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Tom Groenfeldt, Contributor

Financial LEI's -- Required To Reduce Operational Risk

Global identifiers for financial institutions and for products are a fundamental requirement for risk reduction, says Allan Grody, president of Financial InterGroup Holdings, Ltd. The G20 has made adoption of a Legal Entity Identifier (LEI) a priority with standards and a structure to regulate it set for March 2013. Grody says the next step will be a Unique Product Identifier which is required by Dodd-Frank legislation.

“Many approaches are being considered to aggregate risk within and across financial institutions and provide for transparency of financial transactions and risk exposures,” he wrote in a recent report. “Without the ability to view the underlying positions and cash flows, valued in standard ways and aggregated by counterparty through common identifiers, neither risk triggers nor risk exposures can be observed nor can systemic threats be detected.”

Development of an LEI has threatened to become a bit of a muddle. US industry bodies — primarily SIFMA and the DTCC in cooperation with SWIFT — pushed ahead with their own plans to develop a centrally administered identifier, with the DTCC and SWIFT playing key roles. The CFTC for a time appeared to be using the same model for an identifier it required for swaps, but then backed away and said it would wait for the global development of an LEI and call its identifier the CFTC Interim Compliant Identifier (CICI) a sort of LEI Lite which will convert or yield to the LEI standard once it is adopted.

The G20’s Financial Stability Board has chosen a federated model where each country or region can regulate its own LEI registration process.

Grody, who has worked with the FSB and is a strong proponent of the decentralized federated model which it has adopted, has made specific proposals in his paper, "A Second Report on the Global Identification of Counterparties and Other Financial Market Participants," to suggests a design for both the LEI and UPI, and offers ideas for transition and governance.

The LEI promises immense operational efficiencies to financial firms, both in their dealings with counterparties and in their internal record keeping, he said.

Are financial institutions are in favor of implementing an LEI regimen in a time of lower power profits and a host of expensive new regulatory requirements? Grody suggested they might not like the medicine but it will be good for them in the long run.

"The only way this will be done is by regulators compelling the industry. Then they will focus on the huge savings that's there and real. We believe that a regulatory mandate by the G20 is essential to the successful implementation of the Global LEI initiative."