Response of the Global Legal Entity Identifier Foundation (GLEIF) to the European Commission Exchange of VAT-relevant payment data – Survey for Payment industry actors

April 2020

The Global Legal Entity Identifier Foundation (GLEIF) is pleased to provide comments to the European Commission Exchange of VAT-relevant payment data – Survey for Payment industry actors. GLEIF will focus its comments on the use of the Legal Entity Identifier (LEI) in the Survey.

First some background on the LEI.

The LEI is a 20-character, alphanumeric code based on the ISO 17442 standard developed by the International Organization for Standardization (ISO). The LEI connects to key reference information that enables clear and unique identification of legal entities participating in financial transactions. Each LEI contains information about an entity's ownership structure, answering the questions of 'who is who' and 'who owns whom'. It provides a universally recognized identifier paired with essential entity data, rigorous verification processes and high data quality.

The LEI initiative is driven by the Financial Stability Board (FSB) on behalf of the finance ministers and governors of central banks represented in the Group of Twenty (G20). In 2011, the G20 called on the FSB to take the lead in developing recommendations for a global LEI and a supporting governance structure. The related FSB recommendations endorsed by the G20 in 2012 led to the development of the Global LEI System as a broad public good that provides unique identification of legal entities participating in financial transactions across the globe and the subsequent establishment of the GLEIF by the FSB in 2014. As outlined in the GLEIF's Statutes, the Global LEI System is designed and developed to be used by the (i) public authorities and (ii) by the private sector to support improved risk management, increased operational efficiency, more accurate calculation of exposures and other needs. The GLEIF, a supra-national not-for-profit organization, is overseen by a committee of currently 71 global regulators and 18 observers, known as the LEI Regulatory Oversight Committee (LEI ROC). The European Supervisory Agencies (ESAs), ESMA, EBA and EIOPA, as well as the ECB and the European Commission, are represented in the LEI ROC.

The LEI is already required extensively in financial markets regulation in the EU. All EU corporates listed and traded at any marketplace already have an LEI due to the Regulation (EU) 2017/1129 (Prospectus Regulation). Moreover, many other large corporates or financial institutions have already obtained an LEI due to different EU regulatory requirements such as EMIR, MIFID II, MAR, CRR, Solvency II, AIFMD, CRAR, CSDR, Transparency Directive and Securitization Regulation.

With the introduction of its Central Electronic System of Payment information (CESOP), the EU Commission aims to combat cross-border VAT fraud caused by the fraudulent behavior of some businesses in the area of cross-border e-commerce. For fulfilling this aim, it is essential that the payment service providers uniquely identify the payee and the payer with a global identifier. It is stated in the Council Directive (EU) 2020/284 that a payment service provider holds specific information to identify the recipient, or payee, of the payment together with details of the date, the amount and the Member State of origin of the payment as well as of whether the payment was initiated at the physical premises of the merchant. That specific information is particularly important in the context of a cross-border payment where the payer is located in one Member State and the payee is located in another Member State, in a third territory or in a third country. Such information is necessary for the tax authorities of the Member States (the 'tax authorities') to carry out their basic tasks of detecting fraudulent businesses and controlling VAT liabilities. It is therefore necessary that payment service providers make that information available to the tax authorities to help them detect and combat cross-border VAT fraud.

For payment service providers to report this information into national tax authorities, they first would need to uniquely identify the merchant and the location information of the legal entity. Given cross-border e-commerce goes beyond the borders of the European Union, any identification solution should be global in nature. Therefore, GLEIF suggests the EU Commission explicitly require payment service providers to report the LEI of the payee and payer in all payment transactions where a legal entity is an originator and/or beneficiary. The LEI is an international standard that connects to key reference information that enables clear and unique identification of legal entities including their status as active and operating, headquarters, legal address and ownership structure. Moreover, the Global LEI Repository 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 by all users without limitations.

An explicit requirement of the LEI would also be consistent with the Directive (EU) 2020/284, which states that "*On the basis of information they already hold, payment service providers are able to identify the location of the payee and the payer in relation to the payment services they provide, using an identifier of the payer's or the payee's payment account or <u>any other identifier which unambiguously identifies, and gives the location of, the payer or the payee</u>*" (italic, underline added).

From the Directive (EU) 2020/284 and the Survey, GLEIF understands that 25 cross-border payments received per payee will be introduced as a threshold for understanding whether those payments were received as part of an economic activity, and if yes, payment service providers will need to keep records of these payments. In the Survey, Question 24 asks the main challenges in monitoring this threshold.

GLEIF is of the opinion that indeed several challenges might arise in the monitoring this threshold particularly if the payee has multiple accounts in different Member States with different names. Given the 25 or more cross-border payments ceiling is reached, the record keeping and reporting obligations of the payment service provider would be triggered, it is essential that payment service providers exchange information relative to the payee in a systematic and efficient manner within the Union. If the payee information exchange by the payment service providers will be based on entity names, instead of their LEI, a manual intervention would be needed for reviewing and reconciling different entity names and trying to find if indeed the payee with different names actually points to the same payee. Name matching analysis is usually prone to error, given names may have aliases, spelling errors, alternate spellings, abbreviations, foreign translations especially when cross border activity is involved. Therefore, payee identification based on names would cause a high false positive detection rate and prevent payment service providers from easily identifying the payee information correctly. In turn, tax authorities would not be able to efficiently detect fraudulent businesses and control VAT liabilities. For reducing these challenges to a minimum level, GLEIF suggests information exchange and fraud detection could be better carried out with the precise LEI for each payee; rather than parsing names or referencing other proprietary siloed data. Relying on the LEI as the key identifier for identification of the payee would also enrich the usability and efficiency of the CESOP.

GLEIF would like to share a real life example provided by one of its partner firms. This particular EU based firm received an invoice for services provided. The invoice included the name of the firm providing the services, the expected address, the VAT number and the agreed upon amount. The invoice passed the internal review and payment was executed. A month later, the firm received a phone call from the supplier notifying that the payment was past due. To its surprise the firm learned the original invoice had been intercepted and a fraudulent account had taken the place of the account of the supplier. The firm then had to pay the invoice a second time – a considerable loss for an SME. Our partner firm pointed out that if the invoice had contained the LEI plus the account information then the fraudulent payment would never have been made. Instead, the reliance on manual verification and proprietary data, such as the account number, did not allow for an appropriate review. Should the invoice have had the LEI, the VAT and the account number, the bank could have leveraged the open public LEI data to confirm the identity of the recipient of the payment by cross referencing the LEI of the service provider and the account number on the invoice before proceeding with the payment. The sending bank would not have executed the payment unless the two pieces of information were confirmed.

GLEIF thinks that consistent use of the LEI in e-invoices and payments lifecycle would provide verified, authoritative information about the entities involved in payment transactions and guarantee security. GLEIF also has taken the necessary steps to include the LEI on the EU Electronic Address Scheme (EAS) code list so that the LEI can be used in EU eInvoicing.

GLEIF also would like to comment on the Question 30 of the Survey, which asks the most appropriate file format for the transmission of data to Member States.

GLEIF understands that the EU Commission considers different options for creating different or single standard file formats for all or different payment methods, for intra-EU or extra-EU payments. GLEIF recommends the LEI is considered as a mandatory data field in the standard file format adopted by the Commission; whatever format is decided. The standardization and harmonization of required data fields in standard file formats across borders would bring more transparency and efficiency for both reporting entities and the tax authorities.

There is also an opportunity for GLEIF to respond to Question 40 of the Survey, which asks what standards shall be used for payment service providers to transmit the unique identifier of each payment transaction.

GLEIF thinks that ISO 20022 should be used for payment service providers to transmit the unique identifier of each payment transaction. The Payment Market Practice Group (PMPG) suggested that the migration to ISO 20022, and use of the LEI within that migration, a key opportunity to rethink how reference data is sourced and used for payments. The PMPG provided that the incremental cost of adopting the LEI as part of the ISO 20022 migration will be minimal as firms will be making technology and process changes to adopt ISO 20022 more broadly, and the LEI is just one data element in the change process.

For example, as part of the adoption of ISO 20022, the Bank of England has concluded to mandate the use of the LEI for all payment transactions between financial institutions, and plans to work with key stakeholders, including HM Treasury and GLEIF to understand what actions would be necessary to support wider adoption of LEIs in the UK payments messages.

Lastly, given there are several references to the Business Identifier Code (BIC) in the Directive and the Survey, GLEIF would like to provide a clarification on the differences between the BIC and the LEI. BICs plays a key role in addressing messages to operational desks and routing financial transactions on the SWIFT network. Domestic and international payment systems within financial and non-financial institutions or regional and global payments market infrastructures such as Automated Clearing House, Real-Time Gross Settlement Systems and Payment Clearing Systems are based on legacy identifiers or the BIC. However, the BIC does not provide the authoritative source of entity identification like the LEI. A legal entity may have several associated BICs. The open source BIC-to-LEI relationship file published monthly by SWIFT and GLEIF demonstrates this.

