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By Tamawa Desai

LONDON, June 30 (Reuters) - Regulators should avoid enforcing too much control over financial markets or they could end up creating another liquidity squeeze, the head of a major foreign exchange industry association said.

Governments aim to clamp down on financial institutions as excessive risk-taking has been blamed for triggering the worst banking crisis and global recession in decades.

Such steps include making banks hold more capital, banning them from trading some complex products and imposing a tax on assets.

"In some areas 'overtrading' is important to keep liquidity flowing otherwise there is a risk of a liquidity squeeze again," Manfred Wiebogen, president of the Financial Markets Association (ACI), an umbrella body for foreign exchange traders, told Reuters in an interview. The association has some 13,000 international members from more than 60 countries.

"The risk is that too much regulation might come up at once," he said.

Wiebogen welcomed the Group of 20 leaders' decision at the weekend to extend a deadline on banks raising their capital and liquidity levels.

"In some aspects there is a need to hurry. But regulation should avoid too many 'quick shots'."

He also said mandating exchange trading for the currency market was not a solution.

The foreign exchange market is the largest financial market with volume of some \$3.2 trillion per day, of which 30 percent is comprised of spot trade and 51 percent of currency swaps, which are a combination of a spot and forward trade.

"Exchange trading comprises only 2 percent of market share, and that was true even during the credit crisis," Wiebogen said. "The current system works."

Rather, regulators should focus on reducing settlement risks and enhancing transparency, he said.

Wiebogen said much of settlement risk has been mitigated by the formation of CLS Bank, which acts as a central settlement system, but "we need to keep an eye on it."

More than 8,000 participants use the CLS Bank service, including banks and other financial institutions, corporations and individual funds. (Editing by Hugh Lawson) ((tamawa.desai@thomsonreuters.com; Tel: +44207 542 7018, Reuters Messaging: tamawa.desai.reuters.com@reuters.net))

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