Q&A

LEI Created to Help Regulators Scout Systemic Risks, Firms Manage Exposures


David Strongin and **Tom Price**, managing directors at the Securities Industry and Financial Markets Association, tell Dana Wilkie "legal entity identifiers" could promote stable financial markets by providing regulators a tool to better monitor systemic risk and help firms effectively measure counterparty exposure.

Q: The legal entity identifier has been lauded as helping regulators use glo-computer networks to scout through financial firm data for signs of systemic risk. How would it work?
A: A simple way to think about this is to compare an LEI to a U.S. Social Security number. My Social Security number is a key identifier whether I'm paying for my mortgage or a car loan, applying for employment or using my local library. It's one common identifier that is unique to me that helps track all of my counterparties – or the financial relationships I have with others. That's what we create with an LEI. It will be used to track the relationship of legal entities involved in financial transactions. You'll eventually be able to track not only XYZ company, but all the legal affiliates of XYZ. Whether you're dealing with a counterparty in credits, equity, prime brokerage, or derivatives, you'll be able to create a more holistic and accurate picture of your counterparty exposure.

Q: Companies, their affiliates and their subsidiaries already have unique identifying names. Why not use these?
A: Identifying legal entities solely by name can be problematic. Names can be abbreviated, misspelled or changed. For example, Lehman may be LEH in one part of the firm, or LEH LLC in another part of the firm. You can imagine if you are a regulator and you have this database of information and each branch of the firm is identifying itself differently, it becomes difficult to quickly aggregate all that information. Using a common alphanumeric standard is simpler and more effective.

Q: What is the status of LEI in the U.S.?
A: Dodd-Frank mandates LEI use in swaps reporting to the U.S. Commodity Futures Trading Commission starting July 16. To help firms prepare, the industry's solution providers have published a test file of provisional LEIs, and are working on a prototype system which, if accepted by regulators, would be available for use as firms work to comply with the CFTC's July deadline. In addition, the Office of Financial Research is developing data standards for identifying legal entities across the broader financial system. Other U.S. regulators are exploring how to include the LEI in their reporting requirements.

Q: Why did SIFMA pick SWIFT and DTCC to develop LEI?
A: The industry concluded that these solution providers would be able to meet the industry's recommended requirements for an LEI framework as laid out in our letter to regulators. The solution would leverage ISO standard 17442 and would include working with national numbering agencies to provide global coverage. There are many approaches to entity identification, but we believe the SWIFT/DTCC combination is the best path forward.

Q: Regulators in other nations have not mandated LEI. Why not?
A: Canada, Singapore and Australia, among others, have recognized the value of an LEI in some of their draft proposals, but have not, to date, mandated anything. The European Securities and Markets Authority has put out draft requirements that says the LEI must be used once publicly available. A report by the International Organization of Securities Commissions discusses the benefits of the LEI. While we might be first out of the box, you can see the global community moving toward the recognition that an LEI is important as a risk management tool.

Q: It was estimated in one submission to the SEC that each big U.S. bank spends $250 million to $1.25 billion a year on processing non-standardized, faulty or duplicated data. One investment bank estimated it would save $300 million a year from an LEI regime. Can we quantify how much the LEI might help companies save money?
A: It won't replace back office functions, but the LEI makes it easier for firms to aggregate data from multiple sources and reduce the need for reconciling inconsistent information from varying sources. We don't have specific estimates, but I've heard numbers out there in the $400-million-a-year range. The LEI is certainly going to provide cost savings.

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