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EU should avoid US mistake on derivatives trading data

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You wrote in early October that finance ministers from the EU's member states had agreed a mandate for negotiations in talks with the European Parliament on the European market infrastructure regulation (EMIR) (4 October).

They will need to settle a large number of critical issues, particularly relating to extraterritoriality and harmonisation of new regulations internationally.

One issue that could undermine efforts to bring greater transparency to the global market for over-the-counter (OTC) derivatives is a relatively obscure provision of the US's Dodd-Frank Act, which was intended to protect the confidentiality of market data. Instead, it may create global fragmentation of data and hamper the ability of regulators to monitor and mitigate systemic risk.

The problem is the provision's requirement that trade repositories registered with US authorities need to obtain indemnification agreements from regulators prior to sharing critical market data with them. Because this requirement is independent of the location of the entity, it would have an impact on European trade repositories.

Trade repositories are essentially large databases, which aggregate and standardise detailed OTC derivatives trade data. They are vital to increasing transparency in the markets, because regulators can look at data in the repository to see the exposure of a particular entity at the click of a button.

Repositories not only contain the pieces of the jigsaw puzzle, but also assemble the pieces to give regulators a complete global picture. A repository can be truly effective only if it holds all of the pieces of the puzzle.

Unfortunately, the US provision encourages the jigsaw to be scattered. As a result, gathering all the pieces to put together a global picture would be a slow, complex and confusing process – if not next to impossible. US lawmakers and regulators are aware of these problems, but revisions to the Dodd-Frank Act are unlikely to be made before the US presidential election in 2012.

This time-lag creates an opportunity for the EU to create a pragmatic policy with which the US and other nations could harmonise their regulations. But the European Parliament may instead choose to follow the Dodd-Frank example by adopting a similar reciprocal indemnification provision. This would open the door to regulatory arbitrage.

That would be a mistake. Europe should instead push for a uniform global data set, even if it takes a little bit longer to achieve. It is easier to put a puzzle together if you have all the pieces at your fingertips.

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