SEI Trust Company

Quarterly Update
September 30, 2021

REGULATORY/LEGAL UPDATE

In an effort to keep you updated on changing regulations, requirements and litigation that may affect our industry, we are providing you with a summary of recent legislation, legal decisions and/or regulatory guidance that may impact collective investment trusts ("CITs") and their service providers, such as banks and investment managers.

Regulatory Update

- **A Turn Left – The DOL's Newest Proposal Affecting Both ESG Investing and Proxy Voting**

  The most recent proposed guidance from the U.S. Department of Labor ("DOL") signs a pronounced easing of the restrictions on ESG investing imposed by the prior presidential administration. The proposal was expected after the DOL, shortly following the most recent presidential inauguration, issued a non-enforcement policy regarding the final regulations entitled "Financial Factors in Selecting Plan Investments" which had just been finalized in 2020 (and which had originally referenced ESG investing directly, but had been softened to the use of the term "financial factors" to distinguish investment decisions based solely on pecuniary (or financial) interests versus investment decisions made with plan assets to further environmental, social or corporate governance concerns (so called "ESG Investing").

  The history of the DOL's often changed position on ESG investing is beyond the scope of this brief update, other than to note that the DOL's position has been generally set by then-current presidential administration, and this round of guidance is no different. This makes long term planning on the use of ESG investing for plan assets (and by extension, plan asset funds), difficult to say the least. No plan fiduciary is looking for a DOL investigation or examination into its ESG investing practices, yet there are often plan fiduciaries who are looking to invest their plan asset in a manner that would, as a secondary benefit to providing retirement benefits to its plan participants and beneficiaries, in a manner that would further secondary causes, including some that many benefit the industry or resources in which the plan sponsor conducts its business. Additionally, other U.S. regulators and some other foreign regulatory agencies are pushing forward with ESG guidance, and it would be helpful to have DOL guidance that either aligns, or at the very least, does not conflict, with other guidance from other regulatory agencies.

  Additionally, this most recent round of regulatory proposals includes new rules surrounding proxy voting, which had been addressed by a separate, but also somewhat controversial, set of rules issued by the prior presidential administration in 2020.

  The most recent round of proposed regulations were released on October 14, 2021[1] and signals a more permissive environmental in which a plan fiduciary may consider ESG factors when making fiduciary investment decisions regarding plan assets. The regulatory battleground continues to center around Section 404(a) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), which

[1] https://www.federalregister.gov/documents/2021/10/14/2021-22263/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights

requires a fiduciary to discharge his/her duties in accordance with a duty of loyalty ("solely in the interest of the participants and beneficiaries and for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan") and a duty of prudence ("the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims").

The 2021 proposal is now named "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" and makes 5 major changes to the 2020 rule as follows:

1. The rule contains a recognition of ESG as a component that may be material to investment risk and return by including a regulatory safe harbor for conduct deemed prudent to provide that "appropriate investment consideration" of an investment decision includes consideration of "[t]he projected return of the portfolio relative to the funding objectives of the plan, which may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action". Further, the proposal includes these three as "examples" of such investment risk and return characteristics: (a) climate change related factors; (b) governance factors; and (c) workplace practices. There is even a reference in the preamble that an investment decision "may often require" evaluation of ESG related factors, which is a sharp contrast from the 2020 final rule, which indicated that the DOL had expected that ESG factors would not be considered very often, if at all, when making investment decisions plan assets.

2. The "pecuniary factors test" is now the "risk-return test" and ESG counts in making investment decisions. The proposed rule removes the pecuniary factors test and applies a new standard that requires that a "fiduciary's evaluation of an investment or investment course of action must be based on risk and return factors that the fiduciary prudently determines are material to investment value, using appropriate investment horizons consistent with the plan's investment objectives and taking into account the funding policy of the plan." But the real change is in the preamble of the proposal, in which the DOL specifically affirms that ESG factors can be material to such risk and return.

3. The DOL updated the tie breaker standards again. Again, over the many years and variations of DOL guidance, the tie-breaker standard to be applied has swung back and forth from easy to use to impossible to determine. The proposal takes the tie-breaker standard back to an easier-to-use (or rely on by plan fiduciaries) by noting that the ESG factors can be considered if they are not material to the risk reward analysis, as long as the collateral benefits does not sacrifice the risk/return analysis. Further, the new DOL proposal eliminates the onerous documentation requirements needed to make a tie breaker decision using ESG factors, which was interpreted as a crutch for DOL examinations into ESG investing decisions.

4. Under the new proposal, Qualified Default Investment Alternatives (or "QDIAs") can include ESG investment decision making, which was specifically precluded under the old rule. Further, no special rules apply for offering funds with ESG investing structures without the requirement to adhere to any specific or onerous rules.

5. Finally, with respect to proxy voting, the new proposal generally takes plan fiduciaries back to the old proxy voting rules, which favors the presumption of plan fiduciaries voting proxies unless the costs outweigh the benefit (i.e., there is no longer a requirement that the plan fiduciary must make an active decision to vote the proxies, before making the decision on how to vote, which would have made the proxy voting process significantly more cumbersome than it is now). Further, a plan fiduciary may now consider ESG investing type information when making proxy decisions, which is now considered appropriate information under the earlier part of the proposal.

The comment period for this proposal runs for 60 days following its publication in the Federal Register, which was on October 14th. SEI will continue to watch for updates on these rules and will bring you updates when available.

- **Minor Proposed Changes for Collective Investment Trusts Contained in Updated Form 5500 DOL Proposed Guidance**

On September 15, 2021, the DOL, the Internal Revenue Service and the Pension Benefit Guaranty Corporation released proposed changes to the Annual Return/Report for Employee Benefit Plans, otherwise known generally as the Form 5500.[2] The only proposed change relating to bank maintained collective investment trusts is listed in the proposed edits to Schedule H, Line 4i(1) Schedule of Assets Held for Investment ("Schedule"). The proposed edits to the Schedule are intended to streamline information regarding certain assets held by employee benefit plans to make it easier for the three agencies to glean relevant information on certain types of assets, for, in this case, hard to value assets.

The proposal would require return preparers to mark box "c" of that schedule if one or more assets held by the plan is a hard to value asset. The proposed instructions would refer hard to value assets as "(a)ssets that are not listed on any national exchanges or over-the-counter markets, or for which quoted market prices are not available from sources such as financial publications, the exchanges, or the National Association of Securities Dealers Automated Quotations System (NASDAQ)….". This would seem to include CITs, but the provision goes on to read, "Bank collective investment funds…..that are primarily invested in assets that are listed on national exchanges or over-the-counter markets and are valued at least annually need not be identified as hard-to-value assets." However, if a CIT is invested "primarily in hard-to-value assets", then the CIT itself should be marked as a "hard to value" asset in box (c) of the Schedule. The proposal lists the following as hard-to-value assets: non-publicly traded securities, real estate, private equity funds; hedge funds; and real estate investment trusts (REITs)." However, the proposal does not state as what is constitutes "primarily invested for these purposes".

The proposal comment period is open for 45 days following the publication of the proposal in the Federal Register (which was on September 15th). More information regarding this change will be forthcoming if and when the proposal is finalized.

About SEI's Investment Manager Services Division

SEI's Investment Manager Services Division supplies investment organizations of all types with the advanced operating infrastructure they must have to evolve and compete in a landscape of escalating business challenges. SEI's award-winning global operating platform provides investment managers and asset owners with customized and integrated capabilities across a wide range of investment vehicles, strategies and jurisdictions. Our services enable users to gain scale and efficiency, keep pace with marketplace demands, and run their businesses more strategically. SEI partners with more than 550 traditional and alternative asset managers, as well as sovereign wealth funds and family offices, representing nearly $30 trillion in assets, including 49 of the top 100 asset managers worldwide*. For more information, visit seic.com/ims.

*Based on Pensions & Investments' "Largest Money Managers" 2019 ranking.

About SEI Trust Company

SEI Trust Company (STC) is a non-depository trust company chartered under the laws of the Commonwealth of Pennsylvania that provides trust and administrative services for various collective investment trusts. SEI Trust Company is a wholly-owned subsidiary of SEI Investments Company (SEI). For more information, visit www.seic.com/stc.

About SEI

SEI (NASDAQ:SEIC) is a leading global provider of investment processing, investment management, and investment operations solutions that help corporations, financial institutions, financial advisors, and ultra-high-net-worth families create and manage wealth. As of June 30, 2021, through its subsidiaries and partnerships in which the company has a significant interest, SEI manages, advises or administers approximately $1.3 trillion in hedge, private equity, mutual fund and pooled or separately managed assets, including approximately $399 billion in assets under management and $880 billion in client assets under administration.

[2] Available at: federalregister.gov/d/2021-19714.

©2021 SEI