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MEMO

To: City of San Jose Deferred Compensation Advisory Committee

From: Hyas Group

Date: March 4, 2021

RE: Collective Investment Trusts in a Mutual Fund World

For decades, many employees in participant-directed retirement plans (such as 401(k) plans and 457 plans) had the same tools the average retail investor bought: expensive mutual funds. Pension plans with their many millions if not billions of dollars used a very similar but vastly different vehicle: the collective investment trust (CIT).

CITs are not new but given the growing heft of participant-directed retirement plans – especially in the era of pension reform – more and more mutual fund companies are offering CITs and many participant-directed retirement plans are using CITs. In fact, below is a sample list of plans we know that use (or will use in the very near future) the CIT version of an investment on their participant-directed retirement plan menu:

- City of Oakland
- City and County of San Francisco
- City of Santa Clara
- City of Phoenix
- City of Seattle
- City of Spokane
- City of Portland
- Napa Sanitation District
- Kansas City Police
- Marin County
- Snohomish Public Utility District
- California Public Employees' System's (CalPERS)
- There are corporate plans that use CITs such as Google, Facebook, and Adobe.

Finally, the City of San Jose's pension plan likely utilizes CITs.

The benefits of using the CIT version of an investment strategy are mainly a cost and performance. The Table below is an example that illustrates the cost difference of mutual funds versus CITs

Name	Expense Ratio	Five Year Return Average
Vanguard Target Date Investor	0.14%	10.48%
Vanguard Institutional Target Retirement	0.09%	10.53%
Vanguard Target Retirement Date Trust II (CIT)	0.08%	10.55%
T. Rowe Price Large Cap Growth I	0.56%	-
T. Rowe Price Large Cap Growth Trust C (CIT)	0.45%	-

In terms of dollars, given the assets, the estimated annual savings of using the CIT versus utilizing the lowest cost mutual fund version can be found in the table below.

Name	Assets (as of December 31, 2020)	Expense Ratio Difference	Estimated Annual Savings
Vanguard Target Retirement Funds	$344,862,781	0.01%	$34,486
T. Rowe Price Large Cap Growth Fund	$185,353,784	0.11%	$203,889
TOTAL			**$238,375**

However, there are potential downsides of using the CIT version as opposed to the mutual fund. The main two are directly below:

- CITs are not registered with the US Securities and Exchange Commission and are not subject to the Investment Company Act of 1940. Although they may appear to be less regulated, they are strictly overseen by the Office of the Comptroller of the Currency and are subject to a variety of federal and state laws and regulations. In addition, CITs must comply with certain Internal Revenue Service rules.
- There are no ticker symbols with CITs. Many retirement plan participants like to research their funds and track performance and holdings in real time. The unique ticker symbols of mutual funds allow them to do this via online financial sites. Since CITs have no ticker symbol but rather quarterly fund fact sheets, the information can get stale fairly quickly.

The other potential drawbacks generally include the relative newness in the defined contribution world and the operational hurdles such as added paperwork for the plan sponsor. Some other questions have been raised around CITs being able to change their fees at any time. Although this is true (and it is important to note that mutual funds can do the same exact thing), CITs are governed by boards that represent shareholders (also known as investors or retirement plan participants). Monitoring fees will remain an ongoing fiduciary duty to make sure all fees (administrative, investment, etc.) fees participants pay continue to be reasonable.

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Below is a chart that highlights how each of the types of investment vehicles operate:

Characteristics	**CITs**	**Mutual Funds**
What Are They?	Commingled investment vehicles typically maintained by a bank or trust company and only offered 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 Office of the Comptroller of Currency (OCC) and the IRS and 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 NSCC Usually daily valuation	NSCC trading Usually daily valuation

Source: https://www.ssga.com/dc/2019/Collective-Investment-Trusts-vs-Mutual-Funds.pdf

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