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An Evaluation of the Banking System to End the Country's Financial Crisis

Mr. Giri Rajendra Prabhakar[1] **and Dr. Sunita Jain**[2]
Ph.D Scholar, Department of Commerce[1]
Professor, Department of Commerce[2]
Swami Vivekanand University, Sagar, India

Abstract: *The current worldwide financial crisis is the result of a confluence of elements that have existed in previous financial crises as well as some fresh elements. Several flaws in financial architecture and regulation have come to light as a result of the crisis, particularly in how systemically important financial institutions are handled. Financial institutions, systemic risk and vulnerability assessments, and financial institution resolution. The fact that the financial crisis is a global phenomenon has demonstrated that, while financial integration markets provide many advantages, they can also carry a high risk of serious economic consequences. To ensure the stability of a world that is becoming more and more financially interconnected, significant modifications to the international financial architecture are obviously required.*

Keywords: Financial Crisis.

I. INTRODUCTION

Failures in macroeconomic policy, the oversight of banks and non-banking institutions, and the regulation of those institutions have come to light during the present global financial crisis. It is now evident that there was a lack of international consistency and policy coherence, and that agencies involved in regulation, oversight, and crisis management did not always have clear mandates and tools according to these mandates. The global financial crisis has prompted calls for a reevaluation of the global financial architecture as well as a review of the advantages and disadvantages of open financial markets.

In order to restructure financial systems, this study draws lessons from the recent financial crisis. These lessons apply to macroeconomic policy, financial regulation, and the global financial architecture. The study begins with a review of the reasons of the current global financial crisis, relying on historical views and emphasising specifically its international elements. This overview is necessary for a clear diagnosis of the issue. With a combination of several components that are common to earlier financial crises and some new elements, it emphasises the numerous causes of the crisis. It examines the various pathways and mechanisms through which the global financial crisis spread. Additionally, it demonstrates how the ongoing global crisis is leaving behind a sizable legacy of government interventions and macroeconomic effects, particularly in wealthy nations, which will influence present and future changes.

In light of the recent and previous financial crises, the study then outlines ideas and policy initiatives for rebuilding prudential regulation and financial architecture, with a focus on international aspects. The financial crisis has exposed numerous flaws in national financial architectures, particularly in how systemic banks and other financial institutions are handled, how risks and vulnerabilities are assessed, and how financial institutions and claims are resolved. The fact that the financial crisis is a global phenomenon has further demonstrated that economies that are financially integrated have advantages but also hazards that have significant real economic repercussions. The financial crisis makes clear that the global financial architecture still has a long way to go before it institutionally catches up to the closely integrated financial networks. the fields of surveillance, information exchange, crisis management, and liquidity support.

II. REASONS OF THE CRISIS

The reasons of the current global financial crisis are examined in this section. It will emphasise

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There are several explanations for the crisis, including a mix of factors that have been present in previous financial crises and some new factors.2

A remarkable convergence of variables has resulted in the terrible financial crisis that is currently affecting the world economy. Some are brand-new (and unexpected), while others are strikingly reminiscent of previous periods of financial unrest. This section lists the similarities and differences between the present crisis and earlier ones. Even while there is some debate over how much each component contributed to the crisis, taken as a whole, they assist explain the episode's significant breadth and complexity as well as why different policy measures failed to adequately foresee the issue.

The pathways and procedures by which the financial crisis extended to other nations and asset markets are then discussed in Section 3. We also show how the crisis has had a significant impact on macroeconomic outcomes and government interventions, which will influence current policies and reforms. These two sections add to previous examinations of the causes and progression of the crisis, including as those by Rogoff and Reinhart (2008), Calomiris (2009), Gorton (2009), FSA (2009: the Turner Review), and IMF work (see reference list).

2.1 Financial Incorporation and Interconnectedness

Over the past ten years, financial integration has substantially risen, particularly among sophisticated economies. Cross-border gross positions have significantly increased, particularly among OECD nations (Figure 9), as a result of capital account opening up and financial sector reforms. Foreign intermediaries have also become more prevalent in a number of financial systems, particularly several emerging nations. As a result, global risk sharing, competition, and efficiency have all increased. However, this has also raised the possibility of financial crises spreading internationally.

Early on, cross-border spillovers were intensified through a variety of channels, including liquidity pressures, a global sell-off in equities (particularly financial stocks), and the depletion of bank capital, due to growing interconnectedness of financial institutions and markets (Figure 10) and more highly correlated financial risks. Institutions not only in the US but also in other advanced countries and the official sector in some emerging markets held a significant amount of MBS and other US-originated instruments. Spillovers among European banks, notably those in Germany (IKB, July 2007) and France (BNP Paribas' money market fund, August 2007), swiftly emerged as a result of these direct exposures and related funding issues. The crisis rapidly expanded to other markets and institutions as troubled intermediaries compelled to sell other assets and reduce lending due to losses and a lack of liquidity as it struck troubled intermediaries.

2.2 The Role of Leverage

The development of extremely high levels of financial institution leverage andBorrowers played a role in the spread of shocks. Leverage rose dramatically in the financial industry, both directly at European commercial banks and through shadow banking.

System and the nation's growing non-deposit-taking institutions and investment banks (Figure 11). Additionally, the increase in household leverage was distinct from that seen in earlier crises. Prior to the Japanese real estate crisis, for instance, measures of household leverage (the household debt-to-assets ratio) dropped while the household debt-to-income ratio rose substantially, indicating that Japanese homeowners had accumulated equity in their homes as real estate values rose.

Due to this excessive leverage, the system was unable to absorb even little losses, which accelerated the crisis's early counterparty risk and trust drop. Households were more vulnerable to shocks due to loan-to-income ratios that were higher than in the past, while many households had negative equity as a result of even modest price drops in their homes due to high loan-to-value mortgages. Due to excessive leverage, initial liquidity concerns in the financial sector swiftly gave way to solvency issues.

As financial institutions suffered significant losses and had to write down illiquid securities, market-wide solvency worries sparked a rapid deleveraging process and forced asset sales. Further deleveraging and fire sales were compelled by mark-to-market regulations. Hedge funds, who were under pressure to redeem their investments and face funding restrictions, accelerated the unwinding process. This resulted in further asset price decreases, which prompted the sale

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of distressed assets, increased the need for recapitalization, and caused a further loss of confidence, which reached a near-collapse in October 2009.

2.3 Central Role for Households

The transmission of the crisis from the financial to the real sectors is affected by the high household indebtedness, which also makes policy responses and resolution methods more challenging. The overextension of the household sector during the upturn resulted in a number of risky assets whose value was directly or indirectly dependent on steadily rising home values, an issue made worse by rating agencies that weren't working properly. Additionally, households were not well-positioned to withstand losses when the financial crisis hit.

They drastically altered their consuming habits due to wealth, collateral, and confidence effects.

In the real sector, already challenging conditions were made even more challenging by tightening rules for new mortgages and consumer lending. Financial restrictions imposed by stressed financial institutions directly translated into decreased consumer spending, which resulted in cycles of initially localised but gradually spreading declines in corporate sector profitability, layoffs and increases in unemployment, sluggish economies, and more foreclosures. This was because households' savings and net assets were already at historic lows.

The policy reaction was complex and slowed down by the sheer volume of people engaged, the dearth of information available, and the social consequences of household debt restructuring. Although restructuring corporate debt is expensive and painful, there are well-recognized international best practises for dealing with a large-scale corporate default. Problems with moral hazard, the sheer volume of instances, and distribution and equality difficulties make the situation with households more complex. Despite political support for a relief package for mortgage holders, governmental activity on this front was delayed and inconsistent in the United States, and no practical solution materialised. Several nations in Eastern Europe had comparable issues, but they haven't yet taken organised action.

III. THE EVOLUTION OF THE CRISIS

The financial crisis was the first major one on a worldwide scale since the Great Depression. Its proliferation was unprecedented in scale and intensity over several phases, with numerous transmission channels. It required significant government action, which resulted in a number of lasting effects.

3.1 The Channels and Mechanisms of the Crisis

Like in each financial crises, there are additional catalysts, triggers, and amplifying processes. The U.S. housing and mortgage markets' overextension served as the crisis's impetus. The recovery in US home values, which was partly caused by a cycle of tightening monetary policy, served as the catalyst for the subsequent instability, with the subprime sector acting as the main driver. But the crises' ramifications were unprecedented. While the U.S. subprime market was where the crisis first surfaced, it swiftly spread to the country's broader housing markets and other financial markets (such as those for other asset-backed securities).

The initial stage involved direct exposures. This phase, which occasionally involved liquidity runs (mostly because of excessive funding in wholesale markets), affected a few specific financial markets and was largely restricted to banks with direct exposure to the U.S. market.Problems among European banks, especially in Germany (IKB, July 2007) and France (BNP Paribas, August 2007), swiftly emerged as a result of direct exposure to subprime related assets. These occurrences led to interbank and liquidity issues in several markets. Stress on the U.S. home market also revealed housing weaknesses in various other nations, particularly in Western Europe, and led to funding issues in several markets. Mortgage lenders faced strong pressure in the U.K. due to a comparable housing boom to that in the U.S., starting in the autumn of 2007.

Recognition of insolvency issues was slow, and resolution frameworks in practise turned out to be chaotic, which made the issue worse. Lack of scope (for example, investment banks and insurance corporations were not covered), poor coordination (between deposit insurance and lender of last resort facilities), and a lack of specific frameworks for bank resolution, among other shortcomings in resolution frameworks in advanced economies allowed problems to worsen. Authorities were forced to use exceptional measures to intervene in a number of situations as a result of declining market confidence and deteriorating trust..

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3.2 Government Interventions to Resolve the Crisis

Large-scale government interventions have been prompted by the crisis, both to regain public trust in the financial sector and to limit its impact on the actual economy. Mid-October 2008 saw the long overdue shift from concerns about liquidity to solvency (similar to previous crisis episodes), as asset prices crashed across markets and the risks of cascading institutional failures and financial meltdown prompted actions by authorities across a wide range of advanced countries. This also signalled the need for more rapid and significant recapitalization.

These interventions have cost very substantial financial outlays. Based on expenditures and pledges as of June 2009, advanced countries were most negatively impacted, whereas the majority of developing market nations required less capital or other financial sector help (Table 1).7

For the group of advanced countries, in particular, the money given and the guarantees offered were substantial, equal to double digit fractions of GDP on average. Approximately 2 percentage points were given to capital. Up to this moment, asset purchases had been slightly bigger, at 3.5 percentage points of matching GDPs. There have been several contingency expenses that are difficult to estimate, such as the insurance systems for assets or increased deposit insurance limitations, in addition to the significant direct fiscal expenditures that are represented by the statistics. Yes, prior experiences.

An illustration of how financial institutions and the fiscal environment might be distorted is the inclusion of the largest banks in the guarantee in the case of Ireland. The CDS-spreads for the major Irish commercial banks were exceptionally high prior to the extension of guarantees. Postbank CDS-spreads fell precipitously as a result of the guarantees, whilst the sovereign spread rose.

These kinds of measures, which are already common in many wealthy nations, skew asset markets and financial flows.

Since interventions had an impact on global capital flows and financial intermediation, distortions spread on a global scale. The initial manifestation was provided by liquidity support. Even though interbank market prices indicated severe dollar funding pressures for European banks and developing markets, U.S. actions originally centred on offering domestic support. It took mature markets many weeks to respond to these strains. Additionally, even when temporary bilateral swap lines between central banks were established and their scope steadily expanded, market prices indicated that issues persisted.

In the case of emerging markets, the response was slower and the sums offered were more constrained. Many emerging markets were severely affected by liquidity shortages. The need for significant external financial help from a variety of sources arose because emerging markets

3.3 Macro- and Micro-Prudential Oversight and Financial Stability

Bank subsidies from the government have a long history. It can occasionally be highly associated with particular transactions or circumstances and targeted. Policymakers are now concentrating on measures to make their banking and financial systems safer and more shock-resistant as a result of recent occurrences. Although many bank-dominated financial systems withstood the crisis well and did not necessitate significant overhauls, it is evident that the functions and responsibilities of the FSN entities need to be reviewed in order to identify areas where improvements may be made.

Macro- and micro-prudential supervision have been the main areas of attention for the reforms (Milne 2009; IMF 2011b). Crockett's (2000) description of the interdependent macro- and microprudential monitoring measures provides a helpful framework for understanding the crisis. A comprehensive approach to monitoring the financial system and the risks that could endanger it is necessary for a macro- and micro-prudential framework (Galati and Moessner 2011). This means that in addition to banks, other institutions that are counterparties to banks include insurance companies, securities dealers, and organisations that are primarily regulated for market behaviour rather than capital levels. A system of regulation and oversight that takes systemic risk into account as well as a LOLR to offer emergency liquidity assistance in the event that events undermine system trust were absent from the asset-backed securities market, to be sure. Poor due diligence in the selling of mortgages in a flourishing real estate market has consequences that can affect not only sophisticated financial instruments but also less complex financial products where there are significant links. If a large bank needs to be resolved, reform agendas must ensure that essential banking services can continue, and rules must be devised to ensure that the cost of a bank failure falls squarely.

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IV. CONCLUSION

The goal of this article was to reframe the FSN in the context of a systemic crisis, shifting the typical emphasis away from regulation and supervision to a much larger range of actors, including deposit insurance and the central bank's function as LOLR. It is recommended that explaining the Policy-makers are better able to grasp how the FSN should function in emergency situations thanks to the specialised responsibilities played by the many involved parties. Additionally, it will help with a better comprehension of the tools truly needed to contain a crisis and whether the governing body needs to offer those resources.

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