

# ***A Closer Look***

## **The creation and usage of Legal Entity Identifiers (LEIs)**



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Part of an ongoing series

## ***A reference data cornerstone***

### **Are you ready?**

September 2012

*“Indeed, the recent crisis has reaffirmed an old lesson—good data and good analysis are the lifeblood of effective surveillance and policy responses at both the national and international levels.”*

— Financial Stability Board and International Monetary Fund (October 29, 2009)

The recent financial crisis has created a universal awareness of reference data and helped elevate it from a back office concern to a critical business function. Specifically, global regulators have recognized that the consistent identification of clients and counterparties must be a key foundational component in any effort to manage systemic risk. Enter the global legal entity identifier (the “LEI.”)

This *A Closer Look* will outline the evolution of the LEI, provide some regulatory context, and then discuss the current state of industry readiness and suggested activities for those impacted by this change. The big picture involves trade associations, financial services firms, corporate issuers, newly formed global regulators, and even the G20, so let’s see if we can translate all that into what a business trying to stay compliant and even profitable should be doing now.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) created the Office of Financial Research (OFR) under the Financial Stability Oversight Council (FSOC) to improve the quality of financial data available to regulators and policymakers. The OFR can collect data from financial market participants to allow for greater analytics on risk and market data. The adoption of a global LEI to consistently identify parties to financial transactions and aggregate risk information from all reporting entities will facilitate the OFR’s objectives and also serve to facilitate execution of the global regulatory push to limit systemic risk. Common, consistent reference data is the key.

### ***Benefits to regulators***

For regulators, the primary objective of the global LEI is to more effectively measure and monitor systemic risk in order to help prevent a repeat of the 2008 financial crisis and the associated failure of major financial institutions. The LEI should make data aggregation and analysis across financial market participants more efficient, as regulators will be able to consolidate and analyze counterparty risk data without having to reconcile multiple, non-standardized reference data sets. The LEI should also provide the ability to identify trading patterns and to spot multiple firms with similar exposure, enabling regulators globally to more accurately obtain a view on risk to the financial system. The LEI will also facilitate sharing of information internationally, as a common identifier will make it easier to monitor legal entities that span borders and report to various regulators. Lastly, the LEI will allow for the identification of hierarchies through the inclusion of ultimate parent as a data attribute in the LEI reference data (though the inclusion of parent LEIs is likely a “phase 2” item). This key functionality will grant regulators the ability to analyze risk on an aggregate firm level.

### ***Benefits to industry***

Within the financial services industry, a global LEI standard will help individual firms more effectively measure and manage counterparty exposure through a common view of legal entities across the organization. The LEI will provide substantial operational efficiencies by improving the speed and accuracy of data aggregation for risk analysis, easing reconciliation activities, improving vendor feeds, managing corporate actions, and supporting post-merger integrations and the client on-boarding process. Additionally, LEIs will facilitate the ability of large, complex organizations, with multiple businesses globally, to effectively and efficiently respond to regulatory initiatives such as “living wills.”

Finally, there are strategic considerations to the use of a consistent LEI standard within a firm. Better sharing of client information across business silos and an enhanced ability to conduct predictive analytics are just two examples of strategic uses of the LEI. When attempting to match external data to prospective and existing clients, a single LEI can facilitate deeper and broader analysis.

### ***Evolution of the LEI***

In November 2010, the OFR issued a policy directive citing the criticality of a global LEI and its intention to adopt a universal standard for identifying parties to financial contracts. The OFR also suggested that the standard be established and implemented by private industry and other relevant stakeholders through a consensus process. In response to the OFR, a global coalition of financial services firms and trade associations published a proposal for the industry requirements of a global LEI solution in May 2011, entitled

***Requirements for a Global Legal Entity Identifier (LEI) Solution.*** Once the requirements were released, the trade associations, driven by the timeframes stipulated in the Dodd-Frank Act, led a solicitation of interest (SOI) process to recommend the solution providers for the LEI. In July 2011, the SOI process resulted in the following recommendations:

- **Standards body:** International Organization for Standardization (ISO), ISO 17442
- **Core issuing and facilities manager:** Depository Trust & Clearing Corporation (DTCC) and the Society for Worldwide Interbank Financial Telecommunication (SWIFT), along with the DTCC's wholly-owned subsidiary Avox Limited
- **Federated registration:** Association of National Numbering Agencies (ANNA)

In late 2011, the industry and the trade associations began to work with other global market participants to socialize the LEI concept and initiate a global governance approach to ensure that the solution was truly global. In parallel, development began on an LEI solution by the trade association's selected provider, and a project scope and preliminary implementation plan was released in January 2012.

## ***Global regulatory developments***

As part of the globalization of the LEI, the Financial Stability Board (FSB) formed an LEI Expert Group of key stakeholders from the global regulatory community to identify the key issues and framework solutions under five work streams: governance, operational model, funding, implementation and phasing, and scope, confidentiality, and access. The Expert Group was supported by an Industry Advisory Panel composed of 34 representatives from different sectors and regions to help provide industry input into the global public-private LEI initiative. The Expert Group presented its recommendations to the FSB at the end of April 2012, and the FSB presented its recommendation at the G20 summit in June.

The FSB recommendations included a three-tier governance structure which comprises a Regulatory Oversight Committee, Central Operating Unit, and Local Operating Units.

- The Regulatory Oversight Committee (ROC) would have the ultimate responsibility for the governance of the global LEI system.
- The Central Operating Unit (COU) would have responsibility for ensuring the application of uniform global operational standards and protocols.
  - The COU is proposed to be a not-for-profit foundation that would rely on broad industry participation, expertise, and knowledge to identify and develop the most technologically, financially, and legally sound methods to implement the global LEI system, in line with the standards and framework defined by the ROC.
  - A board of directors, which may include both industry representatives and independent participants, would direct the operations of the COU. The COU's board, in consultation with the ROC, would also provide recommendations on whether to outsource any particular function or operation of the global LEI system or whether to develop a particular solution in-house.
- Local Operating Units (LOUs) would be the local implementers of the global system. LOUs would offer local registration, validation, and maintenance of reference data and protection of information that must be stored locally, and would facilitate the use of local languages and organization types.<sup>1</sup>

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<sup>1</sup> FSB press release, "FSB releases 'A Global Legal Entity Identifier for Financial Markets: FSB Report to the G20'" (June 8, 2012).

## ***CFTC: The first regulator out of the gate***

While the FSB is considering broader international issues and structural challenges, in the US, the Commodity Futures Trading Commission (CFTC) has pressed ahead in mandating use of an LEI solution as prescribed within Dodd-Frank's reporting rules.

The CFTC and Securities and Exchange Commission (SEC) final definitions of "swap" and "securities based swap" have been published in the Federal Register. Publication of the final definitions rules are major triggering events that activate the compliance clock for a variety of final rules, including recordkeeping and reporting mandates. The first compliance date for CFTC regulatory reporting requirements (Part 45) is 60 calendar days after publication, or October 12, 2012.

There is a phased approach for reporting implementation, both in terms of which entities must obtain and use a global identifier and which swap product types are scheduled to be reported first.

The following table summarizes the CFTC's Part 45 swaps reporting schedule.

<b>Reporting counterparty type</b>	<b>Swap category</b>	<b>Compliance date guidance</b>
<ul style="list-style-type: none"> <li>• Swap dealers</li> <li>• Major swap participants</li> <li>• Designated clearing organizations</li> <li>• Swap data repositories</li> <li>• Swap execution facilities</li> <li>• Designated contract markets</li> </ul>	<ul style="list-style-type: none"> <li>• Credit default swaps</li> <li>• Interest rate swaps</li> </ul>	<p>Sixty calendar days after the publication in the Federal Register of the CFTC's final rule defining the term "swap"</p> <p><i>October 12, 2012</i></p>
Includes same categories as above	<ul style="list-style-type: none"> <li>• Equity swaps</li> <li>• Foreign exchange swaps</li> <li>• Commodity swaps</li> </ul>	<p>"On or before 90 days after the compliance date for credit swaps and interest rate swaps"</p> <p><i>January 10, 2013</i></p>
Non-MSP or non-SD reporting counterparties to a swap (not otherwise identified above)	<ul style="list-style-type: none"> <li>• All swaps above</li> </ul>	<p>"On or before 90 days after the compliance date applicable to swap execution facilities, designated contract markets, derivatives clearing organizations, swap data repositories, swap dealers, and major swap participants"</p> <p><i>April 10, 2013</i></p>

CFTC Part 46 rules cover reporting of "historical swaps," which include "pre-enactment" and "transition swaps," – swaps contracted *before* Dodd Frank enactment or after enactment but before GTR compliance requirements commence and where the lifecycle of the ongoing contractual economic obligations *remained in effect beyond specified dates*. These historical swaps must also be reported to a swaps data repository.

## ***Bridging the gap: CICI and PLEI***

A gap has emerged between the finalization of the FSB's "global LEI framework" targeted for the first half of 2013 and the Dodd-Frank Act's Part 45 and 46 compliance dates, requiring LEI usage as available. At the time of publication, the CFTC had announced that the DTCC-SWIFT solution will be the official solution provider in the US and the CICI Utility was launched on August 21, 2012.

As a practical matter, this means firms that are actively accessing the DTCC test database to source and map back to their internal golden source legal entity identifiers need to be aware of the fact that the CFTC Interim Compliant Identifier (CICI, also known as the provisional LEI or PLEI) could become the global LEI, but this depends on the outcome of the FSB's global governance and planning process and the role of the DTCC-SWIFT solution in that model.

## ***Impact to firms***

As regulatory bodies like the CFTC finalize reporting requirements and mandate the use of a global LEI solution, other US and global regulators will likely follow. This will require firms to update enterprise systems, reporting capabilities, and existing processes to meet these requirements. This effort is likely to be significant for many firms, as legal entity information may be dispersed across functional lines, product lines, and geographical regions, and display varying degrees of internal synchronizations. As legal entities are classified into various categories (counterparty, issuer, client, and broker), overlap often occurs across systems based on the current on-boarding procedures and transaction types. This has caused duplicate and inconsistent naming conventions between applications and business silos. In many cases, there is no common internal legal entity identifier across all systems, making it very difficult for firms to consistently match internal identifiers with the global LEI.

In future phases, the global LEI will provide firms with a source of hierarchical information for registered legal entities as part of its reference data. Firms will need to account for and manage this additional information to address various forms of corporate action (e.g., mergers, acquisitions, and spinoffs). The percentage of ownership used to determine these values may vary based on local jurisdiction and regional requirements and guidelines. Firms need to evaluate how to incorporate this information into existing reporting structures while identifying existing areas within the firm that could utilize this information.

## ***PwC surveys industry readiness***

PwC has conducted a brief industry survey covering a sample of global financial market participants in order to gain an understanding of the industry's implementation efforts. Surveyed firms self-identified as global companies, doing business or having offices in at least five and up to 100-plus countries, and are planning to register as either major swap participants or swap dealers.

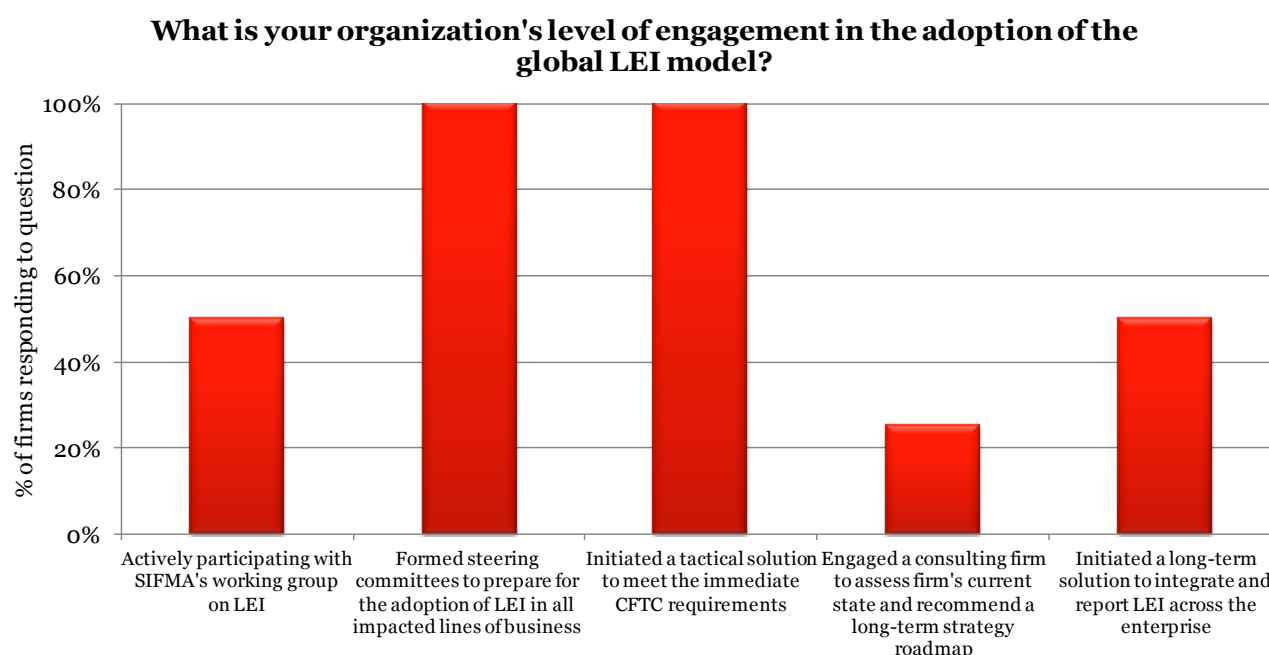
The survey found that while each firm had its own unique approach to handling its internal client/counterparty reference data, all firms will need to amend their current counterparty reference data file with the LEI in order to comply with expected future CFTC regulations.

The survey also evaluated firms' success in matching to the DTCC's LEI test file, available on the Global Financial Markets Association (GFMA) website. This file of randomly selected



entities, coded based on ISO 17442 standards and the core data attributes associated with them, provides an indicative view to the public of the LEI. Of firms surveyed, a majority have attempted and successfully matched a subset of the LEI information currently available in the DTCC test file. A smaller number of firms have looked at the test file but have not yet attempted matching logic. All firms surveyed are aware that the ISO 17442 code will be utilized going forward as the LEI standard, and that the DTCC has released a file with sample LEI data on GFMA's website.

PwC also queried firms about their investment into the LEI initiative, both in terms of spend and headcount. All surveyed firms are actively participating in industry forums and have formed internal steering committees to prepare for the adoption of the LEI for impacted business lines. Additionally, while 100% of the firms indicated that they have already initiated a tactical solution to meet the immediate CFTC requirements, only half have initiated a long-term solution to integrate and report LEI across the enterprise. All firms surveyed have allocated budget towards the LEI initiative, though these investments fall within a wide range, from less than \$500,000 up to \$5 million.



Source: PwC internal research

Firms have also taken varied approaches to the solution architecture and the strategy for matching the LEI to existing counterparty identifiers. All firms indicated that the LEI would be incorporated into existing reference data systems and utilized for regulatory reporting. Many indicated that they plan to leverage a vendor solution in order to match the LEI data to legacy counterparty reference data, while others indicated they would do the matching internally. While all firms are looking to implement a tactical solution for the CFTC requirements, every firm indicated that the tactical solution will be leveraged to construct a long-term strategic solution for handling the LEI, minimizing both rework and throw-away work.

Firms unanimously reported that the data governance should be managed through a centralized data management group or the chief data officer.

PwC asked firms about their biggest challenges regarding the adoption or implementation of the LEI. While answers varied between front office and control functions, some common themes emerged, including:

- The ability to link the LEI to internal firm standards (front office client identifiers, counterparty reference data)
- Data protection and confidentiality issues
- The ability to systematically obtain and update LEIs from source within specified timelines

Finally, firms were asked about other uses of the LEI within the enterprise. Some indicated that the LEI would have no other usage than CFTC reporting requirements, but others indicated that the LEI would be leveraged throughout the enterprise, to improve operational efficiency, increase control, support other regulatory requirements, and inform processes and functions including client on-boarding, risk management, legal, and compliance.

### ***What should you be doing NOW?***

To comply with regulatory timelines, firms will need a multifaceted approach focused on changes to technology, data, organization, and process. Existing entity reference data systems and processes will need to be assessed for their ability to integrate the LEI and provide tactical reporting solutions while developing long-term strategy and processes.

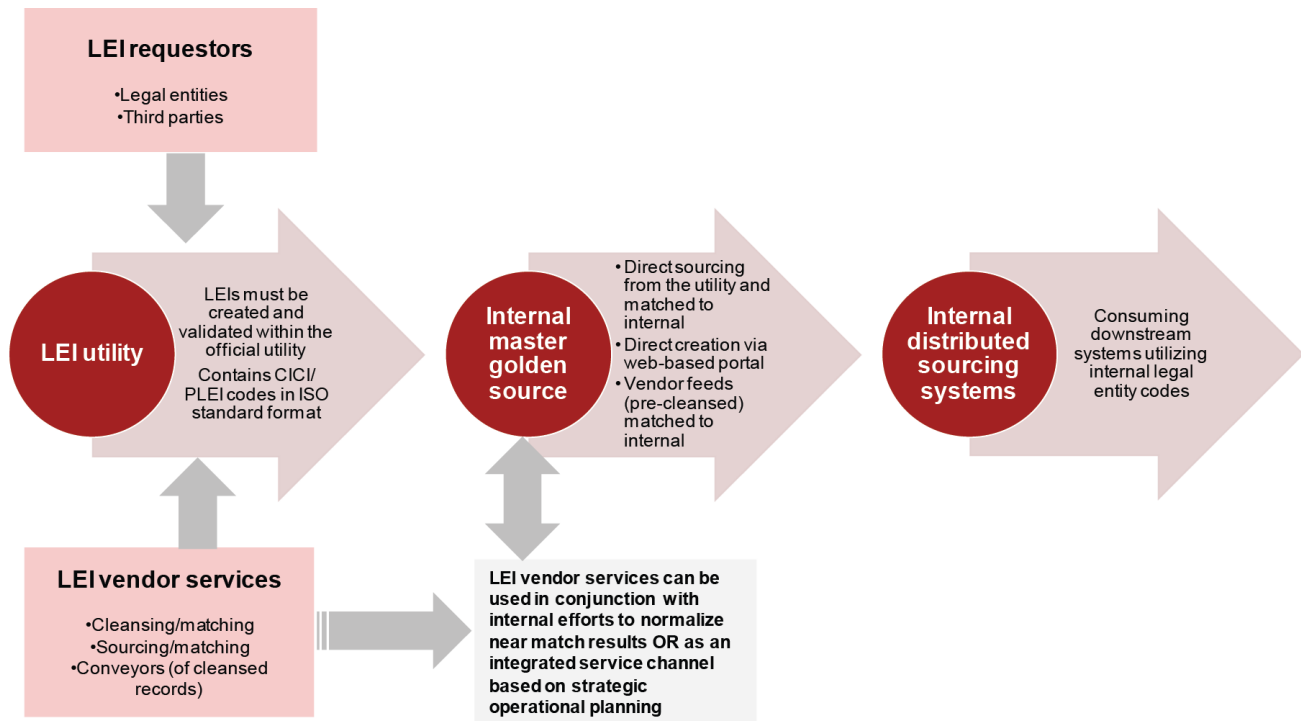
It will be critical for firms to have a centralized data governance structure and sound data quality programs to be able to absorb the new LEI information. The data associated with LEIs represented in the ISO standard will need to be propagated to downstream systems to create integrity and quality of data that will meet regulatory expectations. In addition, to establish and sustain data quality, firms will need to assess existing on-boarding/know-your-customer systems and processes for the ability to capture and validate LEI information.

Firms that have invested in central entity management systems and processes will have a chance to leverage their matching processes and it is highly likely that this investment could be utilized as a point of entry and distribution of LEI. However, organizations should not minimize the effort level that will be required to review exceptions and match the LEI with their internal identifiers. Additional workflows and business rules will need to be established to support this new identifier within the existing systems. Impact analysis will need to be conducted on downstream applications and reporting repositories for their ability to use or store this information, allowing for regulatory reporting across the firm.

Firms that have not implemented central entity management systems and supporting governance structures will be faced with a number of additional challenges. They will need to identify gaps within the information that is currently available while assessing data quality and points of integration within existing systems. A centralized solution should be strongly considered for consistent application of business rules, to merge and clean inconsistent data and allow for an improved matching process. Current reporting structures and tools will need to be assessed for impact and for their ability to incorporate and report against LEIs across the firm.

In order to use LEIs, all firms need to consider how they will source, assess, and perform any required data remediation versus their own validated legal entity ID codes. This includes bringing in the pre-populated LEI data from the DTCC and assessing versus their own internal master golden source, while giving careful consideration for any product aligned to downstream functional systems or regional client/counterparty data stores cached in downstream functional systems.

The graphic below is a very high-level view of possible process flows based on current facts.



Besides the impacts mentioned above, firms should consider the following:

### ***Program structure***

- Work efforts need to consider both the registration and maintenance of internal legal entities and those of clients and counterparties.
- As with other “point in time” exercises, processes, technologies, and organizational responsibilities need to be refined to address go-forward (client on-boarding/know-your-client) needs as well as work required to deal with pre-existing internal and client/counterparty LEIs.

### ***Solution integration***

- Each firm that expects to be a party to swap transactions in any capacity will be accessing the DTCC database to (a) review any LEI records established in their name, and (b) register for/verify LEIs as appropriate based on their own Dodd-Frank legal entity assessment analysis and/or projected responsibilities for trade reporting.
- Firms planning to register as swap dealers or major swap participants should already be accessing the LEI data and running mapping and matching exercises against their own internal legal entity ID codes for their eligible contract parties (i.e., counterparties) that have been validated to trade swaps based on the CFTC External Business Conduct Standards.



- Vendor solutions are available to perform matching and cleansing exercises where test matching rates are poor or near-matches suggest name and address or other nominal data discrepancies are the cause. Vendors are also beginning to offer LEI sourcing services.
- The up-front control and potential remediation effort involved with the LEI introduction will vary in scope based on the overall quality and cohesiveness (maturity) of a firm's client data management capabilities, as well as the size of its counterparty (initially eligible contract participant) population.

## **Conclusion**

The implementation of a global LEI solution has not only gained momentum but is approaching fast. The fact that global regulators and the industry can align behind this important foundational component to manage systemic risk reflects the pressure on governments from taxpayers and puts the implementation of LEI on the fast track. For many data management specialists who have been pushing for this for years and implementing compensating solutions from a people, process, and technology perspective, this is something close to a dream come true.

Regarding progress, the industry is keenly watching the governance, implementation, and maintenance process that the FSB is establishing for global LEIs. LEI implementation will require significant commitment and focus for the foreseeable future, as the global framework takes shape.

For firms with a comprehensive reference data strategy that have invested in centralized processes and solutions, the implementation path should be easier to navigate. However, this is not just a reference data exercise, so careful consideration should be applied when assessing the broader functional consequences of LEI integration across the business, finance, and operations, as well as in corporate regulatory and risk groups. LEI implementation should therefore be viewed with the immediacy of impending compliance requirements but in the context of a longer-term set of strategic objectives. There is clear potential for firms to gain significant benefits and strategic advantages by improving the quality of information across the organization.

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## ***Additional information***

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