

Methodology and scoring of financial regulators

CAPSTONE PROJECT SUMMARY

INTRODUCTION

Financial or brokerage regulators are either government or independent bodies and committees that control the activities of banks, brokerage companies, etc., they practically perform reviewing work, filtering out scammers and fraud activities. Their goal is to make sure everyone plays by the rules so that clients of brokerage and finance companies do not lose their money.

There are a lot of brokers in the market, and even part of them are not regulated. Regulated brokers regularly provide regulators with audited financial reports, maintain internal control and risk management procedures. On the other hand, unregulated brokers can perform in a way that they prefer, so choosing an unregulated broker considers significant risks for the clients' accounts including fraud. In this work we will mostly concentrate on the biggest regulators because they cover most of all brokerage platforms.

Our client is a fintech startup company which helps different investors, traders and individuals to find an online broker fitting to their needs. Our client uses near 500 criteria per broker for scoring them, and the final scores are based on their expertise and users' preferences.

In terms of our Capstone project, the client's goal is to cover brokers that regulated by at least one top-tier financial authority. The classification of regulators as top/mid/low-tier is not methodology-driven currently. Scoring and ranking financial regulators would bring more certainty and clarity for the client when selecting top-regulated brokers.

In this project we started work with the work-in-progress methodology from the client and tried to update and develop it in a methodology format with the opportunity to score our sample of regulators based on it.

There are different financial regulations for brokerage platforms in the world. The goal of the project - is an attempt to create a scoring methodology for these financial regulators and categorize them according to created approach.

Our expected final deliverables by the end of the project:

1. Written regulator scoring methodology in Word and Excel
2. Based on methodology, data is collected for major regulators & these regulators are scored
3. Classification (top/mid/low) of all relevant financial regulators

METHODOLOGY

Stage 1. Creating datapoints and data collection

For our scoring methodology we have chosen the following datapoints:

- Reporting and disclosure (how transparent the reporting schemes within the regulator is)
- Minimum capital requirements (how safe clients balances in case of bankruptcy of a broker)
- Cost of the license and performing brokerage platforms activity
- Average time to open a brokerage platform
- Security requirements (data protection, risk management etc)
- Corporate taxes
- Anti-money laundering (AML) procedures
- KYC (Know Your Client) requirements
- Staff requirements (Requirements regarding any staff specific skills, knowledge, structure)
- Advertising or risk warnings requirements
- Office location requirement

A	B	C	E	G	I	K	M	
#	Regulator	Comment	FCA Financial Conduct Authority	CySEC Cyprus Securities and Exchange Commission	BaFin Federal Financial Supervisor Authority	SEC/FINRA	ASIC Australian Securities and Investment Commission	
1								
17	1	Reporting and disclosure	Transparent (often reports)/Not transparent	- The financial statements and auditor's report should be completed no later than 4 months after the end of the financial year - annual anti-money laundering compliance report (no later than 3 months) - internal audit function's report (no later than 4 months)	periodic audit reports and other financial statements for continued monitoring of illegal financial activities - as of the end of each financial year and to publish it no later than four months after the end of the financial year	An ATS must file with the Division of Trading and Markets quarterly reports regarding its operations on Form ATS-R brokers should offer complete disclosure to its investors regarding the different factors that may affect the profitability of their investments.	should submit periodic audit reports to ensure that companies adhere to a strict code of conduct.	
18	2	Minimum capital requirements	Minimum required (operating) capital	125,000 €.	€200,000	125,000 €.	least \$250,000	AUD 1 Million in operating capital
19	3	Cost of the license and maintaining a brokerage platform	Cost (less is worse)	a fee from of €5,000	from €5,000	EUR 4,545 up to EUR 10,160.	from \$25,000 to \$55,000	2000\$ to 4000\$

Figure 1. How the methodology with the collected data per each regulator looks like

Stage 2. Scoring of financial regulators

In this stage we eventually convert the results to points for selected regulators based on our analytical and professional opinion:

	A	B	C	D	E	F	G
	Name	Description	FCA	CySEC	BaFin	FINRA	ASIC
2	General						
3	Number of regulated entities	The amount	50000	632	9750	3978	10000
4	Reporting and disclosure	This datapoint is aimed at how transparent the reporting schemes within the regulator is: "HIGH" "MID" "LOW"	HIGH	MID	HIGH	HIGH	MID
5	Average time to open a brokerage platform*	This datapoint is aimed at how fast can be opened a platform: "HIGH" "MID" "LOW"	HIGH	MID	MID	MID	MID
6		- The exact period	12 months	6 months	6 months	6 months	8 months
7	Fees						
8	Average costs	Cost of the license and performing brokerage platforms activity: "HIGH" "MID" "LOW"	MID	MID	HIGH	HIGH	MID
9		- Cost of the license	from €5,000	from €5,000	4,545€ up to 10,160€	\$25,000 to \$55,000	2000\$ to 4000\$
10		- Tax rate	19%	12,5%	15%	21%	25%
11	Safety measures						
12	Minimum capital requirements	This datapoint is aimed at how safe clients balances in case of bankruptcy: "HIGH" "MID" "LOW"	MID	MID	MID	MID	HIGH
13		- The exact amount	125,000 €	200,000 €	125,000 €	\$250,000	AUD 1 Million
14	Security requirements	This datapoint means how secure (data protection, risk management etc) the regulator is: "HIGH" "MID" "LOW"	MID	MID	HIGH	HIGH	MID

Figure 2. Summary with final scores per each regulator based on collected data