

Response of the Global Legal Entity Identifier Foundation (GLEIF) to the Board of International Organization of Securities Commissions (IOSCO) Consultation Report for the use of artificial intelligence and machine learning by market intermediaries and asset managers October 2020

The Global Legal Entity Identifier Foundation (GLEIF) is pleased to provide comments to the Board of International Organization of Securities Commissions (IOSCO) Consultation Report for the use of artificial intelligence and machine learning by market intermediaries and asset managers. GLEIF will focus its comments on the use of the Legal Entity Identifier (LEI) in Artificial Intelligence (AI) and Machine Learning (ML) as a best practice.

GLEIF would like to respond to *Question 2: "Do you see any risks or challenges around AI and ML which are not mentioned in the report?"*.

GLEIF would like to bring attention to the Board of IOSCO, the significant impact of the quality of datasets on the performance of AI and ML. Algorithms rely on quality data, and most firms recognize the need for quality data inputs. In particular poor-quality identification data renders AI and ML approaches less reliable, and worse, may result in missing the signal in the data and or unexpected behavior of the algorithm. GLEIF research¹ demonstrates that financial firms use on average 4 identifiers for their legal entity clients which leads to low confidence in the reliability of the associated client reference data. Considering the interconnectedness of the financial sector and institutions, several institutions' use of low-quality data can negatively impact risk assessment and exposure analysis and create a challenge for financial stability. Therefore, GLEIF suggests that IOSCO recommends to institutions that they should use international data standards when building their ML models or AI algorithms.

GLEIF believes that using the LEI in the client identification, a use case mentioned in the Consultation Report, will enhance institutions' capabilities in automating their client onboarding, fraud detection, money laundering, and cyber-attack monitoring. Using the LEI, instead of a plethora of regional, national, or local identifiers, is particularly essential for financial firms operating across borders. The LEI data is structured and machine-readable; so, it can be easily used by any user in the digital environment.

Financial firms are reviewing client onboarding processes for cost and efficiency savings, particularly due to the digitization of processes and workflows. However, the crucial question is how (and if) financial institutions will achieve digitization before adopting a data-driven approach in their client lifecycle management processes? As financial firms adapt their processes and workflows for digitization, there is a genuine risk that siloed, proprietary approaches are relied upon again and would not deliver a sound foundation for transformation. This is where action is required from policymakers to agree on global data standards to ensure an open, interoperable future.

Adopting the LEI and other global standards would help the financial sector extend its common language in a wide range of areas, such as risk management, payments, securities, lending, capital raising,

¹ See GLEIF Research : A New Future for Legal Entity Identification, May 2018. <https://www.gleif.org/en/lei-solutions/lei-in-kyc-a-new-future-for-legal-entity-identification>

investment management, trade and post-trade, and trade finance and reporting. The financial sector is engaging in many initiatives aiming to simplify these transactions, such as adopting distributed ledger technologies or removing regulatory fragmentation. Ensuring full interoperability across these initiatives will be crucial for these new applications' success.

For example, in the recently [published Digital Finance Strategy for the EU](#), it is decided that by 2024, the EU aims to put in place the necessary conditions to enable the use of innovative technologies, including RegTech and SupTech tools, for supervisory reporting by regulated entities and supervision by authorities. The Commission will make full use of available international standards and identifiers, including the LEI. The use of international standards consistently will facilitate the use of RegTech tools for reporting and SupTech tools for data analysis by authorities.

GLEIF also agrees with the considerations highlighted in the Consultation Report and agrees that supervisory and regulatory authorities need to discuss whether it is necessary to define specific minimum standards for the explainability/traceability and effectiveness of the methods used. The algorithms' results would have to be traceable to the extent that the supervisory authorities can monitor them. In addition to performing comparisons with specific minimum standards that may need to be developed, supervisory authorities could also determine the effectiveness of algorithms by benchmarking them against other providers' algorithms. Without the use of the global data standards as part of these specific minimum standards, comparison of data and benchmarking across borders cannot be achieved.

The concentration risk, reliance on the same service providers or intermediaries, is highlighted as another challenge. GLEIF thinks that the clear identification of these service providers and clients with their LEI can help regulators map service concentration and affected clients in a clear and unambiguous manner in case of an unexpected behavior. Mapping the concentration risk can help regulators take necessary measures timely, so these challenges do not become risk factors for financial stability.

As also highlighted by the Financial Stability Board, applications of AI and ML could result in new and unexpected forms of interconnectedness between financial markets and institutions, for instance, based on the use by various institutions of previously unrelated data sources. Network effects and scalability of new technologies may give rise to third-party dependencies. This could, in turn, lead to the emergence of new systemically important players that could fall outside the current regulatory perimeter.

To prevent these challenges and identify interconnectedness between financial markets and institutions timely and on an accurate basis, GLEIF suggests that IOSCO recommends to its members that the LEI should be incorporated into AI/ML facilitated processes. The interoperability and traceability across different systems only can be ensured with transparency. The LEI is the foundational building block to ensure transparency and improved data quality.