

# Does Antitrust Law Increase Systemic Risks Associated with Interdependent Security Issues in Financial Markets?

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The purpose of this research is to investigate whether aspects of the current US Antitrust regime fail to provide sufficient flexibility for new market conditions and challenges such as interdependent security issues characteristic of and prevalent in technologically-advanced network market economies, such as the financial markets, and consequently exacerbate the systemic risk posed by such issues.

As the general aim of antitrust law is to safeguard market competition, these laws scrutinize and constrain the interactions and communications of industry competitors. Accordingly, one concern of antitrust law is horizontal restraints and cartel behavior by industry competitors. Therefore, even certain types of “data dissemination activity” amongst industry competitors could be problematic: “[h]orizontal restraints can be created by exchanges of commercial information among competitors”<sup>1</sup> in addition to discussion of “future market conditions” as evidenced in antitrust precedents.<sup>2</sup>

The intersection of antitrust law and networked markets poses many challenges because successful network markets depend upon frequent and extensive information sharing among industry participants. Network markets are markets in which “the value of a product to a particular consumer is a function of how many other consumers use the same (or a compatible) product.”<sup>3</sup> The financial markets, particularly the derivative markets, are highly networked markets. Network markets, such as the financial markets, are arguably also highly susceptible to interdependent security problems, thereby increasing the exigency of communication and coordination among industry participants to mitigate systemic risks.

Interdependent security problems (IDSP) are categorized as problems in which the “risk faced by one person/firm depends on both its own security investments as well as on the actions of others.”<sup>4</sup> A “Class 1: Partial Protection” IDSP is a situation in which even if a firm chooses to undertake necessary risk management procedures, it could still be exposed to the risks of industry participants who fail to take such measures. But as more firms within the industry undertake such requisite investment, systematic risks should decrease.<sup>5</sup>

The derivative markets, particularly the credit derivative markets, have recently been grappling with an important IDSP: an industry-wide problem of confirmation backlogs. Confirmations are the contracts which document the economic terms of a specific trade and effect the transfer of risk which is central to a derivative transaction. In 2005, this issue ignited such concern among financial market regulators and industry groups that the New York Federal Reserve requested to meet with 14 of the major industry participants to discuss this issue along with other urgent problems posing

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<sup>1</sup> E. Thomas Sullivan and Jeffrey L. Harrison, Understanding Antitrust and Its Economic Implications, §4.10, Mathew Bender & Company (2003).

<sup>2</sup> Id.

<sup>3</sup> Mark Lemley, *Intellectual Property Rights and Standard Setting Organizations*, 90 Calif. L. Rev. 1889, 1896 (2002).

<sup>4</sup> Howard Kunreuther, Lecture: OPIM 900, April 12, 2006.

<sup>5</sup> Id.

possible systemic risks.<sup>6</sup> Even if the confirmation backlog issue is satisfactorily resolved, it is highly characteristic of the types of market security issues constantly challenging this industry, which thrives upon complex and innovative financial engineering techniques.

This research project will investigate the normative, descriptive and prescriptive aspects of the intersection of the antitrust laws with networked financial markets, particularly in regard to interdependent security problems in the credit derivative markets. The first part of this project will consist of a normative investigation of these issues, followed by descriptive, case-study analysis of the confirmation backlog issue in the credit derivatives industry and conclude with prescriptive recommendations both in regard to the antitrust laws and recommended industry actions.

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<sup>6</sup> See for example: Hamish Risk and Justin Baer, "Fed Summons 14 Banks to Discuss Credit-Derivatives Controls," Bloomberg.com (August 24, 2005), available at: [http://www.bloomberg.com/apps/news?pid=10000087&sid=aCcyORCwEhVw&refer=top\\_world\\_news](http://www.bloomberg.com/apps/news?pid=10000087&sid=aCcyORCwEhVw&refer=top_world_news).

