

## **Capital Regulation, Market-Making, and Liquidity (with Thomas Kick, Shikhar Singla and Vikrant Vig)**

### **Abstract**

We investigate the impact of higher capital requirements on market-making activities of banks in corporate bond market. Based on a unique security transactions data of German banks, we exploit the 2011 EBA capital exercise as a quasi-natural experiment. Banks forced to increase capital hold lesser inventory, pre-arrange more trades, have smaller average trade size and provide lesser immediacy in corporate bond markets. We further document a reduction in aggregate corporate bond liquidity following the regulatory intervention. Our results suggest that higher capital requirements have undesired side effects in terms of lower secondary market liquidity.