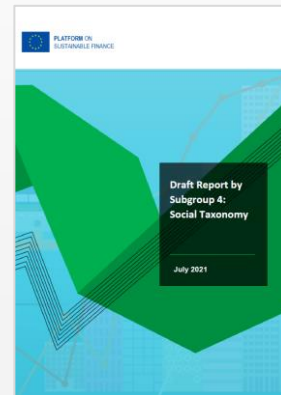


The EU Social Taxonomy Draft Report

Promising buildings blocks



What is a (social) taxonomy?



A **classification system** and a set of **disclosure requirements**. It aims at creating a **common language** and serves as a **compass** for market participants who want to promote or pursue sustainable characteristics or objectives



A **law** that regulates certain business-related social aspects like pension schemes or minimum wages

It will **not include** “hard” corporate governance factors such as, cumulative voting, dual-class share structure, majority voting, poison pills and shareowner rights

What is the purpose of a social taxonomy?

- **Help investors identify opportunities** to contribute to finance solutions around ensuring **decent work, enabling inclusive and sustainable communities and affordable healthcare and housing**
- To **direct capital flows to entities and activities** that operate with **respect for human rights and good corporate governance**
- To **support capital flows to investments that improve the living conditions** especially for the **disadvantaged**

Who are the authors?

The Subgroup 4 of the Platform on Sustainable Finance wrote this report. Its role is to:

1. **Explore extending the taxonomy regulation to social topics** (elaborate social objectives, work out a structure of a social taxonomy, identify approaches to substantial contribution and do no significant harm, reflect on governance, business ethics, anti-bribery and tax compliance, consider harmful activities, suggest a relationship between a green and a social taxonomy)
2. **Advise the European Commission on the functioning of the Article 18 of the Taxonomy Regulation**, which requires the respect of international labour standards and human rights

Features of the social taxonomy

Inspiration from environmental taxonomy

This taxonomy **follows the steps of the green taxonomy** by first defining social objectives, then substantial contributions to achieving these objectives and finally do no significant harm criteria, so that contributing to achieving one objective is not detrimental to the others

Not science-based

The foundation of this Taxonomy consists of **internationally agreed authoritative norms and principles*** that take the place of “science”

2. * Sustainable Development Goals (SDGs), OECD Guidelines for Multinational Enterprises, the UN Guiding Principles on Business and Human Rights, the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work, the International Bill of Human Rights, and the European Pillar of Social Rights.

Context: the need for investment in social sustainability

Global Context



Covid-19

More people in situation of extreme poverty & lack of funding for social needs



Growing inequalities

Growing gap between rich and poor impeding growth & creating political and social unrest



“Just Transition”

Need to accompany the fair transition towards a climate-neutral economy

Corporate/Investor Context



Social Bonds

Rise of social bonds issues since the beginning of the pandemic & investors increasingly looking for social investment opportunities



Social & Human rights risks

Multidimensional risks faced by investors when social and human rights are violated by companies



Business opportunities

Increasing initiatives* by investors to respect human rights

Legislative Context



European Green Deal

Reach net zero emissions of GHG by 2050, decouple economic growth from resource use and “**Leave no person and no place behind**”



Social Climate Fund

(“Fit for 55” legislative package)

EUR 72.2 billion from 2025 to 2032 to finance temporary direct income support for vulnerable households & to support measures and investments that reduce emissions in road transport and buildings sectors

Private investments are needed to finance social welfare. This thinking involves **the prevention of social harm** (i.e., that companies implement systems to ensure human rights are respected) as well as **contribution to the improvement of the provision of basic goods and services**, especially to people and groups in situations of vulnerability

However, there is no widely accepted definition and measurement of social sustainability. Just as for green transition, lack of definitions and a standardized classification system is a hurdle to steering the capital towards socially sustainable activities.

3. *Investor initiatives on human rights and living wage: Investor Alliance for Human Rights, the PRI 2020 Human Rights Framework, or the Corporate Human Rights Benchmark

Proposed layout of the EU social taxonomy & SC/DNSH objectives

HORIZONTAL DIMENSION (ENTITY-LEVEL)

Criteria covering **processes** in place in a company aiming at respecting stakeholder's rights

VERTICAL DIMENSION (ACTIVITY-LEVEL)

Criteria covering activities for social **products & services** based on the concept of the right of an adequate standard of living*

Objectives

Sub-objectives

ENSURING DECENT WORK (W)

W1. Social dialogue | **W2.** Non-discrimination and equalities | **W3.** No child/forced labour | **W4.** Decent employment conditions | **W5.** Health and safety | **W6.** Skills, learning & employment generation | **W7.** Social protection | **W8.** Impacts on workers in the value chain

PROTECTING CUSTOMER INTERESTS (C)

C1. Safety and quality of products & services
C2. Protection of consumers' personal data, cybersecurity
C3. Responsible marketing practices

ENABLING INCLUSIVE & SUSTAINABLE COMMUNITIES (S)

S1. Equality and inclusive growth
S2. Impacts on land and livelihoods
S3. Safety and security, human rights defenders, civic space

IMPROVING ACCESSIBILITY OF PRODUCTS & SERVICES FOR BASIC HUMAN NEEDS (N)

N1. Water including waste water management
N2. Food
N.3 Housing
N.4 Healthcare incl. care work
N.5 Education including vocational training

IMPROVING ACCESSIBILITY TO BASIC ECONOMIC INFRASTRUCTURE (B)

B1. Transport
B2. Telecommunication and internet
B3. Clean electricity
B4. Financial inclusion

GOVERNANCE

GOOD SUSTAINABLE CORPORATE GOVERNANCE (G)

Competencies and diversity of the highest governance body and senior management (gender, skillset, experience, background), including employee participation; Executive remuneration linked to environmental and social factors in line with companies' own targets; Anti-bribery & anti-corruption; Responsible auditing; Responsible lobbying and political engagement

TRANSPARENT AND NON-AGGRESSIVE TAX PLANNING (T)

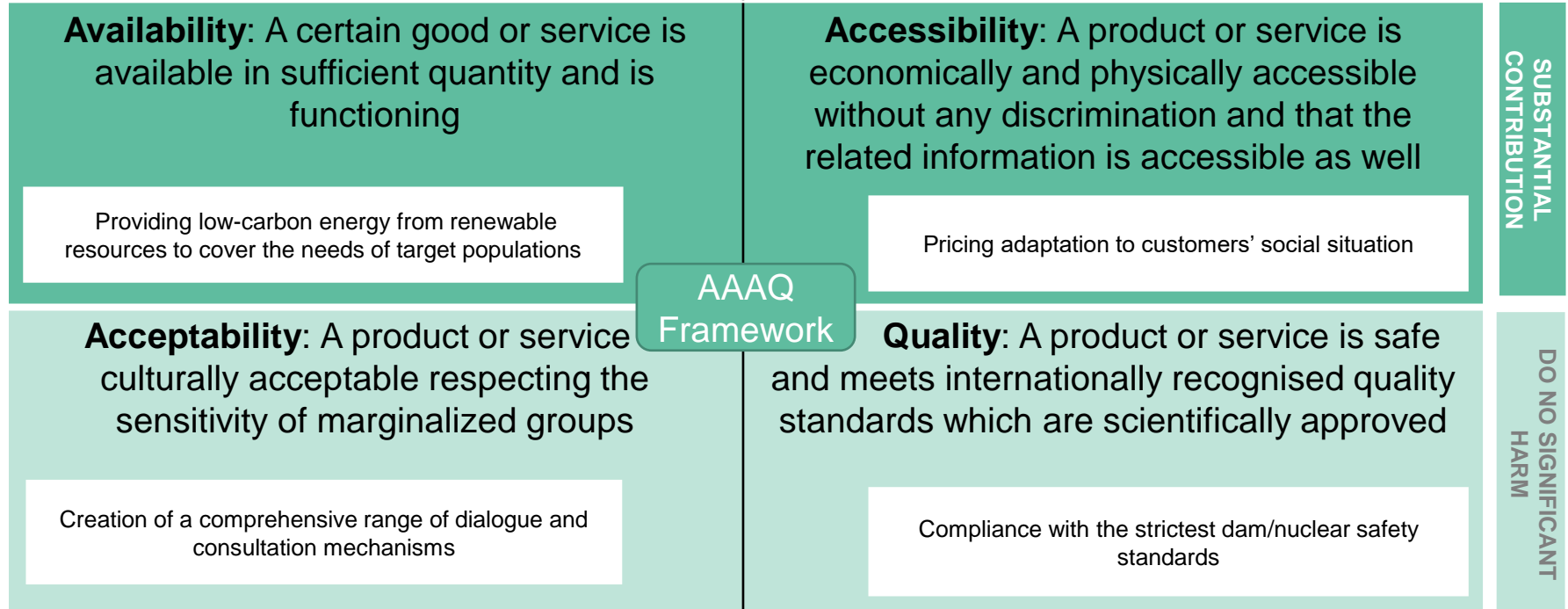
Tax transparency & Tax approach: highest governance body is accountable for compliance with the tax strategy; economic entity seeks to comply with the "letter and the spirit of the law"; economic entity embraces practices to avoid tax avoidance

4. *Article 25 of the Universal Declaration of human rights

AAAQ as an approach for developing SC and DNSH criteria

We will illustrate the AAAQ concept with the example of an energy / utility company

The referring objective is “Improving accessibility to basic economic infrastructure (B)”, and the sub-objective is clean electricity (B3)



How to measure the social impact of an economic entity or activity?

The Subgroup has not yet developed indicators or defined criteria for the social taxonomy. So far, the Subgroup 4 has only set criteria for indicators for a social taxonomy.

When elaborating criteria for products and services, the focus will be on **how, to what extent and for whom** they contribute to the fulfillment of adequate living conditions. The **seven** key drivers will remain the following ones:

To go further: harmful activities

“To mitigate risks of unintended consequences or taxonomy loopholes, exclusion criteria or significantly harmful criteria could be introduced. This would ensure that harmful sectors or activities such as weapons, gambling and tobacco cannot qualify as socially sustainable despite e.g., good worker-related performance”

Harmful activities would be those which are fundamentally and under all circumstances opposed to the objectives suggested in the Draft Report. The justification can come one of the following sources: international agreed conventions (i), and detrimental effects on health and safety (ii)

1 Referring documents

Indicator should be related to a **norm, process or goal** in an internationally recognized standard

2 Good measurement

Indicator should be a **good measurement for improvement** or must be a **good proxy for the topic addressed**

3 Concreteness

Indicator should be **concrete enough** to relate it to a company or activity

4 Incentives

Indicators should **avoid driving perverse incentives** or unintended consequences (example: unintentionally driving divestments from SMEs)

5 Clear direction

Indicator must have a clear direction meaning it should be clear if an increase or decrease shows improvement

6 Level of granularity

Indicator should be at a similar level of detail

7 Data availability

Indicator must be easy to be found and at a reasonable cost thus to have a clear benchmark

Articulations between an environmental and social taxonomy

Model 1: Two independent taxonomies, one which defines environmentally sustainable activities and the other which defines socially sustainable activities

The social and an environmental taxonomy are related only through social and environmental minimum safeguards, with governance safeguards being valid for both

The UN guiding principles would serve as minimum safeguards for the environmental part, while the environmental part of the OECD guidelines would serve as minimum safeguards for the social part

The respective social and environmental do no significant harm criteria would form the basis for detailed social and environmental criteria. The downside would be superficial social and environmental criteria in the respective other part

Model 2: A single taxonomy defining economic activities which are both: socially and environmentally sustainable

There would be one taxonomy with a list of social and environmental objectives and DNSH criteria

It would essentially be one system with identical DNSH criteria for the social and environmental objectives

Depending on how strict these DNSH criteria are the downside would be that there will be fewer activities which would meet both, social and environmental DNSH

Whatever solution will be selected, social and environmental DNSH criteria or minimum safeguards must be comparable. A taxonomy in which minimum safeguards or DNSH criteria for environmental topics of social activities are much stronger or weaker than social safeguards for environmental issues will struggle to gain acceptance. It will not be possible to apply detailed environmental DNSH criteria from the green taxonomy for the social taxonomy while applying light touch 'due diligence' minimum safeguards for the environmental taxonomy.

Areas for improvement and clarification

Natixis CIB Green & Sustainable Hub feedback



DESIGN A TAXONOMY THAT CAN ALSO WORK FOR PUBLIC ENTITIES



THE “ARTIFICIAL” DIFFERENCE BETWEEN INHERENT AND SOCIAL BENEFITS



CONFUSION BETWEEN “SC” AND “DNSH”



SYSTEMATISM IN THE PRESENTATION AND HIERARCHIZATION OF OBJECTIVES AND CRITERIA



GEOGRAPHIC CONTEXTS ARE INSUFFICIENTLY CONSIDERED



THE NOTION OF TARGET OR VULNERABLE POPULATION IS LARGELY UNSUBSTANTIATED



INSTRUMENTS TO DOCUMENT ACTUAL IMPACTS ARE ABSENT



ARTICULATION OPTION BETWEEN VARIOUS TAXONOMIES AND OTHER EUROPEAN REGULATIONS ARE CONFUSING

Key Takeaways

The 61-page Draft Report on “Social Taxonomy” from the Sustainable Finance Platform Subgroup offers an already sophisticated approach and **encompasses meaningful and granular proposals**. It helps grasping what an EU Social Taxonomy could look like

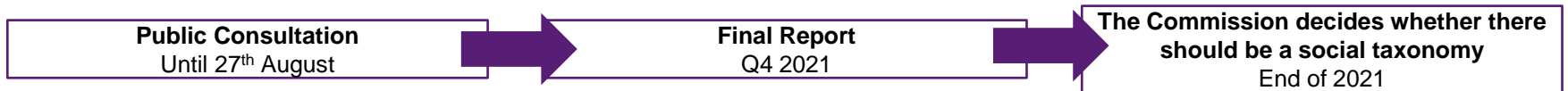
It differentiates on the one hand, **the contribution to social objectives** made through **products and services** sold by companies, in particular the promotion of adequate living conditions for individuals and groups in situation of vulnerability (a so-called “**vertical dimension**” chiefly steered by R&D, business development and marketing departments) and, on the other hand, the **contribution made through processes**, value chains and conducts to the respect of human rights and stakeholders living conditions (an “horizontal dimension” more likely addressed in the CSR team, human resources and purchasing departments)

A stakeholder-centric approach is suggested to reflect both the positive and negative impacts companies have on workers, customers, and communities

The Report interestingly proposes to use the **AAAQ concept**. “Availability and Accessibility” would be used for defining SC and “Acceptability and Quality” for “Do no Significant Harm” (DNSH)

For the time being, social and governance factors are only a component (rather than a principal focus) of the EU Taxonomy of Sustainable Activities

We welcome these preliminary but galvanizing developments!



Our publications on social topics



Report available
online

Relevant articles:

- [The EU Social Taxonomy Draft: promising buildings blocks](#)
- [A growing momentum for Fair Transition Finance](#)
- [The European Union's plunge in the Social Bonds Market](#)
- [Unédic issued the two largest social bonds ever in the midst of the covid-19 crisis](#)