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Leverage Regulations Work and Its Impact for the Stabilisation of Financial Systems

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Abstract

Banks are the most leveraged institutions in the world that have produced protection for the combination of "Federal Deposit Insurance Corporation (FDIC)" and "fractional-reserve banking". The primary purpose of this paper is to evaluate the leverage regulations work and the types of equipment that help in stabilising the financial system. Depending on the leverage ratio an individual bank can measure its total assets and core capital that help in protecting the bank from any kind of financial or economic crisis. Every individual financial sector generally follows some specific rules and regulations to maintain the financial flow. In this regard, utilising the microeconomic framework, the behaviour of banks can be understood. The researcher has selected the "secondary qualitative data collection method" to collect the data and information to lead the further study. In order to describe the collected sources in an understandable way "thematic technique" has been adopted. Preparing five themes in simple and understandable words, the paper has been made valuable for the readers. Moreover, this study paper will serve the readers with reliable and valuable information about leverage regulations work and their impact on the stabilisation of financial systems.

Keywords

Financial risk, financial system, Leverage Regulations Work, policies, security, and stabilization.

INTRODUCTION

Background of the study

Global financial stability risk has increased gradually which indicates the requirement for a proper financial management system. In this regard, leverage regulations work has a great contribution that is able to focus on current market conditions. In the majority of cases of financial systems, systemic issues have been highlighted that needs sustained market access by "emerging market borrowers". The financial stability risk involved ongoing policy support. Accompanied by leverage work regulation, the calculation can measure the risk of excessive leverage which is also helpful in leading economic sustainability. The leverage ratio is helpful in understanding the total rate of loans of any individual bank [1]. It can serve as a potential outcome in the case of banks lending out money borrowed by clients. In emerging weak fundamentals, rising rates, markets, and wide outflows have pushed up the cost of borrowed money which leads to the highest inflation. In this further study, all the factors associated with leverage regulations work and their impact on the stabilisation of financial systems will be evaluated in a clear manner.

Aim and objectives

The research paper aimed to discuss the role of leverage regulations work and their impact on the stabilisation of financial systems. The objectives of this paper are:

- To identify the relationship between leverage regulation work and financial management systems
- To understand the impact of leverage regulations work for the stabilisation of financial systems
- To evaluate the factors that influence the process of leverage regulations work
- To recognise both advantages and disadvantages of leverage regulations work for financial stability

Significance of the study

Observing the current financial stability risks, establishing a "forward-looking monitoring program" is highly essential. Depending on this, all the track of the sources of systematic risk can be identified well. In this segment, leverage regulations work is helpful as financial growth can be possible by protecting by implemented regulations. Thus, banking regulations for leverage ratios have been identified as very complex. The ratio varies depending on the different leverage ratios by the bank. In order to measure an individual bank's solvency risk "the z-score" is the common measure tool that compares risk with buffers. Due to protecting the risks associated with financial stability, changing regulations in leverage ratio has been considered essential. Emerging markets and increasing the level of the economy needs remarkable climate financing to adopt perfect leverage regulations in future research.

METHODS

Research philosophy

The research philosophy has a great impact on generalising the relevant data that is important in leading any research study. In this study, an ***"interpretivism research philosophy"*** has been selected as it is useful for this particular study. It is connected with the specific principles that are able to state the research performance by observing the social world [2]. Thus, there are other philosophies are existed, interpretivism

philosophy can focus on the primary meaning of the research topic and is also able to personnel multiple methods depending on a variety of present issues in the paper.

Research approach

In this particular study, an ***"inductive research approach"*** has been proved as a useful methodological tool. It is capable of drawing a meaningful conclusion after analysing all over the study process. Thus, this research approach is also called "bottom-up reasoning" as it focuses on the total community connected with the research topic [3]. This is also applicable for complete observation and measuring the exact pattern of the research process that is associated with this particular study. As it is able to generate the conclusion after observation, the result becomes reliable.

Research design

Researcher design is identified as the guideline for collecting the data and information. An ***"exploratory research design"*** has been adopted in leading this study as it is able to understand the depth of the research study [4]. It is also applicable for generating issues in the research topic and increasing the variety of options to implement the ways of collecting data and resources.

Inclusion and exclusion criteria

In order to make the outcome better, inclusion and exclusion criteria help to filter the resources that are valid for the research paper [5]. In the inclusion criteria, all the data and information have been evaluated from the journals that are published from 2018 to 2022. In addition, it also has been noticed that all the journals must be in the English language which can understanding by all. All the data have been collected from reliable and authentic sources such as newspaper articles, books, journals, websites, and other online resources. Apart from this, the researcher has excluded all the data and resources that are gathered from doctoral dissertations.

Data collection technique

The researcher has chosen the ***"secondary qualitative data collection technique"*** which is helpful to meet the objectives of this research paper. This technique is useful for saving time and money as these have already existed. Secondary resources are the efforts of other researchers that are generally authentic and give reliable information [6]. In this study, newspaper articles, journals, books, websites, and other online resources have been used to make the paper informative. All the journals have been selected from 2018 to 2022 as they can serve fresh data.

Data analysis technique

Data analysis is another important part of any research as it helps to make the paper understandable for the readers. In this study, a ***"thematic analysis"*** has been adopted to interpret all the collected data. It offers a more attainable form of analysis that is easy to make a proper research process [7]. As it does not require technical knowledge to operate, for the secondary data it has been considered the best option.

RESULTS

Theme 1: Role of Leverage Regulations for financial sectors

The current global financial crisis has indicated the ***"Basel Committee on Banking Supervision (the Basel Committee)"*** to connect in an exhaustive reform of "financial regulations". In the banking sectors, focusing on regulation arbitrage is important as "illiquid assets" in trading account needs a proper risk assessment process [8]. From both empirical and theoretical perspectives, the role of leverage regulations is recommendable. Accompanied by the adoption of leverage regulations an individual bank can pass on massive impartiality funding costs to borrowers that is able to result in less investment amount. Thus, there is a benefit to developing a leverage ratio that is equal to adjust for the banking crisis. Especially to secure the trading accounts and make changes in the risk-weights, there are needed changes regarding regulation arbitrage announced by the Basel Committee.

Due to closing all potential loopholes in regulations, leverage regulations are suitable for the banking sectors. Basically, the leverage ratio is utilised to capture just how many debts an individual bank has compared to its total capital. In this area, the "Tier 1 leverage ratio" is also effective to calculate a "bank's near-term financial health". In order to assure the "capital adequacy" of an individual bank, the "Tier 1 leverage ratio" is persistently used [9]. Due to secure the financial stability risk factors, every banking sector needs to observe the capital base and then apply for any kind of leverage. Understanding the equity, assets, and liabilities of an individual bank, following the leverage ratio is very essential. Following specific regulations in leverage ratio is another criterion that can support the debt ratio with its total capital value.

The analysis of the leverage ratio helps to identify the total value of "Tier 1 capital" which is also an essential element in balancing the financial crisis. Innovative financial instruments are needed to be adopted in the leverage ratio prediction process as it is helpful for overcoming the challenges associated with the financial stability of an individual banking sector [10]. Proper regulations in the leverage process are also effective to promote the right guidelines in the financial leading process.

Theme 2: Relationship between leverage and financial management

The utilisation of borrowed money by the investors is measuring the level of leverage. This is the calculation of how an individual bank uses debt and equity capital to underwrite its assets. Depending on the development of the level of debt, the leverage ratio is generally calculated. Financial management needs proper guidelines and regulations to secure the further journey and protect the financial risks. In financial criteria, there is always a risk regarding the return on debt [11]. The amount of debt must be

limited that could be returned by the company or bank based on its income r profit amount. In the case of having an effective financial management chart or regulations, an individual organisation can set a proper margin for every single work or activity.

The factor of leverage and financial management is interconnected as both are dependent on each other. In the case of having secured financial management, the financial leverage can be maintained well. On the other hand, if the financial leverage ratio has become increased it proves the unstable financial management process. In the process of financial leverage, there are associated multiple losses [12]. It also has been observed in many cases that if "financial leverage" impacts its solvency, an individual bank or organisation can face "bankruptcy". It can be possible if an individual company borrows a high amount of money from another source. Banks are always expected to have a high rate of leverage that can be difficult for the company to return on giving time.

In this regard, many companies which have proper financial management, are trying to avoid taking debt with a higher liquidity rate. It can help an individual company to avoid bankruptcy and other financial crisis [13]. Thus, financial leverage is depending on a variety of elements such as competitiveness, productivity, capability, revenue, profit, employee, business plan, economic support, debt amount, time of return, and many more. The financial leverage is primarily depending on the financial performance of an individual company. Thus, the performance is also measured by EPS, net profit margin, return on equity, return on assets, sales growth, and other essential elements.

Theme 3: Factors influence leverage regulations to secure financial stability

Regulatory design in financial management is very important as it can secure the financial crisis. There are several factors that can influence financial leverage such as growth opportunities, industry median leverage, firm size, profitability, and complexity of assets [14]. In many cases, due to a financial crisis, an individual country lends money from another financially strong country to balance the crisis. It is also associated with the return policy which has to be returned at a particular given time. All the borrowed money is connected with specific rules and regulations based on the specific country. The lender country always needs to focus on the regulations that have been associated with the money and identify whether the money return will be possible or not.

The money lending process always needs proper understanding otherwise it can lead an individual country to be faced a financial crisis to bankruptcy. In this regard, the selection of short-term or long-term debt is important to notice the ability to return on time. The financial manager has a great role to play in the protection of financial crises [15]. A financial manager can identify and calculate the potential risk with the proper identification of different essential key tools. Financial leverage ratio calculation is also under the responsibility of a financial manager. It is very important to be sure that the Debt Company or country must be strong to lead the net income margin toward profit.

Frequently, wrong calculation and prediction of debt process and lending money process becomes a complex position and lead to a huge amount of return equity. For the debt country or company, it becomes very difficult to return a huge amount of money within the given period of time. Meanwhile, the process of financial leverage and lending standards are equally connected with each other [16]. Securing financial stability is highly essential for any country or company as it is a question of existence.

Theme 4: Impact of leverage regulations on the stabilisation of financial systems

In banks, several different types of regulations for the leverage process are associated and it is applicable depending on the company or country which will borrow money. Depending on the productivity, capability, revenue, growth, and profit margin the leverage ratio generally has been set [17]. The companies or countries face rapid growth of financial crisis, the leverage ratio is also increased in those cases. The constant growth of the financial crisis generally made higher leverage ratios. The higher leverage ratios are always pretending as complex elements for a country and company to return. In the majority of cases, this becomes a financial stability disturbance.

In addition to that, the global financial crisis is connected with numerous elements such as "excessive leverage", "global macroeconomic imbalances", "lax financial supervision", "growth of the subprime mortgage sector", and "lax financial regulation". The factor of the global financial crisis leads humanity to think about the depth of the issues and the potential resolution tool that can support financial growth as stable [18]. Thus, the severity of the catastrophe can be measured by calculating the ratio of metrics. The financial stability risk the majority time breakdown both international and domestic financial markets. Leverage regulation is the main supportive factor in lending money or borrowing money for a specific time. In the maximum cases, the banks that are provided money to mitigate the financial crisis of an individual company or country follow "risk-weighted capital requirements".

In order to develop bank resilience, the leverage ratio has a great impact and its sustainability is defending the capability of the lender country or company. Thus, the impact of high leverage always creates difficulties for the company or country to return its debt amount [19]. Maintaining a balance sheet in the leverage ratio process is very important as it is considered a measured tool for the bank to calculate the leverage ratio. Along with this, "economic leverage" is another factor that is also connected with stabilisation of the financial systems of an individual company or country. It indicates the value of debt money that exceeds what the bank paid for the crisis.

Theme 5: Advantages and disadvantages of leverage

Debt is always recognised as a bad element as it creates

tension and pressure to return money at a larger amount than the debt amount. The amount of debt and the leading time of carrying the debt amount is deciding the rate of leverage [20]. Everything has both positive and negative sides and its impact depends on the activity. Similarly, leverage also has both advantages and disadvantages. Leverage is identified as powerful access to capital. It has the ability to multiply the power of every dollar that an individual country or company needs to borrow money.

Leverage is a risky form of finance that can bring a negative impact and even lead to bankruptcy. However, debt is a source of funding that can help a business grow more quickly [21]. In the majority of cases, large-size businesses prefer to borrow money to stable the financial area, and sometimes due to a lack of proper financial management, it leads to a huge amount of leverage that becomes difficult to return. In addition, the process is also more costly rather than any other process of stabilising the financial crisis. Leverage financial products such as high-yield bonds, and leveraged loans, need to pay a high interest that is not possible to return for all countries or companies.

The amount of debt money is considered instant financial support for any specific financial crisis. On the contrary, if the investment plan does not work out, it can transform into a high risk. Even it can lead to a loss of investment and the potential risk of incapability of returning the money. The main profit of leverage is at a time any country or company can get a large amount of money and can do less or more than whatever is needed [22]. Thus, the interest rate in the leverage process can increase higher than the debt money in maximum time becomes difficult to return, and leads to bankruptcy.

DISCUSSION

Analysing the above result it has become understood that financial leverage is a common factor in leading any large-size business or supporting an economic financial crisis. Accompanied by the adoption of leverage regulations an individual bank can pass on massive impartiality funding costs to borrowers that is able to result in less investment amount. It has been noticed that there is a benefit to developing a leverage ratio that is equal to adjust for the banking crisis. Financial management needs proper guidelines and regulations to secure the further journey and protect the financial risks. In financial criteria, there is always a risk regarding the return on the debt that can lead an individual company or country to face bankruptcy [23]. The financial management process and the factor of leverage are interconnected with each other. It has been observed that in the case of having secured financial management, the financial leverage can be maintained well. Thus, in the case of the financial leverage ratio has become increased it proves the unstable financial management process. In the process of financial leverage, there are associated multiple losses.

In many cases, due to facing a financial crisis, generally, it has been noticed that an individual needy country lends money from another powerful country in order to balance the financial crisis. In this area, the money-leading process always needs proper guidelines or regulations to be bound with particular areas to be fixed the amount of return money. In addition to that, the money lender company or country must need to be understood the regulations associated with that. In the case of not understanding the regulations, it can lead to the incapability of returning money and facing bankruptcy [24]. In this regard, a financial manager plays a vital role to support the financial growth and business leading process by implementing effective business strategy. Sometimes, it also has been observed that wrong measurement and wrong planning of business increased the entire leverage process into a complex situation and resulted in a huge amount of return interest that most of the time becomes higher than to the lend money.

The leverage regulations are depending on the specific company or country and the financial manager can control the entire financial growth in the correct way. The financial stability risk the majority time breakdown both international and domestic financial markets. Leverage regulation is the main supportive factor in lending money or borrowing money for a specific in this regard, the global financial crisis is depending on a few elements such as “excessive leverage”, “global macroeconomic imbalances”, “lax financial supervision”, “growth of the subprime mortgage sector”, and “lax financial regulation” [26]. The impact of a high leverage rate is not supportive of the country or company that is facing a crisis. Thus, leverage has some disadvantages but it has also the power to provide instant support to manage the financial crisis. However, having a particular regulation can provide the surety of leverage that cannot be misled.

CONCLUSION

Following the entire analysis it has become stated that financial stability is highly essential for living and leading life. In order to implement post-crisis of any company or country, having proper regulations associated with lending money is very important. In the majority of cases, due to facing a financial crisis, an individual company or country needed to borrow money with specific regulations. In the case of not following the proper investment plan, the return on debt might be difficult and even sometimes leads to bankruptcy. It has been seen that the majority company or countries borrowed money to invest the money in a well-planned business to get a large amount of profit. In this regard, the role of a well-experienced and skillful financial manager has a great role to play as they can support in measuring the outcome of the business. There are several factors associated with leverage and financial management process and it is entirely related to the result of business. Business performance is another key tool that is transforming the outcome of leverage. Moreover, this research paper is helpful for the readers to recognise the main factors interconnected with the leverage system and how it supports stabilising the financial system.

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