The implementation of a global Legal Entity Identifier (LEI) in financial markets. March 2014.

The **Financial Stability Board (FSB**) found, in its analysis of the causes of the 2008 crisis, that one of the major deficiencies in financial markets has been the lack of a common system to identify the parties in a financial transaction which led to a high difficulty in monitoring transactions between participants in different jurisdictions. The FSB adopted at the summit in Los Cabos (June 2012), the **report "A Global Legal Entity Identifier (LEI) for financial markets"**, pursuant to the mandate provided by the G-20 to the FSB at the Cannes summit (November 2011), to lead the co-ordination of international regulatory work and to deliver concrete recommendations on the LEI system.

Thus, the FSB report contains recommendations, principles and proposals for the launch and implementation of a global Legal Entity Identifier (LEI) system that will uniquely identify parties to financial transactions. The global LEI system is a key element of necessary improvements in financial data systems and, consequently, in reducing operational risks within firms. To take the work forward, the FSB set up and an Expert Group who has benefited from strong co-operation between private sector stakeholders (Industry Advisory Panel) and the regulatory community.

The reasons why there is not such a system already in place are mainly two: first, the challenge of gaining agreement that a particular identification scheme offers the best approach; and second, the launch of the global LEI system that could long if relies purely on voluntary adoption and market incentives.

The report supports the view that the LEI is by nature a public good offering collective benefits that are hard to capture by private market incentives alone. Already in 2011 CPSS- IOSCO highlighted, in their report on data reporting and aggregations requirements in derivatives OTC (August 2011), that the system for the identification of entities in financial transactions was a good public interest. Since the global LEI system is by nature a public good, there is a need to make sure that the gains for the broader public are captured and that provision of the LEI is not exploited in ways that do not benefit the public. In this sense, for example, if regulators mandate use of the LEI system, suppliers of the LEI would not exploit their privileged position, overcharge registrants, restrict access, cut corners on data quality or supply other revenue-generating services on non-competitive terms. Therefore, the FSB recommends the establishment of a governance framework for the protection of the public interest while encouraging competitive market forces and mitigating monopoly threats. This governance framework will also facilitate access to the global LEI system and describe functions and public and private sector responsibilities.

LEIs quality and solvency of the global LEI system require reliable standards and operational principles that should be, at the same time, flexible to facilitate integration in the global system of entities from different jurisdictions with different legal systems and to expand quickly, in the future, to include new jurisdictions and new registrants. In this sense, the report contains 35 recommendations (Annex 2) to advance the practical implementation of the system guided by a set of 15 Global LEI System High Level Principles (Annex 3) that set out the objectives the design of a global LEI system must meet.

The Global LEIs system should be designed, operated and governed in a manner that ensures unique entity identification and consistency at the global level, while drawing on distributed local elements and local infrastructures where possible. The FSB recommends a three-tier structure:

- **Regulatory Oversight Committee (ROC)**. The ROC should have the responsibility of upholding the governance principles and oversight of the global LEI system functioning to serve the public interest. The roles and responsibilities have been specified in its Charter (Annex 4), approved by the FSB and endorsed by the G-20 in November 2012. The Charter also refers to the membership of the ROC and to its Executive Committee appointed by the Plenary.

- **Central Operating Unit (COU).** The COU is the pivotal operational arm of the global LEI system and has the responsibility for ensuring the application of uniform global operational standards and for delivering high quality operations within the system. Specifically, the COU is in charge of the global uniqueness of the LEI, open access to the global LEI and high quality reference data for user, and methods for how local system can connect to the COU. The COU has the form of a not profit foundation (Global LEI Foundation GLEIF). A Board of Directors will direct the operations of the COU. The Board of Directors will, in consultation with the ROC, provide recommendations to outsource any particular function or operation of the global LEI system.

- **Local Operating Units (LOUs).** The LOUs have the functions which the ROC determines are not required to be centralised, and provide the primary interface for entities wishing to register for an LEI in each jurisdiction. LOUs could be built on existing local infrastructures (business registry or numbering services), in one jurisdiction there may be multiple LOUs to encourage competition, and could be operated in the private or public sector. In jurisdictions where there are not LOUs, entities wishing to acquire a LEI will need to apply to a LOU across borders or to the COU until the local infrastructure is established.

In **Spain**, the website of the Banco de España (member of the ROC) points that the global LEI system is under development. Applicants for LOU status should reserve a prefixe (pre-LOU) and will be converted in LOUs provided they fulfill the system definitive requirements. Until the design of the global LEI system is finished, an interim solution is being applied that allows legal entities to obtain equivalent codes named pre-LEIs. The Royal Decree-Law 14/2013 of 29 November conferred to the Business Register the functions of issuing and managing the legal entity identifier code and recently, a joint communication from the Ministry of Economy, Bank of Spain, CNMV and Ministry of Justice recognized the Business Register as pre-LOU in our jurisdiction.

The design of the global LEI system ensures that it has a self-sustaining funding model based on non-profit cost recovery. The cost should be modest and not a barrier to LEI acquisition. The charge has two components: a local discretionary charge, and a common fee for support of central functions of the COU and the ROC.
The FSB supports that the eligibility of "legal entities" should be broadly defined in order to ensure that all relevant entities can apply now and in the future as financial markets evolve and adapt. Uniqueness must be guaranteed and so only one LEI may be assigned to any financial counterparty. The initial reference data available at the launch of the LEI will enable the unique identification of the eligible legal entity.

The FSB endorses the standard ISO 17442:2012 that establishes the following identification data: official name, address of the headquarter of the legal entity, the address of the legal formation, the date of the first LEI assignment, date of last update of the LEI , date expiry, and business registry information (if applicable), alongside a 20 digit alphanumeric code. The FSB concludes that it is very important that the system is adaptable and expandable and that new reference data can be added into the global system. In particular, the FSB recommends that work is taken urgently to develop standards for LEI reference data on the direct and ultimate ownership and corporate, essential to prevent timely and effective data aggregation.

The development and implementation of global LEI system, since late 2012, has been proceeding slowly, based on the cooperation of the public and private sector. The FSB created: i) the implementation group, which replaced the expert group for legal and technical works necessary to launch the global LEI system; and ii) the Private Sector Preparatory Group (PSPG), to work together with the IG in the development of the works.

The FSB has published five progress reports to provide information on relevant aspects of the implementation of the LEI system at various stages. The third one contained provisions on the transitional situation created by the issuance of LEIs (pre- LEIs) previously to the launch of the global LEI system. The fourth one addressed, besides transitional provisions, the issue of the legal home and the appointment of the first Board of Directors of the GLEIS foundation. In the fifth progress report the FSB says that has fulfilled the mandate given to it by the G-20, disbanded the IG and transferred its responsibility to the GLEIS foundation. In January 2014, plenary of the FSB endorsed the appointment of the Board of Directors of the GLEIS foundation.

In the **European Union**, ESMA Questions & Answers on the implementation of the Regulation nº 648/2012, on OTC derivatives, central counterparties and trade repositories (EMIR) refer, in questions 10 and 14 of part III (trade repositories), to the LEIs in order to make clear the following: a) a client code can be used for customer that are individual whereas LEIs are used for legal entities, b) the possibility of using interim LEIs (pre-LEIs issued by any of the endorsed pre-LOUs) in the EU, c) the same legal entity would only have one LEI including its

branches/desks, and d) there is no reporting obligation for transaction between branches or desks within the same legal entity (with the same LEI).

If you want to read the report of the Financial Stability Board "A global Legal Entity Identifier for financial markets", please, do click on: http://www.financialstabilityboard.org/publications/r_120608.pdf

If you want to read the any of the five FSB progress reports, please, do click on: http://www.financialstabilityboard.org/publications/r_130111a.htm

If you want to read the ESMA Questions & Answers on the implementation of the Regulation nº 648/2012, on OTC derivatives, central counterparties and trade repositories (EMIR), please, do click on: http://www.esma.europa.eu/system/files/2013-1959_qa_on_emir_implementation.pdf

If you want to see the list of endorsed pre-LOUs in the EU in December 2013, please, do click on: http://www.leiroc.org/publications/gls/lou_20131003_2.pdf