



# Public consultation on social taxonomy. International Bulletin of November 2021.

## Introduction: Environmental taxonomy and the Platform on Sustainable Finance

In 2018, the European Commission (EC) published its **Action Plan** for a greener and cleaner economy containing ten actions aimed at the financial sector to redirect capital flows into sustainable investment, among other objectives. One of these actions is the development of a classification system for sustainable activities that was partially reflected in 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, amending Regulation (EU) 2019/2088 (**environmental taxonomy**). It is partially reflected in the sense that it only addresses the environmental aspect of sustainability. To complete the environmental taxonomy, the Regulation affords a mandate to the Platform on Sustainable Finance to include social objectives in the environmental taxonomy and advise the EC on the practical application of Article 18 of the Regulation on minimum social and labour safeguards and respect for human rights contained in various international instruments of the Organisation for Economic Cooperation and Development (OECD), United Nations (UN) and the International Labour Organization (ILO).

In July 2021, the Platform published two **consultation documents** on:

- A social taxonomy.
- Various options for expanding the existing environmental taxonomy to other activities linked to environmental objectives.

This article describes the main aspects of the first report that are organised in the following sections:

1. Extending the environmental taxonomy to social objectives
2. Defining social objectives

## 1. EXTENDING THE TAXONOMY TO SOCIAL OBJECTIVES

The Platform highly recommends expanding the environmental taxonomy to include social objectives given the current circumstances that have been aggravated by the COVID-19 pandemic and the workplace accidents and abuse that continue to occur in various jurisdictions. There is increasing evidence that a growing gap between rich and poor could hamper the outlook for growth and potentially create political and social instability, which would make the transition to a zero-emission economy difficult.

The Platform notes that in order to achieve a **just transition**, it is necessary to avoid imposing the burden of these changes on workers and disadvantaged communities in different economic sectors (agriculture, mining, etc.). Therefore, public policies are required to maximise the benefits and minimise the negative impact on

workers and communities affected by the transition.

The **objective** of the social taxonomy is to act as a guide when defining social investments and the criteria that have to be applied to invest or create a financial product with sustainable characteristics or objectives. In practice, it should serve to redirect capital flows into activities and entities that respect human rights and into investments that improve living conditions, in particular for disadvantaged social groups. In summary, the social taxonomy should function as a classification system and a mechanism to provide information on social aspects, not as a binding standard that regulates pension rights or the minimum wage, but rather as a guide for investors with sustainability objectives.

In regard to the **recipients** of the social taxonomy, the report clarifies that traditional ways of financing social welfare, such as government spending and stable systems of social security, remain fundamental. However, it highlights the importance and role that private financing must play to prevent social harm by insisting that companies implement systems to ensure human rights are respected and improve access to basic goods and services, particularly for vulnerable individuals and groups.

The Platform refers to the **environmental taxonomy** as the reference that the social taxonomy should follow. Therefore, the social taxonomy, having defined its objectives, should develop the criteria for the substantial contributions to achieve these objectives and the “do no significant harm” principle so that the contribution to one objective is not detrimental to the achievement of the others. Lastly, 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.

The Platform explains that it is necessary to take into account the **fundamental differences** that exist in both areas and the fact that certain aspects and elements of the environmental taxonomy cannot be applied to the social taxonomy, such as the scientific criteria that will have to be replaced by generally accepted international rules and principles.

## 2. DEFINING SOCIAL OBJECTIVES

The Platform makes reference to certain international documents (the United Nations Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, the Declaration on Fundamental Principles and Rights at Work of the International Labour Organization (ILO), the principles of the European Pillar of Social Rights and the European Social Charter) as well as other sources that have given rise to various market practices in the social sphere and, based on these, establishes **two dimensions** for social objectives:

**-Vertical dimension:** referring to the products and services provided by the company that are essential to ensure adequate living conditions. Here, the objectives would be:

1. Promoting adequate living standards. This includes improving accessibility of products and services for basic human needs, such as water, food, housing, health care or education.
2. Improving accessibility to basic economic infrastructure including transport, telecommunications and internet, clean energy and financial inclusion.

For this vertical dimension, the concepts of availability, accessibility, acceptability and quality are suggested as a starting point for the development of criteria.

**-Horizontal dimension:** referring to the processes and conduct of the company to guarantee its activities respect and support human rights. In this case, the objectives would be:

1. Ensuring decent work.
2. Promoting consumer interests.

### 3. Enabling sustainable and inclusive communities.

A third key aspect is **corporate governance**, for which various international agreements will be taken into account. In this case, the objectives would be:

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

Here, the involvement of the company's management and management bodies in all aspects relating to sustainability, as well as the need for **remuneration of directors with executive positions** to be linked to social and environmental factors, is particularly important. Diversity in the board of directors and measures to tackle corruption and bribery are also part of good governance. The Platform also includes, as part of good governance, responsible lobbying and political engagement of the company, within a framework of transparency and to prevent trading in influence.

**Non-aggressive tax planning** is recognised as an essential factor for reducing the growing inequalities observed as a result of the economic crisis and a way to contribute to the local economy of the country where the company is located.

On the basis of these points, the document proposes a series of **criteria for social indicators** that should be referred to international standards or objectives, be sufficiently specific and a faithful representation of the objective they intend to measure, show a clear direction, avoid misleading incentives or unintended consequences and be accessible at a reasonable cost. In addition, all the proposed indicators must consider a similar degree of detail of information.

### **Significantly harmful activities**

To define significantly harmful activities in a social taxonomy, it is proposed to consider them as those which are fundamentally and under all circumstances opposed to the objectives of the text. The reasoning would have two sources: a) the existing international conventions on the prohibition of certain economic activities, such as the manufacture of certain types of weapons; and b) research carried out on the detrimental effects of certain activities, such as the harmful health effects of tobacco.

### **The relationship between environmental taxonomy and social taxonomy**

The Platform understands that instead of considering both taxonomies as independent and separate texts, another alternative could be used in which the texts are interrelated according to two possible models:

**Model 1.** The two texts would be related only through social and environmental minimum safeguards, so that the economic activities that meet the technical selection criteria and the principle of do no significant harm with respect to environmental objectives, and that are subject to the due diligence procedures of the aforementioned UN Principles and the OECD Guidelines, would be considered as sustainable from an environmental standpoint even though they may be exposed to the risk of breaches or infringements of human rights. Under this model, a greater number of economic activities could be considered as sustainable from both a social and environmental standpoint and this would probably lead to higher capital flows into these activities.

**Model 2.** This would entail a greater integration of the two taxonomies but would bring added complexity. An economic activity would have to meet either at least one environmental or at least one social substantial contribution requirement and would also have to meet all relevant environmental and social do no significant harm criteria. In this model, minimum safeguards would be replaced by more detailed social do no significant harm criteria for the environmental taxonomy, while the already existing do no significant harm criteria in the environmental taxonomy would be valid for the social taxonomy as well. In practice, this would mean that there would be fewer activities that meet the environmental and social do no significant harm criteria, the

regulations would be much more restrictive and there would be fewer contradictions.

In any case, both the minimum safeguards and the environmental and social do no significant harm criteria must be comparable in terms of the level detail required by the standard.

### **Changes in the regulations on financial sustainability**

Depending on the model chosen, the environmental taxonomy would have to be changed to include in its articles the social objectives and the criteria that establish substantial contributions and the principle of do no significant harm in these objectives.

The Platform highlights the inconsistencies existing in different regulatory texts such as references to international instruments in the sustainability disclosure regulation and the current environmental taxonomy, or between this last regulation and the mandate that the Platform group working on the social taxonomy has received.

For this reason, and to harmonise the legislation, it proposes that the new corporate governance directive establish the bases of the social criteria for the principle of do no significant harm and that both the disclosure regulation and the new corporate sustainability reporting directive establish the information requirements for the social taxonomy, including the criteria for substantial contributions to social objectives, and modifying the content of the regulation. In all cases, the regulations should reflect the two perspectives (horizontal and vertical) developed by the social taxonomy.

### **Conclusion: Impact of the social taxonomy**

The clearest effect of the social taxonomy will be that it will serve as a guide for institutional and retail investors, issuers and asset managers that establishes the definition of social objectives and the criteria to use if they want to invest in or create financial products with social objectives. This is expected to lead to growth in social investment by companies.

Furthermore, companies will have two options to contribute social objectives, which, in turn, will translate into two types of impact: 1) more effective sustainable governance and human rights processes that have measurable positive impacts for workers, consumers and communities in the value chain of an investment; and 2) the reorientation of capital flows into activities that contribute to accessing products and services that improve living conditions and the basic economic infrastructures.

### **Useful link:**

[Draft Report by Subgroup 4: Social Taxonomy](#)