

Response of the Global Legal Entity Identifier Foundation (GLEIF) to the European Commission Consultation Document Proposal for an Initiative on Sustainable Corporate Governance

February 2021

The Global Legal Entity Identifier Foundation (GLEIF) is pleased to provide comments to the European Commission Consultation Document Proposal for an Initiative on Sustainable Corporate Governance. GLEIF will focus its comments on using the Legal Entity Identifier (LEI) in a mandatory EU due diligence framework through the supply chains for mitigating the negative sustainability impacts, such as climate change, environmental protection, and human rights.

First, GLEIF would like to respond to *“Question 2: Human rights, social and environmental due diligence requires companies to put in place continuous processes to identify risks and adverse impacts on human rights, health and safety and environment and prevent, mitigate and account for such risks and impacts in their operations and through their value chain. In the survey conducted in the context of the study on due diligence requirements through the supply chain, a broad range of respondents expressed their preference for a policy change, with an overall preference for establishing a mandatory duty at EU level. Do you think that an EU legal framework for supply chain due diligence to address adverse impacts on human rights and environmental issues should be developed?”*.

First, GLEIF agrees with the Commission to extend the due diligence risk assessment for all involved parties in a given value chain. The concept of the “value chain” fits well with the Commission’s broader definition of the supply chain, which involves a company’s “business relationships” and includes subsidiaries as well as suppliers and subcontractors.

GLEIF is aware that some Member States already have adopted legislation on sustainable corporate governance (France, Netherlands, Italy), while others consider action (Germany, Finland, Sweden, Austria, Denmark, Belgium, Luxembourg). However, as underlined in the previous Inception Impact Assessment published by the Commission, Member States’ actions alone are unlikely to be sufficient and efficient as sustainability problems are of a global dimension and have cross-border effects (climate change, pollution).

Many companies are growing and establishing subsidiaries or operations networks EU-wide or even global. Even smaller companies have cross-border supply chains. Furthermore, national intervention alone is likely to result in market fragmentation, which increases the costs for companies as well as for investors and other stakeholders. Finally, an EU-wide legislation would create leverage and enable building a global level playing field for all EU companies to operate on sustainable terms.

Therefore, GLEIF thinks that it is essential to develop an EU legal framework for supply chain due diligence to address adverse impacts on human rights and environmental issues. GLEIF invites the Commission to have a more prescriptive rule-setting; so that the EU can achieve harmonization of supply chain due diligence.

GLEIF would like to respond to Question 14: *For the purposes of this consultation, “due diligence duty” refers to a legal requirement for companies to establish and implement adequate processes with a view*

to prevent, mitigate and account for human rights (including labor rights and working conditions), health and environmental impacts, including relating to climate change, both in the company's own operations and in the company's the supply chain. "Supply chain" is understood within the broad definition of a company's "business relationships" and includes subsidiaries as well as suppliers and subcontractors. The company is expected to make reasonable efforts for example with respect to identifying suppliers and subcontractors. Furthermore, due diligence is inherently risk-based, proportionate and context specific. This implies that the extent of implementing actions should depend on the risks of adverse impacts the company is possibly causing, contributing to or should foresee. Question 14: Please explain whether you agree with this definition and provide reasons for your answer.

As highlighted in GLEIF's response to Question 2, GLEIF agrees that the company shall make reasonable efforts to identify suppliers and subcontractors. The Commission's [Final Report on the study on due diligence requirements through the supply chain](#) highlights that just over a third of business respondents are undertaking due diligence which considers all human rights and environmental impacts, and a further third undertake due diligence only in certain areas.

Moreover, most of the businesses who undertake due diligence indicated that third party impacts are included for first tier suppliers only (i.e. the first layer of business relationship in the supply chain). Current due diligence practices beyond the first tier and for the downstream value chain are significantly lower by comparison.

Therefore, GLEIF proposes that the Commission could develop a rule-setting based on the risk level and context, similar to today's due diligence performed by financial institutions. For small suppliers, in less risky sectors or geographies where there are recognized processes and procedures, for example, for environmental protection or human/labor rights, companies could perform a simplified due diligence. Under the scope of this simplified due diligence, the aim could be only the identification of suppliers and/or subcontractors in a given supply chain. For larger suppliers in more risky sectors, for example the extractive industry, the Commission could ask corporates to perform "enhanced due diligence" where the corporates need to go beyond the identification of suppliers through simplified due diligence. With enhanced due diligence, companies would need to take into account all human rights and environmental impacts of business relationships.

GLEIF suggests that the Commission prescribes mandatory data elements, identifiers and documents to be collected as part of the due diligence process to create a harmonized and equal level for all corporates across the Union. GLEIF invites the Commission to consider the LEI as a mandatory data element for identifying and reporting suppliers, subsidiaries and other relevant entities across the supply chain for creating legal certainty and clarity. This standard data collection would benefit the EU with its analysis and assessments of compliance.

The inclusion of the LEI, a global standard for unique identification of legal entities, can ensure maximum transparency, interoperability and clear communication with investors and supervisory authorities.

By mandating the LEI as part of due diligence in supply chains, the EU Commission would introduce a standardized, uniform approach for entity identification across supply chains. This would also benefit companies as it would ensure transparency and clarity regarding the identities of the suppliers with which they are engaging. 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 establish their own due diligence protocol.

GLEIF would like to respond to Question 15: *Please indicate your preference as regards the content of such possible corporate due diligence duty (tick the box, only one answer possible). Please note that all approaches are meant to rely on existing due diligence standards, such as the OECD guidance on due diligence or the UNGPs. Please note that Option 1, 2 and 3 are horizontal i. e. cross-sectorial and cross thematic, covering human rights, social and environmental matters. They are mutually exclusive. Option 4 and 5 are not horizontal, but theme or sector-specific approaches. Such theme specific or sectorial approaches can be combined with a horizontal approach (see question 15a). If you are in favour of a combination of a horizontal approach with a theme or sector specific approach, you are requested to choose one horizontal approach (Option 1, 2 or 3) in this question. Question 15b: Please provide explanations as regards your preferred option, including whether it would bring the necessary legal certainty and whether complementary guidance would also be necessary.*

GLEIF thinks that Option 2 “Minimum process and definitions approach” should be leveraged by the Commission. The Commission should define a minimum set of requirements regarding the necessary processes that should be applicable across all sectors. Minimum requirements could be complemented by sector-specific guidance or further rules, where necessary.

GLEIF suggests that easy, fast, and transparent access to a central open data source about legal entities' identity is key for performing basic due diligence and bringing legal certainty to contractual relationships. Thanks to the Global LEI Repository, a corporate can freely trace the identity of a supplier/subcontractor at no cost to access this data. 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 entities in 200+ jurisdictions by all users without limitations.

Bringing the LEI mandate would be a significant step towards responding to the European Systemic Risk Board's [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)...” and until then “...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”.*

GLEIF would like to respond to Question 16: *“How could companies’- in particular smaller ones’- burden be reduced with respect to due diligence? Please indicate the most effective options”.*

In the Commission's [Final Report on the study on due diligence requirements through the supply chain](#) it is stated that current due diligence practices are slightly less established within SMEs compared with larger companies with over 1,000 entities. The survey results published in the same report implies that there is an overall preference for regulation to apply to all companies regardless of size of the business

For fulfilling the first step in due diligence, identification of a counterparty, all companies can easily conform to use of a single global identifier, the LEI. Use of a consistent standard would enable further downstream innovations. For example, recognizing the value of the LEI for SMEs, the Bank of England has suggested that businesses could pull their data together under a single identity, the LEI, and create a portable credit file to shop around for their financing needs. And because of its global recognition, the LEI will help businesses access finance for cross-border trade, set their identity in a secure fashion vis-à-vis new business relationships and eventually increase their business value.

GLEIF would like to respond to Question 17: *“In your view, should the due diligence rules apply also to certain third country companies which are not established in the EU but carry out (certain) activities in the EU? Question 17b: Please also explain what kind of obligations could be imposed on these companies and how they would be enforced.”*

GLEIF thinks that a new rule setting should also apply to third-country companies not established in the EU. Today's supply chain relationships and value creation are rather complex and global. Moreover, these third countries and the legal entities registered in these third countries often are used to perform activities that might adversely impact the environment, human, or labour rights.

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 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 and reason(s) for updates of the LEI information.

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'.

Practically, GLEIF thinks that corporates shall ask the LEI of their suppliers before doing business. A “no LEI, no trade” rule, which was introduced as part of the Markets in Financial Instruments Regulation in 2018 helped bring transparency to EU financial markets; this same principle transparency can be extended to suppliers by leveraging the LEI in due diligence requirements.

GLEIF currently works on a project with Centre for Financial Regulation in South Africa and Inclusion and Cornerstone Advisory Plus of Senegal to explore the costs and benefits of involving banks in the issuance of LEIs to SMEs in Africa. Through a new operational model called Validation Agent, GLEIF encourages financial institutions to leverage their Know Your Customer (KYC) and onboarding processes for the identification and validation needed to issue an LEI, a global identity. These businesses equipped with the LEI can establish relationships with buyers in a secure and transparent way as they can prove who they are, a prerequisite of any due diligence process.