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A Benefits Attorney's Guide To Collective Investment Trusts

By **Emily Brill**

Law360 (May 21, 2021, 8:37 PM EDT) -- As the use of collective investment trusts in 401(k) plans has skyrocketed over the past two decades, ERISA lawsuits targeting these bank-sponsored investment vehicles have increased in number as well. Here, Law360 explains how CITs come up in the courtroom and offers attorneys' tips on lowering Employee Retirement Income Security Act litigation risk.

CITs and Retirement Plans

A CIT is an investment vehicle run by a bank or trust company that funnels retirement savers' money toward a variety of asset classes, such as stocks, bonds, private equity funds and real estate funds.

Created in 1927 and granted tax-exempt status in 1936, CITs caught the eye of pension plan managers in the 1950s and 401(k) plan managers in the 1980s, according to a 2017 white paper from DST Systems Inc.

But the use of CITs in 401(k) plans really took off in the 2000s, after changes in Congress and on Wall Street increased plan managers' access to the investment vehicles. By 2018, about $1.5 trillion, or 21%, of the total amount of money kept in 401(k) plans was housed in CITs, according to a 2020 report by Wilmington Trust.

And soon Congress is anticipated to permit 403(b) plans — which are essentially 401(k) plans for nonprofits — to use these investment vehicles. That means "a further explosion in demand for CITs" is likely on the horizon, said Erin K. Cho, a partner in the employment and benefits group at Mayer Brown LLP.

"They are the investment vehicle of choice right now for retirement investors," Cho said. "The statistics show that CITs' market share has doubled over the past five years. I don't see that stopping."

Though CITs are similar to the granddaddy of retirement plan investment vehicles — mutual funds — in many respects, their use is rising at a faster pace because they offer lower fees and carry fewer restrictions on the types of assets they can invest in, attorneys say. CITs owe both these advantages to the fact that they're not regulated by the U.S. Securities and Exchange Commission, but by banking laws, attorneys say.

CITs and the Courtroom

Retirement plan managers tend to see investing in CITs as a way to avoid the "excessive fee" ERISA suits that are associated with investing in mutual funds, which generally charge higher administrative fees, attorneys say.

Indeed, a 2008 presentation by a group of Goodwin Procter LLP benefits attorneys noted that there's a "legal impetus" for investing in CITs. And the plaintiffs bar has since argued that 401(k) plan managers could be placing themselves at legal risk by not considering CITs, since they have an ERISA-imposed duty to keep fees reasonable.

But the plaintiffs bar has also zeroed in on the fact that CITs aren't regulated by the SEC, bringing this up in litigation that casts doubt on the investments' prudence.

In a 2017 class action against BlackRock Inc. that is in the process of settling for $9.6 million, 17,000 company workers and retirees argued that BlackRock structured its CITs in such a way as to hide fees.

"Defendants promote the BlackRock proprietary funds offered on the plan menu to plan participants as virtually fee free, yet these funds charged undisclosed, excessive fees related to securities lending," the workers argued in a 2018 amended complaint.

Lawsuits challenging CITs are a new phenomenon, said James Fleckner, the chair of Goodwin's ERISA litigation practice and one of the authors of the 2008 presentation.

"The first suits involving fees and diversified investments in retirement plans — the real first wave of that — started around 2006, 2007," Fleckner said. "There's really been an explosion of suits in the last 15 years. But you haven't really seen suits targeting CITs until the past three years."

Fleckner said he anticipates more challenges to CITs will pop up as the investment vehicles grow in popularity within 401(k) plans. At this juncture, though, the amount of suits challenging CITs pales in comparison to the number of suits targeting mutual funds and nondiversified employer stock funds, he said.

"I think as [CITs] gain more traction in the marketplace, naturally that will collide with an increase in suits," Fleckner said. "You've seen an increased use of managed-account products, and we see more suits now involving managed-account products. You've seen increased use of target-date funds, and we see more suits challenging target-date funds. Since there continues to be an increasing market for CITs, I think you'll see more suits challenging CITs."

CITs and Plan Sponsors

To keep risk as low as possible, Morgan Lewis & Bockius LLP benefits partner Julie Stapel recommended that retirement plan sponsors ask any CIT provider they're considering working with about its reporting practices. That way, plan sponsors will know they'll have the facts to appraise whether a CIT is a good investment, she said.

"That's something plan sponsors should make sure they're comfortable with before putting a CIT on the plan lineup — what kind of reporting are we going to get on a monthly, quarterly basis?" Stapel said. "Even though CITs are not subject to the same reporting [requirements] as mutual funds, they generally have a business interest in making good, helpful disclosures available to plan sponsors."

Stapel said CITs' low fees are a "significant pro" to consider when weighing the pros and cons of placing these investment vehicles in a 401(k) plan. Low fees provide "good, strong protection" from ERISA suits, she said.

But she added that "when moving from a mutual fund to a CIT, a fiduciary should confirm the fees really are lower" before making the jump.

Fleckner agreed, saying the best protection from ERISA fiduciary-breach suits for plan sponsors is an understanding of why they chose the investment vehicles they did.

"ERISA's prudence requirement imposes on companies and the people they've delegated to be responsible for plans … a need to understand why they've selected those funds and what the funds entail," Fleckner said.

--Editing by Abbie Sarfo and Neil Cohen.

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