The LEI Of The Land

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As the Financial Stability Board takes on responsibility for developing the governance framework for the legal entity identifier (LEI), Nicholas Hamilton looks at what the protagonists in the LEI project are doing to prepare the way for implementation

With every passing month, the project to establish a global legal entity identifier (LEI) is gaining pace. In October, Inside Reference Data reported that the Group of 20 Finance Ministers and Central Bank Governors (G-20) had expressed its support for the project in a communiqué at its meeting in Paris. In November, the G-20 went further in its final declaration at its summit in Cannes, which stated: "We support the creation of a global LEI which uniquely identifies parties to financial transactions. We call on the Financial Stability Board (FSB) to take the lead in helping coordinate work among the regulatory community to prepare recommendations for the appropriate governance framework, representing the public interest, for such a global LEI by our next Summit." The involvement of the G-20 and the FSB has been welcomed by the industry, but there is still a lot of work to do in a short time.

The FSB—the global body co-ordinating the work of national financial authorities and standards bodies—has until June 2012, when the G-20 holds its next summit in Mexico, to develop a governance framework for the LEI. It must decide how to tackle issues such as ensuring the LEI provides both appropriate confidentiality and accessibility of information, and that the funding model for the LEI does not give rise to monopoly profits.

To help it do this, there are a number of governance frameworks in use elsewhere-including the governance frameworks of accounting standards bodies and the governance and oversight principles used by industry standards co-operative Swift-which the FSB may be able to use as examples. When the FSB has agreed on a governance framework, it is hoped national authorities will translate it into regulations in individual countries.

With the US Commodity Futures Trading Commission (CFTC) expected to become the first regulator to mandate the LEI in 2012, and with the Canadian Securities Administrators (CSA) and Hong Kong Monetary Authority (HKMA) having expressed their desire to use a global LEI, the need for a consistent approach to implementing the standard across different jurisdictions is a pressing issue. New York-based David Strongin, managing director of the Securities Industry and Financial Markets Association (Sifma), says: "We have achieved a tremendous amount globally to get buy-in. We have the G-20 finance ministers and leaders endorsing the LEI, so from a top-down perspective, it is all going well. But I think our challenge now is to ensure that, as countries start to implement this, they do it in a way that is going to meet the needs of each local marketplace, but also the unique LEI identifier that we have set up globally."

A Global View

The US Office of Financial Research (OFR) is helping members of the Financial Stability Oversight Council (FSOC), including the CFTC, prepare their internal systems for the implementation of the LEI. New York-based Dessa Glasser, chief business officer at the OFR, explains: "The task is ensuring that [the implementation of the LEI] is co-ordinated both domestically and internationally, with foreign governments as well as the financial standards community and industry groups like Sifma, to make sure we have across-the-board adoption."

Frankfurt-based Francis Gross, head of division, external statistics, at the European Central Bank (ECB), believes early adopters of the LEI, such as the CFTC, can provide valuable lessons for the industry, but he also emphasizes the importance of regulators maintaining a global perspective: "Starting off the LEI with more limited implementations that can be done at this moment would give us important proving grounds for refining the practice and for building credibility for a later global solution. In that respect, it would certainly be helpful if such initial implementation efforts, even if they were national, could place themselves explicitly in the international context."

Coalition Requirements

In May, a framework for establishing and operating the LEI was published by a global coalition of financial services firms and trade associations-including the British Bankers' Association (BBA), the Customer Data Management Group (CDMG) and Sifma. The industry coalition's framework covered the data model, operating model, governance model, business model, implementation, compliance, technical principles and the scope of coverage. In July, following a solicitation and evaluation process, the coalition also published a recommendation for the organizations it believes can best operate the LEI. It recommended the International Organization for Standardization (ISO) as the standards body, Swift as the registration authority and the Depository Trust and Clearing Corporation (DTCC) as the facilities manager. The coalition suggested these organizations work with the Association of National Numbering Agencies (Anna) and its network of local national numbering agencies.

The industry coalition published their LEI framework with the intention that it would be used by regulators, the FSB, the G-20 and the International Organization of Securities Commissions (Iosco) as the foundation for a global LEI. The Committee on Payment and Settlement Systems (CPSS) and Iosco expressed support for the industry's efforts in a report in August, but so far the coalition's proposed framework has not been endorsed by any regulators, and it is unclear what role it is playing in the FSB's work.

Sifma's Strongin believes regulators' reticence about the proposed framework may be explained by their need to investigate how the recommendations will impact their local markets, and may also be because the G-20 is deliberating on the issue. However, Strongin believes the recommendations have performed an important function in the LEI project, and that the organizations recommended by the coalition to operate the LEI will be mandated: "We believe our efforts in recommending an LEI framework have helped energize work at the global level. Outside what the FSB and G-20 have put out publicly, we don't know where they are heading or what the actual discussions are like at this point. We would clearly like to believe they are running parallel to our effort and our input, but we don't know." He adds: "We haven't heard that our recommended framework is headed in the wrong direction, so we remain hopeful that what we have provided will eventually be the standard."

While the FSB sets about drawing up a governance framework, the organizations recommended by the industry coalition in July are working to ensure an appropriate infrastructure is in place to operate the LEI. On December 14, ISO closes the ballot on the LEI standard it has developed- ISO 17442, a 20-character alpha-numeric standard that includes two check digits at the end. If, as widely expected, the standard receives 100% approval from ISO's member bodies, it will be published early in the New Year. If not, a further two-month ballot may be required.

Testing Times

To help firms prepare for the implementation of the LEI, Swift and DTCC are developing a test file of records they will be able to run through their systems to see how their back-office applications respond. "All this will allow for a phased roll-out from early next year," says Sven Bossu, Swift's Brussels-based LEI implementation lead.

Bossu thinks ISO was wise to make the standard a dumb number: "One of the key objectives was to come up with an identifier that could be clearly assigned to a legal entity that subsequently would no longer change. Today, a lot of identifiers suffer from the fact they include country codes or specific intelligence in the codes which, due to corporate events or other events happening in the industry, are no longer correct. The LEI will allow people to avoid that, taking away a layer of complexity for the users." Brussels-based Patrik Neutjens, head of reference data at Swift, says the fact the LEI standard will have no intelligence may be new to some companies but, apart from this and the length of the code, he does not think the standard will present a particular challenge to implement.

Although the CFTC has yet to publish its rules, William Hodash, managing director for business development at DTCC, says his company is doing preparatory work for the derivatives market. DTCC is focusing on credit default swaps because it runs the trade information warehouse for credit default swaps. DTCC will turn its attention to other asset classes in accordance with the sequence they are called for by the regulators. The goal is to get as many active counterparties assigned LEIs in advance of the effective date pertaining to each individual asset class within derivatives. Hodash thinks between 20,000 and 50,000 LEIs will be assigned across all the over-the-counter derivatives asset classes.

Hodash says he has seen no signs of resistance to the operation of a global LEI, and he believes that flexibility is the key to keeping things this way in the future. To start with, the LEI database will be populated through both third-party and self-registration, but over time it is expected the self-registration model will be used. Hodash says: "We think the availability of a free, publicly-available, validated LEI database in 2012 will help the industry become comfortable that contributing to the database by self-registration is important and worthwhile."

Hodash thinks OTC derivatives are a good place to start implementing the LEI, and he hopes success in this area will help get the system rolled out globally: "There has been so much discussion about the role of trade repositories in the OTC derivatives industry, and I think people understand the need to apply it there first to aid in systemic analysis of that reporting. I think a successful proof of concept around OTC derivatives counterparties and moving the data into the public realm is key to keeping the global support moving forward."

As the LEI starts to be implemented in 2012, there is still a lot of important work to be done and issues to be resolved, but Tom Price, managing director and head of the technology, operations and business continuity group at Sifma, believes the support for the project across the industry is strong enough to overcome the remaining challenges: "We recognize there is always potential for issues to come up, but I can tell you one thing: I have been doing this for a very long time, and the industry and regulatory bodies are certainly aligned in recognizing there are so many tremendous benefits to having a common standard that, in my own view, there is nothing that is insurmountable."