The Impact of Government Regulation on Financial Institutions Before and After the Financial Crisis

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Abstract. With the development of the social economy, the issue of financial market regulation has become one of the main concerns of the society and the government. Some researchers have found that government regulation has an impact on the financial market, however, the specific results of the impact are still lacking. This paper therefore examines the impact of government regulation on financial institutions, based on two measures of government deregulation and strengthening of regulation, and analyses their positive and negative effects respectively. The study shows that both deregulation and strengthening of government regulation have positive and negative effects on financial institutions, and in comparison, the positive effects of strengthening regulation outweigh the negative effects, therefore, appropriate strengthening of regulation is conducive to the stable development of financial markets.

Keywords: Financial crisis · Government control · Impact of controls · Financial institutions

1 Introduction

At the time of the financial crisis in 2008, the government deregulated investment banking, and whether or not it supported the deregulation policy sparked controversy at the time. As the financial crisis subsided, the market demand for investment banking increased and the content of investment banking business was enhanced, various countries took the regulation of investment banks more seriously and introduced policies and laws to regulate investment banks. This has also led to a debate on the impact of government regulation of investment banks. An examination of this issue is very relevant to the future development of investment banking and the improvement of government-regulated policies. Before the financial crisis, the United States advocated free trade balanced with bottom-line trade controls, but due to the changing international trade environment, trade controls have gradually drifted towards protectionism [1]. The intensity and impact of the efforts to reform the financial regulatory system in the US in '08 due to the devastating financial crisis, both at the executive and congressional legislative levels, was similar to that of Roosevelt's New Deal, both of which had an impact on the financial [2]. However, this paper does not go far enough into the specific impact of

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government regulation, so this paper will look at the impact of government regulation on investment banks. This study is based on the impact of government regulation of investment banks during the financial crisis in 2008 and is divided into two phases to analyze the impact of government regulation of investment banks before and after the financial crisis respectively. The pre- and post-regulation effects are placed under the test of objective data. The paper will first analyze government regulation of investment banks in general terms and its positive and negative effects in the pre- and post-crisis periods, followed by the results of investment banks being regulated or deregulated in the different periods, by analyzing the number of investment bank failures and pre- and post-regulation performance data. Finally, the impact of government regulation and government deregulation will be compared. The aim of this paper is to examine the impact of government regulation on investment banks so that they can be effectively regulated by the government and thus develop in a better and positive way, contributing to the country's stable economic development and social stability. In addition, the research in this paper will help the government to better regulate investment banks, and also provide some useful reference for the government to enact regulatory policies.

2 The Impact of Government Regulation on Financial Institutions: Pre-financial Crisis

2.1 Pre-financial Crisis Control Measures

Prior to the financial crisis, between the 1970s and the 1990s, as the collapse of the Bretton Woods system following the First World War caused a huge impact on the financial sector, causing strict financial regulation to be seen as damaging to financial institutions and systems and limiting their development, governments deregulated finance in order to make financial institutions more competitive and innovative, mainly Efficiency is the main focus [3]. For example, the US abolished the Depository Institutions Control and Monetary Control Act in 1982 and enacted the Guahan-St. Germain Institutions Act. The policy of financial liberalization was implemented worldwide, even in many developing countries, and a system of deregulation began to be adopted, resulting in fewer traditional restrictions, more and more innovative financial derivatives and a shift towards a hybrid business model in the financial sector, which set off a global trend.

2.2 Effects

2.2.1 Positive Effects

After the 1970s, due to technological innovation, diversification and globalization, banks were able and expected to offer a wider range of services. Deregulation was primarily aimed at reducing barriers to banking mergers and acquisitions and encouraging orderly and healthy market competition among banks, and in order to allow US banks to remain competitive in the global banking industry, the government repealed the Glass-Steagall Act, allowing depository institutions and financial firms to merge [4]. At the same time, deregulation also allowed US investment banks to compete in foreign markets. Coupled

with the fact that government deregulation pulls up the level of leverage of financial institutions, and that the greater the degree of government regulation upfront, the higher the relative increase in the level of leverage of upstream financial institutions at deregulation. It became increasingly difficult for pure financial institutions to compete with leverage, so in response to the birth of all-powerful banking in the US, pure business banks decided to increase their leverage and engage in proprietary trading, thereby increasing their competitiveness. On the other hand, financial institutions were driven by the benefits of financial innovation due to the liberalization of the combination of depository institutions with other financial companies, the rapid consolidation of the electronic banking sector with the development of the universal model, advances in science and technology that reduced the costs of information processing and innovation, and the development of futures options trading driven by the rapid development of international trade and investment that stimulated innovation in finance, making financial institutions increasingly strong [5]. For example, the emergence of floating rate notes, SDRs and federal residential mortgages in 1970, the birth of automated quotation systems in 1971, foreign exchange forward trading in 1973 and money market deposit accounts and customized transfer services (ATS) in 1978, all continued to introduce new financial instruments and products in order to attract consumers in a highly competitive market and thus to These were designed to attract consumers in a highly competitive market by introducing new financial instruments and products, thereby differentiating themselves from the competition in the financial markets.

2.2.2 Negative Effects

Liberalized financial policies did not lead to balanced and sustainable economic development. Between 1982 and 1992, a total of 1,442 banks failed in the United States, and as a result of financial liberalization reforms, no corresponding regulatory principles and bottom lines were established during the deregulation period, allowing a large number of financial institutions to engage in financial speculation and generate overexpansion in a competitive market, especially in the context of foreign exchange deregulation [6]. The hyper-international development of financial institutions and the global movement of their assets have led to financial risks spreading globally with their assets. This is because most financial institutions are overly dependent on capital market financing for their earnings and hold a large number of risky financial derivatives and high leveraged operations. Investment banks, however, tend to be more highly leveraged and over-speculative than commercial banks, and are thus exposed to higher risks. Banks fail mainly because there are too many bad loans, which means that a large amount of the bank's loans go into ineffective investments, and when the investments lose money, the bank can't get its money back, making it impossible to run the bank. Because deposits were lost eventually it became impossible to cope with withdrawing them. This leads to a lack of liquidity for the investment banks and, coupled with the lack of support from the central bank, the investment banks go bust. As more and more banks fail, there are often scenes of financial chaos and the deregulated state becomes increasingly unable to control the country's money supply and credit facilities, which leaves the state to take huge losses in the form of national debt [7]. As for financial derivatives innovation, although financial derivatives can be used as a way of risk management control at the

same time can help companies to avoid some risks and improve the efficiency of the market, the lack of market transparency in the process of flow and trading of financial derivatives due to deregulation policies has led to the formation of toxic asset bubbles in financial derivatives [8]. For example, in order to improve competitiveness and avoid shareholder oppression, US investment banks pull up their leverage and use banks as highly leveraged hedge funds. Hedge funds are not regulated by the government due to deregulation policies, and the lack of regulation makes financial derivatives like hedge funds appear out of control scenes, causing the whole financial market system to get out of control and disorder. In addition, because of the deregulated environment, people can better benefit from it and because of the lack of regulation, the lack of responsibility in the fiduciary market has allowed fraud and misconduct in the financial markets. Fraudulent practices by lenders, appraisers, investment banks and rating agencies have occurred in mortgage lending in the United States. Mortgage lenders would help lenders falsify various loan documents, appraisers maliciously increased share prices for profit and received large commissions from them, investment banks securitized highly rated and risky products and marketed them to consumers, and rating agencies rated poor quality housing bonds as high-grade bonds in order to get investors to pursue poor quality products [9]. IndyMac Bank in California, which was taken over by the government after it collapsed due to a run on the bank, was investigated by the FBI for alleged fraud. All of this undoubtedly contributed to the chaos and disorder in the financial markets and was the trigger for the financial crisis in 2008.

3 The Impact of Government Regulation on Financial Institutions: Financial Crisis and Post-financial Crisis

3.1 Government Control Measures

The series of financial market problems that have emerged since deregulation have led to a global awareness of the importance of sensible financial regulation. This, coupled with the outbreak of the financial crisis in 2008, made it impossible for governments to ignore the regulation of financial markets, creating a period of renewed and strengthened regulation. The financial crisis prompted Presidents Bush and Obama to take intensive measures to rescue the financial markets in order to restore consumer and investor confidence and rebuild the economy. In preparation for financial regulatory readiness, the US government issued the Paulson Blueprint and the Obama Plan in quick succession early on, kicking off the strengthening of the US financial regulatory regime. The main elements of the reform of US financial regulation include the establishment of the Financial Supervisory Commission used to monitor and deal with financial stability; the establishment of the Consumer Financial Protection Bureau to protect the legal rights of consumers; the increase in the powers of regulators to allow restrictions on the salaries of financial executives and to allow the splitting of taxpayer and financial institution funds when financial markets are in difficulty; the adoption of the Volcker Rule to limit speculation by financial institutions and the strengthening of regulation of financial derivatives to strengthen protection against financial risk [10].

3.2 Effects

3.2.1 Negative Effects

The increased regulation by the government will undoubtedly affect many small financial institutions, as most of them cannot sustain their competition in the financial market due to the layers of regulation and various policies, resulting in bankruptcy and collapse. The increased government regulation will undoubtedly affect many small financial institutions, as most of them cannot sustain their competition in the financial market due to layers of regulation and various policies, resulting in bankruptcy and collapse. In addition, the regulatory regime restricts the scope of operation of financial institutions, making it difficult for different types of financial institutions to start other businesses, thus lacking competitiveness, inhibiting the development of some financial institutions with a small scope of operation and hindering the operational efficiency and innovation of the financial sector; and in the event of problems or failure of the securities business operated by mixed financial institutions, depositors will bear all the risks, which places an additional burden on society and is not conducive to social stability [11]. This increases the burden on society and is not conducive to social stability. This also deprives some small financial institutions of investors and makes it difficult for small institutions to become headquartered. In response to a number of banks on the verge of bankruptcy, the US government launched the Troubled Asset Relief Program (TARP) in 2008 for a total of US$700 billion. The US government injected $10 billion each to help transform Goldman Sachs and Morgan Stanley in September 2008. Goldman Sachs and Morgan Stanley subsequently repaid all the government bailout funds and paid a total of $2.05 billion in ransom to redeem warrants, and another bailout under this programme, Citibank, brought in $11 billion to the government [12]. The scheme brought back to life the failing financial institutions while restoring the overall strength of the investment banks and increasing the operational independence and flexibility of the firms, but the scheme only targeted some of the larger investment banks, leaving the smaller failing institutions still without government assistance.

3.2.2 Positive Effects

In 2009, as the world economy gradually rebounded, the securities markets improved and the US government's Troubled Asset Relief Programme successfully deleveraged Goldman Sachs and Morgan Stanley and further enhanced their financial strength. For example, Goldman Sachs' debt-to-equity ratio was 11 times in 2009, a reduction of one-third compared to 2007, while Morgan Stanley's debt-to-equity ratio more than doubled compared to 2007, and both financial institutions were still able to generate half of their total assets from their own financial products, indicating that their successful deleveraging has not changed their business strategy of diversifying their profit models [10, 12]. In the short term, strict government controls will bring a certain degree of shock to the national and even global financial markets, people will not be able to accept it for a while, the first reaction is to worry about the future profitability of the financial market, investors will sell stocks in the financial sector, resulting in a decline in share prices, a part of the capital outflow will occur, making the financial market less active, resulting in economic decline; on the other hand, other countries or regions will follow

the developed countries to strengthen government controls, speculative capital will flow into other deregulated countries, the inflow of asset price inflation will generate exchange rate fluctuations. From a long-term perspective, for the country, strict financial regulation can increase the competitiveness of financial institutions in the market, the efficiency of regulation and regulatory loopholes and other issues will be strongly improved, thus enabling the financial market to obtain a long-term stable environment and protection, which will also mitigate the damage of the financial crisis on the economy, consolidate the country's economy and promote the development of the real economy; for the global financial system, strict financial regulation builds For the global financial system, strict financial regulation establishes mature international financial rules and policies and lays the foundation for the future harmony and stability of global financial markets [13].

4 Reasons for US Financial Dominance

And the United States, as the world's financial rule setter, dominated the hugely influential Bretton Woods system and became the hegemon of the global financial system, leading to the status of the dollar as gold, and even after the financial crisis, New York in the United States remained the world's largest financial market. So other countries that enter or want to fight against it need to accept the financial system policies of the United States, whether it is a relaxed financial control or strict financial control, the financial competitiveness of the United States is to some extent higher than other countries. The main reason why the US financial system has become the dominant global system is that it takes the law as the prerequisite guarantee for financial regulation. Since the founding of the United States, the country has placed great emphasis on law-making, from the people to the government, who are the law-makers and decision-makers. The government's main focus in making laws and policies has been on the activities of the market, with the aim of giving the market the freedom to develop and the flexibility to be more efficient and to stabilise the operation of the market. When laws are enacted with a social focus, the aim is always to reduce government intervention, to create a competitive environment and mechanisms for the market to compete autonomously and flexibly, and to use macroeconomic regulation to influence the competitive field so that companies and institutions in the field are strengthened in all respects. Finally, the US is progressive in its policy formulation, which minimizes negative effects and lengthens the market's adaptation period to the policy. Finally, the US policy has been developed in a gradual manner, which has minimized negative effects, lengthened the market's adaptation period and made the policy more robust, with minimal losses and no rebound [14].

5 Discussion

The above analysis is summarised in Table 1, which clearly shows that the disadvantages of deregulation outweigh the advantages and the advantages of increased regulation outweigh the disadvantages. Deregulation can lead to chaos and disorder in the market when it can also improve market competitiveness, while increased regulation will induce healthy competition in the market and improve market efficiency. Comparatively

Table 1. Positive and negative impacts of government regulation in different periods

Period of Time	Measures	Positive impacts	Negative impacts
Pre-financial crisis	Liberalizing financial institutions with a focus on efficiency.	1. Improving the competitive environment in financial markets. 2. Promoting innovation in financial products.	1. The emergence of financial speculation by financial institutions has led to an increase in financial risk. 2. Financial derivatives create toxic asset bubbles. 3. Fraud and misconduct in the financial markets.
Post-financial crisis	Establishment of a regulatory body; establishment of a consumer financial protection authority; restriction of financial speculation; strengthening of regulation of financial derivatives.	1. Operational deleveraging of financial institutions. 2. Improving the competitiveness of financial institutions in the marketplace. 3. Financial markets gain long-term stability. 4. Mitigating financial risks.	1. Large number of small institutions going out of business. 2. Lack of competitiveness due to the inability of financial institutions to conduct other businesses. 3. Decline in financial market activity.

speaking, deregulation does increase the freedom and innovation of the market, but it should not be done in a blanket manner and needs to be strengthened as appropriate to the market environment. And while tighter regulation can control financial risks and improve the operating strength of financial institutions, overly strict regulation can lead to problems such as funding operations for small, good financial institutions. In order to increase competitiveness, the US has enacted laws that allow the banking industry to engage in national banking activities, allowing banks to explore new markets and use new instruments. At the same time, the US has strengthened the rights of financial regulators and enhanced the regulation of financial derivatives and instruments, making the US financial markets not only more competitive but also effectively regulated, creating healthy competition. Therefore, financial markets need to develop within a framework with rules, and appropriate deregulation or strengthening of regulation should be carried out according to the environment and activities in the financial markets. The government can strengthen regulation while liberalizing financial institutions with a focus on efficiency by setting up a regulatory body, establishing a consumer financial protection authority, and strengthening regulation to reduce financial risks while allowing financial institutions to innovate in financial derivatives. In addition, in terms of policy, the government can provide appropriate encouragement and policy support to small financial institutions to promote their competitiveness in the financial market.

6 Conclusion

Through the study, this paper first analyses the financial regulation policies, illustrating them in terms of the deregulation policies before the financial crisis and the strict financial regulation after the financial crisis. It then examines the policies according to their respective positive and negative effects, finding that both relaxed and strict government regulation had both positive and negative effects on the financial markets. Deregulation prior to the financial crisis led to increased competitiveness and innovation in financial markets, while excessive unhealthy competition, excessive speculation by financial institutions and fraudulent behavior can occur. While strict government regulation can lead to the failure of a large number of small financial institutions and short-term market volatility, in the long run, regulation can lead to increased market efficiency and healthy competition, which can lead to the development of financial markets and the country's economy. Finally, a legal and social analysis shows that the US has been able to lead the way in financial market policy making because of its sophisticated legal protection system and socially focused policy approach. As this paper examines, both loose and strict regulatory policies have their positive and negative effects, and government regulation needs to be tailored to the country's own financial market activities and environment, so that financial institutions can be effectively regulated, and the country's economy can develop in a more stable and harmonious financial market environment. This paper only analyses the positive and negative effects of deregulation and strict regulation, without comparing the two types of regulation. Further analysis and research can be carried out in the future on the basis of the aforementioned studies, which will be beneficial to the in-depth study of this topic.

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