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# Collective Investment Trusts

## Lower Costs, Greater Flexibility

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Mutual funds' popularity in defined contribution plans comes from participant familiarity, a perception of portability and greater access to public information. However, investors may not be seeing the full picture. Here we'll review meaningful CIT advantages over mutual funds.

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As defined contribution (DC) plans continue to grow as a source of retirement savings, many plan sponsors are looking to bring best practices from the defined benefit world into their DC plans. We believe the increasing popularity of collective investment trusts (CITs) among plan sponsors reflects the trend toward a more institutional approach to investing in DC plans. A recent study published by Callan Associates shows that some 78% of surveyed DC plans offered at least one CIT in 2020, up from 44% in 2011.<sup>1</sup> In addition to providing the potential for lower overall costs, CITs may offer plan sponsors more options for accessing institutional-quality investment strategies while maintaining ERISA fiduciary standards.

Although traditionally offered by primarily the largest plan sponsors, CITs are now being considered by smaller plan sponsors for a number of reasons, including an increasing focus on plan expenses, pricing flexibility and availability on distribution platforms. Looking ahead, we expect CITs to continue capturing a growing share of defined contribution plan assets from plans of all sizes. CITs and mutual funds typically serve a similar function within a DC plan: Both can provide participants with high-quality, professionally managed investments that, in most cases, offer daily valuation and liquidity. Additionally, both may offer a variety of pricing structures to suit different market segments.

While CITs and mutual funds are similar, there are some key differences to keep in mind, including how they are regulated, their cost structures and the degree of flexibility that each may offer plan sponsors. We'll briefly examine some of those differences here.

The Basics — What Is a CIT?

Many CITs, like mutual funds, are pooled investment vehicles managed collectively in accordance with a common investment strategy. While mutual funds are typically maintained by an asset management company and available to most retirement plans and retail investors, many CITs are maintained by a bank or trust company and offered only to certain qualified retirement plans. In addition, CITs have a separate set of regulators from mutual funds and typically are restricted from making fund information available to the general public. Nonetheless, in many cases, participants can find information online about their CITs by using designated web portals, often established by their recordkeeper or plan sponsor.

Figure 1  
CIT and Mutual Fund  
Characteristics  
at a Glance

	CITs	Mutual Funds
What They Are	Commingled investment vehicles typically maintained by a bank or trust company and offered only to certain qualified retirement plans	Commingled investment vehicles typically maintained by an asset management company and available to most retirement plans as well as the general public
Oversight and Regulation	Often regulated by the Office of the Comptroller of Currency (OCC) and the IRS and Department of Labor (DOL)  Fund trustee can be subject to ERISA standards aimed at protecting plan participants	Regulated by the Securities and Exchange Commission (SEC), among other statutes, under the Investment Company Act of 1940, as amended  Manager not held to ERISA standards
Governing Documents	May be governed by a declaration of trust and investment/operating guidelines  For participants, usually provide fund fact sheets or work with third-party provider to create them	Primarily a prospectus and statement of additional information  For participants, usually provide fund fact sheets or work with third-party provider to create them
Reporting	Audited financial statements  Subject to DOL and ERISA reporting requirements, including but not limited to Form 5500 Schedule C and Sections 404a-5 and 408(b)(2) of ERISA	Annual report  Subject to DOL and ERISA reporting requirements, including but not limited to Form 5500 Schedule C and Sections 404a-5 and 408(b)(2) of ERISA
Fee Structure	May have multiple share classes  Potential for negotiated pricing arrangements	May have multiple share classes
Trading	Most can trade via National Securities Clearing Corporation (NSCC)  Usually daily valuation	NSCC trading  Usually daily valuation

Source: State Street Global Advisors.

Regulatory Structure of CITs

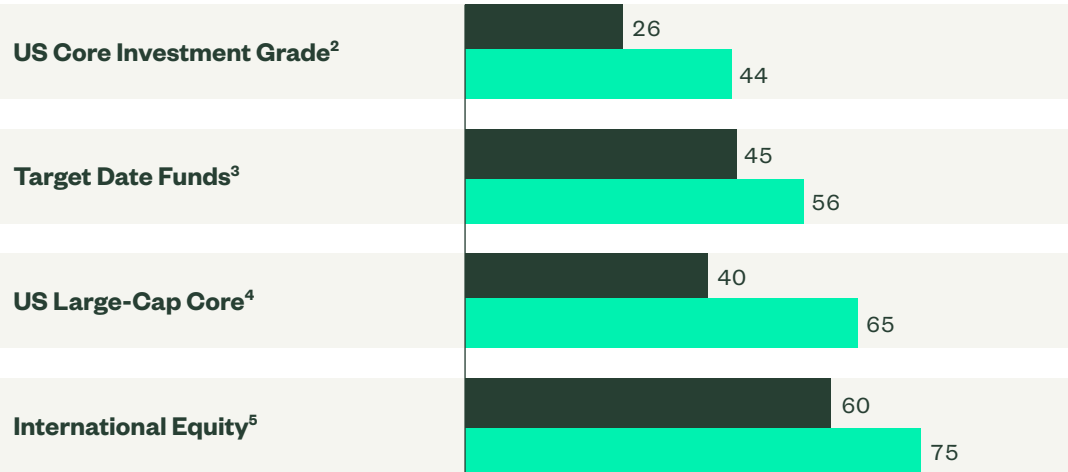
A key difference between CITs and mutual funds is how each vehicle is regulated. Mutual funds are regulated by the Securities and Exchange Commission (SEC), among other statutes, under the Investment Company Act of 1940, as amended. Their governing documents primarily consist of a prospectus and statement of additional information. While mutual funds are typically available to both retail and institutional investors, CITs are generally available only to certain qualified retirement plans and do not have publicly available fund information and tickers. CIT providers are often regulated by the Office of the Comptroller of Currency (OCC), as well as the IRS and Department of Labor, and CITs may be governed by a declaration of trust and investment/operating guidelines. Many CIT managers also have an additional layer of oversight in that they are held to ERISA fiduciary standards. This means that they must manage plan accounts solely in the interest of such plan’s participants and beneficiaries.

Lower Costs and Increased Flexibility

Amid increased public attention to DC plan expenses, many plan sponsors are looking for lower-cost solutions. CITs typically have lower expenses than mutual funds because in many cases they have lower marketing costs, no board of directors, no SEC filing requirements and generally have lower overhead. CITs may also offer more flexibility in pricing, allowing for customized arrangements based on overall plan size. As plan-level assets within a CIT increase, for example, fees could potentially decrease. Additionally, the share class creation process can be quicker for CITs. There are other structural advantages to CITs that can help to reduce costs. One way is through their ability to take advantage of certain internal cross trading practices, which reduces the transaction and trading costs incurred by the fund.

Figure 2  
Comparing Total Expense Ratios (TERs) for CITs vs. Mutual Funds  
CITs May Offer Lower TERs Than Mutual Funds, Extending Greater Cost Advantages

CIT (bps)  
Mutual Fund (bps)



Source: Mercer Global Asset Manager Fee Survey 2020.  
\* Fees assume \$100M asset minimum level.

CITs also benefit from certain tax advantages, especially with international investments, given their mainly institutional and retirement plan investor base. ERISA CITs are afforded a tax rate of zero in nine countries, which represent 47% of the MSCI ACWI ex US IMI Index. Mutual funds pay a tax rate of 10–15% in these same countries. Based on 2021 dividend yields, this difference in tax rates equates to a cost advantage of 14 bps for an ERISA CIT investor over a mutual fund investor.

Figure 3  
**CIT Tax Benefits  
Translate to Positive  
Performance**

Year 2020	Gross Dividend Yield (%)	Erisa — Index Tax Diff (%)	MF — Index Tax Diff (%)	Erisa — Mutual Fund Tax Benefit (%)
MSCI WORLD X US	2.71	0.42	0.22	0.20
MSCI ACWI X US IMI	2.03	0.28	0.15	0.14
MSCI ACWI	1.70	0.36	0.30	0.06

Sources: MSCI Index data, published ERISA and regulated investment company tax rates, as of 12/31/2021.  
Past performance is not a reliable indicator of future performance.

Said differently, assuming your plan has \$100 million in an index fund benchmarked to the MSCI ACWI ex US IMI Index, the decision to utilize a mutual fund over a CIT can cost your plan \$140,000. The difference becomes starker when considering CIT indices that include only developed countries, where the tax benefit is concentrated.

In total, lower fund costs can potentially provide increased retirement savings to participants.

**An Institutional Approach to Investing**

Retail mutual fund managers typically manage portfolios with the needs of both taxable and tax-exempt investors in mind. In contrast, many CITs designed for retirement plans are managed exclusively to meet the needs of tax-exempt investors, making them an attractive choice for many plan sponsors. With an institutional focus, CITs can offer DC plan participants the type of high-quality, low-cost investment strategies enjoyed by pension funds and other institutional investors. Furthermore, CITs can provide sponsors access to more alternative investment strategies that may not be available in a mutual fund. Finally, as institutional investment vehicles, many CITs allow for white labeling by plan sponsors. This can create more flexibility for plan sponsors in designing and naming their investment menu. For example, a plan sponsor could combine multiple managers into a single investment option for participants, such as “the ABC Company Large Cap Equity Fund.” Customizing the names of investment strategies can help participants better understand the products in which they are investing.

Figure 4  
**Retirement Plans Eligible to Use CITs**

Typically Eligible	Typically Not Eligible
Qualified 401(k) plans	403(b) plans
Qualified profit sharing plans	457(f) plans
Qualified stock bonus plans	IRAs and Keoghs
Qualified pension plans	Endowment plans
401(a) government plans	Foundation plans
457(b) government plans	—
Certain separate accounts and contracts of insurance companies	—

Source: State Street Global Advisors.

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## **Communicating CIT Information to Participants**

Today, most CITs are valued daily, can offer transparency of holdings and are traded via the National Securities Clearing Corporation. In addition, most CIT managers will provide plan sponsors with participant fact sheets or will help develop them working with a third party. Such fact sheets can help participants understand certain key holdings and sector exposures of a CIT's investment strategy.

Many providers, including State Street Global Advisors, also allow for their CIT information to be made available on data and fiduciary platforms such as Morningstar®, making it easier than ever to pull information on CIT options.

Keep in mind that CITs are not regulated by the SEC, so participants will not be able to access their daily fund information or research a ticker symbol through public websites or news sources. However, participants may be able to access daily fund information through their plan's designated online portals. When adopting CITs, plan sponsors will most likely need to educate participants about where and how to access fund information online.

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## **Growth on Recordkeeping Platforms**

A growing number of recordkeepers are now able to support robust reporting services for CITs. Plans of all sizes can now access certain CITs through most recordkeeping platforms. If operational changes are necessary, many CIT providers are willing to work with recordkeepers to accommodate reporting requirements. If you're a plan sponsor who is considering CITs, we suggest having an in-depth conversation with your recordkeeper about their capabilities, available investment options and any changes to your service that may be associated with adding CITs to your investment options. Your recordkeeper's experience and expertise can be a valuable resource when introducing CITs to your plan.

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## **Exploring Your Options**

The choice of using CITs, mutual funds or both in your plan will probably depend largely on the size of your plan, the type of plan you offer and your objectives as a plan sponsor. We believe the current CIT market provides a diverse selection of assets classes as well as differentiated share classes for plan sponsors. From an operational and transparency perspective, CITs have evolved to accommodate the needs of defined contribution plans.

Here are some possible conversation starters for your DC plan's investment committee as you consider various types of investment vehicles:

- How can you best serve the investment needs of your participants?
- What impact would lower fees have on your participant's' long-term investment success?
- What types of investment vehicles can your current recordkeeper support?

## Endnotes

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| 1 Callan Institute 2020 Defined Contribution Trends Survey.                      | 4 "US Large-Cap Core" references US Equity Large Cap Core.                     |
| 2 "US Core Investment Grade" references US Fixed Income — Core Investment Grade. | 5 "International Equity" references World ex US/EAFE Equity — Core Developed.  |
| 3 "Target Date Funds" reference US Other — Lifecycle Funds — Target Date.        | 6 MSCI Index data, published ERISA and RIC tax rates, as of December 31, 2021. |

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\* Pensions & Investments Research Center, as of December 31, 2021.

† This figure is presented as of December 31, 2022 and includes approximately \$58.60 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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