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IMPROVING THE PRACTICE OF FINANCIAL MARKET REGULATION

Muratov Sanjarbek Faizullo ugli
Student of the Academy of Banking and Finance of the Republic of Uzbekistan

Abstract
In this article, the scientific theoretical basis for improving the practice of financial market regulation is widely covered. The article discusses in detail the essence, important aspects of regulation of the country's financial market, methods of regulation, and developed scientific proposals for improving the regulation of the financial market.

Keywords: Financial market, capital market, stock market, listing, macroregulator, concept, international stock market, market infrastructure.

INTRODUCTION

We know that the financial market plays a key role in ensuring financial stability in the country. For financial markets to function effectively, it is important to constantly regulate them. In recent years, significant reforms have been carried out to develop the financial market and regulate its largely due to the attraction of foreign investment in all sectors of our economy, the introduction of the best world practices and transparency. Modern theories of financial market regulatio organizations and formed as a result of competition in order to attract issuers and investors at the international level. From the first days of the formation of financial markets, these goals remained practically uncha organizations (primarily in the "Goals and Principles of Financial Markets Regulation" (IOSCO). Thus, the main goals of financial market regulation are: protection of investors and ensuring transparency , fairness and efficiency of financial markets. With the development of financial markets, an increase in the number of professional market participants and market intermediaries, as well as a closer relationship between them, a new goal has b two goals - reducing systemic risks. It is also important to regulate and develop the stock market as an integral part of the financial market. The development of the financial market, especially the stock market, is also important for our country. Therefore, in recent years, extensive reforms have been carried out in this area. As President Sh. Mirziyoyev noted, “the stock market is an important tool for accumulating free money in the economy and directing it to the investment process. Therefore, today the regulation of the financial market and the study of international experience in this area is an important process for the development of the financial market in our country. The global financial crisis has generated momentum for policymakers to craft substantive regulatory reforms geared toward ensuring the integrity and resilience of financial systems in the advanced economies. The macroeconomic consequences of the crisis have also affected many emerging markets and low-income developing economies, even though this group has rebounded more quickly and sharply from the crisis than did advanced economies. While the financial systems of many emerging economies, particularly those in Asia, proved more resilient than advanced economies to the financial crisis, the shared ramifications of the crisis have brought into even sharper relief the importance of sound financial systems for emerging markets as well as developing economies. An Efficient and stable financial system is essential for any economy to achieve sustained growth and to absorb various types of shocks. The financial crisis forced the reconsideration of even basic principles of financial regulation.

Meanwhile, the imperative of financial development remains as strong as ever in emerging markets, although the focus is more on basic elements—such as strengthening of banking systems and widening the scope of the formal financial system—rather than on expanding the use of sophisticated financial instruments and innovations. Remarkably, emerging economy financial systems have in general proved to be more robust and less affected by the global turmoil compared to their advanced economy counterparts—it will be important to carefully identify the right lessons from this outcome. The crisis has highlighted the need for strengthening financial systems to make them more resilient to shocks. Emerging markets face challenges in stabilizing their still-immature financial systems in the face of shocks, both domestic and external, and financial reforms are critical to these economies as they attempt to pursue sustainable high-growth paths. New paradigms for financial development and regulation will have to be suitably reframed for emerging markets, which have a number of varying institutional and capacity constraints. Low-income developing countries, where the breadth of formal financial systems is severely limited, pose an even greater set of conceptual and practical challenges.

LITERATURE REVIEW

Policymakers in emerging markets are grappling with a number of issues, including what lessons the crisis can offer for the establishment of efficient and flexible regulatory structures, the avenues that should be pursued to enable effective regulation of financial firms with large crossborder operations, and the reforms that should be implemented to raise financial inclusion. A broad reconsideration of the optimal, appropriate regulatory and supervisory frameworks of financial firms, products and markets is needed for these economies.

Policymakers in emerging markets face a number of complex conceptual and practical challenges as they attempt to improve their frameworks for financial regulation. They need to balance the quest for financial stability with the imperatives of financial development and broader financial inclusion. These objectives can in fact reinforce one another. There are also various aspects of macroeconomic policies and cross-border regulation that have implications for financial stability and the resilience of the financial sector in emerging markets. This book ties together the various themes of the overall research agenda that covers financial market development, regulation, access and other related issues. The book attempts to assess the implications of the financial crisis for the design of regulatory frameworks and models, taking into account the specific constraints in emerging markets.

The chapters in this volume focus on identifying and evaluating the lessons from the crisis and on designing effective strategies for maintaining the momentum of financial development and inclusion in emerging markets, with a particular focus on those in emerging Asia. The main areas covered in this book are as follows:

—Basic principles of financial regulation: synthesizing evolving paradigms of the key characteristics of optimal regulatory structures to promote financial stability.

—Financial regulatory reforms in emerging markets, with a focus on emerging Asia: dealing with the challenges of limited institutional development and regulatory capacity.

RESEARCH METHODOLGY

What is the right way to approach financial sector regulation and supervision? A reconsideration of basic principles is needed to design an effective and flexible regulatory mechanism that is capable of

dealing with financial innovations and systemic risks. Before the financial crisis, the debate about optimal regulatory structures was focused narrowly on a few issues. One aspect of the debate was whether the United Kingdom's single regulator model, as embodied in the Financial Services Authority (FSA), was better than the multiple regulator framework of the United States, where the presence of different agencies with varying jurisdictions allowed large and complex financial firms to engage in regulatory arbitrage. The crisis exposed gaping weaknesses and flaws in both models. The FSA was responsible for overall financial stability but appears to have regulated with a "light touch," allowing large levels of systemic risk to build up in the system. In the United States, regulatory failures, including a similar "light touch" approach, were compounded by gaps in the overall framework for supervision and regulation that left some products and markets relatively unregulated and created large opportunities for regulatory arbitrage.

ANALYSIS AND RESULTS

Next, consider the role of complex derivative contracts, including credit default swaps. A credit default swap (CDS) is an insurance-like contract written on the performance of a security or bundle of securities. For example, purchaser A buys a CDS from issuer B on security C. If security C has a predefined "credit related event," such as missing an interest payment, receiving a credit downgrade, or filing for bankruptcy, then issuer B pays purchaser A. While having insurance-like qualities, CDSs are not formally insurance contracts. Neither the purchaser nor the issuer of the CDS needs to hold the 12 underlying security, leading to the frequently used analogy that CDSs are like buying fire insurance on your neighbor's house. Moreover, since CDSs are not insurance contracts, they are not regulated as tightly as insurance products. CDSs are financial derivatives that are transacted in unregulated, over-the-counter (OTC) markets.

In principle, banks can use credit default swaps to reduce both their exposure to credit risk and the amount of capital held against potential losses. For example, if a bank purchases a CDS on a loan, this can reduce its credit risk: if the loan defaults, the counterparty to the CDS will compensate the bank for the loss. If the bank's regulator concludes that the counterparty to the CDS will actually pay the bank if the loan defaults, then the regulator typically allows the bank to reallocate capital to higher-expected return, higher-risk assets. The Fed made a momentous decision in 1996: it permitted banks to use CDSs to reduce capital reserves (Tett, 2009, p. 49). Regulators treated securities guaranteed by a seller of CDSs as having the risk level of the seller – or more accurately, the counterparty – of the CDS. For example, a bank purchasing full CDS protection from American International Group (AIG) on collateralized debt obligations (CDOs) linked to subprime loans would have those CDOs treated as AAA securities for capital regulatory purposes because AIG had an AAA rating from an NRSRO, i.e., from an SEC-approved credit rating agency. In light of this decision, banks used CDSs to reduce capital and invest in more lucrative, albeit more risky, assets. For example, a bank with a typical portfolio of $10 billion of commercial loans could reduce its capital reserves against these assets from about $800 million to under $200 million by purchasing CDSs for a small fee (Tett, 2009, p. 64). The CDS market boomed following the Fed decision. By 2007, the largest US commercial banks had purchased $7.9 trillion in CDS protection, and, at a broader level, the overall CDS market reached a notional value of $62 trillion in 2007 according to Barth et al (2009). There were, however, serious problems associated with allowing banks to reduce their capital via CDSs. Given the active trading of CDSs, it was sometimes difficult to

indentify the actual counterparty legally responsible for compensating a bank if an "insured" security failed. Furthermore, some bank counterparties developed massive exposures to CDS risk. For example, AIG had a notional exposure of about $500 billion to CDSs (and related derivatives) in 2007, while having a capital base of about $100 billion to cover all its traditional insurance activities as well as its financial derivatives business. The growing exposure of AIG and other issuers of CDSs should have – and did – raise concerns about their ability to satisfy their obligations in times of economic stress. The Fed was aware of the growing danger to the safety and soundness of the banking system from CDSs. For instance, Tett (2009, pp 157-163) recounts how Timothy Geithner, then President of the New York Federal Reserve Bank, became concerned in 2004 about the lack of information on CDSs and the growing counterparty risk facing banks. Barth et al (2009) demonstrates through the use of internal Fed documents that Fed officials knew by 2004 of the growing problems associated with subprime mortgagerelated assets, on which many CDSs were written. Indeed, the FBI publicly warned in 2004 of an epidemic of fraud in subprime lending. In terms of the sellers of CDSs, detailed accounts by Lewis (2009) and McDonald (2009) illustrate the Fed's awareness by 2006 of AIG's growing fragility and the corresponding exposure of commercial banks to CDS counterparty risk. Yet, even more momentously than the original decision allowing banks to reduce their capital reserves through the use of CDSs, the Fed did not adjust its policies as it learned of the growing fragility of the banking system due to the mushrooming use of increasingly suspect CDSs.

Beginning in 2019 the Financial Accounting Standards Board will require any firms paying to lease real estate, office equipment, aircraft, or similar items to show such leases on the balance sheet. Leasing is likely to get a boost from the 2017 Tax Cuts and Jobs Act which caps interest expense. Consequently, equipment that might have otherwise been purchased will now be leased. Future lease payments should be discounted to the present at the firm's pretax cost of debt (i), since leasing equipment represents an alternative to borrowing, and the present value of the operating lease (PVOL) should be included in the firm's total debt outstanding. Once operating leases are converted to debt, operating lease expense (OLEEXP) must be added to EBIT, because it is a financial expense and EBIT represents operating income before such expenses. Lease payments include both an interest expense component (to reflect the cost of borrowing) and a depreciation component (to reflect the anticipated decline in the value of the leased asset). The enterprise valuation method, or FCFF, approach discounts the after-tax free cash flow available to the firm from operations at the weighted average cost of capital to obtain the estimated enterprise value. The firm's enterprise value (often referred to as firm value) reflects the market value of the entire business. It can be viewed as a theoretical takeover price. That is, it represents the sum of investor claims on the firm's cash flows from all those holding securities, including long-term debt, preferred stock, common shareholders, and non-controlling shareholders. Since it reflects all claims, it is a much more accurate estimate of a firm's takeover value than simply the market value of a firm's equity. For example, in addition to buying a target firm's equity, an acquirer would generally have to assume responsibility for paying off the target firm's debt and preferred stock. Since the enterprise DCF model estimates the present value of cash flows, the enterprise value also can be estimated as the market value of the firm's common equity plus long-term debt, preferred stock, and non-controlling interest less cash and cash equivalents. The firm's common equity value can be determined by subtracting the market value of the firm's debt and other investor claims on cash flow, such as preferred

stock and non-controlling interest, from the enterprise value.40 The enterprise method is used when information about the firm's debt repayment schedules or interest expense is limited.

Deferred tax assets and liabilities arise when the tax treatment of an item is temporarily different from its financial accounting treatment. Such taxes may result from uncollectible accounts receivable, warranties, options expensing, pensions, leases, net operating losses, depreciable assets, and inventories. Deferred taxes have a current and a future or noncurrent impact on cash flow. The current impact is reflected by adding the change in deferred tax liabilities and subtracting the change in deferred tax assets in the calculation of working capital. The noncurrent impact of deferred assets generally is shown in other long-term assets and deferred tax liabilities in other long-term liabilities on the firm's balance sheet. A deferred tax asset is a future tax benefit, in that deductions not allowed in the current period may be realized in some future period. A deferred tax liability represents the increase in taxes payable in future years. The excess of accelerated depreciation taken for tax purposes over straight-line depreciation often used for financial reporting reduces the firm's current tax liability but increases future tax liabilities when spending on plant and equipment slows. The amount of the deferred tax liability equals the excess of accelerated over straightline depreciation times the firm's marginal tax rate. To estimate a firm's equity value, the PV of net deferred tax liabilities (i.e., deferred tax assets less deferred tax liabilities) is deducted from the firm's enterprise value. The use of net deferred tax liabilities is appropriate, since deferred tax liabilities often are larger than deferred tax assets for firms in the absence of NOLs. The impact on free cash flow of a change in deferred taxes can be approximated by the difference between a firm's marginal and effective tax rates multiplied by the firm's operating income before interest and taxes. The analyst may assume the effective tax rate is applicable for a specific number of years before reverting to the firm's marginal tax rate. For example, the effective tax rate for five years increases the deferred tax liability to the firm during that period as long as the effective rate is below the marginal rate. The deferred tax liability at the end of the fifth year is estimated by adding to the current cumulated deferred tax liability the additional liability for each of the next five years. This liability is the sum of projected EBIT times the difference between the marginal and effective tax rates. Assuming tax payments on the deferred tax liability at the end of the fifth year will be spread equally over the following 10 years, the PV of the tax payments during that 10-year period is then estimated and discounted back to the current period.

CONCLUSION

A patent without a current application may have value to an external party, which can be determined by a negotiated sale or license to that party. When a patent is linked to a specific product, it is normally valued based on the "cost avoidance" method. This method uses after-tax royalty rates paid on comparable patents multiplied by the projected future stream of revenue from the products whose production depends on the patent discounted to its present value at the cost of capital. Products and services, which depend on a number of patents, are grouped together as a single portfolio and valued as a group using a single royalty rate applied to a declining percentage of the future revenue. Trademarks are the right to use a name, and service marks are the right to use an image associated with a company, product, or concept. Their value is name recognition reflecting the firm's longevity, cumulative advertising expenditures, the effectiveness of its marketing programs, and the consistency of perceived product quality. When a firm owns less than 100% of another business, it is shown on the

firm's consolidated balance sheet. That portion not owned by the firm is shown as a non-controlling interest. For valuation purposes the non-controlling interest has a claim on the assets of the majority-owned subsidiary and not on the parent firm's assets. If the less than wholly-owned subsidiary is publicly traded, value the non-controlling interest by multiplying the non-controlling ownership share by the market value of the subsidiary. If the subsidiary is not publicly traded and you as an investor in the subsidiary have access to its financials, value the subsidiary by discounting the subsidiary's cash flows at the cost of capital appropriate for the industry in which it competes. The resulting value of the non-controlling interest also should be deducted from the firm's enterprise value.

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