TABB FORUM
WHERE CAPITAL MARKETS SPEAK

The Global Legal Entity Identifier – Hurry Up, But Go Slowly

Allan Grody, Financial InterGroup
29 June 2017

Hurrying up to pass regulation and then figure out how to implement it has so far lead to incremental and unproven implementations. The history so far for OTC derivatives implementations, the precursor for the underlying plumbing for all systems yet to come, is a dysfunctional set of unproven data standards and trade repositories that yet lack the ability to aggregate any of these transactions. Imposing potentially millions of additional LEIs on each newly reported financial transaction, especially in a yet to be tested or proven system, is not prudent.

The Global Legal Entity Identifier (LEI) Foundation (GLEIF) has assigned through its 29 local operating units (LOUs) a half-million LEI codes to date. Operationally they are being used mainly in reporting OTC derivatives transactions to trade repositories. However, nearly one-third of these have not been renewed annually as required.

Renewing these Lapsed LEIs is seen by the government overseer of the GLEIF, the Regulatory Oversight Committee, as essential to maintaining the high quality, viability and legitimacy of the LEI system. The European Union, however, is waiving this requirement. The EU is accepting Lapsed LEIs for its soon-to-be implemented MiFID II regulation. This regulation requires financial market participants engaged in any financial transaction admitted to trading on any organized trading venue to obtain a LEI. DTCC, the operator of the largest LOU, has estimated that requested new LEIs can double by year end, even reaching 2 million additional LEIs.

[Related: "No LEI, No Trade: Preparing for the MiFID II Go-Live"]

This is occurring even though no study of using LEIs as the key to aggregating a single asset type, swaps, across multiple trade repositories has been conducted. This test is essential to determine the quality of the LEI data and the appropriateness of the legal entities' codes used to associate a financial market participant with its reported transaction data. This test is impossible to do today because there still are no standardized transaction data elements reported to multiple trade repositories.

Further complicating the rush to issue additional LEIs is a pilot study currently underway to gather relationship information starting with immediate and ultimate parent LEI data so that counterparties can be aggregated up through their parent entity. This is a process that is essential to the main objective in regulating the OTC derivatives markets, analyzing systemic risk.

The pilot is to last six months. It is currently in its second month and while it is early days, about one-third of the reporting LOUs have yet to begin reporting relationship data. Thereafter, an evaluation will be done to determine whether objectives have been met, any flaws have appeared, any modifications are indicated, and most important, determine what would be the timing for a “go/no-go” decision.

The LEI is the most essential identifier as it is to be paired with both the Unique Transaction Identifier (UTI) and the Unique Product Identifier (UPI) to enable financial transaction aggregation by asset class and counterparty, an essential process to analyze systemic risk. The LEI is also essential to creating uniqueness of financial transaction data to be reported to trade repositories and, ultimately, to regulators.

Other activities underway but yet to be accomplished include agreement on both a universal UTI and UPI code construction technique; a UPI assignment platform for OTC derivatives; and a UTI assignment platform for UTIs. Further requirements are to first identify and then to harmonize (aka standardize) all the data elements associated with OTC derivatives.

The Bank of England recently reported on its attempt to use already reported data in just one sub-segment of the OTC derivatives market, foreign exchange derivatives, in a single trade repository, DTCC’s Trade Repository. It found significant data quality issues with newly created UTIs, UPIs, and LEIs.

Notwithstanding this, European Union regulators are proceeding to mandate an even more comprehensive set of data requirements for most other tradeable instruments, built on work to date on OTC derivatives requirements. New rules are to go into effect this coming January, referred to as the “no LEI, no trade” rule, and the “no LEI, no admission to trading” rule. The rules require an LEI to be issued and present within an order’s data element construction before a trade is placed on a trading venue. It also requires that the issuer of an instrument (stock, bond, et al) also obtain an LEI before the instrument is admitted to trading.

Trading venues, in turn, are required to submit granular instrument-level reference data to the Financial Instrument Reference Data System (FIRDS), a system newly built and overseen by the European Securities and Markets Authority. This approach is in stark contrast to the proposal to collect reference data by the Office of Financial Research (OFR). Whether or not agreeing on the merits of the OFR’s proposed public/private development approach or its determination that standards are needed to progress this further (FIRDS has already defined such standards), ESMA’s FIRDS project was neither discussed nor referenced as a possible approach in the OFR’s report. Neither was our own Central Counterparty for Data Management approach referenced or considered.

The mind-set of hurrying up to pass regulations and then figuring out how to implement it has so far lead to incremental, mainly partial and unproven implementations, each built around legacy best practices. The history so far for OTC derivatives implementations, the precursor for the underlying plumbing for all systems yet to come, is a dysfunctional set of unproven data standards and trade repositories that yet lack the ability to aggregate any of these transactions, now numbering well into the billions. Imposing potentially millions of additional LEIs on each newly reported financial transaction, especially in a yet to be tested or proven system, is not prudent.

This should be foremost in the minds of regulators and, especially, industry groups, as the major implementation milestone is only six months away.