Feedback on the Platform for Sustainable Finance's report on minimum social safeguards in the EU Taxonomy Regulation

6 September 2022

AFME welcomes the opportunity to comment on the Platform for Sustainable Finance's report on minimum safeguards (MS). Our feedback aims to support the effectiveness and usability of the EU Taxonomy Regulation as a framework to enable a just transition. The Platform's advice complements the Taxonomy's provisions ensuring that in order for their activities to be Taxonomy-aligned, companies abide by high standards in the protection of human and labour rights, and aims to support financial institutions' assessment of compliance with minimum safeguards by their counterparties.

The report should aim to establish adequate processes for the protection of human and labour rights, clarify the conditions for non-compliance, facilitate the assessment of such processes, and promote harmonisation of market practices. Coherence with the existing EU sustainable finance regulatory framework and upcoming initiatives should be a priority to strengthen the effectiveness of the requirements while keeping implementation costs at a minimum. To that end, the advice should consider the links with Taxonomy-based frameworks such as the EuGBS, and any divergence with the approach to social matters in other disclosure regimes. The Platform's advice should also be proportionate and recognise that companies operating in different sectors or geographies display different risks of breaching international standards and codes.

We support the focus in the report on seeking to align the assessment of the minimum safeguards with existing and proposed legislation such as the Corporate Sustainability Due Diligence Directive (CSDDD) and the disclosures which will be prepared according to the Corporate Sustainability Reporting Directive (CSRD). However, it is critical to note that the proposed approach would in effect be a substantial widening of the Taxonomy Regulation concept of 'minimum safeguards' and would introduce considerable uncertainty into this concept. In addition, while basing its recommendations on existing and upcoming EU requirements, such as the duties included in the CSDDD and the disclosures prepared according to the CSRD, these frameworks will not contribute to facilitating compliance with the minimum safeguards in the near-term.

We also expect a significant increase in the complexity of implementing and assessing due diligence processes, and we include detailed recommendations in our response to the questionnaire to mitigate this challenge. Neither would it be to the benefit of market participants and the development of sustainability governance to have 'minimum safeguards' under the Taxonomy Regulation, reportable social matters under SFRD, social matters under CSRD and social matters under CSDDD out of kilter with one another. Therefore, it is of utmost importance that inconsistencies between ESG relevant social matters are addressed with attention to ensuring that the rules are coherent and consistent, avoiding duplicative requirements.

We are therefore supportive of the Platform's advice to harmonise and streamline the implementation and assessment of due diligence practices. However, until CSDDD and CSRD are implemented, applying the Platform's recommendations would exclude a large number of companies and their activities that currently meet the criteria in the EU Taxonomy Regulation.

Not all of the proposed criteria to establish compliance with the minimum safeguards are relevant for all companies at the same time.

Instead, market practices as well as financial institutions' assessments rely on a risk-based approach, whereby companies with little exposure to human rights violations do not currently disclose having the due diligence procedures identified in the report, leading to a lack of relevant disclosures by companies. This lack of

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disclosures will clash with the approach proposed by the Platform to rely on corporate reporting, and it will be made worse by the proposed inability to rely on controversy screening as it's currently market practice.

Research gathered by our members shows that only a small proportion of companies currently disclose such due diligence procedures. Analysis using FTSE Russell Green Revenue data suggests that only around only 6.7% of standard global equity indices make substantial contribution to Taxonomy environmental objectives.. Of this 6.7%, only a small fraction is likely to disclose the specific human rights, anti-corruption, tax and fair competition procedures identified by the Platform. If we just focus on human rights due diligence, MSCI has only found evidence of due diligence procedures for around half of these companies, and this is without making any assessment of whether procedures are adequate as proposed by the Platform. The requirements for anti-corruption, tax and fair competition would further reduce this number.

In its next iteration, the Platform's advice should carefully consider the impact of this exclusion on the Taxonomy's objectives to facilitate investment in environmentally sustainable activities.

The Taxonomy, amongst other things, sets the foundations for the criteria to obtain the EU Green Bond designation under the proposed EU Green Bonds Regulation, to prepare product-level disclosures under the Sustainable Finance Disclosures Regulation (SFDR), and on the assessment of investors' sustainability preferences in accordance with MiFID II delegated regulation. Financial institutions use the Taxonomy to screen their investments, and undertakings report on the Taxonomy-alignment of their assets. Without a pragmatic approach to the application of the minimum safeguards, excluding a large number of activities that meet the environmental criteria could undermine the objectives of several pieces of EU legislation and of the Taxonomy itself.

While acknowledging the importance of the minimum safeguards, we encourage the Platform and the European Commission to reflect upon this and consider a more practical, risk-based approach, at least until the implementation of the CSDDD and CSRD.

To establish compliance with the minimum safeguards, and assess whether a company has implemented *adequate* procedures, an alternative approach could take greater account of the nature of business activities, area of operation, and the type of product and services provided. Financial institutions, in particular, should be able to rely on the assessment performed and disclosed by their counterparties, as well as on third-party reviews of their counterparties' due diligence policies. Given the lack of human rights due diligence disclosures,[1] in the interim period, this assessment will have to rely on companies' judgement and on existing best practices. In developed economies, where there are effective codes in place to protect human rights, compliance with domestic legislation could be used as a proxy for compliance with the minimum safeguards.

We would also welcome further consideration given to other issues in the Platform's advice, such as the consequence of non-compliance for the allocation of proceeds from the issuance of EU Green Bonds, or how to distinguish the treatment of minor violations from the treatment of serious breaches. More detailed recommendations in the response to the questionnaire below aim to facilitate and encourage the application of the EU Taxonomy Regulation, and to enable global financial institutions to focus their engagement on companies at highest risk of adverse impacts on human rights.

[1] *The Corporate Human Rights Benchmark's most recent assessment of 200 companies in high-risk sectors score an average of 2.3 out of 10 on due diligence, with 79 companies scoring 0 on all due diligence indicators. For further information, please see https://www.worldbenchmarkingalliance.org/corporate-human-rights-benchmark/*

Questionnaire

The Report proposes two sets of criteria for the establishment of non-compliance with MS: one related to adequate due diligence processes implemented in companies (i.e. relying on corporate reporting and disclosure) and the other related to the actual outcome of these processes or the company's performance (i.e. relying on external checks on companies).

Question 1. Do you agree with this two-pronged approach?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

The advice of the report is that companies covered in the future by the EU due diligence law (the proposed CSDDD) which are acting in compliance with the law would be considered aligned with the human rights part of the minimum safeguards as the demands of these two legislations overlap (provided that the final scope and the requirements of CSDDD will indeed be aligned with the standards and norms of Taxonomy Regulation Article 18).

Question 2. Do you agree with this advice of the report?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

The UNGPs require that due diligence processes implemented in a company result in human rights abuses being effectively prevented and mitigated. To check whether processes implemented in a company fulfil this requirement, the report suggests applying external checks based on a company

- *having had a final conviction at court*
- *or not responding to complaints at OECD national contact points or allegations via Business and Human Rights Resource Centre.*

Question 3. Do you agree with this approach?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

The MS can encourage harmonisation of existing market practices, and facilitate the implementation of the Taxonomy by building on such market practices.

The first alignment criterion, excluding companies that have not established adequate human rights due diligence processes, is in line with market practices and banks' ESG risk assessment methodology.

The second alignment criterion, based on indications that the company does not adequately implement HRDD resulting in human rights abuses, is only partially aligned with existing market practices. As part of their due diligence and risk assessment methodology, already in existence, banks already deem as non-compliant companies that have been convicted in relevant court cases or refuse to collaborate with an NCP. However, deeming a company non-compliant for two years after it fails to answer an allegation within three months is disproportionate and overly stringent, and this recommendation should be amended.

Companies failing to answer to an allegation brought up by the Business and Human Rights Resource Centre (BHRRC) should be considered non-compliant until they have addressed the matter and adopted adequate human rights due diligence processes to avoid future allegations. Further, having had a final conviction at

court is not a reliable criterion, as it may take several years for a court to reach a verdict and it is challenging to provide an exhaustive list of types of court cases that should be selected as criterion for non-compliance with MS. In addition, it is not an appropriate indicator to assess whether a company has effectively implemented due diligence processes at the time of investment and at the time of the final conviction.

We also note that reference to the BHRCC in the second criteria may be inadequate, as the BHRCC compiles civil society reports on human rights and related topics and offers implicated companies the opportunity to respond via its website. However, this is qualitatively different to the process undertaken in court proceedings and OCED NCP cases to arrive at a judgement or conclusion, as the BHRRC does not undertake any assessment or validation of the claims made by the civil society organisations. Further, the BHRCC does not typically provide any assessment on the quality of the companies' responses to these reports, and therefore companies may comply with this requirement without meaningfully engaging with affected stakeholders or providing remedy where needed. Therefore, the requirement is not an effective indicator in demonstrating compliance with the UNGPs and OECD guidelines and may have the unintended effect of diverting resources away from companies undertaking human rights due diligence, to instead developing responses to reports from CSOs via the BHRCC website.

We also suggest the report clarifies that financial institutions should carry out external checks only to counterparties they have a direct business relationship with, so as to exclude their clients' upstream and downstream value chain and ensure a proportionate application of the MS. . It should also be clarified that financial institutions shall not be responsible for assessing the quality of the due diligence processes but should only check whether the company has implemented a process. Further, we suggest to introduce clear criteria for the removal of non-compliance with the MS by, e.g. an external audit, as to ensure auditors and other parties feel confident with the process and avoid a situation where it could appear impossible to return to a status of compliance with the MS.

Question 3.1 Which type of court cases should be selected as criterion for non-compliance with minimum safeguards?

We believe that the conviction criteria is not appropriate as it does not reflect the situation of the company at the time the investment decision is made and judicial procedures often last several years. Furthermore, human rights cover a broad range of issues and there are not specialised courts at the national level (as exists in most civil law countries for labour issues) that rule on human rights violations. Convictions from both civil and criminal courts, as well as arbitration awards, regulatory disciplinary actions and judgements can have the same evidential weight as to conclusive wrong doing.

We therefore recommend that the Platform should not aim to provide an exhaustive list of types of court cases, instead focusing on the substantive, final and public finding of a violation of human rights. Appropriate criteria would be geared towards identifying violations 1) circumscribed to breaches of fundamental human rights; 2) restricted to final convictions with no more possibilities for appeal (presumption of innocence); and 3) a limited time period should be provided after which the conviction could not be used as a non-compliance criterion anymore (right to be forgotten approach).

Question 3.2 Are there other types of external checks you would suggest (data for these checks should be publicly available and lead to the same result for a company)?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

Administrative supervision has been proposed as an important complement to civil liability for enforcing corporate duties to undertake human rights due diligence (Shift/OHCHR report). Reference therefore should be made to checking the outcomes of the enforcement mechanisms of the CSDDD in national contexts once the directive is transposed into national laws.

The draft report provides that *"For EU companies, the external verification of MS compliance should rest with the auditor. It is important that this audit will provide assurance that the six steps of the HRDD process have been adequately implemented."* We support that approach and support that such checks by an external auditor or independent assurance providers (as defined in the CSRD) be generally available to all companies subject to the CSDDD as a means to demonstrate compliance with the MS. In other words, a statement by an external auditor or independent assurance providers whereby the company's due diligence process is effectively implemented should enable compliance with the MS criterion.

The advice given in the Report on corruption, taxation and fair competition is comparable to the advice on human rights in that it requires that a company has implemented processes to avoid and address negative impacts and that the company has not been finally convicted for violations in these fields.

Question 4. Do you agree with this approach?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

The three issues of corruption, taxation and fair competition cannot be treated on the same level.

Concerning corruption, only the first of the proposed two criteria should be maintained. The MS criterion should be the setting up and effective implementation of anti-corruption measures such as the adoption of a code of conduct, setting up an internal whistleblowing procedure, the mapping of corruption risk linked to clients, suppliers and intermediaries, a system of accounting controls, a training system of executives and the personnel who are the most exposed to corruption risk, an internal disciplinary system allowing to sanction employees who have infringed the code of conduct and a monitoring system to control the implementation of these measures. Again, a court conviction cannot be the appropriate criterion because it comes after several years of proceedings and does not necessarily reflect the state of implementation of anti-corruption measures at the time of investment. Also, an isolated case of corruption does not mean that the company as a whole should no longer be able to benefit from the MS compliance.

Concerning competition, and the first criterion: while undertakings have a legal obligation to comply with competition law, they do not have a legal or regulatory obligation to put in place a mandatory competition compliance mechanism, unlike for prevention of corruption and bribery. Competition compliance measures aimed at preventing and detecting anti-competitive behaviour are only strongly encouraged by the competition authorities, which often publish soft law documents highlighting the conditions for the effectiveness of such measures and the benefits that companies can derive from them. However, the concrete implementation of such measures generally depends on a proactive governance strategy of each company. Therefore, while we agree that companies should promote employee awareness and provide tools to ensure compliance with all applicable competition laws and regulations, a transition period will be necessary for companies to develop and implement such processes in order to be compliant with that criterion.

On the second criterion, as discussed above, final convictions in court or by the competent authorities are inappropriate indicators because they may come long after the breach occurred. An investor checking the compliance with MS needs to know whether the company they want to invest in has the necessary compliance procedures in place, at the moment of their investment, to effectively apply competition laws and regulations. Many court convictions come at a time when the company has long reacted and brought about the necessary changes in its compliance policy. Therefore, we believe that only the first of the proposed two criteria should be maintained.

Concerning taxation, the draft report mentions, based on the OECD guidelines for multinational enterprises that companies should comply with the letter and the spirit of tax laws and regulations in which they operate. Firms have implemented processes to identify and manage tax compliance risks and monitor and assess the effectiveness of their implementation. This compliance risk management process is generally set up under the responsibility of the management, under the oversight of boards, but there is no single blueprint for adopting tax risk management strategies. This process can be organised in very different ways depending on each company's specificities and there is no "tick the box" criteria allowing for the evaluation of the respect of MS regarding taxation. As the draft report says itself rightly (p. 45), the topic of tax compliance as an element of MS stands out, in that it is neither considered by CSDDD nor CSRD. Therefore, the assessment of compliance with MS as regards taxation should be restricted to the existence of internal processes to identify and manage tax compliance risks under control of the company's management since the purpose of the MS is only to support an inclusive growth as mentioned in recital 35 of said regulation.

Still in the area of taxation, measures have been adopted to strengthen transparency and the responsibility of the companies. Under public CBCR (Country by Country Reporting), large European companies will be required, by 2024, to annually publish tax and accounting data. These data will have to be provided country by country for EU member states and for each country on the EU black and grey lists (non-cooperative countries) in which the companies are established. This information will also be used by investors to check the compliance of tax policy with MS.

Concerning the second proposed criterion of court convictions for tax evasion, as it has been explained before for the others matters, this cannot be the appropriate criterion.

Question 4.1 Which type of court cases should be selected as criterion for non-compliance with minimum safeguards?

Please refer to the reply to question 3.1.

Question 4.2 Are there other types of external checks you would suggest (data for these checks should be publicly available and lead to the same result for a company)?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

Similarly to what was indicated in the reply to question 3.2 above, administrative supervision/fines are relevant for the enforcement of tax, bribery and fair competition laws.

A suggestion given in the Report on MS is to consider the human rights due diligence processes companies have implemented and do checks on their performance, rather than rely on controversy checks based on media coverage (as is done by some ESG rating agencies).

Question 5.1 What do you think these changes imply for companies?

Companies already face a significant number of requests from external stakeholders, including investors and civil society, interested in understanding to what extent their processes are adequate to comply with the MS. Harmonising the approach to human rights due diligence and reporting can help standardise these requests and require fewer resources for companies to respond, and will help companies provide a more meaningful and effective answer to stakeholders.

The Platform predict that enhanced screens, considering due diligence processes rather than controversy checks, will lead to a significant decrease in the number of companies likely to comply with the MS - and an initial testing of equity portfolios backs this hypothesis.[2] The changes, however, penalise disproportionately smaller companies, that might not have human rights due diligence in place, even if they are not responsible for any actual or potential breaches of human rights.

It needs to be ensured that SMEs are provided with greater flexibility and a less strict approach to due diligence processes, as also envisaged in the approach for the CSDDD which focuses on larger corporates. Research gathered by one of our members shows that only a small proportion of companies currently disclose such due diligence procedures. Analysis using FTSE Russell Green Revenue data suggests that only around only 6.7% of standard global equity indices make substantial contribution to Taxonomy environmental objectives.. Of this 6.7%, only a small fraction is likely to disclose the specific human rights, anti-corruption, tax and fair competition procedures identified by the Platform. While this should increase when the CSDDD is implemented, this may not be for several years. The impact of the proposed approach would therefore be likely to significantly reduce the volume of Taxonomy aligned activities, in particular in the short term. As discussed above, we believe that the impact of the proposed approach on the objectives of the Taxonomy should be carefully considered, consistently with the UNGPs clarifying that due diligence should be proportionate to the means and resources of the undertaking.

This might endanger the growth of the sustainable finance market, as for example green bond issuances could be reduced, as issuances are becoming more complex, and issuers might want to avoid litigation risk. This would run counter the objectives the EU Green Deal and the Capital Market Union. In its next iteration, we believe the Platform's advice should consider the impact of this exclusion on the uptake and usability of the Taxonomy Regulation and other pieces of the EU sustainable finance framework based on the Taxonomy. Until CSDDD and CSRD are implemented, we recommend adopting a practical and proportionate approach to the application of the MS, where the assessment of due diligence processes and controversy checks complement each other in firms' processes to support capital allocation and investment decisions.

Question 5.2 What do you think these changes imply for investors?

Considering the human rights due diligence processes companies have implemented and checking on their performance will be important for investors to meet the MS. Financial institutions will be implementing the MS at the same time as initiatives like SFDR, MiFID 2 ESG amendment, CSRD, EU Taxonomy and in some cases national supply chain acts. Information related to the MS might not be public either, before the application of the CSRD, further increasing complexity. Some investors already screen, directly or through third-party providers, the performance of counterparties' due diligence processes, according to materiality and their resources. Until CSDDD and CSRD are implemented, we recommend adopting a practical and proportionate approach to the application of the MS, where the assessment of due diligence processes and controversy

[2] ISS ESG Insights: *Minimum Safeguards, Maximum Impact? Assessing Alignment with Minimum Safeguards in the EU Taxonomy* (August 19, 2022)

checks complement each other, as controversy checks allow investors to identify "at-risk" counterparties and make investment decisions accordingly.

The OECD guidelines for multinational enterprises highlight the importance of good corporate governance. The Report takes this up by developing criteria for bribery/corruption, taxation and fair competition.

Question 6. Do you agree with this approach?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

Question 6.1 Which other aspects of good corporate governance matters do you believe the advice should cover or refer to would you like to add?

When it comes to corruption, competition and taxation, the concept of "good corporate governance" is vague and not defined by OECD guidelines. Therefore, developing criteria would be key to help assess the processes put in place by the companies in the fight against bribery and unfair competition.

Question 7. Do you have further suggestions or comments on the Report?

The advice takes a constructive approach by basing the recommendations on existing and upcoming EU disclosure requirements. We find it sensible to promote coherence within the framework, including by ensuring that compliance with the future CSDDD may be used as a proxy for alignment with the MS.

The advice takes a proportionate approach where it clarifies that compliance with MS does not apply to financial institutions' retail clients, and that *banks do not have to enquire households on minimum safeguards when providing mortgages or other types of financing.* The advice provides sensible recommendations where it does not penalise companies that have been part of a controversy but plan to address the controversy, have implemented a due diligence process, and aim at using it to improve its human resources process. The advice also helps with the GAR measurement where it recommends that the Art. 8 Delegated Regulation is amended to clarify that MS are assessed at company level and not activity level, as well as to introduce in the template a reference to the sustainability reports that will be published under CSRD.

The Platform's advice contains valuable guidance to harmonise and streamline the implementation and assessment of due diligence practices but, until CSDDD and CSRD are implemented, applying the Platform's recommendations would exclude a large number of companies and their activities that meet the environmental criteria in the EU Taxonomy Regulation. We believe the advice should consider the impact of this exclusion on the Taxonomy's objectives to facilitate investment in environmentally sustainable activities. Until CSDDD and CSRD are implemented, we therefore recommend adopting a risk-based and proportionate approach to the application of the MS.

To establish MS compliance, and assess whether a company has implemented adequate procedures, the Platform could recommend that companies consider the nature of business activities, area of operation, and the type of product and services provided. Given the lack of human rights due diligence disclosures, in the interim period, this assessment will have to rely on companies' judgement and on existing best practices. In developed economies, where there are effective codes in place to protect human rights, compliance with domestic legislation can be used as a proxy for compliance with the MS.

Financial institutions, in particular, should be able to rely on the assessment performed and disclosed by their counterparties, as well as on third-party reviews of their counterparties' due diligence policies. When applied to companies based in other jurisdictions, for which information may be lacking or absent, the advice should

contain practical recommendations on how to account for differences in transparency requirements and in the legal frameworks around human rights. Alongside more proportionate requirements, the advice could provide case studies and examples of adequate due diligence processes.

We further recommend that the Platform's report includes advice to the Commission on how to consider the implications of non-compliance with the MS with other EU legislative tools. The EuGBS will require issuers using the "EU Green Bond" designation to allocate proceeds to activities aligned with the EU Taxonomy Regulation which, in turn, is conditional on companies meeting the MS at the level of the undertaking, introducing an additional layer of complexity. If, after issuance, the company is found to be non-compliant with the MS, it may be prevented from allocating unused proceeds.

Non-compliance with the MS may also clash with the grandfathering provisions in the EuGBS, as bonds may risk losing their EU GB designation after issuance. The possibility for a Green Bond to lose its status before maturity creates disincentives for both issuers, due to increased uncertainty and the need for continuous monitoring, and for investors, who may risk having to exit their positions.

Auditors risk facing increased uncertainty, too, when providing opinions on whether a company that was found non-compliant with the MS has improved its processes in a way that adequately prevents any repetition of human rights or labour rights violations. Clearer guidance on what criteria auditors should adopt would be helpful to address this uncertainty.

We also recommend that the Platform's advice elaborates how to distinguish the treatment of minor violations from the treatment of serious breaches, clarifying that minor violations do not constitute a breach of the MS-related KPIs by banks and investors.

We also note that most of the transport activities listed in the current Taxonomy refer to *financing* in their definition, while this is not the case for other activities, and that section 6 of the report correctly states that banks and insurers would have to conduct an MS assessment of their client, which would be in addition to the ones conducted by the clients themselves, and thus would not be meaningful. This should be clarified in the report and guidance should be provided that banks and insurance companies could rely on the MS compliance made by their clients that are carrying out such activities.

Finally, we find the advice should also clarify whether the National Human Rights Institution (NHRI) or the Global Alliance of NHRIs (GANHRI) can be used as a proxy for MS compliance, how is compliance determined in the case of SPVs that are not considered as project finance, and whether the Commission should consider grandfathering of compliance with the MS.

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