Enhancing party identification in payments messaging with the Legal Entity Identifier

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Abstract

Like other areas of banking, the world of payments suffers from a high cost of regulatory compliance and outdated methods to ensure accurate and reliable data for legal entity identification. The use of the Legal Entity Identifier (LEI) as a key element in legal entity identity management within the payments life cycle can help solve these issues. Including LEIs in the payments life cycle provides verified, authoritative information about the exact legal entity involved in payments transactions to the parties involved in the process. The Payments Market Practice Group considers the migration to the ISO 20022 payments messaging standard, and use of the LEI within that migration, a key opportunity to rethink how and what reference data are sourced and used for legal entity identification, and to make real enhancements to such identification and messaging processes for the payments community.

Keywords: LEI, payments, ISO 20022, benefits, adoption, PMPG

Introduction

The Legal Entity Identifier (LEI) is a unique identifier that provides a mechanism for quickly and unambiguously identifying a legal entity. The term ‘legal entity’ as part of the Legal Entity Identifier (LEI) standard (ISO 17442) 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 (eg trust, partnership, contractual). It includes governmental organisations, supranationals and individuals when acting in a business capacity, but excludes natural persons. It also includes international branches.

The LEI reference data carries useful information about the company and its
corporate structure (immediate and ultimate parent details), and is a globally recognised ISO 17442 standard. The LEI issuance process requires initial and ongoing verification of the reference data through a variety of mechanisms that all contribute to strong (and constantly improving) data quality. It is these features of the LEI that will allow for significant benefits to be achieved in financial markets broadly as there is no other global, legal entity identification scheme that has currently achieved the scale and quality of the LEI. The LEI can be a valuable tool for customer onboarding and credit approval processes; and for smoothing the way through the multiple checkpoints that occur during the typical payments life cycle. The LEI allows firms to be able to link across internal and external systems, databases and service providers using the unique LEI to gain richer data and information about that legal entity, both quickly and accurately. All of this creates efficiency for market participants.

Given the potentially significant benefits to be gained by use of the LEI in payments messaging, the Payments Market Practice Group (PMPG) — a forum of global market practitioners that drives better market practices and the correct use of standards to help the payments industry achieve full straight-through processing and improved customer service — considers that the migration to the ISO 20022 payments messaging standard, and use of the LEI within that migration, represents a key opportunity to rethink how and what reference data for legal entities are sourced and used for payments, and to make real enhancements to the messaging process for the payments community.1,2

CURRENT STATE OF THE LEI IN PAYMENTS

The use of the LEI has expanded beyond the over-the-counter (OTC) derivatives markets to other areas of financial services like securities issuance, securities financing, municipal and funds markets, and corporate banking to now include more than 1.5 million LEIs issued globally. While this is still a small number relative to the total number of legal entities in the world today, the 1.5 million LEIs do cover close to 100 per cent of the gross notional outstanding for OTC derivative trades in most Financial Stability Board (FSB) jurisdictions, and securities issuers for around 78 per cent on average of the outstanding amounts of debt and equity securities in FSB jurisdictions.3 Following this success, the regulatory community is now acknowledging the value of LEI in payments and taking steps to consider, and in some cases, require the use of the LEI in payments. For example, as part of the adoption of ISO 20022, the Bank of England is mandating the use of the LEI for all payment transactions between financial institutions.

In addition to specific rulemakings, there are calls for LEI usage as an important tool in correspondent banking, payments and other areas by the Financial Stability Board (FSB), Committee on Payments Markets and Infrastructure (CPMI), and The Wolfsberg Group. In its 20th May, 2019 report, ‘Thematic Peer Review on implementation of the LEI’, the FSB specifically states that one of its roles in the expansion of the LEI is to ‘facilitate, by working with standard-setting and industry bodies, the effective implementation of the LEI option in payment messages to help address the decline in the number of correspondent banking relationships’.4

BENEFITS FOR PAYMENTS

Including LEIs in the payments life cycle would provide verified, authoritative information about the exact legal entity involved in payments transactions to all parties involved in the process. These benefits can
begin to be achieved even without complete coverage of LEIs for all legal entities. Per the FSB:

‘Widespread coverage has been achieved in some financial market segments, with LEIs identifying reporting entities for close to 100 per cent of the gross notional outstanding for over-the-counter (OTC) derivative trades in most FSB jurisdictions, and securities issuers for around 78 per cent on average of the outstanding amounts of debt and equity securities in FSB jurisdictions.\(^5\)

As a result of this widespread coverage, it is likely that larger financial institutions already collect and store LEIs for 25 per cent or more of their payments customers that are legal entities. The value of such benefits would continue to increase as the LEI coverage increases.

Specifically, use of the LEI in payments would:

- help firms identify fraud and economic crime, and enable enhanced due diligence by gaining a complete view of a company’s footprint;
- facilitate correspondent banking and services for smaller legal entities by providing information-sharing in a standardised format, reducing the risk and cost associated with due diligence processes;
- in trade finance, help unambiguously identify the legal entities in a trade finance transaction that ultimately results in a payment (e.g. fraud may be reduced at the transactional level by leveraging the LEI to better detect attempts at duplicate invoice financing); and
- create efficiency in transaction chains by increasing straight-through processing and improve operational flows by simplifying invoice reconciliation and risk management processes.

Beside the benefits described above, the use of standardised data like the LEI for future innovations like artificial intelligence and machine learning is critical. Indeed, technologies, such as machine learning, have the best outcomes when they can rely on high quality standardised data in their processes. The ability to use machine learning and artificial intelligence for the analysis of entity activity within payments data presents significant opportunities to mine the data for all types of analysis like profitability and fighting financial crime.

**CHALLENGES TO ADOPTION**

As with any new opportunity, there are both real and perceived challenges surrounding LEI adoption that need to be addressed, both at an industry level and within individual institutions. The two areas typically identified as the challenges for LEI adoption are: (1) the need to make systems changes in order to adopt the LEI, and (2) the cost and effort for customers to obtain an LEI.
Experience indicates that adopting new reference data standards and changing payment formats to accommodate new fields can be costly and difficult. For this reason, firms are not quick to make changes unless required. Organisations often store data related to counterparties in multiple unrelated databases; for example, the LEI may be captured in a securities platform, but the same party could be stored in a payments processing system with different data. Thus, as one example, rationalising data to a common legal entity identifier and reference data like the LEI would need to be considered as part of systems changes.

With respect to end users of the payments systems — ie customers — the key issues cited with respect to LEI adoption are the cost and effort to obtain an LEI. Today, the cost of obtaining an LEI is usually borne by the legal entity itself; that same entity must apply to obtain its LEI through one of the 33 LEI operating units (LOUs) in the global LEI system. While costs were historically higher — around US$220 — today, on average, it costs US$68 to register for an LEI and about US$48 to maintain that LEI on an annual basis. To obtain an LEI, the legal entity chooses one of the LOUs, provides a few points of data about itself (company name, address, parent entity information, etc) and then the LEI is issued. This can happen as quickly as intra-day if an entity is registered in certain business registries and the entity uses one of the LOUs offering intraday issuance. It could also take a few days if the process for validation of the entity’s credentials takes longer due to its specific situation (eg not registered in a business or tax registry). Thus, the cost and burden to the end user are actually relatively small. Nevertheless, customers generally dislike having to manage a second process when onboarding with their financial institution to obtain an LEI.

Going forward, as the population of LEIs grows, the cost of getting an LEI will continue to come down. Since 2014, the costs have already reduced by half due to the growth in the population and competition among the LEI-issuing organisations. Further, the Global LEI Foundation (GLEIF) is actively exploring strategies to further reduce the cost and burden of getting an LEI in order to break down this barrier to greater adoption of the LEI.

**ROAD TO ADOPTION**

The payments industry is currently going through an unprecedented amount of change as many domestic market infrastructures are updating their systems and moving towards the use of ISO 20022-based messaging. Many countries around the world are introducing real-time payments schemes in response to the demand from customers and competition from non-financial institutions. At the same time, regulatory bodies are updating their rules to require new data formats as well. The scope and depth of these changes are forcing organisations to recognise the impact of poor reference data. Such changes require the use of structured data and will result in both banks and their customers making changes to the way in which they capture and store information. The costs associated with migration global standards are an unavoidable part of this change. Done right, with an effective migration plan, and consistent adoption of the standards by all parties engaged in the payments process can help to keep costs down and speed the migration.

The PMPG considers the migration to ISO 20022, and use of the LEI within that migration, to offer a key opportunity to rethink how legal entity reference data are sourced and used for payments. As a result, the PMPG recommends that the migration to ISO 20022 is a catalyst to facilitate the adoption of LEI within the payments community. The incremental cost of adopting
the LEI as part of the ISO 20022 migration will be minimal as firms will be making technology and process changes to adopt ISO 20022 more broadly, and the LEI is just one data element in the change process.

In the past, organisations have failed to capitalise fully on the opportunity presented by high-quality reference data. However, in this environment of greater and more in-depth regulation and payment system changes, a strategic approach to reference data management will reduce operating cost and improve risk management and compliance. Following are specific actions that firms can take to implement this recommendation and reap the benefits of the LEI within the payments processes:

- While LEIs have not yet been mandated for identifying legal entities in payments, it is recommended that firms consider a more strategic adoption of the LEI as part of the ISO 20022 migration because it has the potential to deliver fundamental benefits in financial market operations.
- As part of the migration to ISO 20022 messaging, data related to counterparties will need to be reviewed before 2021 and where necessary updated to ensure that data are held in a structured format. While carrying out this analysis, it is recommended that organisations take the opportunity to add, wherever possible, LEIs to the counterparty data.
- As part of the adoption of ISO 20022, and with it the LEI, organisations are recommended to adapt their business processes to ensure that LEIs are captured whenever a new legal entity counterparty or customer record is set up. While not all legal entities will have an LEI, a process to ask the customer if they have an LEI, or to check the free-of-charge GLEIF global LEI index, should be implemented.
- For existing legal entity customers, as part of the migration process, it is recommended that firms determine whether the customer already has an LEI, and if so, add the LEI to the customer record. In addition, the customer reference data should be checked against the LEI reference data using the tools supplied by GLEIF to ensure the data match the supplied company details.
- To maintain good data quality, it will be critical for firms to capture the true relationship between business identifier codes (BICs) and LEIs. Within their own scope, BICs play a key role in addressing messages and routing financial transactions on the SWIFT network. However, as the BIC does not provide an authoritative source of entity identification like the LEI, it is critical to have both identifiers in the payment message where applicable. To support such processes, SWIFT and GLEIF provide a regularly updated BIC-to-LEI mapping table.

**SUMMARY**

The PMPG believes now is the appropriate time for the payment industry to begin its adoption of the LEI and reap the benefits of unambiguous legal entity identification. Coupled with the other changes happening around the LEI to make it cheaper and easier to obtain, the migration to ISO 20022 provides the right opportunity for the industry to educate its clients on the benefits of the LEI and move to adding the LEI into payments messages, infrastructures and processes in a low-cost, efficient manner.

**ACKNOWLEDGMENT**

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REFERENCES


(3) Ibid.

(4) Ibid.

(5) Ibid.