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THE ABCS OF LEIS — AND WHAT YOU MAY NOT KNOW

The authors first describe the origin and structure of the global LEI system. They then turn to topics pertinent to compliance: (1) disseminating LEIs within the organization; (2) maintaining current LEI data; (3) renewing and validating LEI information; and (4) remembering LEIs following corporate actions and transactions.

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Legal entity identifiers (“LEIs”) may not be the most tantalizing subject to cover, but the importance of their role cannot be disputed. It is the tracking device attached to many financial transactions.

An LEI is a 20-character alphanumeric code used across markets and jurisdictions to uniquely identify a legally distinct entity. Each LEI connects to key reference data about an entity’s ownership structure, and thus can be used to answer two critical questions: “who is who” and “who owns whom.”

The global LEI system was established in response to the 2008 financial crisis.¹ It is intended to enhance transparency and enable regulators and private sector firms to better understand the true nature of risk exposure to specific counterparties and across the global marketplace. However, many in the global marketplace may be unfamiliar with LEIs and the LEI-related

requirements that apply to their businesses, particularly if they are not engaged in the derivatives business. In this article, we provide a brief background on the LEI and discuss five of the most common topics we see with LEI compliance.

BACKGROUND

The global LEI system operates in three tiers. The Regulatory Oversight Committee (“LEI ROC”) is a group of public authorities that was established in 2013 by the Financial Stability Board (“FSB”) to coordinate and oversee a global LEI system.² LEI ROC oversees the Global Legal Entity Identifier Foundation (“GLEIF”), which is a Swiss non-profit organization that was established in 2014 by FSB to support the implementation and use of the LEI. GLEIF services ensure the operational integrity of the global LEI system. Finally, GLEIF accredits Local Operating Units (“LOUs”), which are organizations that supply registration, renewal, and other services for LEIs, and act as the primary interface for legal entities wishing to obtain an LEI.

¹ US Office of Financial Research, *Legal Entity Identifier - Frequently Asked Questions* (Aug. 14, 2012) (“When Lehman Brothers collapsed in September 2008, regulators and private-sector firms were unable to assess quickly and fully the extent of market participants’ exposure to Lehman and how the vast network of market participants was connected.”)

² FSB, *Legal Entity Identifier* (Nov. 11, 2020).

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Any legal entity³ is eligible for an LEI, and in fact, may be required to obtain an LEI under legal requirements imposed by national authorities.⁴ However, not all legal entities that enter into financial transactions are required to obtain an LEI.

1. DISSEMINATING LEIS WITHIN THE ORGANIZATION

As previously mentioned, not all legal entities that enter into financial transactions are required to obtain an LEI. Nevertheless, legal entities that have an LEI may be required to include it in regulatory filings.

For example, in 2017, the LEI field was added to the quarterly report that U.S. banks file with their federal regulators regarding their financial condition (“Call Report”).⁵ A bank is not required to obtain an LEI for purposes of its Call Report. However, if the bank has an LEI, it must include the LEI on the Call Report. Recently, the FDIC noted that a significant number of banks that have an LEI are not reporting it on their Call Report, and reminded banks that they must include the LEI if they already have one.⁶ Similar reporting requirements can apply to legal entities engaged in

cross-border investment transactions, securities activities, and other financial transactions.⁷

To ensure the legal entity’s LEI is not omitted from required regulatory filings, entities should disseminate the LEI widely within the organization. Different divisions may need the LEI for different compliance obligations, and if the LEI is broadly distributed, it is more likely that personnel will remember to use it on required reports.

2. MAINTAINING CURRENT LEI DATA

The LEI governance structures and national regulators have established rules and mechanisms to ensure that entities maintain current LEI data. For example, in the United States, the LEI was first used in swaps regulations promulgated by the Commodity Futures Trading Commission (“CFTC”). The CFTC has made clear that the accuracy and completeness of swap reporting are critical to the agency’s mission to protect market participants and ensure market integrity.

Under CFTC regulations, each counterparty to a swap that is eligible to receive an LEI must obtain, maintain, and be identified in all recordkeeping and swap data reporting by a single LEI.⁸ In addition, the legal entity must report reference data⁹ to the LOU responsible for managing its LEI registration (the “Managing LOU”).¹⁰ Any subsequent changes and corrections to a legal entity’s reference data must be reported to the Managing LOU as soon as technologically practicable following

³ The term “legal entity” includes, but is not limited to, unique parties that are legally or financially responsible for the performance of financial transactions or have the legal right in their jurisdiction to enter independently into legal contracts, regardless of whether they are incorporated or constituted in some other way (e.g., trust, partnership, contractual). It excludes natural persons acting in a private or non-professional capacity, but includes certain individuals acting in a business capacity. ISO 17442 (Aug. 2020); LEI ROC, *Statement on Individuals Acting in a Business Capacity* (Sept. 30, 2015).

⁴ E.g., 17 C.F.R. § 45.6 (discussed below); 12 C.F.R. § 1003.4(a)(1)(i) (LEI required for reporters under the Home Mortgage Disclosure Act).

⁵ See, e.g., FFIEC, *FFIEC 031 and FFIEC 041 Instructions* at 18 (Mar. 2020); see also Federal Reserve Board, *FR Y-10 General Instructions* at GEN-4 (Oct. 2016) (similar LEI requirement for reports on nonbank affiliates).

⁶ FDIC, *FIL-3-2022* (Jan. 7, 2022).

⁷ See, e.g., SEC, *Form N-CEN* (Sept. 2021); BEA, *Form BE-10A* (Jan. 2020); SEC, *Form ADV Instructions* (Sept. 2019); see also GLIEF, *Regulatory Use of the LEI* (Jan. 11, 2022).

⁸ 17 C.F.R. § 45.6.

⁹ Reference data includes: (1) the official name of a legal entity and its registered address (“Level 1 Data”) and (2) relationship information, which allows the identification of the direct and ultimate parents of a legal entity (“Level 2 Data”).

¹⁰ 17 C.F.R. § 45.6.

the occurrence of any such change or discovery of the need for correction.¹¹

In addition, GLEIF has established a centralized challenge facility (the “GLEIF Data Challenge Facility”) that extends the ability to trigger updates of LEI data to all interested parties.¹² The GLEIF Data Challenge Facility provides any user of LEI data with the opportunity to substantiate doubts regarding the referential integrity between LEI records, or the accuracy and completeness of the related reference data. It also allows the indication of possible duplicate entries or any lack of timely response to LEI related corporate actions. A challenge to an LEI and/or its reference data triggers a review of the record by the Managing LOU. It is the responsibility of the Managing LOU to resolve the matter in dialog with the impacted legal entity. If required, and subject to further verification against an authoritative source, the Managing LOU will update the information related to an LEI record. This process may require the Managing LOU to contact the legal entity to discuss the information being challenged, which illustrates why it is important to maintain and update all LEI data, including e-mail contact information.

Although the annual renewal process (discussed below) ensures that the legal entity and the Managing LOU review and revalidate the reference data at least once per year, requiring a legal entity to notify the Managing LOU of changes to its reference data and enabling LEI data users to challenge an LEI and/or its reference data ensures high quality data with respect to the global LEI population and, consequently, trust in the global LEI system. Legal entities with an active LEI should be aware of the rules and regulations applicable to them and their obligations to maintain current LEI data.

3. RENEWING AND VALIDATING LEI INFORMATION

After being issued an LEI, a legal entity must periodically certify the continued accuracy of its reference data and renew its registration agreement with its Managing LOU. The LEI data record describing a single LEI includes the data element “Next Renewal Date,” which states the date by which the LEI registration must be recertified and renewed. The

¹¹ *Id.*

¹² LOUs may operate their own challenge processes. *See* GMEI Utility, *Help and Documents* (2022) (“Any user, including any member of the public that establishes a user account in the GMEI Utility, can challenge any entity on the portal via the Challenge process.”).

renewal date, as well as the fee paid by the legal entity to it Managing LOU for performing the revalidation of LEI reference data, is agreed between the legal entity and its Managing LOU. However, LEI ROC mandates that renewals take place no more than one year after the previous verification of the data. If a legal entity fails to recertify and renew its LEI registration by the “Next Renewal Date,” the registration status of the LEI will be set to “lapsed” in the LEI data record.

Legal entities that allow their LEI registration to lapse risk loss of business, although they and counterparties may and should continue to use the lapsed LEI pending renewal.¹³ For example, the CFTC has taken numerous enforcement actions (discussed in further detail below) against CFTC registrants for LEI-related reporting failures. Under CFTC regulations, swaps must be reported by a single counterparty to a registered swap data repository (“SDR”). The party responsible for reporting to the SDR is thus subject to regulatory scrutiny for inaccurate reporting. In most, if not all of these cases, the CFTC sanctioned the registrant for reporting inaccurate LEIs for its counterparties, not the LEI of the registrant itself. Having a lapsed LEI means the data may be out of date, and therefore cannot be relied upon by regulators and other interested parties. Accordingly, CFTC registrants may decide that doing business with counterparties who do not maintain their LEI in good standing is too risky given the heavy fines the CFTC has imposed for reporting inaccurate LEIs.

Entities should also be aware that a lapse in an LEI’s registration status is permanently recorded in a central repository (the “Global LEI Index”) that interested parties can access and search using GLEIF’s web-based search tool. Consequently, a lapse in an LEI’s registration status may be viewed even after it has been reactivated. Therefore, it is important for legal entities to take note of the renewal date for their LEI and recertify the accuracy of its reference data and pay the applicable fees to its Managing LOU in advance of the renewal date.

4. REMEMBERING LEIS FOLLOWING CORPORATE ACTIONS AND TRANSACTIONS

LEI ROC believes that the data within the global LEI system should be granular enough to enable analysis and visualization of changes to an entity both from the present looking backward and from the date of an

¹³ GLIEF, *The Power of Transparency: A Closer Look at LEI Renewal Rates* (Mar. 2, 2017) (“an LEI with the registration status ‘lapsed’ remains a valid LEI”).

entity's entry into the global LEI system looking forward to the present. Therefore, LEI ROC has identified various corporate actions that impact data in the global LEI system ("Legal Entity Events")¹⁴ and has outlined specific standards and rules for how to change LEI reference data following Legal Entity Events. Additionally, LEI ROC has set forth a policy for incorporating such Legal Entity Events and data history in the global LEI system.

For example, following a name change, the LEI will remain the same since the registered entity remains the same. However, the legal entity must report the name change information to its Managing LOU. The old legal name and the date of the change is then stored in historical files and appears in the legal entity's active record. With respect to a merger, the surviving entity will maintain its original LEI and must inform the absorbed entity's Managing LOU to change the status of the absorbed entity's LEI to inactive. The LEI of the absorbing entity is then added as the successor entity in the reference data of the absorbed entity. On the other hand, if a new entity is formed from the merger, a new LEI will need to be registered and allocated to the newly formed entity. Similarly, if an entity spins part of its business off into a new legal entity, the new legal entity will need to register for its own LEI. Further, a legal entity that is acquired by another legal entity must report a change in the LEI of its ultimate parent entity. Accordingly, a legal entity undergoing a Legal Entity Event must be prepared to report the event to its Managing LOU and should be aware that historical data (e.g., former name, dates of changes to reference data, a merged entity's LEI) will be captured and stored in the global LEI system.

5. ENFORCEMENT ACTIONS INVOLVING LEIS

In recent years, the CFTC has brought and settled numerous enforcement actions against CFTC registrants for LEI-related reporting failures. As mentioned above,

in most if not all of these cases, the CFTC sanctioned the registrant for reporting inaccurate LEIs for its counterparties, not the LEI of the registrant itself.

The basis for the violation is typically CFTC Rule 45.6, which provides that "[e]ach counterparty to any swap subject to the jurisdiction of the Commission shall be identified in all recordkeeping and all swap data reporting pursuant to this part by means of a single [LEI]." Often, the failure to comply with the rule is coupled with an additional finding that the swap dealer did not engage in diligent supervision with respect to such activities, in violation of CFTC Rule 23.602.¹⁵

For example, in 2017, the CFTC issued an order filing and settling charges against a provisionally registered swap dealer for, among other things, failing to properly report LEIs for certain swaps. CFTC regulations require the reporting party in a swap transaction to report swap creation data (including LEIs), as well as swap continuation data, to ensure that all data concerning a swap remains current and accurate.¹⁶ The requirement to report continuation data includes the requirement to report life cycle event data.¹⁷ CFTC regulations state that a "life cycle event" includes an LEI for a swap counterparty that was previously identified by name or by some other identifier.¹⁸ In its 2017 action, the CFTC found that the provisionally registered swap dealer did not design its swap reporting systems to re-report a trade based solely upon a change in a counterparty's LEI, absent other life cycle events. As a result, the provisionally registered swap dealer failed to report updated LEI information in continuation data and was ordered by the CFTC to pay a \$550,000 civil monetary penalty.

Similarly, in 2019, the CFTC issued an order filing and settling charges against a different provisionally registered swap dealer that had executed interest rate swaps with counterparties that had not yet obtained an LEI. When such counterparties later obtained an LEI, the provisionally registered swap dealer failed to update its

¹⁴ The Legal Entity Events that LEI ROC believes should be captured in the global LEI system include: (1) change in legal name or doing business name; (2) change in legal address or headquarters address; (3) change of legal form; (4) mergers and acquisitions; (5) demergers and spin-offs; (6) an acquisition of an international branch; (7) transformation of an international branch into a subsidiary; (8) transformation of a subsidiary to an international branch; (9) umbrella fund changes its structure to a stand-alone fund; (10) bankruptcy, liquidation, voluntary arrangement, insolvency; (11) dissolution of an entity, including international branches and subsidiaries; and (12) break-ups.

¹⁵ CFTC Rule 23.602 requires each swap dealer to establish and maintain a system to supervise, and to diligently supervise, all activities relating to its business performed by its partners, members, officers, employees, and agents (or persons occupying a similar function). *See also*, CEA §4s(h)(1)(B) requires the diligent supervision of the business of the registered swap dealer.

¹⁶ 17 C.F.R. §§ 45.3, 45.4.

¹⁷ 17 C.F.R. § 45.4.

¹⁸ 17 C.F.R. § 45.1.

reports to its SDR. The CFTC order required the provisionally registered swap dealer to pay a \$300,000 civil monetary penalty. Further, in 2020, the CFTC issued an order filing and settling charges against another provisionally registered swap dealer for inaccurately reporting swap data for millions of swaps. The errors included, among others, reporting swaps with inaccurate LEIs. The order required the provisionally registered swap dealer to pay a \$5 million civil monetary penalty.

These cases demonstrate the importance of verifying customer and counterparty LEIs. The CFTC has stated that it will continue to closely scrutinize entities that do not meet their reporting obligations and will continue to bring cases in this area. Additionally, other agencies, such as the FDIC, may follow suit. Therefore, legal

entities that enter into financial transactions, particularly those with reporting obligations, should consider establishing a process for verifying customer and counterparty LEIs.

CONCLUSION

In order to achieve the full benefits of a global LEI system, legal entities must update and properly report LEI data. Those who don't, not only erode trust in the global LEI system, but potentially risk loss of business and regulatory scrutiny. Therefore, legal entities should review legal requirements, including reporting instructions, that are applicable to their various businesses and regulatory regimes for LEI-related requirements and consider implementing the practices discussed in this article. ■