Regulators are inching ever closer to the G20 policy goal of greater transparency in the global derivatives markets. 2018 will see the regulatory trends of 2017 both fine-tuned and enhanced.
In the past ten years, several principles, regulations, and codes have been introduced with the goal of piercing the opaque derivatives trading veil and increasing investor protection. In 2018, these initiatives will be fine-tuned to ensure financial markets offer even greater access, uniformity, and visibility.

The Roll-Out of LEIs

The mandatory roll-out of Legal Entity Identifiers (LEIs) under MiFID 2 is set to enhance derivatives trade transparency requirements already found within the European Markets Infrastructure Regulation (EMIR), Market Abuse Regulation, and Securities Financing Transactions Regulations.

All market participants, whether they are large financial institutions or small corporates, require an LEI to enter financial transactions with EU trade counterparties. The LEI requirement therefore impacts non-EU entities trading on EU exchanges or with EU domiciled counterparties. The meaningful, long-term benefits of a coordinated, global LEI system include improved oversight and visibility into the financial sector by ensuring connections between entities are identified and data can be linked.

Although MiFID 2 took effect January 3, the European Securities and Markets Authority (ESMA) announced a six-month grace period on LEI reporting, giving firms more time to comply with the new requirements.

Fine-Tuning the Rules

Transparency of reporting under EMIR is already well underway within the derivatives market, with the rules covering both over-the-counter and exchange-traded derivatives. The next step will be tweaking the rules based on market feedback, the benefit of experience, and the aim of co-existing with overlapping regulations. An industry consultation is underway and should be advanced significantly within 2018.

Transparency in the derivatives market will also be enhanced through Packaged Retail and Insurance-based Investment Products (PRIIPS). The regulation expands on the UCITS 4 requirement to provide retail investors with a standardized Key Information Document (KID) explaining the key features, costs, and risks of investment products. PRIIPS extends this obligation to products that retail investors may have indirect exposure to via a wrapper, including derivatives. As well as outlining their objectives and risks, derivatives must disclose information on all transaction costs and forward spreads in the KID. The regulation took effect on January 1, 2018, although UCITS schemes have until December 31, 2019, to adopt the new standard.

Enshrining the Principles of Transparency

Aside from hard regulations, there has been widespread adoption of the voluntary Foreign Exchange Global Code of Conduct, introduced to restore faith in the foreign exchange market following high-profile misconduct cases. Despite not being law, the Code’s principles of ethics, governance, information sharing, risk management, and compliance are being enshrined in the day-to-day practices of the global FX market. This is partly because of encouragement from asset managers and the Bank of England, a key proponent of the Code.

In the future, the increasing sophistication of technological tools in the derivatives market will lead to a growing demand for transparency. Whether it is in the publication of trade data or the use of new technologies such as distributed ledgers to reduce risk and maximize accessibility, it is imperative that recipients are sufficiently equipped to understand the information they receive.

A Constant Battle

So, when will the market be considered fully transparent? This will be a constant battle. As technological advances continue, we must continually review the landscape and ensure derivatives regulation is keeping up with markets.

“The increasing sophistication of technological tools in the derivatives market will lead to a growing demand for transparency.