



LEGAL ENTITY IDENTIFIER (LEI) – SOLVING THE MYSTERY OF THE NEW REGIME

After the last financial crisis and, in particular, the collapse of Lehman Brothers in 2008, financial regulators and private sector managers found it difficult to uncover the network of participants connected. Consequently, this financial crisis revealed the need to identify financial connections and link data globally so as to make it easier for financial regulators and firms to understand and monitor the true nature of risk exposures. A better financial infrastructure was needed so as to bring about a unified and transparent global identification system for legal entities across markets and jurisdictions and increase the resilience of the financial market.

For this reason the G20 established the Financial Stability Board (FSB), a supra-national regulatory co-ordination body, whose job was to prepare recommendations for LEI governance and the implementation framework. The FSB defined a three-tier structure, consisting of a Regulatory Oversight Committee (ROC), a Central Operating Unit (COU) operated by the Global Legal Entity Foundation (GLEIF, www.gleif.org) and Local Operating Units (LOU).

The Financial Stability Board (FSB), with a secretariat in Basel, Switzerland, was set up to co-ordinate, at the international level, the work of national financial authorities and international standard-setting bodies in order to develop the implementation of effective regulatory, supervisory and other financial sector policies.

The Global LEI Foundation, overseen by the ROC, is the operational arm of the global system. The ROC is a group of 71 public authorities and observers from more than 50 countries and is the governing body which is responsible for the co-ordination of the world-wide framework of the LEI.

The Local Operating Units (LOUs) are the primary interfaces for anybody interested in registering for a LEI. LOUs manage registration, validation and implementation of LEI records. LOUs may have a variety of statuses and may be an entity conducting other activities such as a stock exchange or custodians. A list of LEI issuing organisations/LOUs may be found on: <https://www.gleif.org/en/about-lei/how-to-get-an-lei-find-lei-issuing-organizations>.

Regulation

The use of LEI numbers is already required under a number of European regulations such as:

- The European Markets Infrastructure Regulation (EMIR) as from 1 November 2017 (the EU trade repositories are mandated to reject trade reports that do



- not contain an LEI irrespective of whether they pertain to the EU or non-EU market participants);
- The EU Regulation and Directive on Markets in Financial Instruments, commonly referred to as MiFIR and MiFID II;
 - The EU Market Abuse Regulation (MAR);
 - The EU Capital Requirements Regulation (CRR);
 - The EU Central Securities Depositories Regulation (CSDR);
 - The EU Transparency Directive;
 - The EU Alternative Investment Fund Managers Directive
 - The Swiss Financial Markets Infrastructure Act (FMIA);
 - The Swiss Financial Market Infrastructure Ordinance (FMIO).

The first LEI numbers were issued in 2012 and by mid-2017 the LEI's coverage amounted to over 500,000 entities from 200 different countries.

What is the LEI, who needs it and what are its effects?

A LEI is a 20-character, alpha-numeric code to uniquely identify legally distinct entities that engage in financial transactions. The LEI number is associated with reference data for each entity. It is not solely limited to the European Union and Switzerland, but is a global initiative. One may apply for a LEI code through any of the LOUs endorsed by the ROC in any country. A legal entity is therefore not limited to using a LOU in its own country and can choose to use the registration services of any LOU accredited and qualified to grant LEI registration. Registration for LEI number must be renewed annually.

The LEI number and data associated with it will be available free of charge to regulators and the public. The LEI number will allow financial supervisors to track global transactions and take action where necessary. An entity may transfer the maintenance of its LEI number from one LOU to another. To do so, the entity must contact the new LOU stating its already existing LEI number and providing any further documentation the new LOU may require. The new LOU will contact the retiring LOU. The LEI number will not be changed with this process. No fee should be charged by the retiring LOU for this transfer. The code never changes even if there is a change in the structure of the entity and an entity will have only one code which will be used everywhere in the world. Therefore data about an entity recorded in one dataset at one point in time will be the same data shown in another place at a different time. The LEI number has also become part of the Know Your Customer (KYC) and on-boarding process of financial institutions.

Failure to obtain a LEI number will result in non-compliance with regulatory requirements and prevent the entity from trading in securities. Essentially, every legal entity that is a party to a financial transaction and/or trades in derivatives must be registered for a LEI number.

According to the International Organisation for Standardisation, a legal entity includes, but is not limited to, parties that are legally or financially responsible for the performance of the 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. This includes companies, other



legal entities, partnerships or trusts etc., whether private or public. Natural persons are not included in this definition.

MiFID II/MiFIR and the LEI

From 3 January 2018, all investment firms, credit institutions and their clients will require a LEI number. This means that essentially each legal entity (as enumerated above) will require a LEI number in order to be allowed to conduct purchase or sale transactions on the stock exchange. Article 6 of the Commission Delegated regulation (EU) 2017/590 specifies that a natural person should be identified with the national client identifier (NCI). What constitutes the actual NCI is established on the information and numbers based on the clients' nationality. Several countries allow a concatenation of a person's date of birth, first five characters of their first name and the first five characters of their surname (CONCAT)

Investment firms are therefore to obtain a LEI number from their clients prior to providing a service that would result in a transaction reporting obligation. Otherwise they will not be able to provide their service to those clients. Inversely, many legal entities will not be able to trade listed securities or to carry out related corporate transactions without a LEI number. Transactions mostly include those involving transferable securities, including investments which are negotiable on the capital markets e.g. equities, bonds, units in collective investment undertakings and derivative instruments for the transfer of credit risk. Foreign exchange spot transactions, cash deposits, insurances, mortgages do not fall under the MiFID II definition of financial instruments. The scope of MiFID II/MiFIR is wide and covers practically all regulated markets and addresses the need for more transparency and control.

According to the European Securities and Markets Authority (ESMA), MiFIR states that the following entities will need to be identified with a LEI.

- investment firms that execute transactions in financial instruments;
- the clients (buyer, seller) on whose behalf the investment firm executes transactions, when the client is a legal entity;
- the client of the firm on whose behalf the trading venue is reporting under Article 26.5 of MiFIR, when the client is a legal entity;
- the person who makes the decision to acquire the financial instrument, when this person is a legal entity e.g. this includes investment managers acting under a discretionary mandate on behalf of its underlying clients;
- the firm transmitting the order;
- the entity submitting a transaction report (i.e. trading venue, ARM, investment firm); and
- the issuer of any financial instrument listed and/or traded on a trading venue.

According to the ESMA Guidelines on Transaction Reporting, Order Record Keeping and Clock Synchronisation under MiFID II published on 10th October 2016 and subsequently amended on 7th September 2017, when an investment firm receives orders from a firm it should report the buyer/seller as the firm that sent the order rather than the underlying client.



An EU external asset manager is to disclose the LEI number of the final client when placing an order with a Swiss depository bank/broker. However, a Swiss external asset manager, when placing an order with an EU depository bank/EU broker is not required to disclose the LEI number of the final client. According to the Guidelines a transmission, in terms of the transmission conditions under Article 4 of the Commission Delegated Regulation (EU) 2017/590, is only permissible through an investment firm. A Swiss external asset manager is not an investment firm regulated by MiFID. Therefore, the Swiss asset manager is considered by the EU depository to be the buyer/seller and therefore should be identified with its LEI number. On this basis, below are some examples of trading scenarios and who should be identified with a LEI:

- Non-EU external asset manager makes a market order with a Non-EU depository bank which then instructs an EU broker – LEI of the external asset manager is necessary;
- Non-EU external asset manager makes a market order with a Non-EU depository bank who instructs an EU-Stock Exchange – LEI of external asset manager is necessary;
- Non-EU external asset manager makes a market order with a broker in the EU or a depository bank in the EU which then instructs directly a non-EU Stock Exchange – LEI of the external asset manager is necessary;
- An EU external asset manager makes a market order with a non-EU depository bank/EU depository bank/EU broker which then instructs a non-EU/EU Stock Exchange – LEI of external asset manager and the end client is necessary;
- The end client makes a market order with an non-EU depository bank which then instructs an EU broker – No LEI is necessary, neither from the asset manager nor the client;
- The end client makes a market order with a non-EU depository bank which then instructs an EU Stock Exchange – the LEI of the end client is necessary.

What are “reportable security transactions” within the scope of MiFID II/MiFIR?

Extract of Article 26, paragraph 2 in MiFIR:

- (a) financial instruments which are admitted to trading or traded on a trading venue or for which a request for admission to trading has been made;
- (b) financial instruments where the underlying is a financial instrument traded on a trading venue; and
- (c) financial instruments where the underlying is an index or a basket composed of financial instruments traded on a trading venue

Moving Ahead

It is further advisable that even those that have their assets managed on a discretionary basis obtain a LEI number in order to be immediately ready in case these need to give direct orders via the relevant EEA trading venues in the future. No legal entity will be discouraged from pre-applying for a LEI number.



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