PLATFORM ON
SUSTAINABLE FINANCE

Draft Report by Subgroup 4: Social Taxonomy

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Executive summary

From the outset environmental and social aspects have been part and parcel of the EU's sustainable finance strategy. The need for social investments in order to achieve the sustainable development goals (SDGs) on the 2030 Agenda, as well as to realise the social internal market envisaged in the Treaty on the European Union (Article 3), is widely recognised. So is the need to ensure that businesses show respect for human rights as envisaged in the UN Guiding Principles on Business and Human Rights (UNGPs). There are also many indications that investors see social investments as an opportunity, just as they acknowledge that it is risky not to take social factors into account in investments. It is therefore crucial to spell out what constitutes a social investment, as has been done in the case of environmental investments.

Fundamental EU documents, such as the European Pillar[1] of Social Rights and the associated action plan, the European Social Charter[2], the EU Charter on Fundamental Rights[3] and the European Convention on Human Rights[4], provide strong foundations and inspiration for a social taxonomy. Concerns have been expressed that social matters are regulated at Member State level and between social partners, not at EU level. The Social Pillar aims to rectify this by tending towards a more collective approach. It has long been understood that following certain international rules goes hand in hand with operating in international markets. In this case, the first task of the social taxonomy subgroup of the EU Platform for Sustainable Finance is to suggest a structure for a social taxonomy, bearing in mind the following:

1. what constitutes a substantial social contribution
2. how to not do significant harm
3. what activities are harmful.

The group was also asked to consider the relationship between the social and environmental taxonomies and the regulatory environment.

The group has identified four main differences between a social and an environmental taxonomy.

1. Economic activities such as job creation are inherently socially beneficial. A social taxonomy has to distinguish between these inherent benefits and added social benefits such as improving access to quality healthcare or ensuring decent jobs.
2. Environmental objectives and criteria can be based on science, but a social taxonomy could be founded on international authoritative standards of topical relevance such as the International Bill of Human Rights.
3. The environmental taxonomy links criteria to economic activities. However, some social aspects, such as collective bargaining or tax transparency, cannot be linked to economic activities. Rather, they must be linked to the economic entity.

[1] European Pillar of Social Rights: https://ec.europa.eu/info/strategy/priorities-2019-2024/economy-works-people/jobs-growth-and-investment/european-pillar-social-rights/european-pillar-social-rights-20-principles_en

[2] The European Social Charter: https://www.coe.int/en/web/european-social-charter

[3] European Charter of Fundamental Rights: https://ec.europa.eu/info/aid-development-cooperation-fundamental-rights/your-rights-eu/eu-charter-fundamental-rights_en

[4] The European Convention on Human Rights: https://www.echr.coe.int/documents/convention_eng.pdf

4. For some social topics it might be more difficult to develop meaningful quantitative criteria.

The suggested structure of a social taxonomy would be both vertical and horizontal, with the **vertical** dimension focusing on products and services for basic human needs and basic infrastructure. From this perspective, economic activities that make these products and services more accessible, while doing no harm to efforts to achieve other social objectives, could be considered social. The **horizontal** dimension takes into account impacts on different groups of stakeholders affected by economic activities – workers, including value chain workers, consumers and communities. Horizontal objectives would be likely to include a combination of entity- and activity-level criteria, crucial for ensuring businesses' respect and support for human rights as part of the social taxonomy.

Sustainable corporate governance is regarded as setting the bar for environmental and social sustainability in economic entities. In this area, the focus is on topics such as bribery, taxation and lobbying.

Finally, the group made two suggestions on how to ensure a balance in the relationship between an environmental and a social taxonomy. One suggestion is that just as social and governance-related minimum safeguards (UNGPs and OECD guidelines on multinationals) are part of the environmental taxonomy, minimum environmental safeguards should be part of whatever social taxonomy is decided on, for example along the lines of the environmental part of the OECD guidelines.

1. Introduction

1.1. The environmental taxonomy as the starting point for a social taxonomy

In recent years, institutions and governments the world over have begun to understand the relevance and urgency of measures to ensure a fair and just transition towards an environmentally and socially sustainable society and economy. In 2020, the European Parliament approved the European Green Deal, with its ambitious goals to ensure sustainable growth and environmental protection. Specifically, the plan requires the EU to:

- reach zero net GHG emissions by 2050
- decouple economic growth from resource use
- leave no person and no place behind[5].

To do this, a drastic increase in the flow of capital towards sustainable investment is essential. The magnitude of investment needs for climate change mitigation and adaptation are well known. The OECD estimates that to have a 66% chance of limiting the earth surface temperature increase to below 2 degrees, globally it will take further investments of $630 billion a year for the next decade[6].

There is also a huge need to invest in social sustainability in order to achieve the SDGs. The financing gap to achieve the SDGs in developing countries is estimated to be $2.5-3 trillion a year[7]. The *Employment and Social Development in Europe 2020* report presents Europe's most pressing social investment. Nearly one quarter (24%) of the EU working-age population have found themselves below the at-risk-of-poverty threshold at some point during the last 4 years. The report also highlights the importance of developing workers' skills for productivity gains in companies and the need to invest in communications technology, especially for small and medium-sized enterprises (SMEs)[8].

Against this background, the EU has been considering how to direct private capital towards sustainable activities. The recommendations of the expert group set up for this purpose have led to the action plan on financing sustainable growth[9]. One of the plan's key elements is the development of a classification system for sustainable activities. That classification system has been established with the adoption of the Taxonomy Regulation in July 2020. [10]. The taxonomy, initially covering environmental activities and objectives only, has been created to provide clarity and certainty for investors, decision-makers and citizens. Aimed at giving capital markets guidance so they can recognise sustainable

[5] The European Green Deal 2019: https://eur-lex.europa.eu/resource.html?uri=cellar:b828d165-1c22-11ea-8c1f-01aa75ed71a1.0002.02/DOC_1&format=PDF

[6] OECD, 2017, *Investing in Climate, Investing in Growth*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264273528-en

[7] https://www.un.org/sustainabledevelopment/sg-finance-strategy/

[8] *Employment and Social Developments in Europe 2020*, p. 15: https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8342

[9] https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en

[10] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

investments and allocate resources efficiently, the taxonomy identifies sustainable sectors and activities using four simple principles:

- significant contribution to achieving one or more of the EU's stated environmental objectives (Article 9 of the Taxonomy Regulation);
- no significant harm to any other Article 9 objective (Article 17);
- compliance with minimum safeguards (Article 18);
- compliance with technical screening criteria (Articles 10-15 and 19).

In addition, and of relevance to the social dimension, Article 18 defines the **minimum safeguards** as 'procedures' that the entity implementing a sustainable economic activity must follow and that must be aligned with the following international instruments:

- the International Bill of Human Rights (the Universal Declaration of Human Rights and the UN Covenants on Civil and Political Rights and on Economic, Social and Cultural Rights)
- the International Labor Organization Declaration on Fundamental Rights and Principles at Work
- the UN Guiding Principles on Business and Human Rights
- the OECD Guidelines for Multinational Enterprises.

Social and governance aspects are therefore a feature, rather than the main focus, of the Taxonomy Regulation, currently dedicated to environmental considerations.

Given the taxonomy´s current limited inclusion of social sustainability aspects, the European Commission gave the Platform for Sustainable Finance the mandate to also work on extending it to social objectives and established a subgroup dedicated to this task. This report summarises the subgroup's key initial observations and recommendations.

Some members of the Platform are not convinced that the arguments provided in this report justify extending the Taxonomy Regulation to social objectives. This difference of opinion will be taken into account before final recommendations are put forward.

The mandate of the Social Taxonomy Subgroup

The Social Taxonomy Subgroup has two tasks to accomplish in accordance with its mandate.

Their first task is to explore extending the taxonomy to social objectives in the light of Article 26(2)(a) calling on the Commission to publish a report describing the provisions that would be required to extend the scope of the Taxonomy Regulation.

Their second task is to advise the European Commission on how Article 18 works in practice, requiring as it does the respect of international labour standards and human rights by businesses carrying out environmentally sustainable economic activities, and on the possible need to supplement the requirements of Article 18 ('minimum safeguards').

Accomplishing the first task includes:

- describing the provisions that would be required to extend the scope of the Taxonomy Regulation beyond environmentally sustainable economic activities to cover other sustainability objectives, such as social objectives;
- identifying social objectives related to 'employee, health, human rights, equality and non-discrimination matters';

- suggesting approaches for developing substantial contribution criteria and how not to do significant harm;
- giving some initial consideration to the merits of identifying economic activities that significantly harm social sustainability ('significant harm social taxonomy');
- reflecting on other sustainability objectives that could be covered, such as objectives linked to business ethics, governance, anti-bribery or tax compliance matters, as well as discussing the merits of covering those objectives;
- reflecting on what environmental safeguards are required for socially sustainable activities, in particular on the merits of using the existing 'do no significant harm' criteria for environmental objectives and of defining additional minimum environmental safeguards;
- reflecting on the overall relationship between the social and environmental taxonomies, including potential overlaps;
- reflecting on how to relate a social taxonomy to other relevant EU legislation, including the Corporate Sustainability Reporting Directive (CSRD) and the Sustainable Finance Disclosure Regulation (SFDR).

The subgroup's second task is to 'give advice on the functioning of the minimum safeguards', specifically to clarify how Article 18 works in practice. It will publish a report on how it has fared in accomplishing this task at the end of 2021.

Legislative context

The work done on the social taxonomy is liable to be incorporated into existing legislative texts such as the Non-Financial Reporting Directive[11] and the Sustainable Finance Disclosure Regulation[12]. However, the social taxonomy remains principally related to sustainable corporate governance, decent value chains and sustainable product policy.

The proposed Non-Financial Reporting Directive (NFRD) requires large EU 'public interest' corporations (including many financial services firms) to publish data on the impact their activities have on factors related to environmental social governance (ESG). The Taxonomy Regulation introduces a sustainability classification system according to which companies subject to the CSRD have to report. The Sustainable Finance Disclosure Regulation (SFDR) (as supplemented by the Taxonomy Regulation) further requires some companies to disclose:

- the environmental sustainability of an investment and the basis for any ESG claims they make;
- the ESG factors they take into consideration when making investment decisions.

Through the combination of these interrelated frameworks, the EU is developing a structured ESG framework by requiring non-financial disclosures (Non-Financial Reporting Directive) and offering[13]:

- standardised definitions, in the form of extending the scope of the Taxonomy Regulation;
- standardised processes, in the form of the Sustainable Finance Disclosure Regulation (SFDR).

[11] Directive 2014/95/EU.

[12] Regulation (EU) 2019/2088.

[13] https://eur-lex.europa.eu/eli/reg/2020/852/oj#document1

These measures form part of a broader set of ESG initiatives to channel investments towards environmentally and socially beneficial activities, avoiding green and social washing, far beyond the geographical boundary of the EU, making it possible to meet the Paris Agreement climate targets and be in line with the UN's 2030 Agenda for Sustainable Development.

2. Extending the Taxonomy Regulation to social objectives

2.1. The merits of the social dimension

The 2018 final report of the EU High-Level Expert Group on sustainable finance (HLEG), mandated by the European Commission to advise the financial sector on sustainability risks and on opportunities to steer capital towards sustainable investments, gives as much attention to social as to environmental aspects. The expert group report's key recommendations make it clear that sustainable investing means investing in a way that helps achieve both environmental and social objectives[14].

The 2020 report of the Technical Expert Group (TEG), set up after the HLEG, with the mandate to start working on implementing its recommendations, has elaborated on this idea: 'The TEG considers that a fully realised Taxonomy should incorporate the following additional dimension (i.e. in addition to the aspects already developed in detail): social objectives, in addition to environmental objectives, to identify substantial contributions in addition to minimum safeguards'[15].

Beyond the recommendations of the previous expert groups on sustainable finance, the merits of including social objectives in the proposed taxonomy are outlined below.

The recommendations of the sustainable finance expert groups relate to documents on social rights in the EU, such as the European Social Charter[16] and the European Pillar of Social Rights. The latter highlights the priorities on the EU's social agenda in the three areas of equal opportunities and access to the labour market, fair working conditions and social protection and inclusion[17].

A taxonomy of this nature should define the opportunities for investors to contribute to this European agenda as well as to global agendas such as the SDGs.

The need for investment in social sustainability

Traditional ways of financing social welfare, such as government spending and stable systems of social security, remain fundamental. However, policymakers realise that private investments also have a role

[14] '1. Establish and maintain a common sustainability Taxonomy at EU Level
If Europe is to mobilise capital at scale for sustainable development, it needs a technically robust classification system to establish market clarity on what is "sustainable". This system would cover a wide range of activities, investments and assets that can be clearly linked to the Paris Agreement and the Sustainable Development Goals (SDGs).' https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf , p. 15.

[15] *Taxonomy: Final report of the Technical Expert Group on Sustainable Finance*, March 2020, p. 51.

[16] https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=090000168048b059

[17] https://ec.europa.eu/info/strategy/priorities-2019-2024/economy-works-people/jobs-growth-and-investment/european-pillar-social-rights/european-pillar-social-rights-20-principles_en

to play. Practically speaking, this means that investors should prevent any social harm from being done by insisting that companies implement systems to ensure human rights are respected. It also means that investors should help improve the provision of basic goods and services, especially for vulnerable people and groups.

As outlined in the introduction, huge amounts of capital are needed to mitigate climate change and achieve the SDGs. The resulting lack of funding for social needs has been aggravated to a considerable extent by the COVID-19 pandemic. According to the World Bank's 2020 *Poverty and Shared Prosperity Report*, COVID-19 is likely to have pushed between 88 and 115 million people into extreme poverty — which means living on less than $1.90 a day — around the globe in 2020[18]. And for the first time since its inception the United Nations Development (UNDP) Index forecast a decline in 2020[19].

The issuance of social bonds in order to finance the European instrument for temporary support to mitigate unemployment risks in an emergency (SURE), created to alleviate the consequences of the COVID-19 crisis, has proven crucial for containing a surge in unemployment and maintaining employment, skills, incomes and competitiveness[20].

Between $3.3-4.5 trillion a year needs to be mobilised in order to achieve the objectives of the 2030 Agenda for Sustainable Development. At today's level of both public and private investment in SDG-related sectors, developing countries face an average annual funding gap of $2.5 trillion[21].

On the other hand, the pandemic has shown that private investment can be crucial for social progress: it was private investment coupled with government support that enabled companies to conduct the medical research that in turn made it possible to develop a vaccine against COVID-19.

Even before the outbreak of COVID-19, microfinancing and targeted investment in SMEs had shown how private investment could play a part in lifting people out of poverty. Financial inclusion, meaning making credit and deposits available for poor people and micro-enterprises, can help boost income through self-employment. Research suggests there is less poverty in countries with a higher level of access to microfinance[22].

The need for investment in a just transition

The transition to a sustainable, zero net emissions, climate-resilient economy requires crucial changes in sectors such as mining, manufacturing, agriculture and forestry. These changes will have an impact – not necessarily positive – on the lives of workers in these sectors and their communities. It also requires using land for wind and solar power plants, with potentially negative impacts on land rights, including in developing countries. The term 'just transition' is used to describe the need to avoid unilaterally imposing the burden of these inevitable but necessary changes on workers and

[18] https://blogs.worldbank.org/opendata/impact-covid-19-global-poverty-under-worsening-growth-and-inequality.

[19] https://unsdg.un.org/latest/blog/investing-sdgs-post-covid-world.

[20] https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/eu_sure_social_bond_framework.pdf

[21] https://unsdg.un.org/resources/unlocking-sdg-financing-findings-early-adopters.

[22] Kamel Bel Hadj Miled, Jalel-Eddine Ben Rejeba, 'Microfinance and Poverty Reduction: A Review and Synthesis of Empirical Evidence', 2015, https://www.researchgate.net/publication/280948233_Microfinance_and_Poverty_Reduction_A_Review_and_Synthesis_of_Empirical_Evidence.

disadvantaged communities. In this sense, the term is understood as a conceptual framework encompassing the complexities of the transition towards a sustainable, zero-net-emissions, climate-resilient economy, highlighting public policy needs and aiming to maximise the benefits, while minimising hardship for workers, consumers and communities affected by the transition.

The international trade union confederation defines just transition as a 'tool the trade union movement shares with the international community, aimed at smoothing the shift towards a more sustainable society and providing hope for the capacity of a green economy to sustain decent jobs and livelihoods for all'[23].

Given all of the above, the Commission has integrated a 'just transition mechanism' into its new European Green Deal investment plan[24].

Investors´ demand for socially orientated investments

From 2009 to 2017, Europe's compound annual growth rate of capital invested, using a 'best in the class', ESG-based approach, rose from $130 billion to $580 billion, with an annual growth rate of 20% [25]. In 2021 Bloomberg reported that 'Global Environmental Social and Governance (ESG) assets were on track to exceed $53 trillion by 2025, representing more than a third of the total assets under management globally'[26].

There are signs that this continuously increasing interest in sustainable investments goes hand in hand with a continuously increasing interest in social investments. For example, the number of social bonds issued has increased significantly, especially since the beginning of the pandemic in spring 2020. The International Capital Market Association (ICMA) defines social bonds as bonds issued for the purpose of investing solely in 'social projects directly aimed to address or mitigate a specific social issue and/or achieve positive social outcomes especially but not exclusively for a target population(s)'[27]. Bloomberg reports that proceeds from these kinds of bonds rose from about $20 billion in 2019 to $147.7 billion in 2020[28]. Recent data from Moody's suggest the continuation of this trend in the first quarter of 2021, in which social bonds were issued to the tune of $90 billion[29].

Since 2010, a completely new instrument for socially sustainable investment has been developed, to serve a continuously growing market for social investments that have tangible impacts. These 'social impact bonds' are defined as 'an innovative financing mechanism in which governments or commissioners enter into agreements with social service providers, such as social enterprises or non-profit organisations, and investors, to pay for the delivery of pre-defined social outcomes'[30]. In practice, this means that these bonds link financial returns to social outcomes, such as reducing the

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[23] https://www.ituc-csi.org/IMG/pdf/01-Depliant-Transition5.pdf.

[24] https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_24.

[25] European SRI Study 2018: http://www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study.pdf, p. 17.

[26] ESG assets may hit $53 trillion by 2025, a third of global AUM|Bloomberg Professional Services.

[27] ICMA: June 2020 Social Bond Principles Voluntary Process Guidelines for Issuing Social Bonds 2020, p. 2: https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Social-Bond-PrinciplesJune-2020-090620.pdf.

[28] https://www.bloomberg.com/news/articles/2021-01-11/social-bonds-propel-esg-issuance-to-record-732-billion-in-2020.

[29] https://www.moodys.com/research/Moodys-Sustainable-bond-volumes-soar-to-record-231-billion-in--PBC_1283271.

[30] OECD, *Understanding social impact bonds*, 2016: https://www.oecd.org/cfe/leed/UnderstandingSIBsLux-WorkingPaper.pdf.

number of homeless people in a certain area by providing housing for them or reducing the re-offending rates of short-term prisoners. The return on the investments rises if these social outcomes are realised and declines if they are not.

After a modest start, with annual issues below 15, the trend picked up in 2013.

'Between 2013 and 2016, the number contracted each year rose only slightly, before more than doubling in 2017 to 45 impact bonds and rising again in 2018 to reach a peak of 48 new social impact bonds'[31].

Besides the growing appetite for these sorts of investment products, an increasing number of investors have pledged their support for human rights. Retail and institutional investors are taking steps to align their investments with human rights and promote respect for human rights across portfolios, with new initiatives emerging as a result. In 2020 Principles for Responsible Investment launched a human rights framework for its members[32]. Similarly, the Investor Alliance for Human Rights, of over 170 institutional investors, represents a total of over $5 trillion in assets that are managed across 18 countries[33]. There is a widely recognised imperative, not only in the EU but worldwide also, for better working conditions, as well as dialogue and diversity in the workplace. Investors want to make a positive contribution to redressing the harm done by socially unsustainable practices in this area. This is also reflected in topical investor-led human rights initiatives, for instance in relation to living wages or human rights risks associated with mining tailings[34].

Some of these investments are made to avoid the risks described below. However, for others, such as church investors, value-based banks or charities with social objectives, applying social criteria is part of their approach to business.

Social and human rights risks and opportunities for investors

Investors run particular risks if they do not consider the social implications of their investments. The German Financial Supervisory Authority defines sustainability risks in general as 'environmental, social or governance events or conditions which if they occur have or may potentially have significant negative impacts on the assets, financial and earnings situation, or reputation of a supervised entity.' Specifically, taking sufficient account of sustainability risks means:

- complying with recognised labour standards
- fulfilling employment-related safety and health protection requirements
- ensuring appropriate remuneration and fair working conditions
- ensuring workplace diversity and providing training and development opportunities
- respecting trade union rights and freedom of assembly
- guaranteeing adequate product safety, including by protecting workers' health

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[31] Brookings, *What is the size and scope of the impact bonds market?*, p. 4, https://www.brookings.edu/wp-content/uploads/2020/09/Impact_Bonds-Brief_1-FINAL.pdf.

[32] Sustainability issues (UN Principles for Responsible Investment unpri.org).

[33] About the Investor Alliance for Human Rights | Investor Alliance for Human Rights (investorsforhumanrights.org).

[34] See for example Investor Alliance for Human Rights, the PRI 2020 Human Rights Framework, or the Corporate Human Rights Benchmark.

- applying the same requirements to supply chain businesses as to others
- ensuring projects are inclusive and taking the interests of communities and social minorities into account[35].

Investment risks are not confined to labour rights only. They also overlap with human rights considerations more broadly speaking. The following few real-world examples suffice to illustrate the overlap:

- the collapse of the Rana Plaza building in Bangladesh, causing hundreds of deaths;
- the unacceptable working conditions of fruit and vegetable pickers and slaughterhouse workers in the EU [36].

An example of regulatory risks related to social issues would be that the US Food and Drug Administration (FDA) demand better disclosure of the results of drug trials from pharmaceutical companies, threatening to fine them if they fail to do so[37].

When social grievances and human rights violations like these are widely discussed in the media, the companies involved, as well as their investors, face several risks. For example, a company guilty of such malpractice or violations runs the risk of having to comply with stricter regulation to prevent malpractices or human rights violations, thereby increasing its costs or putting itself at risk of being involved in very expensive litigation. This risk has recently been aggravated, with the adoption of due diligence laws in EU member countries as well as in the EU. Apart from all of the foregoing, companies may experience reputational damage or be boycotted, thus losing their consumer base. Supply chains may be disrupted because of strikes or companies be put at a disadvantage by becoming unattractive employers for highly qualified young people. All of which translates into risks for investors.

There are also fundamental economic reasons for social investments. Despite there being no consensus on the strict relationship between inequality and economic growth, there is increasing evidence that a growing gap between rich and poor could impede growth, including the possibility of its creating political and social instability, which may in turn deter investment. Social divisions fuelled by inequality may also make it more difficult for governments to find the necessary consensus in society to navigate and manage economic and financial crises. Apart from these negative effects for society as a whole, this would have detrimental effects, especially for long-term investors such as pension funds. But companies can help to mitigate these risks. A taxonomy is needed to identify credible approaches to doing so.

There is also increasing recognition that social conditions are related to positive business outcomes. For example, OECD Secretary-General (June 2006 to May 2021) Angel Gurria has argued: 'Job quality is not only important to workers' well-being, but also to the overall productivity of a firm. This is now understood at the highest political levels. The leaders of the G20 countries agreed last year not just to

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[35] BaFin Guidance Notice, p. 13 , https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/dl_mb_Nachhaltigkeitsrisiken_en.pdf; jsessionid=B7ED07B3115996DF33F83BAA92B2423A.2_cid502?__blob=publicationFile&v=5 .

[36] BaFIn: Guidance Notice on Dealing with Sustainability Risks, 2020, p. 13: file:///C:/Users/LOCALA~1/AppData/Local/Temp/dl_mb_Nachhaltigkeitsrisiken_en.pdf .

[37] Regulatory Focus 28 April 2021: https://www.raps.org/news-and-articles/news-articles/2021/4/fda-threatens-drugmaker-with-fines-for-failing-to

prioritise creating more jobs, but to ensure they are quality jobs. And just a few weeks ago, the Labour Ministers gave a strong mandate to the OECD to design policies to improve all aspects of job quality – job security, earnings quality and the quality of our working environment. This will be a major pillar of the revised Jobs Strategy the OECD is currently working on'.[38]

Need for strengthening the definition and measurement of social investment

However, as with green investments, the lack of a clear definition of the essential characteristics of social investments hinders their development and potentially their contribution to solve social problems. Recent studies on the divergence among ESG rating shows, that the categories of human rights and product safety, both social issues, are categories for which the measured deviations are particularly pronounced. The differences, among the widest of all categories, are striking[39]. A Global ESG Survey by BNP Paribas in 2019 found that 46% of investors surveyed (347 institutional investors) found the social aspect to be the most difficult to analyse and embed in investment strategies[40]. A 2017 study comparing 12 rating agency approaches to the S in ESG found four main areas with gaps:

1. social measurement evaluates what is most convenient, not what is most meaningful;
2. current approaches to disclosure are not likely to yield the information needed to identify social leaders;
3. the lack of consistent standards underpinning social measurement increases costs and creates confusing 'noisiness' across the ESG industry;
4. existing measurement does not equip investors to respond to rising demand for socially responsible investing strategies and products[41].

A social taxonomy has the potential to address these issues and harmonise how social aspects are measured. It would make it easier for investors to make informed and consistent decisions and at the same time help to direct resources towards socially responsible activities and companies.

The purpose of the green taxonomy is to redirect capital flows to necessary investments in climate mitigation and adaptation and other environmental aspects. By the same token, the purpose of a social taxonomy would be to direct capital flows to entities and activities that operate with respect for human rights and to support capital flows to investments that improve living conditions, especially for the disadvantaged. The rationale behind the green taxonomy is that sustainable investors need some guidance in order to understand what activities are environmentally sustainable. The same goes for social activities, as there is currently no widely accepted definition or measurement of social sustainability in the context of investments.

[38] https://www.oecd.org/g20/topics/employment-and-social-policy/the-crisis-has-had-a-lasting-impact-on-job-quality-new-oecd-figures-show.htm.

[39] Florian Berg, Julian Koelbel and Roberto Rigobon, 'Aggregate Confusion: The Divergence of ESG Ratings', August 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533.

[40] BNP Paribas Securities Services ESG Global Survey 2019: trends and key figures - BNP Paribas (group.bnpparibas).

[41] Metrics-Report-final-1.pdf (squarespace.com).

2.2. Concerns about a social taxonomy

As captured above there are a number of arguments for extending the taxonomy to cover social objectives. However, there are also concerns and caveats. The main concerns are summarised below.

It would not be possible to define activities as socially sustainable (i.e. in a positive way) or as negative (i.e. as part of DNSH criteria), as this depends on the context, which in the area of social affairs, is predominantly about the national level, including the industrial relations system.

Many of the objectives of a social taxonomy would go beyond EU competences (e.g. on collective bargaining, wages etc). These topics are examples of where a social taxonomy could be inappropriate, in particular due to their prescriptive and detailed nature.

That said, a social taxonomy is not intended to replace national regulation. Rather, it is intended to support investments in activities and economic entities that substantially contribute to achieving social objectives, in much the same way as an environmental taxonomy is designed to support investments in environmentally friendly activities. These criteria can help to define a common ground for internationally comparing companies' contributions to achieving social objectives. By so doing, a social taxonomy would provide investors with a much needed instrument for supporting their investment choices.

To make sure that a social taxonomy does not infringe on national competencies, it should be based on basic social rights laid out in the International Bill of Human Rights and the ILO core labour norms, both valid in all EU countries. On top of this, EU social legislation[42] confers a responsibility on the EU for promoting social rights and social dialogue at all levels; and the EU can take action in the area of social protection (albeit requiring unanimity). However, more detailed aspects on payment, social dialogue and social protection potentially covered by a social taxonomy belong within the national competencies of Member States. Social dialogue for example is designed very differently in Member States. In some it even plays a key role in defining labour rules.

National regulations vary from country to country, setting different parameters for preventing detrimental social behaviour by companies or demanding social contributions from them. Care must therefore also be taken to make sure that criteria do not favour companies located in jurisdictions with more stringent social legislation. In essence, a social taxonomy should not create incentives in opposition to national legislation or social partners' autonomy.

Another concern is that a social taxonomy could direct investment only to certain companies, whereas a broad approach to support companies in their contribution to society and social sustainability is needed, including job creation.

As explained in more detail below, a social taxonomy acknowledges the social contributions companies inherently make. However, in order for it to really work as a way of directing capital flows towards activities and companies that make substantial social contributions, the criteria have to be

[42] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016SC0050&from=ES

more specific. The present suggestion suggests a broad approach to a social taxonomy in as it includes social economic activities like social housing healthcare and education and efforts to reduce negative and maximise positive outcomes for affected stakeholders, independent of what activity the company is carrying out.

A social taxonomy might increase the already increasingly heavy reporting burden the NFRD, SFDR and environmental taxonomy impose on companies, especially as there are currently no standardised social indicators on which companies usually report.

On SMEs in particular, reporting in line with a detailed social taxonomy would impose a disproportionate burden. This would be in contrast to their significance in terms of job creation. Ways must therefore be found of ensuring that the criteria and indicators selected are meaningful and can be reported on at a reasonable cost. One solution might be to adapt reporting requirements to SMEs.

Multinationals are not without challenges of their own when it comes to reporting on social topics. Working in different jurisdictions means that they have to bear in mind different definitions of, and legal standards regarding, notice periods, parental leave and unionisation.

Some are concerned that a social taxonomy would have impacts beyond sustainable investment. Taxonomy criteria could also be used for EU funding and subsidies. Doing so would have a more far-reaching and probably stronger impact on companies than if the taxonomy were used by private investors only.

3. Building a social taxonomy: overarching conceptual aspects

3.1. Environmental taxonomy as a role model for a social taxonomy

In 2018 the Commission asked the TEG to develop an environmental taxonomy, starting with working out criteria for climate change mitigation and adaptation. This was done in the face of the pressing need to mitigate climate change and the urgency to mobilise more private capital for investments in this area. The basic structure of this taxonomy is that it has defined six environmental objectives and criteria for substantial contributions to achieving the objectives and not doing any significant harm. On top of this, minimum safeguards have been put in place to guarantee that human rights and governance aspects are also taken into account. Economic activities qualify as environmentally sustainable if they fulfil at least one substantial contribution criterion while at the same time do not violate any DNSH criteria for the other objectives and align with minimum safeguards. Sustainable funds will inform investors in the future to what degree a "green" sustainability investment fund is invested in activities which meet these criteria.

It is recommended that the development of a social taxonomy follow the model of the green taxonomy where possible, for several reasons.

In the future there will probably be investment funds with social aims, other funds will apply environmental considerations only and yet others might apply both. It is therefore important for investors to be able to compare the degree to which a fund is considered to be in line with the environmental taxonomy, with the social taxonomy or with both taxonomies.

Companies that will have to provide data on environmental as well as social topics should not be overburdened by having to work with two completely different systems.

The Environmental Taxonomy Regulation has gained considerable currency both in and outside the EU. Keeping the social taxonomy in line with its design might therefore help to underline its feasibility and importance.

So the starting point for a social taxonomy follows the steps of the green taxonomy by first defining social objectives, then substantial contributions to achieving these objectives and finally criteria that apply the principle of not doing any significant harm, so that contributing to achieving one objective is not detrimental to the others. Ultimately, the need for minimum environmental safeguards will have to be considered depending on how it is decided in the end to combine social and environmental taxonomies (see Chapter 6).

Differences between environmental and social taxonomies

There are four key differences, outlined below, between the environmental and social spheres. These differences must be taken into account. Some of them will make it difficult to apply certain features of the environmental taxonomy to social topics or may require a slightly different approach, taking into account the specificities of social sustainability.

Environmentally sustainable economic activities tend to aim at reducing negative environmental impacts or reversing them through CO^2 capture or ecosystem restoration. However, economic activities tend to have inherent social benefits by creating jobs and providing training, contributing to taxes and social protection and providing socially beneficial products and services. This means that with respect to social objectives and defining substantial contributions, the taxonomy's role is to differentiate between the inherent and additional social benefits of economic activities. For example, producing drugs is part of a pharmaceutical company's business and cannot therefore be considered as a substantial social contribution. If, however, the company eases access to certain drugs for certain groups of people, this could be identified as an additional social benefit. A substantial contribution in a social taxonomy is therefore largely defined in terms of beneficial impacts, whereas an environmental taxonomy focuses mainly on detrimental impacts.

For both approaches the structure of SC works, but in social we are focussing on activities that often already have an inherent social benefit and aim at an additional benefit by f. ex. making certain products more accessible.Having made this distinction it is important to add that when it comes to respect for human rights avoiding and addressing adverse impacts associated with economic activities is a key part of realising social sustainability, and hence a social taxonomy needs to adequately encompass this dimension.

Linked to this is the issue of whether a social taxonomy takes into account the broad contribution of business to society and its social impact for job creation, productivity growth and human resources investments that companies make in their employees (e.g. pay, skills development, digital technology tools enhancing working conditions, well-being and occupational benefits such as pensions and unemployment insurance). All these issues will have to be considered and a distinction has to be made between the inherent benefit of an economic activity or company and additional benefits that substantially contribute to achieving social objectives. These additional benefits could be that training is tailored to vulnerable groups, or that jobs and accessible infrastructure are created in deprived neighbourhoods.

The environmental taxonomy defines substantial contributions and criteria based on doing no significant harm for specific economic activities. The rationale behind this is that more capital has to be allocated to specific activities needed to mitigate climate change regardless of what else the whole economic entity is doing.

This logic can only be followed in part by a social taxonomy. As noted in the previous point there are economic activities which are essential for the fulfilment of adequate living conditions. For these the method of the environmental taxonomy can be followed.

However, crucial aspects of a social taxonomy relate to processes that aim to reduce negative and maximise positive outcomes for stakeholders affected by business activities. Such processes often function at the level of economic entities and can hardly be related to specific activities. This is most apparent in the cases of trade union rights or tax planning, both central to an economic entity's social impacts. It would be difficult to do justice to these topics by singling out one activity of an economic

entity. In contrast to the environmental taxonomy, the social impact here is not derived from enlarging the production of certain goods or services. It comes mainly from respecting human rights, including labour rights, by implementing due diligence processes, involving stakeholders and operating grievance or dispute resolution mechanisms. Such processes do not relate directly to one or the other economic activity, but operate at the level of the economic entity. A social taxonomy might therefore need to include criteria at both entity and activity levels.

Implementing due diligence processes might, however, be more or less challenging in relation to certain economic activities than others or regions than others. For example, there might be a higher risk of abusing the rights of communities when building a hydro-power station than when developing software. Conversely, the impacts on privacy of end-users might be more challenging to safeguard when developing software than when building a hydro-power station. Or ensuring respect for human rights in countries in which they are not well protected might require more of companies than when operating in countries with high degrees of protection. The consequences which follow from these and other contextual differences have to be analysed more closely, in terms of implications for potential technical screening criteria for example.

The foundations of the environmental taxonomy are natural science and international frameworks such as the Paris Agreement. Criteria are generally developed the basis of scientifically validated research results. A social taxonomy, however, cannot be based on science in the same way. While the science behind climate change gives clear answers on CO^2 reduction requirements, science is not systematically able to play such a role for social factors. Although there is abundant research on social phenomena within social sciences that will influence the development of a social taxonomy, science will not play the same role as it does in the environmental taxonomy. Instead, it is recommended that internationally agreed authoritative norms and principles form the foundations of a social taxonomy. These social norms and standards emerge from structured discussions among stakeholders, thereby gaining acceptance. This is why, for a social taxonomy, documents such as the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights, set out in the eight fundamental conventions identified in the Declaration of the International Labour Organization on Fundamental Principles and Rights at Work and the International Bill of Human Rights, as well as the European Pillar of Social Rights and the European Social Charter, will form the basis for criteria.

Finally, it will be more difficult to develop quantifiable criteria for a social taxonomy than for an environmental taxonomy. Whereas especially with climate mitigation, scientific research makes it possible to attach highly relevant quantitative criteria to economic activities, social sustainability is at the moment often described in more qualitative terms. There are promising attempts to translate these into quantitative indicators, the most prominent being the UN Development Programme's annual report on human development. SDG indicators are also quantified; however, they relate to governments and not to companies. They could however be used for the corporate world by linking SDG achievement or lack thereof of a given country to its corporate contribution to SDG achievement. This would make it possible to understand and analyse how businesses are helping achieve the SDGs. There are other quantified social indicators developed by development banks, mostly at project level, and by microfinance banks and funds. In the future these systems will have to be considered and tested.

4. Articulating and defining social objectives

4.1. Structure

The suggested foundations of a social taxonomy are established international norms and principles. For this reason, and in accordance with the mandate of the social taxonomy subgroup, the following documents have been considered.

- the Universal Declaration of Human Rights
- the International Covenant on Economic, Social and Cultural Rights
- the International Covenant on Civil and Political Rights
- the ILO Declaration on Fundamental Principles and Rights at Work
- the European Convention on Human Rights
- the European Social Charter
- the Charter of Fundamental Rights of the European Union
- the European Pillar of Social Rights
- the Sustainable Development Goals (SDGs)
- the UN Guiding Principles on Business and Human Rights
- the UN Global Compact
- the OECD Guidelines for Multinational Enterprises

To build on approaches available in market-driven standards, the following resources have also been considered:

- International Capital Market Association (ICMA) Social Bond Principles
- International Finance Corporation IFC Performance Standards
- World Benchmarking Alliance Social Transformation
- Living wage financials
- Access to Medicine Foundation
- Initiatives that apply the SDGs in the context of private companies (including Global Reporting Initiative (GRI), United National Principles for Responsible Investment UNPRI, the UN Global Compact).

When considering these international principles and standards from the perspective of a social taxonomy, their usage can be divided into two dimensions. On the one hand they define the benchmark for processes integrated in economic entities to avoid and address negative impacts on human rights. On the other hand, they provide a definition of what constitutes relevant contributions by business to fulfilling economic and social rights like providing certain products and services that can contribute to the fulfilment of the right to an adequate standard of living.

Respect and support for human rights could be called the horizontal dimension of a social taxonomy, since their implementation involves processes that need to be horizontally integrated into an economic entity to obtain positive outcomes for affected stakeholders. Products and services essential for adequate living conditions could on the other hand be called the vertical dimension of a social

taxonomy, as they concern products and services of an economic entity and can be related to economic activities.

Apart from these aspects, the governance of economic entities should be considered, again meaning processes integrated into economic activities that can enable positive social outcomes. Relevant international instruments here include the UN Convention against Corruption, the EU Convention against Corruption involving Public Officials, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the OECD Guidelines for Multinational Enterprises.

If this principle (horizontal vs vertical dimension) is applied for the setting of objectives for a social taxonomy the following structure emerges.

Vertical dimension

Objective: Promoting adequate living standards. This includes improving accessibility of products and services for basic human needs such as:

- water including waste water management
- food
- housing
- healthcare including care work
- education (including vocational training)

Improving accessibility to basic economic infrastructure including (examples, not exhaustive)

- transport
- telecommunication and internet
- clean electricity
- financial inclusion.

Horizontal dimension

Objectives: promoting positive impacts and avoiding and addressing negative impacts on affected stakeholder groups:

- ensuring decent work
- promoting consumer interests
- enabling inclusive and sustainable communities.

All three objectives can include criteria pertaining to impacts in the whole value chain. Respect for human rights will be crucial for the development of criteria that apply the principle of doing no significant harm.

Governance:

- good sustainable corporate governance
- transparent and non-aggressive tax planning.

The two dimensions of a social taxonomy

Within this suggested structure the two dimensions are clearly separated. The process-related horizontal dimension is mainly based on the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, the ILO Declaration on Fundamental Rights and Principles at Work, the European Pillar of Social Rights and the European Social Charter.

The vertical dimension concerns products and services essential for protecting certain economic and social rights. The role of business in relation to this dimension has not yet been spelled out as clearly as its role in relation to the horizontal dimension has been by the UN-Guiding Principles. Nevertheless, key texts include the International Covenant on Economic, Social and Cultural Rights (ICESCR), the SDGs and the European Pillar of Social Rights.

This basis ensures that a wide range of social aspects are covered and that 'social washing' is avoided through a broad recognition of the role of business in furthering social sustainability, from both the horizontal and vertical perspective.

If it focused solely on horizontal aspects, a social taxonomy would ignore the social value of providing goods and services for adequate living conditions and miss the opportunity to define more precisely the parameters that can make such goods and services fully socially sustainable. Ignoring horizontal aspects would mean overlooking the inherent positive impact and real outcomes for people associated with implementing due diligence processes to respect human rights in companies and failing to be in alignment with key international frameworks on business and human rights.

The distinction between vertical and horizontal aspects is a feature of many approaches and systems that spell out the implementation of the SDGs in companies. Although there do not yet exist any authoritative guidelines on how companies can implement and measure their contribution to achieving the SDGs, there is some uniformity in existing approaches in that they take account of a 'contribution through products and services' and a 'contribution through operation and conduct'[43] as has been done by the SDI Asset Owner Platform[44].

In a similar manner the Global Reporting Initiative (GRI) approach to achieving the SDGs in companies distinguishes between two entry points:

- entry point A (horizontal dimension): 'Risks to people and the environment: the contribution every company can make to achieving the SDGs by meeting its responsibility to address potential and actual negative impacts on people and the environment that are linked to its operations and value chains';

[43] SDI Sustainable Asset owner platform: Sustainable Development Investments Taxonomy and guidance. 2020, p. 6, https://apg.nl/media/c1vdc522/sdi-taxonomy-and-guidance.pdf

[44] The SDI Asset Owner Platform is a joined initiative by asset owners with the aim to provide quality data to identify company contributions to the SDG: https://www.sdi-aop.org/

- entry point B (vertical dimension): 'Beneficial SDG-related products, services and investments: the additional contribution that companies can make to achieving the SDGs by applying their knowledge, skills and other capabilities to benefit people and the environment'[45].

These two dimensions are also a feature of other approaches to SDG reporting for companies in the Global Compact[46], and to a lesser extent the UNPRI[47], as well as the rating systems of ESG rating agencies ISS ESG and Sustainalytics[48].

There are, however, also practical reasons for including both the horizontal and the vertical dimension in a social taxonomy and working out separated objectives and criteria for them. The social aspects of companies' products and services are likely to be located in the R&D, business development and marketing departments, whereas their due diligence processes for human rights are more likely to be dealt with primarily by the CSR/sustainability team, human resources and purchasing departments. So it might be easier to report on these two aspects separately.

Analysis of essential texts on human rights and social goals, their implications and current practices suggests that a social taxonomy should consider both the horizontal dimension of processes to manage human rights impacts across an entity's operations and activities and the vertical dimension of social products and services.

This way of structuring objectives in a social taxonomy has far-reaching consequences for the development of criteria.

Examples of horizontal and vertical dimensions of a social taxonomy

The differentiation between the horizontal and vertical dimensions of the proposed structure of a social taxonomy is not thematic. Human rights, such as the right to clean drinking water or healthcare, are addressed in both. The distinction is rather that the horizontal dimension concerns processes to improve respect for and protection of human rights across economic activities in the private sector. The vertical dimension, on the other hand, concerns products and services that may contribute to ensuring respect for social and economic human rights. So the difference is between outcomes for people related to economic entity-level processes versus products and services. The examples below illustrate the distinction between the two dimensions even if they concern the same topic.

Employment

- Process-related, horizontal: training, employment of vulnerable people and groups, buying from regional suppliers to generate jobs (objective: ensuring decent work).

[45] GRI: Business reporting on SDGs: Integrating the SDG into corporate reporting a practical guide, 2018, p.7 ttps://www.globalreporting.org/public-policy-partnerships/sustainable-development/integrating-sdgs-into-sustainability-reporting

[46] UN Global Compact 2017: Blueprint for Business Leadership on the SDG, A principles based approach 2017, p 8ff, https://d306pr3pise04h.cloudfront.net/docs/publications%2FBlueprint-for-Business-Leadership-on-the-SDGs.pdf

[47] UNPRI: The SDG investment case, 2017, p22 https://www.unpri.org/download?ac=5909

[48] Novethic: SDGs: a new focus for non-financial rating agencies, 2018, p. 4, https://www.novethic.com/fileadmin//user_upload/tx_ausynovethicetudes/pdf_complets/Novethic_2018_NonFinancial-Ratings-focus-on-SDGs.pdf

- Product- and service-related, vertical: training services to (re)integrate people into the job market (objective: promoting adequate living standards).

Human rights due diligence

- Process-related, horizontal: social auditing as a part of a HR/procurement process (objectives: ensuring decent work and enabling inclusive and sustainable communities workers and communities).
- Product- and service-related, vertical: social auditing as a service (objective: promoting adequate living standards

Safe drinking water

- Process-related, horizontal: addressing water impacts on communities by building a water treatment plant for entities´ water emissions, closed water circuit, minimising the use of water especially in water-stressed areas (objective: enabling inclusive and sustainable communities communities).
- Product- and service-related, vertical: offering special services to underserved communities (objective: promoting adequate living standards).

Healthcare

- Process-related, horizontal: excellent health and safety processes in the workplace, low rate of injury and occupational disease (objective: ensuring decent work).
- Product- and service-related, vertical: there is an access strategy for the new medicine, which is developed when it is clinically tested. (objective: promoting adequate living standards)

4.2. Social taxonomy – implications of two dimensions

Implications for the scope of sectors

The vertical dimension of the taxonomy related to social products and services is limited in terms of the scope of sectors it applies to. This dimension only includes economic activities that can be defined as social in nature or are inherently social, such as water, food, housing and health-related activities. Unlike the environmental taxonomy, where the sectors are unlimited in theory, there is a manageable number of sectors and activities to cover. Here the question is how to define its substantial contribution most accurately to have a clear answer to the question of whether a special activity falls under this dimension or not. The concept of 'adequate living conditions' as codified in international human rights instruments is the obvious source to look for a more accurate definition.

However, this is different for the horizontal dimension. Any activities can impact stakeholders such as workers and potentially consumers and communities. Having processes in place to respect and support human rights can also be implemented across numerous economic activities. In this respect, the horizontal dimension is closer to the environmental taxonomy as it covers many sectors. In both the environmental taxonomy and the horizontal dimensions of the social taxonomy, there are sectors that are deemed to be more relevant – in other words, at higher risk of negative impacts. However, while it is relatively easy to prioritise sectors with high CO_2 emissions and those that contribute substantially to lowering these emissions, things are different for the implementation of human rights. These are universal rights, and prioritisation might imply that in some sectors or activities these are deemed more important than in others, which would go against their nature. In short, all sectors impact human rights, and we should address all human rights impacts.

At the same time, the sector is not the only parameter that determines human rights risks (the geographic location can be another). Different sectors typically have different salient human rights risks. For example, while impacts on the right to privacy might be key to the technology sector, impacts on workers are known to be a high risk for the garment sector, and impacts on local communities are significant for the mining sector. While no internationally agreed authoritative list of human rights risks exists as they relate to different sectors, there are a number of resources and initiatives that target key social issues and human rights risks associated with different sectors. For example, the UN Office of the High Commissioner on Human Rights (OHCHR) identified sectors with a particularly high risk of human rights infringements in relation to its work on accountability and remediation[49]. These, along with other authoritative sources on sector risks, including from the OECD, might serve as a

[49] OHCHR 2017 Accountability and Remedy Project. Part II: State-based non-judicial mechanisms How State-based NJMs respond to sectors with high risks of adverse human rights impacts: Sector Study – Part 1, https://www.ohchr.org/Documents/Issues/Business/DomesticLawRemedies/ARPII_%20DiscussionpaperonPhase2forUNForum_FINAL.pdf

starting point for prioritising sectors for the horizontal dimension if this becomes relevant for developing criteria (see Chapter 4.4).

The governance dimension is applicable to all sectors. Here it is even more difficult to differentiate between low and high-risk sectors, and this is probably not desirable.

Implications for neutral and harmful activities

With a horizontal and vertical dimension, the question of neutral or harmful activities has to be asked twice. We should ask whether there are activities that undermine adequate living conditions (as warfare could easily do), and whether there are activities that themselves undermine human rights or are neutral to one or both of them. Chapter 5 deals with this in more detail.

Implications for developing criteria

Perhaps the biggest impact of differentiating between two dimensions is that the criteria are developed differently. When working out social criteria for products and services, the focus is on how, to what extent and for whom they contribute to creating adequate living conditions. When working out criteria for the horizontal dimension, these basically address their effectiveness in implementing processes that respect and support human rights. It relates to key impacts on affected stakeholder groups, resulting in positive outcomes for people.

‘Do no significant harm’ – substantial contribution

The vertical dimension might be more focused on substantial contribution, whereas the horizontal dimension might play a more prominent role as ‘do no significant harm’.

While some products and services can contribute to adequate living conditions, their harmful social impacts on other objectives of adequate living conditions are often limited. Healthcare products are unlikely to have detrimental effects on education and basic economic infrastructure. Harmful impacts would mainly affect quality. So questions about the quality of food, water and healthcare will serve as ‘do not significant harm’. In addition to this, ‘do no significant harm’ criteria based on horizontal objectives aligned with the UN Guiding Principles on Business and Human Rights (UNGPs) and OECD guidelines are very important here. Clinical trials of new drugs and building apartments carry the danger of infringing on human and workers’ rights, which have to be addressed in ‘do no significant harm’ criteria.

On the other hand, the horizontal dimension is well suited to drawing up ‘do no significant harm’ criteria by working out criteria for human rights processes. This includes avoiding and addressing negative impacts on affected stakeholder groups. By respecting human rights, business entities have a positive social impact. So it might be pertinent to also develop these or parts of these under ‘substantial contribution’. However, this will be issue-specific and has to be considered more carefully. This includes avoiding perverse incentives or undermining key standards.

Being horizontal, i.e. being the same for several or even all objectives and to a certain degree for all sectors, will have implications for how ‘do no significant harm’ criteria are defined. Such criteria in the environmental taxonomy have been worked out for each objective and sector separately. This excludes ‘do no significant harm’ for climate adaptation, which is generic across objectives and sectors. The model for generic ‘do no significant harm’ criteria for climate adaptation might be used

when defining ‘do no significant harm’ for social objectives. These specify in more detail alignment with the UNGPs and OECD guidelines.

It is a similar story with governance. As criteria will focus on processes to avoid undesirable methods like bribery and tax optimisation, they tend to relate to the ‘do no significant harm’ sphere rather than to the substantial contribution sphere. The generic ‘do no significant harm’ criteria for climate adaptation could therefore be a model for human rights processes as well as for governance criteria.

4.3. Vertical objectives: promoting adequate living standards

Structure

The main objective of the vertical dimension of a social taxonomy is to promote adequate living standards.

The term ‘adequate standard of living’ is linked to the Universal Declaration of Human Rights and to the International Covenant on Economic, Social and Cultural Rights. Article 11 of the latter refers to ’The right to an adequate standard of living’. This implies adequate food, water, housing and clothing, with the subsequent paragraphs referring to the right to ‘the highest attainable standard of physical and mental health’ and the ‘right to education’[50].

The SDGs incorporate these rights and spell them out in goals 1-4 and 6 (no poverty, zero hunger, good health and wellbeing and quality education). To direct capital flows also to activities that are prerequisites for these goals, the objectives ’essential economic infrastructure (SDG 9)’ and ’peaceful and inclusive societies’ (SDG 16) are added. SDG 8 relates to the horizontal dimension as it focuses on processes that companies implement for example to promote decent employment.

On this basis, we recommend including the following two sub-objectives and topics in a future social taxonomy:

- Improving accessibility of products and services for basic human needs such as:
    - water, including waste water management
    - food
    - housing
    - healthcare, including care work
    - education (including vocational training).
- Improving accessibility to basic economic infrastructure, including (examples, not exhaustive):

[50] United Nations Human Rights Office of the High Commissioner (OHCHR): International Covenant on Economic, Social and Cultural Rights, Article 11 https://www.ohchr.org/EN/ProfessionalInterest/Pages/CESCR.aspx

- transport
- telecommunications and internet
- clean electricity
- financial inclusion
- waste management.

In this dimension, criteria will be attached to economic activities in the sense that the provision of social products and services will be assessed at the level of the economic activity. Criteria for substantial contribution and 'do no significant harm' will be developed for these activities and it will be possible to calculate turnover, capital expenditures (CAPEX)/operating expenses (OPEX) for them.

Having defined these objectives, sub-objectives and topics, the next step is to work out substantial contribution and 'do no significant harm' criteria and test them, along the criteria in Chapter 4.6.

Availability, accessibility, acceptability and quality as an approach to developing substantial contribution and 'do no significant harm' criteria

The suggested starting point for developing criteria in this dimension is the concept of availability, accessibility, acceptability and quality (AAAQ). This concept is already used as a tool to implement rights included in the International Covenant on Economic, Social and Cultural Rights[51]. It has been used among other things for the right to water, healthcare and education (see for example [52]and [53]). The aim of the AAAQ approach is to address all possible obstacles to the fulfilment of social, economic and cultural rights and to find ways to overcome them. It is an internationally recognised way to implement and test the fulfilment of these rights and could be used as such for a social taxonomy.

In this regard, availability means that a certain good is available in a sufficient quantity and is functioning. Accessibility means that a product or service is economically (affordability) and physically accessible without any discrimination and that the related information is also accessible. Acceptability means culturally acceptable, respecting the sensitivity of marginalised groups. Quality means that it is safe and that it meets internationally recognised quality standards that are scientifically approved[54].

Approaches to defining substantial contribution

As the AAAQ concept has been most tested for healthcare, this sub-objective was chosen to be the first for developing criteria. The second objective would be housing, as housing is anchored mainly in the private sphere and housing prices are a concern for many people in Europe, especially in big cities. Conversely, AAAQ for food and water is not a priority concern for most EU citizens, and education belongs mostly to the public sphere and so offers fewer investment opportunities.

[51] See the Danish Institute for Human Rights on the right to water: https://www.humanrights.dk/publications/aaaq-manual-right-water-contextualising-indicators

[52] Danish Institute for Human Rights: The AAAQ Manual and the Right to Water – contextualising indicators 2014, https://www.humanrights.dk/publications/aaaq-manual-right-water-contextualising-indicators

[53] https://www.ohchr.org/Documents/Issues/ESCR/Health/RightToHealthWHOFS2.pdf

[54] WHO Factsheet: the right to health, 2008 https://www.who.int/gender-equity-rights/knowledge/right-to-health-factsheet31.pdf p. 4.

When defining ‘improving accessibility of products and services for basic human needs’ as the social objective, the substantial contributions by which activities meet these objectives will be that the availability and accessibility of these products and services has improved.

On the other hand, when improving availability and accessibility, this should not be at the expense of the quality, and where relevant the acceptability, of the products or services.

An example of improved availability and accessibility for two NACE codes:

- NACE Code 72.11: ’research and experimental development on biotechnology’; and
- NACE Codes 21.10 and 21.20: ‘Manufacture of basic pharmaceutical products and pharmaceutical preparations’.

For the definition of ‘substantial contribution’, the following criteria might be suitable:

- the drug is affordable and economically sustainable for the health system in the countries where it is distributed;
- there is an access strategy for the new medicine, which is developed when it is clinically tested;
- the percentage of the patient group that needs the medicine and that is reached is monitored;
- number of countries in which the medicine is needed and filed for registration.

Another example of improved accessibility could be the building and managing of apartments (NACE code 41.20), with x percent lower rent compared to the average rent in a certain region and ensuring that these apartments are let only to certain target groups like those with low income.

Approaches to defining ‘do no significant harm’

In a second step, ‘do no significant harm’ criteria for these activities will need to be developed. In the environmental taxonomy, these criteria are related to all the objectives and might also set thresholds for substantial contribution.

As mentioned, in a social taxonomy it might be difficult to follow this path as linking ‘do no significant harm’ criteria to the other vertical objectives (water and food, education, basic economic infrastructure, decent employment) poses a problem as long as they are viewed as products and services. The more obvious source for defining ‘do no significant harm’ in this dimension is, that while availability and accessibility serve as substantial contribution, acceptability and quality of a product could well serve as ’do not significant harm’.

For healthcare, this would mean that an activity that improves the availability and/or accessibility of healthcare must also meet the ‘do no significant harm’ criteria by meeting internationally accepted standards of quality and by also being culturally acceptable.

For housing, this means that building cheaper apartments must meet the ‘do no significant harm’ criteria of meeting certain quality standards, which implies that the insulation is adequate.

While there would be a fairly common understanding of availability, accessibility and quality of products and services, cultural acceptance will be more difficult to define. This would need to be generally acknowledged, and current debates on cultural differences also need to be taken into account. However, there are examples where acceptability is crucial. If for example schools are built in certain areas and they fulfil all criteria on availability, accessibility and quality, but the curriculum includes discriminatory content against the target group, this would not be acceptable.

The second source of 'do no significant harm' for social objectives in the vertical dimension would be the objectives of the horizontal dimension, i.e. respect for human rights. For example, internationally recognised guidelines must be adhered to during clinical trials. Working conditions must not also violate labour rights when building accessible apartments.

4.4 Horizontal objectives: promoting positive impacts and avoiding and addressing negative impacts on affected stakeholder groups

Overall considerations and the case for a stakeholder-centred approach

Vertical objectives focus on 'what type of business activities' could be considered social due to the substantial contribution of such activities to social sustainability and fulfilment of certain human rights. Horizontal objectives take a different perspective. Rather than focusing on the social characteristics of an economic activity, these objectives focus on the degree to which the economic activities can be considered socially sustainable. Such objectives have less to do with the products or goods being produced, and more with the impact on people that is associated with economic activities – not just where such impacts are inherent to the nature of the products and goods. When defining the objectives of a social taxonomy, a key focal point is therefore that of people, or stakeholders, commonly affected by economic activities. A stakeholder-centred approach to defining relevant objectives of a social taxonomy allows us to focus on key individuals and groups that can be both positively and negatively affected by business or by outcomes related to these groups of stakeholders. Business activities impact people across the entire scope of a business entity's ecosystem or value chain. As a result, stakeholders affected by business activities include an entity's own workforce, value chain workers, directly affected communities, communities affected throughout the value chain as well as consumers or end-users. For the sake of simplicity, a future social taxonomy should recognise three groups of stakeholders most commonly impacted by business: workers, consumers and communities, including as impacted in the value chain[55].

Criteria to extend the due diligence of human rights throughout value chains are aligned with international standards. 'Value chain' refers to the full range of activities involved in bringing a product from conception to distribution or sale and everything in-between. The UNGPs specify that businesses should 'identify and assess any actual or potential adverse human rights impacts with which they may be involved either through their own activities or as a result of their business relationships', and clarifies that 'business relationships' are understood to include relationships with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services.' In terms of EU policy development, the European Parliament

[55] This implies the impacts within the value chain on workers, consumers and communities.

resolution of March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability further states that 'due diligence should encompass the entire value chain'[56].

A social taxonomy can do this by including objectives that determine substantial contributions related to business impacts on these three key stakeholder groups as well as define criteria for doing no significant harm. This approach would align with the recommendation of the European Lab Project Task Force on preparatory work for developing possible EU non-financial reporting standards. In its final report of February 2021, it suggested that the 'S' in ESG (environmental social governance) would be defined using a stakeholder-centric approach[57].

Cross-sector relevance of stakeholder objectives

Introducing stakeholder-centric objectives in a social taxonomy would imply opening up social taxonomy alignment to businesses across many more sectors than is the case if the social taxonomy is confined to sectors and economic activities that are inherently social, from the perspective of the goods and services produced and delivered (see also vertical objectives). In other words, ensuring decent work is often disconnected from the type of economic activity performed – the executive management of a hospital or a shoe brand can be equally good or bad at ensuring decent work.

Opening up the social taxonomy to more sectors via stakeholder-oriented objectives includes the potential for driving change at scale. Another advantage of including more sectors and companies is that it mitigates the potential for asset bubbles associated with a narrower universe of 'socially sustainable' assets combined with high investor demand. Moreover, it enables the taxonomy to recognise and give weight to the main internationally agreed standards on social sustainability in a business context, namely the UN Guiding Principles on Business and Human Rights and the OECD Guidelines on Multinational Enterprises. In this regard, SDG 8 – decent work and economic growth, with targets for national economies on decent work, occupational health and safety, social protection, inclusive economic growth and equitable distribution of wealth, also gives guidance when developing criteria. These standards focus on ensuring that business is conducted responsibly rather than on the social value of the products and activities themselves. Where possible, future criteria related to horizontal objectives may be aligned with the European Pillar of Social Rights as they relate to equal opportunities and access to the labour market, fair working conditions and social protection and inclusion[58].

The alternative scenario of not including stakeholder-oriented objectives and including only ones of relevance when selecting social goods and services would result in only a small number of activities being included. The effect of the social taxonomy would therefore be smaller, and the demand from the investor side to engage in social investments may be difficult to meet. There are strong arguments for opening up the social taxonomy to more sectors, but it also brings with it the dilemma of whether economic entities in all sectors should be eligible for social taxonomy alignment. To mitigate risks of unintended consequences or taxonomy loopholes, exclusion criteria or significantly harmful criteria

[56] P9_TA(2021)0073, Corporate due diligence and corporate accountability, European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL).

[57] European Financial Reporting Advisory Group, Final Report, p. 26.

[58] European Commission: The European Pillar of Social Rights in 20 principles

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.

The need to link stakeholder objectives to both activity and entity when assessing performance in progressing towards a social taxonomy

Technical screening criteria proposed by the Technical Expert Group and currently under development in delegated acts following the Taxonomy Regulation focus on economic activities and set performance thresholds for them. The same approach would be relevant for the vertical objectives of a potential social taxonomy. However, performance thresholds related to horizontal objectives would likely need to relate to both the economic activity and economic entity levels[59]. Some impacts on workers are inherent in all business activities. In that sense, sector or activity neural impacts relate directly to the economic activities, e.g. in the case of high-risk activities from a health and safety perspective. Furthermore, some horizontal criteria might be best formulated at entity level; for example, the existence of certain policies or processes to manage impacts on certain stakeholders in order to have positive outcomes for people. Impacts on communities and consumers are not equally common and relevant across all sectors or economic activities. Associated screening criteria might therefore relate mainly to the activity level.

Criteria development for horizontal objectives will therefore likely target both economic activity and economic entity levels. From a social and human rights perspective, the use of NACE codes to include high-risk sectors would be one way to target key human rights risks associated with select high-risk sectors. It would also allow for an approach similar to the environmental taxonomy.

The degree to which the CAPEX, OPEX and turnover approach from the environmental taxonomy might work for horizontal sub-objectives will likely differ across sub-objectives and associated criteria. For instance, where it might be possible to tie health and safety criteria to CAPEX to a certain degree, it is less evident whether such an approach is meaningful for criteria related to e.g. responsible marketing practices. Whether or not criteria can be tied to CAPEX, OPEX or turnover should however not be mistaken to imply that a certain sub-objective or criteria is of relevance to the social taxonomy.

Qualitative and quantitative metrics

Irrespective of the entity/activity level, stakeholder-centric technical screening criteria would ultimately include qualitative and quantitative metrics and thresholds that target key business impacts on these groups. Qualitative indicators might include dimensions related to policies and procedures in place, including meeting 'do not significant harm' criteria. The social domain in general is not as easily quantifiable as the environmental and quantitative metrics are not always meaningful without context or qualitative information. However, in terms of impacts on workers quantifiable metrics exist within a decent work agenda, including on safe and healthy working conditions, anti-discrimination, freedom of association and employment generation. Internationally agreed thresholds can be derived in certain areas, for instance from ILO standards. In other areas, including those related to consumer and community criteria, there may not always be internationally agreed norms and principles that can be used to determine thresholds. Quantitative metrics can help provide clear outcome-oriented performance benchmarks rather than relying only on policy and procedure level information that will

[59] See section 3.1 on entity vs activity distinctions.

remain proxies to some extent for actual impacts. Criteria development therefore needs to consider which performance dimensions are conceptually sound given their standing in international norms, any tensions with national laws etc., as well as whether it will be feasible to develop metrics and set thresholds for such dimensions.

Recommendations

We recommend including the following three stakeholder-centric objectives in a future social taxonomy:

- ensuring decent work
- promoting consumer interests
- enabling inclusive and sustainable communities.

All three objectives should include criteria that pertain to impacts in the whole value chain.

We should include exclusion criteria to ensure that socially harmful activities are not eligible for social taxonomy alignment as it relates to horizontal objectives.

Adequately reflecting the importance of respect for human rights in a social taxonomy

Respect for human rights as the crucial standard

The horizontal objectives outlined above can help direct attention towards meeting thresholds in key priority areas related to the three affected groups, such as ensuring a living wage for workers, providing consumers with 'cybersecure' products, or ensuring sustained livelihoods for communities. However, they can and should not replace or substitute efforts by all businesses to meet the main standard of business conduct available for impacts on people, namely the UN Guiding Principles on Business and Human Rights (UNGPs)[60].

The UNGPs provide a global standard of expected business conduct for avoiding and addressing any negative impacts that business may have on people. As a benchmark and threshold for what constitutes negative impacts on people, the UNGPs are based on the International Bill of Human Rights as well as ILO core conventions. The OECD Guidelines for Multinational Enterprises mirror these key expectations of business to ensure responsible business conduct. Incorporating and strengthening these standards will be paramount to the credibility of a social taxonomy and to avoiding social washing risks.

For companies, respect for human rights including labour rights, as defined by the UNGPs, involves having in place management policies and processes to identify, prevent, mitigate and account for potential and actual negative human rights impacts that their business causes, contributes to or is directly linked to through business relationships. Importantly, the UNGPs apply to all companies irrespective of size, sector, ownership structure, location etc. To respect human rights, companies are called on to:

[60] OHCHR's Guiding Principles on Business and Human Rights

- adopt a policy commitment to respect human rights (UNGP Principle 16);
- carry out human rights due diligence by 'assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed' (UNGP Principle 17); and
- 'provide for or cooperate in the remediation' of actual negative impacts caused or contributed to (UNGP Principle 22).

Status quo on respect for human rights in the Taxonomy Regulation and implications for a social taxonomy

The Technical Expert Group and later the EU legislator already recognised the importance of these key international standards in relation to the social subject matter by including them as minimum safeguards in the existing Taxonomy Regulation (Article 18). This was absolutely necessary when creating a taxonomy that focused on the environmental sustainability, but should not be at the expense of social sustainability.

However, when including the social dimension in the taxonomy more than is currently the case, we should reassess the inclusion of these standards as minimum safeguards. First, including them only as safeguards risks underplaying the importance of respect for human rights in realising sustainable development, including social sustainability. The UN Office of the High Commissioner on Human Rights stated in 2017 that '*For businesses, the most powerful contribution to sustainable development is to embed respect for human rights in their activities and across their value chains, addressing harm done to people and focusing on the potential and actual impacts*'[61]. Indeed, respect for human rights by business has the potential to transform the lives of workers, communities and consumers and enable social sustainability rooted in internationally acknowledged principles and norms. In short, not doing harm to people is not just a minimum safeguard question – when businesses proactively try to avoid and address potential and actual negative human rights impacts associated with their business, it results in positive and potentially transformative social improvements for those affected. The centrality and transformative potential of respect for human rights by business is not adequately captured by the current inclusion of UNGPs and related standards in Article 18.

Article 18 also does not include information on its practical functioning or application. The Platform on Sustainable Finance has therefore been asked to advise the Commission on the functioning of Article 18. Whilst the task related to Article 18 was originally meant to be developed after the advice on a social taxonomy had been finalised, the two are intertwined and interdependent. For this reason, the Platform has discussed the implications of Article 18 for the social taxonomy. As financial market participants are now starting to apply the Taxonomy Regulation, there are some examples available of early stage implementation practices.

Experience shared by financial market participants highlight challenges in applying the safeguards requirement, including due to data gaps and raises questions about when and how compliance with

[61] OHCHR, 2017, The business and human rights dimension of sustainable development: Embedding "Protect, Respect and Remedy" in SDGs implementation.

article 18 can simply be assumed due to legal compliance.[62] Service providers have further started to develop taxonomy services, some of which reveal concerning application examples. For example, an ESG rating providers indicated using the following indicator for compliance with the minimum safeguards: 'It must be verified that the company has not been subject to (allegations of) failing to meet minimum social safeguards in their operations.'[63]. It is indeed important to track a company's actual performance on human rights – merely checking commitments and policies does not ensure actual implementation and safeguard human rights. However, this must be accompanied by pro-active alignment with the minimum safeguards' requirements. Otherwise a simple check of media reports on human rights violations, which tends to be arbitrary, would suffice to evaluate the human rights performance of a company. There are also concerns about the minimum safeguards requirement as there seem to be huge data gaps at this stage. One way of addressing this is by interpreting minimum safeguards, with prioritisation of salient indicators and the development of standardised reporting templates in line with the future Corporate Sustainability Reporting Directive[64]. In other words, there are indications that the safeguards clause is currently difficult to implement and that the minimum safeguards clause currently cannot be relied on to drive large-scale uptake of respect for human rights by business. This is a concern for undermining sustainable finance in the current taxonomy, but becomes even more problematic if not addressed when introducing social objectives.

Finally, whereas the minimum safeguards in the current taxonomy regulation covers a subject matter that is not the focus of criteria for substantial contribution or doing no significant harm, this is not the case when extending the taxonomy to social objectives. When extending the taxonomy to social objectives the issue of overlaps and interdependence with article 18 appear and need resolution in order to provide clarity for users as well as for addressing the abovementioned risks.

As a potential solution to the challenges with the minimum safeguards clause indicated above and as a way to adequately reflect international standards, generic DNSH criteria that develop criteria for DNSH in alignment with the UNGPs and OECD Guidelines could be considered. Whereas the minimum safeguards clause and potential generic DNSH criteria would be very similar in content, they would differ in their level of specificity, as generic DNSH criteria could be specified and elaborated in a delegated act to come, which could address the implementation weaknesses of the current safeguards clause. These generic DNSH criteria would relate to the economic entity not to the economic activity and in this they would differ from the environmental DNSH criteria. However, just as the generic DNSH for climate adaptation relates to an adaptation plan for an economic activity these social DNSH would relate to human rights processes adopted by an economic activity.

Three stakeholder-centric objectives, prioritised objective dimensions and preliminary considerations on criteria for substantial contribution and 'doing no significant harm'

ENSURING DECENT WORK

[62] United Nations Environment Program Finance Initiative & The European Banking Federation (EBF). 'Testing the application of the EU Taxonomy to core banking products: high level recommendations, 2021, see pp. 34-36, available at Testing-the-application-of-the-EU-Taxonomy-to-core-banking-products-Final-v2.pdf (unepfi.org), last accessed 31.03.2021.
[63] Institutional Shareholder Services (ISS), 'EU Taxonomy in Focus Webinar', available at EU Taxonomy in Focus Webinar - ISS (issgovernance.com) last accessed 31.03.2021.
[64] SG 3 Interim report, pp. 33-35.

This objective would include sub-objectives that emphasise key aspects of respecting and supporting human rights in terms of impacts on affected workers, including on core labour rights. It would also reflect employment generation for certain groups of people as it also relates to the 'just transition'.

We recommend including the following sub-topics (hereinafter 'sub-objectives') when developing criteria for substantial contribution and 'doing no significant harm' in relation to the 'ensuring decent work' objective:

- social dialogue, including freedom of association and collective bargaining
- non-discrimination and equalities
- no child labour
- no forced labour
- decent employment conditions, including living wage and working hours
- health and safety
- skills, life-long learning, and employment generation for certain groups
- social protection
- impacts on workers in the entity's value chain, as it relates to the above sub-objectives.

The practicability and accuracy of the criteria developed for the sub-objectives will have to be identified and tested, including along the template in Chapter 4.6. By way of illustration, the objective in a future social taxonomy could take the following form:

An economic entity will qualify as enabling decent work where it:

- strengthens **social dialogue** with collective bargaining agreements for setting wages and maintains an active global framework agreement[65] between the company and workers where applicable and as appropriate in the national context;
- respects **equalities and non-discrimination** by ensuring that worker representation in equalities groups is balanced at all levels of the organisation, with pay gaps including gender pay gaps monitored and improved, and provides parental leave;
- avoids and addresses instances of **forced labour**;
- avoids and addresses instances of **child labour**;
- permits **decent employment and living wages, while respecting wider collective bargaining arrangements between social partners,** with low reliance on outsourcing and agency workers in precarious employment, pays a living wage to all workers/living income to farmers, ensures decent working hours and that the pay gap between executives and the average worker is not excessive;
- provides excellent **health and safety** arrangements and outcomes, with high worker representation in formal joint management/worker health and safety committees.
- runs extensive programmes for **skills and life-long learning** for all employees, with high worker involvement in programme development and generation of decent employment for certain groups to be defined;
- provides for **social protection**, including employee pensions partly funded by employers and good childcare arrangements, as appropriate in the national context;

[65] Global framework agreements regulate working conditions across a company's global operations and are negotiated on a global level between trade unions and multinationals.

- ensures respect for human rights of affected workers in the value chain by carrying out risk-based due diligence including as it relates to above mentioned sub-objective areas.

Benchmarks for substantial contributions as well as 'do no significant harm' that relate to the worker objective should be rooted in relevant international standards. This includes the International Bill of Human Rights and other core UN human rights conventions, the ILO's Declaration on Fundamental Principles and Rights at Work, the ILO fundamental conventions and the EU's Charter of Fundamental Rights. In this respect, international labour standards would represent a threshold that must be met in order to fulfil the expectation to do no significant harm and a baseline for substantial contributions, which would be expected to go beyond established standards and norms. Where possible, the sub-objectives and associated criteria might further be aligned with the European Pillar of Social Rights as they relate to equal opportunities and access to the labour market, fair working conditions and social protection and inclusion[66].

We should pay attention to developing criteria for substantial contributions and doing no significant harm that strengthen the actual implementation of internationally recognised minimum standards. By way of example, while a living wage is a human right and therefore a non-negotiable minimum standard, the reality is that millions of workers do not earn a living wage. Many of them work in value chains or even for operations of European companies themselves, including in the textile and agricultural sectors. While it is a minimum expectation and suitable for 'do no significant harm' criteria, its realisation would be a substantial contribution to social sustainability. Including a living wage as a substantial contribution would provide an incentive structure for its potential realisation, which is not necessarily implied by inclusion in 'do no significant harm' criteria.

The taxonomy should reflect wider agreement on the importance of collective bargaining. For example, the OECD report 'Negotiating our way up' regards the mechanism as critical to all three dimensions of its jobs quality framework (earnings quality, labour market security and quality of the working environment) and to inclusive growth [67].

In short, criteria development should balance a conceptually sound approach with designing sub-objectives that can attract capital into relevant areas for social transformation.

The criteria related to objectives, whether on substantial contribution or doing no significant harm, may be a mix of entity and/or activity-specific thresholds. For example, the ILO Minimum Age Convention makes minimum age distinctions based on the type of work in question. The ILO also has a number of sector-specific conventions (for agricultural work and mining), and at times distinguishes between industrial and non-industrial work. The OECD has also developed standards and guidance on the responsible business conduct of different sectors, which may help develop criteria. Table 1 contains examples of possible criteria related to living wages and health and safety.

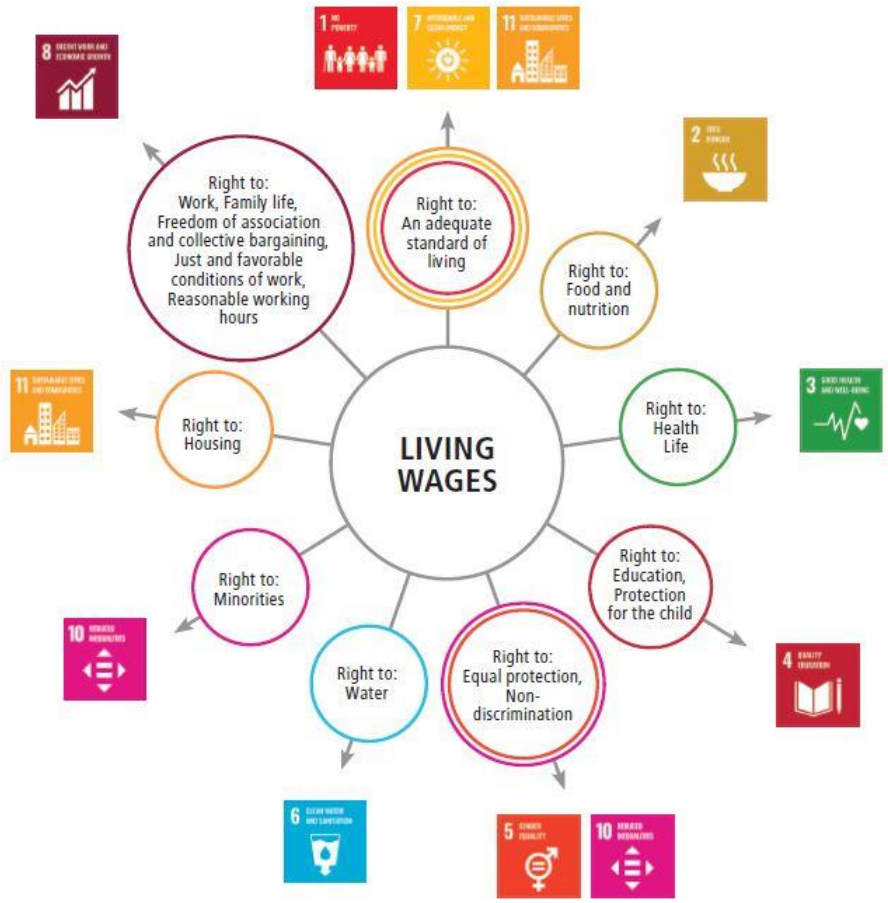
[66] The European Pillar of Social Rights in 20 principles

[67] https://www.oecd.org/employment/negotiating-our-way-up-1fd2da34-en.htm

Specific criteria and thresholds will eventually need to be defined in relation to each sub-objective included (with criteria set at entity and/or activity-specific levels) for each as appropriate in future delegated acts. The final list of sub-objectives and corresponding development of criteria for substantial contribution and ''doing no significant harm' is subject to further development. Where relevant, it should draw on expertise from social parties, i.e. both employers and trade unions. When developing criteria that relate to the sub-objectives, we will also have to consider the complexity associated with national differences, including divergence over the role of social partners and social protection frameworks. As mentioned, internationally agreed standards should provide a basis for setting thresholds applicable across country contexts and for comparing performance across countries. Where possible, criteria development should further reflect relevance across businesses of different sizes, including to be fit for purpose for SMEs.

Living Wages and Living Incomes and the SDGs

Living wages and living incomes are linked to the following SDGs:



Graphic courtesy of Shift Project, Ltd. Learn more at www.shiftproject.org/sdgs

TABLE 1: Example of potential entity-specific elements of future criteria for substantial contribution and 'do no significant harm' related to a living wage

	Substantial contribution	**'Do no significant harm'**	**'Do no significant harm' generic UNGPs (see Chapter 4.2)**
Living wage	ENTITY: (a) The company discloses a time-bound target for paying all workers a living wage or that it has succeeded in paying all workers a living wage. AND (b) The company describes how it determines a living wage for the regions where it operates, making reference to applicable collective bargaining arrangements. AND (c) The company describes how it works to support the payment of a living wage through its business relationships[68].	ENTITY: The company has a publicly available commitment to fair pay/a living wage. AND The company pays its own workers at least the national minimum wage, where such is available, or in accordance with negotiations and collective bargaining by social parties.	Human rights due diligence in alignment with UNGPs

PROMOTING CONSUMER INTERESTS

This objective will include sub-objectives that emphasise key aspects of respecting and supporting the human rights of consumers, including by promoting consumer interests. Accordingly, the term 'consumer' includes both consumers and end-users.

We recommend including the following sub-topics (hereinafter 'sub-objectives') when developing criteria for substantial contribution and doing no significant harm in relation to the consumer objective:

- safety and quality of products and services
- protection of consumers' personal data and privacy as well as cybersecurity
- responsible marketing practices.

[68] Living wage indicator, World Benchmarking Alliance, Social Transformation.

Depending on the type of business and activity, the practicability and accuracy of the criteria developed for the sub-objectives will have to be identified and tested, including along the template in Chapter 4.6. By way of illustration, the objective in a future social taxonomy could take the following form:

An economic entity will qualify as respecting consumers' rights and promoting their interests where it:

- Enhances the **safety and the quality** of its products and services, including by:
    - not including harmful chemicals in its products or not using such chemicals when providing services, wherever less harmful alternatives are available;
    - establishing swift, effective and transparent recall procedures in case their products develop defects that put user safety at risk;
    - offering extended guarantee periods for product defects;
    - designing products to be durable and repairable (availability of spare parts, interoperability with spare parts of competitors) and offering services that allow for a smooth multimodality experience (e.g. in transport);
    - committing to also apply EU safety legislation to products they import;
    - disclosing chemical substances present in products (toys, paints, furniture) or used for services (house painting, hairdressing).
- Provides for the protection of **consumers' personal data and privacy as well as cybersecurity** by design and by default (the most privacy-friendly and secure option must be switched on by default), including by:
    - designing IT interfaces responsibly, refraining from exposing users to dark patterns, with special attention to preventing any type of discriminatory algorithms;
    - designing privacy terms and conditions in plain, short and intelligible language;
    - providing connected products that keep their primary function even if the software is switched off or outdated.
- Engages in **responsible marketing practices**, including by:
    - setting data collection policies that refrain from profiling users for commercial purposes;
    - promoting non-discrimination and diversity in marketing practices;
    - promoting healthy food options in a proactive way, especially when targeting children;
    - providing information on social and environmental impacts in the product supply chain.

Setting technical screening criteria for the consumer objective will differ from the worker example – not all business entities, let alone economic activities, are consumer-facing or have direct impacts on consumers or end-users. This should be reflected in the approach taken to developing criteria.

Benchmarks for substantial contribution as well as 'do no significant harm' that relate to the consumer objective should be rooted in international standards, and in particular in the UN guidelines on consumer protection[69]. In this respect, the UN guidelines would represent a threshold that must be

[69] https://unctad.org/system/files/official-document/ditccplpmisc2016d1_en.pdf

met in order to fulfil the expectation to do no significant harm and a baseline for substantial contributions, which would be expected to go beyond established standards and norms.

In addition, the criteria may be a mix of entity and activity-specific thresholds. 'Do no significant harm' criteria would likely be activity-agnostic as it would primarily be defined by negative duties (not engaging in predatory or misleading marketing etc.). Meeting these thresholds will clearly be more difficult for some sectors than others, but end consumer-facing companies should be able to demonstrate they are not doing significant harm. On the other hand, substantial contribution criteria are likely to involve economic activity level criteria because the potential benefits to consumers will vary significantly across sectors and activities. The expectation may involve general efforts to promote consumer education and disclose product information (related to safety or sustainability) above and beyond that required by local laws. However, what it takes to do this in practice will be sector-dependent.

ENABLING INCLUSIVE AND SUSTAINABLE COMMUNITIES

This objective will include sub-objectives that emphasise key aspects of respecting and supporting human rights in terms of impacts on communities.

We recommend including the following sub-topics (hereinafter 'sub-objectives') when developing criteria for substantial contribution and doing no significant harm in relation to the communities objective:

- equality and inclusive growth
- impacts on land and livelihoods
- safety and security, human rights defenders, civic space.

The practicability and accuracy of the criteria developed for the sub-objectives will have to be identified and tested including along the template in chapter 4.6. By way of illustration, the objective in a future social taxonomy could take the following form:

An economic entity will qualify as enabling inclusive and sustainable communities where it:

- Promotes equality and inclusive growth including by
    - Providing training, capacity building and job opportunities targeted at affected communities including groups in situations of vulnerability.
    - promoting the hiring of locals as well as the use of local content and services in impoverished areas;
    - promoting gender equality by addressing a recognised gender gap or having a transformative impact on gender equality and time savings for women; creating jobs for women, both direct and indirect, incl. special measures to attract women into the workforce or to break down occupational segregation at the level of the activity (e.g. child care facilities, diversity policies that go beyond mere compliance with existing legislation)
- Supports sustainable livelihoods and land rights including by
    - managing community impacts on health, food, water and sanitation, housing and education associated with business operations;
    - protecting culturally and spiritually sacred sites;
    - respecting indigenous and customary land rights when acquiring or using land;
    - redesigning business plans or activities to avoid impacts on indigenous or customary land;

    - carrying out consultations and ensuring free, prior and informed consent from affected communities, at a minimum indigenous people's groups wherever applicable[70]
    - Ensuring safety and security of affected communities
- Supports freedom of assembly and expression including the protection of human rights defenders and civic space by
    - Taking action and engaging with states on issues relating to human rights defenders and restrictions on civic freedoms and the rule of law.
    - Engaging in collective advocacy and multi-stakeholder coalitions

Community related benchmarks for substantial contribution as well as 'do no significant harm' should be rooted in international standards to the extent possible, including international human rights conventions, Sustainable Development Goals and OECD and UN due diligence standards. This proven respect of principles in international human rights conventions and risk-based due diligence would represent a threshold that must be met in order to fulfil the expectation to do no significant harm and a baseline for substantial contributions, which would be expected to go beyond established standards and norms.

In the environmental taxonomy, the importance of respecting the rights of communities in certain sectors has already been acknowledged by introducing the International Finance Corporation performance standard 1 as a 'do no significant harm' criterion, which requires an environmental and social management system[71].

Setting technical screening criteria for the communities objective has some similarity with the consumer objective –not all business entities, let alone economic activities, have a direct impact on communities. In this regard, it will be important to ensure that criteria for substantial contribution do not promote philanthropy or a return to early versions of corporate sustainability reporting, where companies engage in 'do good' activities that have little connection to their operational footprint or the negative impacts associated with their business model. This dilemma will need to be considered.

In addition, while the opportunity to make a substantial contribution to communities may vary significantly based on geographic and other contextual factors, it will not always be defined by the sector in which an economic entity is operating. For example, where the operations of a mining company or manufacturer are located (e.g. in an impoverished area or area populated by indigenous peoples) will likely have more bearing on whether they can substantially contribute towards protecting indigenous people's rights or promoting equality than the nature of their sector. As such, some substantial contribution criteria may be sector-agnostic, although some aspects will likely be more relevant for some sectors than others. We will therefore also need to consider the geographical dimension.

Moreover, there is a risk of overlap between the community objective and worker and consumer objectives as community members are often also workers and consumers. In addition, there is a risk of overlap between this objective and those included in the vertical dimension of products and

[70] Actors such as the UN Working Group, UN Special Rapporteur on the Rights of Indigenous Peoples and UN Permanent Forum on Indigenous Issues have all recognised the obligation to respect the right to free prior and informed consent of indigenous peoples enshrined in the UN Declaration on the Rights of Indigenous Peoples as being relevant to non-state actors, including businesses.

[71] https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/policies-standards/performance-standards/ps1

services for adequate standards of living. Once criteria have been further developed, a consistency review across objectives can help ensure that overlaps and interlinks are adequately addressed.

4.5. Governance

Article 20(j) of the Taxonomy Regulation requires the Platform on Sustainable Finance to 'advise the Commission on addressing other sustainability objectives, including social objectives'.

In preparing the recommendations as per the Platform's mandate, the Commission asked the Platform to include in particular 'a reflection on other sustainability objectives which could potentially be covered, such as objectives linked to business ethics, governance, anti-bribery or tax compliance matters, as well as a discussion on the merits of covering those objectives'.

This was further clarified by the Commission during the first plenary meeting in October 2020, where it asked the group to consider 'good governance practices such as sound management structures, employee relations, remuneration of staff and tax compliance'[72].

Governance is a topic separate from the horizontal and vertical dimensions of a social taxonomy, which were outlined in the previous chapters.

In accordance with the well-established practice to consider environmental, social and governance aspects when investing sustainably, the EU Taxonomy Regulation in its current state already takes governance aspects into account through minimum safeguards, specifically the *OECD Guidelines for Multinational Enterprises* (MNEs). These guidelines particularly address human rights, labour rights, corruption, tax evasion, consumer protection, science and technology, and fair competition. Although OECD country goverments´have set up national contact points (NCPs) for responsible business conduct to identify good practice to help ensure consistency and encourage resolution of issues, certain elements of governance need to be reflected more strongly in the taxonomy than through minimum safeguards. It should not be enough for companies to confirm that they follow the procedures of international guidelines. Rather, it should also be obvious how and to what extent this is done and where possible which outcomes can be observed.

Finally, it must be stressed that governance factors can be relevant to both the environmental and social taxonomies in two ways. Firstly, good corporate governance structures provide a company with the framework for setting guidelines and incentives for behaviour which can benefit its social and environmental performance. Secondly, such structures can help a company mitigate or even avoid any risks stemming from social and environmental factors. Seen in this light, governance objectives can be an enabler for both social and environmental objectives. That said, specifically in the context of the proposed social taxonomy, there are governance topics which can be seen as relating to social aspects only. Examples of this are diversity and non-aggressive tax planning.

[72] Art.2, point (17) of SFDR: ' … provided the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance'.

Having established that there is a role for governance criteria that address ESG performance, we need to clarify that this would not extend to all governance factors contained in other legislation or national reporting requirements. The taxonomy does not need to include 'hard' corporate governance factors such as cumulative voting, dual-class share structure, majority voting, poison pills, shareowner rights, etc. The focus would be on topics listed in international guidelines such as the OECD guidelines for MNEs and those considered important for what could be called 'sustainable governance'. Relatedly, SDG 16 on peace, justice and strong institutions provides useful direction and associated company-oriented frameworks that emphasise the critical role of private actors in supporting the rule of law, transparency, accountability, good governance, and non-discrimination[73]. The objectives below could be incorporated, irrespective of local standards around governance.

As part of an environmental and social taxonomy, we would therefore recommend two objectives:

1. **Good sustainable corporate governance**
2. **Transparent and non-aggressive tax planning**

The practicability and accuracy of the criteria developed for the topics linked to these objectives will have to be tested, including along the criteria in Chapter 4.6. The following topics are suggested for further consideration.

Good sustainable corporate governance

Competencies in the highest governance body:

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

Selected topics are further explained and contextualised below. They would be looked at more carefully when determining what could constitute a substantial contribution and/or doing significant harm in relation to the governance objectives.

Executive remuneration linked to environmental and social factors

A recent report found that many European companies already incorporate environmental, social and governance metrics into executive remuneration. In a study of 365 issuers from major indexes in continental Europe and the UK, 68% have at least one ESG metric in their incentive plans.

[73] Introduction to the SDG 16 Business Framework (unglobalcompact.org).

Environmental, social and governance issues now sit at the heart of good business practice, and for some companies have become a central strategic pillar. As a result, many companies around the world are linking executive remuneration to ESG goals – whether reducing emissions, customer welfare or workforce diversity[74].

Having executive remuneration linked to ESG should be part of the EU taxonomy as it is a reflection of what is happening in the real economy.

That said, some businesses and other stakeholders are voicing strong concerns about linking executive remuneration to environmental and social factors, arguing that it would interfere with the culture and autonomy of a company. These concerns have been acknowledged and are being considered.

Therefore, further consideration needs to be given to the 'how', with experts agreeing that it needs to be based on a company's own sustainability objectives and to be directional but not prescriptive. Linking environmental, social and governance issues to executive remuneration would not be based on a fixed list of indicators for a company or even sector but on the companies' own sustainability strategy and key performance indicators. An option would be to link ESG factors to the structure of long-term incentive plans and the performance measures they are tied to, possibly along with claw back or malus measures[75]. Consideration also needs to be given to any unintended consequences of linking ESG to long-term incentive plans, which might lead to, for example, greenwashing or gamification[76].

Linking executive remuneration to sustainability factors is considered to be a very effective way to steer a company towards achieving the sustainability targets it has set for itself. Together with board diversity, it features as a criterion in most ESG ratings and is part of engagement strategies and dialogues between investors and companies. Furthermore, taxonomy is primarily a tool for sustainable investors, who expect this topic to be included. Finally, leaving companies to choose their own sustainability targets in line with their strategy, which would then be linked to remuneration, means that companies' autonomy is largely preserved.

Developing criteria on sustainability-linked remuneration and board composition

Having presented reasons in favour of including diversity and sustainability-linked remuneration in a taxonomy, we turn now to concerns ('cons') about the taxonomy including 'diversity' and 'executive remuneration linked to environmental and social factors in line with companies´ own targets'.

Cons (expressed concerns):

While gender diversity and sustainability expertise at board level are two undeniable key factors, developing criteria for furthering diversity on boards might encounter serious barriers, not least because in some countries gathering information on employees´ ethnicity or sexual orientation is forbidden by law.

[74] https://www.pwc.co.uk/services/human-resource-services/insights/environmental-social-governance-exec-pay-report.html.

[75] https://www.icgn.org/integrating-esg-executive-compensation-plans.

[76] https://www.unpri.org/pri-blog/embedding-sustainability-into-executive-pay/4825.article.

Board composition and nomination is a fundamental pillar of corporate governance legislated in most Member States, and many of them (e.g. France, Spain, Germany, Italy, etc.) have already set targets and legislation to ensure diversity is a key component of boards for listed companies. At European level, the EU regulatory framework on company law and corporate governance is currently being revised. The upcoming Commission proposal on sustainable corporate governance is expected to address issues related to sustainability expertise in boards and making the inclusion of sustainability metrics compulsory. Such metrics could be linked, for example, to the company's sustainability targets or performance on variable remuneration, taking into account workforce remuneration and related policies. Boards could be required to regularly assess their level of expertise on environmental, social and/or human rights matters and take appropriate measures. Moreover, the proposed regulatory technical standards for the Sustainable Finance Disclosure Regulation already oblige financial market participants to take into account and disclose board gender diversity, which means that all financial products would have to report on diversity anyway.

Nevertheless, setting criteria on executive remuneration may prove to be extraordinarily complex given the variety of long-short term variables and schemes, and could lead to unintended consequences. The right balance between short and long-term, cash and equity compensation will depend on each company´s business model and specific situation. This is why many investors will examine each proposal in detail and sometimes even rely on external technical expertise to make a judgement.

On top of this, it is challenging to compare companies on sustainability-linked remuneration, especially if the targets vary between companies. An alternative approach may be to establish some rules around compensation structure, transparency and policy that responsible investors already apply when deciding whether or not to approve executive compensation at annual general meetings.

This could be perceived as disproportionate and infringing national corporate governance models.

Anti-bribery and anti-corruption

Corruption is understood to include practices such as bribery, facilitation payments, fraud, extortion, collusion and money laundering. It also includes the offer or receipt of gifts, loans, fees, rewards, or other advantages as an inducement to do something that is dishonest, illegal, or that represents a breach of trust. It can also include practices such as embezzlement, trading in influence, abuse of function, illicit enrichment, concealment and obstructing justice.

Corruption is broadly linked to negative societal impacts such as inequality and poverty, damage to the environment, abuse of human rights, abuse of democracy, misallocation of investments, and undermining the rule of law.

Organisations can demonstrate their preparedness to meet these expectations by establishing adequate risk assessment. Investors should expect economic entities to demonstrate their commitment to evaluating the risk of corruption when workers, agents, intermediaries or consultants

deal with public officials. They should also provide regular anti-corruption training for all relevant workers within the organisation, including procurement and sales staff[77].

Whistleblowing is increasingly recognised as an important tool in the prevention and detection of corruption and other malpractice. By disclosing wrongdoing in an organisation, whistleblowers can avert harm, protect human rights, help to save lives and safeguard the rule of law[78]. Whistleblowers are a valuable resource for companies to mitigate risks, and the way an organisation deals with reports can provide a good sense of the effectiveness of different policies and processes, covering issues from financial performance to environmental and social protections.

Responsible lobbying and political engagement

When carried out responsibly, lobbying is a legitimate and beneficial activity, providing policy-makers with information, expertise and resources, and engaging with the public by stimulating and contributing to public debate.

'Lobbying, as a way to influence and inform governments, has been part of democracy for at least two centuries, and remains a legitimate tool for influencing public policies. However, it carries risks of undue influence. Lobbying in the 21st century has also become increasingly complex, including new tools for influencing government, such as social media, and a wide range of actors, such as NGOs, think tanks and foreign governments'[79].

As part of their lobbying activities, companies also engage with, and contribute to, trade associations and other organisations that lobby indirectly on their behalf without specific disclosure or accountability, while the prevalence of the revolving door phenomenon is widespread. Examples include fossil fuel companies lobbying against climate change laws.

Responsible practices include observing a quiet period during elections, and ensuring transparency over payments and collaboration with politicians or political parties. Companies should disclose: (i) their policies and procedures governing direct and indirect lobbying; (ii) payments for lobbying, including amounts and recipients; (iii) their involvement with tax-exempt organisations that write and endorse model legislation; and (iv) governance decision-making and oversight processes.

Organisations are expected by the marketplace, international norms[80] and stakeholders to demonstrate their adherence to integrity, governance, and responsible business practices.

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[77] https://investorsforhumanrights.org/issues/corruption.

[78] https://images.transparencycdn.org/images/2010_1_PP_Whistleblowing_EN.pdf.

[79] https://www.oecd.org/governance/lobbying-in-the-21st-century-c6d8eff8-en.htm.

[80] 1. OECD Convention, 'Convention on Combating Bribery of Foreign Public Officials in International Business Transactions', 1997, 2. *OECD Good Practice Guidance on Internal Controls, Ethics, and Compliance*, 2010, 3. *OECD Guidelines for Multinational Enterprises*, 2011, 4. UN Convention, 'Convention against Corruption', 2003.

Transparent and non-aggressive tax planning

Taxes are important sources of government revenue and are central to the fiscal policy and macroeconomic stability of countries. They are acknowledged by the UN to play a vital role in achieving the Sustainable Development Goals.[81]

Taxes are also considered to be crucial to reducing inequality, thus contributing to the objective of economic, social and territorial cohesion provided in the EU Treaty (Article 174 to 178): 'Aggressive avoidance of tax is not only an increased litigation and reputation risk, on which the market still has insufficient transparency; it is also the single biggest instrument of redistribution of wealth globally with the largest potential impact on levels of global and national inequality'[82].

The role of taxes as a measure against soaring inequalities, especially during a crisis, was highlighted by the *Employment and Social Developments in Europe* report 2020[83].

'Since the 2009 crisis, increasing inequality in market incomes (labour income and capital) in many European countries might have required a larger inequality-reducing effort of tax benefit systems to keep disposable income inequality in check. In fact, automatic stabilisers and discretionary policy changes curbed the inequality increases in the labour and capital markets. In particular, the role of social transfers helped to offset market inequality, while fiscal policy changes had different effects on inequality across countries.'

Taxes are a key mechanism by which economic entities contribute to the economies of the countries in which they operate. Taxes paid by an economic entity reflect that profitability depends on many factors external to it, including access to well-trained workers, markets, public infrastructure and services, natural resources, and an efficient public administration.

Economic entities have an obligation to comply with tax legislation, and a responsibility to their stakeholders to meet expectations of good tax practices. If organisations seek to minimise their tax obligation in a jurisdiction, they might deprive the government of revenue. This could lead to reduced investment in public infrastructure and services, increase in government debt, or shifting of the tax obligation onto other tax payers.

Perceptions of tax avoidance by an economic entity could also undermine tax compliance more broadly, by driving other economic entities to engage in aggressive tax planning based on the view that they might otherwise be at a competitive disadvantage. This can lead to increasing costs associated with tax regulation and enforcement and in the end to higher inequality within and between countries.

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[81] United Nations (UN) Resolution, Transforming our world: the 2030 Agenda for Sustainable Development, 2015. (See in particular Target 17.1: 'Strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection,' under Goal 17: 'Strengthen the means of implementation and revitalize the global partnership for sustainable development.')

[82] https://www.longfinance.net/media/documents/Kepler_Cheuvreux_Inequality_2016.pdf p. 53.

[83] *Employment and Social Developments in Europe* report 2020: p. 37–38 https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8342&furtherPubs=yes .

Tax transparency

Public reporting on tax increases transparency and promotes trust and credibility in the tax practices of economic entities and in the tax systems. It enables stakeholders to make informed judgments about an organisation's tax positions. Tax transparency also informs public debate and supports the development of socially desirable tax policy.

Comprehensive tax reporting enables an organisation to understand and communicate its management approach in relation to tax, and to report its revenue, tax and business activities on a country-by-country basis.

Country-by-country reporting involves the reporting of financial, economic, and tax-related information for each jurisdiction in which an organisation operates. This indicates the economic entity's scale of activity and the contribution it makes through tax in these jurisdictions. In combination with the management approach disclosures, country-by-country reporting gives insight into the economic entity's tax practices in different jurisdictions. It can also signal to stakeholders any potential reputational and financial risks in the organisation's tax practices.

Tax approach

An economic entity's approach to tax defines how the organisation balances tax compliance with business activities and ethical, societal and sustainable development-related expectations. It can include the organisation's tax principles, its attitude to tax planning, the degree of risk the economic entity is willing to accept, and the economic entity's approach to engaging with tax authorities.

Having robust governance, control and risk management systems in place for tax can be an indication that an economic entity's approach to tax and tax strategy are well embedded and that it is effectively monitoring its compliance obligations.

On the tax approach, it is critical to understand:

- whether the highest governance body in an economic entity is accountable for compliance with the tax strategy, including the degree to which the highest governance body has oversight of compliance;
- whether the economic entity seeks to comply with the letter and the spirit of the law (i.e. whether it takes reasonable steps to determine and follow the intention of the legislature)[84];
- whether the economic entity embraces practices to avoid tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created.

[84] Organisation for Economic Co-operation and Development (OECD), 'Taxation', OECD Guidelines for Multinational Enterprises, pp. 60-63, 2011.

4.6 Metrics of a social taxonomy

There are many possible ways to measure the social impact of an economic activity or entity. Some data, for example data relating to staff i.e. on wages, health and safety, is already at the disposal of companies and official bodies. In addition, ESG rating agencies, voluntary reporting systems, development banks and others have worked out indicators which are already implemented in some places. Several suggestions are in place on how economic entities could report on their impact on the SDGs and how this impact could be measured. Many of these systems have already been considered for this work and will continue to play a part in the development of a suggestion for the social taxonomy.

So apart form the question whether there are indicators and data for these indicators the question arises which indicators and data will be most meaningful and practical.

To explore this, we suggest the following criteria for indicators for a social taxonomy.

- The indicator should relate to a norm, process or goal in internationally recognised standards, like the UN guiding principles, the SDGs, the EU Social Charter and the EU Pillar of Social Rights.
- The indicator must be a good proxy for the objective it addresses (example: the proportion of women on a board is a proxy for board diversity but not for non-discrimination in an economic entity).
- The indicator should be specific enough to relate it to an economic activity or to an economic entity.
- The indicator must have a clear direction (example: how to evaluate complaints mechanisms? Is it good if there are many complaints, as this shows that workers trust the complaint mechanism? Or is it good if there are few complaints, as this might indicate that stakeholders do not find many issues to complain about?)
- Indicators should be at a similar level of detail.
- Indicators should avoid driving perverse incentives or unintended consequences (example: unintendedly driving divestments from SMEs).
- Data should be available at reasonable cost. Differences between larger and smaller companies should be considered.

In its subsequent work, the Platform will apply these criteria when developing and selecting specific indicators.

5. Significantly harmful activities considered for a social taxonomy

So far, the environmental taxonomy excludes power generation using solid fossil fuels. This is because power cannot be generated with solid fossil fuels in a way which would be compatible with the Paris agreement[85] .

If the social taxonomy follows this reasoning, significantly harmful activities would be those which are fundamentally and under all circumstances opposed to the objectives suggested in this text. There would be no way to make these activities less harmful.

The reasoning for declaring activities socially harmful would then have two sources. On the one hand, internationally agreed conventions for ex on certain kinds of weapons would be used. On the other hand, research on detrimental effects of certain activities would be used to identify significantly harmful activities. The generally acknowledged results on the detrimental health effects of tobacco use could for example be a reason to identify the production and marketing of cigarettes as significantly harmful.

6. The relationship between the social taxonomy and environmental taxonomy

6.1. Conceptual considerations

The possible relationship between the environmental and social taxonomies can be viewed as a continuum with two opposing extremes. At one end is a single taxonomy defining economic activities which are both socially and environmentally sustainable. This extreme option would pose several problems. For one, it would mean adding together an economic entity's social and environmental sustainability, expressed as percentages, even though they are measuring very different things. The sum would not be transparent or could even be misleading. This approach would also reduce the number of sustainable activities drastically as they would have to meet high environmental and social criteria. This probably means that this approach is not practicable.

[85] REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN

At the other end of the spectrum are two independent taxonomies, one defining environmentally sustainable activities and the other defining socially sustainable activities, without any relation between them. The existing Taxonomy Regulation already rules out the second option. The introduction of minimum safeguards forges a link between the environmental and social parts in that environmentally sustainable activities must not violate the UN guiding principles and the OECD guidelines.

Between the two extremes many options are possible. However, apart from ruling out the two most extreme models, a possible relationship should respect the principle of equivalence of the social and environmental taxonomies.

Based on these premises, the obvious structure for a more loose relationship would be to establish an independent social taxonomy with environmental safeguards. Mirroring the minimum safeguards for the environmental taxonomy, the environmental minimum safeguards for a social taxonomy in this model could be the environmental part of the OECD guidelines (see model 1 below).

Model 1: 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 proposals are also made on the assumption that companies will report separately on their turnover/capital expenditures or operating expenses for social and environmental activities respectively.

Model 1

Objective	SC criteria for	DNSH for	Minimum safeguard (UNGP, OECD)
Climate mitigation	Environment	Environment	UNGP OECD without environment
Climate adaptation	Environment	Environment	UNGP OECD without environment
Circular economy	Environment	Environment	UNGP OECD without environment
Pollution control	Environment	Environment	UNGP OECD without environment
Water	Environment	Environment	UNGP OECD without environment
Biodiversity	Environment	Environment	UNGP OECD without environment
Improving accessibility of products and services for basic human needs	Social	Social	OECD, governance and environment

Improving accessibility of products and services for basic human needs	Social	Social	OECD, governance and environment
Employment	Social	Social	OECD, governance and environment
Impact on workers	Social	Social	OECD, governance and environment
Impact on consumers	Social	Social	OECD, governance and environment
Impact on communities	Social	Social	OECD, governance and environment

Model 1 would have general requirements for social and environmental activities respectively. A general due diligence system for environmental and climate protection on the basis of the UN guiding principles and OECD guidelines might suffice to fulfil the minimum safeguards. With this model, activities with a strong environmental or social profile will be acknowledged on their respective merits without being punished for not meeting specific and strict criteria under the other part of the taxonomy.

In this way, activities which fulfil the environmental SC and DNSH criteria and undergo only general due diligence on the UNGP and OECD guidelines, but which might have some exposure to human rights risks, might still meet the criteria of the taxonomy and be 'environmentally sustainable'. On the other hand, socially sustainable activities would only be required to meet general environmental standards below the 'do no significant harm' criteria of the green taxonomy.

In this model, the human rights criteria, for example, for building social housing would be stricter or at least more detailed than when building green apartments. Similarly, an activity which makes a substantial contribution to communities or to healthcare will have to meet stricter worker's rights criteria than the 'green' production of electric cars. Likewise, a producer of solar panels will have to fulfil stricter environmental criteria than the producer of 'social' pharmaceuticals. Or a mining company might opt to be socially sustainable by introducing high human rights standards for communities, but meet only basic environmental criteria.

In such cases, companies may focus on meeting whatever criteria are easier, be they social or environmental, and be content with superficial due diligence processes for the other part of the taxonomy.

The second model under consideration might solve this problem but bring new ones. In model two, there is a closer relationship between the social and the environmental. An activity will have to meet either at least one environmental or at least one social substantial contribution requirement. On top of that, all activities will have to meet all relevant environmental *and* social do no significant harm criteria. In this option, minimum safeguards would be replaced by more detailed social DNSH criteria for the environmental taxonomy, while the already existing DNSH criteria in the environmental taxonomy would be valid for the social taxonomy as well. This second model might imply that some social DNSH criteria would be generic and similar to the DNSH criteria for climate adaptation in the present delegated act, but would be related to economic entities, not economic activities. As has been shown previously, these social DNSH criteria will mostly be human rights and governance criteria,

based on the UNGP and the OECD guidelines. In contrast to the existing minimum safeguards, these would address risks in more detail and might be sector-specific in some cases (see model 2 below).

Although replacing the minimum safeguards by DNSH criteria looks at first sight like a big change to the system, this might not necessarily be the case. The role model would be the generic DNSH criteria for climate adaptation in the green taxonomy (See appendix 2). These are generic for all sectors and for all environmental objectives, and demand that 'climate risks that are material to the activity have been identified (…) by performing a robust climate risk and vulnerability assessment. The assessment is proportionate to the scale of the activity and its expected lifespan.' The change would be that for climate adaptation these generic do no significant harm criteria would relate to an economic activity, whereas for respect of human rights and governance they would sometimes relate to an economic entity.

So, from a structural point of view, model 2 would involve one taxonomy with a list of social and environmental objectives and DNSH criteria, some of them sector-specific, some generic. The design of such a taxonomy would be more compact because it would essentially be one system with do no significant harm criteria for the social and environmental objectives. Depending how strict these DNSH criteria are, the downside would be that there will be fewer activities which would meet both the social and environmental DNSH criteria. There will be environmental activities which will not attract sustainable investment capital because they do not meet specific social standards, just as there will be social activities which do not attract 'social' investment because they do not meet environmental criteria.

Model 2

Objective	SC criteria for	DNSH including generic DNSH Social DNSH based on UNGP, governance based on OECD environmental DNSH, as worked out in environmental taxonomy
Climate mitigation	Environment	Environment social and governance
Climate adaptation	Environment	Environment, social and governance
Circular economy	Environment	Environment, social and governance
Pollution control	Environment	Environment, social and governance
Water	Environment	Environment, social and governance
Biodiversity	Environment	Environment, social and governance
Improving accessibility of products and services for basic human needs	Social	Environment, social and governance

Improving accessibility of products and services for basic human needs	Social	Environment, social and governance
Employment	Social	Environment, social and governance
Impact on workers	Social	Environment, social and governance
Impact on consumers	Social	Environment, social and governance
Impact on communities	Social	Environment, social and governance

The two models probably have slightly different impacts on capital flows. It is to be expected that Funds will report separately on their alignment with the green and social taxonomy and that economic entities will report the turnover for an activity as socially or environmentally sustainable. If the same activity meets the requirements for both social and environmental sustainability, they can report the turnover twice without having to split them up.

Model 1 would then lead to a situation where more activities are considered either socially or environmentally sustainable, whereas with model 2 there would be less sustainable activities, as DNSH requirements include both social and environmental criteria. So, model 1 would probably lead to more capital being directed to socially and environmentally sustainable activities.

For some sectors, a drawback of model 1 would be that only activities that are already social or environmental by nature, like the production of solar panels, would have to meet stricter and more detailed environmental DNSH criteria (on water, pollution, circular economy and biodiversity) than, for example, the production of medicine. In contrast, the production of medicine would have to meet stricter or more detailed social DNSH criteria (on workers, consumers and communities) than the production of solar panels. From a sustainability perspective, this would not make much sense.

Model 2 would lead to fewer sustainable activities as activities would have to meet detailed and stricter social and environmental DNSH criteria. On the other hand, there would be fewer contradictions. Activities identified as environmentally or socially sustainable would all meet social and environmental DNSH criteria. The distinction between 'socially sustainable' and 'environmentally sustainable' would be less pronounced as they only relate to substantial contributions. On top of this, with model 2 there would be a smaller risk of declaring socially harmful activities as environmentally sustainable and environmentally harmful activities as socially sustainable.

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.

Achieving the necessary balance of criteria for both sides will likely require careful and in-depth discussions with experts from both fields.

6.2. Preliminary reflection on possible changes to the Taxonomy Regulation

The content of a social taxonomy should be introduced by articles describing the social objectives and the framework within which the substantial contribution and do no significant harm criteria for these objectives should be drawn up. This could be based on the recommendations of this report.

Depending on the overall relationship between the social and environmental taxonomy, more or less substantial changes might be necessary concerning the DNSH and minimum safeguards, as suggested in Chapter 6.

Apart from these suggested changes to the Taxonomy Regulation, we would recommend coordinating the legislative processes on the taxonomy, the Sustainable Finance Disclosure Regulation and the Corporate Sustainability Reporting Directive, as well as those on sustainable corporate governance and mandatory human rights and due diligence. All of these relate to investor and company processes and reporting on responsible business conduct (i.e. the horizontal dimension covered in this report) and governance. Given the complexity of these topics, it seems crucial to define a common ground of topics covered and indicators to be reported on.

At present, we see the work being carried out in separate work streams. This creates a risk that investors and companies will face different reporting requirements for different legislative acts. This is already the case with the SFDR in its present state and the Delegated Act on the taxonomy. While Article 18 of the Taxonomy Regulation refers to the UN Guiding Principles on Business and Human Rights and the OECD Guidelines as the principles which the undertaking and activity have to comply with, the SFDR (PAI Annex 1) refers to the UN Global Compact and the OECD Guidelines.

Similarly the SFDR, in Article 2(17), refers to 'an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance'. These are understood to be topics on which the minimum safeguards and do no significant harm criteria are built on, while the mandate of the subgroup for the Social Taxonomy Group included a wider scope of topics, most notably also including human rights and the UNGPs.

The recommendation might be that i) similar to the role played by the due diligence law for the environmental taxonomy legislation, the corporate governance law would form the basis for social DNSH criteria; and (ii) the SFRD and CSRD would address the reporting requirements for a social taxonomy, including the reporting necessary for the substantial contribution criteria This, however, would require considering the sequencing of these legislative initiatives.

As work on the social taxonomy is still progressing, the present social reporting requirements in the SFDR might not be sufficient once the social taxonomy has been fully developed. For example, 'involvement in violations of the UNGC principles or OECD Guidelines for Multinational Enterprises' and 'involvement in violations of the UNGC principles' (SFRD PAI Annex 1) are open to interpretation and need to be more specific in order become criteria in a social taxonomy with the necessary accuracy. The same is true for the indicators and policies to monitor: (i) compliance with the UNGC principles or OECD Guidelines for multinational enterprises or (ii) grievance-/complaint-handling mechanisms to address violations of the UNGC principles or OECD Guidelines. (SFRD PAI Annex 1).

In the light of this report, legislation on reporting should also consider both dimensions of the suggested structure of a social taxonomy.

7. Preliminary reflections on impacts

There are still many questions open as to what a social taxonomy will look like and what the relationship between a social and an environmental taxonomy will be. As a result, impacts can only be vaguely guessed at this stage, especially as evidence-based information on the social impact is scarce.

The most obvious impact of a social taxonomy will be on financial market participants. Institutional and retail investors, issuers and asset managers will have guidance on how social investments are defined and which criteria they have to apply if they want to create or invest in a financial product with social objectives. This will have a knock-on effect on economic entities, which will strive to be recognised as 'social' investments, provide the necessary data, intensify efforts on social economic activities and implement the necessary processes. It will also help to prevent the use of already existing, but less-developed, systems when evaluating socially beneficial investments, thus preventing social washing.

These impacts could be measured by analysing the number and volume of financial instruments with social objectives.

With the structure of a social taxonomy suggested in this report, economic entities would have two options for realising social contributions. This will lead to two kinds of impacts.

One impact would be more effective human rights and sustainable governance processes across economies, with measureable positive impacts and real outcomes for workers, consumers and communities throughout the value chain. This will have positive impacts for trade unions´ rights, the payment of living wages, health and safety, safer and more practicable products for consumers and positive impacts for communities and job creation. At first sight, these all seem rather self-evident and may not be viewed as huge strides towards combating inequality and marginalisation. However, calculation on living wages show that the impact would be decisive and comprehensive. If businesses were to adhere rigidly to the right to a living wage in their own business area, as well as in their supply chain, this would be an important step towards implementing the SDGs. According to calculations by the organisation »Shift«, this would improve the lives of 340-450 million people; if we also factor in

their families, as many as 2 billion people would benefit. In other words, a living wage could improve the lives of around 25% of the world population, as envisaged in the SDGs[86].

In the vertical dimension, capital might flow to activities which will contribute to improving access to products and services that improve standards of living and basic economic infrastructure. Redirecting capital flows in these areas might, for example, help reduce the share of people (currently 19 %) living below the poverty threshold and experiencing energy poverty in the EU[87].

These investments will also help to reduce the number of people living in areas and households with limited or no digital connectivity. It will also help to improve the housing situation by opening up opportunities for investors to invest in social housing throughout Europe. Ideas for measuring the social impact of a social taxonomy include:

- the number of listed EU companies which have implemented the UN Guiding Principles and have staff dedicated to this task and reporting to senior management;
- the number of listed EU companies which have implemented a strategy on living wages throughout their supply chain;
- the number of listed EU companies with transparent, non-aggressive tax planning;
- the number of listed EU companies with strong anti-bribery rules;
- the number of apartments meeting minimum quality standards for people who have the right to live in social housing with a housing permit;
- the development of prices for certain pharmaceuticals.

[86] https://shiftproject.org/resource/the-human-rights-opportunity-in-collaboration-with-wbcsd/living-wages .

[87] Employment and Social Developments in Europe. https://ec.europa.eu/social/main.jsp?advSearchKey=esdereport&mode=advancedSubmit&catId=22&policyArea=0&policyAreaSub=0&country=0&year=0#navItem-1

Annex 1: Roadmap for the development of a social taxonomy

The next steps on the road to a fully developed social taxonomy would be:

- Horizontal dimension
  - Consider which sub-topics can have activity-based criteria
  - Developing metrics for topics related not to economic activities but to economic entities
  - Considering which elements work as minimum safeguards, 'do no significant harm' or 'substantial contribution' criteria, with worker, consumer, community objectives, and working out the level of ambition
  - Examples of thresholds for 'do no significant harm' and 'substantial contribution' criteria with worker, consumer and community objectives, by activity and at entity level.
- Vertical dimension
  - Defining the substantial contribution and do no significant harm criteria for housing and healthcare with the help of experts
  - Exploring whether the availability, accessibility, acceptability and quality (AAAQ) concept works for food, education, water and basic economic infrastructure and how.
- Governance
  - Drawing up criteria on taxes, bribery and lobbying (among others)
- Drawing up a rationale for socially harmful activities
- Discussion of the relationship between the social and environmental taxonomies.

Annex 2: Generic do no significant harm criteria for climate adaptation

From the Annex to the Commission Delegated Regulation (EU) .../...supplementing Regulation (EU) 2020/852

APPENDIX E: GENERIC CRITERIA FOR DNSH TO CLIMATE CHANGE ADAPTATION

I. Criteria

New activity

The physical climate risks that are material to the activity have been identified from those listed in the table in Section II of this Appendix by performing a robust climate risk and vulnerability assessment. The assessment is proportionate to the scale of the activity and its expected lifespan, such that:

(a) for investments into activities with an expected lifespan of less than 10 years, the assessment is performed, at least by using downscaling of climate projections;

(b) for all other activities, the assessment is performed using high resolution, state-of-the-art climate projections across a range of future scenarios consistent with the expected lifetime of the activity, including, at least, 10- to 30-year climate projection scenarios for major investments.

The economic operator has developed a plan to implement adaptation solutions to reduce material physical climate risks to the activity. Those adaptation solutions do not adversely affect the adaptation efforts or the level of resilience to physical climate risks of other people, of nature, of assets and of other economic activities and are consistent with local, sectoral, regional or national adaptation efforts.

Activity upgrading or altering existing assets or processes

The physical climate risks that are material to the activity have been identified from those listed in the table in Section II of this Appendix by performing a robust climate risk and vulnerability assessment. The assessment is proportionate to the scale of the activity and its expected lifespan, such that:

(a) for investments into activities with an expected lifespan of less than 10 years, the assessment is performed, at least by using downscaling of climate projections;

(b) for all other activities, the assessment is performed using high resolution, state-of-the-art climate projections across a range of future scenarios consistent with the expected lifetime of the activity, including, at least, 10-to 30-year climate projection scenarios for major investments.

The economic operator has developed a plan to implement adaptation solutions to reduce material physical climate risks to the activity. The adaptation solutions identified need to be implemented within 5 years from the start of the activity. These adaptation solutions do not adversely affect the adaptation efforts or the level of resilience to physical climate risks of other people, of nature, of assets and of other economic activities and are consistent with local, sectoral, regional or national adaptation efforts.