

# Outdated Thinking Undermines Grand Risk Management Experiment

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## [Global Risk Management Initiative Threatened by Arcane Dispute](#)

Regulators and governments worldwide have started a [grand experiment](#) to organize a bar code-like identifier for financial market participants. But once-innovative, tech-savvy financial utilities may prevent this endeavor from succeeding.

The [Regulatory Oversight Committee](#), a collection of more than 60 regulatory bodies from 45 countries, met this week in Paris to inaugurate the Global Legal Entity Identifier system. The committee was formed from the [Financial Stability Board](#), itself a creation of the Group of Twenty Finance Ministers and Central Bank Governors, whose mandate is to stabilize the global economy.

The meeting finalized governance and organizational issues and set the stage for finalizing operational and technical solutions. The remaining task of how to get the system up and running so systemic risk can eventually be analyzed has proven difficult with "Centralist" and "Federalist" camps still debating the issue.

The construction of the entity code itself may hold the key to providing efficient access to the tags, which are intended to be distributed across a federated global network.

Some personal history to inform the debate: In 1994, when I and colleagues began to understand the impact of the Internet on financial services, our first inclination was to build a "supersite" for the industry – a centralized repository of information.

There were a few websites starting up at the time from pioneering companies, mainly media outlets like Dow Jones and Nikkei. They needed to experiment to make sure they were not preempted by this apparent paradigm shift in distribution technology, especially a totally free one.

At about this time my colleagues at New York University had just won a National Science Foundation grant to place the Securities and Exchange Commission's Edgar database onto a website for public access.

Entrepreneurs at the time were thinking about ways to gather like-minded companies, in my case in the financial space, to aggregate information to draw traffic. We thought the “super mall” or supersite concept would prevail.

Little did we imagine that search technology and bots would win the day over the centralization of data in the concept we had imagined. The federated model would prevail and address earlier concerns of fragmentation in an elegant era of technological harmony. We left the concept of centralization behind.

However, in the financial services industry the old concept of centralization is hard to kill off, mainly because entire cultures in financial institutions have grown up around technology and operational concepts of centralization and interoperability. This is prevalent within and between a financial firm’s many business units and across the interconnected financial system. Monolithic data warehouses are the predominate architecture.

However, the ROC has called for a federated model to organize geographically disparate LEI registries. Each registry is to be created in each sovereign country for identifying uniquely, unambiguously and universally every financial market participant domiciled in their territories. The global system will work as a virtual database, like the Web, not like a centralized data warehouse.

The argument for centralization has been advanced by some of the financial institutions’ favored trade associations, particularly Securities Industry and Financial Markets Association, and by their favored financial market utilities, principally the Depository Trust and Clearing Corp. and Society for Worldwide Interbank Financial Telecommunication. This position has been taken despite the staunch and coordinated will of the global regulatory community, including many leading U.S. regulators, which have spoken otherwise.

Because the ROC's work has not been finalized, and in order to accommodate the Commodity Futures Trading Commission’s reading of the requirements of the Dodd-Frank Act for swaps, the regulator chose to preemptively endorse an LEI-like code and facility, the CFTC Interim Compliant Identifier code and CICI Utility set up by DTCC and SWIFT. The code was set up with the thought that DTCC and SWIFT would create a global LEI Utility.

The ROC has indicated these codes may be transitioned to the new coding scheme of the global LEI when it is finalized. The CFTC has provisioned the CICI Utility for only two years with an option to cancel the mandate with six months’ notice.

The early acceptance of any LEI-like code may not be in the best interest of the global LEI initiative. Accepting a code structure and a process for validating and certifying it without first having a defined procedure authored, approved and accepted by the committee is a prescription for potentially lethal outcomes.

Further, the CICI, containing a randomized 12 character string for the legal entity it is identifying, may not be fit for making global changes, such as those that occur when a merger or acquisition takes place. It may not be fit for data aggregation or systemic risk analysis. It may not

even be fit for reporting creation and continuation data to Swaps Data Repositories, the primary motivation for the CFTC's early endorsement of the CICI and the CICI Utility.

Why? The majority of systemically important financial institutions have normally hundreds, even thousands of legal entities. Goldman Sachs has 10,000; JPMorgan Chase has 4,800. With each identified randomly, and no organizing principle for the identifier common to all of Goldman or JPMorgan, gathering information on the totality of risk of each enterprise would require a huge table to be used internally and across the federated LEI Registries.

Each LEI, wherever it was organized, is to be registered in its sovereign domicile. This mapping issue is compounded when all systemically important entities have to be aggregated.

The merger of two such institutions would similarly require massive tables to be mapped to all internal databases and externally to all the federated LEI Registries.

The simpler approach would be to have Goldman and JPMorgan each have its own ID followed by a distinct sequence number for each of its legal entities. Sending out a simple inquiry using the Goldman or JPMorgan ID would fetch, aggregate and/or change data across the federated network.

Centralizing all the random codes in a single database, or multiple ones as DTCC and SWIFT are contemplating, would simplify the issues, but still not solve the mapping problems.

Better to create a fit-for-purpose code that works in the required federated mode than to shoehorn in a code designed for a centralist view of the world.

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