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THE GLOBAL LEI SYSTEM: A SOLUTION FOR ENTITY DATA?

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The Global LEI System – A Solution for Entity Data?

The Global LEI System – or GLEIS – has been in development since the middle of last year. Development has been patchy at times, but much has been done, leaving fewer outstanding issues, but also raising new questions.

Emerging Structure

What's emerging is a structure for the GLEIS going forward, complete with a mechanism for registering and accessing LEIs. More pre-LOUs (Local Operating Units) are coming to the table, and getting endorsed by the relevant regulatory bodies. And financial institutions continue to invest in the data management infrastructures and organisations they need to host and maintain their entity data.

Key Elements

And yet, key elements of the GLEIS remain to be finalised, probably chief among them the Central Operating Unit (COU), which will be responsible for coordinating the activities of the LOUs, among other things.

In this report, we talk to Bloomberg's Peter Warms, Depository Trust & Clearing Corp.'s Ron Jordan and the London Stock Exchange Group's Emma Kalliomaki about what remains to be done to ensure the GLEIS becomes the de facto identification schema for entity data globally, and how practitioners can use the LEI now in their entity data management initiatives, among other burning issues related to the GLEIS.

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A-TEAM Q&A: The Global LEI System – A Solution for Entity Data?

The Global LEI System – or GLEIS – has been in development since the middle of last year. Development has been patchy at times, but much has been done, leaving fewer outstanding issues, but also raising new questions.

What remains to be done to ensure the GLEIS becomes the de facto identification schema for entity data globally? And how can practitioners use the LEI now in their entity data management initiatives?

Most of the key elements of the global LEI system – or GLEIS – are in place, but the LEI Foundation that will underpin the critical Central Operating Unit, or COU, is not yet in place. Who will be the directors of the foundation and when can we expect the COU to be in place?

Emma Kalliomaki, London Stock Exchange Group: Only the ROC is

really able to provide a definitive answer to this question. As far as I am aware, the ROC has been working as a priority to finalise the Board and an announcement is imminent. Based on the application criteria, we do know there will be 15 Board members spanning across 4 specified regions with a minimum of 3 directors from each (regions being 1.North America, 2.Europe, 3.Asia and 4.Central & South America, Oceania & Middle East).

The Board will consist of experienced professionals ensuring all key areas required for establishment of the COU can be fulfilled such as sectorial knowledge, organisational (strategic and governance) experience, technical, developmental (process implementation) and legal expertise. It is my understanding that Pre-LOUs were excluded from the selection pool.

The COU will be central to the operation of the GLEIS system, but what exactly it will do is not

yet clear. Among other things, it is expected to manage a central database of LEI data. If it does this, which vendors or organisations would be interested in supporting this? And how would this work with consolidated LEI data that is being made available by pre-local operating units, or pre-LOUs, such as the CICI utility and WM Datenservice?

Jordan: The COU is not yet formed so it is premature to speculate on what functions it may or may not perform. However, it is a requirement that all pre-LOUs make their databases of pre-LEIs freely available. Therefore, there should be no limitations on who can create a consolidated file of pre-LEIs. Currently, there are no standards in place on the formats or naming conventions to be used by pre-LOUs when publishing files, adding to the cost and complexity to create and maintain a consolidated file. Going forward, we expect the pre-LOUs will work with the COU to create and adhere to file publication guidelines to reduce the cost and complexity of creating and maintaining a consolidated file.

Kalliomaki: The primary reason for the London

Stock Exchange providing a consolidated set of pre-LEI data is for enhanced validation for duplicate avoidance. Due to this, we will continue to integrate pre-LEI data direct from source to ensure timely accessibility to the data for validation purposes. The decision to make the consolidated dataset available was due to demand from market practitioners based on the limited availability of a consistent and efficient way of accessing the universe of pre-LEI data. Whilst establishment of the COU is integral to the GLEIS, I do not see its creation preventing pre-LOUs from utilising all pre-LEI data for duplicate avoidance.

Additionally, in the absence of the establishment of the Global LEI Foundation and the Board of Directors, it is extremely positive that progress is being made through the collaboration of the ROC and its Committee on Evaluation and Standards (CES), the PSPG and the Pre-LOUs to address practical matters and introduce standardisation into the interim system. The initial foundations are being laid that will only be further enhanced by the establishment of the COU.

Warms: The establishment

of the COU is a critical step forward for the GLEI system. Today, LOUs are acting independently, which creates inconsistencies in LEI data attributes, delivery methods, and communication to stakeholders across the industry. The COU will act as a foundation and supported by various stakeholders such as LOUs, the Regulatory Oversight Committee (ROC), data vendors, and LEI users.

The COU, with guidance from the ROC, will provide a primary file of consolidated LEIs that meets required ISO standards and provides a consistent set of attributes for each LEI. The COU will have direct communication with the ROC, which will enable it to respond quickly to inquiries and streamline updates of newly issuing LOUs.

This system would be an improvement to the current consolidated data feed available from DTCC/WM Daten, which has limited resources devoted to issuing LEIs, reviewing challenges, and integrating content received by newly issuing LOUs. This consolidation will relieve programming headaches caused by monitoring multiple LOU data feeds and create a master LEI framework, which is currently unavailable to the market.

The Regulatory Oversight Committee, or ROC, of the GLEIS has endorsed a handful of pre-LOUs, making their LEIs globally acceptable to regulators that are part of the ROC. How many more does it need to endorse to make the global system viable from a regulatory point of view?

Jordan: We believe the system is now globally viable. The ROC endorsement means that any of the 50+ regulators who signed the ROC charter will now accept any pre-LEI from any pre-LOU for regulatory reporting purposes. Over 100,000 entities currently have a pre-LEI assigned by an endorsed pre-LOU. The CICI Utility alone has issued 90,000 pre-LEIs for entities in over 140 jurisdictions. And regulators in the North America, Europe, and Asia are now approving rules requiring pre-LEIs to be used for regulatory reporting. We expect the rulemaking to move beyond OTC Derivatives into other asset classes, next year.

Kalliomaki: Given ROC endorsement and global acceptance of pre-LEIs is already in place, I believe regulators already consider the interim system viable. Both CFTC and ESMA have

formally communicated the use of pre-LEIs assigned by endorsed pre-LOUs as globally accepted. Also indicative of broader regulatory acceptance, the European Banking Authority recently held a consultation recommending the adoption of pre-LEI, and subsequently LEI, for the use of supervisory purposes for every credit and financial institution in the EU.

Warms: In early October 2013, the ROC released a statement endorsing DTCC, WM Datenservice and INSEE as viable LOUs for regulatory reporting. In November, the ROC extended acceptable LOUs when it endorsed Takasbank and the London Stock Exchange as issuing entities.

There are presently 17 sponsored LOUs that are part of the GLEI. Eight of these are live, issuing LOUs, (five are ROC-endorsed LOUs, and 3 non-endorsed LOUs – Irish Stock Exchange, National Settlement Depository (Russia), and Dutch Chamber of Commerce). From a regulatory perspective, the number of endorsed LOUs does not impact the viability of the GLEI system. In reality, regulatory authorities only need one endorsed LOU to issue LEIs since LOUs do not restrict foreign entities

from registering for LEIs through their utility.

For example, if an Irish incorporated entity falls under the CFTC mandate, there is no requirement for the entity to receive a LEI from the Irish Stock Exchange (non-endorsed issuing LOU). This Irish incorporated entity has the capability to go to any of the endorsed LOUs overseeing a foreign country and register for a LEI to meet CFTC reporting mandates. To put this in perspective, although only five LOUs are endorsed, these LOUs have issued slightly over 100,000 LEIs in 150+ countries (approximately 50% US-based, 15% German-based, 5% Cayman Islands-based, 5% Luxembourg-based, 5% UK-based, 20% across about 150 countries).

Will the tipping point of LEI adoption in global capital markets be driven by regulation or market adoption?

Jordan: The tipping point has passed. Regulators and market participants have aligned interests and both understand the enormous value of the LEI for internal and systemic risk analysis. Regulators are adopting rules requiring pre-LEIs and the market has embraced the global system. In addition, data quality remains paramount and the

LEI system incorporates an economic model that does not impose undue burdens on registrants for pre-LEIs or firms that are required to report transactions with pre-LEIs.

Kalliomaki: A combination of both is driving adoption however, with the current focus on regulatory deadlines (EMIR - 12 Feb 2014), focus must be placed on ensuring those entities impacted by regulation are the priority. With market practice, as firms incorporate LEI into their datasets the requirement to have all entities covered will increase demand to those entities not currently in scope by regulatory mandates – although I believe it is only a matter of time before regulation eventually captures all entities.

Warns: Although the LEI is recognised for its important role in financial data and risk management going forward, a considerable amount of work is needed to encourage the use of the LEI as a primary identifier. The GLEI system needs the ongoing support of regulations and momentum behind market adoption in order for the system to reach the ‘tipping point.’ Ultimately regulatory coercion may be the primary driving force behind

adoption.

In the last 18 months, the GLEI saw early adopters among financial firms driven to incorporate the new identifiers because of regulatory pressure applied by ROC members, the CFTC and NAICs. Earlier this year, the burst in LEI volume was related to the CFTC’s deadline for LEIs to be used in regulatory reporting. In the short term, we anticipate that pending EMIR regulations will spur a new wave of adoption among European-based financial entities and cause a spike in the volume of new LEIs through the first half of 2014 as the EMIR regulations take effect. Regulatory changes will ultimately drive global adoption of LEIs more than any other single factor.

At the A-Team Group Data Management Summit in October, the suggestion was made that the LEI is little more than a large mapping exercise. Do you think this is the case and will it be the case in future?

Jordan: Mapping will always be required when a new identifier is introduced into an existing system containing legacy identifiers. However, over time, as the number of LEIs issued and the number of regulators requiring LEIs grows, the LEI

will begin to be more widely used by financial firms and vendors and potentially allow firms to retire certain existing identifiers. We also believe that the LEI may become the ‘master key’ within many systems to which other identifiers are mapped or other information is appended.

Kalliomaki: With the introduction of a new identifier, it is inevitable that mapping exercises will have to take place. The current coverage of pre-LEIs allocated still remains only a subset of the universe of entities that exist and therefore, the requirement to cross-reference from internal and proprietary identifiers will be required for some period of time. Ultimately the benefits gained, both by regulators and firms with the ability to measure and monitor risk and exposure, as well as improved operational efficiencies, will far outweigh the efforts related to mapping.

Warns: Although mapping entity data is a necessary practice in order to incorporate the LEI, data mapping serves a much larger purpose in the data governance process.

The LEI is a key component to an institution’s data governance and risk

management process, and it will only grow in importance in the years to come. Presently, the LEI is a mandatory identifier used in the reporting of swap transactions monitored by the CFTC - however, it is only months away from serving a similar role in Europe when EMIR regulations take effect, according to recent reports by the European Securities and Markets Authority (ESMA) and European Banking Authority (EBA). Ultimately, the LEI could act as a primary entity-level identifier used in the reporting of equity trades, fixed income issuances, and other transactions.

During the initial stages of LEI adoption, mapping exercises are essential. Various methods can be employed when mapping the LEI and incorporating it in other data sets. Adopters can map to proprietary identifiers by monitoring the eight issuing LOUs, or by working with data vendors that can manage the mapping exercise and efficient data integration through their current feeds. As the LEI system takes shape over time, mapping will undoubtedly become more systematic, however it will not disappear until LEI sees adoption by stakeholders at every stage of the capital markets. Whether the LEI sees

full adoption or not it is capable of serving its ultimate purpose within risk management transactions. Its dependency on proprietary or vendor identifiers has yet to be determined.

Initial use cases identified for the LEI obviously include risk, but also tasks such as KYC and client onboarding. Do you see more use cases emerging over time?

Jordan: The initial purpose of the LEI is to enable regulators to improve their systemic risk management capabilities, and financial firms may also realize benefits from the LEI for internal risk analysis. The LEI itself is not a solution for KYC or client onboarding, but may be one component to assist firms to perform those functions. Adoption of the LEI by firms and vendors will enable the entire financial community to determine how the LEI can be used, whether as part of market research, analysis, or other things. Without predicting the future, it is not a stretch to assume that an accurate, consistent, globally adopted standard of entity identification will unleash use cases that we cannot yet contemplate. But it is critical that the initial objective be satisfied first:

Strengthen systemic risk capabilities of regulators to analyse positions and transactions of firms they oversee on a globally integrated basis.

Kalliomaki: The most obvious benefits relate to risk as this will help regulators and entities to standardise data to provide better aggregated data views to measure and monitor risk and exposure. The use of LEI for identifying issuers and guarantors will also be extremely beneficial for linkages to securities reference data. Over time there are also general operational efficiencies related to data management and as well as improved business-to-business activities based on standardised identification. Additionally, the use in future regulation, such as MIFIR, are likely use cases.

Warms: Yes, we are already witnessing a focus on entity content, such as the LEI, KYC and on-boarding, by global banks. Global banks are being significantly impacted by an onslaught of regulatory reform. Regulations such as Dodd Frank, EMIR, FATCA and Basel III are pushing global banks to managing internal resources more efficiently to handle concurrent and equally important regulatory implementations.

Since many regulations concentrate on entities and issuers, it has become practical to develop streamlined internal databases, often first of a kind, that focus on managing and organizing entity content and serve the risk reporting, compliance, debt aggregation and other regulatory reporting requirements.

Turning to market participants, what should they be doing about the LEI at the moment and what should they be planning?

Jordan: Market participants will likely be both users of and contributors to the LEI system.

As users, market participants must ensure that they satisfy current regulatory reporting requirements that require them to include pre-LEIs for their organization and their counterparties. Regulations and requirements vary so firms need to be diligent to understand them. Mapping the pre-LEI to existing in-house identifiers may require firms to access the publicly available information and integrate it into their systems, or otherwise gather it from their clients.

As contributors, market participants will be required to register for a pre-LEI for

any legal entity required to have one, and to maintain their LEI reference data at least once per year. Market participants will also need:

- To understand the rules governing which legal entities are required to obtain a pre-LEI;
- To understand the reference data information required to be provided to register for a pre-LEI; and
- To have a process to update and maintain their LEI reference data.

Kalliomaki: The priority is to ensure they are prepared for meeting their regulatory obligations including confirming pre-LEIs are in place for their own entities, all clients and counterparties that are impacted. With specific reference to EMIR, firms should be ensuring they have all they require for reporting obligations which includes the selection of their trade repository such as UnaVista, the London Stock Exchange's trade repository, which was recently approved as a register trade repository across all asset classes.

Warms: What should practitioners be doing now with respect to entity and the GLEIS?

At minimum, practitioners should be carving out a place to store the LEI, or

implement a means to map to the LEI. We have included the LEI in our entity file, mapped against our entity ID, thus making it very easy for our clients to obtain the LEI. Conversely, we have witnessed many clients who have less sophisticated systems in place struggle to gain access to the LEI. They have portfolios of entities but no means to map the LEI against their entity list. Data management providers like Bloomberg PolarLake, amongst others, are quickly responding to this need.

How will the global LEI help practitioners come to grips with their entity data? What will be the benefits?

Warms: The global LEI initiative has truly brought entity-level data into the spotlight. It has stressed the importance of establishing entity databases versus the previous practice of creating silos of systems based on proprietary, limited-universe instruments identifiers. More importantly, LEI has also created the need for clients to evaluate their risk management systems, which was the primary purpose of the LEI when it was developed two years ago.

The LEI looks to serve the role as a key universally accepted identifier, however

it's essential to recognize that it is only one piece of the risk management puzzle. At the entity level, there is a need for additional data sets to empower LEI data, which includes industry classification, entity hierarchies, and country of risk. In addition, in order to produce accurate risk assessments, practitioners need comprehensive instrument databases with correct security classifications and a robust data model to support the exposure to a given LEI. These additional needs challenge practitioners to expand their entity data sets beyond the LEI in order to meet risk management systems requirements.

Furthermore, GLEIS has stressed the importance of entity-level corporate actions. The current system requires the maintenance of entities to re-certify their LEI annually in order to stay compliant within their LOU. I would challenge practitioners to determine if a one-year maintenance period is reliable for risk management purposes. Entity corporate actions are a daily occurrence and it's essential to reconcile risk systems for quality and compliance frequently. In order for practitioners to create credible entity databases, they cannot simply rely on the LEI systems. They need to

devote significant resources to maintain their data or link their data to a reliable data vendor source.

Utilising licensed and proprietary identifiers at both the entity and security level can be costly. Instead, incorporating open and free identifiers over time will not only bring down costs but will allow for open flow of information.

In your experience, are market participants ready to meet regulation such as EMIR that mandates use of the LEI?

Jordan: The financial services industry, largely through its trade organizations like the Global Financial Markets Association, has been active in the LEI discussions for over two years. Market participants have helped shape the design and implementation of the global system, and are generally aware of reporting obligations. The on-going challenge will be to ensure that smaller financial firms and non-financial firms, that require a pre-LEI, understand that fact and do what is necessary to obtain one. We believe there may be hundreds of thousands or even a million entities that will ultimately require an LEI, so spreading the word to these segments represents the next major challenge.

Kalliomaki: Market participants have been preparing as much as possible given there has been a lack of clarity on some elements of EMIR including modifications related to identification usage. The confirmed usage of endorsed pre-LEIs as the only counterparty id was only formally communicated in the 22 Oct EMIR Q&A as the previous 5 August had only mentioned an interim LEI meeting the conditions of the ROC.

Additionally, in the fund arena, there was uncertainty on the level at which an LEI was required and only more recently has the acceptance that sub-fund level identification is required, are fund managers obtaining their LEIs.

Warms: The preparation for regulations such as EMIR has been a very difficult process for market participants. Our conversations with clients span introductory LEI discussions to very detailed and specific use cases.

The LEI developments have required us to continuously engage with our customers to assure they have the latest information about the regulation and are aware of Bloomberg's procedures. In numerous cases, market participants are doing their best to prepare to integrate

LEIs into their data systems, however do not fully understand how the LEI will be used until the regulations are mandated and LEI use is put in practice. These types of market participants have been best prepared, however it does not represent all LEI parties.

A large group of practitioners have been loosely following the LEI developments; however have not undergone detailed integration projects. Our expectations are for this group to dwindle in size as the LEI reaches the ‘tipping point’ discussed earlier, which will be heavily influenced by regulatory mandates. We have found that the 2012 and 2013 ISO, G-20, and CFTC developments have better prepared market participants for future regulations, including EMIR. These positive steps will continue to better prepare market participants.

Finally, is there anything particular that will make or break the global LEI system?

Jordan: The global LEI system is in its formative stage; yet still represents a major achievement. It is a public good with global support and a sustainable

economic model. Its purpose aims to improve risk analysis, which is in the public interest. As the global LEI system evolves and as the COU and other governance capabilities are established, it needs to stay true to its mission. It needs to contain accurate information maintained by LOUs that have expertise in legal entity data management; it needs to ensure that it doesn’t try to be all things to all people, and by doing so stays disciplined in managing its scope and related costs; and it needs to ensure that the interests of global politics do not overwhelm those of data practitioners and users.

Kalliomaki: The system is already well under way and with the level of regulatory mandates already in place, I can only see this further increasing across more jurisdictions. The current absence of the COU does not hinder implementation of the GLEIS but it will be the next major step towards launching the official LEI system.

Warms: Right now it would be premature to say that a specific event that would ‘break’ the global LEI system. It has received

positive endorsements from global regulators, global financial corporations, and the G-20. The system has consistently taken positive steps forward in addressing data quality, stressing the importance of risk management, and acting as a key identifier. This is new to the market and there is a reason that participants are allocating significant resources to LEI integration – the LEI is here to stay.

There are still major developments required to ‘make’ the GLEI system. The formation of the COU is among the most relevant developments. We know that a COU will be established in Switzerland by end of year, but are unaware of the operational date. Currently, disparate LOUs are going live without proper oversight and controls. Beyond that, the COU will be required to establish a ‘live’ approach to address corporate action events.

An annual re-stamping or re-certification process is not enough to create confidence and usability of the LEI system. Market participants will be required to employ an independent source of entity corporate actions data so that they can govern and manage their reporting processes.

