BLOOMBERG EMBRACES THE LEGAL ENTITY IDENTIFIER

An In-Depth Analysis of the Evolution of the LEI and What It Means for Financial Services Firms

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Bloomberg’s Implementation of the Legal Entity Identifier Tackles Need to Introduce More Transparency in Financial Markets

WEAKNESSES REVEALED IN THE SYSTEM
The financial meltdown in 2008 exposed a number of weaknesses in the global financial system. The lack of transparency in the market, the use of highly complex financial instruments, together with increasing globalization and ever-larger financial institutions, added a substantial degree of systemic risk.

Following the near-collapse of the financial markets and the economy, regulators and those charged with sorting out assets in the aftermath were confronted with yet another difficulty. Unwinding the affairs of soon-to-be-defunct companies was complicated by the fact that it was often difficult to discern exactly who owned what. In the case of debt instruments, determining what party would ultimately be liable for the debt was complicated by the extensive use of linkages.

Continuing forensic analysis made clear that confusion over the exact identity and nature of counterparties resulted in difficulty in making informed decisions. Parties to a transaction were unable to fully assess the true nature of risk present in the transactions they were involved in. Greater clarity of identity could well have mitigated some of the large missteps that led to a global financial reset.

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As a result, financial reforms emerging from governing bodies around the world have mandated the development of unique identifiers for legal entities. In the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the development of a system that will add a new level of transparency to the market and improve the ability of firms to assess the level of risk in a potential transaction.

Bloomberg believes this new system can improve the transparency of world financial markets and add to future stability. Industry progress toward the development and adoption of the new standard demonstrates the considerable interest in this new system; it is expected to address a previously neglected area.

This paper examines what the LEI will accomplish as a stand-alone identifier and what it will not. This paper also examines the role Bloomberg Data Solutions can play in conjunction with the LEI to create a comprehensive system for identifying security owners and mitigating credit risk.

WHAT THE LEI MEANS FOR FIRMS
Companies, financial institutions and regulators all recognize the need for a global system that uniquely identifies legal entities. This rare consensus, and the value such a system offers, may be the reason that the newly crafted system has moved rapidly from conception to implementation.

Reducing Opacity
LEIs are expected to play a major role in eliminating the opacity surrounding complex financial transactions like those that led to spectacular domino-like failures seen in the last few years.

The establishment of a LEI system offers firms and regulators the ability to quickly assemble audit trails of security transactions, including buyers and sellers, intermediaries and bottom-line guarantors.

Identify Systemic Risks
LEIs also lay the foundation for tools that will allow regulators and analysts to examine the potential systemic risks caused by unexpected failures of large entities. LEIs will help buyers make more informed decisions by clearly identifying the counterparty involved in a transaction—and the potential risk. One of the most prominent targets in the move to identify entities is the Special Purpose Entity (SPE) or Special Purpose Vehicle (SPV).

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SPVs are a popular form of legal entity, frequently used to isolate a larger corporation from risk. Although useful for the creating entity, SPVs result in complex transactions with murky ownership. SPVs played a large role in hiding the counterparty risk inherent in many large, failed transactions. Buyers in a transaction often failed to understand the relationship between the entity issuing an instrument and the party responsible for repayment.
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The Provisional LEI
A new public utility is being created to house the LEI and associated data sets. Facility management will be provided by The Depository Trust & Clearing Corporation (DTCC), while SWIFT will serve as a registration authority. Although created, the utility has not yet been made available for the LEI registration process. Initially, the Legal Entity Identifier (LEI) will be added to trade confirmations, used in reconciliations and assigned to compliance mandates.

The development of the LEI is an important step forward for the global financial system and its major players. As the LEI is adopted and included on transactions, this identifier will gain in value. As of July 2012, approximately 24,000 provisional LEIs have been assigned to OTC derivative swap dealers and other financial entities. Provisional LEIs may continue to be assigned until the utility is officially deployed.

Phase I Limitations
There are limitations to what the first phase will achieve. The first phase of the LEI is not linked to instruments an entity may own. Thus, using the LEI alone will not allow firms to perform instrument-exposure risk analysis. Nor will the LEI alone build relationships between parent and subsidiary companies. The hierarchical relationship between assets and entities is neither consistently defined nor maintained against a golden copy. Institutions using the LEI will depend on the accuracy of the version maintained by their data provider; subtle differences between providers are possible.

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Furthermore, legitimate questions surround the workability of a global identifying system. The task of keeping such a registry up-to-date is a large undertaking. Tagging transactions with LEI data and developing the ability to analyze linkages will require vast amounts of data processing power and skill.

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Enhanced Features
Just as important, the integration of the LEI into Bloomberg systems enables important capabilities that the initial LEI lacks. As part of the Bloomberg Credit Risk package, the implementation of the LEI will enable firms to build complete entity relationship trees that offer transparency into the real structure of companies.

Bloomberg links LEIs to instruments, enabling firms to understand both exactly who is the ultimate owner of a specific bond issue and who is the obligor. Coupled with our fundamentals database, firms can perform a complete instrument risk analysis.

Cost Savings
Mapping the LEI to entities that a firm wishes to track may require the addition of staff and a commitment of resources. Once that assignment is made to the entities a firm wishes to trade with, further mapping must be done to raise security-level information such as bonds and other instruments to the entity level. Bloomberg’s hierarchies allow for the immediate mapping of entities to securities, thus relieving firms of the need to perform these laborious and expensive tasks.

We have already begun mapping the LEI to Bloomberg’s company identifier (ID_BB_COMPANY). Bloomberg is also taking steps to prepare for the forthcoming complete implementation of the LEI and will be prepared to have it mapped into our data products.
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Bloomberg recognizes the value and importance of the LEI, and we have moved early and decisively to incorporate it into our systems. Our approach offers clients a seamless method for adopting the LEI and extends the value of our world-class market data, fundamentals and credit-risk-analysis capabilities.

Firms that recognize the value and adopt this approach early on will achieve a competitive advantage that results in a better understanding of their current holdings as well as a markedly improved decision-making capability with lower overall risk.

Mapping entities and securities on a scale this large is no small feat, a fact that has driven Bloomberg’s rapid response to create a bridge to this new utility. Firms that employ Bloomberg products and services will be positioned to embrace the LEI quickly and to realize substantial cost savings.

For more information about the availability of the LEI via Bloomberg Data License, contact Peter Warms (pwarms@bloomberg.net) or Steve Meizanis (smeizanis@bloomberg.net) in Bloomberg Data License Product Development.