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Feature Articles

This month's focus: **"How Financial Regulation Can Be Market Friendly"**

International financial regulations are still being tightened even seven years after the collapse of Lehman Brothers: the start of application of Basel Ⅲ to internationally active banks, the introduction of minimum total loss-absorption capacity (TLAC) to global systemically important banks (G-SIBs), tightening of restrictions on the scope of banks' risk-taking activities, and tightening of regulations on shadow banking. Given various international regulatory reforms as a whole, there is the revival of a trend toward tightening uniform regulations that directly restrict risk-taking activities and take a "command and control approach" toward financial institutions. It may have undesirable side-effects, such as increasing uncertainty in the bank management environment, constraints on economic growth, distortion of financial institutions' incentives, and a negative impact on market liquidity.

Global financial regulatory reform in response to the global financial crisis triggered by the Lehman shock has progressed to its current stage of implementation after having mainly been concerned with market regulations such as those affecting OTC derivative markets and prudential regulations on Systemically Important Financial Institutions (SIFIs), etc. It should be noted that market issues such as volatility are again being tackled as a present concern, and that financial inclusion, financial education, and consumer protection are seen as medium- to long-term challenges.

Policies to tighten financial regulations, introduced worldwide after the financial crisis, seriously impacted the business strategies of commercial banks and investment banks and led to dampening market transactions such as securities market making. In European and US securities markets, the liquidity of junk bonds and emerging market bonds with low creditability has already started to deteriorate. With the rise in the US policy interest rate and bond yield, some financial experts fear adverse effects on the real economy. In the securities market, the presence of non-banks, that face less stringent