MEMORANDUM

TO:	European Banking Authority (EBA)	FROM:	PJ Di Giammarino CEO JWG PJ@jwg-it.eu www.jwg-it.eu +44 (0) 20 7870 8004
SUBJECT:	Consultation on Draft Recommendation on the use of Legal Entity Identifier (LEI)		
DATE:	28 November 2013		

Introduction

JWG [1] is delighted to have the opportunity to respond to the EBA's Consultation on its Draft Recommendation on the use of Legal Entity Identifier (LEI). We have been involved in this important debate for over three years and we would like to offer some perspectives on the EBA's data collection initiative. In developing this response we have drawn from the views of our members - comprising senior personnel from operations, risk and compliance at major financial institutions - and our research on EU regulatory reporting. For the avoidance of doubt, however, the views in this response are our own.

Executive summary

The EBA faces a number of hurdles in mandating the use of the LEI for EBA risk reporting:

- **Regulatory clarification:** Using LEIs for multiple regulatory purposes increases complexity. Currently, the industry is just coming to grips with the realities of defining what LEIs are required for OTC trading and has a number of unresolved issues (e.g., sub-funds, branches, legal personality etc.). Learning from this experience, regulatory guidance is required up-front to achieve the outcomes desired by risk supervisors.
- **Operational risk**: The global LEI system is still a work in progress. As we transition from the pre-LEI system to the final standards we risk overburdening the system with volumes far in excess of what we are ready for. Additionally, in the absence of a COU it will be difficult to reconcile standards and mitigate operational risks.
- **Implementation complexity:** The total cost of adoption of the LEI is neither minor nor measured in registration fees. There is a significant cost burden on investment firms and financial counterparties. In

[1] JWG Group Limited is a financial services think-tank which works with regulators, investment firms and their information technology supply chain to help determine how the right regulations can be implemented in the right ways. We are actively engaged with firms in helping to catalogue and interpret the many requirements across the G20 reform programme.

other words, the opportunity cost of doing the LEI properly is significant and potentially disruptive if not phased in in an appropriate manner.

We support the EBA's consideration for an extended timeline and 'phased approach' to LEI registration as this will significantly reduce the complexity, cost and risk associated with the implementation of the LEI at an EU level. However, the timelines as drafted are very aggressive and need to take account of a significant effort on behalf of the EBA and the industry to address the risks explained in more detail below.

1. What are your views on the use of pre-LEIs as unique identification codes for supervisory purposes for credit and financial institution in the European Union?

We agree that the adoption of common identifiers, such as the LEI, need to be explicitly mandated. However, clear use cases for the information need to be defined at a granular level. The global LEI system is still a work in progress and there are a number of steps that have to yet to be taken before we have a 'final' LEI. For example, LOU portability standards, the Central Operating Unit's (COU) embedded hierarchy standards, and the list of entities which are in scope for the LEI (e.g., funds, branches, legal personality etc.).

There is still a lot of uncertainty over which entities can, and should, be registered for an LEI. The protocol for the registration of certain entities, such as funds or branches, is still uncertain as the ROC has yet to set guidance. Firms now have to make judgement calls on what is appropriate in examples such as whether sub-funds should be registered in addition - or instead - of the umbrella fund. A protocol is especially important in the event that the ROC's final standards for the LEI conflict with the EBA's requirements for its use.

In order to prioritise what needs to happen, when and for what purpose, clarity on individual scenarios is required. For example, will all trading entities need an LEI for reporting purposes to be issued by a local LOU? Are sub-funds, branches, market venues and trade repositories going to be assigned LEIs? Will large exposure reports require firms to register their counterparties for LEIs? Will hierarchy be required for risk management purposes?

Without guidance on these types of issues, we run the risk that reported data will be undermined by lack of referential integrity of the data and result in 'Garbage In, Gospel Out' (GIGO). Furthermore, it is possible that we will wind up with conflicting regulatory requirements across risk, trading and other 2014 regulatory initiatives (e.g., AMLD IV).

In summary, we believe a guidance effort is required to define what type of entities should be registered and what the EBA's expectations are.

2. Can you provide inputs for assessing the costs and benefits of this draft recommendation?

The costs of validation, enrichment and quality assurance should not be underestimated. Ensuring data quality is a labour-intensive task that requires skilled people who understand the issues within firms' systems to reconcile the differences in reporting techniques.

The type of information contained within the EBA's risk reports will be stored in a variety of systems and data siloes across firms. Risk information will be sourced independently from the balance sheet or transactional information. As a result of this, linking firms' financial, risk and product reporting with new LEIs will require upgrades across the firms' information systems, in order to ensure the ability to cross reference each other remains consistent.

There are a number of implementation costs for the LEI. For example, KYC systems will need to be modified to require LEI capture, new workflow will need to be introduced to account for expired LEIs and extensive data quality programmes will need to be implemented. See Figure 1 outlines the wide scope of costs associated with the LEI implementation.

Figure 1: **LEI implementation cost drivers**

Category	Cost area	Driver
1. External	Registration fees	▸ Number of entities requiring an LEI ▸ Cost of registration
	Maintenance fees	▸ Number of entities maintained with LEI ▸ Portability fees per entity
2. Internal procedures	Management	▸ Governance structure and LEI 'ownership' ▸ Documentation and meetings
	Registration process	▸ Apply, receive and communicate approvals cross-group ▸ Documentation timing
3. Internal systems	Modification	▸ Monitoring systems ▸ Number of LEIs requiring modification (per month)
	Integration	▸ Number of systems using LEI ▸ Graphical User Interfaces (GUI)
	Data quality management	▸ Exception management ▸ Audit procedures
	Updates	▸ Deduplication of LEIs ▸ Incident resolution

We agree that the average price across pre-LOUs for registering an entity for an LEI is approximately €133 plus additional costs associated with its maintenance. However, this cost is merely the tip of the iceberg.

Regarding the first category, the number of entities required to register for risk reporting is a considerable increase over the number required for EMIR, i.e., trading entities. Some estimates place this increase in the region of 900%, i.e., a firm that is required to register 500 LEIs for EMIR will need to register 5,000 for risk reporting. A firm registering and maintaining 5,000 entities for 5 years will spend €2.16 million[2]. Whilst negligible in terms of total operating cost, it is a substantial uplift in the current spend on reference data.

[2] 5,000 entities multiplied by the average cost of registration and maintenance for 5 years is €433: €133 for the first year and 4 years of maintenance totalling €300

However, this external fee pales in significance to the internal costs. For example, considerable effort is required for the internal procedures described in the second cost category. Some estimates have placed the work required for this, in the short term, at approximately one full time equivalent (FTE) per LEI registration. From this we can estimate the one year cost of implementing 5,000 entities to be an additional €5.7 million. Over the next 4 years, whilst less time is consumed in maintenance, an additional €2.9m will be spent making a total of €8.6m[3]. From this analysis, we can see that the external registration cost is a mere 20% of the internal registration cost.

The costs of the internal systems changes identified in Figure 1 are not insignificant. Scores of source systems, data warehouses, risk analytics systems, management information and reference data management systems will need to be updated. As mentioned above, these risk systems will need to be kept in synch with other systems that are using the LEI as well (e.g., trading, AML). For a large firm, this could cost millions.

Obviously, there is a benefit to the adoption of the LEI that could well make a positive business case for it. However, this benefit needs to be clearly identified and off-set against the costs of its implementation. For further discussion of the business case please see our recent post[4].

In summary, we believe the EBA should revisit its cost assumptions and work with the industry to develop and publish a cost/benefit case for the LEI's introduction into the risk space.

3. Please, provide your feedback on the proposed timeline and the proposal of having less tight deadlines for banks not included in the EBA sample

Any tight risk deadline can be met, however, there will be consequences in higher costs and reduced quality.

The quality of the systems within firms will increase and the cost of their implementation will diminish with more time to understand risk reporting requirements, how these fit with trading requirements and the appropriate rollout plan.

It is worth noting that as LOUs have only been approved for a few months firms have had a small window to register. This means that for the purposes of EMIR, we can expect a large rush of registrants in the run-up to the February trade reporting deadline.

We are concerned that the capacity of current LOUs to process the number of LEIs that firms will require may not be sufficient for the EBA's current timeline. Each LEI registration will have to go through a validation phase, deduplication checks and issuance procedures. Processing the many thousands of registrations resulting from the entirety of the EU financial sector attempting to comply is likely to take some time.

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[3] Cost of a blended day required for 1 time registration, maintenance and senior management involvement multiplied by 5,000 entities plus .5 days in subsequent 4 years

[4] 19 Nov 2013 RegTechFS http://regtechfs.com/the-cost-of-implementing-the-lei-cdos-under-the-gun/

We understand LOUs are currently constrained in their ability to register and have anecdotally learned that an average of approximately 15 LEIs per day can be registered as a bulk upload. Although this is only one data point this is indicative of a manually intensive system that will not scale quickly and with the quality levels required.

Our work with the industry has indicated the existence of upward of a million legal entities in Europe. Even presuming that the scope of CRD will cover 250,000 legal entities, this is still more than twice the current size of the global pre-LEI population, which is already bigger than the Swift BIC database. Presuming 150,000 would need to be registered 10,000 man days would be required by the pre-LOUs just to verify and register them.

Clearly, there is a real risk of the system 'bottle necking', leaving firms without the LEIs to report with. An extended timeline for firms to register LEIs will go a long way towards mitigating this risk.

In summary, the EBA's timeline needs to take into account a proper volumetric analysis according to pre-LOU and their processing capacity. It could well be that additional years would be required.

Conclusion

JWG strongly endorses a 'phased in' approach to LEI implementation and an extended timeline for compliance.

A coherent European regulatory strategy for LEI adoption will set the tone for international consistency should take account of our three recommendations which we summarise as:

- **LEI Risk guidance:** A more detailed set of use-cases inclusive of risk requirements for the LEI
- **Total cost model:** An agreed end-to-end cost model inclusive of all actors in the system (financial, non-financial and registrars)
- **Volumetric analysis:** A dynamic model of the throughput capacity of the LEI registration and validation system that can be used to set timelines.

JWG, as always, is very happy to collaborate in further exploration of these issues.