LEIS- THE NEW GLOBAL LICENCE PLATE?

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"By failing to prepare, you are preparing to fail" – Benjamin Franklin (1709 to 1790)

European banks and brokers may have breathed a sigh of relief over ESMA's Legal Entity Identifier (LEI) eleventh-hour festive season reprieve a little too early.

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The LEI, the global financial services industry's car licence plate, is a 20-digit alpha-numeric code that uniquely identifies legal entities participating in financial transactions.

It was introduced following the 2008 financial crisis because regulators and market participants found that they could not accurately assess counter-party risk.

The complex group structures of some market participants together with differing ways of referring to legal entities meant that it was not easy to understand which legal entities counter parties were dealing with, who those legal entities were owned by and as a consequence who owned what to whom.

The Markets in Financial Instruments Regulation (MiFIR) which came into force on 3 January 2018 required EU investment services firms to identify themselves and their clients that are legal persons with LEIs for the purposes of transaction reporting pursuant to the Market in Financial Instruments Directive (MIFID) II obligations. This includes firms who execute orders, make the decision to acquire the financial instrument, transmits orders and/or submit transaction reports.

EU trading venues are also required to identify each issuer of a financial instrument traded on their systems with a LEI when making daily data reports to the Financial Instruments Reference Data System (FIRDs).

Legal entities, regardless of where they are from, who are clients of an EU investment services firm or are issuers of financial instruments traded on EU markets need to get an LEI regardless of whether they are not subject to LEI requirements in their own jurisdictions.

In scope EU investment firms and operators of trading venues are required to have appropriate arrangements in place to collect and verify the LEIs of clients before the transaction takes place.

The ESMA statement was not in fact a reprieve but merely a six month delay with strict conditions. Investment service firms cannot transact for clients without LEIs unless they have obtained in advance the relevant information and make the application for them. Once the LEI is obtained the investment firm will then need to submit its transaction report. The obligation has not gone away.

Trading venues will need to report their own LEI codes instead of the LEI codes of non -EU issuers whilst chivvying non -EU issuers to comply.

LEIs should not be new to in scope firms as they are already required by a host of EU regulations and directives, two of which being the European Markets Infrastructure Regulation (EMIR), for counterparties to derivatives contracts as well as beneficiaries, brokers, CCPs and clearing members, and Market Abuse Regulation (MAR), for issuers of financial instruments and entities involved in the reporting of suspicious transactions.

LEIs are also required by a number of other international regulations such as Dodd- Frank, where the US have required them since 2012. Other international regulators of mature financial markets such as Hong Kong, Singapore and Canada are also passing regulations requiring their adoption.

The adoption of the LEI is like a vaccine. Unless it is globally adopted across all public financial markets there is a risk of outbreaks of disease. The interdependence of financial markets are elevating the level of adverse impact.

On the positive side, comprehensive adoption of the LEI could potentially be a transformative innovation for financial services allowing the better integration of global markets and a driver to reduce cost.

A recent report by McKinsey & Company highlighted the advantages it could bring to commerce in making more efficient client onboarding processes and in the issuance of letters of credit.

The process of securing an LEI regardless of jurisdiction has also been made easier by the Global Legal Entity Identifier Foundation's (GLEIF) introduction of the Registration Agent which helps legal entities access the network of LEI issuing organisations.

The GLEIF is also responsible for the monitoring of the data quality processes and for accrediting the LEI issuers.

Legal entities do not have to use issuers in their own jurisdiction and can use the services of any accredited issuer which is a great boon for multi- national organisations who can use one issuer for their group.

The responsibilities of the legal entity are in fact minimal. The legal entity needs to provide accurate reference information such as the correct legal name and registration number, which the issuer must then cross check with local authoritative sources such as national company registers before issuing an ISO compliant LEI. Changes to data need to be updated and annually renewed.

LEI issuers are obliged to keep fees reasonable and to provide open access because the LEI is seen as a public good.

So banks and brokers need now to use ESMA's six month grace period to apply for LEI for those clients without them so that business can continue to be transacted smoothly.

Clients, regardless of location of in scope firms who refuse to submit the relevant data, could find themselves shut out of markets as firms choose to turn down business rather than risk contractual liability and enforcement actions for failing to submit compliant transaction reports.

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