

FREQUENTLY ASKED QUESTIONS ABOUT THE GLOBAL LEGAL ENTITY IDENTIFIER (LEI) SYSTEM (GLEIS)

ALLAN D. GRODY

Background

The G20's Global Legal Entity Identifier (LEI) initiative is intended to provide regulators transparency into the financial system and a computerized means to aggregate financial transactions so that they may carry out mandates to observe and mitigate risks to the global economy. This capability would be useful to limit systemic risk, a key objective promoted by the various global and sovereign regulators that make up the Financial Stability Board (FSB) and the Regulatory Oversight Committee (ROC). Its first use is intended for swaps data reporting.

Q What is the LEI and what business entities are covered?

A The LEI is a globally unique identifier for all financial market participants entering into financial transactions. See below from the Financial Stability Board's (FSB's) June 8, 2012 Recommendation 8¹

SCOPE OF COVERAGE Eligibility of 'legal entities' to apply for a LEI should be broadly defined, in order to identify the legal entities relevant to any financial transaction. No more than one LEI may be assigned to any legal entity.

For purposes of this definition, the term 'legal entity' refers to a legal person or structure organised under the laws of any jurisdiction. Legal entities include, but are not limited to, unique parties that are legally responsible for the performance of financial transactions or have the legal right in their jurisdiction to enter independently into legal contracts, regardless of whether they are incorporated or constituted in some other way (eg trust, partnership, contractual, etc). It excludes natural persons, but includes governmental organizations; and supranationals, defined as governmental or non-governmental entities established by international law or treaty or incorporated at an international level. Examples of eligible legal entities include, without limitation: all financial intermediaries; banks and finance companies; all entities that issue equity, debt or other securities for other capital structures; all entities listed on an exchange; all entities that trade stock or debt; investment vehicles, including mutual funds, pension funds and alternative investment vehicles constituted as corporate entities or collective investment agreements (including umbrella funds as well as funds under an umbrella structure, hedge funds, private equities, etc); all entities under the purview of a financial regulator and their affiliates, subsidiaries and holding companies; and counterparties to financial transactions.

Q An ISO 17442:2012 Legal Entity Identifier (LEI) Standard has been endorsed by the FSB and now the ROC. It is the official length, character string and check digit method for the LEI. In its first appearance, however, it was interpreted by some that in satisfying the non-intelligence requirement of the standard it was to be exclusively an 18 character randomly generated number/character set. Is this still the case?

A No. Subsequent studies have further partitioned the code into a four (4) digit prefix, two (2) zeros (0's) for future expansion, a 12 character entity-specific code component and two check-sum digits calculated from the previous 18. However, the randomly generated number/character set is still thought of and being used as a non-intelligent code construction for the entity-specific portion of the code. The United States Commodity Futures Trading Commission (CFTC) and Germany's BaFin have endorsed such a preliminary LEI, the pre-LEI CICI in the US swaps market and the pre-LEI GEI in Germany. (It should be noted that the more granular code construction is not an ISO standard, but rather an implementation approach of the standard).

Q What does "non-intelligence" mean in the LEI code construction?

A Non-intelligence means that no computer or human can parse the code and find out anything about the underlying entity. Finding out about the code's owner (the entity) and other characteristics of the entity must be referenced from one or more databases, referred to as LEI Registries, by using the code to access this information. However, this does not mean that the code can't be memorized so that upon observing the code it is recognized as identifying a specific legal entity.

¹ Financial Stability Board, A Global Legal Entity Identifier for Financial Markets, Recommendation 8, http://www.financialstabilityboard.org/publications/r_120608.pdf, June 8 2012, at page 35

Q What does persistence of the LEI code mean as defined by the FSB in their LEI recommendations?

A Persistence of the LEI code is defined by the FSB as:

“The code should be persistent, in the sense that the code would never be assigned to another entity.”

However, this does not mean the identity of an entity assigned an LEI cannot receive another LEI after a corporate event changes its organizational affiliation. An LEI inherited by another LEI, as for example in a merger or acquisition would be “decommissioned” and a new number assigned. The decommissioned number would be left in the reference data of the LEI registry containing the new LEI. The new LEI can contain the decommissioned code as reference data pointed to in its LEI Registry for audit trail purposes.

Q As the US Treasury's Office of Financial Research (OFR's) Chief Counsel now holds the Chair of the ROC, how should the OFR's recent report referencing “one golden standard” for the LEI be interpreted?

A The FSB and now the ROC have described a “consistent” and “uniform” global legal entity identifier system. As the ROC takes over from the FSB's regulatory Implementation Group (IG), and forms the Central Operating Unit (COU) and its Board of Directors, it will be their decision after consultation with industry experts as to what such a consistent and uniform LEI standard will be. The Committee on Evaluation and Standards (CES) has the responsibility to review and advise on all standards.

Q What was intended for the March 2013 launch of the global LEI system? The recommendations allow for some jurisdictions to act as “early adopters.”

A In advance of the full global LEI system being established, local jurisdictions have begun moving ahead with identification systems for swaps data reporting. Some have issued a pre-LEI, as the term is defined by the ROC, intended to be consistent with the global LEI standard. These are the first LEI candidates for evaluation by the ROC for inclusion into the global system.

Q A recent FSB report noted that the March 2013 commencement date is ambitious given that the only LEI-like code that exists today for reporting is the US's CICI (the CFTC's Interim Compliant Identifier). WM DatenServe recently announced that its German Entity Identifier (GEI) portal was also available for registering legal entities. Has the CICI become the LEI in the US, and the GEI in Germany as of the announced March, 2013 commencement date?

A The CICI and the GEI do conform to the intended global LEI standard (as pre-LEIs). The FSB's IG and now the ROC has made an explicit commitment for the CICI, the GEI, and any other pre-LEI authorized by a public authority that is a member of the ROC to be able to “transition” to the global LEI. However, those transition rules have not yet been finalized. The ROC has stated that the detailed procedure for obtaining global recognition related to the transition towards the LEI will be disclosed shortly after settling remaining issues. At this time, the unofficial date as reported in the press by LEI and now ROC officials for the startup is July 2013 in deference to the expected start date for international swaps regulations becoming effective. However, the issues related to harmonization of international swaps regulation is still being debated as of this writing and the July date may also be postponed.²

Q The FSB report identifies the US supplier of the CFTC's CICI as a candidate to become a LOU (Local Operating Unit) for the Global LEI System (GLEIS). Noting that the CFTC has given the US supplier, the CICI Utility, an interim mandate which expires in mid-2014 and is callable on six (6) months' notice, when will this candidate or others be granted final LOU status?

A The criteria to become an LOU within the GLEIS have not yet been established other than that a ROC member must sponsor a pre-LOU candidate. We assume that establishing such criteria will be one of the priorities of the ROC and the CES. The final decisions will be made by the yet to be established Board of Directors who will establish and oversee a Central Operating Unit to set and maintain standards for the LEI, the LOUs and the network.

Q The CFTC has exempted counterparties in privacy jurisdictions and foreign banks and foreign branches of US banks from having to register a CICI until the exemption expires in July 2013. What will happen thereafter?

A It was assumed that this “issue” will be resolved prior to the date of the expiration of the exemptive order. There is a group of foreign regulators meeting together with the CFTC to resolve this issue, primarily around the arguments of extraterritorial overreach of the CFTC in swaps regulation where the CICI and other pre-LEIs will be first used. One CFTC Commissioner has expressed doubt that this date can be met. This issue has been “resolved” with the US's SEC

² U.S. Needs More Time on Overseas Swaps, Democratic Senators Say, Bloomberg News, <http://www.bloomberg.com/news/2013-06-26/u-s-needs-more-time-on-overseas-swaps-democratic-senators-say.html>, June 27, 2013

through accepting “substitute regulation” but they have yet to mandate security-based swaps data reporting or use of the CICI.

Q What is the current state of implementations of the first uses of candidate pre-LEIs, the CICI in Swaps regulations in the US and elsewhere?

A The CICI is currently being used in the US by 70 Swap Dealers and 8 Major Swap Participants to report information to Swap Data Repositories (SDRs) and to the CFTC. The CFTC reports they were overwhelmed by the data coming to them in varied reporting formats. Nearly 1000 different data elements are being sent to describe swaps creation and continuation data. The next reporting date was April 10, 2013 when all swaps counterparties would have had to report this same information on their swaps transactions. The CFTC provided an exemptive relief order on April 9th and effectively postponed swaps data reporting to them, although they continue to require counterparties to acquire a CICI and report to the three SDRs and two more that are applying for status as SDRs in the US. Globally, there are currently 15 other SDRs and more expected.

The CFTC, at an April 30, 2013 Technical Advisory Committee meeting, described to the industry the issue of their lack of capability to aggregate data from disparate locations, and sought direction from the industry and particularly from SDRs. A proposal has been made to the CFTC, to each SDR and to them collectively that they pursue a federated model to aggregate data, similar to how the aggregation of separate LEI registries for the GLEIS is to be performed as required by the FSB and now the ROC.

The FSB in their April 15, 2013 progress report on OTC Derivatives reform recognized this as a global problem and sought a study to define a best approach to aggregating the data of multiple SDRs that are being formed globally. These SDRs will rely on multiple local LEI registries and the individual LEIs registered therein to be the first pillar for the aggregation of data across counterparties and across hierarchies of relationships of LEIs. The global aggregation of SDR data has now been taken up at the global level by the Financial Stability Board with a scheduled date of mid-2014 for a final report on options.³

Q The goal of the LEI initiative is to identify the contagion of systemic risk building up in the global economy. How will that be accomplished?

A The concept is to aggregate LEIs into their appropriate control structures such as by accounting consolidation rules to determine risk across all the legal entities that comprise a financial market participant. It is also the objective to do so across legal entity

structures such as trusts and Special Purpose Enterprises (SPEs) used for various purposes including securitizations and derivatives. Finally, it is expected that control groups will need to be aggregated in instances where economic interdependence can cause funding or repayment difficulties.

Q What has been determined as to how to organize such control structures?

A One approach being discussed is to set up LEIs with reference data that identifies its parent and/or ultimate parent identifiers. Whether both or one or the other will be required at LEI set up time or at a later time is still under consideration. An additional concept of an ultimate control entity has been proposed which would conform to definitions of non-equity controlling interests. Finally, the concept of a categorization of control groups that are not affiliated entities has been proposed. These are categories of businesses that are economically interdependent due to their interconnectedness within an industry or segment of an industry or within a particular governing set of risk regulations i.e. banks or brokers or hedge funds, as examples and more granularly, swaps market participants in the US, in Europe, or in total globally.

Q Are there proposals to use the GLEIS to observe the contagion of systemic risk building up across the financial system?

A Yes. One proposed approach leverages the individual LEI registries in a networked solution to perform systemic risk aggregation. It requires each LEI register to conform to specifications for a “network architecture” and “plug-in card” envisioned by the FSB, not unlike how the architecture of the Internet interoperates. This proposal recognizes that the only place the complete and timely set of LEIs will be updated and stored is in the Global LEI system (GLEIS), a federated global LEI registry network which is to be locally administered in home country jurisdictions. This home/host country is also where risk data associated with financial transactions are to be sourced from, making the LOUs a natural place to aggregate this data locally and, in turn, make risk data available globally through the same virtual data-basing and intelligent network concept envisioned by the FSB for the LEI.

Q What is an intelligent network?

A The “concept” of an intelligent network has its roots in early work on semantic networks where meaning through data tags is imparted to the data that flows through it. A lot of this work was conducted and still is conducted in the military and intelligence communities. The systemic risk and straight-through-processing (STP) application of such an intelligent network is at the heart of the federated network approach envisioned for the GLEIS.

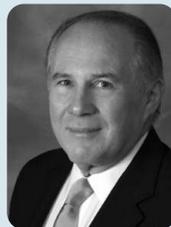
³ FSB's Plenary Progress Report see Press Release , June 25, 2013 at Page 2

The concept of an intelligent semantically aware real-time financial network was previously presented to the SEC, the CFTC, and the US Treasury's Office of Financial Research. This was done in late 2010, in response to these three agencies' separate solicitations of interest in a global identification system and its use in swaps regulation and data reporting. It is part of the public record of each agency.

Most recently this work and the evolving LEI network were proposed to the European Union (EU) as the backbone of an intelligent semantic network. The network is referred to as the Financial Industry Ontologies for Risk and Regulation Data (FIORD) Project, proposed under the EU's Seventh Framework Program (FP7) for Research. The proposal was submitted on April 26, 2013 by a consortium of European Universities, financial institutions and technology companies. Its aim is to provide novel algorithms, software infrastructures and methodologies for real time interaction, visualization, analytics and decision support applications over extremely large volumes of data (both structured and unstructured).

Mr. Grody advises the FSB on the GLEIS and is the Advisory Board Chairman of the FIORD Project.

ABOUT THE AUTHOR



Allan D. Grody is the President of Financial Intergroup Holdings Ltd. He is a founding editorial board member of the Journal of Risk Management in Financial Institutions and founding partner of Coopers & Lybrand's (now PwC's) financial services advisory practice. He was the founding professor of the graduate risk management systems course at NYU's Stern School of Business and was a founding Board Member of the Futures Industry Association's Technology Committee. As an industry practitioner he held staff and management positions in commercial finance and international banking, and in investment management and the securities industry.

He writes and speaks frequently on topics at the intersection of risk management and data management within the context of current regulatory reform efforts aimed at risk adjusting the financial system. He can be reached in New York City at (917) 414-3608 and at agrody@FinancialIntergroup.com



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Contact Alex Voicu at alexv@prmia.org for more information.