

# Regulations of financial markets course code

[Parts of the World, Asia](#)



Financial regulations are the laws and rules that tells the financial institutions such as brokers, banks, etc. can do. The main purpose of these regulations is to protect investors and maintain the financial stability. Setting the minimum standard for capital, investigating and punishing conduct and regular inspections are some of the regulatory activities. Example of regulations and its authorities are: The US Securities and Exchange Commission (SEC) was created in 1934 and now enforces American securities laws including the 1933 act that sets standards for securities, the 1940 Investment Companies Act. Finra is the US industry body that inspects and regulates broker-dealers under the oversight of the SEC. BaFin is the German financial regulator that supervises about 4, 000 banks, insurance firms and other financial services companies. (FINANCIAL TIMES, n. d.)

There are about 18 regulatory bodies in the Pakistan: the State Bank of Pakistan, the Securities and Exchange Commission of Pakistan, the Competition Commission of Pakistan, the Pakistan Electronic Media Regulatory Authority, the National Electric Power Regulatory Authority, the Oil and Gas Regulatory Authority, the Drug Regulatory Authority, the Civil Aviation Authority, the Pakistan Nuclear Regulatory Authority, the Pakistan Standards and Quality Control Authority, the Public Procurement Regulatory Authority, the Private Education Regulatory Authority, the Pakistan Medical and Dental Council, the Pakistan Engineering Council, the Pakistan Nursing Council, the Pakistan Tibbs Council, the Pakistan Veterinary Medical Council and the Pakistan Environmental Protection Agency. But all these regulatory bodies function directly under the government and those who man these bodies are also hired and fired by the government.

Financial sector is only concerned about financial institution transactions of the economy. They provide loan facilities, and act as intermediaries to use fund from saving others into investment uses. The financial sector should provide the following services: Value exchange: a way of making payments. Intermediation: a way of transferring resources between savers and borrowers. Risk transfer: a means for pricing and allocating certain risks. Liquidity: a means of converting assets into cash without undue loss of value.

Traditional economic theory suggests that there are three main purposes of financial regulations.

1. 1. to constrain the use of monopoly power and the prevention of serious distortions to competition and the maintenance of market integrity;
2. 2. to protect the essential needs of ordinary people in cases where information is hard or costly to obtain, and mistakes could devastate welfare;
3. 3. where there are sufficient externalities that the social, and overall, costs of market failure exceed both the private costs of failure and the extra costs of regulation.

We regulate finance over and above the way we regulate other industries because finance exhibits market failures that can have devastating consequences. When financial markets malfunction seriously, the real economy takes a nosedive". The financial crisis started after the problem of US sub prime mortgage market and the German GDP fell by 6%. Many

people said that the bigger the boom, the bigger the fall will be. Regulators said that it may be easier to manage the crisis by pricking a bubble whose dimensions were uncertain. After the financial crashes, recessions are mostly severe, painful and long. Hence, these are hard to manage as the policymakers are surrounded by the fog of war. Because each banker will claim that if they are not saved, then the entire financial system will fall apart, and some are right too. In financial crises, information about the market is scarce, rumors are plentiful and tax payers are angry. Crashes are best avoided or dampened, rather than managed. There are mainly two market failures in finance that require regulation: asymmetrical information and social externalities. There are other failures too. Principal-agent problems abound, but these are not so unique to finance

One of the vital functions of financial regulation is to match the interests of sophisticated sellers with the unsophisticated buyers. This regulation is carried out by rules on how the product is sold, what can be sold and who can sell it. This process of consumer protection involves differentiating the investors who are less vulnerable than vulnerable consumers. In the wholesale markets where the trade size and turnover are large, professional investors dominate while the individual rule in the retail exchange traded market where trade size and turnover are small. This differentiation is important because it showed how potential investors turned out during the crisis. One of the other reasons of financial regulations is because there are social externalities.

A social externality occurs when the overall consequence of an activity is not captured by the private interests of those involved in the activity. The classic

<https://assignbuster.com/regulations-of-financial-markets-course-code/>

social externality is pollution from a factory. The parties related to the sugar factory do not have to bear the costs of these pollution, hence they would likely increase the production which would eventually go above the social optimal level. The classic Pigouvian response to a social externality is to 'internalize' it through taxes. The sugar mill pays a tax scaled by the amount of pollution it produces, encouraging it to invest in pollution reduction. This will force the factory owners to reduce the production to the socially optimal level and those taxes can be used to favor those who suffer from the pollution.

One of the unique aspects of finance is that banks lend to banks. Bank A may borrow from Bank B to lend one of its customers a loan to buy a car from a customer of Bank B. Shoe shops do not lend to shoe shops. Therefore, the loss of one shoe shop can't determine loss for the other shoe shop but the banks are interrelated and hence one bank loss can affect the other bank. So, a single bank fails, and it can cause the market and the whole financial system to fail as well. Obviously, the cost of failure of one bank is nothing in front of the cost of failure of the financial system. Hence, this is also a social externality. Government insurance is often offered to the depositors against this externality as a regulatory measure. Furthermore, the government requires them to hold greater capital than they wish to hold to avoid moral hazard problem. However, this response only secures the individuals in the system but ignores the risks that rise from overall collective behavior of bank.

Some of the financial regulations in Pakistan are as follows: the technique that is trailed by the State Bank of Pakistan is multi-pronged i. e. to enhance the market structure and rivalry, to fortify the administration and hazard administration inside money related foundations, to develop enough budgetary framework and to add to sound macroeconomic administration through financial and conversion standard strategies. The fractional or uneven achievement in accomplishing the last objective especially over the most recent three years can be attributed to the shortcoming in the monetary arrangement. The means that have been taken to invigorate rivalry and enhance the market structure comprise of bringing down section obstructions, canceling loan fee roofs, privatizing government possessed banks, advancing mergers and solidification of budgetary organizations, extending the economies of extension for banks, changing bank spreading strategy and expelling direct credit controls.

In the domain of money related organizations reinforcing, impetus structure is designed to the point that the bank proprietors remain to make generous misfortunes in case of indebtedness emerging from intemperate hazard taking. Capital sufficiency prerequisites and credit misfortune arrangements satisfy this job. Constraining bank property of unnecessarily dangerous resources, averting loaning to related gatherings, requiring broadening and ensuring those banks have suitable credit examination, assessment and checking strategies set up are altogether determined by this thought.

Corporate administration code and best practices have been recommended for the banks by the SBP. Unfavorable determination in bank section is kept away from and the people liable to abuse bank don't get bank licenses. Fit

and legitimate criteria and character stipulations, budgetary back-up and past reputation are examined precisely for the controlling investors, chiefs of the sheets, CEOs and senior administration of the banks.

One of the positive advancements in Pakistan's monetary framework has been the development of the installment framework from the conventional money and paper-based methods of installments to a system of more complex, innovatively determined frameworks. " In spite of the fact that money keeps on being the overwhelming method of repayment of installments particularly in rustic zones, non-money methods of installments have expanded in Ishrat Husain 35 volume over time"

The saving money segment has put vigorously in IT foundation in the most recent decade that has brought about expanded acknowledgment of e-saving money as the favored retail installment instrument. As of end June 2010, the quantity of continuous on-line branches established 73 percent of aggregate bank offices and 31 percent of aggregate electronic exchanges. ATM-based exchanges are picking up ubiquity and now represent more than 50 percent of electronic exchanges. These electronic exchanges establish 33% of the aggregate exchanges and have developed by 22 percent contrasted with paper exchanges that developed at about a rate of 2 percent as it were. Essentially, the execution of the Real Time Gross Settlement (RTGS) framework by the SBP has encouraged mechanization of extensive esteem exchanges hence lessening the settlement hazard. The legitimate foundation in Pakistan anyway stays frail and is an obstruction to monetary segment development.

Changes and legitimate foundation and authorization are consequently fundamental. Last yet not the slightest is the macroeconomic awkward nature in monetary and outer records traversing over most recent three years that posture framework wide test to money related strength in Pakistan. Huge open area getting to fund budgetary shortages and additionally misfortunes of state-possessed ventures has added to the vulnerabilities of the managing an account framework. The pomposity of the banks who charge higher than market costs for exercises, for example, item financing have moved to generally safe weighted resources in their portfolio by loaning to the legislature and subsequently demonstrating higher capital ampleness proportions and bigger benefits could have genuine repercussions on monetary development, business, money related consideration and value dependability later. This is the sore point that has put the money related soundness most in danger. (Hussain, 2011)

To look out for problems caused by the financial regulations, we will consider examples from the 2008 financial crisis. The process has been coordinated by the Financial Stability Board, a G20 offshoot working closely with the Bank for International Settlements, that established earlier global financial-sector rules. Those pre-2008 rules were clearly deficient. Banks and other financial institutions didn't have enough capital to ride out the crisis. Voters were incensed that taxpayers' funds had to be used to bail out the financial fat-cats. So, the main purpose of these reforms was to increase the capital requirements of the banks and eliminate the previous game of the Basel rules so that banks (mostly in Europe) who were previously small and skinny



cannot operate with that level of capital. However, there are many internal conflicts in the global-rule making.

Just after the 2008 financial crisis, political will of root-and-branch reforms were generated through the anger of the public. But it takes time to sort out the technical details and Wall Street have been quite successful in steering the rule-making to avoid damaging either their franchise or their bottom line. Delay is the deadliest form of denial, and when public anger was less so the proposed rules started to fade away. Meanwhile, the deep-seated risks inherent in the financial sector have gone largely unaddressed.

In 2008 crisis, it was demonstrated that market response was the most crucial damaging risk instead of external events like housing bubble. Another problem occurs when investors try to overstate their balance sheet items. Since risk management is similar throughout the market hence every player reacts in the same way and market collapses because there are too few buyers and too many sellers. Prudential rules cause the banks to recapitalize at the time when the markets don't want to offer capital. These issues require the restructuring of the financial sectors and no one has the guts to do that. The continuing focus on risk-weighted capital requirements means the system is still vulnerable. Bond holders were treated differently than anticipated in 2008 crisis which contributed a lot in those crises. The problem was that instead of treating bond investor's funds to support the banks who were failing, they were paid back as if they were guaranteed depositors. It would be a painful political move to force the bond holders to write off their debts or bail them out and might have been a run in other

financial institutions. Because it was easier to pay out the bond holders even though this shifted the burden of the bank on the tax payers.

When Ireland's largest banks failed in 2009 the bondholders (mainly European banks) were left unscathed. Despite the apparent lesson here, the higher capital requirements specified by new rules are achieved by designating exactly this sort of bailing-in process for some bondholders. The new rules cause us to raise a question on a basic issue that do we really need global rules in the financial sector. Non-G-SIBs bank requires less capital, but their approach is also same. Every country will try to protect their national pride and hence they will apply prudential regulations and they will aim to implement new rules whether it answers the current circumstances. I believe that it's better that if you want to apply global rules then apply them on only these banks that pose a threat to the global economy. Different controllers, (counting most G20 nations) ought to have had a much clearer brief to set their own, more straightforward adaptations, more fitting to their conditions.

All things considered, equipped local supervision will do much more to maintain a strategic distance from emergencies than worldwide principles. So, would we be able to close this enormous exertion was a look for an answer for an issue that needn't bother with this high level of worldwide co-appointment? Even more vitally, are there higher-need territories which do, indeed, require all-inclusive uniform principles? Consider, for instance, another G20 plan thing: organization impose; or, in the language, base disintegration and benefit moving. This is a live issue for Australia, given the

vocal anteroom for bringing down organization impose. A portion of those pushing are, obviously, spurred by the straightforward individual want to make good on less government obligation. Yet, even unengaged eyewitnesses who need to advance a successful expense framework comprehend that capital is the most portable of assets; benefits will move to whatever nation has the least assessment rate.

Does this versatility embrace as unavoidable the present position where numerous outside multilateral organizations pay almost no assessment in Australia? At the danger of sounding guileless, there ought to be an option, where organizations make a reasonable commitment to the expenses of directing the economy in which benefits are earned. In any case, this can't occur without worldwide standards, decides that would need to explore the alternate points of view of vast, outside contributing nations and a capital merchant like Australia. We will require a decent universal procedure to get a reasonable result. If G20 can't viably address an issue this way, which unambiguously requires a worldwide arrangement, we should scrutinize its importance.

To control and keep away from further insecurity of the money showcase he State Bank of Pakistan interceded and made after strides, Injected around \$20-100 million in the cash advertise. Lowered the Statutory Liquidity Requirements (SLR) and Cash Reserve Requirement (CRR) from 34 % to 30% A pushed worldwide monetary down turn has seized Foreign Direct Investment (FDI) which saw a decay by 47. 5 % amid the time of July 2008 to April 2009 Most of this reduction was in the state of an out stream of private

portfolio venture adding up to US\$ 1 billion. Anyway, settlements made by abroad laborers stayed stable which were roughly US \$ 6. 4 billion. Amid the period under audit Pakistan couldn't raise assets from the capital markets abroad as whole world was at that point going through such uncommon and exceptional emergency. Truth be told Pakistan's presence was especially confined in the worldwide capital markets amid the said period especially in 2008-09.

Even though Pakistan has been intense with directions throughout the years, outrages and fakes have kept on happening. It appears anyway solid directions you put to control things, hoodlums discover a route past these shields. The Axact Scandal is a sparkling case of simply that. The organization masked itself as a Software business and even occupied with the business to some degree. Be that as it may, the principle business for Axact was offering counterfeit degrees. From fields like building, restorative, business organization and past, this organization was occupied with wrongfully orchestrating degrees for individuals for a robust expense. The organization representatives delighted in a Silicon Valley compose condition with swimming pools and indoor recreational focuses. Clearly the organization was profiting and with the set number of items that they had it been extremely abnormal that they were so productive. The administrative bodies for this situation, the SECP and even the FBR ought to have paid heed to the organization's shady exercises prior. It is apparent that directions must be set up to counteract tricks like these later. (Kartio)

To deal with a possible crisis in the future, we need to understand the fact that crisis occurred not because of liquidity but insolvency risks. Secondly, the requirement for bank capital is totally wrong and requires adjustments. Trillions and billions of dollars have gone in waste to save the liquidity crisis which was not the bigger issue. So, to prevent financial crisis soon, following regulations should be applied and adjusted. Increase capital requirements for shadow banks and depository institutions and make them countercyclical. Eliminate liquidity requirements. Instead, go for ways to solve insolvency risks. Improve consumer literacy and restrict consumer leverage. Design a more integrated regulatory structure. Focus on bank governance and culture. And, in response to issues. Temporarily resolve a financial crisis by imposing dividend restrictions and by providing government capital support that dilutes shareholders. Enforce greater consequences on executives of failing banks. Banks are restricted from potential growth because of these liquidity requirements like they should have a certain percentage of treasury funds, and cash and this prevents them from lending more to corporations and individuals.

To conclude, I agree that financial sectors should be regulated. Although they have worsened the situation in the past (financial crisis 2008) but if the markets and institutions are not regulated, there will be high chance of moral hazard and asymmetric information which will eventually lead to frauds and market collapse. On the contrary, the regulations should be studied practically, then hypothesis and afterwards they should be applied according to the current circumstances and situations of the market and not based on theoretical studies which are based on past trends.

**REFERNCES:**

1. 1. FINANCIAL TIMES. (n. d.). Retrieved from LEXICON: <http://lexicon.ft.com/Term?term=financial-regulation>
2. 2. FINDER-WUSTL, C. (2018, march 25). HOW WE CAN PREVENT ANOTHER FINANCIAL CRISIS. Retrieved from futurity: <https://www.futurity.org/financial-crises-regulation-insolvency-1712122/>
3. 3. Hussain, I. (2011). Financial Sector Regulation in Pakistan. 44. Kartio, M. A. (n. d.). Challenges Faced by Banking Industry of Pakistan during Global Financial Crisis (2008-12).
4. 4. MEHMOOD, M. (n. d.). Retrieved from CSSFORUMS: <http://www.cssforum.com.pk/off-topic-section/general-knowledge-quizzes-iq-tests/99947-there-about-18-regulatory-bodies-country.html>