrictions and limitations</td>
<td>Overseen by bank regulators and subject to ERISA/DOL regulation</td>
</tr>
<tr>
<td>Publicly available performance information; performance information published in newspapers and online; most are Morningstar® rated (if 3 years old)</td>
<td>Can access performance information through retirement recordkeeping website; distribution of more uniform performance information*; some CITs are Morningstar® rated (if 3 years old)</td>
</tr>
<tr>
<td>Single management fee charged; investors in different share classes may pay different amounts for other services or distributions May include 12b-1 fees</td>
<td>Different fee structures based on services and size of plan No 12b-1 fees</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TRANSACTIONAL</th>
<th>DIFFERENCES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Generally restrict access to, or require high minimums for, lower-cost institutional share classes**</td>
<td>Commonly have no or low minimums</td>
</tr>
<tr>
<td>When employee leaves plan, CIT cannot be rolled over into an IRA</td>
<td>When employee leaves plan, CIT cannot be rolled over into an IRA</td>
</tr>
</tbody>
</table>

*Rule 404a-5 requires standardized disclosure on fee and performance for all investment options offered in participant-selected retirement plans.
**This comparison is general in nature only and is not an exhaustive list of distinguishing features. It also does not account for retirement plan relationships where features of these products may be different (e.g., applicability of redemption fees).
***Mutual fund shares are redeemed at current NAV, which may be more or less than original cost.
****This comparison is general in nature only and does not account for retirement plan relationships where features of these products may be different (e.g., applicability of redemption fees). CIT units are generally redeemed at current NAV, which may be more or less than original cost.

Please visit [im.bnymellon.com/planetdc](http://im.bnymellon.com/planetdc) for access to additional articles and the full version of the magazine.