

## **Response of the Global Legal Entity Identifier Foundation (GLEIF) to the European Commission Sustainable Corporate Governance Inception Impact Assessment**

**October 2020**

The Global Legal Entity Identifier Foundation (GLEIF) is pleased to provide comments to the European Commission Sustainable Corporate Governance Inception Impact Assessment. GLEIF will focus its comments on the use of the Legal Entity Identifier (LEI) in the supply chains and its role in improving to mainstream sustainable corporate governance across Member States.

First some background on the LEI.

The development of a system to uniquely identify legal entities globally had its beginnings in the 2008 financial crisis. Regulators worldwide acknowledged their inability to identify parties to transactions across markets, products, and regions for regulatory reporting and supervision. This hindered the ability to evaluate systemic and emerging risk, to identify trends, and to take corrective steps. Recognizing this gap, authorities, working with the private sector, have developed the Global LEI System with a global governance framework representing the public interest that will, through the issuance of unique LEIs, unambiguously identify legal entities engaged in financial transactions. Although the initial introduction of the LEI was for financial regulatory purposes, the usefulness of the LEI can be leveraged for any purpose. The LEI is use case agnostic and can be used in any process of entity identification, from finance to healthcare to verifying all counterparties of businesses supply chain.

The LEI itself is a 20-digit, alpha-numeric code based on the ISO 17442 standard developed by the International Organization for Standardization (ISO). The code connects to key reference information that enables clear and unique identification of legal entities participating in financial transactions including their ownership structure. Moreover, the LEI provides freely accessible look up (identification) of the parties to transactions. The complete database of LEIs and the associated LEI reference data is available free of any charge or barrier to anyone on the web. GLEIF operates under the Open Data Charter terms, which means the data can be used for searching legal entities in 200+ jurisdictions by all users without limitations.

First, GLEIF suggests that setting clear and harmonized rules for due diligence in supply chains at the EU level is necessary for creating a level playing field for all EU companies. Many EU companies, small or big, are sourcing supplies from entities based in countries with lesser social, human rights or environmental standards. In some countries the identification and mitigation of related risks and impacts is weak. Supplier due diligence is a first foundational step to ensuring a minimum is met for social, human rights, and environmental standards. GLEIF proposes that the LEI should be a mandatory data element for due diligence requirements in the supply chain so as to ensure maximum transparency and clear communication with investors and supervisory authorities.

By mandating the LEI as part of due diligence in supply chains, the EU Commission could have the opportunity to introduce a standardized, uniform approach for entity identification across supply chains. GLEIF thinks that this clear guideline would be appreciated by many companies as this uniform approach would ensure transparency and clarity on who the suppliers they are engaging with. Setting out

minimum mandatory requirements for all would also help to save certain costs compared to what companies are facing now, trying to keep up with disparate recommendations and expectations or trying to establish their own due diligence protocol.

As stated in the EU Commission's Final Report on due diligence requirements through the supply chain, the Commission could consider recognizing that certain third-party verification schemes could be used as part of the risk assessment and risk mitigation process. The LEI can be used as part of these third-party verification mechanisms. The report provides an interesting example of how certain provisions of the EU Timber Regulation were interpreted and applied in the German Administrative Court in Cologne. The Court found against a German company that sourced timber from a supplier in Democratic Republic of Congo, based on the fact that the company should have recognized that the certificate produced by the supplier was fake. As the defendant company failed to recognize this, they were found not to have met the due diligence requirement, which the Court emphasized is "not merely a purely formal requirement". The Court also referred to the seriousness of these requirements in light of the role of illegal logging in climate change.

This example shows the importance of easy, fast, and transparent access to a central open data source about legal entities' identity. If the German company had requested the LEI of the timber supplier in Congo, it could have a higher assurance about the identity of this company and could verify the information on the certificate before engaging in a business relationship. The Global LEI System solves the problem of entity identification for all legal entities on a global scale and creates the first level of trust.

From banking to supply chain management, industries everywhere are adjusting to the digitization of processes and transactions. As in the physical world, transacting within this new digital economic landscape requires trust and transparency. All players operating within the global supply chain need to trust that the person or organization they are interacting with, is who they say they are. Identity management sits at the heart of digital transformation. With an increasingly siloed digital identity management landscape, there is a risk that proprietary platforms and solutions may hamper innovation and frustrate users.

Therefore, GLEIF suggests that requirements for SMEs could be designed in a way to help these entities' access to finance and supply chains, by simply creating more transparency about these entities particularly in jurisdictions where business registry information is not well organized. In some developing countries, local systems for entity identification are not easily accessible, may not be transparent, and sometimes lack quality standards. In countries that lack transparency and identity, more than 50% of economic activity is conducted by unregistered businesses. As a result, firms remain cut off from essential services such as payments, credit facilities, and supply chains. Given that trust is the key component of a thriving SME ecosystem, it is crucial for these entities to prove who they are as part of supply chain due diligence. The requirement of the LEI for such entities would also satisfy the Regulation (EU) 2017/821 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas, given Union importers of minerals or metals shall provide the name and address of the supplier to the Union importer. LEI reference data comprise the most essential elements of identification including:

- The official name of the legal entity as recorded in the official registers.
- The registered address of that legal entity.

- The country of formation.
- The codes for the representation of names of countries and their subdivisions.
- The date of the first LEI assignment; the date of last update of the LEI information; and the date of expiry, if applicable.

Moreover, each LEI record includes the 'Level 2' data that answers the question of 'who owns whom'. Specifically, legal entities that have or acquire an LEI report their 'direct accounting consolidating parent' as well as their 'ultimate accounting consolidating parent'.

To ensure broader awareness of the LEI in non-financial reporting and sustainable finance, GLEIF also engages with the Global Reporting Initiative and Sustainability Accounting Standards Board (SASB) Foundation and explores the synergies between these organizations and the Global LEI System.

Lastly, GLEIF would like to reiterate its willingness to work with the Commission and all other related stakeholders to make sustainability and a focus on long-term impacts part of the decision-making process. Requesting the LEI from counterparties in the supply chains would be the first foundational step of trust in supplier due diligence and provide the transparency needed to better monitor sustainability across supply chains.