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# Could the Global Legal Entity Identifier Be Useful for Financial Transparency Legislation in the 116th Congress?

## Overview

The 116th Congress is examining legislation related to financial transparency. This has come in the form of bills—H.R. 2513, S. 2563, S. 1978, or S. 1889—that would mandate greater disclosures of the natural persons or "beneficial owners" who benefit from or control a corporation or similar legal entity. Other bills, such as H.R. 4476, seek to promote financial transparency and data standardization among securities, commodities, and banking laws to make information reported to financial regulatory agencies more easily electronically searchable. The global Legal Entity Identifier system, increasingly used in the financial sector since its 2009 inception, but seemingly little known among broader audiences, may be of interest to Congress in light of such legislative activity.

## What Is the Legal Entity Identifier?

The Legal Entity Identifier (LEI) is a tool aimed at promoting transparency and improving risk management in the international financial system. Its origins stem from problems highlighted by the 2008 financial crisis. These included excessive opacity in credit risks, and the huge, hard to measure, losses accrued across affiliates of large financial conglomerates. For example, when Lehman Brothers failed in 2008, financial regulators and market participants found it difficult to gauge their financial trading counterparties' exposure to Lehman's large number of subsidiaries and legal entities, domestically and overseas. To better track such exposures, the Financial Stability Board (FSB) and G-20 helped design and create the LEI.

The LEI is a voluntary international system assigning each separate "legal entity" a unique 20-digit identifying number. This number can be used across jurisdictions to identify a legally distinct entity engaged in a financial transaction—including a cross-border financial transaction. This makes it potentially useful in today's globally interconnected financial system. The LEI was designed to enable risk managers and regulators to identify parties to financial transactions quickly and precisely.

The LEI's unique identifying number acts as a reference code—much like a bar code—which can be used globally, across different types of markets, and for a wide range of financial purposes. These could include capital markets and derivatives transactions, commercial lending, and customer ownership, due diligence and financial transparency purposes; as well as risk management purposes for large conglomerates that may have hundreds or thousands of subsidiaries and affiliates to track. A large international bank, for example, may have an LEI identifying the parent entity plus a different LEI for each of its legal entities that engage in other financial transactions.

Although the origins of the LEI stemmed from concerns over credit risk and safety and soundness that surfaced during the 2008 financial crisis, the LEI may also have additional benefits for financial transparency. A May 2018 study from the Global Legal Entity Identifier Foundation asserted, based on multiple interviews with financial market companies, that the lack of consistent, reliable automated identifiers was creating a great burden on the financial industry; that most in the industry believed the "Know Your Customer" process of onboarding new clients would likely become more automated; and that "there is clearly an opportunity to align on one identifier to generate efficiencies." Similar conclusions were reached in a 2017 study by McKinsey & Co. The current LEI system is aimed more at tracking financial transactions of various affiliates, but such a unified global identifier might be useful for more easily tracking ownership of affiliates, or of newly created corporate entities.

As of July 2019, more than 1.45 million LEIs have been issued to entities in over 180 countries, worldwide. However, use of the LEI remains largely voluntary. In the United States and abroad, only some aspects of financial reporting require use of the LEI. Nevertheless, LEI usage in a wide range of disparate U.S. regulations is growing.

## Policy Issues

Some have called the lack of a widespread adoption of a common legal identifier a collective action problem. In a collective action problem, all participants in a system benefit if everyone participates; if only a few participate, those few bear high costs, as early adopters, with little benefit. Collective action problems are examples of situations where a government-organized solution may result in more widespread benefits. Some academics have urged regulators to mandate LEI usage in regulatory reporting as a means of solving this collective action problem. The federal Office of Financial Research noted that, "Universal adoption is necessary to bring efficiencies to reporting entities and useful information to the Financial Stability Oversight Council, its member agencies, and other policymakers."

Various potential policy problems could arise if multiple financial regulators each created or mandated their own unique legal identifier. This could result in redundant paperwork and extra compliance costs for businesses. It could also obscure, rather than clarify, analysis of complex webs of financial transactions among multiple legal entities if those entities could choose among identifiers. Finally, multiple identifiers could pose additional challenges to industry and regulators' technological efforts underway to

use data in analyzing compliance and enforcement issues in the financial sector.

## Current Uses of the LEI

The LEI is being used globally, but, as of the end of January 2018, LEI coverage was concentrated in Canada, the European Union, and the United States. According to a May 2019 FSB study, legal entities in the United States had registered for the most LEIs, at 14.4% of the total; followed by the United Kingdom at 10.8%; Germany at 9.2%; and the Netherlands at 8.3%.

In the United States, the LEI is increasingly being adopted both voluntarily through industry practice and regulatory measures for a disparate range of purposes in the financial sector. The Regulatory Oversight Committee of the LEI found that as of April 30, 2018, there were 27 instances in U.S. rules or statutes where use of an LEI was either required, requested, or recommended. Its use spans the payment and mortgage systems, securities and derivatives trading, electricity, banking, and other sectors. A few examples include the following:

- Securities and Exchange Commission (SEC) rules requesting investment advisers use the LEI when submitting certain disclosure forms to the SEC;
- SEC rules on holdings by money market funds;
- Commodity Futures Trading Commission (CFTC) rules on reporting derivatives transactions;
- National Association of Insurance Commissioners use of LEI on forms describing investment counterparties;
- Consumer Financial Protection Bureau rules requiring some home mortgage lenders obtain and report LEIs;
- Bank regulators' requirement that certain banks with deposit insurance obtain and report LEIs; and
- Federal Energy Regulatory Commission rules that some electricity market participants obtain LEIs.

The FSB's May 2019 review on LEI usage found that globally, the LEI was used to identify participants in nearly 100% of the total dollar amount of over-the-counter derivative trades in most developed countries. Globally, about 78% of the total dollar amount of debt and equity issued in these countries came from issuers with LEIs.

But FSB found that, where regulatory adoption mandates were absent, LEI adoption and maintenance (or updating) rates have been significantly lower. According to FSB, usage has been low outside securities and derivatives trading, despite the fact that "higher LEI coverage (including for nonfinancial corporations) would support regulatory uses such as for AML (anti-money laundering) and CFT (countering the financing of terrorism), as well as other business and industry uses such as know your customer (KYC) processes and the transfer of funds, especially across borders." Moreover, the lack of widespread governmental requirement has limited the LEI's usefulness in capturing positive externalities for the market as a whole and for regulators.

## Congressional Issues

The increasing usage of the LEI is relevant to two areas of recent interest to Congress: (1) data standardization, including whether and how to promote this to enhance data analysis and new technology adoption in the financial sector; and (2) beneficial ownership disclosure issues. H.R. 4476, introduced September 24, 2019, would mandate that each financial regulator take steps to standardize the data it collects from industry, and that the data each agency collects should include standard identifiers. As noted in H.R. 4476, the data standards promulgated by each financial agency "shall include a common nonproprietary legal entity identifier that is available under an open license." It is not entirely clear whether the LEI would be one possible such identifier. The bill states that the agencies should "incorporate standards developed and maintained by voluntary consensus standards bodies"—which might potentially include the LEI. It does not appear that all the agencies must agree on one universal identifier as opposed to each agency choosing or creating their own identifier.

Bills—such as H.R. 2513, S. 1889, S. 1978, and S. 2563—that deal with beneficial ownership disclosure would mandate that persons who form corporations or limited liability companies in the United States disclose the beneficial owners of those entities. The bills generally require that such ownership information be reported to the Financial Crimes Enforcement Network (FinCEN) within Treasury, which would store this information in a database. S. 1889 and S. 1978 do not specifically discuss a type of standardized numeric "identifier." S. 2563 creates a "FinCEN identifier," a unique identifying number assigned by FinCEN to a person reporting their ownership of a corporation or limited liability company. It appears that the identifier would be used by FinCEN to mask the actual name of the person with a number; but it is unclear if such FinCEN identifier would be used for any further purpose. H.R. 2513 would also create a "FinCEN ID number to any individual who requests such a number and provides FinCEN with the information…" (required to prove identity). Both H.R. 2513 and S. 2563 would require any individual with a FinCEN ID number to submit an annual filing with FinCEN updating their identifying information.

The FSB's May 2019 review argued that LEIs could prove useful for AML and ownership disclosure purposes, such as in these bills. FinCEN's May 11, 2016 final rule imposing certain beneficial ownership disclosures on corporate entities opening bank accounts rejected a commenter's suggestion to require use of the LEI on the beneficial ownership disclosure form financial institutions submit to FinCEN. FinCEN wrote that the vast majority of legal entities subject to such disclosure would be small or nonfinancial entities unlikely to otherwise apply for LEIs and that the costs of mandating an LEI solely for the purposes of FinCEN's form would thus exceed the benefit. FinCEN stated other challenges are that the body assigning LEIs does not require the beneficial owner to be a natural person, (as opposed to another legal entity); that they use a 50% ownership threshold as opposed to the 25% threshold used by FinCEN; and that they do not verify identities of beneficial owners—thereby rendering the LEI's utility as an alternative source of verification minimal.

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