

The Impact of Regulatory Changes on Risk Management

Research Proposal

1.1 Introduction

In recent decades, the financial market has become vulnerable to significant regulatory changes that have had long and severe consequences over risk management practices (Gallati, 2022). In the late 20th century, there were a series of financial crises, including savings and loan crisis of the 1980s (Vartanian, 2019) and the global financial crisis 2008. Due to this series, the world realized the need for a more robust regulatory framework and oversight (Duffie, 2018). In response, international regulatory bodies, including the US Securities and Exchange Commission (SEC) and the Basel Committee on Banking Supervision, drafted initial reforms to reduce the risks within the financial systems. The Basel Accords, specifically Basel II and Basel III, have established standards against capital adequacy, liquidity management, and risk management within banking institutions (ElBannan, 2017).

Similarly, the Dodd-Frank Wall Street Reform and Client Protection Act in the United States was among the significant pieces of legislation that were targeted towards improving transparency, consumer protection, and oversight of systemic risk within the market (Carlson, 2017). Due to these regulatory changes, there was a significant change in risk management practices. Banking and financial sector organizations were forced to adapt to strict capital requirements, stress testing, and new reporting methods. Even operational, credit, market, and liquidity risks became stricter, demanding sophisticated risk modeling and technology (Gallati, 2022). Hence, the study aims to investigate the impact these regulatory changes have on risk management strategy and their effectiveness in improving the stability of financial institutions.

1.2 Problem Statement

As financial markets become more complex and interconnected, regulatory bodies have also evolved, introducing several reforms to save the financial system from systemic risk and to protect other concerned stakeholders, including investors and consumers (ElBannan, 2017). However, there still needs to be a greater understanding regarding whether these regulations have succeeded. One of the crucial issues is that regulatory changes have unintended consequences, such as stricter capital requirements that prompt financial institutions to shift their risk exposures in ways that were not immediate, apparently leading toward new and unpredictable vulnerabilities (Gallati, 2022). Moreover, due to the diversity in these regulations, emerging from different regions and jurisdictions, regulatory arbitrage has increased where institutions exploit these disparities to their advantage (Willessen, 2017). Additionally, the impact of these changes on smaller financial institutions that still lack resources compared to their larger counterparts in complying with these new rules also needs to be examined. Small institutions face higher compliance costs and numerous difficulties in adopting new risk management practices (Navaretti et al., 2018). Hence, this research investigates the effectiveness of regulatory changes in reducing risk and assuring financial stability, highlighting any consequences and disparities in their application across different segments of the financial industry.

1.3 Relevance and Significance

Understanding how regulatory changes influence risk management in today's financial market is quite essential since after the global financial crisis of 2008, numerous regulatory changes were adopted to maintain financial stability due to the realization of the need for a practical risk management framework. These changes aimed to prevent any recurrence of such a crisis, making it essential to understand whether it is effective in achieving this objective. Moreover, as the

financial system is interconnected, a single failure can have a cascading effect. Regulations are designed in such a manner to reduce systemic risk through stricter controls and prudent risk management. (Duffie, 2018) Regulatory changes are also developed to protect investors and consumers. They were understanding how the changes ensure that individuals and investors reliant over financial institutions are protected from undue risks (Carlson, 2017). Efficient risk management also contributes towards an efficient market, which ensures that the capital is allocated effectively and supports economic growth. Regulatory changes influence how resources are allocated and their contribution towards market efficiency. Recently, several significant technological advancements have demanded a robust regulatory framework that adapts to these changes, influencing risk management practices as well, such as cybersecurity and fintech (Gallati, 2022).

Moreover, it is important to note that financial institutions operate across borders and need a unified approach towards regulation where a study of its effects on risk management recognizes its implications for international financial stability. The study will also help identify and address the concept of regulatory arbitrage, where organizations exploit regulation changes to gain a competitive advantage. On the other hand, from a theoretical perspective, the study expands the understanding of the relationship between regulatory changes and risk management practices, highlighting its effectiveness and consequences. It further informs and refines the theoretical framework, which helps design a more adaptive, resilience and efficient risk management framework within an evolving regulatory landscape.

References

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