A GUIDE TO COLLECTIVE INVESTMENT TRUSTS

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Collective Investment Trusts (CITs) have risen to prominence because of their attractive fee structure and operational similarities to mutual funds. In the last decade, CIT assets have surged from $995bn to $3.8tn.

Once only utilised in large retirement plans, CITs have moved into the mainstream as an attractive vehicle for both large and small defined contribution (DC) plans.

According to Callan's 2019 Defined Contribution Survey, 70 per cent of plan sponsors reported having CITs on their investment menu, a notable increase from about 40 per cent in 2011.

But CITs have several meaningful differences with mutual funds that plan sponsors should be mindful of when evaluating vehicle options.

WHAT IS A CIT?

CITs are pooled funds that can allow investors to benefit from economies of scale.

Assets are commingled into one portfolio, often referred to as a fund, with a defined investment strategy.

They are organised as trusts and maintained by either a bank or a trust company.

WHO CAN INVEST IN A CIT?

CITs are only available to certain types of qualified US retirement plans, including both defined benefit (DB) and defined contribution (DC) plans.

They are not available to:

- Individual investors
- Foundations
- Endowments
- Church plans that are not qualified under Code Section 401
- Other non-ERISA plans.

WHY INVEST IN A CIT?

CITs have become increasingly popular with retirement plans because they are generally less expensive than mutual funds.

With more scrutiny on fees, many plan sponsors have added CITs as an option to their investment menu to lower overall costs.

By design, CITs offer many of the same operational efficiencies as a mutual fund, including daily liquidity and transparency.

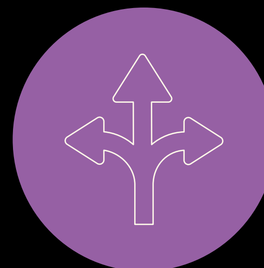
Another advantage is that you invest alongside other institutional investors and are not subject to retail investors' inflows and outflows, which may be inconsistent over time.

WHY ARE CITS LESS EXPENSIVE?

Generally speaking, CITs have structural benefits that make them cost effective for plan sponsors, including:

Lower regulatory costs

Lower marketing and distribution costs



Greater pricing flexibility

CITs are not registered with the Securities and Exchange Commission (SEC). As a result, they have lower operating costs because they incur fewer regulatory, legal and board related fees.

Since CITs are not marketed to the general public and are only available to retirement plans, they have lower distribution and marketing expenses compared to mutual funds.

One of the key advantages of CITs is their ability to offer greater pricing flexibility relative to mutual funds. Under SEC rules, mutual funds must charge the same management fee to all share classes of the fund. CITs, on the other hand, can offer share classes with different management fees depending on the share class minimum. As a result, larger plans can benefit from lower CIT expense ratios.

While CITs have many advantages, it's important to note that CITs are not subject to the same regulatory requirements as mutual funds. Plans should evaluate their options to ensure that a CIT is suitable for their investment needs.

HOW DOES A CIT COMPARE TO A MUTUAL FUND?

There are many commonalities between a mutual fund and a CIT, but also meaningful differences that plan sponsors should be mindful of when designing their retirement programme.

Characteristics	CITs	Mutual Funds
Oversight and regulation	Office of the Comptroller of Currency (OCC), the Internal Revenue Service (IRS) and the Department of Labor (DOL)	Registered with the SEC and subject to securities laws and regulations
Governance	Investment managers are retained by the CIT Trustee and subject to the trustee's supervision and oversight	Investment Manager approved by a fund's board of directors, subject to the board of directors' supervision and oversight
Marketing limitations	Cannot be marketed to the public	Marketing subject to FINRA requirements
Eligible investors	Qualified retirement plans only	Subject to prospectus criteria, but there are far fewer limitations
Offering documents	Declaration of Trust and Offering Memorandum	Prospectus and Statement of Additional Information (SAI)
Fees	Generally lower and may be scaled depending on the share class	Generally higher. Management fees remain the same across different share classes of the same fund
Operating costs	Generally lower operating and distribution costs	Generally higher operating and distribution costs
Reporting	Typically, performance and holdings information is made available by the Trustee	Publicly available
Pricing	Daily	Daily
National Securities Clearing Corporation (NSCC) cleared and traded	Yes	Yes

REGULATORY STRUCTURE

CITs are subject to the DOL rules, and they are required to operate in compliance with ERISA.

Under ERISA, plan sponsors have a fiduciary responsibility to offer reasonably priced investment options.

Utilising CITs in a retirement plan may help plan sponsors to meet this requirement by keeping overall costs low.

ROLE OF THE BANK OR TRUST COMPANY

CITs are maintained by a bank or a trust company and are audited annually by independent auditors.

The bank or trust company will act as the CIT's trustee and their role is to provide oversight to the CIT's investment manager. The Trustee is also responsible for appointing the CIT's appointing service providers, including the investment adviser.

CITs are organised according to the trust documents that govern their operations and investments.

The bank or trust company is responsible for the administration of the CIT including:

— Pre- and post-trade monitoring

— Production of monthly statements

— Accounting and record-keeping services

— The valuation of the CIT.

THE EVOLUTION OF CITS

Plan sponsors were reluctant to use early versions of CITs because of their complexity: investor withdrawals and subscriptions had to be processed manually, there was little visibility on holdings and they were valued infrequently.

For many years mutual funds provided plan participants with a better experience, including daily valuations, transparency of holdings and more seamless transactions.

In 2000 CITs were added to the NSCC mutual fund trading platform, FUND/SERV. This allowed CITs to offer standardised transaction processing and daily valuations. With smoother operations, CITS began to grow in popularity.

For the past two decades, CITs have operated in a similar fashion to mutual funds. This helped propel their broader use.

Initially, CITs were utilised in large plans. However in recent years, an increasing number of record-keeper platforms offer CITs. This has made CITs accessible to retirement plans of all sizes.

As assets have grown, CITs have become more visible to the investment community. Third-party data through Morningstar and eVestment has increased, providing additional transparency and reporting capabilities.

In total, the operational advancements, increase of adoption across record-keeping platforms and third-party reporting have made CITs a mainstream investment vehicle for retirement plans, especially within the DC market.

With smoother operations, CITs began to grow in popularity.

GROWTH OF CITS

Mutual funds remain the most common investment vehicles for retirement plans, but the steady growth of CITs is changing the landscape for plan sponsors.

What's driving this shift to CITs? Fees remain an important consideration for plan sponsors. According to Callan's 2020 Defined Contribution Survey, the top three things that a plan sponsors evaluate when selecting investment funds are:

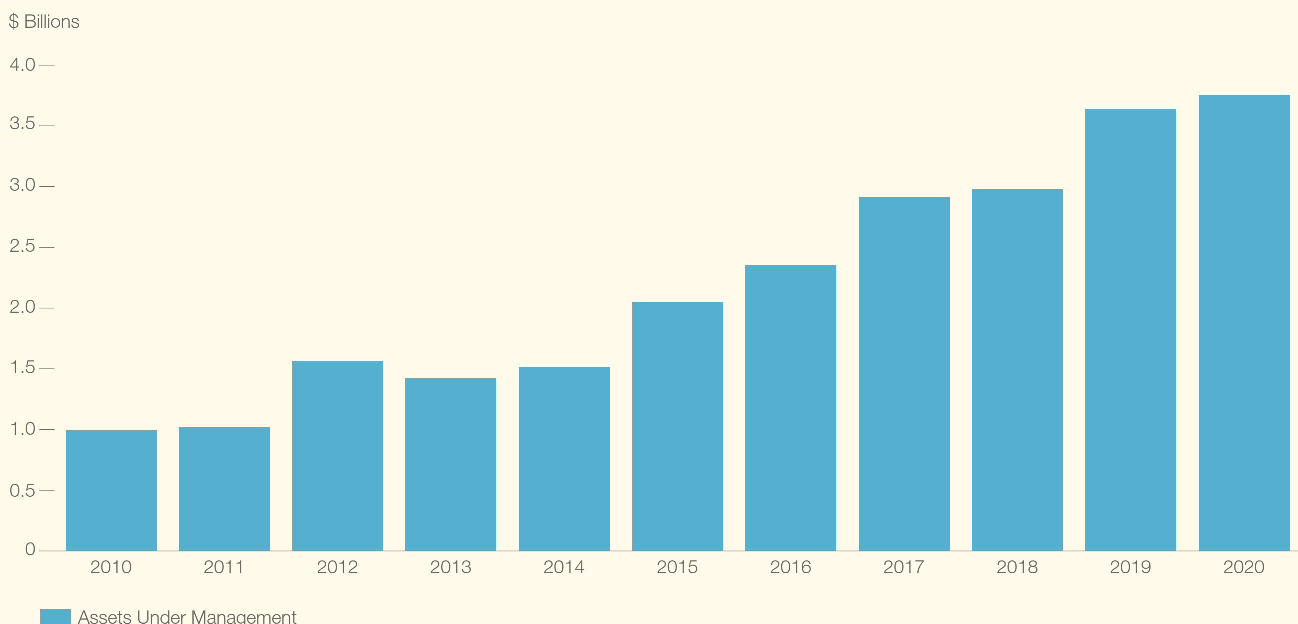
1. Investment performance
2. Cost and fees
3. Fits a style or strategy gap.

Unsurprisingly, more than 40 per cent of plan sponsors said they were likely to switch to a more institutional vehicle, such as a CIT, to reduce fees.

CIT assets have more than tripled in the last decade, growing from $995bn in 2010 to $3.8tn at the end of 2020. In the last six calendar years alone, CITs have grown year over year with positive net inflows.

CITs have grown from a low base to become a widely accepted investment option for retirement plans.

Growth of CIT assets under management (billions of dollars)



Source: Morningstar as of 31 December 2020.

THE OUTSOURCED CHIEF INVESTMENT OFFICER (OCIO) OPPORTUNITY

A growing number of DC plans have looked to OCIO solutions to help navigate the regulatory environment and growing ERISA fiduciary standards.

DC plans represent the fastest area of growth for OCIO providers, according to a 2019 P&I Survey. OCIO mandates with DC plans grew over 44 per cent to $164bn from 2018 to 2019.

CITs can be attractive vehicles for OCIO programs because of their lower cost and flexible pricing.

CONTINUING THE CONVERSATION

The retirement landscape has evolved, and plan sponsors now have more types of vehicles to choose from.

There are many considerations when picking a vehicle. Plan sponsors should weigh their options and take into account the size of their investment, the operational capabilities of their record keeper, and the needs of their participants.

To learn more about our various vehicle options, please email us at CITenquiries@bailliegiffford.com

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