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Progress on the Legal Entity Identifier

GLEIF has been reporting monthly statistics on the LEI since January

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Regulators have been reporting on the total number of Legal Entity Identifiers (*LEIs) issued since the new swaps regulatory regime was put in place in the US in 2012 and in the EU in 2014. Since January 2016 the Global Legal Entity Identification Foundation (GLEIF) has been reporting LEI statistics on a monthly basis.*[1] *The month of July, 2016 was the second month in a row of net gains in new LEIs issued vs. existing issued LEIs that have not been renewed (have lapsed). Lapsed LEIs had exceeded newly issued LEIs for some time.*

While encouraging it's also troublesome that while total LEIs issued as of month-end July stands at 454,699, only 313,378 have been renewed as required annually. More discouraging is that the two most prominent US regulators that were first to support the LEI back in 2010, the CFTC and the Federal Reserve, and the most prominent trade association, SIFMA, are now hesitating on going full throttle on its implementation. Besides being concerned over the failure to renew LEIs, other reasons are that the regulatory requirement for the LEI system to be operational, taken to mean useful for aggregating swaps reporting data, is no yet proven; and that maintenance of LEIs needs to be more timely to reflect corporate events that change control or cause LEIs to expire.

Current Status

The first test of the usefulness of the LEI, along with two other identity standards, the unique product identifier (UPI) and the unique transaction identifier (UTI), was to take place in the newly regulated global swaps market. These codes, rushed into production after the 2007 – 2008 financial crisis, had not been coordinated amongst regulators as to their code structure or their ability to be used in data aggregation.

The result was predictable, billions of transactions being reported to swaps regulators with no means to access them or aggregate them, hence no ability to detect systemic risk and no benefit for industry members. These 'Barcodes of Finance' was expected to allow for straight-though-processing for financial institutions as the barcodes of commerce had done for the commercial and retail trade supply chain. For financial regulators it was expected to provide an automated means to observe the build-up of enterprise risk across silos of businesses within each financial institution and systemic risk across the global financial system.

To aggregate transaction data for valuation and risk analysis these independently derived codes have to be mapped together - product or contract codes horizontally for a total picture of a single asset position and the LEIs vertically through its hierarchies of ownership and control for an aggregated view of a counterparty.

These processes are the same across all financial market participants and their products. These mappings are in addition to the mappings to the hundreds of proprietary codes required of data vendors and software companies so that financial institutions can ingest them into their business applications. To this later point the regulators promised the industry that these proprietary codes had the potential to be replaced over time with these Barcodes of Finance.

A Closer Look at LEI Issuance

Progress has been slow. The chart below follows the seven month period, month-by-month, of reports of total issued LEIs, newly created LEIs and lapsed LEIs (failure to renew LEIs on first or subsequent annual anniversary of LEI registration).

Report of LEI Population							
2016	January	February	March	April	May	June	July
Total LEIs Issued	419,175	424,559	430,338	436,019	442,186	449,027	454,699
Newly Issued	4,747	4,992	5,459	5,178	6,067	6,512	5,387
Lapsed	6,742	7,418	11,330	7,318	6,383	5,364	4,614
Increase/decrease	-1,995	-2,426	-5,871	-2,140	-276	+1,148	+773

At the July 2016 end of reporting period, 454,699 LEIs had been "Issued", of which 69.8% or 313,378 had been 'validated'. At this time many, but not all regulators require a swaps market participant under their jurisdiction to obtain a LEI. Besides LEIs being issued, sustaining those registered LEIs in a validated state is a critical determinant of success of the LEI initiative. The LEI when used in a swaps transaction remains active whether the LEI is renewed or not. This can be one reason the issued vs. validated LEIs are at variance by 30% as there is no compulsion to renew a LEI.

A Slow Down in Momentum

This lack of compulsion to renew LEIs was evident in the European Securities and Markets Authority (ESMA) final rules on MIFIR (Markets in Financial Instruments Regulation)[2] and MIFID (Markets in Financial Instruments Directive)[3]. These rules, while requiring a LEI for a client or a counterparty, do not require that reporting parties require an LEI to be renewed. This even though ESMA proposed rules compel use of a LEI in order to place trades in any financial market.

Asset servicing functions and changes to economic events that require either updating of LEI data or replacement of LEIs will be out of synch with the LEI renewal process of the GLEIF, which only requires LEI to be revalidated annually. This is even more troublesome as LEIs are being proposed to be used as a component of the UTI to create uniqueness of each UTI. The LEI's and the UTIs will rapidly become stale and out of synch with the actual operations of the financial system.

In the US the lack of embracing the LEI beyond swaps transactions was even more disappointing.

When asked for a recommendation, the Securities Industry & Financial Markets Association (SIFMA) did not recommend to the Securities & Exchange Commission (SEC) that its broker-dealer members be compelled to obtain an LEI. These LEIs were to be used to uniquely identify themselves in the SEC mandated Computer Audit Trail System (CATS).[4] Earlier SIFMA's CEO was advocating regulators' mandating of the LEI in a Financial Times editorial as recently as August 2014.[5]

This follows the Federal Reserve's similar hesitation in 2015 in mandating LEIs for their reporting requirements.[6] The CFTC in similar manner has only been renewing the US issuer of LEIs one year at a time, permanent authorization conditioned on when the GLEIS is 'fully operational'.[7] This 'fully operational' criteria may be the result of the Financial Stability Board conditioning the LEIs finalization on the ability to use the LEI for risk data aggregation in swaps transactions.[8] This is a capability not yet available, although it has always been a critical requirement from inception. A proposed pilot is expected in late 2016-2107.

In April, 2016, in the US Congress, a bill was brought forward for consideration that would hold the Office of Financial Research (OFR) responsible for the progress of the LEI initiative. It would require that the OFR report on regulations mandating the use of the LEI to ensure the adoption of the LEI by primary financial regulators.[9] It should be noted that even though the LEI was first championed by the OFR and worked on its deployment initially as a US undertaking it did so without any reference to the LEI in the Dodd-Frank legislation. This amendment in some respects creates the justification for the OFR's pursuit of the LEI. Right now the OFR has been pursuing the LEI under Dodd-Frank authority to pursue 'other necessary data' after direct reference to establishing a LEI was removed from early drafts of Dodd-Frank.

Moving Forward

To gain acceptance as the global standard the GLEIF must transition the LEI from a once-a-year renewal to a more timely updating cycle. Registrants themselves are responsible for the accuracy of the LEI data, they therefore, should also be responsible for the maintenance of the LEI in timely announcing mergers, acquisitions, bankruptcies and other changes or expirations of LEIs. Further, not until the LEI is incorporated into internal financial systems as the de-facto global identity standard, with standard hierarchies of control and ownership will significant progress be made in the lapse rate even though regulatory compulsion will surely increase the issuance rate.

The GLEIF is faced with a herculean task to make the Global LEI System (GLEIS) and its LEI data relevant to industry members. Industry members have been looking for significant operational costs and risk reduction as part of following regulatory mandates to obtain an LEI. Regulatory compulsion was the accepted means by which this would be accomplished. This was thought the best way to overcome the long-standing inertia of the failure to take collective action by industry members themselves. Without regulatory mandates, and the industry supporting it in practice, then a new approach may be needed.

The industry through XBRL International is already focused on automating at-source input on LEIs, their hierarchies and changes to each using the XBRL Reporting language. Two working groups, the Corporate Action Working Group and the LEI Working Group are set to make direct at-source digitization of LEI registration and maintenance information directly accessible to consumers of this data. This data would be exportable to the GLEIS through XBRL Taxonomies, the same technique that digitizes financial statements at-source. With these tools timely preparation and reporting of new registrations and maintenance updates of LEIs is made practicable. The GLEIF should incorporate such plans toward achieving the virtual real-time global utility its Regulatory Oversight Committee proposed to and was accepted by its governing global standards setter, the Financial Stability Board.

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