# Quinte Financial Technologies | FinTech Solutions

**Assignment on**

**BASEL III, SECURITIES AND EXCHANGE COMMISSION,**

**DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT**

**AND SARBANES-OXLEY ACT (SOX)**

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Table of Contents

[Basel III 3](#_Toc169194474)

[Securities and Exchange Commission 6](#_Toc169194475)

[Dodd-Frank Wall Street Reform and Consumer Protection Act 9](#_Toc169194476)

[Sarbanes-Oxley Act (SOX) 13](#_Toc169194477)

# Basel III

Basel III is the third Basel Accord, a framework that sets international standards for bank capital adequacy, stress testing, and liquidity requirements.

Basel III aims to strengthen the requirements in the Basel II regulatory standards for banks. In addition to increasing capital requirements, it introduces requirements on liquid asset holdings and funding stability, thereby seeking to mitigate the risk of a run on the bank.

**Key Components of Basel III**

1. **Capital Requirements and buffers:**

Regulatory capital consists of:

* + Common Equity Tier 1 – common shares, retained earnings and other reserves.
  + Additional Tier 1 – capital instruments with no fixed maturity.
  + Tier 2 – subordinated debt and general loan-loss reserves

Minimum:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | CET-1 | AT-1 | T-2 | Total |
| (As of 2015) | 4.5% | 1.5% | 2% | 8% |

Buffer:

|  |  |  |  |
| --- | --- | --- | --- |
|  | CET-1 | Total | |
|  | Additional | Minimum | Buffer |
| Capital Conservation Buffer | +2.5% | 8% | 10.5% |
| Countercyclical Buffer | +2.5% | 8% | 10.5% |

1. **Leverage Ratio:**

Introduced as a non-risk-based measure to complement the risk-based capital requirements. Minimum Requirement: 3% of the bank's total exposure (total assets and off-balance sheet exposures).

However, there have been discussions and implementations in various jurisdictions to impose higher leverage ratio requirements for globally systemically important banks (G-SIBs) to further enhance their resilience.

The leverage ratio buffer for each G-SIB will be set at 50% of its risk-based capital buffer.

For example, a bank with a 2% risk-based buffer will have a 1% leverage ratio buffer and so will be expected to maintain a leverage ratio of at least 4%.

1. **Risk Management and Supervision:**

**Original Basel III Requirements:**

* + **Risk Management**: Emphasized enhanced risk management practices to better identify, measure, monitor, and control risks.
  + **Supervision**: Strengthened the supervisory review process to ensure that banks maintain adequate capital and liquidity levels.

**Current Implementation:**

* + Banks are required to implement robust risk management frameworks covering all significant risks, including:
    - credit risk
    - market risk
    - credit valuation adjustment risk
    - operational risk
  + **Stress Testing**: Regular stress tests are mandated to assess banks' resilience under adverse economic conditions.
  + **Internal Capital Adequacy Assessment Process (ICAAP)**: Banks must regularly evaluate their capital adequacy relative to their risk profile.
  + Supervisors actively engage with banks to ensure compliance and take corrective actions as necessary. This includes periodic on-site inspections and off-site monitoring.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
| Output Floor | 50% | 55% | 60% | 65% | 70% | 72.5% |

**3. Liquidity Requirements:**

* **Liquidity Coverage Ratio (LCR):**
  + **Original Basel III Requirements:**
    - **LCR**: Requires banks to hold sufficient high-quality liquid assets (HQLA) to cover total net cash outflows over a 30-day stress period.
    - **Minimum Requirement**: Initially set at 60% in 2015.
  + **Current Implementation:**
    - The LCR requirement is fully implemented at 100%. Banks must maintain HQLA equivalent to 100% of their net cash outflows over a 30-day period.
* **Net Stable Funding Ratio (NSFR):**
  + - **NSFR**: Ensures banks have stable funding to support their activities over a one-year time horizon.
    - The NSFR requirement is fully implemented at 100%. Banks must maintain a stable funding structure to match their long-term asset profiles.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2017** | **2018** | **2019** |
| **Liquidity Coverage Ratio** | 80% | 90% | 100% |
| **Net Stable Funding Ratio** | 100% | | |

# Securities and Exchange Commission

The U.S. Securities and Exchange Commission (SEC) is an independent agency of the United States federal government, created in the aftermath of the Wall Street Crash of 1929. It is responsible for overseeing the securities industry in the United States.

The SEC's regulations are designed to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The primary purpose of the SEC is to enforce the law against market manipulation.

The SEC is headed by five commissioners who are appointed by the president, one of whom is designated as chair. Each commissioner's term lasts five years. The current SEC chair is Gary Gensler, who took office on April 17, 2021.

The SEC consists of five divisions and 23 offices. The five divisions and their respective roles are:

**Key SEC Regulations**

1. **Securities Act of 1933**
   * **Purpose**: To ensure transparency in financial statements so investors can make informed decisions.
   * **Key Provisions**: Requires companies to file a registration statement and prospectus, providing detailed information about the company's operations, financial condition, and management.
2. **Securities Exchange Act of 1934**
   * **Purpose**: To regulate the secondary trading of securities (stocks, bonds, and debentures) in the United States.
   * **Key Provisions**:
     + **Creation of the SEC**: Established the SEC to enforce federal securities laws.
     + **Periodic Reporting**: Companies with publicly traded securities must file periodic reports (Forms 10-K, 10-Q, and 8-K) to disclose financial and other significant information.
     + **Insider Trading**: Prohibits insider trading and mandates disclosures by officers, directors, and principal stockholders.
3. **Investment Company Act of 1940**
   * **Purpose**: To regulate the organization of investment companies and the activities they engage in.
   * **Key Provisions**: Requires investment companies to register with the SEC and adhere to regulations that ensure transparency and fairness.
4. **Investment Advisers Act of 1940**
   * **Purpose**: To regulate the actions of investment advisers and ensure they act in the best interests of their clients.
   * **Key Provisions**: Requires investment advisers to register with the SEC and adhere to fiduciary standards.
5. **Sarbanes-Oxley Act of 2002**
   * **Purpose**: To protect investors from fraudulent financial reporting by corporations.
   * **Key Provisions**:
     + **Enhanced Financial Disclosures**: Requires top management to certify the accuracy of financial information.
     + **Internal Controls**: Mandates the implementation of strong internal controls over financial reporting.
     + **Public Company Accounting Oversight Board (PCAOB)**: Created to oversee the audits of public companies.
6. **Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010**
   * **Purpose**: To prevent the excessive risk-taking that led to the financial crisis of 2008.
   * **Key Provisions**:
     + **Consumer Protection**: Establishes the Consumer Financial Protection Bureau (CFPB).
     + **Volcker Rule**: Limits the types of speculative investments banks can engage in.
     + **Whistleblower Program**: Provides incentives for individuals to report securities violations to the SEC.
7. **Regulation Best Interest** 
   * **Purpose**: To enhance the standard of conduct for broker-dealers and associated persons when making recommendations to retail customers.
   * **Key Provisions**: Requires broker-dealers to act in the best interest of their clients and disclose any conflicts of interest.

* **Enforcement Actions**: In 2021, the SEC filed 697 enforcement actions, resulting in $3.9 billion in penalties and disgorgements. This underscores the SEC's active role in policing securities markets.
* **Market Oversight**: The SEC oversees more than $110 trillion in securities trading annually, covering millions of transactions and thousands of market participants.
* **Investor Protection**: Through its Office of Investor Education and Advocacy, the SEC helps investors understand their rights and provides resources to avoid fraud.

# Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act, often referred to simply as Dodd-Frank, is a comprehensive piece of financial reform legislation passed in 2010 in response to the financial crisis of 2007-2008. It aimed to reduce risks in the financial system, enhance transparency, and protect consumers.

**Key Provisions of Dodd-Frank**

1. **Consumer Financial Protection Bureau (CFPB)**
   * **Purpose**: To protect consumers from unfair, deceptive, or abusive practices and ensure they have access to accurate information for making financial decisions.
   * **Functions**: Regulates financial products and services, enforces consumer protection laws, and provides financial education.
   * Since its inception, the CFPB has handled over 2.6 million consumer complaints and secured more than $12 billion in relief for consumers as of 2021.
2. **Volcker Rule**
   * **Purpose**: To prevent banks from engaging in proprietary trading and from owning or sponsoring hedge funds and private equity funds.
   * **Impact**: Limits risky activities by banks that could pose a threat to the financial system.
   * Banks have significantly reduced their proprietary trading activities. For example, the top six U.S. banks reduced their trading assets from $500 billion in 2008 to around $150 billion by 2019.
3. **Financial Stability Oversight Council (FSOC)**
   * **Purpose**: To identify and monitor systemic risks to the financial system.
   * **Functions**: Coordinates regulatory efforts among different financial regulatory agencies and makes recommendations to reduce risks.
   * The FSOC has designated several non-bank financial institutions as systemically important financial institutions (SIFIs), subjecting them to enhanced oversight.
4. **Orderly Liquidation Authority**
   * **Purpose**: To provide a mechanism for the federal government to liquidate failing financial institutions in an orderly manner.
   * **Impact**: Aims to prevent the collapse of large, interconnected financial institutions from destabilizing the entire financial system.
   * While no major financial institution has been liquidated under this authority, the presence of the mechanism provides a credible backstop.
5. **Enhanced Regulation of Derivatives**
   * **Purpose**: To bring transparency and reduce risk in the over-the-counter derivatives market.
   * **Provisions**: Requires standardized derivatives to be traded on exchanges and cleared through central counterparties.
   * As of 2020, approximately 90% of new interest rate derivatives and 80% of new credit default swaps are centrally cleared, significantly reducing counterparty risk.
6. **Increased Capital and Liquidity Requirements**
   * **Purpose**: To ensure that banks have enough capital and liquidity to withstand financial stress.
   * **Impact**: Enhances the resilience of financial institutions.
   * U.S. banks' Common Equity Tier 1 (CET1) capital ratios have increased from an average of 5.5% in 2008 to over 12% in 2021.
7. **Credit Rating Agency Reform**
   * **Purpose**: To improve the accuracy of credit ratings and reduce conflicts of interest.
   * **Provisions**: Requires more transparency and accountability in the rating process.
   * The SEC has increased its oversight of rating agencies, leading to several enforcement actions and fines for misconduct.
8. **Investor Protections**
   * **Purpose**: To enhance protections for investors.
   * **Provisions**: Improves disclosure requirements and strengthens the fiduciary duties of investment advisers.
   * Enhanced disclosure requirements have improved transparency, and the fiduciary rule for investment advisers (though partially rolled back) has set higher standards for financial advice.
9. **Office of Financial Research (OFR)**
   * **Purpose**: To support the FSOC by collecting data and conducting research on systemic risk.
   * **Impact**: Enhances the ability to identify and respond to emerging risks.
   * The OFR has published numerous reports and data sets on systemic risk, contributing to better-informed policy decisions.

**Integration and Comparison**

When integrating and comparing the provisions and their impacts:

1. **Consumer Protection and Transparency**
   * The establishment of the CFPB has provided significant relief to consumers, highlighting the effectiveness of focused consumer protection. The data showing billions in relief underscores its impact.
   * Enhanced disclosure and fiduciary requirements for investment advisers have similarly aimed to protect investors, though the impact has been somewhat mitigated by regulatory rollbacks.
2. **Risk Reduction and Market Stability**
   * The Volcker Rule and derivatives reforms have substantially reduced risky trading activities and improved market stability. The significant reduction in proprietary trading assets and the increase in centrally cleared derivatives illustrate these improvements.
   * Increased capital and liquidity requirements have made banks more resilient, as evidenced by the higher CET1 ratios, ensuring they can withstand financial stress better than before.
3. **Systemic Risk Oversight**
   * The FSOC and OFR have enhanced the ability to monitor and respond to systemic risks. The designation of SIFIs and the wealth of data produced by the OFR contribute to a more stable financial system.
   * The Orderly Liquidation Authority, although not yet tested in a major crisis, provides a crucial tool for managing the failure of large financial institutions without resorting to taxpayer-funded bailouts.
4. **Credit Rating Agencies**
   * Reforms targeting credit rating agencies have led to increased accountability, though the effectiveness can be variable. Enforcement actions and fines show progress, but ongoing vigilance is necessary.

The Dodd-Frank Act has brought substantial reforms to enhance consumer protection, reduce systemic risk, and improve the stability and transparency of the financial system.

# Sarbanes-Oxley Act (SOX)

The Sarbanes-Oxley Act of 2002, commonly referred to as SOX, is a U.S. federal law enacted in response to major corporate and accounting scandals, including those involving Enron, Tyco International, and WorldCom. The Act was designed to protect investors by improving the accuracy and reliability of corporate disclosures and increasing the accountability of corporate management.

**Key Provisions of SOX**

1. **Public Company Accounting Oversight Board (PCAOB)**
   * **Purpose**: To oversee the audits of public companies to ensure that audit reports are accurate and independent.
   * **Function**: The PCAOB registers audit firms, establishes audit standards, inspects audit practices, and enforces compliance.
2. **Corporate Responsibility**
   * **Section 302**: Requires senior corporate officers to certify the accuracy of the financial statements and disclosures.
   * **Section 404**: Mandates that management and external auditors establish and report on the adequacy of the company's internal control over financial reporting.
3. **Enhanced Financial Disclosures**
   * **Real-Time Disclosure**: Companies must disclose material changes in their financial condition or operations on a rapid and current basis.
   * **Off-Balance-Sheet Transactions**: Enhanced disclosures are required for off-balance-sheet arrangements and obligations.
4. **Auditor Independence**
   * **Non-Audit Services**: Prohibits audit firms from providing certain non-audit services to their audit clients to prevent conflicts of interest.
   * **Audit Partner Rotation**: Requires the rotation of the lead audit partner every five years.
5. **Corporate Fraud Accountability**
   * **Criminal Penalties**: Establishes harsher penalties for securities fraud, including longer prison terms and larger fines.
   * **Whistleblower Protections**: Provides protection for employees who report fraudulent activity.
6. **Analyst Conflicts of Interest**
   * **Purpose**: To reduce conflicts of interest between securities analysts and the companies they analyze.
   * **Provisions**: Requires disclosure of any potential conflicts of interest.

**SOX Impact:**

1. **Compliance Costs**: The costs of SOX compliance have been significant, particularly for smaller companies. A study by Protiviti in 2020 estimated the average cost of SOX compliance to be around $2.1 million per company, with smaller companies spending more relative to their size.
2. **Audit Quality and Financial Reporting**: Research indicates that SOX has led to improved audit quality and financial reporting. A study by the PCAOB found that the number of financial restatements by public companies decreased by more than 30% in the decade following SOX’s enactment.
3. **Market Confidence**: Investor confidence in U.S. financial markets increased post-SOX. A survey conducted by the Financial Executives International (FEI) showed that 83% of financial executives believe that SOX has helped to restore investor confidence.
4. **Internal Controls**: A survey by Audit Analytics found that the number of companies reporting material weaknesses in internal controls declined significantly from 16.2% in 2004 to 5.1% in 2018, reflecting improvements in internal control systems.

Thank You