ESRB
European Systemic Risk Board
European System of Financial Supervision

RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD

of 24 September 2020

on identifying legal entities

(ESRB/2020/12)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macroprudential oversight of the financial system and establishing a European Systemic Risk Board[1], and in particular Article 3(2)(a), (b), (d) and (f) and Articles 16 to 18 thereof,

Having regard to Decision ESRB/2011/1 of the European Systemic Risk Board of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board[2], and in particular Article 15(3)(e) and Articles 18 to 20 thereof,

Whereas:

(1) The global economy is based on an intricate, tightly knit and extremely complex network of financial transactions that are created by a vast number of cross-border contracts with effects reaching across the world. This network comprises not only financial institutions, but any entities that have relationships with each other and with the financial markets. Breakage of any single crucial node in this network has the potential to cause large parts of the whole to unravel, with significant global implications. Clear identification of the individual entities and the connections between them is a key requirement for drawing a reliable map of the global economic and financial landscape, which is necessary in order to reduce contagion.

(2) Financial contagion occurs because financial and non-financial entities are linked through financial transactions, and by financial assets and liabilities. Channels for contagion are created by direct exposure through links between the financial and the non-financial sectors as well as by indirect exposure where entities form part of the same group. Contagion between financial and non-financial entities can spread in both directions and is more dramatically demonstrated during crises. Thus, a financial crisis can spread from the financial to the non-financial sector, as demonstrated by the failure of the investment bank Lehman Brothers in 2008; an economic crisis can spread from the non-financial to the financial sector, originating, for example, in the over-indebtedness of non-financial entities or in any severe crisis of supply or demand. The economic and financial effects of the crisis caused by the coronavirus (COVID-19) pandemic offer an example of the close interlinkages between the non-financial and financial sectors. Enabling the correct identification of non-financial entities is therefore equally as important as the correct identification of financial entities, to ensure financial stability.

(3) Large financial groups, such as those of global systemically important institutions (G-SIIs), have highly complex legal structures that concentrate numerous obligations, including many which are large. G-SIIs often have a significant number of subsidiaries and/or international branches and interact with numerous major counterparties. The failure of one or more such G-SIIs would

1 OJ L 331, 15.12.2010, p. 1.
2 OJ C 58, 24.2.2011, p. 4.

have a negative impact on the financial system in many countries and, more widely, on the global economy. Policies have been put in place to reduce both the probability of G-SIIs failing and the impacts of such failure. The latter objective could be achieved by improving global recovery and resolution measures. The more complex the group structure, the greater the cost and time needed to recover and resolve it. Identifying such groups, as well as their legal entities and overall structure, is therefore crucial to ensuring financial stability.

(4) In 2012, the G20 endorsed the recommendations of the Financial Stability Board (FSB) regarding the framework for development of a global legal entity identifier (LEI) system for parties to financial transactions, and encouraged global adoption of the LEI to support authorities and market participants in identifying and managing financial risk[3]. Since its introduction, the LEI has been adopted by more than one million entities across more than 200 countries. The use of a unique, exclusive and universal legal entity identifier has increased authorities' abilities to evaluate systemic and developing risks and adopt remedial measures. In particular, the clear identification of contractual parties in a network of global financial contracts processed electronically at a very high speed permits authorities to make use of existing technologies to analyse interconnectedness, identify potential chains of contagion, and track market abuse for financial stability purposes. The LEI has also become critical for connecting existing datasets of granular information on entities from multiple sources.

(5) In 2017, G20 leaders welcomed recommendations for promoting the use of common identifiers, in particular the LEI for entities[4]. However, in 2019, in a thematic review on the implementation of the LEI, the FSB listed a set of challenges still faced by the LEI system[5]. These include the low rate of adoption of the LEI by entities outside the securities and over-the-counter (OTC) derivatives markets; the one-off bursts of issuance following the adoption of Union regulations such as Regulation (EU) No 648/2012 of the European Parliament and of the Council[6] (commonly referred to as 'EMIR') and Regulation (EU) No 600/2014 of the European Parliament and of the Council[7] (commonly referred to as 'MiFIR') without sustained growth over time; the insufficient level of voluntary adoption of the LEI; and the limited adoption of the LEI by non-financial entities. Moreover, whereas most parent entities of G-SII groups have LEIs, coverage does not generally extend to all international subsidiaries and branches, or all counterparties.

(6) The European Systemic Risk Board (ESRB) is responsible for the macroprudential oversight of the financial system within the Union. In carrying out its tasks, the ESRB should contribute to ensuring financial stability and mitigating the negative impacts on the internal market and the real economy. For these purposes, the availability and wide adoption of a worldwide unique identifier to unequivocally identify entities engaged in financial transactions is of key importance. The low rate of adoption of the LEI referred to above constitutes a factor that may hamper the reliability of financial stability analysis, making it difficult to accurately assess and

[3] See 'G20 Leaders' Declaration', available on the G20 website at https://g20.org/en/g20/Documents/2012-Mexico-Leaders-Declaration0619-loscabos.pdf
[4] See 'Annex to G20 Leaders' Declaration: G20 Hamburg Action Plan', available on the G20 website at https://www.g20germany.de/Content/DE/_Anlagen/G7_G20/2017-g20-hamburg-action-plan-en__blob=publicationFile&v=4.pdf
[5] See 'Thematic Review on Implementation of the Legal Entity Identifier', available on the FSB's website at https://www.fsb.org/wp-content/uploads/P280519-2.pdf
[6] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).
[7] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84).

compare risks across national markets. Existing gaps in the adoption of the LEI should therefore be addressed.

(7) The purpose of this Recommendation is to contribute, in line with the ESRB's mandate, to the prevention and mitigation of systemic risks to financial stability in the Union through the establishment of systematic use of the LEI by entities engaged in financial transactions. To achieve this objective, this Recommendation seeks the introduction of a Union legal framework to uniquely identify legal entities engaged in financial transactions by LEIs and to make the use of the LEI more systematic in respect of supervisory reporting and public disclosure. Taking into account the time frame for the adoption of such a Union framework, the ESRB recommends that relevant authorities pursue and systematise their efforts to promote the adoption and use of the LEI, making use for this purpose of the various regulatory or supervisory powers which they have been granted by national or Union law.

(8) As a first objective, the Recommendation is aimed at ensuring that all legal entities established in the Union that are involved in financial transactions obtain and maintain an LEI. Adoption of the LEI in the Union has mainly been driven by regulatory requirements laid down in legislation such as Regulation (EU) No 648/2012, Regulation (EU) No 600/2014, Regulation (EU) 2015/2365 of the European Parliament and of the Council[8] and Regulation (EU) No 909/2014 of the European Parliament and of the Council[9]. Those requirements apply to entities involved in OTC derivatives transactions, in transactions in derivatives and other financial instruments traded on trading venues and in securities financing transactions, as well as to securities issuers. Other legislative and non-legislative acts, such as Regulation (EU) No 575/2013 of the European Parliament and of the Council[10] – applicable to credit and financial institutions – and the European Banking Authority (EBA) Recommendation on the use of the Legal Entity Identifier (LEI)[11], as well as the European Insurance and Occupational Pensions Authority (EIOPA) Guidelines on the use of the Legal Entity Identifier (LEI)[12], also require or recommend the use of the LEI. However, there is no uniform approach across markets and use of the LEI currently does not extend to non-financial sectors, leaving LEI coverage fragmented and important sectors excluded. A Union legal framework regulating LEI use in the Union would achieve coherent implementation across all sectors of the economy, thereby maximising the benefits arising from the use of the LEI. Meanwhile, and until such a framework is adopted, entities supervised in the Union should be encouraged to obtain an LEI and authorities supervising them should, to the extent permitted by law, require them to have an LEI.

(9) The principle of proportionality should be applied so as to avoid an extra cost burden. For example, Union legislation could exempt smaller entities that do not form part of a wider group from the requirement to obtain an LEI, or require that they be provided with an LEI at no cost.

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8 Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (OJ L 337, 23.12.2015, p. 1).

9 Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1)

10 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

11 Recommendation on the use of the Legal Entity Identifier (LEI) (EBA/REC/2014/01), available on the EBA's website at https://eba.europa.eu/regulation-and-policy/supervisory-reporting/consultation-paper-draft-recommendation-on-the-use-of-legal-entity-identifier-lei-

12 Guidelines on the use of the Legal Entity Identifier (LEI) (EIOPA-BoS-14-026), available on EIOPA's website at https://www.eiopa.europa.eu/sites/default/files/publications/eiopa_guidelines/lei_gls_en_ori.pdf

Addressing the cost aspects of the LEI by means of a proportionate approach is of very considerable importance given that methods of identifying legal entities differ between jurisdictions. Within the Union, national and other identifiers exist and are in use to cover specific needs. For example, the European Unique Identifier (EUID) is used in the Business Registers Interconnection System to ensure interoperability among Member States' business registers. Nonetheless, the LEI, as a global identifier that aims at universal coverage and addresses a large variety of applications, is better suited for the purpose of monitoring financial stability, given the important interconnections that exist between entities in the Union and in third countries. The ESRB is of the view that business registries across the Union could have a role to play in the allocation of LEIs, alongside national identifiers and EUIDs.

(10) Since the LEI became available, national supervisory authorities and European Supervisory Authorities (ESAs) have been strongly promoting the LEI and its use in connection with reporting requirements. However, gaps in this area remain. Therefore, a second objective of the Recommendation is to ensure the systematic and comprehensive use of the LEI for identification of entities in the reporting of financial information. First, if the entity subject to the reporting obligation were required to hold an LEI to identify itself, this would allow authorities to uniquely identify entities across different reporting frameworks. Second, the LEI should be used in a more systematic and comprehensive way to identify other entities for which the reporting entity is also required to report information, Such entities include – but are not limited to – issuers of financial instruments, counterparties to financial transactions, and related entities.

(11) An entity for which financial information must be reported may not have an LEI. This will be the case, for example, where an entity established in the Union is exempted under the principle of proportionality or where an entity established in a third country has not acquired an LEI. Various legislation has already been implemented to limit the access of entities without an LEI to financial markets in the Union. The rule under Regulation (EU) No 600/2014 that is known as the 'no LEI, no trade' rule has been of crucial importance for the adoption of the LEI in the Union by requiring an LEI as a pre-condition for access to Union markets.[13] In cases where the lack of an LEI is not justified, the ESRB encourages addressees of this Recommendation to adopt a similar approach to the 'no LEI, no trade' rule, where appropriate.

(12) Since the LEI became available, national statistical authorities, national supervisory authorities and ESAs have also been promoting the LEI and its use in the context of public disclosures. The LEI has been voluntarily used or required to be used in certain public registers, publication of stress tests results and other mandatory or voluntary disclosures of data. Nonetheless, the LEI is not yet used in a systematic way as this has not been made obligatory in all cases, whether under Union or national law. To contribute to the third objective of this Recommendation – that is, to promote the awareness and use of the LEI by the general public and facilitate the general public's access to company information through the use of the LEI – relevant authorities should further enhance and systematise references to the LEI in their disclosure of information about entities.

[13] See Article 13(2) of Commission Delegated Regulation (EU) 2017/590 of 28 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the reporting of transactions to competent authorities (OJ L 87, 31.3.2017, p. 449) which provides that 'An investment firm shall not provide a service triggering the obligation to submit a transaction report for a transaction entered into on behalf of a client who is eligible for the legal entity identifier code, prior to obtaining the legal entity identifier code from that client'.

(13) This Recommendation has been prepared taking into account ongoing international and European initiatives in the area, including, for example, the FSB's proposals in its thematic review in 2019 on the implementation of the LEI referred to above.

(14) This Recommendation is without prejudice to the monetary policy mandates of the central banks in the Union.

(15) Recommendations of the ESRB are published after the addressees have been informed, and after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react,

HAS ADOPTED THIS RECOMMENDATION:

SECTION 1

RECOMMENDATIONS

Recommendation A – Introduction of a Union framework on the use of the legal entity identifier

1. The Commission is recommended to propose that Union legislation incorporates a common Union legal framework governing the identification of legal entities established in the Union that are involved in financial transactions by way of a legal entity identifier (LEI), paying due regard to the principle of proportionality, taking into account the need to prevent or mitigate systemic risk to financial stability in the Union and thereby achieving the objectives of the internal market.

2. The Commission is recommended to propose that Union legislation that imposes an obligation on legal entities to report financial information, while paying due regard to the principle of proportionality, as expressed in Recommendation A(1), include the obligation to identify by way of an LEI:

   (a) the legal entity subject to the reporting obligation; and

   (b) any other legal entity about which information must be reported and which has an LEI.

3. The Commission is recommended to propose that Union legislation incorporates an obligation on authorities to identify by way of its LEI any legal entity about which they publicly disclose information and which has an LEI, paying due regard to the principle of proportionality, as expressed in Recommendation A(1).

Recommendation B – Use of the legal entity identifier until the possible introduction of Union legislation

Pending any action taken by the Commission to comply with Recommendation A and the possible introduction of corresponding Union legislation, it is recommended that to the extent permitted by law and subject to the principle of proportionality:

1. the relevant authorities require or, where applicable, continue to require, all legal entities involved in financial transactions under their supervisory remit to have an LEI;

2. the authorities, when drafting, imposing, or amending financial reporting obligations include or, where applicable, continue to include, in such obligations an obligation to identify by way of an LEI:

   (a) the legal entity subject to the reporting obligation; and

   (b) any other legal entity about which information must be reported and which has an LEI;

3. the authorities identify or, where applicable, continue to identify, by way of its LEI, any legal entity about which they publicly disclose information and which has an LEI.

SECTION 2

IMPLEMENTATION

1. Definitions

For the purposes of this Recommendation the following definitions apply:

(a) 'relevant authorities' means:

(i) the national competent or supervisory authorities as specified in the Union acts referred to in Article 1(2) of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[14], Regulation (EU) No 1094/2010 of the European Parliament and of the Council[15] and Regulation (EU) No 1095/2010 of the European Parliament and of the Council[16];
(ii) the ECB under Article 9(1) of Council Regulation (EU) No 1024/2013[17];
(iii) designated authorities pursuant to Chapter 4 of Title VII of Directive 2013/36/EU of the European Parliament and of the Council[18] or Article 458(1) of Regulation (EU) No 575/2013;
(iv) macroprudential authorities with the objectives, arrangements, tasks, powers, instruments, accountability requirements and other characteristics set out in Recommendation ESRB/2011/3[19];
(v) resolution authorities designated by Member States pursuant to Directive 2014/59/EU of the European Parliament and of the Council[20];

(b) 'authorities' means:

(i) relevant authorities;
(ii) the EBA;
(iii) EIOPA;
(iv) the European Securities and Markets Authority;
(v) the Single Resolution Board;

(c) 'legal entity identifier' (LEI) means a 20-character reference code to uniquely identify legally distinct entities that engage in financial transactions and associated reference data and which is

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14 Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

15 Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

16 Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

17 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

18 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49EC (OJ L 176, 27.6.2013, p. 338).

19 Recommendation ESRB/2011/3 of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (OJ C 41, 14.2.2012, p. 1).

20 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

based on the ISO standard 17442 developed by the International Organization for Standardization;

(d) 'legal entity' means an entity that is eligible for an LEI according to the ISO17442 standard and guidance on the eligibility for LEI published by the Regulatory Oversight Committee for the Global Legal Entity Identifier System;

(e) 'financial transaction' means, in accordance with paragraph 1.66(c) of Annex A to Regulation (EU) No 549/2013 of the European Parliament and the Council[21], the net acquisition of financial assets or the net incurrence of liabilities for each type of financial instrument.

[21] Regulation (EU) No 549/2013 of the European Parliament and the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (OJ L 174, 26.6.2013, p. 1).

2. Criterion for implementation

When implementing the Recommendation due regard should be paid to the principle of proportionality, taking into account the objective and the content of each recommendation.

3. Timeline for the follow-up

In accordance with Article 17(1) of Regulation (EU) No 1092/2010, addressees are requested to report on the actions taken in response to this Recommendation, or adequately justify any inaction, in compliance with the following timelines:

1. Recommendation A

   By 30 June 2023, the Commission is requested to deliver to the European Parliament, to the Council and to the ESRB a report on the implementation of Recommendation A.

2. Recommendation B

   By 31 December 2021, the addressees of Recommendation B are requested to deliver to the European Parliament, to the Council, to the Commission and to the ESRB a report on the implementation of Recommendation B.

4. Monitoring and assessment

1. The ESRB Secretariat will:

   (a) assist the addressees, ensuring the coordination of reporting and the provision of relevant templates, and detailing where necessary the procedure and the timeline for the follow-up, with a view to limiting the reporting burden on the addressees;

   (b) verify the follow-up by the addressees, provide assistance at their request, and submit follow-up reports to the General Board via the Steering Committee.

2. The General Board will assess the actions and justifications reported by the addressees and, where appropriate, may decide that this Recommendation has not been followed and that an addressee has failed to provide adequate justification for its inaction.

Done at Frankfurt am Main, 24 September 2020.

Francesco Mazzaferro

Head of the ESRB Secretariat,
on behalf of the General Board of the ESRB
Francesco MAZZAFERRO