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Regulation Best Interest

How wealth management firms are implementing the Rule Package

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Executive summary

Regulatory background

On June 5, 2019, the U.S. Securities and Exchange Commission ("SEC") adopted Regulation Best Interest ("Reg BI")[2] under the Securities Exchange Act of 1934 (the "Exchange Act"). Reg BI imposes principles-based standards on recommendations to retail customers[3,4], requiring that broker-dealers and their natural associated persons ("Associated Persons"), among other things, act in "the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer."[5]

To meet their best interest obligations, broker-dealers that provide investment recommendations to their retail customers must also adhere to the following four component obligations: Disclosure Obligation, Care Obligation, Conflict of Interest ("COI") Obligation, and Compliance Obligation.

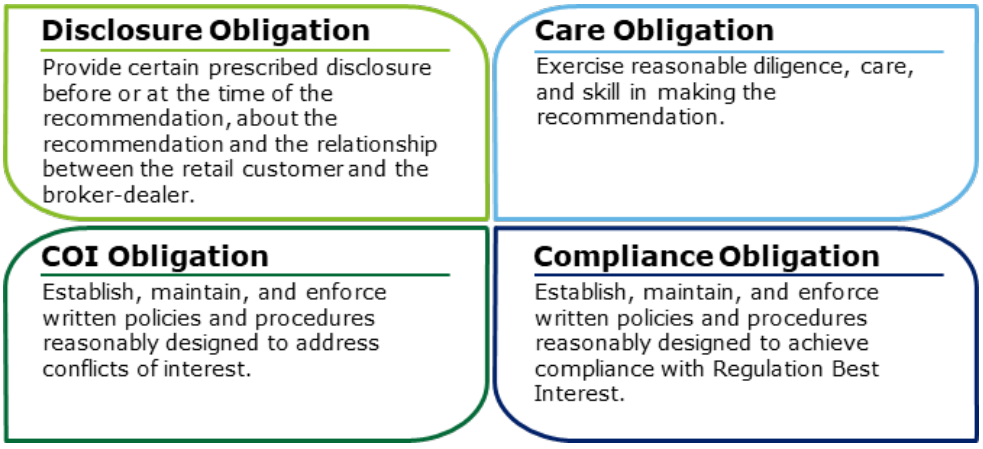


Figure 1. The four component obligations of the General Obligation of Reg BI

Reg BI aims to provide retail customers with full and fair disclosure about the products and services offered by broker-dealers, including relevant COIs, to allow these customers to make appropriate investment decisions pertinent to their investment goals and needs while understanding the associated risks with such decisions.[6] Additionally, each broker

[2] *Regulation Best Interest*: The Broker-Dealer Standard of Conduct, SEC Release No. 34-86031, adopting Rule 15l-1 under the Exchange Act.
[3] A "retail customer" is a natural person, or the legal representative of such person, who: receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and uses the recommendation primarily for personal, family, or household purposes. *See Rule 15l-1(b)(1)*.
[4] The terms "retail customer" and "retail investor" are used interchangeably throughout this report as the terms are defined and used differently between the Reg BI and Form CRS adopting releases given their applicability and scope. A particular term may be used for alignment in terminology with the respective adopting release and for this reason may appear to be inconsistent from section to section. Firms should defer to the SEC guidance and rule language for clarity of definitions and usage in particular contexts.
[5] SEC Rule 15l-1(a)(1)
[6] *Regulation Best Interest*: The Broker-Dealer Standard of Conduct, page 213, SEC, 2019.

dealer and registered investment adviser (each a, "Registrant") must file a Customer Relationship Summary Form ("Form CRS") with the SEC and provide a copy to each retail investor.[7] In two pages or less (or four pages or less in the case of dual registrants),[8] Form CRS must summarize the Registrant's business practices, registration status, relationships to retail investors, fees, costs, COIs, standards of conduct, and disciplinary history. Registrants must also engage in enhanced recordkeeping practices.[9]

The compliance date for Reg BI, the associated recordkeeping requirements, and the initial Form CRS filing requirements, (hereafter, referred to collectively as the "Reg BI Rule Package") is June 30, 2020.

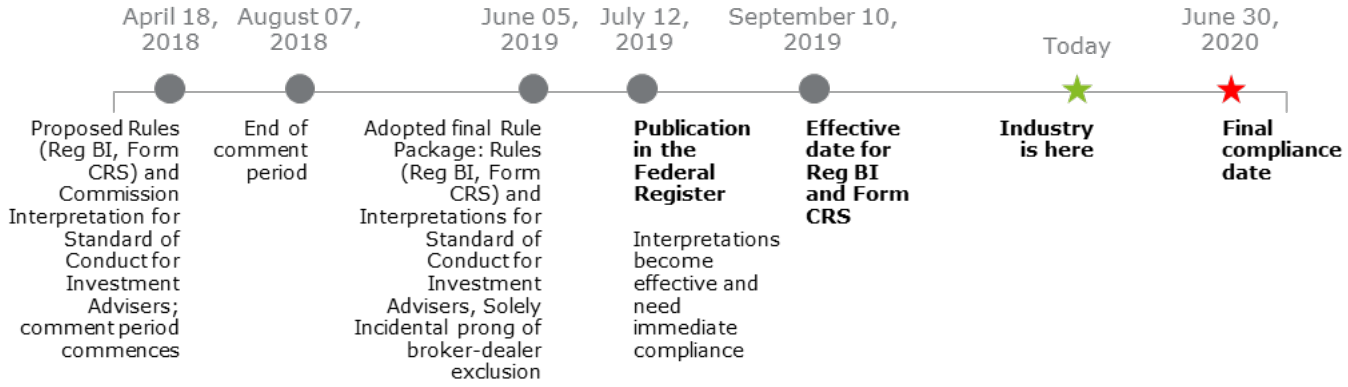


Figure 2. Reg BI Rule Package timeline

Introduction to the survey

Approach and purpose

The Securities Industry and Financial Markets Association ("SIFMA") engaged Deloitte & Touche LLP ("Deloitte") to facilitate a survey to understand the implementation challenges, anticipated business, operating model, and technology changes, resource allocation, and time and cost commitments expected by SIFMA member firms in implementing the Reg BI Rule Package. 48 SIFMA member firms (hereafter referred to as "survey participants" or "Firms") that provide financial advice and related services to retail customers, participated in the survey. The survey was closed on December 2, 2019, and responses are as of this date. Deloitte & Touche analyzed survey participants' responses, which were provided on an anonymized basis, to identify the compliance decisions and requirements that Firms will likely need to implement to operationalize the Reg BI Rule Package. The aforementioned analysis has been summarized in the contents of this report.

[7] See Form CRS Relationship Summary; Amendments to Form ADV, Exchange Act Release No. 86032 (Jun. 5, 2019).
[8] For singular broker-dealers and RIAs, Form CRS must not exceed two pages in paper format. For dual registrants that include their brokerage services and investment advisory services in one relationship summary, the relationship summary must not exceed four pages in paper format.
[9] *Regulation Best Interest*: The Broker-Dealer Standard of Conduct, page 361, SEC, 2019.

Survey participant composition

The 48 member firms that participated in the survey consisted of dual registrants, broker-dealers and RIAs that are owned by or affiliated with banks, holding companies, insurance companies, and trust companies, as well as independent dually-registered broker-dealers and registered investment advisers. A summary of key demographics about the survey population follows:

- 90% were **dual registrants**
- 46% derived at least three-quarters of their **revenue** from their wealth management businesses, 36% of which have assets in excess of $100 billion
- 90% have **open architecture platforms**, and 74% of those with open architecture platforms offer both **affiliated/proprietary** and **non-affiliated/proprietary products**
- 25% have more than 5,000 **producing registered representatives**[10] and 19% have more than 5,000 **registered investment advisory representatives**[11] (hereafter collectively referred to as "Financial Advisors")
- 58% have more than 100,000 **retail brokerage accounts** and 38% have more than 100,000 **fee-based retail accounts**

The survey participant population was categorized by size to facilitate further analysis, as follows:

Small Firms
500 or less Financial Advisors and less than 100,000 retail brokerage and/or fee-based accounts

Medium Firms
501 to 5,000 Financial Advisors ***or***
100 to 500 Financial Advisors and greater than 100,000 retail brokerage and/or fee-based accounts

Large Firms
More than 5,000 Financial Advisors and greater than 100,000 retail brokerage and/or fee-based accounts

The table below provides additional information for the different size categories of Firms:

	Financial Advisors				
Retail Accounts	**1-100**	**101-500**	**501-1,000**	**1,001-5,000**	**5,000+**
1-10,000	8%	2%			
10,000-50,000	2%	10%		2%	
50,001-100,000		10%	4%		
100,000+		8%	8%	17%	29%

Small Medium Large

Figure 3. Survey participant distribution by size

[10] For the purposes of this report, producing registered representatives are individuals permitted to sell brokerage products and services, such as financial advisors, licensed bankers, and insurance and annuity representatives.
[11] For the purposes of this report, registered investment advisory representatives are individuals permitted to sell advisory products and services, such as financial advisors and licensed bankers.

Summary of findings

Confidence in meeting the compliance date varies.

77% of survey participants expressed a moderate to high level of confidence in meeting the compliance date of June 30, 2020, while 83% of survey participants expressed a moderate to high level of confidence in being able to sustain compliance with the requirements of the Reg BI Rule Package after June 30, 2020.[12]

Business model shifts are fundamental in nature.

The top three business model changes ranked by survey participants include changes to commissions and/or fee schedules, changes to Financial Advisor compensation and incentive programs, and rationalization of product and/or product types on the product shelf. Business model changes may vary, depending on the size and complexity of the current business model of the firm, and could permanently impact the choices available to retail customers.

Operationalizing the Reg BI obligations are creating implementation challenges.

Various aspects of the Reg BI Package require significant implementation effort.[13] For example, the development and delivery of Form CRS has been ranked as one of the most challenging to implement by 79% of the total participant population, specifically, 56% of Large Firms, 61% of Medium Firms, and 33% of Small Firms. Additionally, the Care Obligation, specifically evidencing best interest rationale for certain recommendation types, and the Disclosure Obligation were ranked as two of the greatest implementation challenges by 77% and 72% of survey participants, respectively.

Conflicts of interest are a high priority focus area.

The Reg BI general standard and four component obligations will require firms to have a robust COI framework that takes into account business model shifts such as eliminating certain products and services from their retail customer product shelf and eliminating or changing third party revenue sources. 88% of survey participants ranked enhancements to existing policies and procedures, and updating existing controls or creating new controls as changes contemplated in response to the COI Obligation. Additionally, 54% of survey participants agreed they would eliminate certain COI and 69% of survey participants said they would enhance their existing COI registry.

Preparedness includes evaluating and strengthening the compliance framework.

Developing and delivering targeted training programs is crucial to successful change management and facilitating salesforce and support staff readiness. Pre-compliance date

[12] For the purposes of this survey, confidence in meeting the compliance date of June 30, 2020, and confidence in being able to sustain compliance with the requirements of the Reg BI Rule Package were assessed on a scale of 1-5, with 1 being "least comfortable" and 5 being "very comfortable." Survey responses of a comfort level of 3 or higher were included in the population of moderate to high level of confidence.

[13] Based on Firms that ranked these obligations as a 1, 2 or 3 in response to the question, "Please rank the following obligations based on the order in which your firm expects the greatest implementation challenges, with 1 being the Most Challenging Obligation and 6 being the Least Challenging Obligation."

testing, implementation of technology-enabled solutions to help support/evidence compliance with the Reg BI Rule Package, as well as to detect potential Reg BI Rule Package violations have been ranked as top of mind changes by survey participants.

Cost of compliance involves significant up-front investments.

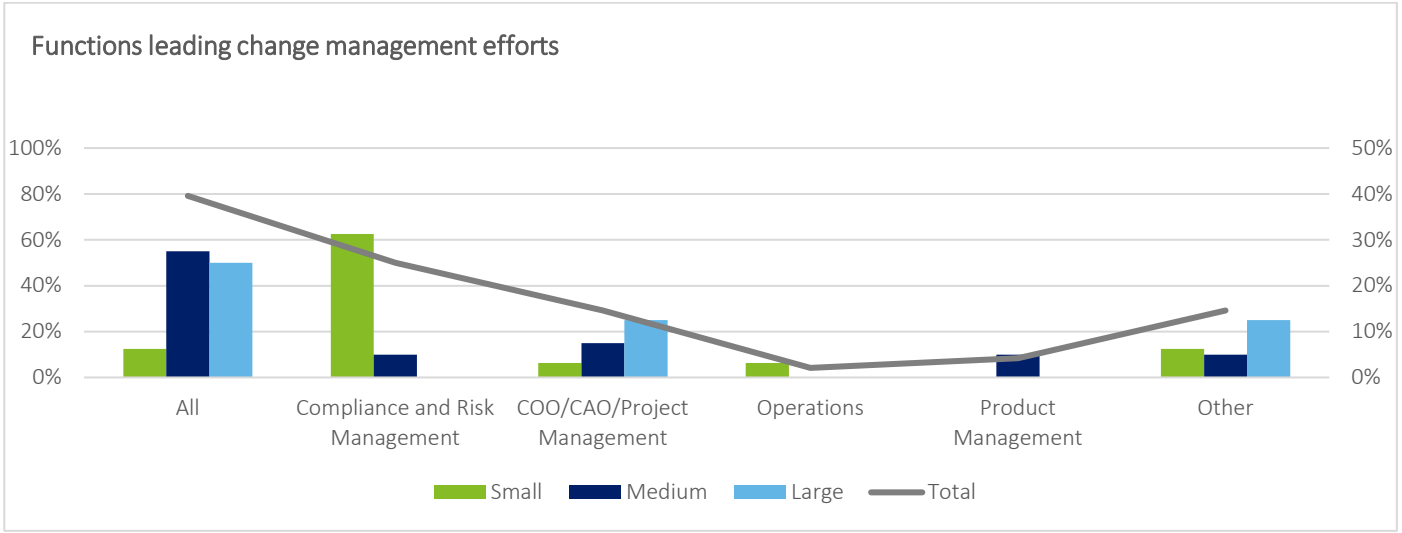
Approximately $114 million[14] across 20 survey participants has been allocated to readiness efforts. Evidencing compliance with various requirements will require significant investments in enabling technology, as Firms seek to provide the necessary tools and applications to their salesforce and support staff, and as such technology costs were estimated at over $61 million, i.e. 54%. Further, many firms will reallocate the resources of their existing staff towards readiness efforts. Talent and technology strategies for ongoing compliance vary and include an average of 48% reduction in funding after June 30, 2020, based on survey participants that reported budgeted and projected spend amounts. In other words, based on survey participants' responses, much of the technology costs appear frontloaded in implementing the rule, rather than relating to ongoing compliance.

[14] Based on amounts provided by 20 Firms in response to the question, "Please provide for your firm, the anticipated/budgeted annualized spend for technology and nontechnology, readiness to comply with the rule by June 30, 2020, and expected future annual cost of compliance."

Assessing readiness: June 30, 2020 and beyond

Who is leading change management efforts?

Large-scale regulatory change requires a collaborative approach to assess impact, make key decisions, and design and implement a sustainable target-state model. This includes, but is not limited to, policies and procedures, processes, enabling technology and training. Survey participants' responses suggest there are both differences and similarities in their approach to operationalizing the requirements of the Reg BI Rule Package. For most Firms, readiness for the Reg BI Rule Package will comprise a **collaborative effort** across business lines and their respective governance and control functions across multiple lines of defense. Firms are employing a cross-functional approach to change management with workstreams that include representation from compliance, legal, risk management, supervision and oversight, the chief operating and/or administrative office and project management office, product management, and operations, amongst others. In 40% of instances,[15] survey participants responded that the compliance, legal, risk management and supervision and oversight functions are driving readiness efforts.



[15] Certain survey participants selected the response option of "Compliance and Risk Management" while others responded as "Other, please specify" supplemented with "Legal" or "Supervision Oversight".

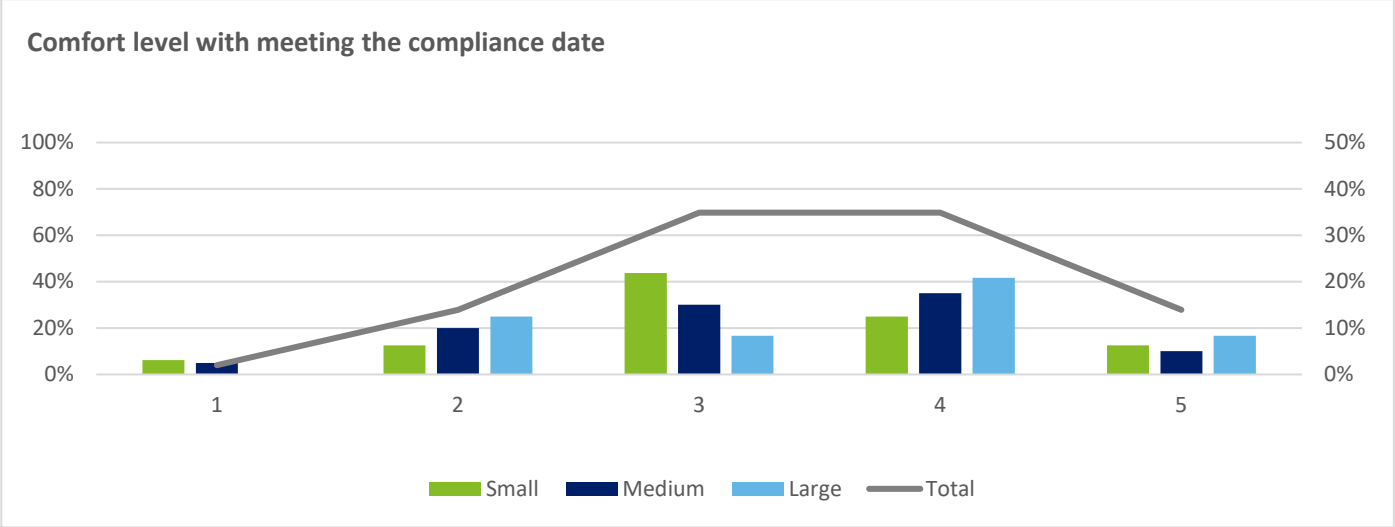
How mature are readiness efforts?

Readiness efforts for regulatory change generally comprise the following flow of activities:

- Assess the potential impacts of a rule's requirements to business and operating models
- Conduct gap analyses to help determine necessary changes to its business and operating models
- Design an achievable and sustainable target state
- Create an implementation plan for the desired target state
- Implement the desired target state and test

Figure 4. Typical flow of activities to prepare for regulatory change

Firms were asked to rank, on a scale of 1-5, where 1 is "Least Comfortable" and 5 is "Very Comfortable", their comfort level in meeting the compliance date of June 30, 2020. 77% of survey participants expressed having a moderate to high-level of confidence, i.e., 3 or greater, with meeting the compliance date of June 30, 2020.

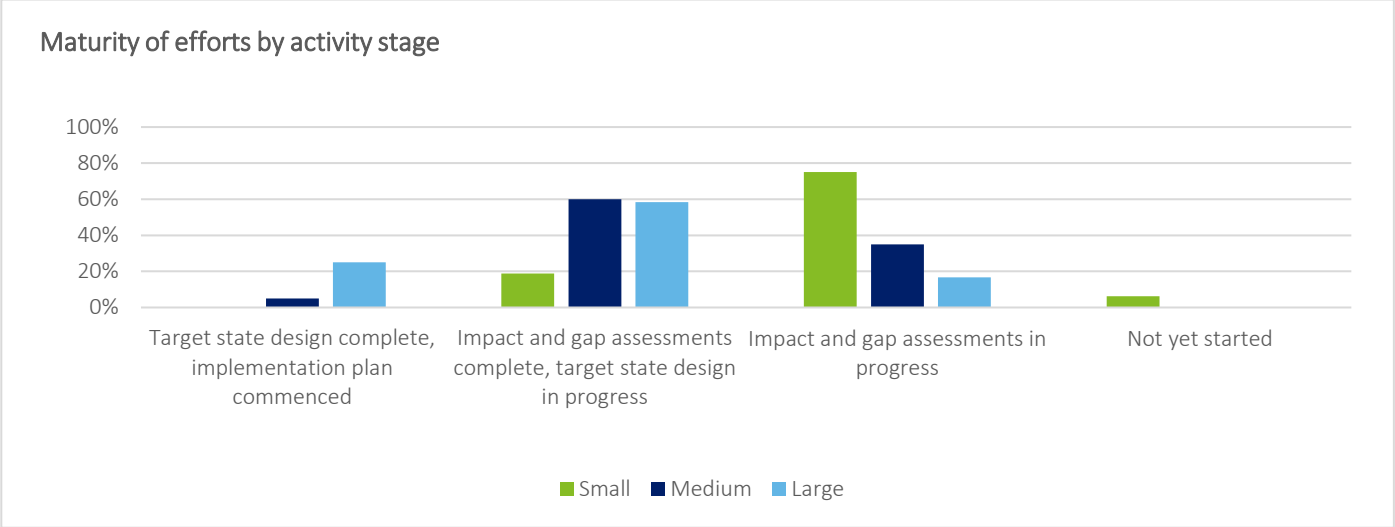


[16]

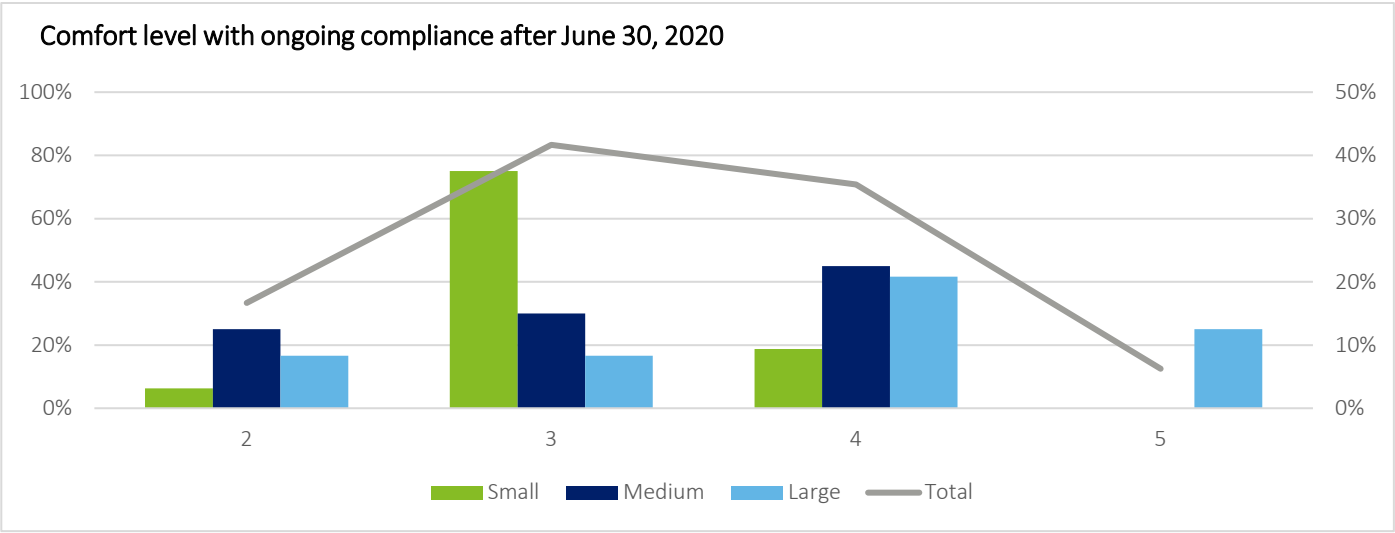
[16] The horizontal axis in this chart is a scale of 1-5, where 1 is "Least Comfortable" and 5 is "Very Comfortable".

Of this 77% noted above,

- 12% have completed target-state design and commenced their implementation plan
- 46% have conducted impact and gap analyses and commenced target-state design
- 43% are in the process of performing impact assessments and gap analyses



The ability to sustain a scalable framework that supports ongoing compliance is essential to a robust approach to regulatory change. 83% of survey participants responded that they have a moderate to high-level of confidence to be able to **sustain compliance** with the requirements of the Reg BI Rule Package after June 30, 2020.



[17]

[17] The horizontal axis in this chart is a scale of 1-5, where 1 is "Least Comfortable" and 5 is "Very Comfortable".

Impact of the Reg BI Rule Package on wealth management firms and retail customers

Survey participants' approaches to **business and operating model shifts** in response to the Reg BI Rule Package vary. Based on survey participant responses, business model shifts include harmonization of retail customer product shelves and changes to Financial Advisor compensation and incentives; and operating model shifts include enhancing processes, policies and procedures and training.

Business model shifts in response to the Reg BI Rule Package

Assessing the impact of the Reg BI Rule Package to a Firm's business is essential to determining changes needed to its business model, many of which will likely drive the investment choices, i.e., investment products and services available to its retail customers.

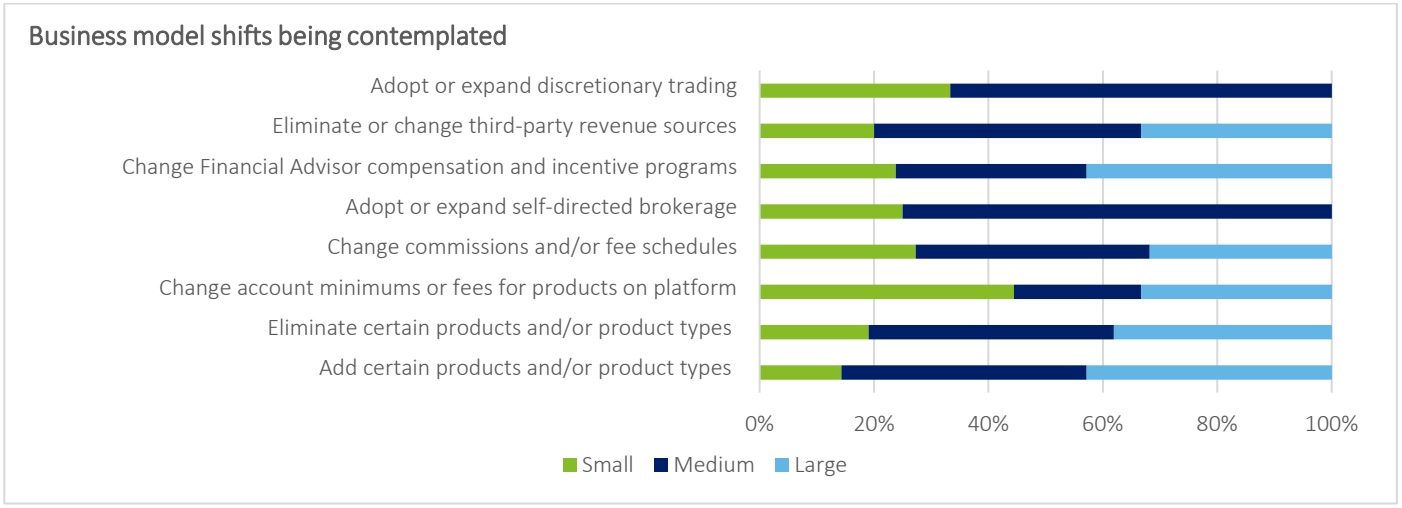
Just under 69% of survey participants say that they are contemplating a mix of business model shifts in response to the Reg BI Rule Package; the shifts that were ranked as most common across this survey participant population were as follows:

- 46% will make changes to commissions and/or fee schedules
- 44% will eliminate products and/or product types from the retail customer product shelf
- 44% will change their compensation and incentive programs for Financial Advisors
- 31% will eliminate or change third-party revenue sources
- 23% will take the following steps **simultaneously**:

  - adding certain products and/or product types to the retail customer product shelf and/or eliminating certain existing products and/or product types to the retail customer product shelf
  - instituting changes to account minimums or fees for products on platform, commissions and/or fee schedules
  - making adjustments to Financial Advisor compensation and incentive programs; adopting or expanding self-directed brokerage platform or discretionary trading platform
  - eliminating or changing third-party revenue sources.

Certain trends by size of Firm were also observed, specifically,

- 44% of survey participants categorized as Small Firms will make changes to account minimums or fees for products on the platform
- 75% of survey participants categorized as Medium Firms will adopt or expand self-directed brokerage
- 67% of survey participants categorized as Medium Firms will adopt or expand discretionary trading
- 43% of survey participants categorized as Large Firms will add certain products and/or product types to the retail customer product shelf as well as change Financial Advisor compensation and incentive programs
- At the time of the survey, Large Firms did not state they would expand or adopt self-directed brokerage and/or discretionary trading as a future change (in response to the Reg BI Rule Package) to their business model



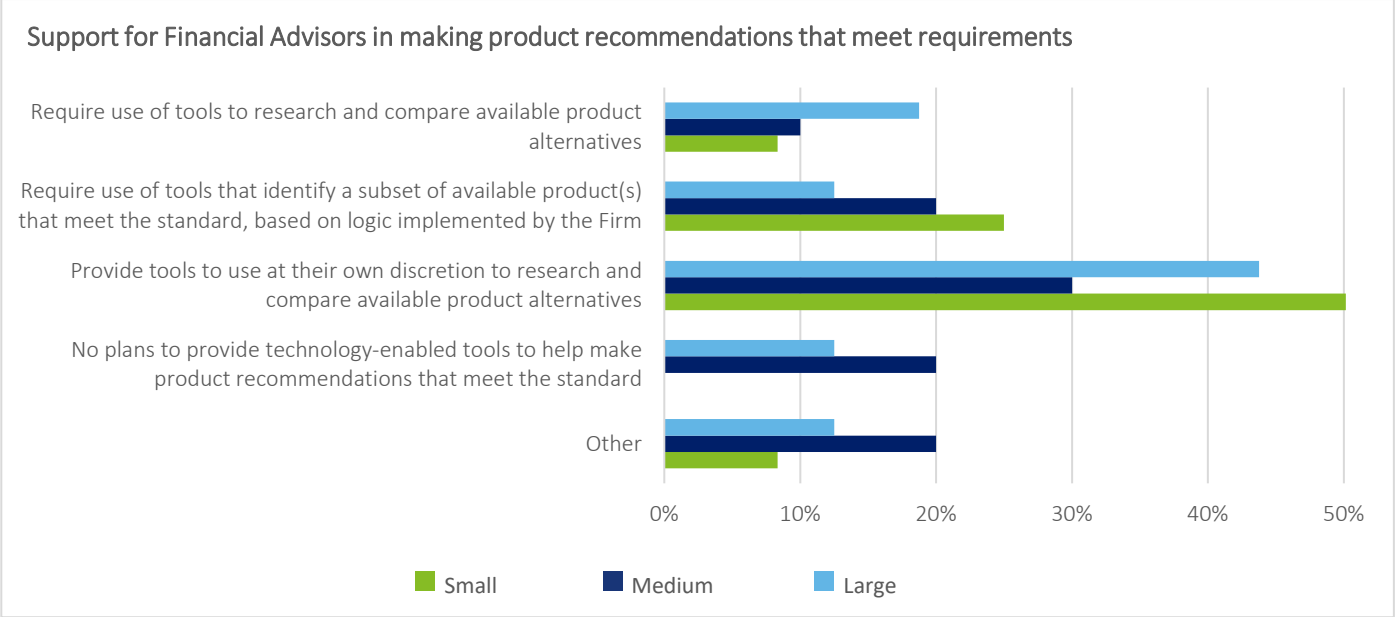
Operating model shifts in response to the Reg BI Rule Package

Operationalizing the requirements of the Reg BI Rule Package will require changes that significantly affect people, processes, and technology. Notably, **defining best interest** was ranked as the most challenging operating model change by 36% of survey participants. Operationalizing processes to evidence compliance with the component obligations of Reg BI as well as the requirements related to Form CRS and Recordkeeping will require varying levels of effort, the details of which follow in the sections below.

Care Obligation

46% of survey participants say **processes for product due diligence and establishing product suitability guidelines** require the greatest change to their Firm's operating model (i.e., changes required to people, process and technology). Further, one-third of survey participants agreed the Care Obligation will require the most technology-based uplift. In order to support Financial Advisors in making product recommendations that meet the requirements of the Reg BI Rule Package, Firms plan to use **technology-enabled tools** as follows:

- 42% of survey participants plan to provide such tools for Financial Advisors to **use at their own discretion** to research and compare available product alternatives
- 19% will **require the use of such tools** that identify a subset of available products that meet the standard based on the **best interest rules logic** implemented by the Firm, while 13% will require the use of tools to research and compare available product alternatives in light of the retail customer's **investment profile**
- 13% currently do not plan to provide Financial Advisors with additional tools to support product recommendations. However, these Firms will require, under certain circumstances, that Financial Advisors **choose from a pre-determined set of substantiations and/or use free-form text fields** to document best interest rationale. This is further discussed below under actions required of Financial Advisors and Supervisors to document and substantiate review of best interest.



Financial Advisors will be required to document best interest rationale across various recommendation types as follows:

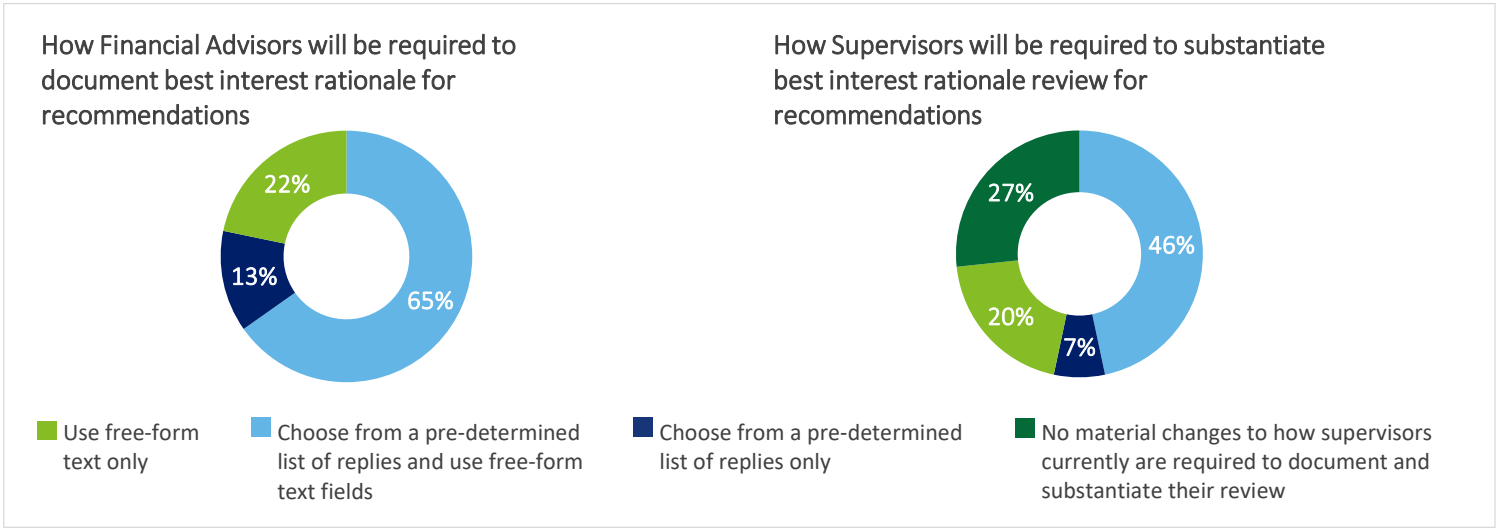
- 56% of survey participants will require best interest rationale documentation for **specific product recommendations** such as complex products and for **product switches,** related to mutual funds, variable annuities, unit investment trusts, and structured products
- 52% of survey participants will require best interest rationale documentation for **rollover recommendations**
- 46% of survey participants will require best interest rationale documentation for **account type recommendations and switches**
- 25% of survey participants will require best interest rationale documentation for **investment strategy recommendations**
- 50% of survey participants will require best interest rationale documentation for **all types** of recommendations; this includes five Large Firms, eleven Medium Firms and eight Small Firms.

Among survey participants that will require Financial Advisors to document best interest rationale for recommendations noted above, Firms are implementing a range of tools and requirements for Financial Advisors to use,

- 65% of Firms will allow Financial Advisors to choose from a pre-determined list of replies *and* use free-form text fields
- 35% of Firms will require Financial Advisors to use *either* free-form text fields (22%) *or* choose from a pre-determined list of replies (13%)

For those circumstances under which Firms will require **supervisors to document and substantiate their review** of Financial Advisors' recommendations for best interest,

- 46% of survey participants will provide a pre-determined list of replies *and* allow the use of free-form text fields
- 27% will require the use of *either* free-form text fields (20%) *or* choose from a pre-determined list of replies (7%), and
- 27% of survey participants say they will not make material changes to how supervisors currently are required to document and substantiate their review.

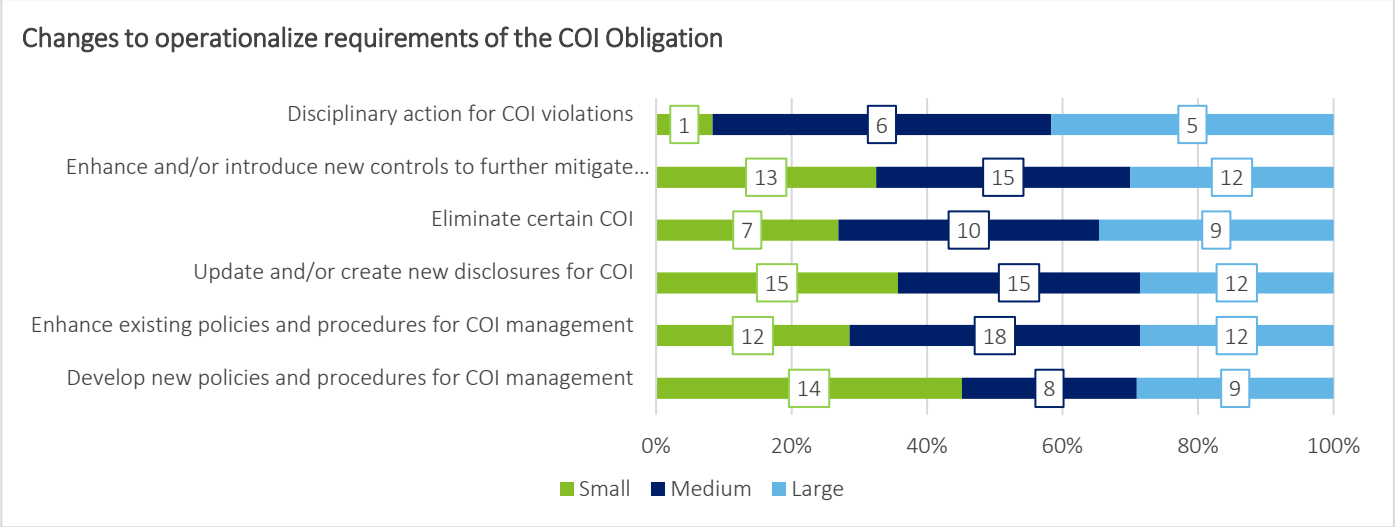


COI Obligation

The COI Obligation aims to identify and address COI through elimination or, at a minimum, disclosure. In addition, certain COIs will also require mitigation in addition to disclosure in order to comply with the Reg BI Rule Package. To support these requirements, survey participants are contemplating one or more of the following changes to comply with the COI Obligation:

- 65% will develop new policies and procedures to manage COIs
- 88% will enhance existing policies and procedures to manage COIs
- 88% will update or create new disclosures for COIs
- 54% will eliminate certain COIs
- 83% will enhance and/or introduce new controls to further mitigate certain COIs
- 25% will institute disciplinary action for COI violations

The chart below details the changes Firms are expected to take to operationalize the COI Obligation.

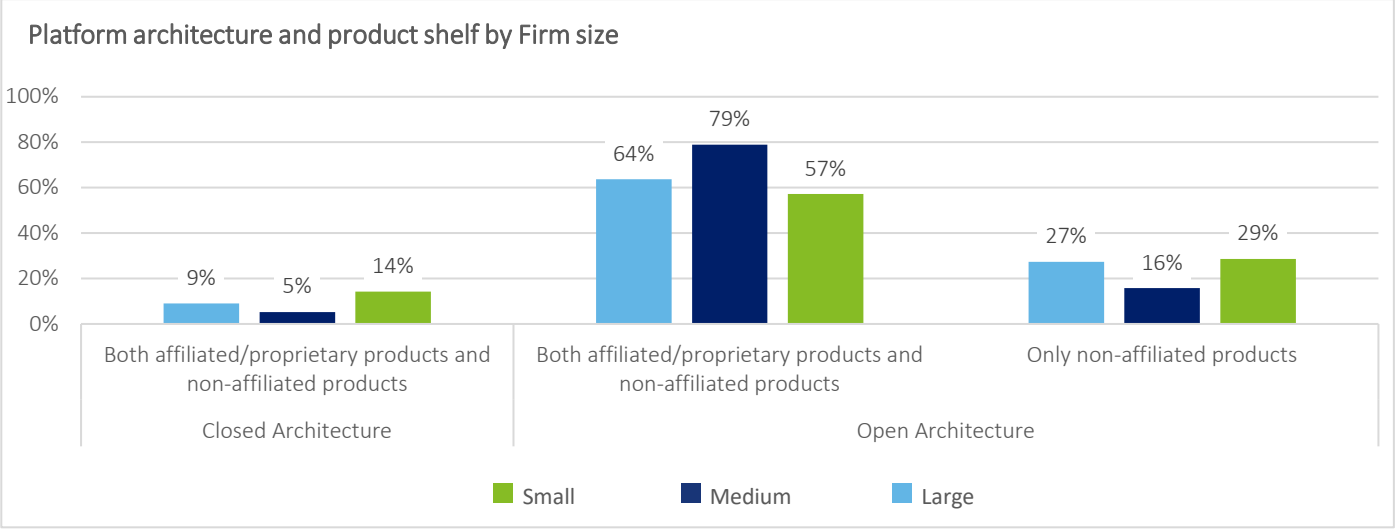


As part of normal course of business, firms come across real, perceived and potential COIs between the firm and its clients, its employees and its clients, amongst others. A COI registry is an inventory of conflicts that the Firm has identified. Practices for the development and maintenance of a COI registry vary widely, however they generally will include the conflicts themselves as well as a mapping to the controls, where applicable, developed to mitigate these conflicts.

Of the 48 survey participants that responded to the question, 69% currently have a COI registry and intend to enhance that registry as a result of actual or perceived conflicts of interest identified through analysis of and various changes to business models, while 15% of survey participants plan to create a COI Registry as a result of the Reg BI Rule Package. An average of 89% of this survey participant population plan to take the additional steps of enhancing policies and procedures for managing COI, updating existing and/or creating new disclosures for COI, and enhancing and/or introducing new controls to further mitigate certain COI.

A Firm's platform and retail customer product shelf factor into the impact assessment of the requirements of the COI Obligation. Certain business model changes such as the elimination of third-party revenue sources or the addition or elimination of certain products to the retail customer product shelf composed of affiliated/proprietary products and non-affiliated products, could raise questions as to whether certain products receive preferential treatment over others and create real or perceived COI, which will require disclosure. Additionally, comprehensive due diligence around product platforms, ongoing criteria for evaluating determinations on whether to add or delete products, and decisions on how to manage and disclose conflicts of interest with proprietary products will support adherence to the requirements of the Care and Compliance Obligations.

The chart below shows the distribution of platform architecture and retail customer product shelf by Firm size.[18]



Compliance Obligation

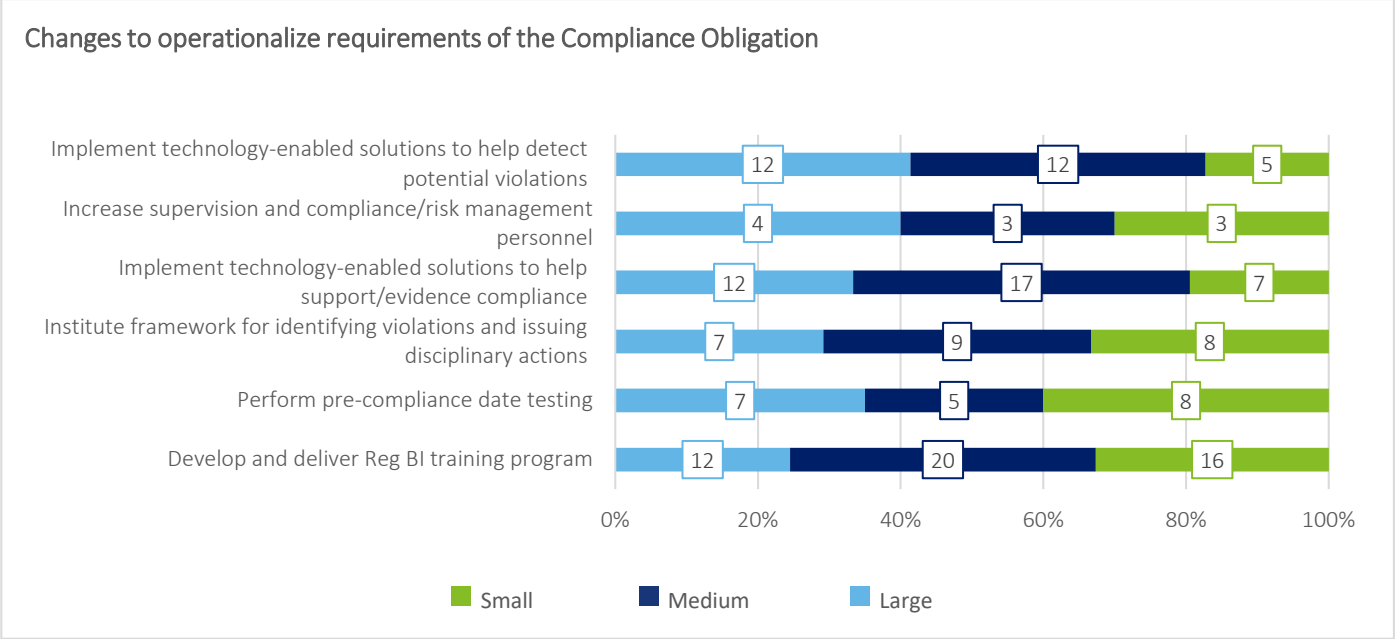
The Compliance Obligation[19] requires Broker-Dealers to **establish, maintain, and enforce written policies and procedures** reasonably designed to achieve compliance with Reg BI, in addition to the policies and procedures required by the COI Obligation.

Survey participants were asked to select all the steps they are contemplating to take in response to the Compliance Obligation. While all survey participants plan to develop and deliver **training programs** to operationalize the requirements of the Compliance Obligation, the additional steps vary as follows:

- 42% plan to perform pre-compliance date testing
- 21% plan to increase supervisory, compliance, and risk management personnel
- 75% plan to implement technology-enabled solutions to help support/evidence compliance
- 60% plan to implement technology-enabled solutions to help detect potential violations
- 10% of survey participants selected **all of the above** steps, as their response and also noted instituting a framework to identify violations and issue disciplinary actions for the same as an additional step

[18] This chart does not represent four Firms that responded to the question, "What is your Firm's platform architecture?" with "other", therefore only representing responses provided by the remaining 44 Firms.
[19] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Compliance Obligation, SEC, 2019.

The chart below details the actions that will be taken in response to the Compliance Obligation by Firm size.



Implementation challenges

Survey participants ranked obligations under the Reg BI Rule Package that they expect will present the greatest implementation challenges and those that will require the most technology-enabled uplift/effort. The obligations were ranked on a scale of 1-6 where, 1 presents the greatest implementation challenge and 6 presents the least implementation challenge and 1 requires the most technology-enabled uplift/effort and 6 requires the least technology-enabled uplift/effort.

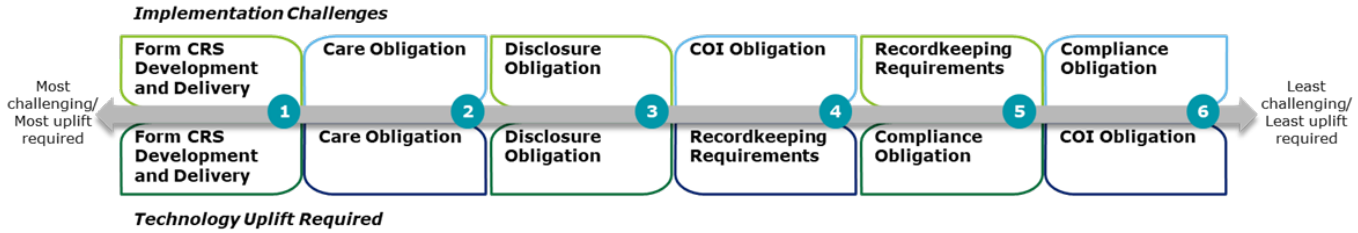


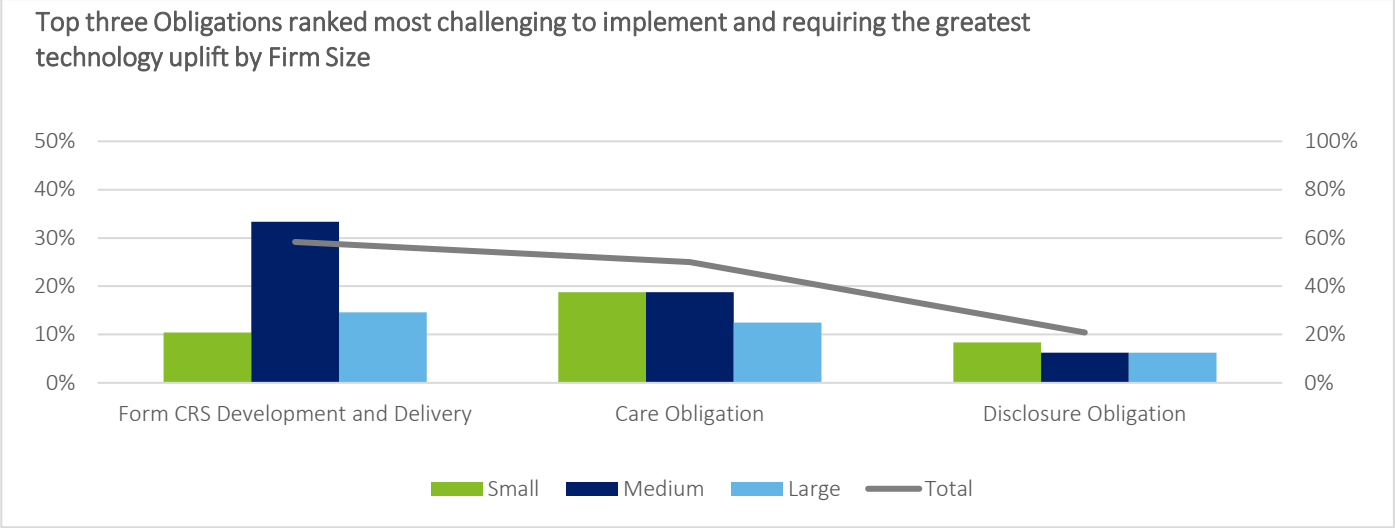
Figure 5. Obligations ranked by level of implementation challenge and amount of technology effort required

Approximately 47% of survey participants ranked the requirements related to **Form CRS Development and Delivery** as the most challenging to implement, and 68% of those also agreed that implementing Form CRS will require the greatest technology-based uplift. A deeper dive into the implementation requirements for Form CRS indicated that approximately 38% of survey participants ranked implementation of timing of delivery,

tracking of delivery, and mode of delivery as equally challenging, while 74% ranked ongoing updates to Form CRS as the least challenging.

Just under 32% of survey participants agreed that challenges related to implementation of the **Care Obligation** pose implementation challenges and will also require significant technology-based uplift. Under the Care Obligation, broker-dealers must exercise reasonable diligence, care, and skill when making a recommendation to a retail customer.[20,21]

The **Disclosure Obligation** was ranked as the third most challenging obligation to implement among the top three by 21% of the survey participant population.



In considering specific recommendation types, survey participants said they anticipate evidencing compliance with Reg BI requirements for certain recommendation types will be more challenging than others, e.g., 31% of survey participants, 90% of which were dual registrants, agreed that **implicit hold recommendations**[22] will be the most challenging to evidence compliance with the Reg BI Rule Package, followed by **explicit hold recommendations**[23] at 29%. Other recommendation types include account type, rollover, hire me, series of recommendations, and investment strategy

[20] Under the Care Obligation, broker-dealers must exercise reasonable diligence, care, and skill when making a recommendation to a retail customer to: understand potential risks, rewards, and costs associated with recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers; have a reasonable basis to believe the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the interest of the broker-dealer ahead of the interest of the retail customer; and have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile. Whether the broker-dealer has complied with the Care Obligation will be evaluated as of the time of the recommendation (and not in hindsight).

[21] Please refer to the SEC Reg BI Small Entity Compliance Guide, 2019 for additional information.

[22] "For the purposes of Regulation Best Interest, implicit hold recommendations are generally recommendations of "not to buy, sell or exchange assets pursuant to [a] securities account review … at the time agreed upon monitoring occurs…." *Regulation Best Interest*: The Broker-Dealer Standard of Conduct, Compliance Obligation, page 83, SEC, 2019.

[23] An explicit hold recommendation refers to an explicit recommendation to hold assets or continue to use existing investment strategies involving securities.

recommendations. Approximately 40% of survey participants responded that evidencing compliance with the relevant requirements[24] **for hire me recommendations** would be challenging.

More than 70% of survey participants ranked recordkeeping as the least challenging requirement and believe it requires the least technology-based uplift compared to other requirements under the Reg BI Rule Package. This may be largely attributable to the fact that recordkeeping processes have evolved and matured over the years in response to various regulatory requirements and the need to scale as businesses grow.

Talent strategy

Although there was general agreement that the staff needed for readiness efforts is greater than the staff needed to maintain a sustainable compliance program, talent strategies employed by survey participants vary. As such, 67% of Firms have not earmarked funding for a people strategy for readiness efforts while 13% were generally undecided on their overall people strategy, i.e., funding and resource allocation.

46% of survey participants responded that they would **use existing staff** for readiness efforts. Reallocated resources of existing staff will primarily be dedicated to the design of a target-state operating model which includes enhancing processes and controls and enhancing technologies to support business model and operational changes.

Engaging professional services firms and incremental full-time staff will contribute approximately $8 million to readiness costs, i.e., 34% of the total funding indicated for survey participants' people strategies. Survey participants that will or already have **engaged professional service firms** indicated they will prioritize impact assessments and gap analyses as well as technology enhancements, while the 19% of survey participants that responded they will add incremental full-time staff will do so in the areas of supervision, compliance, and risk management.

Generally, the survey sought to assess which types of activities would require the greatest amount of resources to prepare firms for the compliance date of June 30, 2020; approximately 38% and 36% of survey participants ranked the implementation of new/enhancements to existing technologies and the enhancements to processes and controls to support business model and operational changes, respectively, as the readiness efforts requiring the greatest amount of resources.

At least 27% of survey participants have considered allocating funding to staffing needs after the June 30, 2020, compliance date.

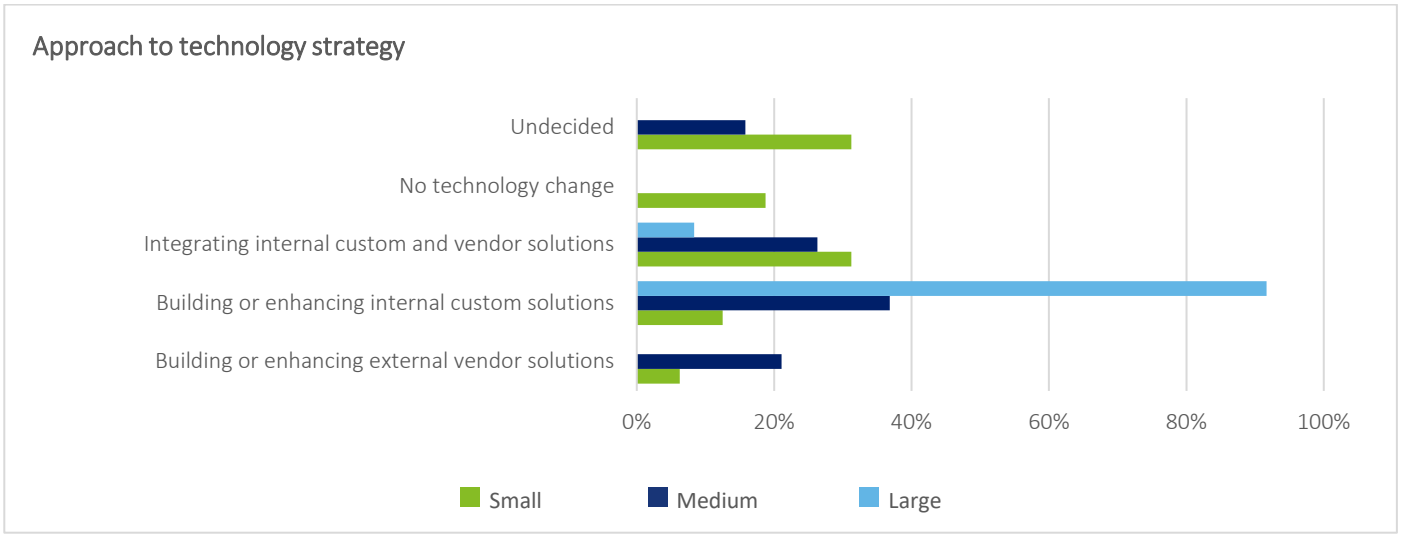
Technology strategy

Technology will play a significant role in survey participants' efforts to prepare for ongoing compliance with the requirements of the Reg BI and the Form CRS disclosure and filing requirements. A multitude of processes and system applications that span the wealth management life cycle such as account onboarding, customer relationship management and trading, supervision and compliance surveillance, etc. will implement

[24] Indicated prior to the release of the *Frequently Asked Questions ("FAQ") on Regulation Best Interest*, SEC, 2020

technology-enabled solutions to help support/evidence compliance with the requirements of Reg BI. Although survey participants expect to spend an aggregate of close to $62 million on technology enhancements by June 30, 2020, based on the survey responses reviewed, their approach to technology will vary.

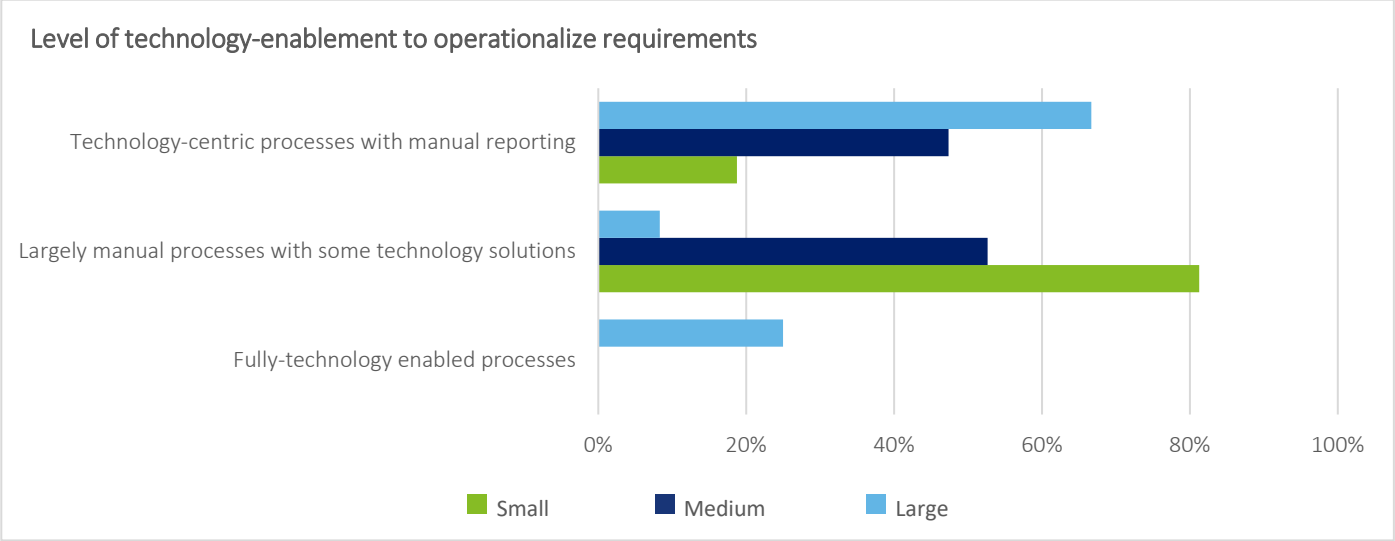
Approximately 77% of survey participants plan to adopt a technology strategy that either includes building or enhancing internal or external custom solutions or integrating both internal and external solutions, with 92% of Large Firms leaning towards building or enhancing internal custom solutions.



A summary of technology-based enhancement plans among survey participants follows:

- 42% of survey participants plan to utilize technology-centric processes with manual reporting
- 50% of survey participants plan to use manual processes, along with some technology solutions
- 6% of survey participants plan to implement fully technology-based processes

81% of Small Firms, 53% of Medium Firms and 8% of Large Firms are leaning towards utilizing largely manual processes with some technology solutions, while 25% of Large Firms said they would use solutions that are fully enabled by technology.



Approximately 17% of survey participants remain **undecided** on their technology strategy, while 6% of survey participants **currently do not plan to implement** any technology changes as a result of the Reg BI Rule Package and will use manual processes with some technology-based solutions.

Survey participants agreed their **account onboarding systems** and **customer relationship management systems** will require the most effort as they seek to operationalize business model and operating model decisions. Supervision and surveillance systems, disclosure technology and compensation systems were also top of mind and expected to require significant changes.

Approximately 29% of survey participants have considered allocating funding to technology after the June 30, 2020, compliance date.

Cost of compliance

Of the 48 survey participants, 42% or 20 Firms, comprised of eight Small Firms, four Medium Firms and eight Large Firms provided responses to the question, "Please provide the anticipated/budgeted annualized spend for readiness to comply with the rule by June 30, 2020 and expected future annual cost of compliance as they relate to people, process, and technology." A summary of their responses follows.

Costs associated with readiness

Readiness for the Reg BI Rule Package compliance date will require significant investment in people, processes, and technology, primarily driven by the following:

- Implementing or enhancing **systems** required for the Reg BI Rule Package
- Establishing or enhancing **processes** to operationalize the Reg BI Rule Package
- Incrementally hiring full-time **employees** to support ongoing processes for the Reg BI Rule Package

The 20 Firms noted above indicated that they have committed an aggregate of just under $114 million toward readiness efforts. Although costs associated with readiness varied greatly amongst survey participants, the median current spend was approximately $3.28 million.

More than 54% of current costs, i.e., $61.56 million, were attributed to technology enhancements, and 12 of these Firms account for the largest current spend, i.e., between $2 million and $9 million. These Firms appear to be prioritizing the operationalization of the Care Obligation and are focused on providing Financial Advisors with the tools necessary to research and compare available product alternatives and document best interest rationale.

About 20% of current costs are attributed to Firms' talent strategy, and 8% of survey participants account for the largest current spend, i.e., between $1 million and $7 million. These Firms appear to be utilizing a mix of existing staff and incremental full-time staff for the purposes of designing a target-state model and implementing new or enhanced technologies.

The remaining 26% of current costs are attributed to Firms' efforts related to operational enhancements across various wealth management activities. These include but are not limited to, developing or enhancing policies and procedures, disclosure delivery and management, compliance and supervision processes, and training.

Costs associated with ongoing compliance

Being able to maintain a sustainable framework is essential to ongoing compliance after the Reg BI Rule Package's compliance date of June 30, 2020. The 20 Firms noted above indicated that they have committed funding for ongoing compliance. The aggregate expected annualized spend across these 20 firms, which indicated funding for ongoing

compliance, is $59 million or an average annual spend of over $2.9 million per firm. Overall, survey participants' responses suggest that Firms expect to reduce spending after the compliance date of June 30, 2020, by almost 48%, i.e., current annual spend of $114 million versus anticipated annualized spend of $59 million.

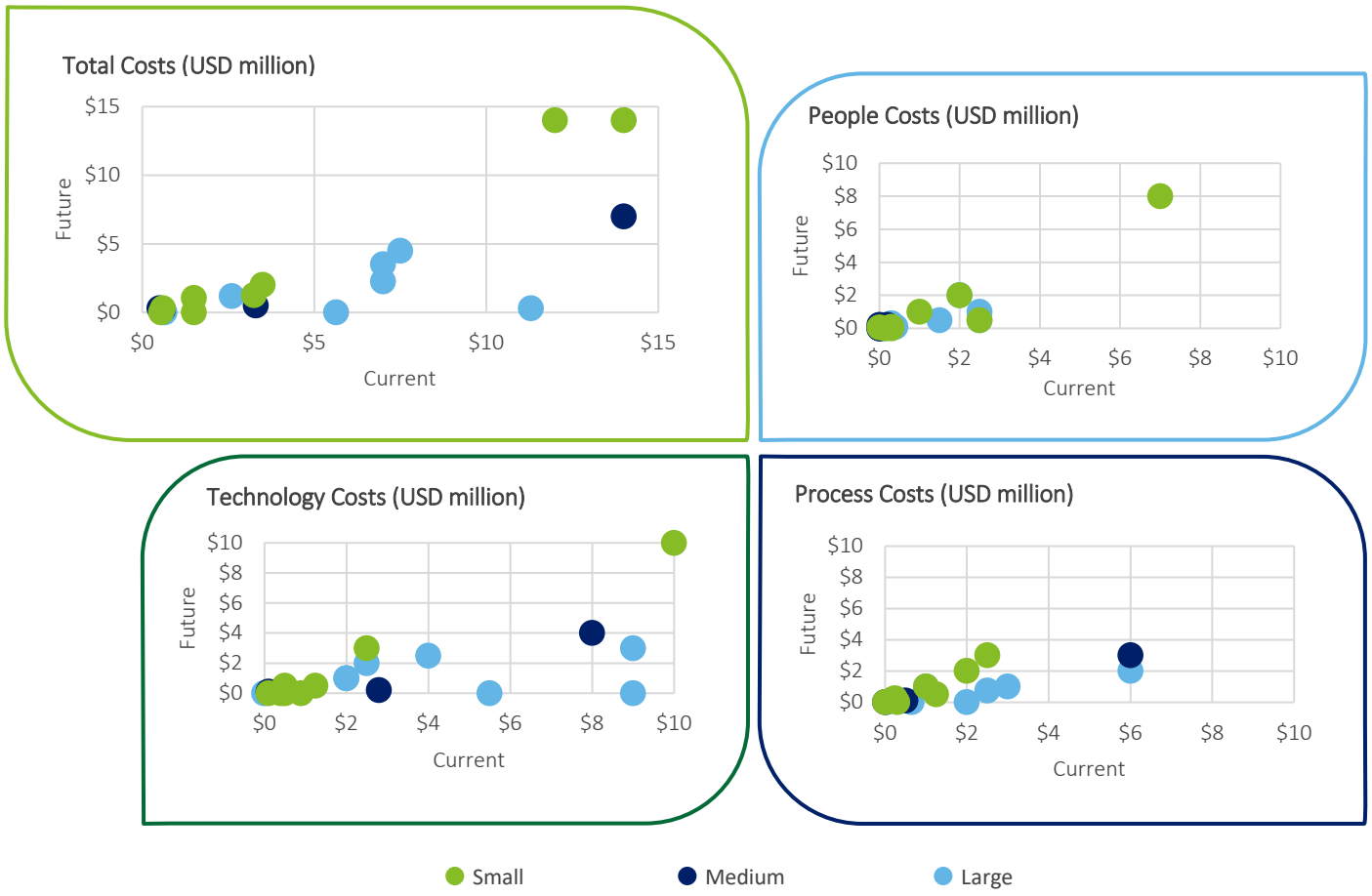


Figure 6. Anticipated/budgeted annualized spend for readiness and expected annual future costs across people, process, technology and total in USD millions

Estimated total costs for the industry

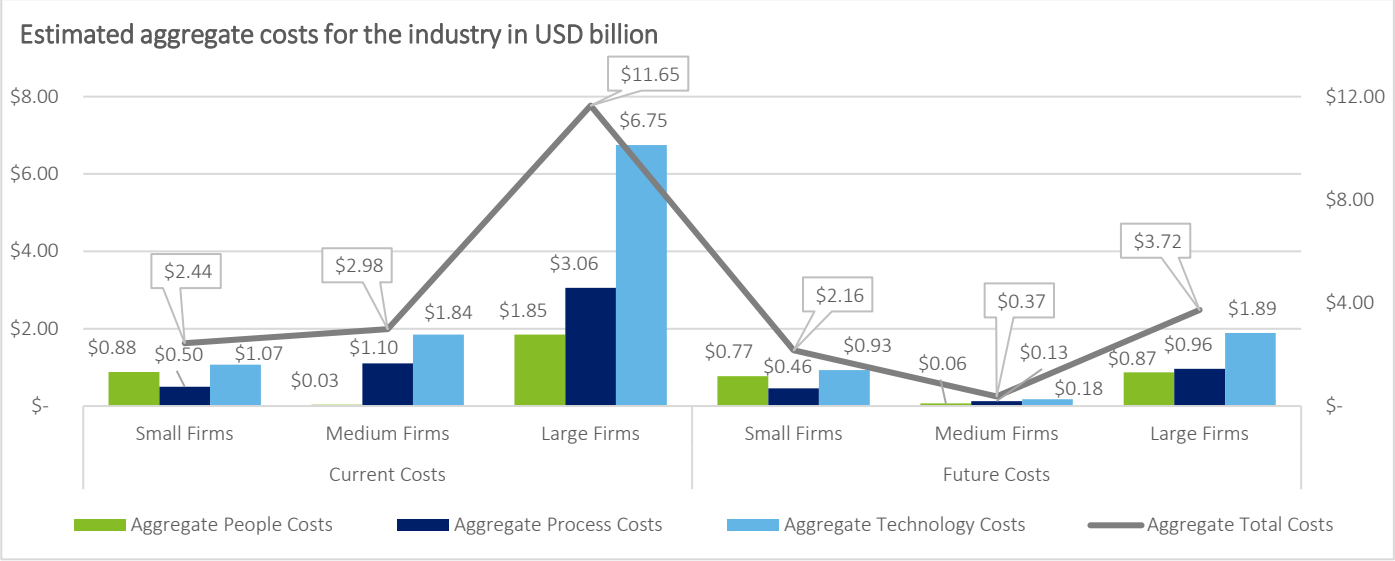
In order to understand the potential aggregate costs to the broader industry, Deloitte applied the following methodology to harmonize the categorizations of Firm size as defined in the adopting release[25] and those which were utilized in this report (see section *Survey participant composition*).

- The adopting release categorizes[26] broker-dealers with greater than 500 Financial Advisors as "large broker-dealers" and broker-dealers with less than 100 Financial Advisors as "small broker-dealers". Deloitte has categorized Large Firms as Firms that have more than 5,000 Financial Advisors and greater than 100,000 retail brokerage

[25] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, SEC Release No. 34-86031, adopting Rule 15l-1 under the Exchange Act.
[26] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, page 666, SEC, 2019.

and/or fee-based accounts, Small Firms as Firms with less than 500 Financial Advisors and less than 100,000 retail brokerage and/or fee-based accounts, and therefore all other Firms were considered as Medium Firms, resulting in the survey participant population to comprise of 18.75% Small Firms, 22.92% Medium Firms, and 58.33% Large Firms.

- Next, the number of survey participants that responded to the questions on costs were adjusted using the proportions of the size categorizations above and the population of broker-dealers as defined in the release, i.e., 2,766. This resulted in eight Small Firms, four Medium Firms and eight Large Firms[27], which were then multiplied by cost weightings of $64.83, $158.47, and $201.68, respectively.
- The average current and future costs for Small, Medium, and Large Firms across people, process, and technology were multiplied by the weightings derived above to find the total population expenditure.



The aggregate up-front costs for the industry are estimated at approximately $17.07 billion, while the aggregate annualized spend is estimated at approximately $6.25 billion. These aggregates are across people, process and technology.

[27] Complete responses for only 20 out of 48 survey participants were received for the question, "Please provide the anticipated/budgeted annualized spend for readiness to comply with the rule by June 30, 2020 and expected future annual cost of compliance as they relate to people, process, and technology."

Concluding thoughts

The business and operating model decisions taken by Firms vary in scope and nature, but the collective results will have a lasting impact on the investment choices for retail investors.

Operational decisions to support ongoing compliance with the requirements of the Reg BI Rule Package will require fundamental changes to processes, enabling technology, and the supporting controls framework. Substantial investments in a Firm's talent and technology strategies have been made to support readiness efforts. Funding commitments to support ongoing compliance after June 30, 2020 fall as Firms will reap the benefits of up-front investments made for Reg BI Rule Package readiness.

Strengthening policies, procedures, and developing a robust training program are essential to supporting and being able to evidence ongoing compliance with requirements of the Reg BI Rule Package, specifically the principles-based nature of the General Obligation and its core obligations. A Firm's policies, procedures and training should be tailored to support the approach the Firm has taken to operationalize the requirements of the Reg BI Rule Package.

The shifts made across the industry will be fundamental to the wealth management paradigm as it exists today. Although much of the focus and effort is geared towards readiness for June 30, 2020, the approach taken after the compliance date will be refined in the weeks and months that follow.