K R News

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CITs—Not Necessarily a “No Brainer” Fiduciary Decision

CITs—What are they?

A Collective Investment Trust (“CIT”), sometimes called a Common Collective Trust, is a tax-exempt, pooled investment vehicle maintained by a bank or trust company, available only to ERISA-qualified retirement accounts, governmental retirement plans, and church retirement income accounts. CITs are growing in popularity because they offer a low-cost structure—even small, qualified retirement plans are considering and may benefit from CITs as an investment option for participants.

CITs—How are they different from mutual funds?

CITs are generally cheaper investment options than the mutual fund equivalent primarily due to a lighter regulatory burden, and CITs not dealing with retail investors. Additionally, lower administration, marketing, and distribution costs than comparable retail products contribute to their lower cost.

What should you know about CITs before investing?

The decision to move from a mutual fund to a CIT is not as simple as a mutual fund share class change. Fiduciaries must examine and understand the extent to which they are selecting a different investment. Important considerations include:

Plan Documents

Investing in a CIT requires careful review of the plan and its investment policy statement (“IPS”). While CITs offer flexibility to invest in a broader range of alternative assets, a new CIT may lack the long-term performance history that a plan’s IPS requires. Further regulatory guidance requires certain language be contained in plans investing in CITs. Therefore, fiduciaries must ensure the plan document and the plan’s IPS allow for investments in CITs and that a CIT that may not have an extensive track record can meet the IPS monitoring and selection criteria.

Securities Lending

A CIT has the option, similar to mutual funds, to lend a portion of its portfolio securities, usually for short sales, to a third party. A CIT is not as limited as mutual funds in how much of its portfolio can be lent out. While lending can boost returns, it introduces additional party risk if borrowers fail to return the securities.

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Alternative Investments

CITs have more investment latitude than mutual funds to invest in illiquid alternatives such as private equity. Mutual funds are regulated by the SEC and are limited to holding no more than 15% of their net assets in illiquid investments. CITs, however, are not limited in the proportion of their portfolios that can be allocated to less liquid investments.

This flexibility requires fiduciaries to consider the suitability and risk—such as liquidity risk—associated with these assets.

Tracking Error

CITs are designed specifically for retirement plans and do not have retail investors. CIT tracking error to an index tends to be smaller than the tracking error found in mutual funds with retail investors. However, investment differences described above may create greater tracking error as compared to the actively managed mutual funds originally selected by the fiduciary. Fiduciaries should consider participant expectations and (for CITs with shorter histories) whether measuring the fund using historical performance of the same manager but a different fund is appropriate.

Management Structures

CITs qualify for exemptions from certain federal securities laws, which can reduce costs. However, these exemptions apply only when a bank or trust company has significant control over the investment decisions. In some cases, a CIT may be designed to resemble a mutual fund and use a firm as a subadvisor. If that firm is not the trustee, a separate fiduciary—who can hire and fire the investment manager—must be involved. This added layer can introduce complexity. For smaller retirement plans in particular, using CITs may lead to more parties being involved, including additional fiduciaries that should be evaluated and monitored, creating potential conflicts.

While CITs can be an effective investment option for retirement plans, investing in them is a fiduciary decision that requires thorough due diligence and proactive planning and monitoring. To learn more about fiduciary obligations related to CITs, please contact a member of Kutak Rock's Employee Benefits and Executive Compensation practice group.