

Feedback on the Platform on Sustainable Finance's draft report on social taxonomy

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INTRODUCTION

AFME welcomes the opportunity to comment on the Platform on Sustainable Finance's draft report on a social taxonomy. The initiative to consider an extension of the EU Taxonomy framework to social objectives comes in a context where market participants strengthen their efforts to identify, screen and integrate social factors into their business and investments and, at the same time, regulators increase the attention to the "S" component of ESG policy. AFME has been supportive of incremental legislative action to support a just transition towards sustainability, and we wish to contribute our views on how a social taxonomy may best enable banks' role in financing companies and activities with a positive social impact.

A social taxonomy aimed at defining the key principles and objectives for social investment could provide investors with decision-useful information, enhance voluntary disclosures from all market participants, increase consistency and comparability, and further stimulate the growth of the sustainable finance market. Firms could benefit from a common definition of social activities applicable across the EU when defining their business objectives and, for financial institutions, when engaging with clients and investors or when gathering sustainability information. With the inclusion of criteria targeting economic entities, in addition to criteria targeting economic activities, a set of EU principles could also lay down the basis for a tool to screen and track firms' social impact. Nevertheless, the differences in approaches to defining social objectives and measuring social outcomes is also one of the key concerns identified by both the Platform in its draft report and AFME members.

Whilst there is broad agreement among investors on the objectives and metrics to use when screening environmental impact, social issues have a qualitative, less tangible nature and are based on cultural, historic and sometimes political and/or policy factors that may vary significantly across jurisdictions as well as within the Union. It is therefore challenging and complex to define social objectives and quantify performance levels. Furthermore, the data limitations that have thus far been the greatest obstacle to the development of sustainable finance are especially severe in relation to social factors. Data on social factors is often qualitative, making access to reliable and comparable data particularly challenging. Combined with the complexity of the existing Taxonomy framework, data gaps would have a significant negative impact on a social taxonomy's usability. In addition, we believe that the Platform's report should add emphasis on the potential clashes with national regulation, the risks of increasing the reporting burden, especially for SMEs, and the impacts of any prescriptive measures on the evolving market for ESG investment products and ratings.

The activity-based, or "vertical", dimension of a social taxonomy should be based on a materiality assessment and avoid limiting the range of eligible activities or creating a prescriptive list of eligible or always excluded activities. This is because potentially every activity and investment may have an impact on social factors such as employment, education, health and safety, housing, energy transition and other social objectives, and it

Association for Financial Markets in Europe

London Office: 39th Floor, 25 Canada Square, London E14 5LQ, United Kingdom T: +44 (0)20 3828 2700

Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 788 3971

Frankfurt Office: Bürohaus an der Alten Oper, Neue Mainzer Straße 75, 60311 Frankfurt am Main, Germany
T: +49 (0)69 153 258 963

www.afme.eu

would be detrimental to have a pre-defined exhaustive list of eligible activities. This dynamic approach would also help take into consideration the cultural, local and sectoral specificities across different jurisdictions that can give a social character to an activity in a certain context. A necessary first step would be to agree on a definition of social objectives laying down the foundations for a set of criteria to screen activities' social impact. On the basis of such criteria, market participants and policymakers would be able to assess activities without the need for a close-ended and prescriptive classification based on NACE codes, or to label *a priori* activities “fundamentally and under all circumstances” opposed to social objectives.

The process-related, or “horizontal”, dimension of a social taxonomy, on the other hand, should be targeted at a narrow set of principles based on international conventions and frameworks, 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 Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights. Such principles-based approach may help address the wide differences in defining social objectives and measuring social outcomes observed across jurisdictions.

As regards the model for linking an environmental and a social taxonomy, we strongly support *Model 1*, whereby the Commission develops a social taxonomy with minimum environmental safeguards alongside the existing “green” taxonomy with minimum social safeguards. Keeping the taxonomies separate ensures that both frameworks can be tailored to screening for environmental and social factors, respectively, and recognises the different nature of social objectives. The additionality of criteria proposed in *Model 2*, on the other hand, would restrict the number of activities eligible under a single framework with both social and environmental screening criteria and involve additional complexity. Ultimately, the approach in *Model 1* would greatly improve the usability of a social taxonomy and facilitate decision making for investors with specific sustainability objectives.

We would also like to emphasise the need for a social taxonomy to remain a fully voluntary framework. Based on the considerations outlined above, we do not believe that a social taxonomy can be coupled with transparency requirements similar to those under Article 8 of the Taxonomy Regulation, nor should it preempt EFRAG’s work to develop due diligence disclosure standards under Articles 19 and 29 of the CSRD proposal, or set the basis for the measures to be unveiled by the Commission in the upcoming initiative on sustainable corporate governance, at least at this preliminary stage and until there is consensus on the objectives, metrics and indicators to assess social outcomes. We encourage the EU authorities to ensure future work on social objectives is consistent and well sequenced with the existing initiatives under the EU sustainable finance agenda, and to engage with their international counterparts on the social aspect of ESG with a view to minimising fragmentation of approaches internationally.

We also advise the Platform and the Commission to exercise caution with the objective to “harmonise how social aspects are measured”, as this would be premature in the existing landscape and we find that market participants have led the way with a number of industry-driven initiatives showing a beneficial variety of approaches to measuring social outcomes. Instead, at this stage, we recommend focusing on defining a set of common principles to support market participants’ investment decisions and to foster global convergence.

QUESTIONNAIRE

Questions on the draft report:

1. The draft report describes the merits of a social taxonomy and potential concerns.

Which in your view are the main merits of a social taxonomy? (tick all boxes)

- supporting investment in social sustainability and a just transition
- responding to investors' demand for socially orientated investments
- addressing social and human rights risks and opportunities for investors
- strengthening the definition and measurement of social investment
- other

A principles-based social taxonomy could provide investors with decision-useful information, enhance voluntary disclosures from all market participants, increase consistency and comparability, and further stimulate the growth of the sustainable finance market. Firms could benefit from a common definition of social activities applicable across the EU when defining objectives and, for financial institutions, when engaging with clients and investees or when gathering sustainability information. With the inclusion of criteria targeting economic entities, in addition to criteria targeting economic activities, a set of EU principles could also lay down the basis for a tool to screen and track firms' social impact.

- none

Which in your view are the main concerns about a social taxonomy? (tick all boxes)

- interference with national regulations and social partners' autonomy
- increasing administrative burden for companies
- other

At this stage, the development of a social taxonomy raises many concerns across the industry. In addition to the differences in approaches to defining social objectives and measuring social outcomes, we believe it would be especially challenging to define an exhaustive and simple framework to classify economic activities based on their social impact. Whilst there is broad agreement among investors on the objectives and metrics to use when screening environmental impact, social issues have a qualitative, less tangible nature and are based on criteria that vary significantly across jurisdictions as well as within the Union, strongly anchored into national cultures and histories. Furthermore, the data limitations that have thus far been the single greatest obstacle to the development of sustainable finance are especially severe in relation to social factors, adding to the potential administrative burden

for companies.

- none

2. Structure of the social taxonomy: The draft report suggests a structure for a social taxonomy distinguishing between a vertical and a horizontal dimension. The vertical dimension would focus on directing investments to activities that make products and services for basic human needs and for basic economic infrastructure more accessible, while the horizontal dimension would focus on human rights processes.

The objective linked to the vertical dimension of the social taxonomy would be to promote adequate living standards. This includes improving the accessibility of products and services for basic human needs such as water, food, housing, healthcare, education (including vocational training) as well as basic economic infrastructure including transport, Internet, clean electricity, financial inclusion.

The objective linked to the horizontal dimension would be to promote positive impacts and avoid and address negative impacts on affected stakeholder groups, namely by ensuring decent work, promoting consumer interests and enabling the creation of inclusive and sustainable communities.

In your view, are there other objectives that should be considered in vertical or horizontal dimension?

- Yes
- No
- No opinion

Please explain your choice

We find it challenging to define a close-ended list of activities to include in a vertical dimension and believe, instead, that it should be based upon a materiality assessment and include the widest possible range of activities. This is because potentially every activity and investment may have an impact on social factors such as employment, education and other social objectives, often as a secondary target (e.g., construction of social infrastructure, urban redevelopment, investment in cultural institutions, etc.), and it would be detrimental to have a pre-defined exhaustive list of eligible activities. This dynamic approach also help take into consideration the cultural, local and sectoral specificities across different jurisdictions. We also recommend referring to the two dimensions in the proposed social taxonomy as “activity-based” and “process-based” to facilitate the framework’s usability, as the terms “vertical” and “horizontal” may not be self-explanatory.

3. Which of the following activities should in your view be covered in the vertical dimension (social products and services)?

A1 - Crop and animal production,

A1.1 - Growing of non-perennial crops
A1.2 - Growing of perennial crops
A1.4 - Animal production
A3 - Fishing and aquaculture
C10 - Manufacture of food products
C10.8.2 - Manufacture of cocoa, chocolate and sugar confectionery
C10.8.3 - Processing of tea and coffee
C10.8.6 - Manufacture of homogenised food preparations and dietetic food
C13 - Manufacture of textiles
C20.1.5 - Manufacture of fertilisers and nitrogen compounds
C20.2 - Manufacture of pesticides and other agrochemical products
C21 - Manufacture of basic pharmaceutical products and pharmaceutical preparations
C23.3 - Manufacture of clay building materials
C23.5 - Manufacture of cement, lime and plaster
C25.2.1 - Manufacture of central heating radiators and boilers
C30.1 - Building of ships and boats
C30.2 - Manufacture of railway locomotives and rolling stock
C30.3 - Manufacture of air and spacecraft and related machinery
C30.9.2 - Manufacture of bicycles and invalid carriages
C31 - Manufacture of furniture
C32.2 - Manufacture of musical instruments
C32.3 - Manufacture of sports goods
C32.5 - Manufacture of medical and dental instruments and supplies
D35.1 - Electric power generation, transmission and distribution
D35.3 - Steam and air conditioning supply
E - Water supply; sewerage; waste management and remediation activities
E36 - Water collection, treatment and supply
E37 - Sewerage
E38 - Waste collection, treatment and disposal activities; materials recovery
E38.3 - Materials recovery
E39 - Remediation activities and other waste management services
F41 - Construction of buildings
F42.1 - Construction of roads and railways
F42.1.2 - Construction of railways and underground railways
F42.2.2 - Construction of utility projects for electricity and telecommunications
F43.3 - Building completion and finishing

G45.2 - Maintenance and repair of motor vehicles
G46.1.6 - Agents involved in the sale of textiles, clothing, fur, footwear and leather goods
G46.1.7 - Agents involved in the sale of food, beverages
G47.5.1 - Retail sale of textiles in specialised stores
H49.1 - Passenger rail transport, interurban
H49.2 - Freight rail transport
H49.3 - Other passenger land transport
H49.3.1 - Urban and suburban passenger land transport
H50.1 - Sea and coastal passenger water transport
H50.3 - Inland passenger water transport
H51.1 - Passenger air transport
J58.1 - Publishing of books, periodicals and other publishing activities
J59.1 - Motion picture, video and television programme activities
J60 - Programming and broadcasting activities
K - Financial and insurance activities
L68.2 - Renting and operating of own or leased real estate
M71 - Architectural and engineering activities; technical testing and analysis
M72.1.1 - Research and experimental development on biotechnology
N77.1.1 - Renting and leasing of cars and light motor vehicles
N77.2 - Renting and leasing of personal and household goods
N78.1 - Activities of employment placement agencies
N78.2 - Temporary employment agency activities
N78.3 - Other human resources provision
O84.1.2 - Regulation of the activities of providing health care, education, cultural services and other social services, excluding social security
O84.2 - Provision of services to the community as a whole
O84.2.4 - Public order and safety activities
O84.2.5 - Fire service activities
O84.3 - Compulsory social security activities
P85.1 - Pre-primary education
P85.2 - Primary education
P85.2.0 - Primary education
P85.3 - Secondary education
P85.3.2 - Technical and vocational secondary education
P85.4.2 - Tertiary education
Q - Human health and social work activities

Q86.1 - Hospital activities

Q86.2 - Medical and dental practice activities

Q87 - Residential care activities

Q88 - Social work activities without accommodation

Q88.9.1 - Child day-care activities

Q88.9.9 - Other social work activities without accommodation n.e.c.R - Arts, entertainment and recreation

R93.1.3 - Fitness facilities

S95 - Repair of computers and personal and household goods

S96.0.4 - Physical well-being activities

Other (please specify)

Based on the arguments outlined above, a social taxonomy should not limit the range of eligible activities or create a prescriptive list of eligible or always excluded activities. Instead, we believe that market participants should first agree on a definition of social objectives laying down the foundations for a set of criteria to screen activities' social impact. On the basis of such criteria, market participants and policymakers would be able to assess activities without the need for a close-ended and prescriptive classification based on NACE codes.

4. The objectives in the horizontal dimension, which focusses on processes in companies such as the due diligence process for respecting human rights, would likely necessitate inclusion of criteria targeting economic entities in addition to criteria targeting economic activities?

Do you agree with the approach?

- Yes
- No
- No opinion

Please explain your choice

The horizontal dimension is transversal to all sectors, goes beyond individual activities, and can be traced back to the company's business and governance. An entity-level approach facilitates the financing of socially responsible companies through instruments other than debt, including equity and derivatives. At the same time, an entity-level approach to due diligence throughout the entire value chain may be disproportionate if introduced as a requirement and a more nuanced approach to the application of the horizontal dimension objectives would be welcome. In the derivatives markets, for example, transactions may be entered into where a party to the derivative transaction has only a very limited nexus to any human rights implications of an underlying project or transaction. Provisions on due diligence for human rights across the value chain are already provided in the CSRD proposal and, potentially, in the forthcoming sustainable corporate

governance initiative. We urge the Platform to wait for the outcome of the legislative process on the CSRD to ensure legal consistency.

- 5. The report envisages harmful activities as those which are fundamentally and under all circumstances opposed to the objectives suggested in this proposal for a social taxonomy. There would be two sources on which this rationale can be build: internationally agreed conventions, e.g. on certain kinds of weapons & detrimental effects of certain activities, for example on health.**

Based on these assumptions, would you consider certain of the following activities as ‘socially harmful’?

A1.1.5 - Growing of tobacco

B5 - Mining of coal and lignite

B7 - Mining of metal or iron ores

B9 - Mining support service activities

B9.1 - Support activities for petroleum and natural gas extraction

C10.8.1 - Manufacture of sugar

C10.8.2 - Manufacture of cocoa, chocolate and sugar confectionery

C10.8.3 - Processing of tea and coffee

C11.0.1 - Distilling, rectifying and blending of spirits

C11.0.2 - Manufacture of wine from grape

C11.0.5 - Manufacture of beer

C11.0.7 - Manufacture of soft drinks;

C12 - Manufacture of tobacco products

C13 - Manufacture of textiles

C15.2 - Manufacture of footwear

C20.2 - Manufacture of pesticides and other agrochemical products

C25.4 - Manufacture of weapons and ammunition

C25.4.0 - Manufacture of weapons and ammunition

C30.4 - Manufacture of military fighting vehicles

G46.1.6 - Agents involved in the sale of textiles, clothing, fur, footwear and leather goods

G46.3.5 - Wholesale of tobacco products

G46.3.6 - Wholesale of sugar and chocolate and sugar confectionery

G46.4.2 - Wholesale of clothing and footwear

G47.1.1 - Retail sale tobacco predominating

N80.1 - Private security activities

O84.2.2 - Defence activities

Other (please specify)

Based on the arguments outlined above, a social taxonomy should not limit the range of eligible activities or create a prescriptive list of eligible or always excluded activities. Instead, we believe that the first step should be to agree on a definition of social objectives laying down the foundations for a set of criteria to screen activities' social impact. On the basis of such criteria, market participants and policymakers would be able to assess activities without the need label a priori activities "fundamentally and under all circumstances" opposed to social objectives.

Activities should be assessed from the perspective of their social responsibility (respect for human rights and human needs) rather than simply be classified as socially harmful (or excluded from the taxonomy). Including them in a social taxonomy would help ensuring they are conducted in a socially sustainable manner.

6. Sustainability linked remuneration is already widely applied in sustainable investment. In your view, would executive remuneration linked to environmental and social factors in line with companies' own targets, therefore also be a suitable criterion in a social classification tool such as the social taxonomy?

- Yes
- No
- No opinion

Please explain your choice

Sustainability-linked remuneration, as well as the governance objectives referred to in the next question, are already being addressed in the forthcoming initiative on sustainable corporate governance. We encourage the EU authorities to ensure future work on social objectives is consistent and well sequenced with the existing initiatives under the EU sustainable finance agenda, including CSRD, the sustainable corporate governance initiative as well as with the existing regulatory and supervisory framework applicable to financial market participants (i.e., CRD IV and the EBA Guidelines on sound remuneration policies).

7. The report envisages governance objectives and analyses a certain number of governance topics. Please select the governance topics which in your view should be covered (tick all relevant boxes):

1. Sustainability competencies in the highest governance body
2. Diversity of the highest governance body (gender, skillset, experience, background), including employee participation.

3. Transparent and non-aggressive tax planning
4. Diversity in senior management (gender, skillset, experience, background)
5. Executive remuneration linked to environmental and social factors in line with companies' own targets
6. Anti-bribery and anti-corruption
7. Responsible auditing
8. Responsible lobbying and political engagement
- Other

8. The report suggests two models for linking an environmental and a social taxonomy:

Model 1: The social and an environmental taxonomy would only be related 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 environmental minimum safeguards for the social part. The downside would be thin social and environmental criteria in the respective other part of the taxonomy.

Model 2: There would be one taxonomy with a list of social and environmental objectives and DNSH criteria. It would essentially be one system with the same detailed 'do no significant harm' criteria for the social and environmental objectives. The downside would be that there would be fewer activities that would meet both social and environmental 'do no significant harm' criteria.

Which model for extending the taxonomy to social objectives do you prefer model 1 or model 2?

- MODEL 1
- MODEL 2
- no opinion

Please explain your choice.

Model 1 ensures that the environmental and social frameworks can be each tailored to screening for environmental and social factors, respectively, and recognises the different nature of social objectives. The additionality of criteria proposed in Model 2, on the other hand, would restrict the number of activities eligible under a single framework with both social and environmental screening criteria. Ultimately, the approach in Model 1 would greatly improve the usability of a social taxonomy and facilitate decision making for investors with specific sustainability objectives.

9. What do you expect from a social taxonomy?

We expect a social taxonomy to build on the progress being made by market participants to identify social objectives and measure social outcomes, and provide a clear and easily accessible framework applicable to social activities. Thanks to the lessons learned through the ongoing development of a taxonomy for environmentally sustainable activities, we expect the development of a social taxonomy to address cautiously and proactively the difficulties with defining social objectives, substantial contributions to achieving these objectives and finally criteria that apply the principle of not doing any significant harm – all taking into consideration the need for transition towards socially sustainable objectives and accommodating the possibility for activities to improve their “social performance” with incentives for companies. We further expect policymakers to carry out a detailed impact assessment to address the specific concerns linked with the nature of social factors, such as dealing with intangible and qualitative metrics, building on common principles shared across different jurisdictions, and avoiding overly prescriptive measures or reporting obligations. By addressing the concerns and considering the recommendations outlined in this feedback, we expect a social taxonomy to provide investors with decision-useful information, enhance voluntary disclosures from all market participants, increase consistency and comparability, and further stimulate the growth of the sustainable finance market. Building on the comprehensive set of sustainable finance initiatives developed so far, we expect EU authorities to ensure future work on social objectives is consistent and well sequenced with the existing initiatives under the EU sustainable finance agenda, such as the CSRD proposal and the sustainable corporate governance initiative, and to engage with their international counterparts on the social aspect of ESG with a view to minimising fragmentation of approaches internationally. EU authorities and market participants, in turn, can expect banks to strengthen their commitments to financing companies and activities with a positive social impact, and AFME to continue contributing to the process of developing an effective framework to identify, screen and integrate social factors into business and investments.

AFME contacts

Oliver Moullin, Managing Director, Sustainable Finance, General Counsel and Company Secretary

Oliver.Moullin@afme.eu

Giorgio Botta, Senior Associate, Sustainable Finance

Giorgio.Botta@afme.eu

Pablo Portugal, Managing Director, Advocacy

Pablo.Portugal@afme.eu

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