Investment management regulation: Navigating the present, and preparing for the future

Investment management firms should integrate a dynamic regulatory readiness posture in their organizations to help them respond more effectively to changing regulatory requirements.

Deloitte Center for Financial Services

Deloitte. Insights

KEY MESSAGES

A packed rulemaking agenda and additional expected capacity at the SEC are likely to drive an increase in regulatory intensity for US investment management firms in 2024: The "DREG" index projects a higher level of regulatory intensity this year, as the SEC plans to finalize as many as 21 new rules with fresh industry requirements and increase its budget and headcount to record levels.

Cross-functional teams can help navigate the complex regulatory environment: Establishing a cross-functional Regulatory Assessment and Response Execution team could help investment management firms assess the impact of regulatory changes, prioritize them, and formulate an effective response. This cross-functionality also can aid in developing a more comprehensive interpretation of rule changes while considering any potential "interlocking impacts" on the firm.

Investment management firms with greater technological maturity may benefit from more effective compliance capabilities: Recent rule-making actions from the SEC show that enhanced technical capabilities to enable greater transparency in disclosures and additional data set collection may be needed at investment management firms. Given the scope of these new requirements, investment management leaders may benefit from conducting an in-depth review of their firms' reporting and disclosure technological capabilities across all their funds.

Regulatory intensity is continuing. And the pace of regulatory change is requiring investment management leaders to react fast—under the Security Exchange Commission's current chair, investment management firms have only had 46 days on average to comment on rule proposals, about 20% fewer days than the periods under previous chairs.[1] They have had many proposals to potentially comment on. In the last year, the industry has faced new proposals in areas ranging from additional fund disclosures and reporting requirements, commonly referred to as the "names rule," to emerging technologies such as generative artificial intelligence, to rules designed to ensure the proper oversight of functions outsourced to third parties. Leaders at investment management companies will likely stay busy in 2024, as this increased regulatory intensity could further impact everything from compliance programs to governance practices and disclosures to investors. In this active regulatory environment, communication and agility may be more important than ever to help ensure compliance and avoid unwanted regulatory scrutiny that could result in penalties. To reduce this risk, investment management leaders may benefit from reexamining cross-functional collaboration procedures to eliminate gaps and maximize efficiencies throughout their organizations. Leading investment management firms will likely integrate a dynamic regulatory readiness posture across their organizations that fosters collaboration and utilizes flexibility to help them respond more effectively to changing regulatory requirements.

Deloitte laid out a three-stage regulatory readiness framework a few years ago that is still relevant today:

1. Sensing and influencing
2. Planning and prioritizing
3. Implementing a compliance change management program[2]

This report dives deep into the second stage of the framework—planning and prioritizing—using a proprietary index to help guide decision-makers so they can navigate through a rapidly evolving regulatory environment and provide a tool to help them gauge the current and emerging levels of regulatory scrutiny.

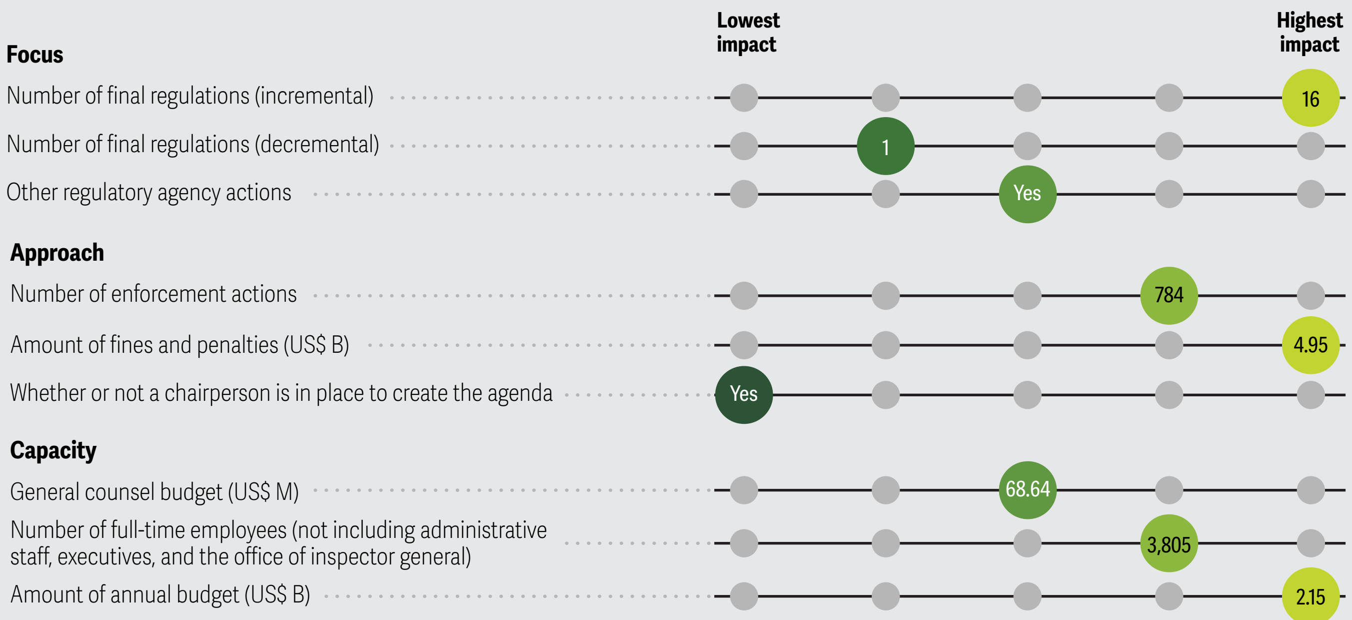
Regulatory intensity set to escalate in 2024

For financial markets and securities regulators, ensuring capital market stability and investor protection tends to be of paramount importance. As part of this, the US Securities and Exchange Commission (SEC) and other federal and state agencies generally take actions that fall broadly into three categories: adjusting focus, changing approach, and modifying capacity. The Deloitte Center for Financial Services has developed an index (referred to as the Deloitte Center for Financial Services Regulatory Index, DREG for short) to quantify the overall US regulatory intensity for investment management firms (see "The Deloitte Center for Financial Services Regulatory Index"). The overall intensity is driven by one or a combination of these three categories (figure 1).

Figure 1

How three types of actions influenced regulatory intensity in 2023

The Deloitte Center for Financial Services Regulatory Index, or DREG for short, is driven by three key inputs: regulators' focus, approach, and capacity. Here's how those factors influenced the DREG index in 2023.



Sources: Deloitte Center for Financial Services; US Securities and Exchange Commission, *Fiscal year 2024: Congressional budget justification and annual performance plan; Fiscal year 2022: Annual performance report,* March, 2023.

The level of intensity of the regulatory environment can change based on how regulators are focusing on new and existing rules. For example, the SEC finalized 16 new rules in 2023 that added requirements, whereas in 2020, it had finalized 17 rules, such as those related to securities offering reforms for closed-end companies and private markets, which either removed requirements or expanded certain exemptions for the industry.[3] The DREG index levels of 98 in 2020 and 113 in 2023 are due, in large part, to the two different focuses of the SEC in these two years (figure 2). The type of approach also contributes to the index level. The chairperson or administration in charge may choose to encourage compliance in the manner they deem fit—for instance, by adjusting the number of enforcement actions or changing the penalty fine amount. The difference in approach can be instructive when two index levels are similar, such as those in years 2016 and 2022. Enforcement actions reached a high of 868 in 2016, yet fines and penalties totaled a below average US$4.1 billion.[4] In 2022, enforcement actions totaled 760, about average, but the fines and penalties totaled a record aggregate amount of US$6.4 billion.[5] The direct cost of noncompliance increased in 2022 when some investment management firms were hit with a record dollar amount of fines.[6] This is in contrast to 2016, when the average dollar amount fined by the SEC decreased from the prior year for the first time since 2011.[7] Similarly, a regulatory agency may determine an increase in the potential capacity for examinations as the preferred route to encourage compliance. The agency may increase its capacity in 2024 with a larger budget—possibly over US$2.4

billion—representing a 12% increase from fiscal year 2023, and about 5% additional headcount.[8] Therefore, a packed rulemaking agenda and the additional expected capacity at the SEC are drivers of the rise in the DREG index level to 125 in 2024.

In 2024, the SEC plans to finalize as many as 21 new regulations with fresh industry requirements, an increase from 16 in 2023.[9] For a more detailed review of these rules, refer to the 2024 investment management regulatory outlook. This flurry of activity has led some industry participants to believe that the number of new rules has been too much too fast for the industry.[10] However, this pace is not likely to ebb. The SEC is planning to continue its record rule-setting pace in 2024. If the SEC finalizes just 75% of its proposed agenda for 2024, it will surpass the previous highwater mark set in 2023.[11]

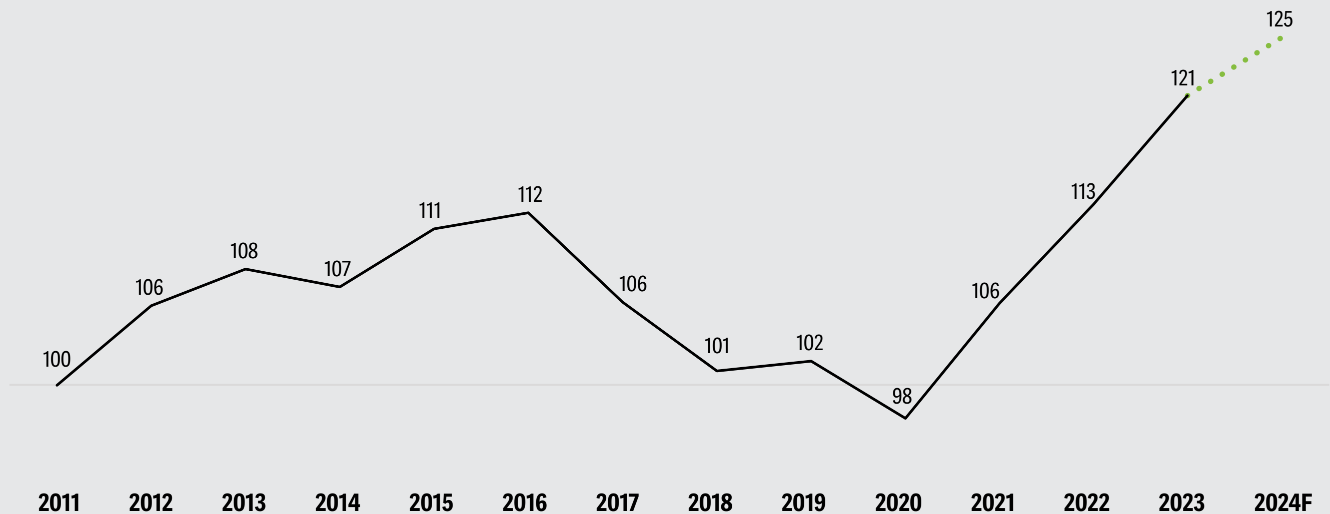
THE DELOITTE CENTER FOR FINANCIAL SERVICES REGULATORY INDEX

- 2011 is used as the base year, as it's the first full year following the passage of the Dodd-Frank Wall Street Reform and the Consumer Protection Act.[12]
- The index uses actual data for years 2011 through 2023. For 2024, values are estimated based on 2024 budget requests and the SEC's 2024 rulemaking agenda list.
- The individual variables are weighted depending on their perceived effect to the industry, and a "smoothing factor" is also applied to each input to limit the effect any one variable can have on the index value.
- The SEC's final rules have been categorized into three buckets: add, neutral, and remove. Only the rules that add or remove requirements have an effect.

Figure 2

Regulatory intensity is likely to increase for US investment management firms in 2024

Deloitte Center for Financial Services Regulatory Index, level of intensity (100 = 2011 baseline year)



Sources: Deloitte Center for Financial Services; US Securities and Exchange Commission (SEC) annual performance reports (fiscal year 2012 to fiscal year 2022); SEC, Fiscal year 2024: Congressional budget justification and annual performance plan; Fiscal year 2022: Annual performance report, March, 2023; SEC, "Rulemaking activity"; SEC final rules.

Moreover, regulators have returned to using fines and penalties as a method to encourage compliance.[13] The SEC issued a record dollar amount of enforcement penalties in 2022, followed by the second-highest dollar amount ever in 2023.[14] Client communications continues to be an active area for SEC investigations. In February 2024, the SEC announced penalties totaling over US$81 million against 16 investment management firms for failures to properly preserve electronic communications.[15] Regulators in the United States may continue using penalties as a tool to correct behavior, rather than encouraging compliance through other means. This means that noncompliance could become costlier than ever before, and this trend may continue for the foreseeable future.

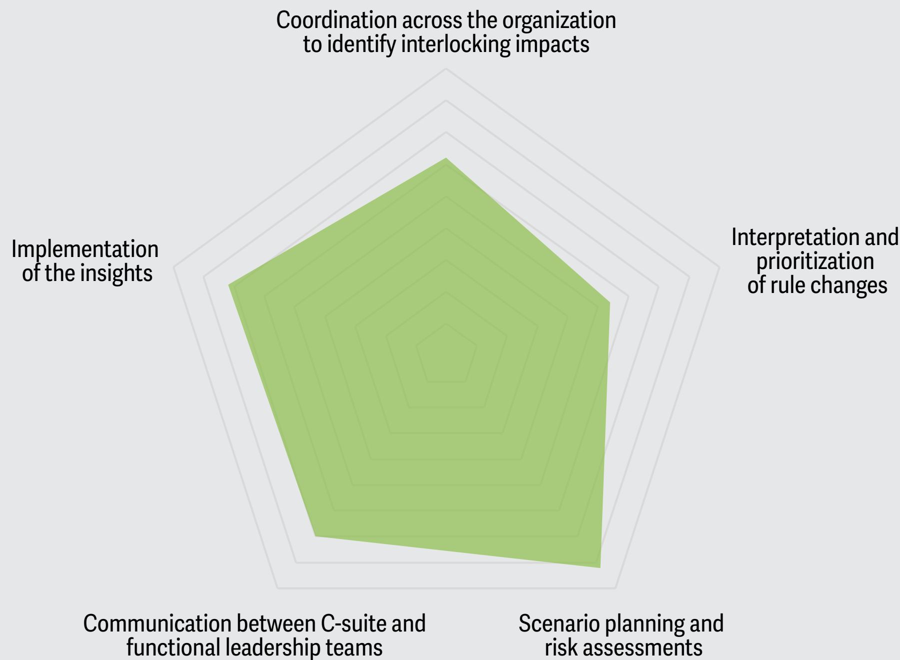
The heightened focus on new rules marks a shift for the agency after several years in which it was more likely to reexamine the utility, and in some cases redundancy, of existing rules. For example, in 2018 and 2019, several final rules from the SEC were aimed at streamlining the overlaps between US generally accepted accounting principles and required disclosures by certain issuers, expanding the exemptions available under Regulation A to more issuers, and easing some restrictions on proprietary trading that had been in place under the Volcker Rule.[16] This focus on existing rules was the main driver of the relatively lower intensity index values seen from 2017 to 2020. Two additional elements that contributed to the lower intensity values were the relatively less frequent use of enforcement actions, and lower fines and penalties. During this period, regulators seemed to mainly turn their attention toward rules and regulations already on the books to deliver on their mission to help facilitate financial markets stability.[17]

Leading investment management firms tend to manage their regulatory-ready posture through proactive planning

Regardless of the strategies regulators employ, investment management firms will likely benefit from having a formal action plan in place to strengthen compliance and mitigate the risk of enforcement actions. By implementing a standardized compliance plan across the firm, investment management leaders may enhance their monitoring capabilities of new rules or amendments and identify instances of "interlocking impacts."[18] With so many new rules under consideration, it could be exceedingly difficult for regulators and investment management firms to fully understand their impact and any potential unintended consequences. One way to standardize a compliance plan is to establish a Regulatory Assessment and Response Execution (RARE) team with specific capabilities (refer to figure 3 for an illustrative example) that can facilitate coordination and communication across the organization.[19] RARE team members are cross-functional within the organization, helping to ensure a consistent view of how regulatory changes might affect the firm. This cross-functionality also can aid the firm in developing a more comprehensive interpretation of rule changes and prioritizing them on an enterprise-wide basis, while considering any potential "interlocking impacts." Through scenario planning and risk assessments, the RARE team can assist in formulating an effective response based on the potential impact of regulatory changes on the firm. The team can then relay these insights to leadership, who can implement them throughout the firm, fostering a coordinated response and developing suitable regulatory change solutions.[20]

Figure 3

Where a Regulatory Assessment and Response Execution (RARE) team may be effective



Source: Deloitte Center for Financial Services.

Another potential advantage of having a RARE team is that it can facilitate a centralized evaluation of compliance systems, instead of a scattered approach that may cause inefficiencies. Feedback from the RARE team can assist leaders in understanding how changing regulatory demands could affect existing roles and responsibilities, thereby helping them in creating a target operating model for their investment compliance monitoring systems.[21] This method allows leaders to identify and prioritize compliance areas specific to their organization's needs, which can lead to a more efficient response.

Moreover, ensuring effective coordination and communication throughout the organization can help people better understand the impact of the new rules and seamlessly incorporate any necessary process alterations. Leaders who communicate the desired outcomes of their compliance programs internally are more likely to successfully achieve their business strategy goals.[22] Communicating these outcomes also tends to facilitate consistent compliance monitoring across the organization.

Investment management firms with greater technological maturity may benefit from more effective compliance capabilities

Recent rule-making actions from the SEC show that enhanced technical capabilities may be needed at investment management firms. For example, the SEC voted in October 2023 to adopt a rule amendment dating from the Dodd-Frank Act to require additional data collection around short-selling practices for the purpose of making it publicly available in aggregate.[23] In light of the new amendments, some hedge fund groups have sought clarification in courts concerning whether

aggregate or individual short position disclosure reports are required.[24] While the final outcome of this litigation is still undecided, the quest for increased transparency is unlikely to dissipate. Another final rule concurrently adopted by the SEC and the Commodity Futures Trading Commission makes significant changes to the Form PF filling requirements for private fund investment advisers.[25] The final rule mandates the collection of numerous additional data sets to enhance data quality and requires disclosure to investors to improve comparability across funds. Given the scope of these new requirements, investment management leaders may benefit from conducting an in-depth review of their firms' reporting and disclosure technological capabilities across all their funds.

Investment management firms can potentially enhance their operating models' agility and effectiveness in responding to regulatory changes by either insourcing or outsourcing technical compliance capabilities. A higher level of in-house technological maturity could enhance a firm's ability to effectively adapt to regulatory changes. Leaders who indicated in 2020 that their organizations were already "seasoned" in integrating AI technologies into their business will likely have a better understanding of the potential impacts of the proposed rules on their operating models in 2024.[26] Regardless of their stage in the AI adoption curve, investment management firms could benefit from developing a compliance strategy that optimally uses both talent and AI capabilities to limit regulatory scrutiny.[27]

Some organizations may consider outsourcing certain compliance activities as a more appropriate approach to satisfy new regulatory mandates. As expectations for heightened attention to compliance with record-keeping and surveillance of employees at regulated firms grow, some investment management firms have taken steps to have video calls in addition to text messaging proactively monitored with the implementation of third-party communication surveillance platforms.[28] Leading investment management firms seem to be focusing on assessing their regulation-ready capabilities to better mitigate their regulatory compliance risks. Given the complexities of effectively and efficiently increasing monitoring capabilities, some have engaged with not only compliance specialists, but also outside counsel and risk professionals.[29] These steps may be necessary for some organizations to build and maintain a healthy compliance posture in a more cost-effective way.

A vigorous compliance posture for 2024 and beyond

With a tight regulatory environment likely to stick around for some time, investment management companies will likely prioritize taking action to review procedures and identifying gaps in 2024. A robust regulatory readiness framework that employs sensing and influencing, planning and prioritizing, and implementing a compliance change management program could position investment management firms for compliance success, allowing leaders to manage regulatory readiness even as they continue to develop core businesses. Building and maintaining a collaborative team environment as well as flexible processes that can effectively respond to emerging regulatory demands will likely be instrumental over the coming year, since change seems to be the only constant in regulatory intensity.

Endnotes

1. Kenneth E. Bentsen, Jr., "The unprecedented speed and volume of SEC rulemaking," Securities Industry and Financial Markets Association, September 21, 2023.
2. Doug Dannemiller, J. Lynette DeWitt, and Ankur Gajjaria, "Building regulatory-ready organizations," *Deloitte Insights*, April 27, 2017.
3. Deloitte Center for Financial Services analysis of SEC rules.
4. Deloitte Center for Financial Services analysis of SEC's enforcement actions; US Securities and Exchange Commission (SEC), *Addendum to division of enforcement press release: Fiscal year 2023*, September 29, 2023; SEC, *Division of Enforcement 2017: Annual report*, November 15, 2017; SEC, "SEC announces enforcement results for FY 2015," press release, October 22, 2015; SEC, "Year-by-year SEC enforcement statistics," accessed March 18, 2024; SEC, "Year-by-year monetary sanctions in SEC enforcement actions," accessed March 18, 2024.
5. Ibid.
6. Ibid.
7. Ibid.
8. SEC, *Fiscal year 2024: Congressional budget justification and annual performance plan; Fiscal year 2022: Annual performance report*, March 13, 2023.
9. SEC, "Agency rule list – Fall 2023," accessed February 21, 2024; SEC, "Rulemaking activity," accessed February 21, 2024; Deloitte Center for Financial Services analysis.
10. Courtney Degen, "SEC, DOL prepare for big year of rule-making with election looming," Pensions & Investments, January 3, 2024.
11. SEC, "Agency rule list – Fall 2023"; SEC, "Rulemaking activity"; Deloitte Center for Financial Services analysis.
12. Congress.gov, "H.R.4173 - Dodd-Frank Wall Street Reform and Consumer Protection Act," July 21, 2010.
13. SteelEye, "SEC and CFTC impose a combined $9.2bn in penalties in the US in 2023 as FCA fines fall for first time in 7 years," press release, January 25, 2024.
14. Chris Prentice, "US SEC enforcement penalties fell in FY2023 even as industry bars rose -official," Reuters, October 26, 2023.
15. SEC, "Sixteen firms to pay more than $81 million combined to settle charges for widespread recordkeeping failures," press release, February 9, 2024.
16. SEC, "Disclosure update and simplification," August 17, 2018; SEC, "Conditional small issues exemption under the Securities Act of 1933 (Regulation A)," December 19, 2018; SEC, "Revisions to prohibitions and restrictions on proprietary trading and certain interests in, and relationships with, hedge funds and private equity funds," July 5, 2019.
17. Jean Eaglesham, Dave Michaels, and Danny Dougherty, "Regulators' penalties against Wall Street are down sharply in 2017," *The Wall Street Journal*, August 6, 2017; Elad L. Roisman, "Remarks at SEC Speaks 2020," SEC, October 8, 2020.
18. Craig Friedman, Irena Gecas-McCarthy, and Jim Eckenrode, "*2024 investment management regulatory outlook,*" Deloitte, February 7, 2024.
19. Dannemiller, DeWitt, and Gajjaria, "Building regulatory-ready organizations."
20. Ibid.
21. Deloitte, "Less noise, please, and more signal," accessed March 18, 2024.
22. Deloitte, *Struggling with the asset management compliance puzzle?*, 2020.
23. SEC, "SEC adopts rule to increase transparency into short selling and amendment to CAT NMS plan for purposes of short sale data collection," press release, October 13, 2023.
24. Carolina Mandl and Michelle Price, "Hedge fund groups sue US SEC in bid to vacate short-selling rules," Reuters, December 13, 2023.
25. SEC, "SEC adopts amendments to enhance private fund reporting," press release, February 8, 2024.
26. Beena Ammanath, "Why CFOs should have artificial intelligence on their minds," Deloitte, September 2020.
27. Friedman, Gecas-McCarthy, and Eckenrode, *2024 investment management regulatory outlook*.
28. Iain Withers and Sinead Cruise, "Asset managers on alert after 'WhatsApp' crackdown on banks," Reuters, August 18, 2022.
29. Brooke Masters, "Private funds prepare to spend billions on compliance after SEC rule," *Financial Times*, September 23, 2023.

About the authors

Maria Gattuso
mgattuso@deloitte.com

Maria Gattuso leads Deloitte's Regulatory Remediation practice for financial services and has more than 25 years of experience in financial services. She focuses on regulatory and compliance matters for Deloitte's investment management and wealth clients, including in connection with regulatory investigations on a multitude of issues such as sales practices, conflicts of interest, and fee billing practices.

Ryan Moore
ryanmoore@deloitte.com

As an Audit & Assurance partner, Ryan Moore primarily serves clients in the investment management sector and has over 20 years of experience serving clients, performing high-quality audits, and advising on SEC rules. His current clients include RICs, hedge/alternative funds, and business development companies.

Sean Collins
scollins@deloitte.com

Sean Collins is a manager at the Deloitte Center for Financial Services, and researches and writes about the investment management industry. He has experience in the financial services industry as a buy-side equity analyst as well as experience in corporate finance. Collins is a CFA charterholder and has an International MBA from the University of South Carolina.

Acknowledgments

The author, **Sean Collins**, wishes to thank **Meghan Burns** of the Deloitte Center for Regulatory Strategy for her valuable insights, as well as Deloitte Center for Financial Services colleagues, **Mohak Bhuta**, **Patricia Danielecki**, **Doug Dannemiller**, **Paul Kaiser**, **Seth Raskin**, and **Neerav Shah**.

About the Deloitte Center for Financial Services

The Deloitte Center for Financial Services, which supports the organization's US Financial Services practice, provides insight and research to assist senior-level decision-makers within banks, capital markets firms, investment managers, insurance carriers, and real estate organizations. The center is staffed by a group of professionals with a wide array of in-depth industry experiences as well as cutting-edge research and analytical skills. Through our research, roundtables, and other forms of engagement, we seek to be a trusted source for relevant, timely, and reliable insights. Read recent publications and learn more about the center on Deloitte.com.

Connect

To learn more about the vision of the DCFS, its solutions, thought leadership, and events, please visit www.deloitte.com/us/cfs.

Subscribe

To sign up for more information and personalize the content sent to you, including our latest research, articles, and webcasts, please visit My Deloitte.

Engage

Follow us on X at: @DeloitteFinSvcs

Continue the conversation

Industry leadership

Maria Gattuso
Principal | Account leadership | Deloitte & Touche LLP
+1 203 321 7098 | mgattuso@deloitte.com

Maria Gattuso leads Deloitte's Regulatory Remediation practice for financial services, focusing on regulatory and compliance matters for investment management and wealth clients.

Ryan Moore
Partner | Audit & Assurance | Deloitte & Touche LLP
+1 617 437 2814 | ryanmoore@deloitte.com

Ryan Moore is an Audit & Assurance partner, serving clients in the investment management sector, performing audits, and advising on SEC rules.

The Deloitte Center for Financial Services

Jim Eckenrode
Managing director | Deloitte Services LP
+1 617 585 4877 | jeckenrode@deloitte.com

Jim Eckenrode is the managing director of the Deloitte Center for Financial Services, where he is responsible for defining the marketplace positioning and development of the center's eminence and key activities.

Doug Dannemiller
Senior research leader | Deloitte Services LP
+1 617 437 2067 | ddannemiller@deloitte.com

Doug Dannemiller is the senior research leader for investment management at the Deloitte Center for Financial Services.

Sign up for Deloitte Insights updates at **www.deloitte.com/insights**

Deloitte Insights contributors

Editorial: Abrar Khan, Hannah Bachman, Pubali Dey, and Debashree Mandal
Creative: Molly Piersol, Sofia Sergi, Pooja N Lnu, and Natalie Pfaff
Deployment: Atira Anderson
Cover artwork: Sofia Sergi

About Deloitte Insights

Deloitte Insights publishes original articles, reports and periodicals that provide insights for businesses, the public sector and NGOs. Our goal is to draw upon research and experience from throughout our professional services organization, and that of coauthors in academia and business, to advance the conversation on a broad spectrum of topics of interest to executives and government leaders.

Deloitte Insights is an imprint of Deloitte Development LLC.

About this publication

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or its and their affiliates are, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your finances or your business. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. None of Deloitte Touche Tohmatsu Limited, its member firms, or its and their respective affiliates shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.

Copyright © 2024 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited