Financial Regulation Seminar

Title: *The Mechanisms of Derivatives Market Efficiency*
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Speakers: Daniel Awrey (Oxford)

About Dan Awrey:
Dan Awrey is an Associate Professor of Law and Finance at the University of Oxford and Academic Director of the MSc in Law and Finance programme. Dan's teaching and research interests reside in the area of financial regulation and, more specifically, the regulation of banks, investment funds, derivatives markets, and financial market infrastructure.

Abstract:
Gilson and Kraakman (1984) provide a causal framework for understanding how information becomes incorporated into security prices. This framework has gone on to play an influential role in public policy debates surrounding securities fraud litigation, mandatory disclosure requirements, and insider trading restrictions. It has also provided a basis for understanding the economic role of securities underwriters and other reputational intermediaries. Yet despite its enduring influence, there have been few serious attempts to extend Gilson and Kraakman's framework beyond the relatively narrow confines in which it was originally developed: the highly regulated, order-driven, and relatively liquid markets for publicly-traded stocks.
This article examines the mechanisms of derivatives market efficiency. These mechanisms respond to information and other problems not generally encountered within public equity markets. These problems reflect important differences in the nature of derivatives contracts, the structure of the markets in which they trade, and the sources of market liquidity. Predictably, these problems have lead to the emergence of very different mechanisms of market efficiency. This article describes these problems and evaluates the relative effectiveness of the mechanisms of derivatives market efficiency. It then explores the implications of this evaluation in terms of the current policy debates around mandatory derivatives trade reporting, the push toward central clearing of standardized derivatives, dealer capital and liquidity

regulation, and the optimal balance between public and private ordering within derivatives markets.