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2024 investment management
regulatory outlook

Center for
**Regulatory
Strategy**
US

A message from the Deloitte Center for Regulatory Strategy

Entering 2024, the investment and wealth management industries continue to face a period of intense regulatory and operational change. The Securities and Exchange Commission's (SEC) rulemaking agenda under Chair Gensler has been historic in terms of both the volume and significance of regulatory proposals. At the same time, enforcement activity has increased substantially.¹

This sharp shift in the regulatory environment has left firms surprised by aggressive enforcement and hefty fines for widespread compliance failures.² To avoid a similar pattern in 2024, firms should consider taking a proactive approach to their compliance program assessment efforts and expand, as needed, their remediation efforts to regulatory areas of focus. This will be in addition to enhancing their capabilities to adapt operational and compliance processes to comply with new and amended rules at scale given the volume of regulatory change on the horizon.

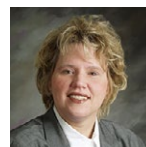
Investment managers face additional regulatory pressure from the Financial Stability Oversight Council (FSOC), which appears intent on designating new systemically important financial institutions (SIFI). SIFI designation for a large investment manager would impose a new layer of regulatory scrutiny from the Federal Reserve Board of Governors (FRB). The FRB supervisory processes are distinct and more open-ended than the SEC regulatory construct.

Technology and business transformation will be a through line for firms as they navigate this challenging environment. Although many changes will be driven by regulatory imperatives, we encourage our clients to maximize their return on regulatory-driven initiatives by also seeking opportunities to enhance their processes and business models with technology. In light of the challenges and opportunities that the current regulatory environment presents, we have chosen to focus this year's outlook on impacts from the regulatory agenda, operational complexity, and transformation.

Sincerely,



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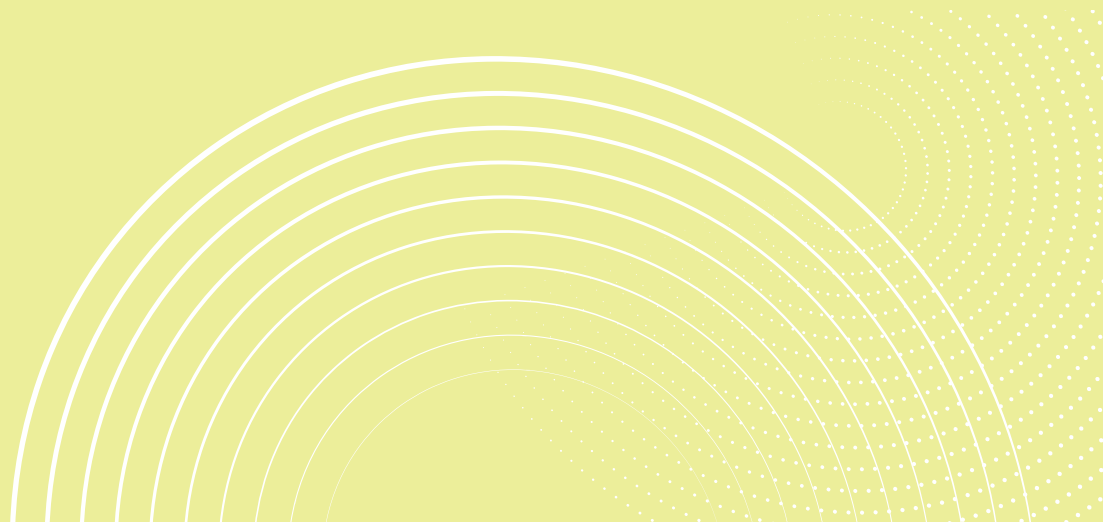
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A complex regulatory agenda: Impacts to the firm and end investor

The significance of the regulatory agenda for investment management is not limited to the volume of rulemakings nor is it limited to the SEC. Other regulatory bodies (e.g., Department of Labor, state regulators) are pressing forward with their own regulatory change initiatives. For large investment managers, the prospect of SIFI designation, headwinds from a challenging US political environment, and an increasingly complex geopolitical landscape are additional hurdles to overcome. For wealth managers, evolving expectations for sales practices potentially will be an area of risk and a moving target. From a product perspective, the operational impacts of certain policies being pursued are unparalleled in recent memory.³

Among the new rules that will reverberate throughout the industry in 2024 are a final rule on public company cyber incident disclosure and a yet-to-be finalized cybersecurity rule for registered investment advisers (RIAs), registered investment companies (RICs), and business development companies (BDCs)⁴, as well as a proposed new rule that would set standards for firms' oversight of third-party service providers.⁵

Although proposed swing pricing for open-end funds ultimately may not be enacted (and was not enacted for money market funds), liquidity fees finalized in the money market fund rule are economically similar and impactful, nevertheless. Under the new money market fund regime, institutional prime and institutional tax-exempt funds are required to impose liquidity fees on redeeming investors when daily net redemptions exceed 5% of new assets. The rule also includes increases to minimum daily and weekly liquidity requirements and the elimination of redemption gates for all registered money market funds. The prospect of redemption gates was seen as a contributing factor to the rapid mass redemptions at the outset of the COVID-19 pandemic. Enhanced liquidity requirements are intended to make these funds more resilient in stressed periods. A final rule for open-end funds is still in development and ultimately may follow a similar approach to the final money market fund rules.

Similarly, final rules issued in August 2023 have reshaped regulation of private fund advisers (PFAs). The regulatory package includes new rules affecting PFAs to funds relying on the 3(c)(1) and 3(c)(7) exemptions under the Investment Company Act of 1940 (each a "Covered Fund"), including (i) a rule requiring PFAs to prepare quarterly statements, (ii) an audit rule, (iii) a restricted activities rule, and (iv) a rule prohibiting preferential treatment in each case with respect to Covered Funds.⁶ Beyond complex implementation efforts associated with the massive rules package, certain new rules will fundamentally change the way PFAs operate. Six industry trade groups have sued the SEC over the rules package, and litigation is currently ongoing in the Fifth Circuit Court of Appeals.⁷ At the very end of 2023, eleven pension funds and three industry trade associations filed an amicus brief urging the federal appellate judges to dismiss the suit.⁸

The SEC also has proposed several environmental, social, and governance (ESG)-related rulemakings, one of which has been adopted. The newly amended Fund Names Rule expands "the rule's 80% investment policy requirement beyond its current scope, to apply to any fund name with terms suggesting that the fund focuses in investments that have, or investments whose issuers have, particular characteristics. This coverage will include, for example, not just fund names with terms such as "growth" or "value" but also terms indicating that the fund's investment decisions incorporate one or more ESG factors."⁹ Several other significant ESG-related rulemakings are on the horizon as well. Public company climate disclosure is a cornerstone of SEC Chair Gensler's regulatory agenda. The rule, which was among the first major proposals issued by the agency under Chair Gensler's leadership, would require all public companies to disclose certain environmental-related metrics on their Form 10-K. The rule is highly controversial in certain circles, and the agency may face a lawsuit if the rule becomes final.¹⁰

A second proposal, which is targeted at the investment management industry and builds on the public company rule, remains in proposed form. A recent California (CA) state law further complicates the political calculus. The new law requires all companies with more than \$1 billion in annual revenue to disclose Scope 1, 2, and 3

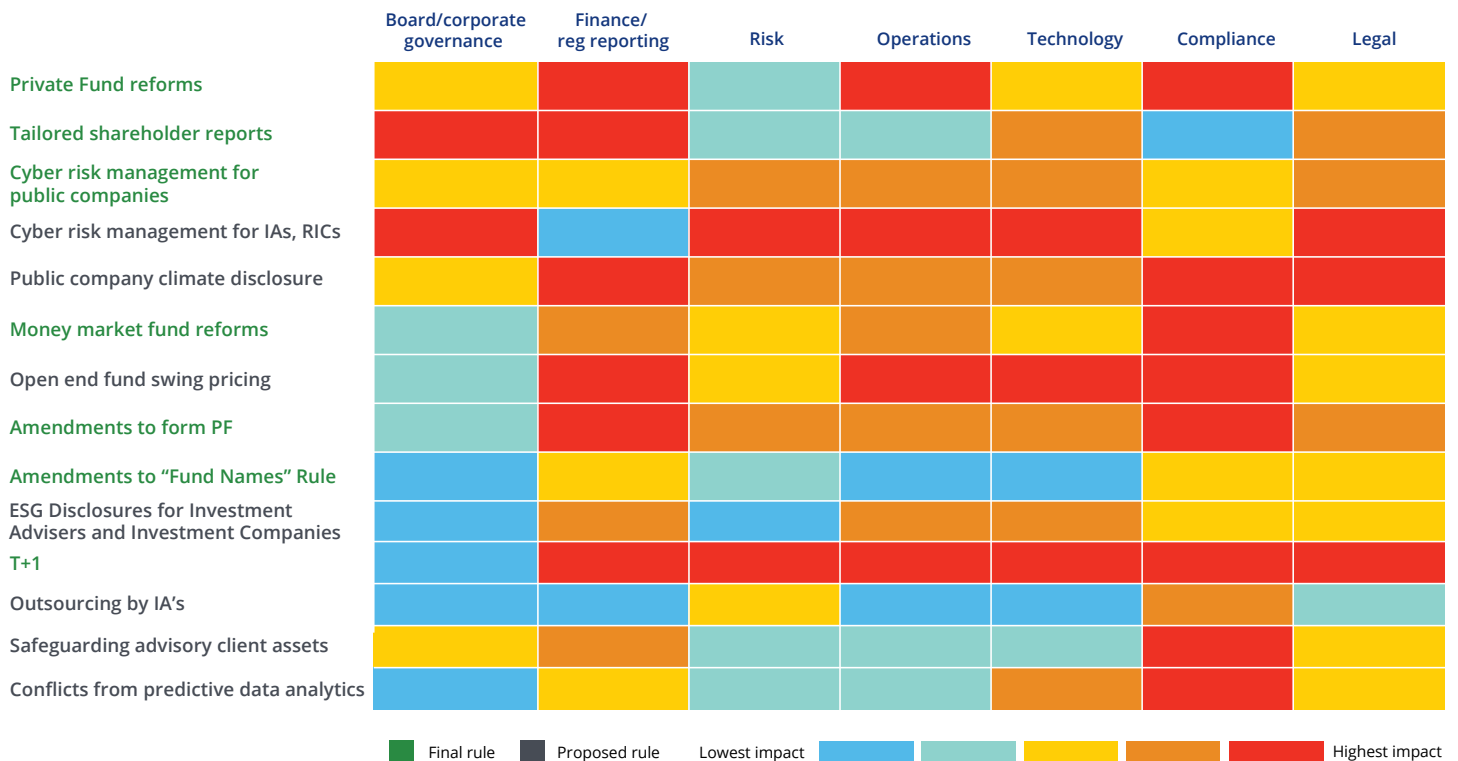
emissions beginning in 2026.¹¹ The state has effectively front-run the federal agency in its regulatory approach, and this development is highly consequential to the SEC’s approach. On the one hand, the SEC need not risk litigation for the sake of disclosures that most significant companies will be required to make anyway under the CA law. On the other, the CA law factors into the “economic baseline” that the SEC will need to consider. In other words, by requiring these disclosures of large US companies, CA has reduced the additive costs and burden that the federal regulator must weigh in its consideration of a final rule. Additionally, the Biden administration last fall reworked guidance for independent agencies conducting cost-benefit analysis to make these assessments more favorable to ESG rules.¹²

Managing operational complexity

Fund reform

The SEC ultimately chose not to require swing pricing in its final money market fund reforms. However, the final rules require funds to impose liquidity fees, under certain conditions, which constitute a significant operational effort, nevertheless.¹³ To implement the mandatory liquidity fees, funds will need to determine levels of fees they are required to charge and implement solutions to monitor net redemptions and trigger associated liquidity fees when redemptions cross the 5% threshold. Enhancements to daily and weekly liquidity minimums will constitute a significant undertaking as well and may require firms to rework their liquidity risk management programs.

Figure 1: Heat map of recently final rules



Source: Deloitte analysis of regulatory agenda

Fund names

Under the expanded Investment Company Act “Names Rule,” funds using the terms “growth” or “value” or that have a “thematic focus”—ESG-focused funds—will be required to invest at least 80% of the fund’s assets in alignment with the investment focus suggested by the fund’s name. The final rule requires a fund to review the treatment of portfolio assets under the policy at least quarterly and allows the fund up to 90 days to get back to compliance if it departs from the 80% investment policy requirement.

ESG-themed offerings have expanded in recent years. To comply with the final rule, firms will need to adapt their fund offerings either by changing the investment strategy or ensuring compliance with the requirements of the amended Names Rule. Each impacted fund will require a review of the fund’s name, investment strategy, and underlying composition. Firms may want to consider adjusting their offerings—particularly if they offer products whose names are implicated but whose underlying investment strategy is not consistent with the requirements of the rule. All funds newly scoped into the rule will require continuous investment monitoring to ensure compliance with the amended 80% investment policy requirement, as well as preparation of associated disclosures. In many cases, funds will be required to refile their prospectuses in line with the rule’s new requirements, including defining terms used in its name and criteria the fund uses to select investments in line with defined terms.

Although firms have an extended compliance period for this rule, they should begin identifying affected funds as soon as possible. The amendments have tiered compliance dates with December 11, 2025 as the compliance date for large entities and June 11, 2026 for small entities.¹⁴ Firms’ implementation of the amended rule can be divided into three phases: (1) identification of impacted funds, (2) business decision to implement the rule or change the fund’s name, and (3) manage remaining impacted funds into compliance.

Cyber

In April 2022, the SEC proposed standards for cybersecurity risk management for RIAs, RICs, and BDCs. A final version of the rules, which would be adopted under both the Investment Advisers Act of 1940 and the Investment Company Act of 1940, is expected sometime this year. As proposed, both funds and advisers would be required to:

- Have adequate policies and procedures to address cybersecurity risks
- Maintain cybersecurity books and records
- Report significant cybersecurity incidents to the SEC on new Form ADV-C within 48 hours
- Disclose additional information about cybersecurity risks and incidents to the SEC

In the interim, the SEC also finalized a set of cybersecurity rules for all public companies (including BDCs). The rules establish expectations with respect to public firms’ cyber risk management and governance strategies and also require disclosure of material cyber incidents to the agency on Form 8-k.¹⁵ The Form 8-k incident disclosure requirements became effective December 18, 2023, and firms will need to make certain disclosures about their cybersecurity risk management, strategy and governance on their 2023 Form 10-k as well.¹⁶

Thus, public firms should already be in the process of adapting their cyber programs to these new requirements. However, firms that will need to comply with both rule packages should not assume that they are prepared for a final rule specific to investment management simply because they have parallel efforts to implement the public company rules. Firms that anticipate they will be affected by both rule packages can consider undertaking a side-by-side review of the two sets of requirements, looking for synergies and gaps. The packages each have different sets of reporting requirements, which may be implemented by different teams. Importantly, asset management firms may be held to more stringent and immediate incident

reporting requirements since the proposed rule would require reporting of significant incidents (a lower bar than material) to the SEC within 48 hours. Firms should consider this forthcoming rule package as they prepare for the public company rules, or they risk needing to rework their efforts when the industry-specific rules become final.

Safeguarding proposal¹⁷

In early 2023, the SEC issued an expansive “safeguarding” proposal that would dictate standards for “qualified custodians” to RIAs far beyond the reach of the existing custody rule. In proposing the rule, the SEC partly sought to bring crypto assets under the umbrella of assets to which SEC custody standards would apply. However, the rule—as proposed—would expand the custody standard far beyond securities, to *all* assets held by qualified custodians.

SIFI designation

In November 2023, FSOC finalized a new analytical framework for identifying, assessing, and responding to potential risks to US financial stability and issued new designation guidance. The guidance eliminates certain SIFI designation requirements previously put in place, thereby lowering the standards for designation.¹⁸ SIFI designation would constitute a sea change in the regulatory oversight of investment management. Large investment managers generally have sophisticated compliance teams that handle many initiatives from global, federal, and state regulators. However, FRB oversight, which is the core component of SIFI designation, activates a supervisory process presently foreign to many firms. Importantly, the prescriptive nature of SEC rulemaking, while potentially costly to implement, offers firms a relatively clear picture of regulatory expectations. The FRB supervisory process, on the other hand, is more subjective in its approach with supervisors empowered to effect impactful requests on organizations absent the public rulemaking process. The specter of SIFI designation may be a significant concern for large investment managers this year. Fortunately, it appears that the

Biden administration has not coalesced around a new SIFI target yet. Various appointees indicated their pet priorities over the course of 2023. However, from a market capitalization perspective, the largest investment managers should expect to be short-listed as SIFI targets.

Anticipating impacts to the end investor

Funds are not the only interested parties affected by the deluge of final rules. Investors also will face consequences from the newly final rulemakings. Liquidity fees included in the final money market fund rules serve as a good example since end investors ultimately will be charged these fees under certain circumstances. Private fund reform and the safeguarding proposal are two other examples. Investors in Covered Funds will now consistently receive quarterly statements. The outstanding safeguarding proposal also would have spillover effects for end clients since a far broader scope of assets will come under the SEC’s proposed safeguarding rule, such as physical commodities and real estate.¹⁹

The vast final rulemakings also present the challenge of interlocking impacts. It is typical for any piece of policy to result in some unintended consequences. However, the pace and breadth of rulemaking make it difficult for the regulator to assess the interlocking impacts from the various rules under consideration, especially since the agency is still considering many different alternatives to specific proposals.

Chief among the unintended consequences that regulators would like to prevent are those that impact the end investor—and the retail investor especially. Nevertheless, retail investors will also be affected by the sea of regulatory change. For example, the new Names Rule may result in fewer ESG-themed funds being offered. At the same time, retail investors will have greater assurance that ESG-themed funds invest in accordance with their stated priorities. More broadly, retail investors and investors generally may see higher fees as funds pass on some of the costs associated with the new and amended rules.

Responding to impacts to the firm

Firms are likely to struggle to implement so much change at once. Even for firms accustomed to heavy-handed regulatory oversight, the amount of operational change mandated by some of the new and forthcoming rules will likely be challenging. For PFAs to Covered Funds that are accustomed to a lighter regulatory footprint, the new rules will result in business overhauls not previously contemplated (e.g., with respect to certain investor reporting practices as well as business practices that constitute preferential treatment). As we detailed in 2022, the impacts of such a large regulatory agenda will be felt across firms and functions.²⁰ From the board to the back office, firms will need to ingest the deluge of new rules and allocate competing resources for implementation. In a tepid economic environment, many firms are looking to streamline rather than expand cost centers such as compliance. However, firms that underinvest in regulatory implementation initiatives risk being caught unprepared by a more aggressive enforcement posture, which we outline below.

As already discussed, the onslaught of significant rulemakings and proposals makes regulators' job more difficult and raises the likelihood of unintended consequences from any particular rule. Thus, firms may want to consider conducting their own assessments of the interlocking impacts of the many regulatory alternatives under consideration.

The new cybersecurity risk management packages are a strong example of the complexity that firms will face, not only with respect to their compliance obligations, but also to implementation. The public company rules, which are already final, include certain requirements that may be less stringent than what ultimately is required of firms by the investment management-specific cyber rules package, which is not yet final. Firms affected by both sets of rules that implement the public company rules in a vacuum may face potential rework when the industry-specific rules become final. At a minimum, firms will need to stand up another regulatory implementation effort associated with the final rules. At some firms, these various efforts may compete for the same resources (in terms of budget and staff) and place atypical burdens associated with regulatory implementation efforts on teams that typically serve other functions (e.g., day-to-day management of compliance needs).





Enforcement in focus









For firms, rulemaking is not the only ambition of the reinvigorated SEC; enforcement has also sprung to action in full force. In its fiscal year 2023, the SEC brought 780 enforcement actions, and settlements and fines totaled \$5 billion.²¹ For years, regulators have been evaluating fine amounts and their effect as an economic deterrent. In the past few years, we have seen regulators begin to resize their fines in accordance with this thinking. At the same time, penalties for some complex compliance obligations have ballooned.²² Although enforcement activity ebbs and flows, firms should understand that it appears regulators see recently elevated fine levels as “rightsizing” what they perceived to be insufficient consequences for noncompliance. Regulators’ goals with recent fine amounts are, in part, to create an effective deterrent in hopes of avoiding widespread industry compliance failures in the future.²³ Thus, firms should not consider fine amounts of recent years to be outliers, but rather an indication of future amounts, even if overall fine levels fluctuate with the general approach to enforcement.

In October 2023, the SEC released its examination priorities to correspond with the end of its fiscal year.²⁴ The 2024 priorities include topics that should be familiar to firms, and we encourage our clients to consider these priorities in light of ongoing rulemaking initiatives. Figures 2 and 3 illustrate how various new rules, pieces of guidance, or proposals align to the SEC’s stated examination priorities for 2024. Firms should be cautious that the regulator likely will examine closely for compliance with existing rules on many of the topics where new rules are under consideration. Ideally, firms should be proactive about leveraging regulatory guidance and the contents of outstanding proposals to meet expectations even if a new rule is not yet firmly on the books.



Figure 2. 2024 SEC examination priorities for investment advisers

Examination priorities are designed to assess advisers' commitment to duty of care and loyalty, including reviewing investment guidance, alignment with clients' interests, financial incentives, and investor disclosures

Examinations of Investment Advisers	Examinations of Investment Advisers to Private Funds
 <p>Marketing practice To assess if advisers, including those for private funds, comply with policies to prevent Advisers Act violations, disclose marketing information on Form ADV, and maintain necessary records <i>Ongoing efforts:</i> SEC Examinations Risk Alert: Marketing Rule</p>	 <p>Portfolio management risks Focus on issues such as underperformance in private funds, substantial fund outflows, valuation challenges, as well as private funds, that rely more heavily on funds that leverage and hold illiquid assets <i>Ongoing efforts:</i> Third party risk management: SEC Investment Adviser Proposal</p>
 <p>Compensation arrangements To assess advisers' fiduciary duties to clients, regarding compensation and payments; revenue optimization methods, like bank deposit sweep programs; and fee breakpoint calculations, especially with manual billing systems</p>	 <p>Compliance and due diligence practices Adhere to Advisers Act custody rules, including Form ADV accuracy, timely private fund audits, and financial statement distribution along with aligning due diligence procedures with established policies, protocols, and disclosures <i>Ongoing efforts:</i> Risk Alert: SEC Investment Adviser Supervision</p>
 <p>Valuation assessments To assess if the investment recommendations made by the advisers lack liquidity or are difficult to value, examples being commercial real estate or private placements</p>	 <p>Advisory committees compliance and fee accuracy Ensure compliance with contract terms related to limited partnership advisory committees, and similar structures, as well as increasing focus on accurate calculation and allocation of private fund fees and expenses <i>Ongoing efforts:</i> SEC Private Fund Adviser Reforms: Final Rules</p>
 <p>Safeguarding and disclosure assessments To assess the adequacy of advisers' protective measures for securing clients' confidential non-public data while also examining the accuracy and completeness of regulatory filings including Form CRS</p>	 <p>Conflicts, controls, disclosures and Form PF reporting Focus on conflict, controls, and disclosures for private funds managed alongside registered investment companies, use of affiliated service providers and policies/ procedures for Form PF reporting including reporting for specific events <i>Ongoing efforts:</i></p> <ul style="list-style-type: none"> • Form PF and Share Repurchase Disclosures: Final Rules • Names Rules: SEC Final Amendments

Source: SEC, "[2024 examination priorities](#)," October 16, 2023.

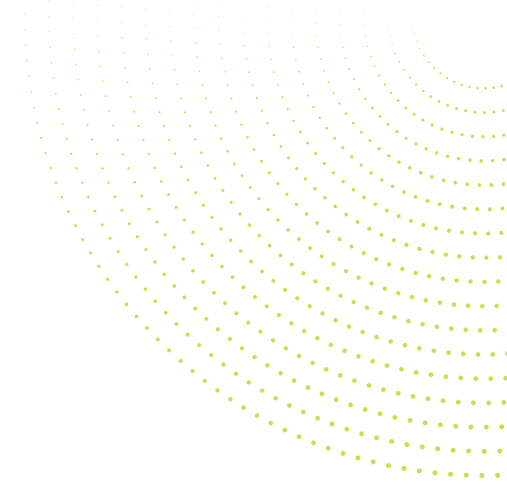
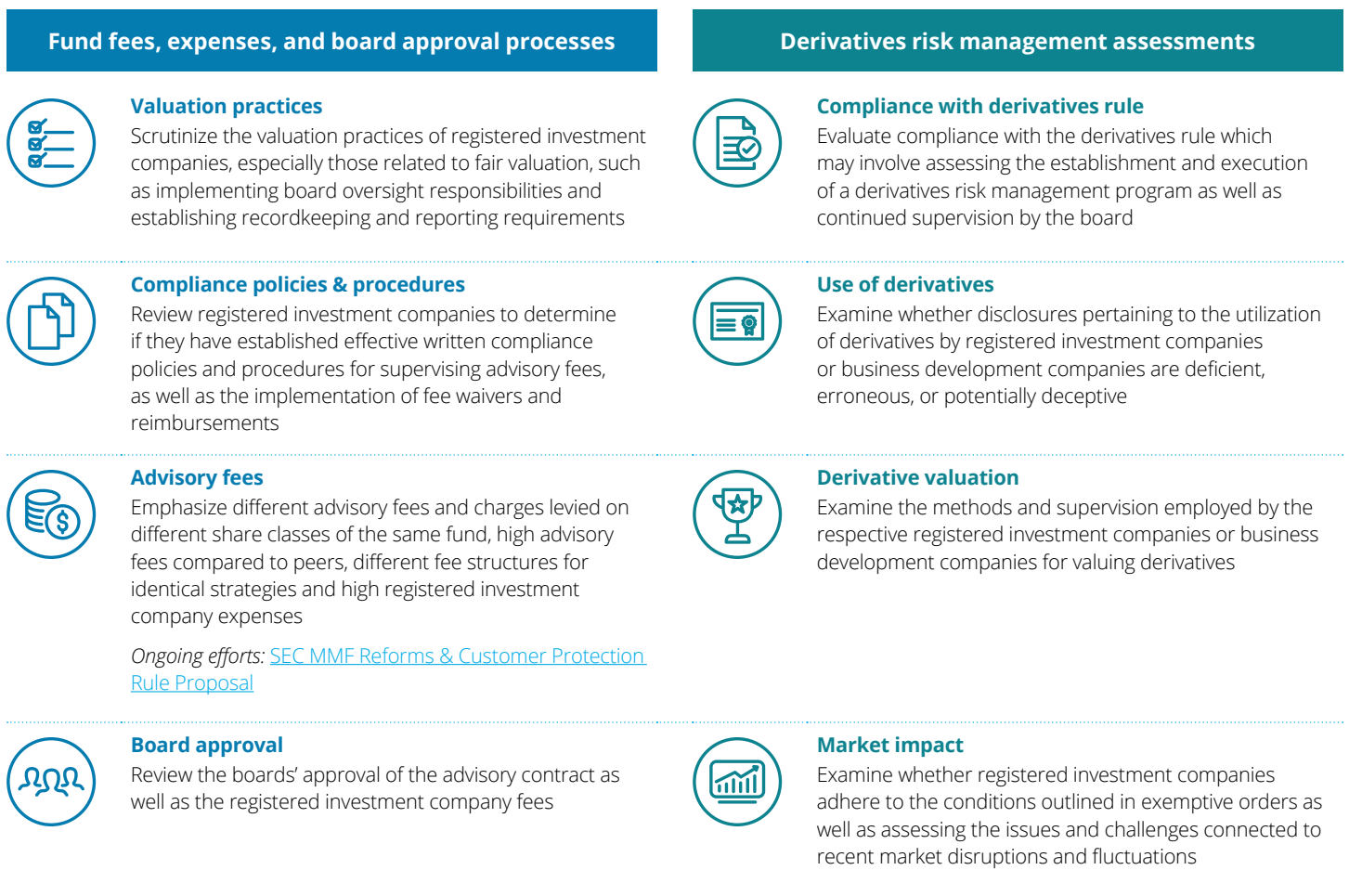
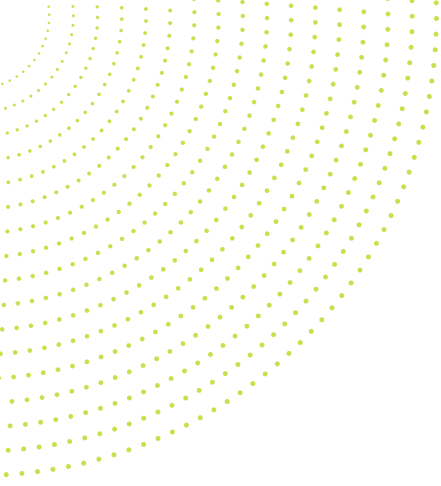


Figure 3. 2024 SEC examination priorities for investment companies

The examination priorities will focus on assessment of compliance programs, governance practices, disclosures made to investors, and the precision of reporting to the SEC



Source: SEC, "2024 examination priorities," October 16, 2023.



As one example, under the SEC’s “Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers” proposal issued in August 2023, firms would need to evaluate and have policies in place to address any conflicts that may arise from use “or potential use” of “covered technologies” in investor interactions.²⁵ The implications of the proposal are far-reaching, and while a final rule may be potentially less far-reaching, firms can leverage the outstanding proposal to consider leading practices for their use of artificial intelligence (AI). For example, firms should assume that regulators will not tolerate a “black box” approach to AI whereby regulators would not be able to see the algorithms’ mechanics and how outputs are generated. Instead, they likely need to document how they employ and supervise this technology.

The “Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers” proposal has received industry pushback, not only for being overly broad, but also for creating duplicative obligations since firms are already required to avoid conflicts under the Regulation Best Interest (Reg BI) and fiduciary standards.²⁶ Firms should be cautioned that, in light of these existing obligations, market regulators are not dependent on the proposal becoming final to begin bringing enforcement actions related to firms’ use of AI.

Responding to evolving expectations for sales practices

We expect a sales practice focus to examination and enforcement activity this year. The SEC’s stated exam priorities and recent regulatory issuances suggest several sales practice topics that are top-of-mind for the regulator, including Reg BI, the marketing rule, and an outstanding AI proposal. Additionally, the Department of Labor released a new fiduciary rule proposal in October 2023.²⁷ Taken together, firms should infer an evolving approach to sales practice expectations.

In 2023, the SEC released two risk alerts related to Reg BI.²⁸ The guidance signals advancing expectations with respect to firms’ Reg BI obligations. Whereas the rule in text is principles-based, recent guidance suggests a turn to a more prescriptive approach. The agency may be attempting to harmonize Reg BI with RIA’s fiduciary standard and, therefore, investment advisers may be interested in tracking the agency’s evolving expectations with respect to the rule.

After several years with the rule in place, regulators appear more willing to scrutinize firms’ programs and broker-dealers’ activities and records.²⁹ The SEC’s 2024 exam priorities stated that its examinations will focus on products recommended by broker-dealers and advisors that are complex, illiquid, and high cost. “Examinations may also focus on recommendations to certain types of investors, such as older investors and those saving for retirement or college,” the agency noted.³⁰

The SEC’s enforcement division continues to analyze whether wealth managers, who are dually registered as broker-dealers, have comprehensive and well-targeted policies and procedures that will maximize Reg BI compliance.³¹ The costs, risks, and rewards of variable annuity sales and investment strategies are under scrutiny, with more enforcement expected, as we have seen toward the end of 2023.³² The SEC will continue to make clear through enforcement or otherwise that the care obligation cannot be satisfied through disclosure alone. Advisors must be able to demonstrate a reasonable understanding of the individual retail investor’s investment profile and have a reasonable basis to conclude that the recommendation or advice provided is in the retail investor’s best interest, as well as consider reasonably available alternatives.

Preparing for examinations

This year, we expect an advanced exam approach to the marketing and valuation rules. To prepare for this new posture, firms should refer to SEC guidance issued last year to ensure that their programs will meet the regulator's expectations.³³ In July 2023, the SEC issued a risk alert entitled "Examinations Focused on Additional Areas of the Adviser Marketing Rule."³⁴ The alert outlines prior areas of focus for the regulator—emphasizing that the agency will continue to examine firms in these areas, including policies and procedures, the substantiation requirement, and firms' books and records.³⁵ It then outlines "additional areas" that the regulator will begin focusing on from an examination perspective, including testimonials, endorsements and third-party ratings. Specifically, examiners will look for clear and prominent disclosures associated with testimonials, compliance with oversight requirements associated with testimonials, and written agreements.³⁶ Staff will also be examining for compliance with new requirements regarding the use of third-party ratings in advertisements and amendments to Form ADV. The risk alert makes clear that these expectations apply to private fund advisers as well.³⁷

Although the SEC hit many of the largest Wall Street firms with sizable fines for recordkeeping failures with respect to electronic communications, enforcement sweeps on the topic continue. Therefore, firms ought to remain vigilant and—if they have not yet done so—take steps to remediate in an effort to reduce the risk of additional future enforcement.



Although enforcement activity ebbs and flows, firms should understand that it appears regulators see recently elevated fine levels as "rightsizing" what they perceived to be insufficient consequences for noncompliance.

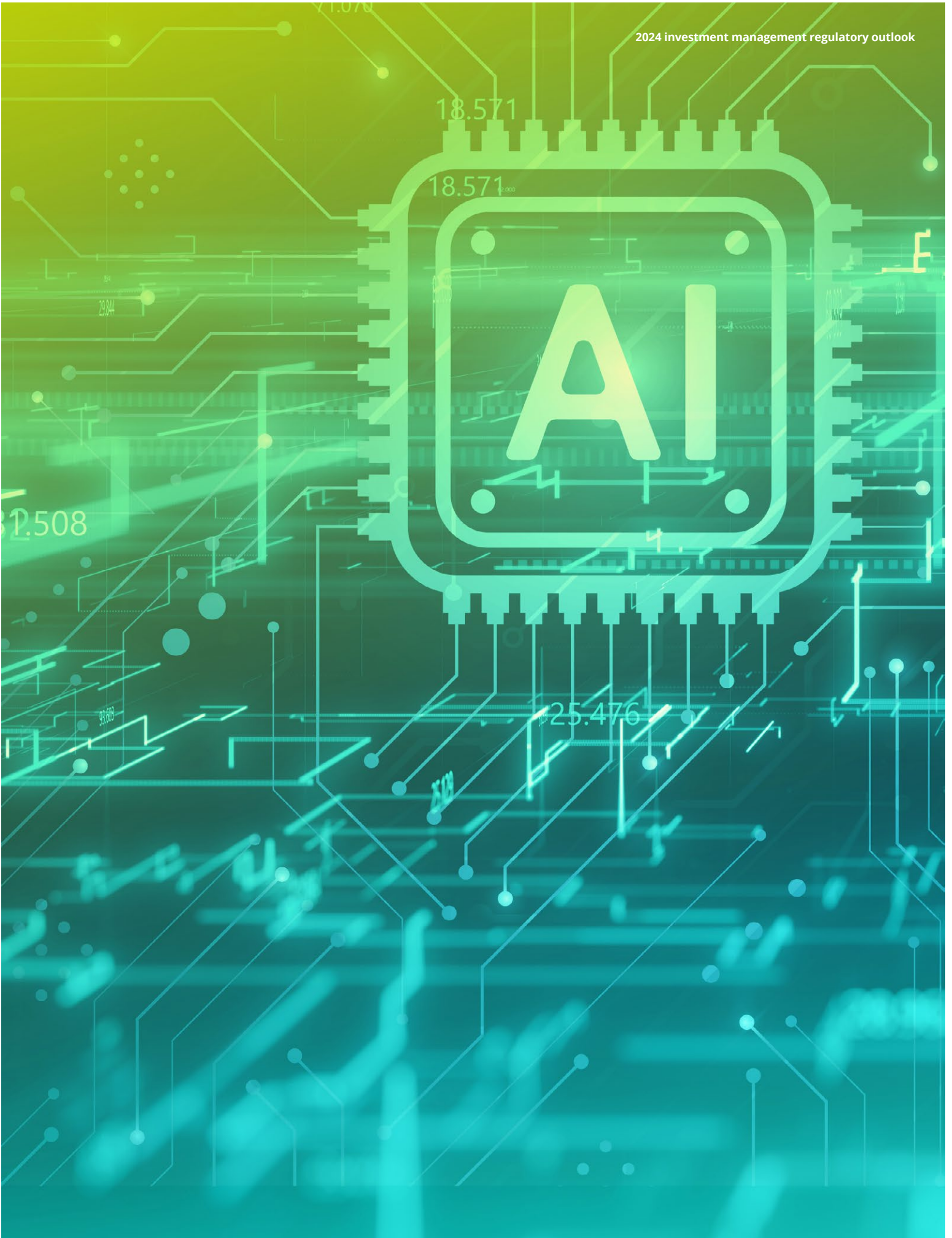
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Technology and business transformation

Leveraging AI and technology

Firms will face a cascade of compliance dates in 2024 and 2025. To successfully adapt to the unpredictable regulatory environment, some may need to reconsider their business or operational strategy. We challenge our clients to explore new models—whether business, technology, or staffing—that can enhance their regulatory response and leverage mandatory compliance spend to improve their core offerings.

Any discussion of transformation would be inadequate without considering the leaps forward in AI over 2023. The introduction of open-source generative AI represents a paradigm shift across sectors and industries. Firms are still struggling with how to harness these powerful tools most effectively, and experimentation will be a natural part of this process. Firms face two distinct challenges in creating an effective generative AI strategy: (1) how best to leverage their people resources, and (2) how to implement generative AI functions in a way that does not draw unwanted regulatory scrutiny.

Regulators and policymakers have begun to demonstrate their expectations with respect to AI broadly. In late 2021, the Bank for International Settlements (BIS) published a seminal paper on potential regulatory approaches to AI.³⁸ Among the paper's primary conclusions was the need for a "human in the loop." Forward-looking firms will leverage this foundational principle in their oversight and compliance programs. As noted earlier, in August 2023, the SEC issued an extremely broad predictive data analytics proposal, aimed at creating explicit expectations for firms' oversight and use of AI.³⁹ Under the proposal, firms would need to evaluate and have policies in place to address any conflicts that may arise from use "or potential use" of "covered technologies" in investor interactions.⁴⁰ Under the proposed rule and as discussed by BIS, firms would not be able to employ "black box" approaches to AI in investor interactions.

Beyond the market regulators, the policy landscape for AI regulation is picking up pace. In September of 2022, the Biden administration published principles for an "AI bill of rights," and in October 2023 President Biden signed an executive order outlining his administration's approach to ensuring "safe, secure, and trustworthy AI."⁴¹ On Capitol Hill, high-profile hearings have yet to produce a legislative outcome. As the United States has not yet addressed data privacy through federal legislation, it is hard to imagine federal AI legislation that does not in some way impact data privacy or use, further complicating an already difficult topic. As such, legislation may be illusive for a number of years and particularly in the face of the 2024 election cycle. Nevertheless, firms will need to pay close attention to the wider environment and be on alert for impacts to and opportunities for their AI strategy in the broader policy debate as the states are likely to become proving grounds for a spectrum of policy approaches this year.

Modifications to existing business models and rethinking what the firm does best

The sweeping new rules and proposals under consideration by the SEC may push firms to consider extensive changes to their business. In certain instances, it is possible that new regulatory requirements or restrictions may challenge a firm's existing business model or make the existing model suboptimal. When weighing the most significant of the rule changes discussed above, firms should carefully consider opportunity cost. Is maintaining the status quo still an option for the firm in light of regulatory changes? Are alternative models more attractive considering new regulatory requirements? Has the firm reevaluated its core competencies and what it believes it does best? Firms may be well served by examining these questions rather than simply pushing forward with compliance implementation.

A particularly important strategic decision for firms will be the choice between insourcing and outsourcing. The amalgam of new regulatory requirements coming at firms may change the decision calculus with respect to certain activities.

A proposed rule from the SEC would set guardrails around how firms manage outsourced compliance activities.⁴² Under the proposal, advisers would be required to conduct adequate due diligence prior to selecting a service provider and to evaluate the service provider's performance periodically. Advisers would need to maintain books and records related to their due diligence and provide "census-type" information on their use of service providers to the SEC on Form ADV. As proposed, the rule includes certain activities that are clearly in an adviser's best interest (e.g., due diligence and periodic monitoring). However, by codifying these activities as requirements in rule text, the SEC is creating an enforcement tool for instances where the agency believes sufficient supervision of service providers is lacking. Related to (but independent of) this proposal, firms' decisions to outsource compliance activities does not alleviate them of the risk and responsibilities associated with those activities.

For example, if an adviser outsources a certain compliance activity to a service provider and the provider fails to perform the activity in a compliant manner, it is the adviser who is liable from a regulatory perspective. The proposed rule does not change this dynamic; rather, it provides the SEC with more information regarding firms' outsourced activities and gives the agency greater ability to manage firms' use of service providers.

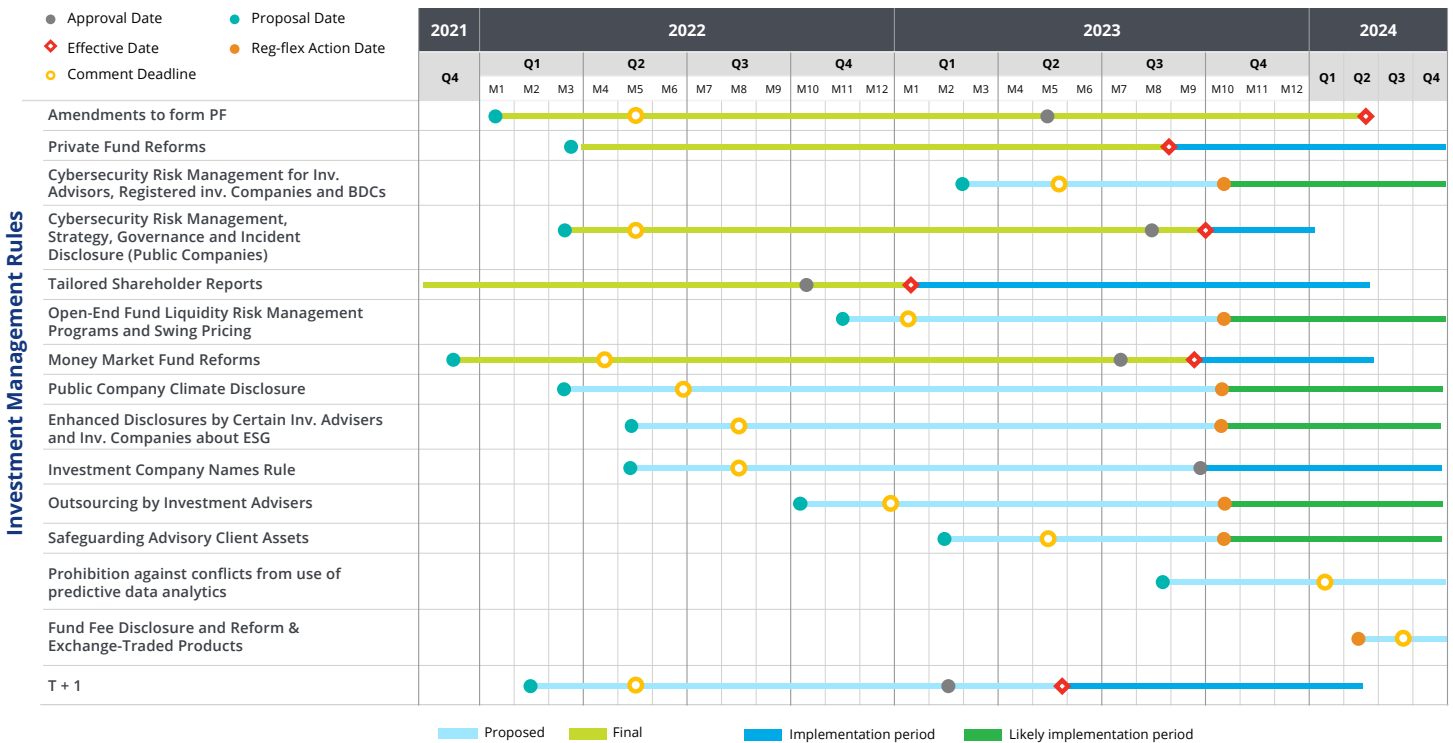




The road ahead

2024 will bring significant regulatory changes to the investment and wealth management industries (Figure 4) and firms are likely to encounter geopolitical and market volatility as well. Re-doubling efforts to improve baseline activities like cybersecurity and data management should pay dividends with respect to both regulatory oversight and profitability. The year began with approvals for cryptocurrency-linked exchange-traded funds opening up a new asset class to the industry.⁴³ From fund reform to evolving AI policy to ESG rulemakings, an effective response to the converging challenges of 2024 will require a steady hand.

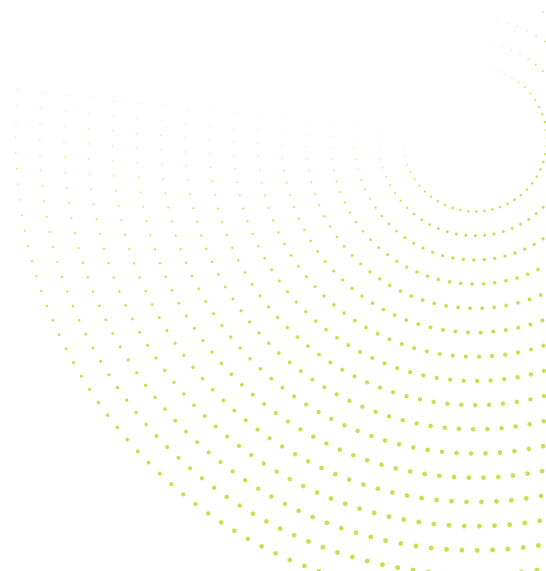
Figure 4. Timeline of active SEC rules for investment and wealth management



Source: Deloitte analysis of regulatory agenda.

Endnotes

1. Securities and Exchange Commission (SEC), "[SEC Announces Enforcement Results for FY 2023](#)," November 14, 2023.
2. Ibid.
3. Deloitte analysis of SEC regulatory agenda.
4. SEC, "[Cybersecurity Risk Management for IA's, RIC's and BDC's](#)," February 9, 2022.
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