Navigating the year ahead
Securities regulatory outlook 2018
United States
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This publication is part of the Deloitte Center for Regulatory Strategy, Americas’ cross-industry series on the year’s top regulatory trends. This annual series provides a forward look at some of the regulatory issues we anticipate will have a significant impact on the market and our clients’ businesses in 2018. The issues outlined in each of the reports provide a starting point for an important dialogue about future regulatory challenges and opportunities to help executives stay ahead of evolving requirements and trends. For 2018, we provide our regulatory perspectives on the following industries and sectors: banking, securities, insurance, investment management, energy and resources, life sciences, and health care. For a view of the other trends impacting securities in 2018, we encourage you to read the Deloitte Center for Financial Services companion paper.

We hope you find this document to be helpful as you plan for 2018 and the regulatory changes it may bring. Please feel free to contact us with questions and feedback at CenterRegulatoryStrategyAmericas@deloitte.com.
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Another year has passed, so what has changed?
This time last year, we expected 2017 to be a period of uncertainty for financial services regulation. Financial services firms were challenged by the continuing lack of clarity over the final shape of post-crisis reforms, the implications of Brexit, and a new US political administration. We also saw significant pressures on the banking and life insurance sectors from sluggish economic growth and low interest rates in Europe and the US, as well as from competition from new entrants (particularly fintechs).

Looking ahead to 2018, most of these challenges and uncertainties remain.

Economic growth, but how robust?
Global growth prospects improved through 2017 and continue to be broadly positive, albeit more subdued than in the period before the financial crisis. China, Europe, and Japan have all been outperforming expectations, and although India’s economy has slowed lately, the long-term outlook is upbeat. There are now signs that the extraordinary monetary easing of the last ten years is starting, slowly, to unwind in Europe and the US, although this stands in contrast to the situation in China and Japan.

There are reasons for caution. Asset markets and prices have seemed impervious to the prospect of tighter monetary conditions and geopolitical tensions. This has left many commentators worrying that markets are in the grips of a bout of irrational exuberance. There are also signs of price bubbles in commercial and residential property markets, as well as leveraged finance markets, and of elevated levels of consumer indebtedness, particularly in the advanced economies.

Supervisors across the globe are very alert to the financial stability risks posed by the political and economic climate, and we expect them to focus on the ability of financial institutions in all sectors to deal with the downside risks of an abrupt shift in market sentiment and any increase in asset price volatility, irrespective of the trigger. Boards are expected to keep their risk appetites under review, and will also need to engage closely with stress testing, whether prompted by supervisors or carried out internally.

What does this mean for the regulatory agenda?
Last year we predicted that there would be no wholesale rolling back of the post-crisis regulatory framework, and this continues to be our view. The consensus in the US is that there will be some meaningful adjustments to the Dodd-Frank Act, but no large-scale repeal or rewrite. In the EU there remains a considerable volume of legislative work ongoing; and even where there is no new legislation, there is a great deal of “fine tuning” of existing rules. The Asia Pacific region faces a long tail of implementation work, and must also deal with the impact of regulation from outside the region.
At the international level, the Financial Stability Board (FSB) has shifted its primary focus toward a post-implementation evaluation framework, which will be “progressively applied” in the coming years. This is part of a rebalancing away from introducing new rules and toward assessing the effectiveness of what has been done over the past decade. Boards will need to be ready to demonstrate to supervisors that they have embedded change and that this is leading to the desired outcomes.

One major area where a number of significant unanswered questions remain is bank capital requirements. Although the Committee on Banking Supervision (BCBS) has until now been unable to complete the Basel III package, final agreement on the open issues seems within reach. We do not see any major economies as being in a hurry to introduce yet-more legislation, and we also see those economies being more willing to depart from the letter of global standards where they conclude it is in their interest to do so.

As a consequence, financial services firms need to be prepared to deal with the challenges of diverging regulatory frameworks. At a minimum they will need globally coordinated approaches to understand overlaps, incompatibilities, and potential synergies.

Supervisors are turning more attention to long-term structural issues
Technological innovation, aging populations, and climate change have all caught the attention of the regulatory and supervisory community as emerging risk areas. We expect some supervisors to begin to challenge boards, risk committees, and senior management to demonstrate that they understand the impact on their customer bases, business models, and risk profiles—and that they are set to take effective mitigating actions where needed.

- **Fintech**: While new technologies present opportunities, regulators want to understand the potential risks and the likely impact on incumbents’ business models. The FSB has a clear interest in the subject. The European Commission is expected to deliver a fintech “action plan” in January. Similarly, US regulators are considering the implications of new technologies, including third-party relationships among fintechs and banks. They’re even exploring special purpose bank charters for fintechs.

- **Climate change**: The FSB has taken the lead internationally with its Task Force on Climate-Related Financial Disclosures, which made its final recommendations in June 2017. A number of regulators in the Asia Pacific region are instituting policies to encourage green finance. The Bank of England (BoE) is also researching climate change, and the EU recently proposed to integrate environmental risks into the mandates of the European Space Agency (ESA) as part of its action plan on sustainable and green finance.

- **Aging populations**: Aging populations worldwide will create a widening pool of potentially vulnerable customers and influence demand for different types of financial services. They will also affect how financial institutions engage with their customers. At the international level, the International Organization of Securities Commissions (IOSCO) is taking forward work on aging populations.
Leadership changes

Finally, we note that by the end of 2018, the most senior leadership of many of the world's leading regulatory bodies will be starkly different from what it has been for the majority of the post-crisis regulatory reform era. Mark Carney’s term as chairman of the FSB has been extended through to December 2018, lending some additional continuity to reform efforts. But this will be his final year at the top of the FSB. We expect Stefan Ingves to stand down as chair of the BCBS in the near future. There's also a great deal of change in senior leadership across national and regional regulatory bodies, particularly in the US. It remains to be seen how far new leaders will uphold the key tenets of the international supervisory agenda of the last decade, particularly its emphasis on cross-border coordination, or whether supervisory priorities will tilt more toward promoting the competitiveness of individual jurisdictions.

On balance we think that these new leaders will emphasize practical supervisory initiatives over (new) rulemaking, as well as the need for firms to demonstrate that they’re financially and operationally resilient to a range of threats, both old and new. New leaders will be keen to consolidate the outcomes and achievements of the prudential policy agenda that has dominated the last 10 years and focus their tenures on continuing structural challenges as well as emerging risks and issues.

Acting in the face of uncertainty

While we expect some greater clarity about the regulatory outlook to emerge in 2018, the overriding challenge for firms remains coping with uncertainty, including from the global impacts of Brexit and how markets in Europe and elsewhere will be reshaped by Markets in Financial Instruments Directive (MiFID) II. This will put a premium on firms maintaining strategic flexibility, while they also adopt new technologies to react to the threat from “challengers,” improve their customer service and outcomes, better manage their risks, and help control costs. With yields, income levels, and return on capital still under severe pressure, cost control will continue to be extremely important. Even though interest rate rises are underway, they will be neither quick enough nor big enough to alleviate pressure on incumbents’ business models.

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Introduction

Most securities organizations are forging ahead with their risk and compliance initiatives, even as regulatory uncertainty will likely remain a significant and ongoing challenge. Even if lawmakers and regulators make certain definitive changes, securities organizations must continue to drive effectiveness and efficiency of their risk and compliance programs so they meet applicable laws, regulations, and supervisory expectations. And in most cases, they don't have the time or luxury of waiting to see how things will shake out. Thankfully, many of the changes securities organizations are making to achieve compliance are useful improvements that are worth doing from a risk and business perspective.

Here's a look at the key regulatory trends securities organizations will likely need to monitor and address in 2018. By embracing regulatory complexity in 2018, organizations can accelerate performance and stay ahead of changes so that they can navigate the regulatory landscape.

To stay on top of the latest regulatory news, trends, and insights, we invite you to visit our website at www.deloitte.com/us/about-dcrsamerics.
The Dodd-Frank Wall Street Reform and Consumer Protection Act mandated that security-based swap dealers register with the US Securities and Exchange Commission (SEC), and that other swap dealers register with the Commodity Futures Trading Commission (CFTC). Now, both agencies have proposed—but not yet adopted—their proposed capital rules. However, staff at both agencies have indicated at industry meetings and other events that they are poised to recommend that their respective commissions adopt each proposal substantially in its current form.

Both proposals offer swap dealers alternatives about how they compute their regulatory capital. The most significant choice is whether a dealer should use standardized charges for market and credit risk, or apply to the agencies for permission to use its own quantitative models to compute those charges.

Deloitte & Touche LLP has helped swap dealers compare the charges and we have generally found that for a dealer with a significant book of swaps, using the standardized charges requires a much higher amount of capital. Swap dealers in that position should, if they have not already done so, start preparing to apply to the SEC and CFTC for model approval.

Although the SEC’s security-based swap dealer capital rule has not yet been adopted, the SEC does have an existing capital rule for “Over the Counter Derivative Dealers” (a rule now limited to over-the-counter options in equities) under which it will accept applications for model approval. It will also coordinate the approval process with the CFTC and National Futures Association (NFA) for dually registered swap dealers. By applying now, firms can be better prepared to comply once the rules are adopted.

The most significant choice is whether a dealer should use standardized charges for market and credit risk, or apply to the agencies for permission to use its own quantitative models to compute those charges.
The CFTC has also proposed liquidity rules for swaps dealers. The intent is to align the liquidity component with the corresponding prudential regulatory rule of the parent or holding company. While this will create a certain level of consistency within an organization, it will also bring a level of complexity to which swap dealers may not be accustomed.

The liquidity requirements will correspond to the capital approach described above. Swap dealers taking the bank-based capital approach will need to calculate their own modified version of the Liquidity Coverage Ratio (LCR), which is calculated by taking the value of the firm’s high quality liquid assets (HQLA) and dividing it by a stressed view of the maximum expected net cash outflows in the subsequent 30 days. Alternatively, firms that use the net liquid asset capital approach will be required to use an internal liquidity stress testing model with a prescribed list of stress assumptions over a 30-day period. This will result in a ratio similar to the LCR. The liquidity buffer requirements will be more restrictive, allowing only unencumbered US government securities and cash as assets.

The challenges will be many, including: maintaining a ratio of over 100 percent; managing the quality and controls necessary for assets to qualify as HQLA; calculating the denominator of the equation; and managing the swap dealer’s balance sheet.

Unlike the implementation of the Federal Reserve’s LCR calculation, there will not be a phased approach to meeting the ratio requirements. Banks that are subject to this rule were allowed to satisfy the 100 percent requirement in phases, but the proposed rule for swap dealers would require complete compliance from the beginning.

The HQLA requirement for a swap dealer is slightly less restrictive than for a bank. This will allow more flexibility in managing HQLA, but also requires more granular data with the same analysis of “Readily Marketable and Liquid” securities.

A swap dealer that holds nostro cash will need to demonstrate that the collateral is excess and free from expected obligations such as in the cash of FX nostros expected to meet settlement needs, or segregated cash and securities identified to meet segregation requirements.

The denominator of the LCR potentially brings new challenges by requiring an institution to detail its 30-day cash inflows and outflow. Netting is normally a critical step to managing cash flow, but this disaggregation—plus a 25 percent haircut to inflows—automatically creates a need for greater HQLA.

While some aspects of the liquidity requirements have not been finalized, it is clear that alignment to the prudential regulators will increase the complexity—and potentially the cost—to operate a swap dealer.

Similar to swap dealers taking the net liquid asset capital approach, proposed rule 18a-1 may also be finalized. This rule would define liquidity for securities-based swap dealers and alternative net capital broker-dealers.
On October 6, 2017, the Treasury Department released the second of four reports pursuant to President Trump’s executive order setting forth the Administration’s “Core Principles” for regulating the US financial system. The report covers capital markets (debt, equity, commodities, and derivatives), central clearing, and other operational functions, and offers recommendations for Congress and the regulatory agencies.

Although the report provides President Trump’s nominees a roadmap for enacting the Administration’s policy priorities, it remains unclear which of the recommendations will be implemented, or how quickly. However, the recommendations—nearly all of which could be enacted without Congressional action—may inform the regulatory and supervisory agendas of the SEC and CFTC.

Below are several of the report’s most significant recommendations:

**Recommendations for Congress**

- Repeal Dodd-Frank-mandated disclosure requirements for conflict minerals, mine safety, resource extraction, and pay ratios
- Extend the length of time for a company to be considered an emerging growth company to up to ten years
- Designate one lead agency from among the six that promulgated the credit risk retention rule
- Consider further action to achieve maximum harmonization in the regulation of swaps and security-based swaps
- Provide the SEC rulemaking authority with respect to exceptions from the clearing requirement for security-based swaps
- Allocate greater resources to the CFTC for the supervision of central counterparties (CCPs)
- Restore the SEC and CFTC’s full exemptive authority and remove the restrictions imposed by Dodd-Frank

**Recommendations for federal regulatory agencies and states**

- Expand several capital formation-related provisions of the JOBS Act
- Mitigate conflicts of interest due to “maker-taker” rebates and payment for order flow compensation arrangements
- Allow certain broker-dealers to satisfy best execution obligations through securities information processor (SIP) data
- Consider amending Regulation NMS to enable competing consolidations to provide an alternative to the SIPs
- Adopt amendments to Regulation ATS “substantially as proposed,” but with certain revisions
- Consider the impact that trading book capital standards, such as the Fundamental Review of the Trading Book, would have on secondary market activity
- Expand qualifying underwriting exemptions under the risk retention rules across eligible asset classes
- Harmonize margin requirements for uncleared swaps with non-US jurisdictions
- Maintain the swap dealer de minimis registration threshold at $8 billion
- Complete the position limits rules, but ensure the appropriate availability of bona fide hedging exemptions for end users

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The SEC customer protection rule

In June 2016, the SEC announced its risk-based sweep of certain broker-dealers to assess compliance with the customer protection rule. The sweep was largely led by its Enforcement Division and was precipitated by certain cases they had brought. The sweep began with an extensive document request that was applied to a group of larger securities firms, along with an amnesty period during which all securities firms could self-report violations.

Since the initial document request, very few firms have received any significant follow-up from SEC staff—and given that nearly two years have now passed, the status of the SEC sweep is in question. However, the SEC oversees Financial Industry Regulatory Authority (FINRA), and the SEC’s attention to the Customer Protection Rule may be prompting FINRA examiners to pay even more attention to the rule than before.

FINRA examiners are scrutinizing, among other things, legal documentation of clearance and custodial arrangements, the classification of customer and broker-dealer accounts (with a particular focus on links between related accounts), and whether certain concentration limitations are triggered. Also, FINRA has been more aggressive about bringing Customer Protection Rule enforcement cases.

Firms that are subject to SEC Rule 15c3-3 should consider conducting detailed internal or external reviews of their Rule 15c3-3 compliance controls. Those reviews should be supplemented by detailed testing, particularly with respect to clearance and custody of customer securities.
The Department of Labor (DOL) delayed the full applicability date of its “Conflict of Interest Rule” on fiduciary investment advice (the “Rule”) from January 1, 2018, to July 1, 2019. Other regulatory agencies have indicated that they are exploring similar rules for wealth management professionals that would require a fiduciary standard of care when delivering advice to retail investors. Specifically, the SEC is considering its own fiduciary rule proposal, and individual states—such as Nevada—have begun to implement legislation related to providing advice to investors under a fiduciary standard. Further, despite delays and uncertainty around the DOL rule’s implementation dates, the Rule continues to serve as a catalyst for change across the wealth management industry.

Many of the wealth management marketplace implications were highlighted in a 2017 Deloitte & Touche LLP report for the Securities Industry and Financial Markets Association (SIFMA)\(^1\). Key themes include:

**Increase in fee-based accounts for retirement investors.** The majority of survey participants indicated that fee-based account program participation increased through lowering account minimums and/or revising existing program minimums or launching new offerings. Study participants consistently indicated that the trend toward fee-based accounts was accelerated by the Rule and other factors across the industry.

**Reduction in product shelves and enhanced product due diligence processes.** Approximately 95 percent of firms surveyed reduced or consolidated product shelves in response to the Rule. The most impacted products were mutual funds and variable annuities. Study participants noted that mutual fund and annuity offerings were primarily reduced due to enhanced due diligence processes and/or product manufacturers’ inability to meet compensation changes required by the wealth management organization. Further, virtually all responding firms indicated changes to product due diligence efforts, primarily through enhanced internal research or third-party research support.

**Enhanced rollover and due diligence processes.** Virtually all survey participants have further explored firm policies and processes related to the rollover of client assets from retirement accounts. Also, the majority of participants have enhanced their rollover review processes, including increasing the size of oversight teams and/or leveraging vendor rollover review tools.

Implementation efforts to comply with the DOL’s Fiduciary Rule may have slowed in recent months given the delay. But the wealth management industry appears to be continuing to migrate toward a fiduciary model for delivering advice to both retirement and non-retirement clients. This trend toward a fiduciary model will likely continue, and could accelerate under certain scenarios, including the DOL’s Rule moving forward as planned; the SEC drafting its own version of a rule; and/or individual states continuing to pass related legislation.

The securities industry has seen a shift as the regulatory environment has driven organizations to take a serious, yet fresh look at the state of their cybersecurity risk management programs. Institutions at both the state and federal levels remain committed to protecting securities firms from the influx of cyber threats, and to raising the bar on cyber risk management and reporting. And all signs point to this behavior continuing for the foreseeable future.

Cybersecurity continues to be a major focus for the SEC. In September 2017, the Commission announced the creation of a new Cyber Unit that will focus on targeting cyber-related misconduct, and Enforcement Division Co-Director Stephanie Avakian subsequently noted that the Commission views its cyber-related enforcement as falling into three separate types of cases: (1) cases where misconduct is used to gain some sort of unlawful market advantage; (2) cases involving failures by registered entities to take appropriate steps to safeguard information or ensure system integrity; and (3) cases where there may be a cyber-related disclosure failure by a public company. With respect to the final category, she noted that, although the Commission has not yet brought a case in this area, she can “certainly envision a case where enforcement action would be appropriate,” though the SEC recognizes the complexity here and is not looking to second-guess “reasonable, good faith disclosure decisions.”

A report by the New York State Department of Financial Services (DFS) noted that, cyberattacks against financial services institutions are becoming increasingly frequent and sophisticated. To address such threats, the DFS finalized a new cyber regulation, which requires covered firms to conduct a risk assessment and submit an annual certification, among other things. In addition, firms must have a chief information security officer (CISO) and a written cybersecurity policy, and boards must receive reports and be involved in creating standards. Third-party risk must be managed consistent with internal risk management, and any nonpublic data must be encrypted and protected from alteration. Among numerous other requirements are periodic penetration testing and vulnerability assessment, as well as breach reporting. Audit trail data must be preserved, and entities must track and maintain data that enables the accurate reconstruction of all financial transactions, along with any accounting necessary to respond to a cybersecurity event for at least three years. Any information needed to reconstruct material financial transactions and obligations must be kept for five years. The system must also track and maintain data logging of all privileged authorized user access to critical systems.

One development that holds promise—especially for smaller companies that may not view data security as one of their core competencies—is the opportunity to outsource data tracking and maintenance to a qualified entity. The DFS regulation, for example, allows companies to use a qualified outside service for their cyber program.

Demonstrated compliance with leading practices and cyber regulations may be useful for firms with both consumer and investor stakeholders. To that end, the American Institute of Certified Public Accountants (AICPA) unveiled a cybersecurity risk management attestation reporting framework. The AICPA’s framework strives to expand cyber risk reporting to address expectations of greater stakeholder transparency by providing a range of stakeholders, both internal and external, with information about an entity’s cyber risk management program effectiveness.

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What has become clear from evaluating the requirements from the DFS, as well as the guidance from the AICPA, is that a comprehensive cyber risk management program needs active involvement and oversight from the board to hold the organization accountable and help shape and address expectations for improved cyber risk reporting that is integral to the achievement of an organization's business objectives.

In an era where cybercriminals could be state-sponsored, part of a political cooperative, or just after the money, how can boards and senior executives assess the soundness of their cybersecurity programs? The banking network SWIFT articulated three overarching objectives: ‘Secure your Environment’; ‘Know and Limit Access’; and ‘Detect and Respond.’ These objectives translate to a focus on security, vigilance, and resilience as an approach to reduce an organization’s vulnerability, while being prepared to respond quickly and resume normal business.

- Being secure means focusing protection around the risk-sensitive assets at the heart of your organization’s mission.
- Being vigilant means establishing threat awareness throughout the organization, and developing the capacity to detect patterns of behavior that may indicate, or even predict, compromise of critical assets.
- Being resilient means having the capacity to rapidly contain the damage from an attack, and to mobilize the diverse resources necessary to reduce the broad impact—including direct costs and business disruption, as well as reputation and brand damage.

The number of cyberattacks—and associated costs—will likely continue to rise, as will hackers' sophistication. Much of the new cyber regulation is designed to encourage organizations to implement the right level of security, vigilance, and resilience—along with sound governance—to form the best line of defense.
The SEC approved Rule 613 introduced the requirement for a Consolidated Audit Trail (CAT), a central repository of all US securities transactions to be used for regulatory purposes by self-regulatory organizations (SROs) and the SEC. The rule was a response to Wall Street’s well-known “Flash Crash,” and its primary purpose is to identify the beneficiary owner of every securities transaction. In February 2015, the SROs submitted the CAT National Market System (NMS) Plan to operationalize the CAT, and on November 15, 2016, the plan was unanimously approved by the SEC and immediately took effect. The NMS Plan outlines the reporting requirements for industry participants, as well as the requirements of the plan processor.

When CAT goes into operation, all US broker-dealers and SROs will be required to report all equity and options life cycle events to the repository on a daily basis. In addition, US broker-dealers will be required to submit customer account information to the repository. This will make CAT the world’s largest repository of securities transactions, receiving an estimated 58 billion records per day. The SROs will have 12 months to submit equity and options life cycle events to the CAT. Large broker-dealers will be required to begin reporting within 24 months, and small broker-dealers will be required to report within 36 months. Also, once it is up and running, the CAT NMS Plan will require SROs to define plans to retire duplicative reporting.

The CAT will have an end-to-end impact on the reporting of securities transactions. Trade order management systems will be required to capture timestamps in a millisecond format, and all relevant systems will be required to have their clocks synchronized within 50 milliseconds of each other across all technology platforms.

Firms will be required to report customer data to the CAT. This will have an impact on client onboarding, as well as on systems and processes that capture changes in name and address information and customer master management.

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There will be many opportunities for firms to address existing challenges and shortcomings in their nonfinancial regulatory reporting programs, including issues with the accuracy and completeness of data, as well as definitions of individual data elements. Also, changes related to the CAT will give firms new data sources and more granular data than they had in the past. This enhanced data can be combined with advanced analytics to identify customer, trading, and fraudulent behaviors. It also has the potential to demonstrate best execution requirements.

To prepare for the CAT, firms need to identify resources and acquire budgets for technology, operations, and compliance. And with only 24 months to implement the required process and technology improvements, firms should get started immediately.

In early 2017, the SROs selected Thesys Technology Inc., as the Plan Processor (Plan Processor), and Thesys CAT, LLC (Thesys CAT) was formed to stand up and operate the CAT. Thesys CAT’s bid was based on their strength in analytics, robust approach to security, and technical competencies. Since being formed, Thesys CAT has been preparing for the Exchanges (Participants) to report equity and options trade life cycle information. Also, they have been working hand in hand with the industry to develop technical specifications for orders.

The CAT has been a lightning rod for attention from broker-dealers and industry groups such as SIFMA, Financial Information Forum (FIF), and Security Traders Association (STA). Because it will include sensitive information—such as Personal Identifiable Information (PII) and information about cyber events—SROs and Thesys CAT have prioritized making the security model and operations robust and earning the industry’s confidence that information will be protected.

For broker-dealers, this provides an opportunity to recalibrate their CAT readiness and implementation programs and allows for more industry input to the technical specifications and industry testing. In order for the CAT to be successful, each individual firm needs to have a robust technical and control environment that can
deliver error-free, quality data to the CAT. To make that happen, a firm needs to focus on data acquisition within its own system to ensure completeness, accuracy, and quality. Also, firms should be considering how to address the various nonfinancial regulatory reporting issues that have nagged the industry, and then work to develop a more robust reporting environment.

2018 is the year for broker-dealers to build and implement their CAT solutions. Primary focus areas should include data acquisition and data lineage from source systems to the destination platform. Historically, it has been challenging for firms to understand how data flows from order management systems (OMS) to reporting platforms. It has also been challenging to understand the transformation that the data goes through to meet the reporting requirements.

The other major focus area for broker-dealers is customer data. Most firms have customer data in a central repository, an anti-money laundering (AML) platform, and disaggregated in their trade order management systems. Managing customer data will present firms with a number of significant challenges, including: (1) identifying the golden source, (2) sourcing the data and evaluating data consistency, and (3) meeting the technical customer specification requirements.

A key aspect of the CAT implementation is the industry testing and data quality programs that will ultimately determine when duplicative reporting platforms will be retired. SROs have stated that in order to retire Order Audit Trail System (OATS) and Electronic Blue Sheets (EBS), data quality standards need to be met. Last but not least, a lot of attention is being focused on the sensitivity and security of CAT data. The SROs’ regulators, the government, and the firms themselves all have a vested interest in making sure the CAT is secure—with a robust security model, policies and procedures, oversight, and sophisticated security methods being deployed to provide a level of understanding and comfort. This is a significant challenge; however, just because it is difficult, does not mean it should not be done.
Data quality and data analytics

In preparation for the daily reporting of huge volumes of data to CAT, broker-dealers should assess their current data readiness capabilities (data sourcing, data quality, and data governance), identify gaps, and implement needed enhanced data management architecture and operating models. As part of their data readiness for CAT reporting requirements, broker-dealers should keep in mind the following considerations:

- Assess data management and reporting capabilities of authoritative sources (e.g., trade capture and customer management information systems) and implement enhanced data architecture to meet CAT reporting requirements
- Implement enhanced data governance capabilities, including data reconciliation and data controls to ensure accuracy and integrity across duplicative reporting requirements for CAT and the existing reporting requirement for EBS and OATS
- Implement improved data sourcing process with enhanced data security, data archival, and data recovery capabilities
- Robotic process automation (RPA), cognitive technologies, and big data analytics solutions should be considered for CAT reporting to achieve higher efficiency across regulatory reporting and data management processes
- Improved data visualization tools and dashboards
- For more information on data readiness, please read our full report on managing data challenges for consolidated audit trail (CAT) reporting [https://www2.deloitte.com/us/en/pages/risk/articles/data-management-challenges-cat-controls.html].
Employee conduct and the risk culture within financial services organizations have been central themes across the industry, arising from the past decade’s many well-publicized and highly-damaging market manipulation scandals. Regulators have responded to the scandals by conducting horizontal business practices reviews, issuing consent orders, and pursuing organizations and individuals to hold them accountable. Industry bodies are issuing standards of good market practices, and organizations are signing statements of commitment to better market discipline. Also, industry bodies are encouraging organizations to build a conduct risk management program in the front office supported by the other lines of defense.

Improving conduct across the industry is an essential part of rebuilding trust. Organizations around the world are focusing on managing conduct risk more effectively, with the goal of better balancing the need to achieve business priorities against the need to embed a risk management and compliance environment that delivers fair outcomes to customers and the marketplace overall.

Organizations have typically provided guidance to employees through policies and procedures that meet both local rules and regulations, and that describe acceptable and expected standards of employee behavior. Regulators, however, are becoming increasingly interested in an organization’s ability to have a more holistic view of conduct risk across the product life cycle in order to help identify blind spots, unknown risks, and other vulnerabilities that could undermine the integrity of risk management and threaten fair outcomes.

Key regulatory and industry trends to be aware of include:

- **Cross-industry supervisory feedback.** Some regulators have adopted a horizontal approach to performing supervisory activities, either across the industry or focused on organizations under similar consent orders. Lessons learned from these horizontal reviews and related feedback are an important benchmark for any organization’s response to conduct risk, and can be applied beyond financial services. Feedback tends to focus on raising the standards for what constitutes a “good practice,” including accountability and responsibilities across the three lines of defense, and control assessments and related preventative and detective controls.

- **The second wave of consent orders.** For wholesale institutions, some regulators are issuing new consent orders to organizations that were not included in the first wave, which started in late 2014. Regulators continue to pursue organizations and individuals for similar or related conduct issues and control weaknesses, and inability to stay focused on outcomes.

- **Industry guidance and codes.** Outside of the consent orders, industry groups such as the Fixed Income, Currencies and Commodities (FICC) Markets Standards Board (FMSB) and the FSB have published guidance for addressing potential misconduct in financial markets and set common standards of good business practices. Organizations are expected to apply this guidance and to monitor adherence across their businesses globally.

- **Enterprise conduct risk management programs.** Organizations under consent order have been required to address this topic programmatically through enterprise conduct risk management programs that proactively identify and manage conduct risks across the organization. Now, regulators are starting to push similar expectations through their regular supervisory activities for organizations outside of the consent orders.

- **Demonstrating ongoing effectiveness.** Organizations that have been operating under consent orders for a number of years are now being challenged by regulators to demonstrate that their enhanced conduct risk management practices are sustainable and will continue to operate effectively after the consent orders have been lifted. The key is to build conduct risk frameworks that embed the lens of conduct through all business activities, not to approach conduct as another risk to manage. Developing metrics and management information that helps management and boards monitor effectiveness is essential.
• **Public disclosures and certifications.** In some instances, such as with the new BIS FX Global Code, firms are expected to issue statements of commitment to upholding standards that are consistent with industry principles and with codes in their own organizations. In addition, firms are publishing their own enhanced codes of conduct as well as additional client disclosures to improve the transparency of business practices and clarify the nature of their relationships with clients.

• **Assessing risk culture.** Culture is a vital factor for managing conduct risk. Many firms are complementing their conduct risk frameworks with assessments that shine a light on attitudes and behaviors in their organizations that might be detrimental to the interests of customers and the broader marketplace. Firms are also participating in an annual industry survey published by the Banking Standards Board (BSB) that seeks to provide a benchmark of culture-related challenges and to drive organizational changes that improve standards across the industry.

It has become increasingly clear that the tide of expectation has turned, and that both regulators and clients in the financial services industry will no longer accept the poor conduct and behaviors of the past. To demonstrate their commitment to restoring trust, a firm should continue to invest in enhancing its control infrastructure across all lines of defense, and should be proactive in managing conduct risk and addressing employee behaviors that put the organization at risk.

For more information, please refer to the Deloitte & Touche LLP report entitled “Managing Conduct Risk.”
Within the next 10 years, RPA and cognitive technologies such as natural language processing (NLP) will likely be ubiquitous in the workplace. While this might require a massive overhaul in how people work, in the end the required adjustments will likely be worth the effort.

One popular technology that has already been widely implemented in the securities sector is RPA. With RPA, software “robots” execute routine business processes by performing repeatable, deterministic, and routine business processes that require interaction between multiple systems. RPA mimics the way people interact with systems and follows simple rules to make decisions. These robots can not only improve process efficiency and accuracy, but also reduce costs and increase flexibility and scalability.

Other breakthrough innovations generating interest include artificial intelligence (AI), cognitive technologies, and blockchain. Two widely discussed cognitive technology solutions are (1) machine learning applications that can make predictions and decisions without the need for explicit programming, and (2) NLP applications that can interpret unstructured data (e.g., free text) and transform it into structured data that is analyzable. AI and cognitive technologies like these use algorithms to extend what humans or traditional data systems can do on their own. And the data produced from both AI, cognitive technologies, and client interactions is now being distributed both internally and externally using the efficiency, speed, and security of blockchain technology.

There are many opportunities to apply automation and AI across the compliance life cycle to drive significant gains in efficiency, quality, and productivity. Examples include combining advanced data analytics with analysis of email communications and external news to detect potential insider trading activities; enhancing testing through RPA; and improving regulatory compliance by using NLP applications to extract regulatory requirements and then mapping them to control activities.

Applying these automation tools can meaningfully improve the kind of work performed by compliance functions, and by the organization as a whole. These tools not only reduce costs and provide faster processing with higher quality, they also allow compliance professionals to focus on higher value tasks, such as investigating and remediating exceptions, data analysis, strategic design, or redesigning inefficient control activities.

From a regulatory perspective, the SEC has invested heavily in analytic and automation tools to support its examination and enforcement teams. For example, the SEC uses NLP to identify themes within tips, complaints, and referrals. The SEC has also developed sophisticated software and tools such as Advanced Relational Trading Enforcement Metrics Investigation System (ARTEMIS) to identify and assess unusual trading patterns.

With the SEC using advanced data analytics and other cognitive technologies to identify and prioritize high-risk areas, securities organizations and compliance functions could benefit from using those same kinds of tools to gain better insight into their business and compliance processes.

Of course, achieving the potential benefits of these technologies requires planning and coordination. Senior leadership must take a holistic view of technology and develop a strategy and framework that aligns business, compliance, and technology goals and objectives. Additionally, organizations must carefully assess opportunities for automation by evaluating which processes to automate and how the various technologies would support business needs and future strategic initiatives.

Although most people are now comfortable embracing and incorporating the latest digital technologies into their personal lives, fully integrating technology into the workforce is still a point of hesitation for many organizations, especially in compliance functions. Whether that fear is rooted in Hollywood images of killer robots, or the gnawing feeling that we might all soon be replaced by smart machines—the reality is that technologies such as AI and RPA are simply too powerful and compelling for any business to ignore. Of course, as is true with any tool, success or failure will ultimately hinge on how you use it.
As automation and cognitive tools become the norm, jobs will need to be reinvented to adapt for future growth. Using robots will allow compliance professionals to spend less time doing manual tasks and more time thinking critically and applying expertise, experience, and judgment. It will also enable organizations to cultivate a more diverse workforce with a wide range of valuable skills and knowledge that efficiently integrate with the organization’s advanced cognitive tools.
Taking decisive action in uncertain times

Regulatory uncertainty remains a fact of life. But in most cases, waiting for absolute certainty is not a viable option. Instead, securities organizations need to keep moving forward as planned, with deliberate linkage between regulatory strategy, business strategy, and building infrastructure for governance, regulatory reporting, and risk management that scales and is flexible. Senior management will need to take decisive action while at the same time paying close attention to emerging regulatory developments and staying as flexible as possible. The good news is that many of the changes securities organizations are currently implementing make good sense from a business perspective—not just a regulatory perspective—and are thus worth doing no matter how the future unfolds.
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