

Remarks of Matthew Reed, Chief Counsel, Office of Financial Research, U.S. Department of the Treasury at the Industry Forum & Working Groups Event, International Securities Industry Organization for Trade Communication, September 9, 2013, Baltimore, Md.

Thank you for inviting me to join you here today.

I would like to say a special thank you to Karla McKenna for extending the invitation for me to speak, as well as for her work on the standard for the legal entity identifier, or LEI, and her invaluable technical support for the LEI system's Regulatory Oversight Committee, on which I serve as Chair.

Karla told me you would be interested in hearing about the latest developments in the implementation of the global LEI system and I will be glad to provide that update today. I will also provide you with some context for the environment that has sustained the LEI as it took root, began to grow, and became poised to flourish on a worldwide basis.

I think we all agree we have reached a time—finally—when data standards have arrived. A consensus is emerging among policymakers across the globe that standards are essential for the effective monitoring, supervision, and understanding of the financial system, and the LEI is recognized as the cornerstone for future global financial standards.

For a strong signal that financial standards have moved into the regulatory limelight, look no further than the fact that promoting data standards is engrained into the mandate of the Office of Financial Research, or OFR. The Dodd-Frank Act listed seven items under the “purposes and duties” of the OFR. Second on the list was “standardizing the types and formats of data reported and collected.”

Grasping the importance of standards is a lesson that has been learned many times in history—often the hard way after mounting problems or sobering calamities made the need for standards painfully obvious.

On my desk at work is a blue book with colorful but unsightly page makers sticking out of the sides. The book by Marc Levinson is called, “The Box: How the Shipping Container Made the World Smaller and the World Economy Bigger.” It is a book about how the standardization of shipping containers lowered costs, saved time, and streamlined the flow of commercial goods across the globe. Before the mid-1960s, shipping containers came in many sizes. Goods were loaded, reloaded, stored, and stocked at ports and depots across the world. The amount of handling and spotty security made these goods vulnerable to theft. After standardization finally took hold, a container full of freight could be locked up securely at its departure point and transported faster and at lower cost by trucks, trains, and ships across the world.

Another success story for standardization is the railroad track gauge, or the distance between the metal rails on a track bed. Before the Civil War, no standard gauge existed, so rail freight had to be unloaded and repacked from one train to the next to proceed to its destination. In 1864, a standard gauge was mandated for use on the Transcontinental Railroad and that gauge became the U.S. standard by 1886.

One final example of standardization came after the Great Baltimore Fire of 1904, which burned for 30 hours and destroyed 1,526 buildings over 70 city blocks. The catastrophic damage might not have been so bad if the fire crews from Washington had been able to hook up their fire hoses to Baltimore's fire hydrants, but their hoses did not fit. The National Fire Protection Association later adopted a national standard for fire hydrant connections. However, the standard has not been government-mandated or universal adopted, and a replay of the Baltimore tragedy occurred as recently as 1991 during a fire in Oakland, California, where 25 people died, including a police officer and a firefighter.

These stories teach us that standards and their universal adoption are critical for building infrastructure. Roads, rails, water lines, and nuts-and-bolts would all be messy and mismatched without standards.

Unfortunately, the financial industry and its regulators have been slow to grasp the importance of standards in building the infrastructure necessary to support today's global financial system.

Like the fire here in Baltimore 110 years ago, this country had an economic brand of wildfire in 2008 that spread across much of the world, wiping out trillions of dollars of wealth, sending millions of workers into unemployment lines, and pushing the global economy to the brink of disaster.

The crisis highlighted the seriousness of the problem of identifying financial connections and underscored once again the urgent need for a global system to identify and link information about financial transactions for insights on risk exposures across the system. The linchpin for these links is the ability to identify with precision the entities doing the transacting. Missing from our financial infrastructure—but necessary—is a legal entity identifier, or LEI.

In a moment, I'll discuss the latest news about our efforts to develop the LEI. But let me briefly describe some other standards-related work that has become part of the rebuilding of financial system infrastructure, a task that is now on the minds and agendas of policymakers.

For example, the OFR coordinates the work of the Data Committee of the FSOC—the Financial Stability Oversight Council—which is focused on a wide range of standards-related initiatives, including ownership hierarchies and data sharing protocols. We are also working on improving data standards for swaps data repositories.

Across the federal government, other data standards activities preceded the LEI work, and have ushered in this new era of policymakers' focus on standards. For example, look at the use of the Extensible Business Reporting Language by the federal banking and securities regulators to collect financial data from the industry. These efforts were implemented in the last decade and have now become part of the financial disclosure nomenclature alongside substantive standards like GAAP.

Another more recent example is the Financial Management Service, an office of the Treasury Department, promoting standards for sharing data across the federal government. In the same way that XBRL promises to allow apples-to-apples comparisons of reports by public companies and banks, these FMS efforts seek to normalize financial management reports and information produced by agencies.

Although many of these initiatives preceded the recent financial crisis, the crisis nudged this work closer to the front of the agenda. Title VII of the Dodd-Frank act asked regulators to focus on swaps data and create repositories to hold those data so that we could better understand the derivatives markets. Those provisions carried with them the implicit requirement that standards be implemented for reporting the data in a usable fashion. Title IV contemplated reporting for private funds and the sharing of the resulting data with the FSOC, again carrying the implicit requirement that the data be presented in useful form. And the OFR was charged with "standardizing the types and formats of data to be reported." In this modern age of global electronic markets, the only logical way to fulfill those mandates is to make standards an early part of the conversation.

Financial standards can take hold in one of three basic ways. They can evolve organically when a single player in a market becomes dominant, such as Microsoft and Apple producing the dominant operating systems for personal computers. They can emerge from cooperation within industry organizations, like the National Fire Protection Association, which coordinated the standards for fire hydrants at the beginning of the last century. Or standards can be set through government involvement, particularly when there are high implementation costs or collective action problems that can arise from proprietary interests or dispersed benefits. At the OFR, we think about each approach as we consider whether standards are needed and how they might be encouraged. Regulatory compulsion played a role in many standards development efforts because a collective action problem needed solving. The LEI is no exception, but it has also benefitted from important contributions by voluntary consensus-based organizations and the private sector.

To frame the problem that the LEI is designed to solve, I have used the example of City National Bank, a national bank headquartered in Los Angeles. There are 14 banks in the U.S. called City National, and 10 times more that use a variant of the name. So an identification code is a natural way to distinguish one bank from the other. City National Bank has several. The bank has an RSSD ID, a unique identifying number assigned by the Federal Reserve to all financial

institutions, main offices, and branches. It also has a unique FDIC certificate number, a central index key from the SEC, a code from the Society for Worldwide Interbank Financial Telecommunication, commonly known as SWIFT, and other proprietary identification numbers from vendors.

The tangle of identification schemes and names applies not only to banks. Separate identifiers also exist for securities firms and insurance companies.

Given all of these different identification codes and the potential for name confusion, the need for a unique, precise, globally recognized identifier is evident.

The LEI is like a bar code—a unique ID for companies participating in global financial markets. When the LEI system is fully implemented globally, the OFR and other government entities will have a powerful tool to help in assessing potential threats to financial stability. This capability lies at the heart of the OFR's mission.

For financial firms, the LEI will provide a clearer view of their risks and interconnections. It will also reduce costs for collecting, cleaning, aggregating, and reporting data. Industry groups have estimated that the world's largest banks spend more than \$1 billion per year on standardizing disparate data sources.

A hybrid of industry support, government action, and international cooperation has carried the LEI forward to where it is today. The essential element has been the leadership of the Group of 20 nations and their finance ministers, the Financial Stability Board and other regulators working with the Board, and U.S. government entities that include the OFR.

The private sector has participated in this partnership every step of the way, most recently through a Private Sector Preparatory Group that is providing advice and expertise.

Throughout the global process, the OFR has played a key role by leading work streams and collaborating with other regulators and the industry to provide recommendations to the G-20 to guide the governance, development, and implementation of a global LEI system.

These combined efforts have brought the LEI and other financial standards from the back office to the forefront of policy discussions. The reason is simple: the global financial system contains enormous—and growing—volumes of data. Without standards to harmonize these data, we have a gargantuan amount of noise.

One of the guiding principles in establishing the LEI system has been that this crucial international standard must be freely available to the public, to businesses, and to authorities. Vendors will provide add-on services to the LEI, which will further promote its use and demonstrate its utility in the marketplace. However, the LEI system will not sanction profiteering or facilitate monopolistic private gain. The LEI is recognized as a public good because it would help public authorities not only to identify threats to the world's financial

system, but also to assess them and respond to them more effectively to promote stability. For that reason, authorities concluded that collective action problems needed solving and that the identification of key participants in our financial markets needed to be returned to the public domain so that regulators could be more effective in identifying threats to financial stability, fighting financial crime and terrorism, and conducting micro-prudential regulation and market oversight.

So, where is the LEI? The answer is that it is here—and its use is rapidly spreading. In fact, more than 80,000 pre-LEIs are already in use. That total includes codes issued by the DTCC as CFTC Interim Compliant Identifiers, or CICIs, which conform to the LEI standard.

More pre-LEIs are being assigned every day and the international community has embraced a framework for global acceptance of pre-LEIs to underpin an interim LEI system for producing fully standardized codes until the LEI system is fully up and running.

The OFR is working with other federal financial regulators to include use of the LEI in rules for reporting data to government agencies, just as the Commodity Futures Trading Commission is already requiring use of the LEI in swap data reporting. This reporting has become a critical piece of our financial infrastructure.

We are all eager for this keystone standard to permeate financial data across the global marketplace but we have to admit that, for an international collaborative undertaking, we have come a long way at lightning speed.

Regulators began discussing how to create an LEI in 2010. The OFR issued a policy statement in November of that year, calling for the establishment of an LEI and providing impetus to efforts by regulators and industry. The financial industry responded with a proposed solution. The SEC and CFTC each proposed swaps rules that required the use of an LEI as a way to spur adoption.

Late the following year, the G-20 directed the FSB to begin to develop a framework for the LEI standard. A few months later came the adoption of a technical standard developed by the International Organization for Standardization, better known as ISO. Karla McKenna was critical to that effort and continues to provide valuable guidance.

That standard is ISO 17442, a 20-digit, alpha-numeric character set. The LEI links to basic “business card” information, such as the company name and address, the date the LEI was assigned, and the date of the most recent update to the registry.

The LEI project reached another high point in June 2012, when the G-20 endorsed an FSB report that provided a blueprint for the LEI system. The G-20 envisioned a three-tiered public-private governance system designed to protect the public’s interest in the system, while ensuring that it meets private sector needs.

At the top level overseeing the system is a Regulatory Oversight Committee, or ROC. The ROC met for the first time in January of this year, when I was selected Chair. Global authorities from more than 50 countries and jurisdictions attended the meeting. Members from the Japan Financial Service Agency and Banque de France were selected as Vice Chairs.

Since then, we have fully developed the ROC, approved bylaws, and established committees that have undertaken the work of setting up the rest of the governance framework for the global LEI system. The middle tier of the framework is the Central Operating Unit, organized as a foundation in Switzerland. We have been putting the pieces in place through the Swiss legal system to establish the Global Legal Entity Identifier Foundation. By next month, we plan to have selected the foundation's board of directors.

In the middle, the Central Operating Unit will ensure that all parties that implement the LEI adhere to governing principles and standards, including reliability, quality, and uniqueness, so that we can achieve our shared goal for "one golden standard" for the LEI.

The third and final tier is an international network of Local Operating Units, or LOUs, that will register entities and assign the LEIs. The LOUs will validate and maintain the reference data associated with each LEI, and make these data continuously available to the public and regulators, free of charge. At present, four pre-LOUs in the U.S. and Europe are issuing codes. The ROC is negotiating an interim system that will recognize the pre-LOUs seeking to join the system, so that the codes they issue can be used for regulatory reporting under rules all over the globe. In all, 13 utilities have expressed an interest in issuing codes, and as I noted, four have already issued more than 80,000 codes.

The worldwide phase-in of the LEI is being driven by the legislative and rulemaking processes of each jurisdiction requiring the use of the LEI and by the adoption of the LEI by firms for risk management and reporting.

As use of the LEI spreads throughout the world financial system, we expect the LEI to become increasingly valuable. We also expect the trend of adoption of the LEI to spur further adoption in a reinforcing cycle that will make the LEI ubiquitous in financial reporting and data management throughout the world.

That is the vision; it is an exciting one; and with the continued help of people around the world—and in this room today—we will reach this remarkable achievement.

Thank you again for the opportunity to be here. I would be glad to respond to your questions.