Response of the Global Legal Entity Identifier Foundation (GLEIF) to the European Central Bank on its Digital Euro Consultation

January 2021

The Global Legal Entity Identifier Foundation (GLEIF) is pleased to provide comments to the European Central Bank on its Digital Euro Consultation. GLEIF will focus its comments on the use of the Legal Entity Identifier (LEI) in the conceptual and design process of digital Euro and how the LEI can help to improve the efficiency and speed of payments, while also facilitating competition and innovation within the Union.

First, GLEIF would like to respond to Question 7: *"What requirements (licensing or other) should intermediaries fulfil in order to provide digital euro services to households and businesses? Please base your answer on the current regulatory regime in the European Union."*

In today's regulatory framework in the European Union, supervised intermediaries (e.g., banks) are responsible for identification and onboarding of entitled users, be that natural persons or legal entities, and routing domestic and cross border payment transactions. Identification of relevant entities and performing customer due diligence within the European Union is regulated by the Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

GLEIF is aware that the European Commission plans to leverage the existing Directive (EU) 2015/849 for a future EU rulebook to bring more clarity in the applicable rules and the division of responsibilities regarding cross-border issues. The EU Commission will table its conclusion for the new EU rulebook by the end of Q1 2021. In its response to the Commission's public consultations on this area, GLEIF suggested that the use of the LEI by financial institutions can help to effectively identify their customers during the due diligence phase as the LEI is an open, global, digitized standard for entity identification verification in the form of a 20-digit alpha-numeric code. Use of the LEI consistently at the Member State level and the EU level can reduce errors related to language ambiguity, human interpretation, and manual intervention.

Another advantage that the LEI presents is that the LEI broader interoperability enables it to be integrated seamlessly into both centralized and decentralized digital identity management systems, together with the eIDAS-compliant digital certificates that are already harmonizing the use of e-signature technologies across the EU. Therefore, regardless of the European Central Bank's decision for a centralized or a decentralized approach for its digital euro back-end infrastructure, the LEI can be used and recorded by users and/or supervisor intermediaries to identify all parties in a transaction, including settlement agents acting on behalf of their customers.

This approach would build on lessons learned from other EU regulatory implementations which have introduced siloed, single purpose identifiers to facilitate a specific application. For example, the Payment Services Directive (EU) 2015/2366 (PSD2) introduces a mix of approaches for identifying legal persons. It introduces a new identifier for Third Party Payment Service Providers (TPPs) (the PSP identifier) – this is administered and maintained nationally by the National Competent Authority (NCA). The PSP identifier

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must be embedded in the TPP's eIDAS/PSD2 Certificate to enable authentication between TPPs and banks. So within one regulation the following results:

- the eIDAS/PSD2 certificate is not usable for any other digital transaction partly because it contains an identifier customized for the PSD2 implementation
- each NCA maintains a register with its own identifiers for banks, TPPs, and the NCA itself thereby rendering it difficult to aggregate data within the PSD2 ecosystem
- the PSP ID identifier cannot be used to connect to other data sources, enable analysis, or facilitate any other digital communications outside the PSD2 protocol.

What if the LEI were used instead? The eIDAS/PSD2 certificate could be parsed and, using the publicly available LEI lookup API, banks could get a clearer picture of the TPP it is engaging with. TPPs would not need to put in place another process for managing another company identifier. NCAs could implement a less complex structure for recognizing TPPs. In total, all parties gain in efficiency and the PSD2 framework is rendered more interoperable, thereby also facilitating a more integrated EU payments market. GLEIF is aware that the Commission will launch the review of PSD II in 2021 and GLEIF will its share feedback with the Commission.

Another example is the EU Directive 2019/1151 amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law. This Directive introduces the EUID as a new published information on Companies regulated under the Company Law Directive. The EUID was originally created to facilitate digital communications between EU business registers participating in BRIS. The EUID covers a very limited amount of legal entities within the EU and has never been used to facilitate any regulatory initiative or private sector communications on legal entities. Rather than introducing the LEI as a universal identifier for EU Companies, the Directive increases complexity and confusion by creating yet another single, limited use identifier for certain types of legal entities. The European Systemic Risk Board recently produced a report recommending the following in its Recommendation of 24 September 2020 on identifying legal entities (ESRB/2020/12):

"*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)…*"

With this recommendation the ESRB recognizes that the LEI is an important tool for ensuring the 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 in financial ecosystem.

In any case, despite needs to further improve the existing regulatory framework within the EU independent from the digital euro initiative of the European Central Bank, GLEIF would like to reemphasize the importance of unique identification of legal entities in payment transactions so as to ensure the digital euro architecture enables a faster, more efficient and reliable payments infrastructure.

GLEIF would like to respond to Question 10 - "*What should be done to ensure an appropriate degree of privacy and protection of personal data in the use of a digital euro, taking into account anti-money laundering requirements, and combating the financing of terrorism and tax evasion?*"

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In today's financial system, KYC checks and identification of entities is still challenging for financial institutions due to the lack of a standardized approach to legal entity verification. A research report produced by Loudhouse on behalf of GLEIF found that financial institutions on average use 4 different identifiers for a legal entity client. Using multiple identifiers leads to inconsistent information, a drain on resources as reconciliation of different identifiers requires manual intervention, and lack of transparency due to reliance on proprietary identification systems. Identifiers of legal entities are easily obtained from a host of different issuers but the associated reference data are not kept up-to-date in a systematic way. The challenges for keeping the client reference data up-to-date continue even after the client is onboarded. This includes regular verification of business card information and changes to the ownership structure. Overall, only two thirds of financial institutions believe they hold accurate client information.

The European Central Bank indicates in its Report in a digital euro if the legal identity of digital euro users were not verified when they access services, any ensuing transaction would be essentially anonymous. European Central Bank rightly highlights that anonymity should be ruled out, not only because of legal obligations related to money laundering and terrorist financing, but also in order to limit the scope of users of the digital euro when necessary – for example to exclude some non-euro area users and prevent excessive capital flows, (Requirement 13) or to avoid excessive use of the digital euro as a form of investment (Requirement 8). If users are identified when they first access digital euro services, different degrees of privacy can still be granted by both the issuer (the Eurosystem) and the providers of intermediary services. That being said, the European Central Bank suggests that the privacy could be selective and the system operator could permit only certain types of transactions to be executed without registering the identity of payer and payee.

GLEIF would like to highlight the potential problems relative to the selected privacy and suggests that digital euro transactions could be fully transparent to the operator of the infrastructure who should nevertheless guarantee data protection, as is typically the case with electronic payments currently. Particularly for legal entity payers and payees, leveraging the open, publicly available Global LEI Repository can help to reinforce trust in the privacy model as LEI reference data does not contain personal information. Relaxing privacy requirements or imposing registration obligations only for large-value transactions could create holes in the anti-money laundering landscape. In some cases, criminals only make transactions in small amounts for not being tracked. Without identifying and registering these actors properly, it is not possible to track the frequency of their transactions in an automated way. The only way to enable fully automated, straight-through processing is to use the LEI in payment transactions and financial messaging on a consistent and standard basis.

The benefits of the LEI in payments were elaborated in a joint paper published by the GLEIF Chairman, Gerard Hartsink and Bank of England's Executive Director, Victoria Cleland. In this paper, Hartsink and Cleland highlighted that consistent use of the LEI in the payments landscape could bring several benefits for stakeholders, including payment service providers, payment service operators, and end-users. Payment service operators can access richer data through the adoption of the LEI in ISO 20022 payments messages. Through integrating the LEI in their automated processing, payment service providers could support their KYC and client entity onboarding processes, reduce false positives in AML alerts and enhance their correspondent banking relationships without compromising privacy of their client entities.

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For the identification of senior managing officials and beneficial owners, GLEIF would like to provide an update on its latest work in Verifiable Credentials (VCs). Thanks to advances in distributed ledger/blockchain technology, digital identity management with the additional feature of decentralized identity verification is now possible. Based on a concept known as Self Sovereign Identity (SSI), this new approach to authentication and verification of digital identity began as a means by which a person, the identity owner, has ownership of his/her personal data together with control over how, when, and to whom that data is revealed. In several proof of concepts (PoCs), GLEIF challenged SSI providers to extend the basic concept of "individual wallets" and to create "organization wallets". In these wallets, the basis for identity is the organization's LEI, and the VCs issued to persons in their official roles within or in relation to the legal entity are tied to the organization and its LEI. Critical to this is the fact that the contents of the wallet credentials, in the form of a digital schema, can be designed by each organization to cover the particular identification and verification needs that the organization may have. The initial PoCs conducted by GLEIF simulated a regulatory filing. In this scenario, the SSI provider and GLEIF enabled a trust chain by connecting VCs anchored in the blockchain. The regulator was able to verify the authenticity of the VCs of persons in official roles at the legal entity, the legal entity itself, the LEI Issuer, as well as GLEIF. Work recently has begun by the International Standardization Organization (ISO) on an international standard for identifying official organizational roles, that is planned to be used within these credentials to clearly state the roles of persons acting on behalf of legal entities.

GLEIF would like to submit its comments for the *Question 14 – "What would be the best way to integrate a digital euro into existing banking and payment solutions/products (e.g. online and mobile banking, merchant systems)? What potential challenges need to be considered in the design of the technology and standards for the digital euro?*"

GLEIF strongly encourages the European Central Bank to design the technology and rules for the digital euro in a way to enable interoperability of existing banking and payment solutions/products.

The cross-border payments landscape is evolving in the direction of increasing efficiencies, richer data utilization and greater international harmonization through the adoption of the ISO 20022 standard. The ISO 20022 standard was updated in 2016 to include the ability to verify financial institutions using an LEI code instead of a BIC. BICs are primarily bank codes and not a unique entity identifier whereas LEIs can be obtained by any company wishing to trade on the financial market and only one LEI can be attributed to a legal entity.

This addition allows a much broader range of companies (e.g. FinTech) to standardize their payment messaging in line with the ISO 20022. It also allows companies to speed up current Know Your Customer requirements that are often too costly and ineffective. There is a general industry support for broader adoption of the LEI along with the ISO 20022 standard. The European Central Bank also incorporated ISO 20022 for its Target 2 and Euro1/Step1 market infrastructure, which will go live in November 2022. However, although the LEI is already incorporated as a data field in ISO 20022 messages, bank markets, including the EU, allow optional use of the LEI. GLEIF suggests that this is an excellent opportunity for all significant markets to mandate the LEI as part of their migration strategy.

Allowing the LEI only on an "if available" basis, also for digital euro transactions, would cause policy makers and practitioners to lose themselves in the sea of proprietary/local identifiers. Using a local identifier, instead of a global and digital one, would be the main challenge in operationalizing the digital euro infrastructure given system-to-system communication or connectivity between financial

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institutions and Eurosystem's infrastructure can only work in an interoperable ecosystem. If the ECB makes the LEI mandatory for all intermediaries, settlement agents and their legal entity clients, then challenges relative to identification and interoperability would be solved at the very early stage.

Lastly, GLEIF would like to respond to the Question 18: "*What role can you or your organization play in facilitating the appropriate design and uptake of a digital euro as an effective means of payment?"*

As an open, digitized identification standard, the LEI enables financial institutions to conduct fully automated, straight-through processing. By enabling firms to replace outdated manual processes, the LEI increases both the speed and the effectiveness of client onboarding and ongoing compliance checks. This includes improving screening against sanctions and watch lists thereby enabling new efficiencies for both institution and client, lowering costs significantly.

In the fight against terrorism financing and money laundering among legally registered entities, there is no other identification tool as powerful.

For example, Piers Haben, Director of Banking Markets, Innovation & Consumers from the European Banking Authority highlighted that "*The mandatory use of common identifiers in reporting frameworks but also in all public information would allow to improve the quality of the data, reduce redundancy, enable data processing, aggregation and calculation, as well as assure the comparability between data from different sources and times. A further increased use of LEI could potentially support the fight against money laundering and terrorist financing during both onboarding and subsequent monitoring of the business relationship and associated transactions to detect suspicious transaction and make the application of CDD measures more efficient*."

In the Stage 2 Report published by the FSB, the LEI is suggested as a unique identifier for precisely identifying the beneficiary and originator in payment messages. As part of the "Focus area D: Increase data quality and straight-through processing by enhancing data and market practices", the Report highlighted that poor data quality and limited standardization of data exchange make cross-border payments more complex to process, in turn affecting their speed, price and transparency. Promoting the adoption of common message formats directly mitigates the friction around fragmented and truncated data. As one of the leaders of this work, Bank of England's Victoria Cleland, emphasized that further adoption of the LEI and achieving goals in data standardization would also help to achieve other building blocks on KYC and information sharing in enhancing cross border payments. And in its concluding Stage 3 report the LEI features prominently as part of the solution for making cross border payments cheaper, more accessible, and transparent for all parties.

As part of the planning of the Stage 3 report, GLEIF will continue to work with FSB for further adoption of the LEI in cross border payment messages. GLEIF would be happy to support the European Central Bank in the design of the digital euro, particularly areas related to identification and verification of parties to a digital euro transaction.

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