

The Regulatory Complexity of Innovation in The Financial Market

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Abstract

The complexity of modern financial markets is aggravated by the pace of financial innovation and can be considered an element with two variables: information costs and limited rationality. This limitation of reason has two foundations: the neurophysiological one, with regard to the human limitation in the accumulation and processing of information, and the language one, regarding the restricted capacity to transmit information. Due to the complexity, agents use heuristics as a strategy to understand the facts. For this reason, four fundamental elements in the regulatory process must be analyzed: connective technology, informational distortion, regulatory fragmentation and reflexivity. These elements, in turn, can be separated according to three influences: (i) regarding the veracity of the information, (ii) regarding the processing of information and (iii) regarding the change of information. In this way, it reflects on financial innovation and how its process of change is influenced, considering the incentives of the agents themselves that can mitigate the complexity and improve the understanding of the dynamics in accelerated evolution in modern financial markets and, consequently, illuminate the regulatory challenges arising from the interaction of complexity and innovation.

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