Response of the Global Legal Entity Identifier Foundation (GLEIF) to the Financial Action Task Force (FATF) Digitalization Questionnaire

December 2020

The Global Legal Entity Identifier Foundation (GLEIF) is pleased to provide comments to the Financial Action Task Force (FATF) Digitalization Questionnaire. GLEIF will focus its comments on using the Legal Entity Identifier (LEI) to ensure data interoperability, consistency, and comparability amongst financial institutions so as to enhance information sharing capabilities and better enable the fight against money laundering and terrorism financing at the global level.

First, GLEIF would like to respond to *Question 10: Please describe how new technologies allow greater effectiveness to be achieved, if compared to traditional approach*.

GLEIF would like to highlight that today AML screening processes are inefficient and ineffective as they require manual reconciliation of names and addresses. Even though 'natural persons' typically represent two-thirds of the entries on sanctions and watch lists, a high proportion of financial crimes involve the use of a company name. This is why identifying the legal entities that appear on these lists is crucial to curb financial crime.

Financial institutions confirm that manual reconciliation of legal entity names is particularly challenging across borders, given there are different languages, character sets, differences in translations, and abbreviations. For instance, a matching relationship between two records is only direct when a customer name exactly matches the name in the sanction list(s). However, the existence of more than one "Main Street Trading Inc" causes a tremendous number of false positives. To reduce false positives for legal entity clients, a consistent, quality controlled, and open means of identifying the client is needed.

GLEIF suggests that using the LEI, a machine-readable, globally recognized unique identifier, would enable automation in AML/sanctions screening. The LEI, a 20-digit alphanumeric code, would allow financial institutions to eliminate name matching thereby increasing compliance checks' efficiency, regardless of the technology solution used.

Therefore, GLEIF thinks that the success of new technologies or solutions will depend on the data sources that are leveraged. Suppose legacy systems or proprietary data prevails over open data or globally accepted unique identifiers. In that case, the financial industry will miss a significant opportunity to fight against financial crime globally and holistically. With the support of regulators, the financial sector should adopt the LEI as the Rosetta Stone for legal entities involved in financial transactions, thereby enabling automation for AML/sanctions screening and more efficient information exchange.

The LEI helps with digital identification and representation of legal entities as the LEI is already integrated into machine-readable financial statements, digital certificates and distributed ledger applications. For example, an LEI embedded in a digital certificate enables the recipient to conduct identity proofing for persons and entities, as well as the association between the two, in the digital sphere. By embedding the LEI in the digital certificate, the recipient has the benefit of holding cryptographically strong binding information about the legal entity and then performing the tasks of authentication and authorization independent of being online.

GLEIF demonstrated in 2019 how an eIDAS compliant certificate can be linked to a company's annual financial reporting in a completely machine-readable fashion via the LEI through the GLEIF's Annual Report of 2018. These certificates, for the first time, connect the role of the signatory to an organization through the LEI and can therefore be used to verify – automatically, through the shared LEI – that the filed document and the signatories represent the same organization. This allows any interested party to quickly and easily consolidate and verify information on a filing entity. The LEI embedded digital certificates could help financial institutions in onboarding their clients digitally.

GLEIF partners with stakeholders in Europe and around the world to pilot a solution which allows organizations to create and manage 'organization wallets' that confirm an organization's identity and verify employees' authority and other representatives to act on behalf of the organization. When digital credentials conform to the World Wide Web Consortium's (W3C) Verifiable Credentials Data Model, they are called verifiable credentials (VCs). These credentials can be used to securely identify authorized representatives when they execute an increasing number of digital business activities, such as approving business transactions and contracts, including client onboarding, transacting within import/export and supply chain business networks and submitting regulatory filings and reports. What makes the LEI so attractive in both the world of digital certificates and Self Sovereign Identity (SSI) solutions is its unique value proposition – a globally recognized standard for legal entity identification which connects to key reference information including their ownership structure for the legal entity.

Therefore, for fulfilling any objective that requires unique and unambiguous identity verification in a digital environment, the LEI can form the basis for ensuring interoperability across different system operators and making sure that these identities can be re-used in a wide range of financial services across borders.

GLEIF would like to respond to *Question 15. Has the adoption of new technologies had an impact on the regulatory framework (were new or additional requirements created)?*

Digitalization has triggered new ways of doing business, from digital onboarding to instant payments. And this digitalization is accelerated in a world where physical contact has become obsolete due to the Covid-19 crisis. The global regulatory framework regulating these new activities is now challenged to adapt quickly to a changing global financial system.

For example, FATF's Guidance on Digital ID published in March 2020 provided a very timely and useful framework for financial institutions who increasingly started to onboard their natural person clients remotely. On the contrary, the lack of similar guidance for legal entities during the Covid-19 crisis has caused fraudulent businesses to take advantage of this loophole in the international governance framework. For instance, in the EU, the European Anti-Fraud Office (OLAF) has opened an inquiry concerning the imports of fake COVID-19 related products. OLAF announced that approximately 20.000 businesses have been set up on e-commerce platforms that allow the selling of medical equipment without checking and verifying their identity. Some jurisdictions, such as the United States, reported an increasing propensity for money laundering activities due to the increase of anonymous companies.

Therefore, GLEIF sees the urgent need for adopting global standards and best practices by FATF and other international policymakers, where the entity identification is the key.

In the regional context, the European Union's European Systemic Risk Board (ESRB) in its recently published Recommendation highlighted that clear identification of the legal entities and the connections between them with the LEI is a key requirement for drawing a reliable map of the global economic and financial landscape and called to action all relevant parties to close the LEI gap in the EU. Specifically, it recommends introducing a Union framework on the use of the LEI by June 2023.

The Financial Stability Board, under G-20 Leaders' mandate, confirmed the urgent need and demand for making cross border payments cheaper, more accessible, and transparent for all parties in its cross-border payments roadmap report. As part of these efforts, the FSB, in its Stage 3 Report, stated that it will explore options to improve global adoption of the LEI with GLEIF, the Regulatory Oversight Committee, and national authorities. Beginning in October 2020, the FSB, in consultation with the Committee on Payments and Market Infrastructure, International Monetary Fund, World Bank, GLEIF, the International Organization for Standardization (ISO), and other stakeholders, started to explore the scope for, and obstacles to develop, a global digital Unique Identifier for cross-border payments, and potentially other financial transactions, that takes into account existing identifiers, including the LEI for legal entities. When the legal entities in payment messages are identified with their LEI, there will be clear standard identification of legal entities in payment transactions. Financial institutions can easily feed this information into the AML/sanctions screening processes that will allow more certainty in the screening of transactions digitally.

Additionally, the continued development of distributed ledger technology networks has enabled the development of virtual assets and new financial services players to enable transactions involving these assets. Specifically, the emergence of Virtual Asset Service Providers (VASPs) has triggered regulatory efforts for these new actors. GLEIF participated at the Joint Working Group's work on interVASP Messaging Standards (JWG), and the LEI was adopted as an optional field in inter-VASP Messaging Standard IVMS101. IVMS101 is intended for use in the exchange of required data between VASPs. This opens the door for leveraging the LEI to bring transparency and enhance consumer protection for crypto-assets and tokenization transactions. GLEIF expects to see more regulatory activity in this area.

GLEIF would like to respond to the Question 17. *In your opinion, what type of actions (both at international and national level) could assist in addressing the existing challenges*?

Financial firms are reviewing client onboarding processes for cost and efficiency savings, mainly due to the digitization of processes and workflows. However, the crucial question is how (and if) financial institutions will achieve digitization before adopting a data-driven approach in their client lifecycle management processes? As financial firms adapt their processes and workflows for digitization, there is a genuine risk that siloed, proprietary approaches again serve as the foundation for transformation – and this is where action from policy makers in setting interoperable standards can help ensure an open interoperable future.

National and international policymakers can encourage LEI adoption as a means to remove siloes and barriers to cross-border financial monitoring and transactions. Today, human intervention is needed for "translation" of data, as machines or systems do not focus on interoperability. If the LEI is deployed as a key identifier for legal entities in systems, machines can communicate with each other in an automated way without any need for human intervention. Therefore, GLEIF thinks that policymakers should proactively intervene to establish best practices by leveraging the LEI.

In a recent report published by the Bank of International Settlements, the Global LEI Repository is already mentioned as a "non-documentary verification" source under the "Verification of identity of legal persons". The LEI was also added under the "potential additional information" column, next to "at a minimum" (basic requirements), and in the footnote, it is stated that subject to developments in the LEI project, this information may become required in the future. The Bank of International Settlements could make the LEI a required field; so that financial institutions' uptake for the LEI would surge.

Similarly, FATF could add the LEI in its related Recommendations, particularly on D. Preventive Measures and E. Transparency and Beneficial Ownership of Legal Persons and Arrangements, as a best practice that financial institutions should adopt as part of customer due diligence and record keeping requirements for legal entity clients. Having FATF measures endorse and allow reliance on the LEI as a identifier in AML and screening would signal to financial institutions that the LEI should be an essential component in these processes.

GLEIF would like to respond to the Question 23. *What kind of information is shared?*

GLEIF would like to provide information about the Danie Consortium, which enables the sharing of the legal entity reference data among participating financial institutions using the LEI as the linking identifier.

The Danie consortium was set up to help financial institutions improve their client reference data quality by benchmarking data with peers without revealing data sources and with encryption. The consortium was formed in late 2019 with the objective of enhancing data quality by using a distributed reconciliation engine and cryptographic transmission to securely and anonymously identify each member's data outliers by comparing their data to values submitted by other members. The consortium includes banks and data providers that decide on measures of quality of client reference data based on a matching key.

The DANIE community has developed and is using a reference data app called Datalign. Datalign uses the LEI as a matching key. Participants can benchmark all their datasets linked to LEIs, such as legal names, company addresses, Business Identifier Codes (BIC) and NACE codes. Datalign has been tested to manage 700,000 LEIs, allowing banks to load thousands of companies' worth of data on to the platform and submit 10 to 15 attributes, each one of which can be compared to data from the other banks.

This project's current stage does not include data reconciliation for KYC; therefore, the ultimate beneficial ownership is not shared among participating financial institutions.

GLEIF would like to comment on the Question 25. *Please describe the types of new technology used or under consideration to share/exchange/pool AML/CFT information amongst financial institutions (e.g., privacy enhancing technologies, such as homomorphic encryption or federated learning).*

The LEI plays a transformational role in creating a collaborative financial ecosystem. To enable financial institutions to respond to new regulatory compliance requirements and realize a variety of improvements to their customer due diligence processes, GLEIF has created a new operating role for financial institutions in the LEI issuance process, called the Validation Agent.

The LEI is not a stranger to the financial institutions as the LEI today is required more than 116 regulations worldwide. The legal entity clients of financial institutions that perform financial transactions in capital markets are mandated by various regulatory bodies across the world to have a LEI for reporting purposes. By doing so, regulators can paint a clear picture of who is involved in their markets, thereby enabling more effective risk management. To date financial institutions have not broadly adopted the LEI to improve their portfolio surveillance. In this respect, they are a step behind regulators in realizing the benefits from LEI adoption.

Until now, the process of obtaining an LEI is most commonly undertaken when an entity is onboarded by their financial institution, and has required the entity to liaise directly with an LEI issuing organization, thereby repeating many of the onboarding processes the entity just undertook. Considering that obtaining an LEI is a legal requirement for many clients, this process duplication can create frustration.

The Validation Agent Framework empowers banks to leverage their KYC, AML and other regulated business-as-usual onboarding processes to obtain an LEI for their customers during initial onboarding or a standard client refresh update. In other words, financial institutions acting as Validation Agents can liaise with the LEI Issuer on its client's behalf to 'validate' key identity data, such as the legal name and business registry information, confirming that these checks and processes have already been performed.

By expanding LEI issuance beyond legal entity clients that require an LEI for financial compliance, a Validation Agent can equip its whole business client base with globally recognized identities, which can be used across borders with any legally registered counterparty or supplier around the world.

In this way, financial institutions can use the LEI to solve the problem of cross-border trust for their clients worldwide. The Global LEI System is the only open, commercially neutral, standardized, and regulatory endorsed system capable of establishing digitized trust between all legal entitles, everywhere. As awareness of these enabling attributes increases, the Validation Agent role is also likely to be assumed by financial institutions seeking to become recognized leaders in identity management, positioning themselves as facilitators of global trade.

What's more, if the LEI becomes more prominent and available in AML reporting then regulators, in particular across borders or jurisdictions, will be better equipped to identify and trace illicit financial behavior, which in turn protects both businesses and the general public.

GLEIF is actively engaging with the global banking community to support trials of the Validation Agent Framework. In recent weeks, GLEIF announced the J.P. Morgan as the first Validation Agent of the Global LEI System.

As the number of the Validation Agents increases and the LEI population grows, there could be less effort needed to onboard a client with an LEI. The LEI would give a financial institution the first foundational step to perform further KYC checks. Through a single click or call to the GLEIF Application Programming Interface (API), data users could be directed to the Global LEI Repository and access the entity's open public reference data and relationship information without any fee barrier. Each LEI record also has a ChangeHistory and LastUpdateDate, which give users the most up-to-date picture about a legal entity.

GLEIF would like to provide comments for the Question 31. *Based on the above response, please describe the main obstacles associated with the use of emerging technologies to share/exchange/pool AML/CFT information between financial institutions*.

As per our response to Question 25, GLEIF sees financial institutions' interest in the Validation Agent operating model. The adoption of this model will eventually trigger the LEI growth, and financial institutions would benefit collectively for broader coverage of legal entities.

That being said, GLEIF also thinks that there are certain challenges for the wider roll-out of this model. The first is the resistance to change to the existing processes, legal agreement templates with clients, and procedures within the financial institutions. Although a better client experience sounds appealing for many financial institutions, improving their data management and making changes in the existing processes is not prioritized.

Although financial institutions confirm that regulatory mandates such as the LEI helped them to streamline their internal data management and clean their master data, it is sometimes hard to find the executive support without a regulatory requirement to drive the change.

GLEIF would like to provide comments for Question 33. *What kind of solutions could help overcome the challenges associated with the development or deployment of new technologies for information sharing/pooling (e.g., national, international, regulatory or other?)*

GLEIF thinks that there are two inter-related ways to break resistance to change: (1) crises and (2) regulatory mandate.

Generally, crises pave the way for regulators to push for more harmonization and improvements in the financial ecosystem. This is how the Global LEI System was born, at the aftermath of the financial crisis of 2008. The LEI is indicated as one of the most useful regulatory requirements by market participants.

Given the LEI is already used by financial institutions, a master data management approach can source and integrate LEIs, proprietary identifiers, and vendor identifiers from multiple systems, map them to each other and reconcile underlying data. This approach requires a strategic attitude towards entity data management.

GLEIF thinks that regulators, as they did in the past for other regulatory reporting regimes, could take steps such as requiring the LEI for Suspicious Activity Reports (SARs), identifying the LEI as a documentation source for customer due diligence, or incorporating the LEI into their AML monitoring programs.

GLEIF would like to comment on the *Question 35. Please describe the main benefits and/or challenges associated with the use of new technologies to analyze large data sets for AML/CFT purposes.*

Consistent, high quality and globally recognized identifier for legal entity clients is essential to AML programs in today's digital world. The LEI is the essential building block for legal entity "client identification" in AML programs. GLEIF suggests the LEI should be required for all Suspicious Activity Reports (SARs) prepared by financial institutions. Regarding the receipt and processing of SARs, the LEI's inclusion would streamline report processing and analysis. The inclusion of the LEI would guarantee a unique and unambiguous identifier is associated with the entity, instead of reliance on name matching. The LEI would also link to the direct and ultimate parents of the legal entity.

Supervisory authorities could avoid name matching and the associated manual reconciliations of client identity and instead focus on the report's substantive details. This would dramatically improve monitoring and record-keeping for SARs and, more broadly, in supervisor's own database of tracking legal entities. Data lineage is a key component to monitoring entities over time. As such, the LEI could be used as the primary entity identifier for tracking legal entities reported to Financial Intelligence Units, thus creating a historical record of repeated entities over time. The LEI could also be used to track all reports from each reporting financial institution historically. Aggregation of reported content could be achieved by associating the LEI of the entity to the LEI of the reporting FI.

A practical example: If the intelligence flow from a financial institution to relevant parties includes the LEI, the supervisory authorities and law enforcement agencies would have better intelligence regarding the entity's identity in question. Law enforcement, working through bilateral relationships, cannot know which bank has a footprint and so are hindered in finding intelligence that will progress the case. Making the LEI part of cross-border intelligence sharing mechanisms would bring maximum transparency to the global community. Practically, collection of the LEI of the financial institution A, B, C, D and the LEI of the legal entity X from all these institutions would facilitate law enforcement agencies' and supervisory authorities' data aggregation and help to see that the entity X poses a risk for the global financial community.

Lastly, GLEIF would like to respond to the *Question 37: Please provide case studies on past, ongoing or planned initiatives regarding the adoption, implementation and practice of the AML/CFT relevant technologies. This should include examples of tools that allow for greater information sharing, privacy enhancing technologies, Regtech and Suptech tools, including KYC utilities, transaction monitoring tools, etc*.

GLEIF would like to provide an update on its ongoing project in Africa, where KYC/AML requirements have emerged as a challenge with impacts to SMEs access to trade finance. According to a recent report published by the African Development Bank, stringent KYC rules have led to two effects in the region (i) More expensive to process small transactions for micro, small and medium enterprises (MSMEs). Many MSMEs have difficulties accessing trade finance as financial institutions operating in the region do not want to spend time and effort performing KYC checks for a new client. (ii) The number of international banks participating in trade finance has fallen.

Therefore, establishing a trusted, globally recognized identity is a first step to financial inclusion and overcoming challenges related to MSMEs proving their identity when seeking access to finance, including trade finance. Once registered in the Global LEI System, the MSME's reference data is recognized universally, available as open data, and distributed electronically free of charge thus providing transparency across the global marketplace. The starting point for this journey is through the integration of financial institutions in developing countries into the Global LEI System. By bringing financial institutions into the Global LEI System and leveraging their existing efforts in KYC, there is an opportunity to expand LEI issuance to MSMEs in Africa and create a pool of legal entities with LEI.

Moreover, equipping MSMEs with an LEI would help financial institutions to future-proof their operations in the KYC/AML and payments areas. With existing clear benefits and regulatory support, GLEIF would like to explore the cost and benefits of leveraging the identification and validation processes of financial institutions to enable LEI issuance for MSMEs in Africa. For this purpose, GLEIF has engaged a local expert to compile a project team of a local bank(s), LEI Issuers and relevant local regulators. In the specific project term, the financial institution would complete an onboarding process to become a validation agent.