INVESTMENT MANAGER SERVICES

CITs go mainstream.

Low cost, flexibility spark growth and opportunity in the DC market.

Collective investment trusts (CITs) continue to grow in popularity, and we believe they'll eventually become the primary investment vehicle in most defined contribution plans.

Introduction.

Collective investment trusts (CITs) are one of the most intriguing stories across the defined contribution investment landscape in the last five years.

Not long ago, CITs were confined to only the largest defined contribution (DC) plans and stable value products. But, today they are available across all market segments—including even the smallest, startup plans—and all asset classes. While "low cost" is often considered the primary driver of their rising popularity, it's not the only factor. The flexibility that makes CITs the ideal vehicle for many of the retirement industry's recent innovations (e.g., white-labeled multi-manager funds, outsourced chief investment officer (OCIO) programs, custom target date funds, retirement income, and advisor managed accounts) plays an equally important role in their growth.

This paper will take a deep look into the recent growth trends of CITs and the factors that made them possible. We'll also examine current industry developments that will help ensure this growth extends well into the future. Ultimately, we believe CITs will move even more into the mainstream in the coming years to become the primary investment vehicle used in most defined contribution plans.

CITs: Brief history and current landscape.

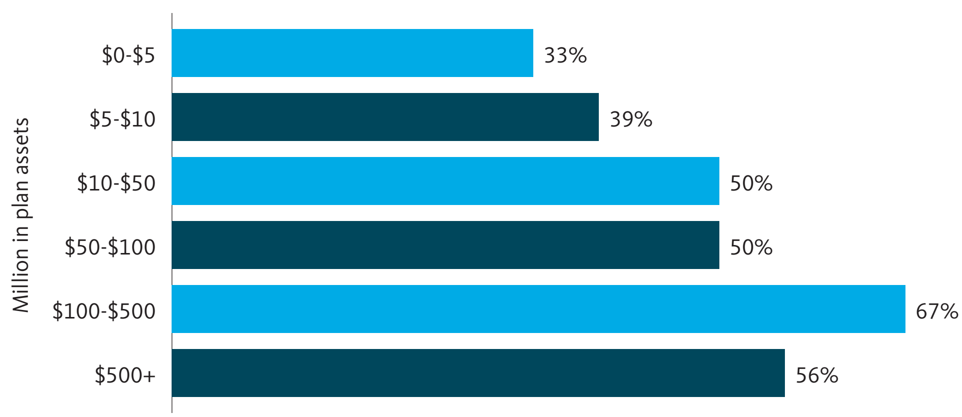
CITs aren't new. In fact, 401(k) plans have used CITs within their investment lineups since the first plan was introduced in the early 1980s.

As DC plans grew in popularity; however, mutual funds—with daily valuation and more transparent performance and financial information—quickly accumulated the lion's share of assets and established themselves as the vehicle of choice.[1]

However, in the wake of the 2008 financial crisis and the subsequent passing of the DOL fiduciary rule in 2016, the pressure on plan sponsors to reduce defined contribution fees increased significantly. Not surprisingly, low-cost CITs began attracting considerable interest from plan sponsors and their advisors and consultants.[2]

While the DOL's fiduciary rule was ultimately struck down in 2018, the momentum behind lowering plan fees continued to drive CIT adoption. By 2020, asset management firms surveyed by the Retirement Leadership Forum (RLF) reported increased demand for CITs across all segments of the DC plan market. The demand was most pronounced among plans with at least $50 million in plan assets; however; many managers reported higher demand for CITs down into the under $5 million market (Figure 1).

Figure 1. Asset managers increasing demand for CITs, by market segment, 2020



Source: RLF 2020 DCIO Benchmarking Survey. n=18

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1 "Collective Investment Trusts," Coalition of Collective Investment Trusts, 2021

2 Nick Thornton, "DOL fiduciary rule expected to sharpen scrutiny of DC plan fees, *BenefitsPRO*, Oct. 14, 2016

This strong demand for CITs has translated into significant growth in CIT assets in DC plans. In 2020, assets held in CITs accounted for more than 27% of the DC assets. Just two years later, as the aforementioned demand translated into asset flows, that number increased to nearly 34% (Figure 2). In dollar terms, this means that more than $3 trillion of the $9.3 trillion in DC assets were in CITs at the end of 2022.[3]

Figure 2. Percentage of total 401(k) AUM in CITs, 2020 vs 2022

Source: Retirement Leadership Forum 2021 and 2023 DCIO Benchmarking Surveys. n=14

Of this $3 trillion, target date funds account for $1.3 trillion, or more than 40% of all CIT assets in DC plans.[4] In fact, target date funds have seen a more rapid shift to CITs than any other asset class. CITs made up 47% of target date assets in 2022, up from under 20% a decade earlier.[5] Managers such as BlackRock, T. Rowe Price, State Street, and Vanguard all have more target date assets in CITs than in mutual funds.[6] As a sign of CITs' dominance in the target date space, Capital Group, considered the "last holdout" for a mutual-fund-only target date lineup, launched CIT versions in 2018.[7]

To date, the demand for lower fees from advisors, consultants, and plan sponsors has been the primary driver of CIT growth. In a 2022 RLF survey, 100% of asset managers cited the "pressure on pricing and fees" as one of the top two reasons for increased asset flows into CITs.[8] No other growth driver (i.e., the fact that CITs' flexibility makes them ideal for use in various packaged retirement solutions) garnered votes from more than one-third of the respondents.

An additional point worth noting is that the increased availability and transparency of CIT information was a key contributing factor to their growth. When Morningstar first began tracking performance data on CITs in 2006, they had only 650 funds in their database.[9] Today, Morningstar's public databases track more than 7,000 CITs, a development that makes it considerably easier for plan fiduciaries to assess and compare their performance.[10] Additionally, some CITs now have tickers and CUSIPs that allow plan participants to easily look up the most current information on their investments in these vehicles. Nasdaq Funds Network (NFN) reported that by the end of 2021, they had issued CUSIPs for more than 650 CITs.[11]

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3 "Quarterly Retirement Market Data," Investment Company Institute, Q4 2022

4 "2023 Target-Date Strategy Landscape Report," Morningstar, 2023

5 ibid

6 ibid

7 Greg Iacurci, "American Funds offering TDFs in Collective Investment Trusts," *InvestmentNews*, Aug. 3, 2018

8 "Navigating the New World of Distribution Partnerships," Retirement Leadership Forum, 2022

9 Adrien Martin, "Morningstar Makes Collective Investment Trusts More Comparable to Mutual Funds," *PLANSPONSOR*, Nov. 29, 2006

10 Craig Keim, "Collective Investment Trusts as Investment Options in Qualified Plans," T. Rowe Price, January 2021

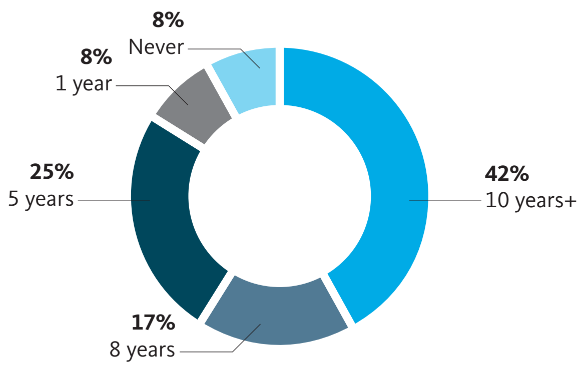
11 "Collective Investment Trusts (CITs) Offer High Potential for RIAs and Plans Sponsors," Nasdaq, April, 29, 2021

Looking ahead: Expectations of continued growth.

Asset managers expect the strong growth in CIT assets to continue to the point where they overtake mutual fund assets in DC plans within the next decade.

Ninety-two percent of asset managers believe their CIT assets will exceed mutual fund assets at some point in the future. And, while 42% of respondents expect the shift to take 10 or more years, one-half expect to hit this milestone in eight years or fewer (Figure 3).

Figure 3. Asset managers predict when their CIT assets will exceed mutual funds



Source: RLF 2023 DCIO Survey. n=12

The shift will happen even more quickly for target date funds. Morningstar predicts that target date assets in CITs will surpass those in mutual funds by the first quarter of 2025. Given that CITs were 47% of target date assets at the end of 2022, and flows to CITs made up 79% of the $153 billion in 2022 net flows, their prediction seems very much on point.

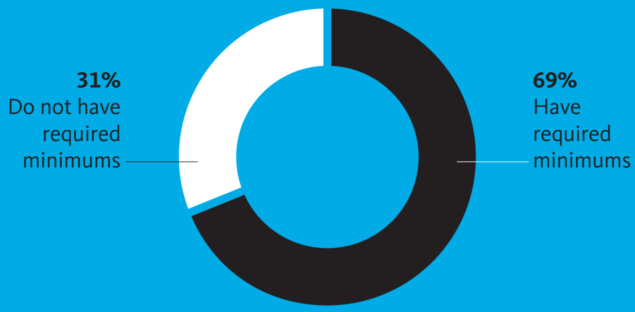
Drivers of future CIT growth.

As noted earlier, past CIT growth was largely driven by fee pressure on retirement plans and the related plan sponsor demands for the lowest cost investments possible.

However, access to CITs was often limited to larger plans because CITs carried minimum asset requirements. These minimums, often $1 million or more, frequently put CITs out of reach for smaller plans.

As recently as 2022, nearly 70% of asset managers imposed minimum asset requirements on their CITs (Figure 4). One might expect, then, that as CITs saturate the larger market—a recent Callan survey found that more than 80% of plans with at least $1 billion in assets had CITs in their lineup[12] —growth would slow. However, a number of recent trends are opening up CIT access to new segments of the DC market. At the same time, "packaged" solutions are increasingly turning to CITs as the investment vehicle of choice. This section will look deeper into both of these drivers of future CIT growth.

Figure 4. Prevalence of CIT minimums among asset managers



Source: RLF CIT minimums and breakpoints survey. n=13

[12] "2023 Defined Contribution Trends Survey," Callan Institute, 2023

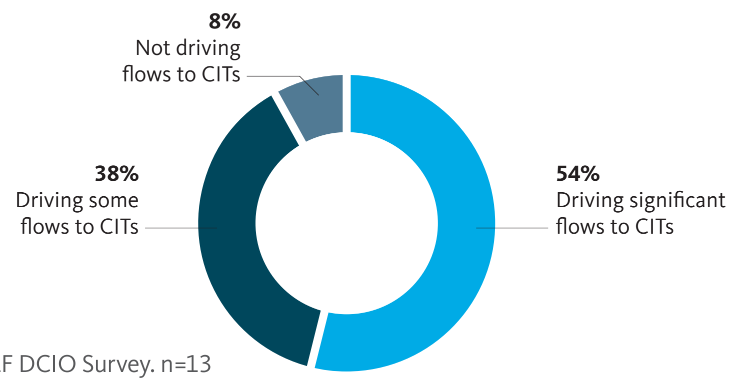
Trend 1: The rise of relationship pricing

Relationship pricing of CITs occurs when asset managers offer preferential pricing on their CITs to their distribution partners (i.e., retirement advisors) if the partner agrees to hit a minimum asset threshold over a specified time period. This trend is having a significant positive effect on assets in CITs. While the concept is not a new one, its use in the past was restricted to very large plans that used their significant asset as leverage to demand special pricing (often supported in this effort by the plan's institutional consultant). While relationship pricing in the institutional market continues, more recently, the emergence of large, specialist retirement advisors (often called "aggregators") has accelerated the trend.[13]

As specialized retirement advisor firms grow quickly through acquisitions, they are using their size and scale to negotiate lower costs on CITs with asset managers. Offering these discounts is attractive to asset managers because it gives them exposure to the very large (and growing) books of business of the advisor firm. In turn, the advisor firm gains a significant competitive advantage over their smaller rivals because they can pass these lower costs to the plan sponsor.

Given the "win-win" nature of these relationship pricing arrangements, it's not surprising that asset managers see them as a valuable tool for driving asset flows into CITs. A 2023 RLF survey found that more than half of asset managers are seeing significant flows to their CITs from these relationship pricing partnerships with aggregator firms (Figure 5).

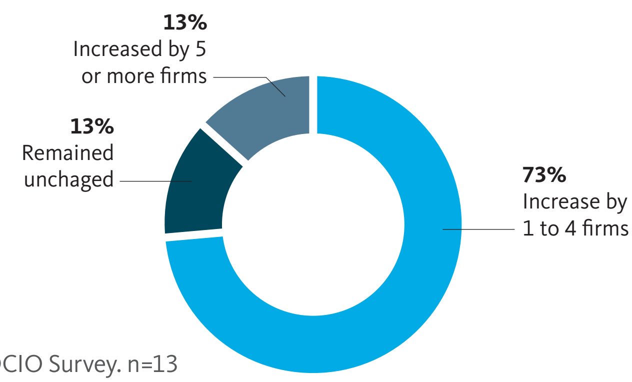
Figure 5. Effect of relationship pricing on flows to asset managers' CITs



Source: 2023 RLF DCIO Survey. n=13

Because of this success, asset managers continue to forge new relationship pricing arrangements with their distribution partners. During the last two years, for example, the typical asset manager has put in place relationship pricing agreements with between one and four advisor firms. As these newer partnerships gain traction, we expect them to be a critical driver of the continued growth of CITs (Figure 6).

Figure 6. Relationship pricing agreements added between asset managers and advisor firms in last 2 years



Source: 2023 RLF DCIO Survey. n=13

[13] For more information on the trends related to specialized retirement advisors, see SEI's white paper "The Future and the Promise of the Aggregators."

Trend 2: Packaged products turn to CITs

While the rise of relationship pricing arrangements is having a significant impact on current growth in CIT assets, a second trend, packaged products, promises to extend their growth well into the future.[14] So, what is a packaged product? While there is no technical definition of what qualifies something as a packaged product, there are common characteristics:

- They involve centralized creation of a group of investments that work together as a "package" within a DC plan.
- The investments included in the package are overseen by a fiduciary, typically the advisor or consultant who creates the packaged product. If required, a third-party fiduciary may also perform the investment oversight.
- The package is used across multiple plans within an advisor, consultant, or recordkeeper's book of business.

Because a single placement in a packaged solution opens opportunities with many plans, asset managers typically offer their lowest cost CITs when competing for a spot in the lineup. The creator of the packaged product, meanwhile, sees CITs as a way to keep costs low for any plan sponsor that uses the product, regardless of plan size. Recent examples of packaged solutions that use primarily CITs can be seen in Figure 7.

Figure 7. Packaged products that use CITs

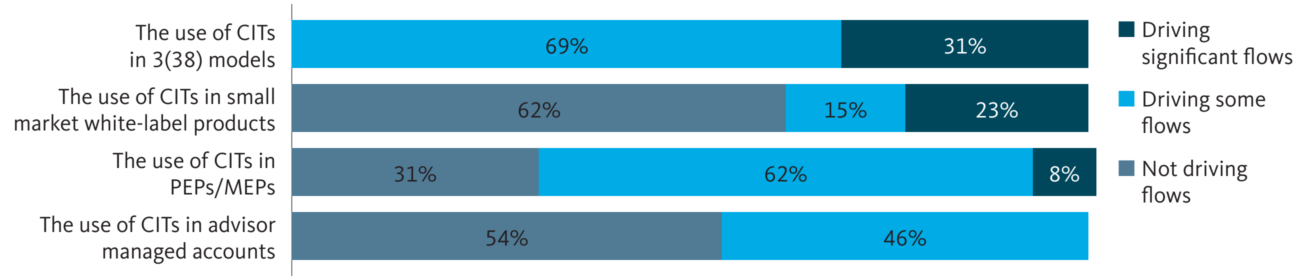
Packaged product example	Examples of CIT usage
Fiduciary investment lineup programs, i.e., 3(38)	Raymond James exclusively uses CITs in their program where they create, manage, and act as fiduciary for the defined contribution investment lineup to keep costs low.
Multi-employer, pooled employer, or group of plans	New pooled plan solutions from consultants Willis Towers Watson and Aon have all-CIT lineups as a way to offer lower pricing to smaller plans.
Advisor managed accounts	Many of the largest advisor managed account providers, such as CAPTRUST, OneDigital, and HUB International utilize CITs to keep costs low and to offset the cost of advice.
Small market white-labeled products	The all-CIT lineup in OneDigital's bundled DC product for small businesses gives it a pricing advantage over similar solutions from other advisor firms.

Source: Company press releases and RLF Research interviews, 2023

While packaged products hold considerable promise for asset managers, to date, their effect on asset flows to CITs has been more modest when compared to the relationship pricing discussed earlier (Figure 8). Only 31% of asset managers have seen significant flows from their CITs in 3(38) programs, and the percentages drop even further for packaged products such as white-labeled DC solutions, PEPs, and advisor management accounts. We would expect, however, that these flows will increase as many of the newer packaged solutions gain traction in the DC marketplace.

[14] For a deeper look at the growth of packaged products in DC plans, see SEI's white paper "The Rise of Packaged Products in the DC Market."

Figure 8. Packaged products' effect on driving flows to asset managers' CITs



Source: RLF 2023 DCIO Survey

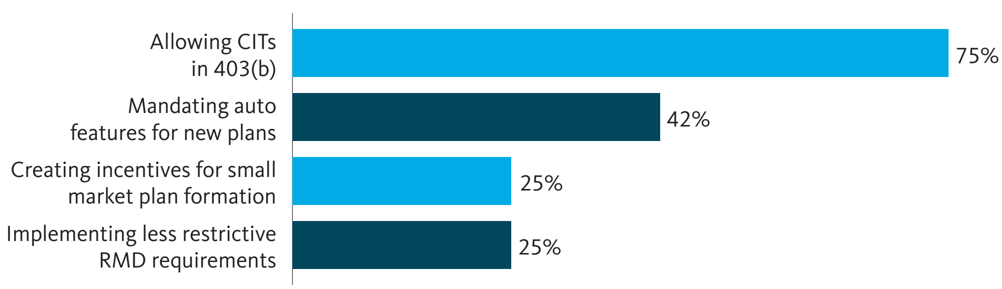
Trend 3. Permitting CITs in 403(b)s

Because of inconsistencies in the Employee Retirement Income Security Act (ERISA) between 401(k) and 403(b) plans, CITs have never been available to 403(b) plan participants. So it was with much anticipation that retirement industry professionals scanned the final version of SECURE 2.0 in December of 2022, looking for the language that allows 403(b) plan participants access to the same low-cost investments as 401(k)s. In fact, when asked about the aspects of SECURE 2.0 that would have the largest impact on their business, 75% of asset managers listed "Allowing CITs in 403(b)s" in their response (Figure 9).

Unfortunately, while SECURE 2.0 did mandate updates to ERISA to allow the change, it did not include the amendments to the relevant securities laws needed to permit CITs in 403(b)s. These securities law changes fell under the jurisdiction of the U.S. House Financial Services Committee, which declined to approve the changes due to "consumer protection" concerns.[15]

Despite this setback, asset managers remain confident that this omission will be corrected in future legislation, and in fact, in early May 2023, the House introduced the Retirement Fairness for Charities and Educational Institutions Act of 2023 (H.R. 3063) to correct the omission from SECURE 2.0.[16]

Figure 9. Asset managers' view on most important aspects of SECURE 2.0



Source: RLF 2023 DCIO Survey. n=12

[15] Paul Muholland, "CITs a No Go for 403(b) Accounts," PLANSPONSOR, Jan. 6, 2023
[16] John Sullivan, "House Officially Introduces Bill to Allow 403(b)s to Invest in CITs," National Association of Plan Advisors, May 3, 2023.

Approach the growth of CITs strategically.

Asset managers, plan sponsors, and consultants are viewing the expansion of CIT usage in DC plans as a positive development.

To efficiently participate in this growth opportunity, taking a strategic and consultative approach to developing an optimum CIT pricing and share class structure is suggested. In addition, selecting a trustee that can strategically and professionally support the growth of an asset manager and plan sponsor's CIT business is really important. Not all trustees are created equal. Identifying a trustee that has demonstrated their expertise and value in the DC market is another critical component to support business growth.

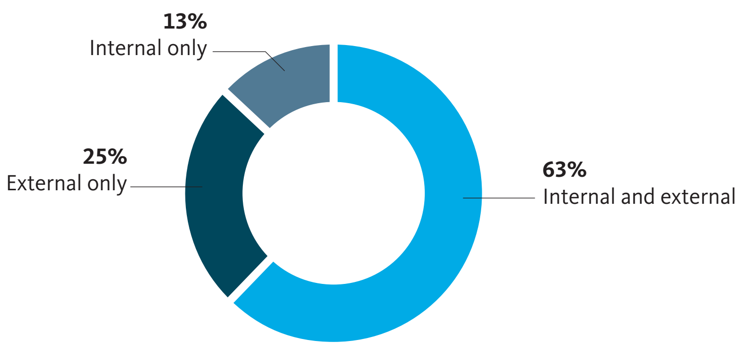
Develop a rational CIT pricing structure

In addition to lower fees, one of the most important benefits CITs provide is the ability to customize fees by creating different share classes. Unlike mutual funds, CITs provide asset managers the opportunity to structure fees based on the level of assets managed for a particular client, consultant, or advisor through relationship pricing. With the continued pressure on plan sponsors to lower fees for plan participants, the expansion of relationship pricing, and the much anticipated opportunity for 403(b) plans allowing the use of CITs, asset managers should be aware that they may need to develop additional CIT share classes to participate fully in this growth.

Leverage the trustee's expertise as the business grows

The CIT's trustee is critical to managing the CIT operations and the administrative, legal, and regulatory (i.e., non-investment related) requirements faced by asset managers. As their CIT businesses continue their rapid growth, most asset managers are embracing the full-service, turnkey approach of a third-party trustee instead of, or in addition to, an internal one (Figure 10). They are finding that the specialized firms are better equipped to handle not only the administrative side of things, but also the sheer volume of transactions they are seeing as the use of CITs expands.

Figure 10. Trustee(s) used by asset managers for their CITs



Source: RLF 2023 DCIO Survey. n=13

The benefits of working with a third-party trustee go well beyond the day to day. Because a well-established third-party trustee works with dozens of asset managers, they have "seen it all" and can use this expertise to help asset managers navigate the more strategic issues they face as they expand their lineup of CITs. Examples include:

- Providing guidance in determining which investment strategies would be most beneficial to offer in a CIT structure
- Defining the optimal pricing and share class structure
- Setting CIT minimums and other eligibility requirements
- Providing insight into the ever-changing fiduciary landscape

If you are looking to bring more value to the table and rise to a higher, strategic-level partnership, leading CIT trustees are broadening their roles and taking a more "consultative" approach to delivering their expertise and services to asset managers, plan sponsors, and consultants. Having another expert at the table during the product development process, during strategy meetings, or even in the day-to-day operations can significantly enhance an asset manager's CIT offering.

Summary and conclusions.

Within a short, five-year time period, CITs have shifted from a niche product for the large market to a mainstay across DC business.

CITs are now being offered in virtually all asset classes (including target date funds, small cap, mid-cap, large-cap equity, fixed income, and international). In fact, CIT assets in target date funds are poised to surpass those in mutual funds in the next two years, and possibly for all asset classes in the next decade. While the mutual fund may not be “dead” in retirement plans, it’s certainly surrendered its dominant position.

The current DC environment has all the right conditions to support this projected growth of CITs. Continued fee pressure alone should ensure steady growth. Meanwhile, new opportunities such as relationship pricing, packaged products, and the availability of CITs in 403(b) plans provide a clear runway for future growth.

To keep up with the rapidly growing demand for CITs, it’s important that asset managers develop a more purposeful CIT strategy, especially when it comes to pricing arrangements and share class creation. An experienced trustee, beyond managing the fiduciary and administrative aspects, can be an indispensable partner in designing a CIT strategy that’s built to scale for the large opportunity ahead.

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With capabilities across investment processing, operations, and asset management, SEI works with corporations, financial institutions and professionals, and ultra-high-net-worth families to solve problems, manage change, and help protect assets—for growth today and in the future. As of March 31, 2023, SEI manages, advises, or administers approximately $1.3 trillion in assets.

For more information, visit seic.com.

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SEI Trust Company ("STC") is a non-depository trust company chartered under the laws of the Commonwealth of Pennsylvania, which provides trustee, custodial, operational, and administrative services to various collective investment trusts. STC was formed in June 1989, is a wholly owned subsidiary of SEI Investments Company (NASDAQ: SEIC), and is regulated and examined by the Pennsylvania Department of Banking and Securities.

The company's sole business line is the servicing of collective investment trusts, and through its network of strong relationships with advisors, distributors, and other service providers, it is able to offer flexible products that can be marketed to the U.S. retirement plan market. STC provides trustee, accounting, valuation, administrative, and fiduciary services, including investment management for the CITs. STC utilizes the services of various investment advisers, sub-advisors, and providers of accounting and administrative services (including affiliates) in connection with its responsibilities for maintaining CITs.

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For more information, visit seic.com/IMS.

About Retirement Leadership Forum

The Retirement Leadership Forum (RLF) is a best practices research firm serving the needs of more than 30 recordkeeping and DCIO businesses. Spun out of the Corporate Executive Board, the RLF has more than 15 years of research published in the retirement space. The group is known for providing leading industry insight and hosting superior executive events.

For more information, please visit https://retirementlf.com/.

[17] Based on *Pensions & Investments*' Largest Money Managers 2021 ranking

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