SEI Trust Company Quarterly Update

LEGAL/REGULATORY UPDATE

In an effort to keep you updated on changing regulations, requirements and/or 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.

REGULTORY UPDATE

Department of Labor's 2024 Fiduciary Rule – Industry Response & Complaints

May 2, 2024 – Federation of Americans for Consumers Choice

The 2024 Fiduciary Rule[1] (the "Fiduciary Rule") designed by the Department of Labor ("DOL") broadly expanded the definition of an investment advice fiduciary under ERISA. Among other things the Fiduciary Rule is designed to modify several prohibited transaction exemptions ("PTEs") as well as amend the current framework for the "five-part test" used to determine whether a person is an investment advice fiduciary and therefor subject to ERISA and DOL's authority.

The Rule has been met with critical backlash since the initial proposal was released in October of 2023. More recently, as of May 2nd, 2024, a formal complaint was filed in the Eastern District of Texas under case caption Fed'n of Americans for Consumer Choice Inc. v. DOL[2], by the trade association Federation of Americans for Consumers Choice (FACC), along with various other companies engaged in the insurance industry. The complaint urged the Court to declare the Fiduciary Rule unlawful and ultimately to vacate it in its entirety.

More specifically the complaint alleged that the DOL has greatly overstepped their authority under ERISA and the Internal Revenue Code ("Code") as it relates to the creation of the Fiduciary Rule and specifically those amendments related to PTEs. The FACC claims that the redefining of the term "fiduciary" under the Fiduciary Rule is extremely broad and that the PTE amendments are explicitly in violation of the Administrative Protection Act ("APA"). FACC asserts that the Fiduciary Rule changes the definition of a "fiduciary" such that it is "fundamentally inconsistent with Congress' intent as expressed in the text of ERISA and the Code, as well as the historical and common law understanding of the term."[3]

In 2018, a Fifth Circuit case under the Eastern District of Texas struck down the proposal to redefine the

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[1] The "Fiduciary Rule" actually includes several amendments to current DOL guidance, from amending the DOL regulation as to the definition of fiduciary investment advice to various amendment to long standing prohibited transaction exemptions that are widely used by the financial services industry today, including PTE 77-4, 86-128 and 84-24. The DOL is attempting to move the financial services industry to use the PTE 2002-20, which is also being amended by the proposals.

[2] Federation of *Americans for Consumer Choice Inc. v. U.S. Department of Labor* No. 6:24-cv-00163 (E.D. Tex. May 2, 2024) case challenged the DOL's new 2024 Fiduciary rule raising concerns that the rule imposes undue burdens on insurance agents selling annuities and other products to clients rolling over their retirement investment. See, Federation of Americans for Consumer Choice v. DOL

[3] See "The ERISA Edit: Investment Advice Fiduciary Regulation Faces First APA Challenge" Miller & Chevalier, available at https://www.millerchevalier.com/publication/erisa-edit-investment-advice-fiduciary-regulation-faces-first-apa-challenge

parameters within the five-part test to establish who qualifies as a fiduciary relating to giving investment advice. The FACC's complaint is reliant on the previous ruling from 2016 as they maintained that the 2024 Fiduciary Rule is almost identical to that which was proposed back in 2016. In 2016, the Fifth Circuit ultimately found that the proposed rule included individuals engaged only in one-time sales of certain investment products that did not have an established pre-existing relationship with investors they were target marketing. Therefore, the court ultimately found this to be an unlawful extension of ERISA.

May 24, 2024 - American Council of Life Insurers

On May 24th, 2024, the DOL received yet another complaint relating to the redefining of the term "fiduciary" under the Fiduciary Rule. A group of insurance trade associations led by the American Council of Life Insurers ("ACLI") filed their complaint[4] in the Northern District of Texas. Similar to the complaint filed on behalf of the FACC, the ACLI also alleges that the Fiduciary Rule reads eerily similar to that of the proposed 2016 fiduciary rule. They concluded that the Fiduciary Rule is invalid for the same reasons the 2016 rule was struck down. ACLI further notes that the common-law definition of "fiduciary qualifications" depended largely on the existence of a prior existing relationship of "trust and confidence" which doesn't exist in the context of "sales recommendations".

The ACLI's complaint included a detailed list of the DOL's rule-making process including:

1. The DOL has not been able to establish that the Fiduciary Rule was necessary in light of the existing regulations that currently apply to the retirement investment industry.

2. the Fiduciary Rule disproportionately effects annuities;

3. the cost benefit analysis completed by the DOL was not conducted in a timely manner, but rather the process was rushed and ultimately incomplete; and

4. comments made about the Fiduciary Rule were not addressed during the rule making process.

In conjunction with the complaint, the ACLI filed a motion for a preliminary injunction, preventing the law from taking effect. As a result, the Final Rule's original effective date of September 23, 2024, has been officially delayed until further notice.

Most recently, on September 20th, the DOL filed notices of appeal in both Texas courts where the Fiduciary Rule was challenged. The DOL has yet to submit briefs in support of its argument.

ESG 401(K) Rule

On June 28, 2024, the United States Supreme Court handed down its decision in *Loper Bright Enterprises v. Raimondo*[5], in which it may have critically altered the course of administrative law by overturning the longstanding *Chevron* doctrine, which previously required courts to defer to reasonable agency interpretations of ambiguous law. After the Supreme Court overturned the 40-plus year *Chevron* doctrine, the Fifth Circuit, weighed in on the implications the ruling will have on a Biden administration rule designed to promote sustainable investing into 401(k) plans. The Biden administration is said to have heavily relied on *Chevron* in pushing forward with sustainable 401(k) plan investments. Republican state attorneys are now gearing up to challenge the Biden administrations rule as a first of what could be many post-*Chevron* court test cases.

Judge Don Willett of the Fifth Circuit court, appointed by former president Donald Trump, reiterated that the Fifth Circuit has always reserved the right to revisit cases at a lower court when another precedent is

[4] American Council of Life Insurers at al. v U.S. Department of Labor Et al,. NO. 4:24-cv-00482 (N.D. Tex. May 24, 2024) available at: 2024-05-24_ACLI-v-DOL_Complaint.pdf (millerchevalier.com)

[5] [5] See Loper Bright Enterprises v Raimondo available at: Bloomberg Law

reversed or overturned, acknowledging that ESG rules should be no different[6]. Others such as Daniel Winik, a government lawyer representing the Department of Labor ("DOL") and its Employee Benefits Security Administration, a supporter of the environmental, social and corporate governance rule ("ESG") also takes no issue with revisiting the ruling post *Chevron*. Many like him believe that the district courts will come to the same conclusion on this rule despite the outcome of *Loper* . Many however, believe this ruling does not need to be revisited at all, citing that the decision relied on more than just *Chevron* alone.

Conversations continue to ensue surrounding the "tie-breaker" standard, which allows fiduciaries to select one investment over another based on collateral benefits such as sustainability factors in the case where two or more options would be economically identical. Though the DOL attorney Daniel Winik points out that it is "probably pretty rare"[7] that two investment options are predicted to have identical financial outcomes, which seemingly undermines the republican arguments surrounding a "secondary loyalty" in choosing investments relating to the ESG rules. Those arguing in favour of the Republican states and private parties who promulgated the Administrative Procedure Act challenge against the 2022 EBSA rule prefer not to see this case brought down to a lower-level review, noting that another round of arguments would continue to delay litigation matters.

SEC Market Stress Proposals - Gary Gensler, Chair of the U.S. Securities and Exchange Commission

The Investment Company Act of 1940 (the "1940 Act") was adopted by Congress following the failure of many investment trusts and investment agencies. The 1940 Act has led to continuous praise over the last 90 years in establishing well-regulated collective investment vehicles. This has allowed for greater diversification and lower costs for everyday investors rather than purchasing individual stocks and bonds. The SEC rules in conjunction with the 1940 Act addressed Depression-era investment failures and have reduced the risk of financial haemorrhaging spreading from funds. Gary Gensler, Chair of the U.S. Securities and Exchange Commission ("SEC") has been vocal in reminding investors that though risk has been reduced there is still a level of anticipated risk in times of stress.

Mr. Gensler shared his concerns in a speech given before the Investment Company Institute ("ICI"). He included in his statements his belief that there is a potential liquidity mismatch regarding the design of money market funds and open-end bond funds. Referring to 2008 and 2020, he references the high risk Americans were faced with as money market and open-end bond funds became more volatile. In 2008 the Federal Reserve established liquidity facilities and the Department of Treasury temporarily guaranteed money market funds in an effort to combat the increased risk. This led to a series of reforms adopted in 2010 and 2014. Mr. Gensler states that at the onset of the COVID-19 pandemic the Federal Reserve once again stepped in to support money market and open-end bond funds. The support included stabilizing short-term funding markets by establishing the Money Market Mutual Fund Liquidity Facility. Mr. Gensler notes for the first time the governmental support broadened to assist corporate and municipal bond markets[8].

Mr. Gensler's hypothesis that real-world events demonstrate an increased level of stress on money market and open-end bond funds led to the SEC's proposals intended to address design issues and enhance liquidity risk management. Money market funds were developed in the 1970s during a time of high inflation. These funds provided shareholders market-based returns fully backed one-to-one and are invested in vehicles with short maturity duration. Mr. Gensler continued to reiterate money market funds offer no capital buffer, and furthermore are not without risk. He cites this as reasoning to update the rules addressed in 2014. The ultimate goal of these updates would include preventing the Federal Reserve from having to provide continued support to these funds in the future. The proposal includes enhancing liquidity

[6] See "Fifth Cir. Mulls Sending ESG 401(k) Rule Case Back Post Chevron available at Fifth Cir. Mulls Sending ESG 401(k) Rule Case Back Post-Chevron (1) (bloomberglaw.com)

[7] See "Fifth Cir. Mulls Sending ESG 401(K) Rule Case Back Post Chevron" available at Fifth Cir. Mulls Sending ESG 401(k) Rule Case Back Post-Chevron (1) (bloomberglaw.com)

[8] See "Bear in the Woods Remarks" before the Investment Company Institute available at SEC.gov | "Bear in the Woods" Remarks before the Investment Company Institute

requirements and preventing money market funds from imposing limits on redemptions in times of increased stress. In an effort to address the reduction of dilution in times of high stress, the SEC proposes implementing swing pricing and other alternatives regarding liquidity fees. These provisions would only apply to institutional prime and tax-exempt money market funds.

Similarly, Mr. Gensler provided an overview on the SEC's proposal to provide maturity and liquidation transformation for open-end funds. He reminded those of the corporate bond ETFs purchased by the Federal Reserve in 2020 to alleviate stress in the markets. The result of those actions taken by the Federal Reserve back in 2020 has led to the SEC introducing proposals regarding pricing and liquidity. he noted the SEC would first like to update the 2016 liquidity rule to establish minimum standards for liquidity classifications, designed to prevent funds from overestimating liquidity of their investments. Next, the SEC has introduced several alternatives in regards to pricing. These alternatives include swing pricing and/or liquidity fees to ultimately ensure that redeeming shareholders bear the appropriate costs regarding their redemptions, especially in times of increased stress to the market. Lastly, the SEC proposed shortening the lag time between when investors place an order and when the funds actually receive said orders. His reasoning for this includes the theory that the lag time in data reaching fund companies increases vulnerability and risk.

Mr. Gensler concluded by opining on the current positioning of short-term investment funds and collective investment funds, stating that the 2012 rules lack limits on illiquid investments and minimum levels of liquid assets. Furthermore, he included that the SEC is in current discussions with bank regulators regarding the suspected risk associated with short-term investment funds and collective investment funds. The SEC's goal in introducing these proposals is to provide further protection for investors while mitigating risk and eliminating the need for governmental intervention during times of high stress in the market.

Update September 4, 2024

August 28, 2024, the SEC adopted amendments to reporting requirements that are meant to triple the amount of Form N-PORT data available to investors. The additional reporting requirements provide the SEC and investors with additional information regarding certain registered investment companies on Form N-PORT. The SEC declined to adopt mandatory swing pricing of mutual fund share as previously proposed in the original release.

LEGAL UPDATE

The End of the Chevron Deference:

Loper Bright Enterprises v. Raimondo

The legal doctrine known as *Chevron* deference was adopted in 1984 when the United States Supreme Court decided *Chevron U.S.A., Inc. v. Natural Resources Defence Council, Inc*. The doctrine instructed courts to use an agency's reasonable interpretation regarding any ambiguous statue that it administers. This doctrine has been heavily relied upon in modern administrative law over the past 40 years. Importantly, this doctrine provides the foundation upon which agency decisions and regulations are reviewed by the courts.

On June 28, 2024, the Supreme Court decided *Loper Bright Enterprises v. Raimondo,*[9] which dealt with two owners of a fishing company based out of New England. The Magnunson Stevens Act establishes catch limits to prevent over-fishing and also requires that fishing boats have two government appointed inspectors on board at all times to monitor compliance. Fishing companies are likely to incur the cost of these monitors, around roughly $700 per day. Loper Bright Enterprises argued that the National Marine Fisheries Service (NMFWS) had no authority to enforce the monitoring requirements. Though a district court disagreed citing *Chevron*, this case ultimately made its way to the Supreme Court. The Supreme

[9] See Loper Bright Enterprises v Raimondo available at: Bloomberg Law

Court ruled to eliminate requirements that the courts defer to reasonable interpretation of broad or ambiguous statutes ultimately eliminating the Chevron doctrine and substantially reshaping administrative law.

The Supreme Court's decision maintains that the Administrative Procedure Act requires courts to exercise "independent judgement" when determining the definition of statutory provisions. While these courts are still able to seek aid from long-standing interpretations by agencies, they ultimately must independently interpret statues and effectuate the will of Congress. The overturning of *Chevron* is an attempt to allow courts to return to "traditional understanding of the judicial function". Courts can still review an agency's interpretation of a statute for guidance, but ultimately the court has the final say on the interpretation behind what a law means.

The ruling allows courts to actively participate in scrutinizing federal regulations and levels the playing field, allowing for the resolution of statutory ambiguities to be determined by regulated entities. Congress still maintains the authority to delegate to other federal agencies but must clearly define the scope of that delegated authority. The Supreme Court importantly clarifies that the ruling does not overturn prior cases decided under the Chevron framework. Three of the dissenting Justices emphasize that the new framework only further expands the Supreme Court's power at the expense of the executive branch and other subject matter expertise agencies. The dissenters further state that they believe that this ruling could potentially enable judges to make policy decisions on cultural issues citing climate change, and artificial intelligence as examples.

This ruling will ultimately impact the entirety of the "policy life cycle" which includes how bills are drafted and what delegation language is used. We are likely to see an increase of litigation as regulated entities gain more leverage and an increase in uncertainty for existing regulations. The ruling provides a clouding of doubt relating to existing agency interpretation and regulations that heavily rely on broad or ambiguous statutory language. This may lead to more detailed and specific statutory language moving forward with a potential to revisit existing legislation including at the DL and SEC levels. The ruling has produced a level of uncertainty in the legal and regulatory space. Over the next few years, we will begin to evaluate the true impact of this ruling.

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, 2023, SEI manages, advises, or administers approximately $1.2 trillion in assets.