# Response of the Global Legal Entity Identifier Foundation (GLEIF) to the European Commission's Initiative titled ESG ratings and sustainability risks in credit ratings

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The Global Legal Entity Identifier Foundation (GLEIF) is pleased to provide comments to the European Commission's Initiative titled ESG ratings and sustainability risks in credit ratings. GLEIF will focus its comments on using the Legal Entity Identifier (LEI) as a data element in ESG reporting to increase ESG rating transparency at the entity level and facilitate comparability of ESG data exchange.

Investors must be able to identify quickly the entity and the entity's subsidiaries in which they are investing. Let us imagine a Danish investor who plans to invest in a Swedish fashion company. Would this investor's investment decision change if this Swedish fashion company’s subsidiaries in Bangladesh does not consider supplier risks? How can this investor access the relationship information on the headquarters company and subsidiaries through a single data source, ideally in an easily consumable and machine-readable format? A similar scenario can be extended to financial institutions. Imagine that this Swedish fashion company applies for a sustainability-linked loan with a financial institution. How can this financial institution analyze the entity's eligibility for this type of loan and make its environmental, social, and governance (ESG) risk assessment ideally in an easy and transparent way?

A key challenge in ESG reporting, data collection and data exchanges today is the lack of standardization for entity identification. This makes it difficult to find, compare and consume ESG data globally – leading to a lack of transparency and inefficiencies. Without a clear, standardized and global entity identification system ESG reports lose value as it is not easy to evaluate performance indicators across different reporting regimes or jurisdictions. There are innumerable national and regional standards for entity identification across the world and while different identifiers serve national needs, they can create significant conflicts and inefficiencies when reconciling data across geographical borders. And these geographical borders could apply to the movement of goods and services or company structures.

GLEIF welcomes the Commission’s study on the transparency around data sourcing and methodologies of ESG ratings. Starting ESG data collection with a holistic entity identification approach via is the foundational step to achieve transparency at the entity level. Without ensuring transparency at the entity level, it is not possible to achieve the timeliness, accuracy and reliability of ESG ratings. Moreover, it is also equally important to know from a supervisory point of view, who the rating provider company is, thereby, supervisors can analyze any potential conflicts of interest and mitigate any associated risks.

The Progress report on bridging data gaps published by the Network for Greening the Financial System (NGFS), a network of 83 central banks and financial supervisors, highlights that an obstacle to accessing and making use of existing climate-related data is the lack of unique identifiers, which are crucial for interlinking climate-related data and financial data. The LEI can help to link financial and non-financial information. GLEIF agrees that non-financial reporting and financial reporting are currently not formally connected, leaving potential gaps, overlaps and a lack of coherence. The LEI is in a perfect position to connect non-financial reporting and financial reporting given the LEI is already included in 124 financial markets rulemaking from around the world. For example in the EU, all publicly listed companies shall report their LEI according to European Single Electronic Format (ESEF) requirements. ESEF's mandatory inclusion of an LEI within financial reports automatically links the filing entity to its annually verified LEI reference data – such as name, registered address and corporate ownership structure - held within the Global LEI Index, which is free to access online. This empowers market participants who rely on official documents to inform strategic decisions (e.g., traders, investors, regulators) to quickly and easily consolidate and verify information on a filing entity. Similarly, the Sustainability Accounting Supervisory Board included the LEI in its proposed XBRL taxonomy for companies which have reporting obligations under the ESEF reporting guidelines and thereby recognized the unique role of the LEI as a global and digital entity identification solution for ESG reporting. When the LEI is extended to non-financial reporting, location of firms and supply chains can be collected through publicly available Global LEI Repository at a very granular and transparent manner, which is crucial for assessing physical and transition risks. For example, the U.S. Customs and Border Protection is launching a Global Business Identifier Evaluative Proof of Concept (EPoC)which aims to determine a single identifier solution that will uniquely discern main legal entity and ownership; specific business and global locations; and supply chain roles and functions. The LEI is one of the three identifiers involved in the EPoC. The linkage of financial and non-financial reporting can also help the standardization of data sources across ESG rating providers.

European supervisors already recognize the LEI's value in non-financial reporting. For example, the Eurosystem highlighted the importance of the LEI for linking financial and non-financial information and other data sources in its response to the European Commission (EC) public consultations on the Renewed Sustainable Finance Strategy and the Non-Financial Reporting Directive review. Eurosystem also emphasized that the LEI would enable digital-age innovation and thus foster potential growth in new markets and reduce costs and operational risks of the reporting entities. The European Commission has adopted Commission Delegated Regulation (2022/1931) which supplements the Sustainable Finance Disclosure Regulation ((EU) 2019/2088), where the LEI is required under Article 2, where available, and, Appendix II (Environmental and/or social characteristics), Appendix III and V (Sustainable investment objective).

In ESMA's report assessing the implementation of ESMA's Guidelines on the disclosure of ESG factors in credit rating agency (CRA) press releases, ESMA highlights that converting .PDF documents to text raises the risk of information being lost during the conversion process.

Therefore, as highlighted in the NGFS report, the use of the identifiers, including the LEI, and digital reporting of ESG information can improve supervisory efforts, transparency of ESG ratings and increase comparability of ESG data.