

Entity data – a key component in understanding risk and identifying exposure

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Single name exposure or 'issuer risk' is the exposure to a single name issuer or group of issuers by virtue of the securities held in an investment portfolio or fund. Understanding single name exposure is an essential component of the risk management process and complements forward-looking risk metrics by providing a consistent view on an 'on-demand' basis.

A consistent single view approach is essential for understanding how and where an organisation is exposed to a single name by an individual portfolio, across business functions, at group level and across the firm as a whole. The advantages of this approach can add value in two distinct ways: first, on an ongoing basis, to ensure that an investment portfolio remains in compliance both with defined investment policy and regulatory reporting requirements such as managing credit, market and operational risk, financial instruments' collateral, as well as a variety of global risk management and liquidity risk regulations; second, on an ad hoc basis, the ability to quickly and accurately understand a firm's total exposure in relation to a single name or market stress event. This is an essential component in risk mitigation.

The changing regulatory landscape

Regulators have responded to the recent market turmoil by increasing their demands for transparency, control and understanding of exposure. To this end, new regulations and directives have been introduced as existing ones continue to mature, including Basel II/III, UCITS IV/V, MiFID II, Dodd-Frank Act, the USA PATRIOT Act, as well as the current approach to liquidity risk management by many international regulators, as well as Solvency II for the insurance industry. As regulations, standards and directives evolve, firms will need to create new compliance processes to meet reporting requirements both nationally and globally.

Reference data – and particularly business entity data – is a key component in the identification and management of risk exposure. Maintaining an accurate and consistent view of business entity data available across the organisation is key. Firms need to bring together the disparate data sources that they hold on companies, issuers and underlying issues in order to create a shared single view of entity data and associated risks. Full disclosure of the details behind a firm's instruments and the issuing entities, guarantors, counterparties and customers - and the 'high-risk' overlap between them - is essential. By establishing a centralised, holistic view, firms can ensure consistency of data and support the in-house distribution frequencies required across business functions.

Yet the true value of business entity data can only be realised effectively when combined with securities master and other business content. This allows applications to embed a mapping of corporate groups to all the instruments and the related derivatives associated with all the members of a corporate group. By deploying business entity data alongside existing in-house information services, complete maps of the ownership structure and related securities can provide a more detailed background picture of any one issuer.

On the surface these inter-related structures may seem complex, but the benefits resulting from integrating these data sets can be significant to a variety of functions across the enterprise, as well as providing a greater level of clarity in understanding a firm's exposures – especially when it comes to issuer, credit, counterparty and market risk.

Under current and proposed liquidity risk measures, firms will need to look closely at bringing together instrument data, counterparty data and other data from across the organisation so that they can better measure their risk under a 'stress and scenario test' requirement.

Do you know your firm's risk exposure?

When news of either a single name stress such as the Lehman's default or a wider market stress event such as the Greek sovereign debt crisis breaks, firms need to quickly ascertain their total exposure by identifying which of their investment portfolios could be affected. The longer the process, the more significant the impact can be on a firm's exposure.

Risk managers will look to identify the true level of total exposure across a number of factors: by a single name issuer, by related issuers, such as parent/subsidiary relationships, by asset class, sector, country and region.

Therefore if a chief risk officer (CRO) or chief information officer (CIO) poses the question; "What is our firm's total exposure to a credit rating downgrade of Greek sovereign debt?", then a risk manager might construct a filter of the various data points to ascertain both *direct* and *indirect* levels of exposure:

1. What is my *direct* exposure to Greek sovereign debt?
2. What is my *direct* exposure to a 'single name' Greek bank and its subsidiaries in different countries?
3. What is my *indirect* exposure to French and German banking groups with a significant exposure to Greek sovereign debt?
4. What is my potential *indirect* exposure to stress events in other eurozone nations such as Italy or Spain?

If position and accounts data has to be collated from individual trading desks and accounting databases, applied to reference data held in multiple different systems and supporting differing formats, and finally combined on spreadsheets, then ad hoc risk exposure calculation becomes an onerous and difficult task.

Without a consistent view of reference data to support the structured and unstructured data around each deal, the greater the potential for inaccuracy and delays and therefore the greater the risk to the firm.

Understanding the relationships between a security and its issuer in the context of its membership within a broader corporate group can also bring wider business benefits. Greater transparency of inter-relationships between securities, issuers and market data provides risk managers with additional tools to monitor investment strategy and help ensure the firm's risks are commensurate with the business services that they provide.

The challenges

Maintaining high-quality, enterprise-wide business entity data

Acquiring and maintaining up-to-date business entity data is not without its challenges: disparate sources, a lack of standards and the manual collection of the data can often result in inconsistency and duplication. Many firms still keep their reference data in individual silos for use by internal credit, risk and settlement systems, among others, and often entity data and securities data have been maintained separately. A siloed approach makes it difficult to share data across the organisation and can necessitate a costly and time-consuming manual mapping process to identify global exposure to various entities, industries, regions and asset class.

An enterprise-wide, holistic approach to managing exposure risk is therefore required. Disparate data sources that generate counterparty, issuer and client records across different functions need to be aggregated in order to create a single view of entity data shared across the firm.

Many firms now understand the mission-critical connection between central data management strategies and business entity data management, and are integrating their issue-to-issuer links into the securities master where they can be used for trading analysis and risk assessment. Internal auditors and risk managers are engaging actively with the data maintained internally, exploring its extent and limitations.

Data maintenance and event triggers

Equally as important is the processing of event triggers as part of an over arching data governance policy. A trigger event is an action resulting in changes to entity data that may have implications for one or more functions within a firm. Outlining the specific events material to each business function within the maintenance policy can help firms to maintain a holistic view of upcoming changes that may impact customer, operational or regulatory risks. Changes to entity data may come from many sources and via multiple departments in a firm.

Updates as a result of trigger events may be passed to various business functions, especially where it is clear that changes or checks will need to be made, while others may be missed, which could result in hidden risks.

Active maintenance of event triggers such as; default event, company reorganisation., M&A activity, credit rating downgrade, company filings and client on-boarding can also

help identify potential risks impacting related entities within the 'family tree' of the subject entity, helping firms comply with internal or client-imposed investment restrictions.

Global Legal Entity Identifier (LEI)

The lack of a global identification standard, unique identification of entities – counterparties, issuers, institutional clients and guarantors – has been a major stumbling block. Many firms are forced to act as aggregators of entity reference data, cross-referencing data from different sources and allocating their own proprietary identifiers to manage the process.

In early July 2011, the Global Financial Markets Association (GFMA) recommended that the Depository Trust & Clearing Corporation (DTCC), Swift and DTCC's Avox unit run a core LEI utility for data collection, maintenance, LEI assignment and quality assurance of a new 20-character ISO standard (ISO 17442). The initiative to adopt an LEI standard was driven by the US Office of Financial Research (OFR) and the Commodity Futures Trading Commission (CFTC) under Dodd-Frank legislation to support the Financial Stability Oversight Council (FSOC) activities around systemic risk monitoring.

As a US-led initiative, the real barometer of success will be through the global adoption of the new standard. Initial industry response has been positive and the next steps will involve further consultation with international regulatory bodies to achieve this objective.

The need for high-quality business entity data is a clear priority for the industry and regulators alike. For firms, the rewards for investment are thought to be significant as the consequences of not understanding your exposure can be very high. Portfolio concentration risk, counterparty and credit risk, operational and reputational risks, as well as settlement, financial, legal and other regulatory issues, are all at stake if a firm fails to efficiently manage its entity data.

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