Assessing the Role of Transparency in Derivatives Regulation

(Work in Progress)

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Transparency has been a watchword in financial regulation since Louis Brandeis, then chief economic advisor to President Woodrow Wilson, made his case for greater disclosure in the financial industry in a series of essays entitled *Other People's Money and How the Bankers Use It*. Brandeis's conception of transparency has become firmly embedded in American financial regulation. However, the complexity of the modern financial landscape presents a challenge to transparency, both as a mechanism for ensuring the relatively free and open flow of capital, and as an achievable goal in and of itself. The current debate over derivatives regulation is an apt illustration of the inherent tension between the use of transparency as a regulatory tool on the one hand, and the realities of the modern financial markets on the other. Derivatives are financial instruments that can serve a valuable purpose, reducing transaction costs and enabling the shifting of risk to those most willing and able to bear it. However, they have also been blamed for causing or contributing to the recent financial crisis by increasing systemic risk. Consequently, increasing transparency with regards to derivatives trading has been a focus of recent regulatory reform. While some regulatory efforts to improve transparency are necessary, the question remains whether these efforts will be sufficient to manage the risks caused by increased trading of complex derivative instruments. Furthermore, broad and generalized regulations to increase market transparency may not be the most cost-beneficial way to address concerns about the derivatives markets. In examining these issues, this Article will point out a number of shortcomings associated with transparency-based regulation, and will offer some proposals to make derivatives regulation more effective.

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