SEI Trust Company Quarterly Update March 31, 2023

LEGAL/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.

LEGAL UPDATE

SECURE 2.0 Act of 2022

The SECURE 2.0 Act of 2022 ("SECURE Act 2.0") was signed into law by President Biden on December 29, 2022 with the intention of building upon the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act"). This bipartisan act includes 92 provisions aimed to offer more flexibility in regards to retirement savings, improving retirement savings options and to lower the costs employers incur when establishing a retirement plan[1].

However, one provision that did not make it into the final act was the required updates to the various securities laws that would have permitted 403(b)[2] plans to invest in bank-maintained collective investment trusts. While SECURE Act 2.0 did contain a provision that amended the Internal Revenue Code to permit 403(b) plans to invest into group trusts that are exempt from federal taxation[3], the act failed to include provisions that would permit a bank or trust company to commingle assets into an investment pool and meet the exemptions from various US federal securities laws, most notably Section 3(c) (11) of the Investment Company Act of 1940 ("1940 Act"). At least one industry reporting agency noted that the failure to include the relevant provisions was intentional and, while still able to be corrected, is unlikely to happen until there is another bill to use to make the technical corrections necessary and that may not be until the next appropriations bill.[4]

A short summary of some of the notable plan administration provisions is outlined below:

Notable Withdrawals Provisions:

- Effective January 1, 2024, plans may now allow for one emergency expense withdrawal per year for either personal or family expenses. The maximum withdrawal amount is $1,000 and is required to be paid back in a three year period. If the amount withdrawn is not repaid over the three year

[1] See https://www.congress.gov/bill/117th-congress/house-bill/2954/text for text of the full act.

[2] A 403(b) plan is generally is a retirement plan offered by public schools and certain charities. It's similar to a 401(k) plan maintained by a for-profit entity. Just as with a 401(k) plan, a 403(b) plan lets employees defer some of their salary into individual accounts.

[3] Section 403(b)(7)(A) now reads: "if the amounts are to be invested in regulated investment company stock to be held in that custodial account" and inserting "if the amounts are to be held in that custodial account and invested in regulated investment company stock or *a group trust intended to satisfy the requirements of Internal Revenue Service Revenue Ruling 81–100* (or any successor guidance)" (emphasis added). Our CITs are all designed to be group trusts exempt from taxation pursuant to Rev. Ruling 81-100, supported by a determination letter received from the Internal Revenue Service.

[4] See *CITs a No-Go for 403(b) Accounts*, January 6, 2024 at https://www.plansponsor.com/cits-a-no-go-for-403b-accounts/

period participants will have to wait the three year period before exercising another emergency withdrawal.
- Employee certification for hardship withdrawals will become effective for plans beginning on or after December 30, 2022. This will allow employees to provide a written certification to plan sponsors that their withdrawal is due to a valid financial need and that there are no other reasonable alternatives to assist in remedying the financial setback. The withdrawal amount cannot exceed the amount needed to satisfy the financial hardship. Plan sponsors will then not be required to obtain additional documentation to substantiate the hardship.
- Domestic abuse survivors will now have the opportunity to make withdrawals either the lesser of $10,000 or 50% of the participant's current vested account balance to leave unsafe situations. This withdrawal can be repaid to the plan over a three year period from the date of the initial distribution.

Increased Retirement Savings Access:

- Effective for plan years beginning on or after January 1, 2024, a plan can allow an employer to match contributions to "qualified student loan repayments".
- Part-time employees will also be receiving benefits from the new Act, requiring plans subject to ERISA to maintain dual eligibility, allowing an employee to become eligible for a plan after completing one year's work at 1,000 hours or two consecutive years working 500 hours each year.
- An online database will be put in place which will be known as the "*Retirement Savings Lost and Found*" allowing participants to locate contacts for retirement savings that may have fallen to the wayside over the years.
- Victims of qualified federally declared disasters will now be able to withdrawal up to $22,000 from their retirement account without any penalty.

Of the 92 provisions contained in SECURE Act 2.0, some are effective immediately, while other provisions will become effective throughout the coming years, some as far off as 2033.

Additionally, with the failure of SECURE Act 2.0 to contain all of the relevant provisions to permit 403(b) plans to invest into CITs, certain entities have been circulating that there are still opportunities for "CIT-like group trusts" for 403(b) plans. ***However***, this "opportunity" appears to be only available to certain plan sponsors that meet guidelines of the SEC (somewhat old) no action letters and are generally only available to plans that have an extremely large amount of assets (which may be only the top 1-2% of 403(b) plans). And if a 403(b) plan sponsor intends to build its own set of funds through this older US Securities & Exchange ("SEC") no action guidance, there are a number of difficult requirements to jump through from the securities laws perspective and may even require the 403(b) plan qualifying as a 401(k) plan as well, which might take some significant legal work.[5]

Therefore, at this time, for most 403(b) plans sponsors who want to offer CITs to their participants, it continues to be a waiting game for Congress to make some additional technical corrections in the (hopefully near term) future.

REGULATORY UPDATE

SEC Proposes Reworking Mutual Fund Liquidity Framework, Including Mandating Swing Pricing

The SEC has proposed amendments intended to amend rules under the 1940 Act with respect to fund liquidity and swing pricing (the "Proposal").[6] The liquidity framework for most open-ended funds would be

[5] See, for example, https://www.sec.gov/divisions/investment/noaction/1995/stable-value-group-trust-122895.pdf, https://www.sec.gov/divisions/investment/noaction/1994/panagora042994.pdf, and https://www.sec.gov/divisions/investment/noaction/heb051801.htm

[6] See Proposed Rule available at https://www.sec.gov/rules/proposed/2022/33-11130.pdf

significantly impacted by these changes. So far the Proposal has been approved by a vote of three to two. Significant changes to expect upon the adoption of this Proposal include:

- an amendment to Rule 22c-1 which will now require most open ended funds, excluding money market and exchange-traded funds, to implement swing pricing. These funds would also be required to implement a "hard close" for transacting in fund shares;
- a proposed amendment to Rule 22e-4 would require the revision of current liquidity categories and daily liquidity classifications;
- and would require detailed and frequent reporting of monthly portfolio holdings, the implementation of swing pricing and liquidity risk management to the SEC and the public.

The SEC believes that swing pricing is an important tool for addressing dilution. However funds in the United States may have been more apprehensive to implement this tool in the past as there hasn't been any type of incentive to utilize swing pricing likely due to the operational hurdles, cost, and lack of familiarity among investors. The Proposal would require covered funds to implement policies and procedures that adjust the fund's current NAV per share by a "swing factor" if the fund has (i) net redemptions or (ii) net purchases exceeding 2% of the fund's net assets. Imposing this regulatory requirement is seen as a tool to overcome apprehension surrounding swing pricing. This Proposal comes as a response to market stress caused by the COVID-19 pandemic, as the SEC has found that some mutual funds were ill-equipped at managing liquidity and limiting dilution. Due to the inability to manage these factors in a stressed market environment, funds began to explore emergency relief procedures suggesting a possible need for government intervention to alleviate liquidity and dilution issues. The SEC establishes that their main goal is to provide funds with the proper tools to navigate stressful market conditions.

But for CITs, the more problematic portion of the proposal is the hard close provision, which allows for an order to purchase or redeem shares to be executed at the currents day's NAV only if received by the fund, its designated transfer agent or a registered securities clearing agency before the fund's pricing time (generally 4 PM) on that particular day. If not received in time, the order will be executed base on the following day's NAV for the fund.

This portion of the provision is particularly problematic for the retirement plan industry, whose record-keepers (as fund intermediaries) now regularly receive participant orders by 4 PM, but do not transmit those orders to the mutual fund, its designated transfer agent until at some point after 4 PM. Additionally, while this "hard close" requirement does not directly include CITs, most industry observers believe that CITs unintentionally will be swept into this requirement, as it will be difficult for record-keepers to program their systems to transmit mutual fund orders at one time, and the CIT orders at a different time. For example, the American Bankers Association ("ABA") noted in its comment letter that, due to the processing time for intermediaries, the hard close would impose an earlier cut-off time for plan investor-initiated orders, possibly as early as 10 a.m. ET, in order to receive that day's price. That means plan participants won't be able to make timely decisions based on market activity that takes place after that time, while other mutual fund investors can make decisions up to the fund's close, which unfairly prejudices certain investors over others.

This new Proposal has been met with critical feedback from the industry. The Investment Company Institute ("ICI") has expressed his concerns regarding the implementation of swing pricing and the operational hurdles funds may face adopting this new pricing method. Further, both the ICI and the ABA are concerned with the possible risk of confusing investors, especially investors in 401(k) and other participant directed plans, and the plan record-keepers' ability to comply with the hard close requirements. Even certain consumer industry groups have noted that the hard close provisions should not be adopted by the SEC.

As currently written, the new hard close requirements would become effective 24 months after the effective date of the amendments, and the liquidity rule and reporting changes would also be effective 12 months after the effective date should this proposal be adopted.

Final DOL Environmental, Social, and Governance (ESG) Rules

In March of 2021 the US Department of Labor ("DOL") began reviewing the "Financial Factors in Selecting Plan Investments" 2020 rules previously issued by the prior Presidential administration. The current legislation has come with its fair share of negative consequences in regards to consideration of climate change and other environmental, social and governance ("ESG") factors. The overwhelming majority of public commenters agree that further clarification of these regulations are necessary to eliminate uncertainty that may deter fiduciaries from taking steps that many other marketplace investors take to enhance investment value and performance.

One of the main goals of these new regulations[7] is to clarify the application of the Employee Retirement Income Security Act of 1974, as amended ("ERISA")'s fiduciary duties of loyalty and prudence to investment course of action and choosing investments including but not limited to, selecting Qualified Default Investment Alternatives ("QDIAs"), and exercising shareholder rights through proxy voting and the use of written proxy voting guidelines and policies. The DOL emphasized that this new ruling will not affect the duties of loyalty and prudence require ERISA plan fiduciaries to focus in on relevant risk-return factors of participants and beneficiaries

Tie Breaker Test: This standard previously required that before fiduciaries could turn to collateral factors to break a tie, the competing investments must be economically indistinguishable. There was also a considerable amount of documentation required related to the use of collateral factors. Originally this documentation was intended to provide a safeguard against the risk that plan fiduciaries will improperly find economic equivalence and make decisions based on non-pecuniary factors without a proper analysis and evaluation. Some believe the excessive documentation left fiduciaries wary of considering ESG factors. The final rule replaces previous tie breaker provisions and will now require fiduciaries to prudently decide that competing investments or investment courses of action serve the financial interests of the plan equally over an appropriate amount of time. The final rule also removes the documentation requirement, but still maintains the fiduciaries cannot accept reduced returns or increased risks to secure collateral benefits.

Proxy Voting and Shareholder Rights: The previous regulation in regards to examples of permissible proxy voting policies has been amended to remove the two "safe harbor" examples as the DOL believes these two safe harbors do not properly safeguard the interests of plans, participants and beneficiaries. Previously, these safe harbors allowed for a policy to limit voting resources as well as permitting a policy of refraining from voting on proposals in the case that the plan's holding in a single issuer relative to the plan's total investment assets is below a quantitative threshold. The previous 2020 rules required maintaining records on proxy voting activities and closely monitoring the obligations when involving investment managers or proxy voting firms. This has been since eliminated due to the perception that proxy voting and other shareholder exercises were being treated differently in regards to their rights versus other fiduciary activities. There was also an increased risk of misperception that proxy voting and other shareholder rights are unfavorable or carry a greater fiduciary obligations than other fiduciary activities.

However, new final rules on the investment duties of ERISA fiduciaries contains a special rule on proxy voting by ERISA pooled investment vehicles (which includes CITs), which requires action by December 1, 2023. Despite requests to do so, the DOL in its final rule did not remove this provision, which imposes an additional burden on investment managers (including trustees) of ERISA-governed pooled investment vehicles holding assets of multiple ERISA plans. According to this provision, the commingled fund's investment manager would be required to reconcile, insofar as possible, any conflicting investment policy statements of the individual investing plans, including with respect to proxy voting, thereby potentially being required to vote (or abstain from voting) proxies in a manner that reflects those differing policies in proportion to each plan's economic interest in the pooled fund. Recognizing the difficulties this would present, the regulation provides an alternative approach, whereby the manager may require investing plans to accept the manager's/fund's investment policy statement, including any proxy voting policy, as a condition to the plan's investment in the fund. This provision will be effective December 1, 2023. The proxy voting language, which is generally in our form of Application (or could also be called Participation Agreement), should ideally specifically authorize and direct the manager to vote proxies in accordance with its proxy voting policy, which should also be disclosed to the investing fiduciary. We expect that this will require some minimal updates to the Application used for each of the CITs that STC sponsors.

[7] The final rule is available here: https://www.federalregister.gov/documents/2022/12/01/2022-25783/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights

Joint Statement on Crypto-Asset Risks to Banking Organizations

On January 3, 2023, the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) released a statement highlighting major risks associated with crypto-assets and crypto-asset sector participants.[8] Over the past year, the three agencies announced that they have seen heightened volatility surrounding the crypto-asset sector, prompting the agencies to closely monitor crypto-asset related risks posed to banking organizations and participants.

Throughout their discovery into this sector, these agencies have expressed increased concern for fraudulent scams among participants. The official joint statement made by these agencies points to the vast inaccuracies and misrepresentations made by crypto-asset companies. These findings include misrepresentations surrounding federal deposit insurance, legal uncertainties related to custody practices, and other unfair practices, all of which have a significantly negative impact on institutional investors, retail investors, customers, and other counterparties. The volatility in the crypto-asset markets along with risk prone stablecoins expose crypto-asset companies along with banking organization that hold stablecoin reserves to potential issues surrounding deposit flows.

These agencies have issued warning surrounding the lack of governance mechanisms, the absence of contracts, clearly established roles, responsibilities and vulnerabilities related to outages, cyber-attacks, and trapped/lost assets. The lack of maturity in regards to risk management and governance has also exposed participants and banking organizations to high level risks. Based on these findings the agencies believe that issuing or holding crypto-assets that are issued or transferred on a public, open or decentralized network are highly unlikely to be consistent with current safe and sound banking practices. Each agency has developed procedures to closely supervise banking organizations to further understand the threats that crypto-assets pose to participants and banking organizations. The agencies are encouraging banking organizations to ensure proper risk management by implementing appropriate policies and procedures, effective monitoring, and include board oversight.

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) delivers technology and investment solutions that connect the financial services industry. 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 December 31, 2022, SEI manages, advises, or administers approximately $1.2 trillion in assets.

[8] See announcement available at https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1.html.