Preamble

If any of you follow my monthly research note on the Legal Entity Identifier, a 20-character code referred to as the LEI, you will recognize this monthly reminder: "The LEI is but a small step in the global data standards landscape yet a giant leap forward for financial transparency"

Introduction

With this in mind let me begin by declaring that the LEI is the single most important identifier in finance. It is uniquely assigned to financial entities, commercial clients, trade counterparties and other financial market participants.

The registration to-date of over 2 million computer-readable LEIs and their reference data is by far the most successful example of a global financial industry government/private sector partnership.

However, what remains to be done presents a significant challenge to its continued success.

Let's remember the objective for the LEI: global adoption by financial market participants – to be compelled by regulatory mandates to give regulators the ability to aggregate risk data at a granular level for systemic risk analysis.

The LEI initiative must show success against these objectives or it will become just another entity identifier code along with many others. That was the original fear of many industry members.

The recent origins of governments' call for a common, computer readable entity identifier code arose from the Lehman bankruptcy. Before then there was a long history of failed attempts to create one, all led by voluntary industry efforts. There was no interest in calling on a government authority to compel such an initiative - no central global authority existed to take this on.

The financial crisis spurred regulatory interest in analyzing the contagion of risks building up across the entire global financial system. It was now understood that a common legal entity identifier is critical for aggregating data for risk analysis.

The G20 and its Financial Stability Board took on the task. It was the most significant central global authority and it was willing to deal with the problem.

Creating the LEI

The FSB proceeded to establish the Regulatory Oversight Committee, supported by 70 regulators from 50 countries, and gave it the mandate to create an implementation capability to register and maintain LEIs. The Global LEI Foundation – GLEIF – was empowered to implement the LEI. They, in turn, organized local operating units – LOUs – in different countries to assign and register LEIs. There are 38 LOUs.

The FSB correctly understood that without a common computer readable entity identifier, no efficient, timely and transparent financial system can be built – neither to meet the real-time requirements of straight-thru-processing – to analyze risk across single multi-silo-structured firms - nor to observe the contagion of systemic risk building up across the global financial system.

Interoperability

Interoperability as a substitute for a common entity standard was proposed as an alternative and still is today. However, this concept does not account for the hundreds of proprietary codes that must be identically matched (mapped) across the vast financial supply chain.

The originators of these proprietary codes - internal within firms and infrastructure entities, and within data vendors and software companies - are all attempting to synchronize the updating of new codes and changes to existing codes.

Not every participant in the financial supply chain gets the changes right, nor updates and communicates the changes in a timely manner. Data vendors are the primary means by which financial institutions update their entity data bases. Real-time processing will require exactitude in updating entity codes.

Obstacles for Continued Success of the LEI

Global adoption of the LEI requires 20 – 40 million registered LEIs, whether using the FSB's estimate or industry estimates. GLEIF's goal is to register 20 million LEIs by 2027. This is 10 times the rate of current trends.

One obstacle to this goal is the 740,000 LEIs (35% of the total) that have not been renewed. Another obstacle is verifying the accuracy of LEIs associated with parent/child relationships.

There are over 320,000 relationship records defining ultimate and intermediate parents for 123,000 legal entities. The ROC requires the use of accountants' financial report consolidation protocols to define these relationships.

There are over 3.5 million relationships that are not recorded with an LEI. This omission is permitted under account consolidation protocols. Risk management aggregation protocols define relationships differently.

GLEIF Going Forward Strategies

GLEIF has initiated a number of strategies to deal with some of the obstacles:

- A Registration Agent concept was created to assist legal entities in registering a LEI and annual renewals. There are 138 Registration Agents, the largest being GS1 (the barcode numbering organization) with 38.

- A Validation Agent concept was created for large financial entities and outsourcing companies to assist LOUs in validating reference data and registering a LEI, for themselves and for their clients.

- A digitally verifiable LEI has been designed by GLEIF. The vLEI can be held by any business with a valid registered LEI. GLEIF is offering to register an LEI for any business, not just financial market participants. The vLEI is an encrypted LEI that can be used in digital commerce and in document signing.

- GLEIF has initiated the BIC and ISIN mapping service, to assist matching these codes to the LEI.

- GLEIF has moved away from relying exclusively on regulatory mandates to a combination of regulations and voluntary actions of industry members. Regulatory compulsion was once thought to be the answer to full global adoption. However, the industries long-standing collective action problem has now moved on to be regulators' collective action problem.

Financial Transparency Act (HR 2989)

There is a current piece of legislation adopted by the US House of Representatives - the Financial Transparency Act, HR 2989 - that, if enacted, would greatly facilitate the US's use of the LEI.

The FTA requires all financial transaction data reported to a financial agency be standardized - with the same product and legal entity codes formatted the same way. It will finally make financial data completely computer literate. However, there is no reference to the specific GLEIF-sponsored LEI in the Act.

Global Systemically Important Banks (G-SIBs)

Now, I would like to turn to discussing the 30 Global Systemically Important Banks - G-SIBs - 8 headquartered in the US, 8 in the European Union, and 3 in the UK. Each of the three groupings come under a single headquarters oversight regulator for risk analysis and determining risk capital. It should be easier for these G-SIBs and their three regulators to get on with completing the LEI mission then requiring each regulator in 200 countries to mandate first the LEI, then their renewals, then LEIs for each parent of a legal entity.

These G-SIBs are also engaged in implementing the Basel Committee on Banking Supervision's BCBS239 principles for collecting and aggregating financial data. The LEI and its hierarchical parent relationship structures, as stated in BCBS239 - and reiterated in the FSB's LEI Peer Review, is an essential pillar of such aggregation.

That Peer Review found that 55% of market participants considered parent relationship data maintained by GLEIF insufficient for their risk aggregation needs. Only 17% responded it was not an obstacle - 28% had no response.

A Plan of Action

To regain momentum of the LEI initiative the US Treasury and its FSOC members should engage the eight US headquartered G-SIBs to join a reinvigorated government/private-sector partnership to finish the mission of both the LEI and its use in risk aggregation.

The Treasury's FSOC will soon have additional power through HR2989 to mandate a common legal entity identifier. However, the generic wording of a 'legal entity identifier' described in the legislation should be reworded to specify GLEIF's LEI.

The risk data aggregation mission of BCBS239 which requires the proper hierarchies of relationship data, should also be part of finishing the mission. Fortunately, GLEIF has already created the path to assisting with this approach - engaging the G-SIBs to become Validation Agents.

To assure proper hierarchical constructs of the LEI, the eight US headquartered G-SIBs should enlist the assurance services of the four largest public auditors that audit one or more of these banks. They are best able to interpret the accounting consolidation rules for LEI hierarchies. This will assure the completeness of the LEI data as a starting point. Later these hierarchies can be adjusted for risk analysis.

Finally, the eight G-SIBs uniquely and exclusively come together in a lobbying trade association, the Financial Services Forum. It is an advocacy organization whose members are <u>exclusively</u> the CEOs of the eight G-SIBs. Engage them all at once through the Financial Services Forum.

A call from the US Treasury Secretary, Janet Yellen to the Chairman of the Forum, David Solomon, CEO of Goldman Sachs should get the ball rolling.

The approaches suggested here would give the LEI initiative a short-term win in meeting the original mission objectives of observing systemic risk - first for this critical market segment, the US's financial system – and then to be taken up other G-SIBs.