

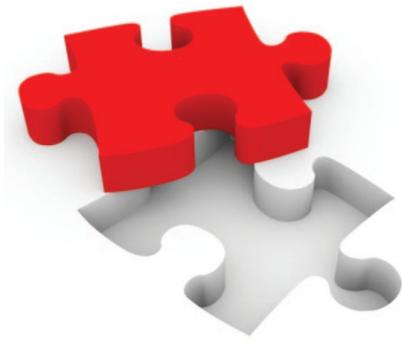


The Legal Entity Identifier (LEI)

A summary of the key features of Financial InterGroup's proposed LEI framework

 Financial InterGroup UK

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The Regulatory Challenge

Financial service industry regulators are focused on observing systemic risk across enormously complex interconnected global financial institutions. While these systemically important financial institutions continue to improve their enterprise risk management systems, regulators are now intent on imposing further regulations to analyze the risk exposures that arise across these firms.

Many attempts are underway to understand how to aggregate risk within and across financial institutions and provide for transparency of financial transactions and risk exposures. It is understood that without an 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.

It has been accepted by regulators that the very first pillar of global financial reform is a standard for identifying the same financial market participant to each regulator in the same way. Getting agreement on a globally unique and standardized legal entity identifier (the LEI) is the first step.

Our Research

Our research has focused on the past and current efforts by industry members and sovereign regulators, newly empowered through the G20's Financial Stability Board (FSB) to develop a global identification system for such purpose. We have reviewed the origins of systemic risk in the financial industry and its related data issues and how standard identification of financial market participants and the products they trade connects to regulators' and financial institutions' ability to analyze systemic risk. This has resulted in our proposals for a global identification system and approaches taken in other industries and economic sectors.

Our Proposal

Financial InterGroup has proposed a government and industry partnership in which governance is shared and operating elements of the global identification system are compartmentalized for control, security and confidentiality purposes. This is underpinned by a global standards convention designed by Financial InterGroup with its operational and technical implementation. The standard proposed is a set of eleven (11) unique, unambiguous and universal characters constructed around a two part apportionment and assignment process between regulators and financial market participants. It is shown that this two part construction is essential to accommodate requirements of sovereignty, control and confidentiality put forward in more recent regulatory requirements.

We are satisfied that our proposed global identification system addresses all known elements of regulators' requirements for the LEI. It also lays the foundation for further rule making and issues yet to be addressed for contract and instrument identification, financial event identification and data aggregation of valued positions and cash flows for systemic risk analysis, the ultimate objective of the rule making.

On the pages that follow we set out our vision of a global LEI system by describing the key features of our proposal.

Key Features	Proposed Solution	
	Description	Comments
Scope of Coverage	<ul style="list-style-type: none"> The proposed solution supports all aspects of the global Legal Entity Identifier (LEI) initiative as mandated by the G20 via the Financial Stability Board (FSB) It provides the technological and operational framework to satisfy the initial requirement for the registration, validation and maintenance of information relating to unique legal entity identification (LEI) across the globe for all Financial Market Participants (FMPs) It has been designed to extend this capability in the form of either an implementation or in releasing open source specifications to others for: <ul style="list-style-type: none"> unique product identification (UPI), unique transaction (swap) identification (USI), and unique financial (corporate) event identification (FEI) 	The proposed solution creates the LEI facility by which global and sovereign regulators that are aligned to the Financial Stability Board (FSB) and the Regulatory Oversight Committee (ROC) can observe and limit accumulations of FMP exposures as a means to more effectively manage systemic risk
COU (Central Operating Unit)	<ul style="list-style-type: none"> The proposed solution supports both the Centralized Operating Unit (COU) and the associated Local Operating Units (LOUs) As each LOU is on-boarded, the COU randomly chooses and then distributes a range of codes to each LOU These codes are unique globally and are assigned at the consolidated business entity/ control entity (ultimate parent) level Its random choice method is programmed never to produce a duplicate code 	The COU acts as the control mechanism for assignment of code-sets to LOUs that in turn dispense codes as each ultimate parent business entity / control entity requests pre-registration. The resulting code formats are uniform and consistent allowing rapid access to entire sets of LEIs per entity with no mapping tables required.
Code Structure	<p>The proposed solution has a two part LEI code construction, fully compliant with the ISO 17442:2012 LEI standard:</p> <ul style="list-style-type: none"> First portion: Registration Identifier (RID) administered by sovereign or regional regulators, Local Operating Units (LOUs), each within their own jurisdictions, assigned directly to requesting business entities at the ultimate parent business entity / control entity level Second portion: Self-assigned by each registered business entity to identify each of its operating units or subsidiaries subordinated to the ultimate parent business entity / control entity 	<p>The proposed solution facilitates:</p> <ol style="list-style-type: none"> Control and confidentiality exercised by sovereign states Establishment of business hierarchies with consolidated group level control structures Remote control and synchronization of individual operating units / subsidiaries within each ultimate parent business entity / control entity Maintenance of LEI reference data and changes to ownership status relative to corporate actions of recorded LEIs. In a globally federated network the various codes used by multi-national companies will number in the hundreds and many in the thousands per entity, spread across multiple LOUs. The RID portion of the code will be used for quick access and aggregation of multiple LEIs under different categories of control structures.
Self Registration	The proposed framework requires that each counterparty or issuer of securities or contract market operator or other financial market participant is exclusively responsible for identifying itself through its initiating documentation: articles of incorporation, broker/dealer license, bank charter, or account opening forms with a financial institution	The financial market participant is best positioned to ensure that complete and accurate data is registered

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Certification	The proposed framework requires that the identity of financial market participants is validated by an independent trusted agent identified relative to each sovereign domicile, e.g. auditors, law firms or other designated certifying agents that compares initiating documents to information tagged prior to legal entity registration	Provides assurance that data registered in the GLEIS is maintained in a complete, accurate and timely manner with oversight provided by qualified third parties who understand local laws and practices and can translate them into GLEIS requirements. The proposal is that auditors are the preferred certifying agent as they have a privileged place in understanding business hierarchies and ownership structures and could be relied upon to ensure information in the GLEIS is accurate as part of their standard auditing procedures.
No Intelligence	The proposed LEI codes have no intelligence, i.e. no country or issuing agency code, no ability to parse the number to determine meaning	This ensures the persistence of the LEI (see 'Persistence' below) by requiring that all changes are reflected in the reference data, not the LEI coding
Persistence	The proposed framework ensures that all changes relating to a legal entity are reflected in the associated reference data	If changes are applied exclusively to the reference data, the LEI code remaining unchanged, then the LEI code can persist in perpetuity thereby providing an audit trail for any and all changes. This does not mean that, for example, a merged company cannot be assigned a new LEI code; it only means that in such circumstances the old LEI code is retired, never to be used again. A retired LEI code remains associated with the new LEI code as an audit trail relating to a corporate event.
Confidentiality	The LEI itself need not be confidential but there may be a requirement by sovereign states or governments to ensure parent / child relationships and ownership structures are maintained confidentially. The proposed solution accommodates this requirement through redaction algorithms administered at the source of self-registration.	Sovereign regulators and exchanges (and their auditors) are privileged observers of this information and would be best positioned to protect globally agreed and locally regulated LEI confidentiality rules by administering the registration process and invocation of the algorithm
Federated vs. Centralised	The proposed solution has adopted sophisticated and state-of-the-art technology by overlaying the LEI network as a virtual private network (VPN) 'tunnelled' through the Internet. The Internet itself has been built with inherent resilience there being no single point of failure and thus provides optimal conditions as the network architecture and at the application layer.	In a federated VPN model a directory of LEIs can be replicated so there is no single point of failure as demonstrated in the world wide web's Domain Name Server (DNS) network on the internet. There are many servers available that can, for example, resolve an LEI into an address to locate its LOU. Each server in the DNS network contains or can access the same directory.
The Network Card and the Plug-in Architecture	As required by the FSB the local federated LEI Registry has been designed using sophisticated and state-of-the-art technology around a 'network card' and 'plug-in' architecture at the LOU level that will federate up as the logical virtual database overseen by the Central Operating Unit (COU)	Software at the application layer will aggregate business hierarchies while redaction algorithms mask identification when required by local law or practice. Software anchors will be deployed in local servers (each LOU's LEI registry) to allow access via Automated Program Interfaces (APIs) or Service-Oriented Architectures (SOAs) to multiple vendor products, tools and services in keeping with the requested non-discriminatory and freely available use of LEIs. This technique permits any vendor to offer its services and plug their own hardware, software and other technology into the 'network card' based on the local registration authority's preferences and bidding process.

Financial InterGroup's Principals



Allan D. Grody

Allan is the founder of the Financial InterGroup companies. He has been active in the financial industry for over four decades and has had hands-on experience in multiple sectors of the financial industry. He advises on domestic (USA) and international issues related to financial institutions' global strategies, restructuring and acquisition needs, information systems, communications infrastructures and risk management systems.

In an earlier career, he was the founder and Partner-in-Charge of Coopers & Lybrand's Financial Services Consulting Practice, which was subsequently merged with Price Waterhouse and eventually sold to IBM. Professor Grody founded and taught the only graduate level Risk Management Systems course at NYU's Stern Graduate School of Business. He also lectures on financial markets, financial information systems and venture investing.



Peter J. Hughes

Peter is a Principal of Financial InterGroup and Managing Director of its UK based company. He is a former country/regional executive with JPMorgan Chase, Fellow of the Institute of Chartered Accountants in England & Wales and a Visiting Research Fellow at the York Management School, University of York.

At Financial InterGroup he leads consulting projects and provides advisory and training services to some of the globe's leading banks, global IT and consulting firms, trade associations and banking institutes with particular emphasis on cross-enterprise risks, operational risk, Basel II & III, capital management (including the Internal Capital Adequacy Assessment Process - ICAAP), finance transformation, data management, risk measurement and management systems and risk based auditing.

Contact Us

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