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CFTC's amends rules to identify global participants in swaps markets

Allan D. Grody examines the implications of the recent CFTC CICI Utility ruling.

Underlying their recent order for identifying swaps counterparties, the CFTC's CICI Utility assigned codes to swaps market participants in over 150 countries. Are these codes only suited for swaps counterparties, or can they be used for their ultimate required goal of aggregating all financial institutions' risk across all asset classes?

On June 10, 2013 the CFTC issued an Amendment to their Swaps Data Reporting rules that modified its acceptance of codes known as CFTC Interim Compliant Identifiers. CICI's were designed and distributed by its preliminarily (pre-) designated local operating unit (LOU) provider DTCC-SWIFT.

These codes, referred to more generally as pre-LEIs are expected to become part of the Global Legal Entity Identifier System. The GLEIS is a G20 sponsored initiative of the Financial Stability Board. The FSB recently turned over the project to a sixty-one member Regulatory Oversight Committee. The ROC itself is made up of representatives from sovereign financial regulators including the CFTC. The CFTC expects that DTCC will become one of the LOUs in the global system, issuing CICIs that will become LEIs.

The order recognises that other LEI-like codes may be issued, certainly in sovereign foreign jurisdictions. It noted that so far seven other pre-LOUs have been given an identifier prefix for use in ensuring the uniqueness of all identifiers issued by any LOU or pre-LOU. It noted one jurisdiction Germany in particular, where WM DatenService has recently become the second provider of pre-LEIs for swaps counterparties. This code is known as the German Entity Identifier.

Not to breach the ROC's global uniqueness criteria as multiple assignments of LEI codes for the same counterparty would surely do, the CFTC recognised that they would have to have mutual recognition of each of the others' codes. This order accommodates this reality, a major capitulation by both the CFTC and DTCC toward globalisation of the swaps markets where federation and mutual acceptance is the order of the day. Neither control by US institutions nor any other central controlling interests will prevail.

However, the ambitions for the LEI are much broader than identifying swaps counterparties. Both the Commission and the G20 are expecting that the LEI will become the lynchpin for aggregating financial market participant risk exposures across all asset classes and all interconnected financial institutions. This data aggregation capability is to provide a means to see systemic contagion building up across the global financial system.

The CFTC recognised this objective in their order by stating

"optimum effectiveness of LEIs as a tool for achieving the systemic risk mitigation, transparency, and market protection goals of the Dodd-Frank Act would come from creation of a global LEI, on an international basis, that is capable of becoming the single international standard for unique identification of legal entities across the world financial sector."

The FSB likewise has declared

"The potential benefits of the LEI include: to support authorities in fulfilling their mandates to assess systemic risk and maintain financial stability; conduct market surveillance and enforcement; supervise market participants; conduct resolution activities; prepare high quality financial data and undertake other regulatory functions."

Are these pre-LEIs used for swaps data reporting in fact the desired single international standard for performing systemic risk? The CFTC in their order took a bit of liberty by stating the CICIs and GEIs will become LEIs

"...identifiers issued by pre-LOUs recognised by the ROC, including WM Datenservice, the CICI Utility, and eventually others, will become LEIs in the global LEI system".

The ROC has only publically given assurances that pre-LEIs would be "transitioned" to LEIs when the GLEIS is finalised. The CFTC order itself recognizes this, making its order conditional by stating its CICI is to be accepted "After the ROC has adopted standards for approval of pre-LOUs and the LEIs issued by them as globally acceptable".

A lot of work remains to understand what role the code construction itself would have in the context of enabling systemic risk analysis. It might well be that the pre-LEI code construction itself is not an optimal fit for aggregating the hierarchies of multiple LEIs that are now and will increasingly be registered in multiple LOUs.

Many systemically important financial institutions have hundreds and many have thousands of potential LEI's to be registered and some have upwards of 10,000 such entities. There now is no means in the two codes currently being registered, the CICI and the GEI, to quickly pull together all of each business or control entities component parts.

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The entity specific portion of the code is a randomly generated code, each bearing no computerised link to its affiliate or subsidiary expect by placing it into a table of codes to associate one to the other. Only through large mapping tables will this be possible, an earlier era best practice that gave us huge cost and risk and that we were to get rid of though the global LEI system.

It may well be that the CICI, the GEI and other pre-LEIs are to be simply another code, this one for swaps counterparties reporting to its regulators. The real LEI may well need further work before it is perfected and rolled out for prime time as the lynchpin of systemic risk analysis.

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