IGNITES

OPINION

CITs Light on Fees, but Not on Regulation

Opening access to 403(b)s would give the plans lower-cost investment options, without compromising on regulatory oversight or transparency.

By Jason Levy | January 2, 2025

Jason Levy
is a senior counsel at
Great Gray Trust

The House of Representatives, the Senate and retirement policy experts, including Boston College's Center for Retirement Research, agree: 403(b) retirement plans should have access to collective investment trusts, because they are strictly regulated, transparent and often confer meaningful cost savings and increased protections to retirement investors.

The Secure 2.0 Act amended the Internal Revenue Code to allow 403(b)s in CITs, and legislation passed in the House and pending in the Senate with bipartisan support would finish the job of providing this access.

The widespread support for those bills has focused attention on the retirement security enhancements that will be available to participants in 403(b)s when they receive the same access to CITs afforded for decades to private-sector retirement plans, such as 401(k)s.

Ignoring these considerable benefits, the president of Versanture Consulting argued in a recent commentary that 403(b)s shouldn't have equal access to CITs based on false premises that CITs are subject to "reduced oversight," "more limited transparency" and offer "reduc[ed] protections for 403(b)s."

These claims couldn't be further from the truth. Let me address them one by one.

CITs are subject to strict regulatory oversight. Because they can be offered only to retirement plans, virtually all CITs accept investments from plans that are subject to the Employee Retirement Income Security Act — a critical feature ignored by the Versanture article.

If an Erisa plan invests in a CIT, the CIT, its trustee and its investment manager are subject to the law's full array of fiduciary duties, described by appellate courts as "the highest known to the law."

They are also required to comply with Erisa's strict "prohibited transaction" rules and must make fulsome disclosures concerning the fees and other amounts charged to benefit plan investors or otherwise received by them.

By contrast, the assets of a mutual fund aren't considered Erisa plan assets and therefore the manager of a mutual fund in which an Erisa plan invests isn't subject to Erisa's fiduciary obligations.

In addition to Erisa protections, CITs and their trustees are also subject to regulation by federal or state bank regulators, as well as to fiduciary duties under common law. Although CITs aren't subject to registration under the '40 Act or Securities Act of 1933, they remain securities for purposes of the anti-fraud provisions under the Securities Act of 1934.

Given the robust regulation of CITs, it is patently false to argue that they are subject to "reduced oversight" or offer "reduc[ed] protections for 403(b)s" merely because they are structured differently from mutual funds and don't have boards of directors.

CITs are transparent. Department of Labor regulations mandate standardized disclosures of the key information to facilitate investment decisions for all investments in a participant-directed defined-contribution plan, regardless of investment vehicle. These requirements obligate clear disclosure of the fund's cost, the type of investment fund and objective and the fund's investment performance over standardized periods compared with an appropriate benchmark.

A retirement plan participant has access to fact sheets describing a CIT's key investment information on the plan recordkeeper's website in the same way the participant would access key investment information about a mutual fund. Likewise, participants see the daily value of the fund updated in the same manner as mutual fund valuations.

CITs afford retirement plan investors with enhanced benefits and protections. CITs have been available to private-sector retirement plans for decades, and responsible plan fiduciaries for 401(k)s are increasingly using them because they often are cheaper than mutual funds with similar investment strategies. Morningstar has observed that CITs are cheaper than comparable mutual fund share classes 88% of the time, while the average active CIT costs 60% less than the average active mutual fund,

These lower costs aren't due to "reduced oversight" but occur because mutual funds can be offered to the entire investing public, whereas CITs are available only to retirement plans. As a result, CITs must comply with a regulatory regime and disclosures that are tailored to retirement plan investors, while mutual fund disclosures must be adequate for everyone.

Although 403(b)s can be exempt from Erisa, the law's look-through rules ensure that as long as one of the investors in a CIT is an Erisa plan, all the plan assets will be managed in accordance with the Erisa standard.

As a practical matter, CIT trustees can be expected to use the same CIT vehicles for Erisa and non-Erisa plans to avoid the additional expense and administrative complexity of operating separate vehicles, conferring Erisa protections on non-Erisa 403(b)s as a result.

Rather than being less regulated and transparent, CITs' most marked contrasts to mutual funds are their typically lower cost and, for now, exclusion from 403(b)s. Ending that exclusion and giving 403(b) participants access to lower-cost investments would be a win-win.