

Next Steps for Making Collective Investment Trusts Available to More Retirement Plans

by William D. Jewett on January 3, 2023

Collective investment trusts (“CITs”) have become an increasingly popular choice for 401(k) plan investment menus over the past decade, consistent with a trend toward lower-cost investment options that has been driven, in part, by widespread litigation. However, certain technical restrictions have kept CITs from being offered as investment options in other types of retirement plans, such as 403(b) plans and 457(f) plans. The signing into law of SECURE Act 2.0 on December 29, 2022, comes as welcome news, since it includes a provision amending the Internal Revenue Code to authorize investments by 403(b) custodial accounts in CITs, effective January 1, 2023.

However, this change in the tax law will not in itself clear the way for investment providers to offer CITs to 403(b) plans because a deterrent remains under the Investment Company Act of 1940: a CIT holding assets of 403(b) plans would not be exempt from regulation as an investment company, as CITs are intended to be. Specifically, Section 3(c)(11) of the Investment Company Act of 1940 excludes from the definition of “investment company” a CIT that holds assets attributable to qualified plans, governmental plans, and church plans, but it does not similarly exclude a CIT that holds assets of 403(b) plans other than governmental plans or church plans. It is reasonable to conclude that investment providers offering CITs will not offer them to 403(b) plans generally until Section 3(c)(11) is amended.

A different technical impediment may be discouraging investment managers that operate CITs from including them on the investment menus of their own 401(k) plans. An investment manager that wants to include a proprietary mutual fund on its 401(k) plan’s investment menu can rely on Prohibited Transaction Class Exemption 77-3, which permits a plan to invest in a mutual fund that pays compensation to a plan fiduciary or an affiliate, notwithstanding the potential conflict of interest. But PTCE 77-3 does not extend to CITs.

Suppose an investment manager that offers a mutual fund paying it fees totaling 50 basis points also offers the identical strategy in a CIT that charges negotiated fees averaging 25 basis points. The investment manager may determine that, based in part on participant interest, the strategy should be offered in its 401(k) plan, and it may soon take comfort in the provision of new rules on investment selection under Section 404 of ERISA stating that a plan fiduciary does not violate its duty of loyalty solely because it takes into

account participants' preferences.¹ However, since PTCE 77-3 would provide relief from ERISA's prohibited transaction restrictions only if the investment manager selects the more expensive mutual fund, the investment manager may be concerned that it is precluded from selecting the less expensive CIT, notwithstanding its obligation to provide cost-effective investment options. The concern would be based on longstanding Department of Labor guidance that a fiduciary may not use its fiduciary authority to cause a plan to pay an "additional fee" to the fiduciary.² While a 25 basis point fee would not be an "additional fee" when compared to an alternative that charges 50 basis points, it would be an "additional fee" when compared to a CIT with all fees waived. The investment manager might conclude, out of an abundance of caution, that it would be required to waive all fees in connection with its 401(k) plan's investment in the CIT, and it might therefore decide to offer the mutual fund, notwithstanding the higher fees.

The consensus view that offering CITs is advantageous to plan participants should be matched by a consensus view in favor of eliminating the last legal impediments to more widespread use of CITs. In the case of 403(b) plans, this will require an act of Congress, but one that is not subject to any real controversy. In the case of investment managers who wish to offer proprietary CITs in their own 401(k) plans, an amendment to PTCE 77-3 would be required for fiduciaries to have the same level of comfort as with proprietary mutual funds. Stakeholders may want to speak out in favor of these changes in the coming months.

If you have questions regarding the availability of CITs for retirement plans, please contact any member of [Verrill's Employee Benefits & Executive Compensation Group](#).



William D. Jewett

Partner

T (617) 292 2856

[email](#)

¹ Final Rule, Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, Dept. of Labor Regs. 2550.404a-1(c). This new provision takes effect January 30, 2023.

² Dept. of Labor Regs. 2550.408b-2(e)(1).