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EPC Newsletter

OPINION AND EDITORIAL

A New Global Initiative Driven by the Financial Stability Board and the G20: the Legal Entity Identifier (LEI) Empowers Market Participants to Mitigate Risks and Increase Operational Efficiencies

The LEI is based on the ISO 17442 standard and is available to any market participant free-of-charge

BY GERARD HARTSINK

Created in 2009, the Financial Stability Board (FSB) seeks to strengthen financial systems and increase the stability of international financial markets globally. In the wake of the 2008 financial crisis, the FSB as well as the finance ministers and central bank governors represented in the Group of Twenty (G20) advocated developing a universal legal entity identifier (LEI) applicable for public and private purposes to any legal entity that engages in financial transactions. Implementation of the LEI will increase the ability of authorities in any jurisdiction to evaluate risks, conduct market surveillance and take corrective steps. The LEI is currently required in the United States and the European Union for the execution of transactions with, and reporting of, counterparties to over-the-counter (OTC) derivative trades. Many other regulators around the world are implementing the LEI for financial market transactions or are considering doing so. Use of a LEI also generates tangible benefits for businesses including reduced counterparty risks and increased operational efficiencies. Following up on the recommendations of the FSB endorsed by the G20 in 2012, public authorities cooperating with private sector experts created the Global LEI System (GLEIS). In June 2014, the FSB established the Global LEI Foundation (GLEIF) as the operational arm of the GLEIS. In this article, Gerard Hartsink, Chairman of the GLEIF Board, outlines next steps to promote global LEI adoption and identifies, specifically, the added value of applying the LEI in the payments industry.

The views expressed in this article are solely those of the author and should not be attributed to the European Payments Council.

Key Information in this Article

The legal entity identifier (LEI) is based on the ISO 17442 standard developed by the International Organization for Standardization (ISO) and is available free of charge for users.

In 2011, the Group of Twenty (G20) called on the Financial Stability Board (FSB) to take the lead in developing recommendations for a global LEI and a supporting governance structure.

The related FSB recommendations endorsed by the G20 in 2012 led to the development of the Global LEI System (GLEIS) that will, through the issuance of LEIs, provide unique identification of legal entities participating in financial transactions across the globe.

This GLEIS is composed of three tiers:

1. **Regulatory Oversight Committee (ROC):** established in January 2013 with responsibility for the governance and oversight of the GLEIS. It represents members from public authorities across the globe.
2. **Global LEI Foundation (GLEIF):** established in June 2014 as the operational arm of the system.
3. **Federated Local Operating Units (LOUs)**: supply registration and other services, and act as the primary interface for registrants for LEIs.

In June 2014, the FSB reiterated that global adoption of the LEI underpins multiple “financial stability objectives” and also offers “many benefits to the private sector, including lowering operational risks and facilitating straight through processing".

Areas where the application of the LEI would add value, specifically, for the payments industry include:

- Corresponding banking relations: identification of direct and indirect participants.
- SEPA Direct Debit and other direct debit schemes: transparency for users of entities involved in direct debit transactions.
- E-payments: identification of web merchants and transparency to users.
- Scheme owners: LEI as a mandatory attribute for risk management by the scheme manager.

The legal entity identifier (LEI)

The LEI is a 20-digit, alpha-numeric code based on the ISO 17442 standard developed by the International Organization for Standardization. It connects to key reference information that enables clear and unique identification of legal entities participating in global financial markets and/or in financial transactions.

The Financial Stability Board and the Group of Twenty drive the LEI initiative

The global LEI initiative is driven by the Financial Stability Board (FSB) and the finance ministers and governors of central banks represented in the Group of Twenty (G20).

The G20 is an informal forum for international cooperation, and consists of 19 major economies plus the European Union (EU) [1].

Created in 2009, the FSB is an international body that monitors and makes recommendations about the global financial system. It does so by coordinating national financial authorities and international standard-setting bodies as they work towards developing strong regulatory, supervisory and other financial sector policies. It fosters a level playing field by encouraging coherent implementation of these policies across sectors and jurisdictions. The FSB, working through its members, seeks to strengthen financial systems and increase the stability of international financial markets. The policies developed in the pursuit of this agenda are implemented by jurisdictions and national authorities. The FSB Charter was endorsed by the heads of state and government of the G20 [2].

In the wake of the 2008 financial crisis, regulators worldwide acknowledged their inability to identify parties to transactions across markets, products, and regions. The FSB, together with the finance ministers and central bank governors represented in the G20, therefore, advocated developing a universal LEI applicable to any legal entity that engages in financial transactions. Implementation of the LEI will increase the authorities' ability to evaluate systemic and emerging risk, identify trends and take corrective steps.

At its November 2011 Cannes Summit the G20 called upon the FSB to take the lead in developing recommendations for a global LEI and supporting governance structure. The resulting FSB proposals were subsequently endorsed by the G20. The 'G20 Leaders Declaration' of 19 June 2012 (see 'related links' below) states: "We endorse the FSB recommendations regarding the framework for development of a global LEI system for parties to financial transactions, with a global governance framework representing the public interest. (...) We encourage global adoption of the LEI to support authorities and market participants in identifying and managing financial risks."

The Global LEI System (GLEIS)

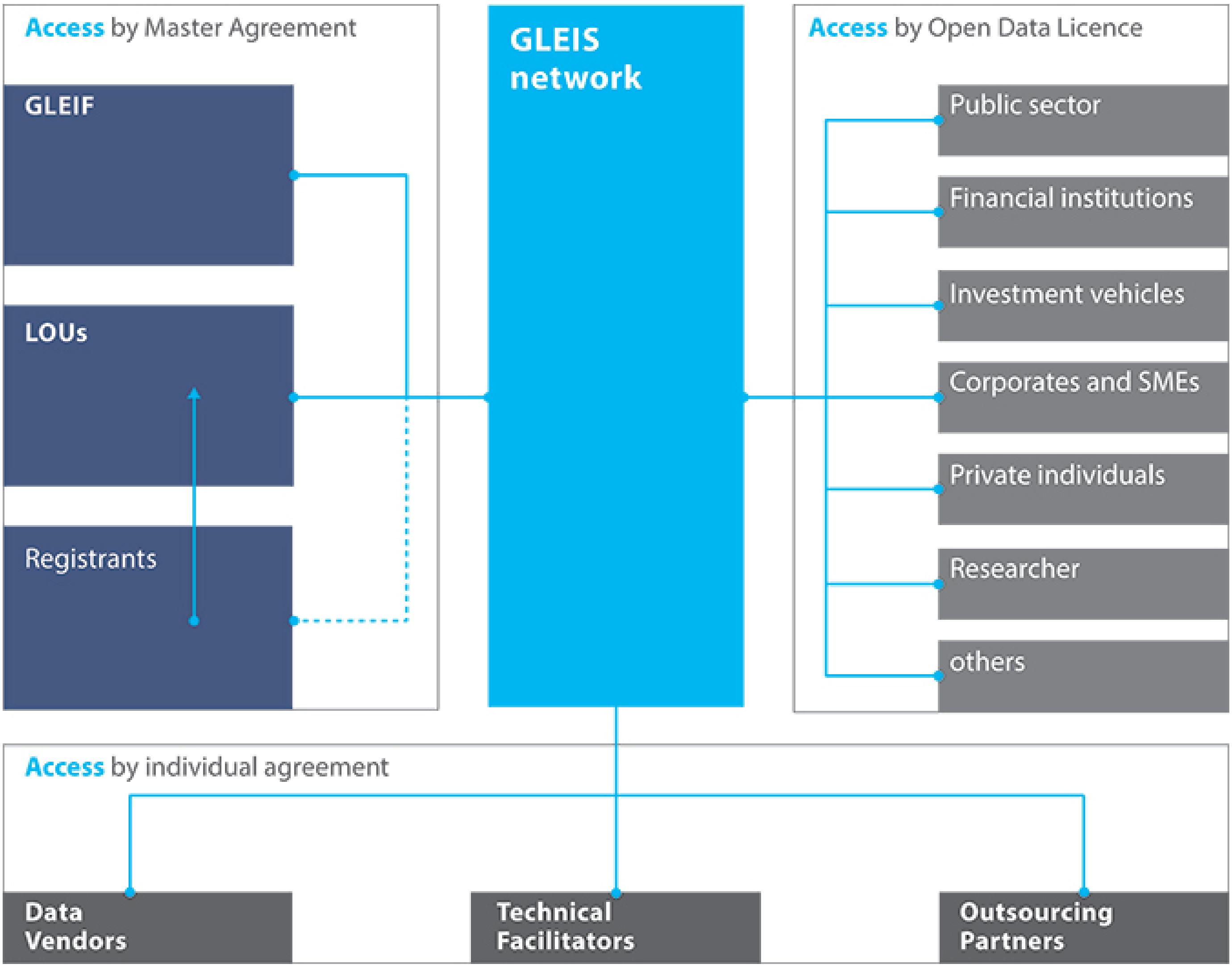
Following up on the recommendations of the FSB endorsed by the G20 in 2012, authorities, working with the private sector, have developed the framework of a Global LEI System (GLEIS) that will, through the issuance of LEIs, provide unique identification of legal entities participating in financial transactions across the globe.

This GLEIS is composed of three tiers:

1. **Regulatory Oversight Committee (ROC):** established in January 2013 with responsibility for the governance and oversight of the GLEIS in the public interest. The ROC took over the leadership of the LEI initiative from the FSB in January 2013, and now has about 80 members from public authorities across the globe. (To learn about the membership of the ROC, refer to the 'related links' below.)
2. **Global LEI Foundation (GLEIF):** acts as the operational arm of the system. It supports the application around the world of uniform operational standards and protocols set by the ROC and supports the maintenance of a 'logically' centralised database of identifiers and corresponding reference data.

3. **Federated Local Operating Units (LOUs)**: focus on supply registration and other services, and act as the primary interface for registrants for LEIs. So far about 325,000 LEIs have been issued by about 20 LOUs.[3]

Figure 1: GLEIS as a Legal Network. (Source: GLEIF.)



Next steps by the Global LEI Foundation (GLEIF) to promote adoption of the LEI

The Global LEI Foundation (GLEIF) supports, on a not-for-profit basis, the implementation and use of the LEI for legal entities that engage in financial transactions. Specifically, the GLEIF performs the following services:

- Accredits and monitors the LOUs, its partner organisations participating in the GLEIS.
- Provides the technical infrastructure necessary to unite and to make publicly available the LEI information published by the LOUs.
- Manages the relations with the LOUs, the ROC and other stakeholders in the GLEIS.
- Publishes all the LEI information via its global LEI repository – to go live in 2015 – available free-of-charge to any user and without any licensing, intellectual property rights or similar restrictions. The repository will contain an up-to-date listing of all LEIs and their associated legal entity reference data as well as comprehensive search capabilities.

The GLEIF delivers its services for free to users.

In 2015 the GLEIF will finalise the master agreement that defines the roles of the GLEIS partners and implement the compliance framework necessary to ensure that the GLEIS partners adhere to the master agreement.

Planned application of the LEI to financial transactions

The LEI is planned for use by public authorities of any jurisdiction to assess risks, conduct market surveillance and enforcement, and to supervise market participants.

The LEI is currently required in the United States and the EU for the execution of transactions with, and reporting of, counterparties to over-the-counter (OTC) derivative trades. Many other regulators around the world are implementing the LEI for financial market transactions or are considering doing so. (Detailed information on initiatives underway is available on the GLEIF Website, see 'Legal Entity Identifier: Existing and proposed rulemaking' included in the 'related links' below).

The benefits of global LEI adoption

The FSB reiterated in a press release of 30 June 2014 (see 'related links' below) that "providing unique identification of parties to financial transactions across the globe" underpins multiple "financial stability objectives including: improved risk management in firms; better assessment of micro and macro prudential risks; the facilitation of orderly resolution: promoting market integrity and containing market abuse and financial fraud; and supporting higher quality and accuracy of financial data overall. It shall also provide many benefits to the private sector, including lowering operational risks and facilitating straight through processing."

The value of the LEI for the payments industry

The LEI could further reduce the counterparty risks and increase the operational efficiencies for all participants in the payments industry. The following options are worth exploring:

Corresponding banking relations: managing transaction risk in correspondent banking is a challenge for financial institutions. It is not always clear what the legal entity of the counterparty is, in particular when dealing with legal entities in group structures or in the case that a bank acts as an intermediary bank. Complying with anti-money laundering (AML) and anti-bribery regulations as well as with requirements defined by the US Office of Foreign Assets Control (OFAC) makes the managing of counterparty risks complex and costly when transacting with direct and indirect participants. Many financial institutions have faced substantial fines for transactions in correspondent banking relations.

SEPA Direct Debit (SDD) and other direct debit schemes: in accordance with the SDD Rulebooks released by the European Payments Council (EPC), each SDD mandate[4] is identifiable based on the 'unique mandate reference' and the 'creditor identifier'. Creditors (billers) collecting payments under the SDD Schemes are obliged to obtain a creditor identifier which relates to a legal entity, or an association that is not a legal entity, or a person assuming the role of the creditor. Each SDD collection can be traced back - immediately and unmistakably - to the creditor. As a result, any creditor collecting SDDs can be rapidly and unequivocally identified. A mandate – issued under the SDD or any other direct debit scheme existing globally – that would include a LEI and a reporting of the LEI with the collection on the account statement would provide a further indicator of the legal entity that initiated the direct debit transaction. Any user could easily trace the legal entity by accessing for free the LEI data published by the GLEIF.

E-payments: the delivery of goods and services via web merchants would benefit from the use of the LEI for e-payments. For example, the LEI could become mandatory on the payment page of the web merchants. The web merchant would benefit because the LEI would increase the consumer's trust in the offer. The consumer would also benefit because he or she would have the option to check, without any costs, the identity of the supplier of the goods and services.

Scheme owners: the owners of credit transfer, direct debit or card schemes could implement the use of the LEI for the scheme participants in their files and in their processes. Adding the LEI as a mandatory attribute to scheme management would strengthen the risk management of the scheme owners. The majority of financial institutions in the EU already has a LEI and, as such, would not be faced with additional costs for this purpose.

As demonstrated in Europe and other regions of the world, harmonisation and standardisation initiatives significantly contribute to streamlining business processes to the benefit of all market participants. Global adoption of the LEI is the next step.

Gerard Hartsink is Chairman of the GLEIF Board.

Related links:

International Organization for Standardization (ISO) Website: ISO 17442:2012 Financial services -- Legal Entity Identifier (LEI)

Financial Stability Board (FSB) Website: About the FSB

G20 Leaders Declaration (19 June 2012): See 'Reforming the financial sector and fostering financial inclusion' / item 44

The Legal Entity Identifier Regulatory Oversight Committee – LEIROC Website: The Regulatory Oversight Committee for the Global Legal Entity Identifier (LEI) System (Members and Observers)

Financial Stability Board (FSB) press release (30 June 2014): Establishment of the Global LEI Foundation

Global LEI Foundation (GLEIF) Website

Global LEI Foundation (GLEIF) Website - Legal Entity Identifier: Existing and proposed rulemaking

Related articles in this issue:

The Future of Payments: European Commission Invited Exchange of Views at its Conference on Emerging Challenges in Retail Finance and Consumer Policy. Participants discussed latest developments, and ones to come, in terms of consumers' safety, accessibility and convenience

Guidelines on the Security of Internet Payments Released by the European Banking Authority: a Two-Step Approach. EPC response to the consultation on guidelines on the security of internet payments launched by the European Banking Authority

Related articles in previous issues:

One Thing is Crystal Clear: Praise Belongs to Gerard Hartsink and Claude Brun for their Invaluable Contributions to SEPA! EPC pays tribute to former EPC Chair Hartsink and Vice Chair Brun who concluded their tenure in June 2012 (EPC Newsletter, Issue 15, July 2012)

The Silent Revolution. The impact of ISO 20022 on payments services in general and SEPA in particular. By Gerard Hartsink and Petri Aalto (EPC Newsletter, Issue 3, July 2009)

EPC Newsletter: Articles published in the section 'Focus: On Integration and Innovation'

EPC Newsletter: Articles published in the section 'ISO 20022 in the SEPA Context'

EPC Newsletter: Articles published in the section 'Opinion and Editorial'

1 http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI%282015%29545712.

2 In 2009, the heads of state and government of the G20 endorsed the FSB's original Charter of 25 September 2009. In 2012, the G20 endorsed the FSB's restated and amended Charter which reinforces certain elements of its mandate, including its role in standard setting and in promoting members' implementation of international standards and agreed G20 and FSB commitments and policy recommendations. http://www.financialstabilityboard.org/about/history/.

3 Any legal entity of any jurisdiction can use the registration services of any Local Operating Unit (LOU), i.e. any LOU is allowed to register legal entities of any jurisdiction.

[4] The SEPA Direct Debit (SDD) Schemes allow a creditor (biller) to collect funds (in euro) from a debtor’s (payer’s) account, provided that a signed mandate has been granted by the debtor to the creditor. A mandate is signed by the debtor to authorise the creditor to collect a payment and to instruct the debtor's bank to pay those collections.

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