



PLATFORM ON
SUSTAINABLE FINANCE

Final Report by Subgroup 4: Social Taxonomy

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This report represents the overall view of the members and observers of the Platform on Sustainable Finance. However, it may not necessarily, on all aspects, represent the individual views of member institutions or experts. This report is not an official Commission document nor an official Commission position. This document does not reflect the views of the European Commission or its services. Nothing in this document commits the Commission nor does it preclude any policy outcomes.

Executive summary

Environmental and social aspects have been part of the EU's sustainable finance strategy since the very beginning. It is widely recognised that there is a need for social investments to both: (i) achieve the sustainable development goals (SDGs) of the UN's 2030 agenda; and (ii) create the social internal market set out in the Treaty on European Union (Article 3). It is also widely recognised that businesses must show respect for human rights as envisaged in the UN guiding principles on business and human rights (UNGPs).

The high demand for social bonds (to finance social housing, healthcare, and jobs for target groups) is another indicator that investors see social investments as an opportunity. This high demand also shows that private capital can be directed to socially valuable activities. At the same time, investors acknowledge that if they neglect social factors they run the risk of being associated with human-rights abuses like child labour and slave labour. It is therefore crucial to define clearly what constitutes a social investment, as has already been done with environmental investments.

Fundamental EU documents provide strong foundations for a social taxonomy. These documents include: the document on the European pillar¹ of social rights and the associated action plan; the European Social Charter²; the EU Charter on Fundamental Rights³; and the European Convention on Human Rights⁴.

Concerns have been expressed that social matters are regulated at Member State level and between social partners, not at EU level and that a social taxonomy would overburden companies, especially small companies, with additional reporting requirements.

In this document, the Platform on Sustainable Finance proposes a structure for a social taxonomy within the present EU legislative environment on sustainable finance and sustainable governance. This environment currently consists of: (i) the existing legislation and proposed initiatives on the EU taxonomy; (ii) the proposed corporate sustainability reporting directive (CSRD); (iii) the Sustainable Finance Disclosures Regulation; and (iv) the sustainable corporate-governance (SCG) initiative. Although all these pieces of legislation influence this report, the focus of this work was above all on the present structure of the environmental taxonomy, a point which was even more stressed when public feedback highlighted that market participants expected a common structure for social and environment.

Subgroup 4 of the platform was also asked to: (i) consider the relationship between the social and environmental taxonomies; and (ii) reflect on other sustainability objectives like governance and the regulatory environment.

¹ 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 <https://www.coe.int/en/web/european-social-charter>.

³ https://ec.europa.eu/info/aid-development-cooperation-fundamental-rights/your-rights-eu/eu-charter-fundamental-rights_en

⁴ https://www.echr.coe.int/documents/convention_eng.pdf

From this point of departure, the group considered two main differences between a social taxonomy and an environmental taxonomy. These two differences are set out in the bullet points below.

- While most economic activities have detrimental impacts on the environment, most economic activities such as the creation of decent jobs, paying taxes and production of socially beneficial goods and services can be considered inherently socially beneficial. A social taxonomy has to distinguish between such inherent benefits and additional social benefits that directly contribute to the realisation of human rights such as improving access to quality healthcare or ensuring decent jobs.
- While environmental objectives and criteria can be based on science, a social taxonomy has to be based on international authoritative standards of topical relevance such as the International Bill of Human Rights.

While keeping these differences in mind, the suggested structure of the social taxonomy employs the following structural aspects of the environmental taxonomy: (i) the development of social objectives; (ii) types of substantial contributions; (iii) 'do no significant harm' (DNSH) criteria; and (iv) minimum safeguards. However, the social taxonomy deviates from the environmental taxonomy by containing sub-objectives which spell out different aspects of the three social objectives.

Starting from internationally agreed documents on human rights, the objectives for a social taxonomy are set out in this document according to the type of stakeholders that economic activities can affect. Stakeholders affected by business activities include an entity's: (i) own workforce (including value-chain workers); (ii) end-users/consumers; and (iii) affected communities (directly or through the value chain⁵). The suggestion therefore is that a future social taxonomy should be centred around these three groups of stakeholders to whose lives and livelihoods economic activities can make a positive contribution.

The suggested structure of a social taxonomy therefore consists of three objectives, each of which addresses a different group of stakeholders:

- decent work (including for value-chain workers);
- adequate living standards and wellbeing for end-users⁶;

⁵ We adopt the Global Reporting Initiative definition of value chain: An organisation's value chain encompasses the activities that convert input into output by adding value. It includes entities with which the organization has a direct or indirect business relationship and which either

(a) supply products or services that contribute to the organization's own products or services, or

(b) receive products or services from the organization.

This definition is based on United Nations (UN), The Corporate Responsibility to Respect Human Rights: An Interpretive Guide, 2012. The value chain covers the full range of an organization's upstream and downstream activities, which encompass the full life cycle of a product or service, from its conception to its end use.

⁶ The concept of end user has to be understood as the ultimate user of a finished product. It includes consumers, i.e. persons that use/consumer the product for private purposes, but is expanded to end uses for professional use (workers, employed or self-employed, using certain products, i.e. medical doctors using a laptop or a MRI device, bus drivers driving a bus...).

- inclusive and sustainable communities and societies.

With this structure the three stakeholder groups of workers, consumers and communities are covered. At the same time this follows the European Financial Reporting Authority Group's (EFRAG) draft approach to non-financial, sustainability reporting by companies under the proposed Corporate Sustainability Reporting Directive (CSRD), which is also based on these three stakeholder groups.

Sub-objectives to these three objectives will ensure that various aspects integral to these objectives can be addressed. These aspects include: health and safety; healthcare; housing; wages; non-discrimination; consumer health; and communities' livelihoods.

Within each of these objectives, there are different types of substantial contributions. The first type of substantial contribution is substantial contributions which focus on the additional inherent social benefits of the activity itself, like the research and marketing of pharmaceuticals. The second type is substantial contributions which focus on avoiding and addressing negative impacts on workers, consumers and communities. This second type includes; (i) occupational health and safety (OHS); (ii) training workers for a just transition; (iii) paying wages agreed in collective agreements; and (iv) ensuring a decent life for the worker and his/her family. The third type of substantial contribution is enabling activities which enable other activities to provide social benefits.

A further structural element will be "do no significant harm" criteria. These ensures that when an activity is contributing to one of the social objectives it is not doing harm to any of the other objectives. "Do no significant" harm criteria will be linked to the activity. For topics which cannot be linked to the activity but must be linked to the economic entity (such as 'transparent and non-aggressive tax policy'), minimum safeguards will be employed to avoid inconsistencies. These inconsistencies include counting a substantial social contribution for a company which in another area is acting against social and or governance principles. In this way, corporate-governance topics will generally be linked to the entity and will be recognised in minimum safeguard criteria.

Finally, the social taxonomy considers socially harmful activities. Similar to the environmental taxonomy, the question in this case is which activities can be considered socially harmful under any circumstances.

Apart from these structural elements of a social taxonomy, two suggestions for how to ensure a balance in the relationship between an environmental taxonomy 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 the future social taxonomy, for example, along the lines of the environmental part of the OECD guidelines for multinational enterprises (MNEs). This would mimic the way that social and governance-related minimum safeguards (UNGPs and OECD guidelines for MNEs) are part of the environmental taxonomy. The other suggestion is to integrate the social and environmental taxonomy more closely with environmental and social "do no significant harm" -criteria being valid for both the social and the environmental part all activities.

Finally, we present some requirements for future social criteria and indicators within this framework alongside ideas about the next steps for developing a social taxonomy.

The report takes into account and fully respects the specificities of national systems and national powers. It also takes into account the joint commitment of the European Parliament, the Council and the Commission to pursue the principles enshrined in the European pillar of social rights.

1. Introduction

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

In recent years, institutions and governments around the world have begun to understand the relevance and urgency of measures to ensure a 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 European Green Deal requires the EU to:

- reach net-zero greenhouse-gas (GHG) emissions by 2050;
- decouple economic growth from resource use;
- leave no person and no place behind⁷.

To achieve this, a rapid 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 further investments of \$630 billion a year worldwide for the next decade will be needed to have a 66% chance of limiting the temperature increase on the earth's surface to below 2 degrees⁸.

There is also a huge need to invest in social sustainability to achieve the UN's SDGs. The financing gap to achieve the SDGs in developing countries is estimated to be \$2.5-3 trillion a year⁹. The *Employment and Social Development in Europe 2020* report presents Europe's most pressing need for social investment: poverty reduction. 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: (i) the importance of developing workers' skills to improve productivity in companies; and (ii) the need to invest in communications technology, especially for small and medium-sized enterprises (SMEs)¹⁰.

Against this background, the EU has been considering how to direct private capital towards environmentally sustainable activities. The recommendations of the expert group set up for this purpose led to the 2018 action plan on financing sustainable growth¹¹. One of the plan's

⁷ Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal, COM/2019/640 final, 11.12.2019.

⁸ OECD, 2017, Investing in Climate, Investing in Growth, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264273528-en>.

⁹ <https://www.un.org/sustainabledevelopment/sg-finance-strategy/>

¹⁰ *Employment and Social Developments in Europe 2020*, p. 15: <https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8342>.

¹¹ Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan: Financing Sustainable Growth, COM/2018/097 final, 8.3.2018.

key recommendations is that the EU should develop a classification system for environmentally sustainable activities. That classification system was created with the adoption of the Taxonomy Regulation in July 2020¹². The taxonomy initially only covers environmental activities and objectives only. It was created to provide clarity and certainty for investors and decision-makers. Aimed at providing guidance to capital-market participants so they can recognise sustainable investments and allocate resources efficiently, the taxonomy identifies sustainable sectors and activities using four simple components:

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

In addition, and of relevance to the social dimension, Article 18 sets out 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 UNGPs;
- the OECD guidelines for MNEs.

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

The taxonomy contained only limited reference to social sustainability. For this reason, the European Commission gave the Platform on Sustainable Finance the mandate to also work on extending the taxonomy to social objectives and set up a subgroup dedicated to this task. This report summarises the key initial observations and recommendations on this task.

These recommendations are a proof of Taxonomy concept and not to be considered as the actual EU Social Taxonomy objectives. The objectives presented in this report might not be the final objectives that the Commission will use.

1.2 The mandate and work of the PSF on Social Taxonomy

The Subgroup on Social Taxonomy was given two tasks to accomplish in accordance with its mandate.

¹² 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, OJ L 198, 22.6.2020.

Their first task was to explore extending the taxonomy to social objectives in accordance with article 26(2)(b) of the Taxonomy Regulation. This article called 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 consisted of two parts both related to so-called minimum safeguards. The first part was to advise the European Commission on how Article 18 works in practice. Article 18 requires businesses carrying out environmentally sustainable economic activities to uphold international labour standards and human rights. The second part was to assess whether there was a need to supplement the requirements of Article 18 (with so-called minimum safeguards).

Accomplishing the first task requires the following:

- 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 ‘employees, -health, human rights, equality and non-discrimination matters’;
- suggesting approaches for: (i) developing substantial-contribution criteria; and (ii) 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) and discussing the merits of covering those objectives;
- reflecting on what environmental safeguards are required for socially sustainable activities, in particular the merits of: (i) using the existing DNSH criteria for environmental objectives; and (ii) drawing up additional minimum environmental safeguards;
- reflecting on the overall relationship between the social and environmental taxonomies, including potential overlaps between the two;
- reflecting on how to relate a social taxonomy to other relevant EU legislation, including the CSRD and the Sustainable Finance Disclosure Regulation (SFDR).

Part of the second task was to ‘give advice on the functioning of the minimum safeguards’, specifically to clarify how Article 18 works in practice. The Subgroup on Social Taxonomy will publish a report on how it has fared in accomplishing this. The output of this task will be relevant and therefore will need to be considered during future steps in drawing up the social taxonomy, for example in: (i) deciding on detailed criteria for substantial contribution and DNSH; or (ii) selecting the final taxonomy model as described below.

The Subgroup started its work in October 2020 and explained its first ideas about a structure of a social taxonomy in a webinar in February 2021. In July 2021, the draft report was published following another webinar. This draft report was put to public feedback for 7 weeks. Afterwards, comments and suggestions from the public feedback were incorporated in the now final report.

1.3. Reaction to consultation for public feedback

1.3.1. Feedback received

From 12 July to 6 September 2021, the draft report on a social taxonomy was published for public feedback. There were 268 responses to the questions on the merits of a social taxonomy, concerns about a social taxonomy, and some of the proposed features of the social taxonomy. The results of the consultation showed that:

- 78% of the respondents agreed with at least one of the merits of the social taxonomy outlined in the draft report;
- 15% did not see any merits in the social taxonomy outlined in the report;
- 6% did not answer this question.

The merits of a social taxonomy that were most often mentioned were:

- that it strengthens the definitions and measurement of social investment (65%);
- that it supports investment in social sustainability and a just transition (62%);
- that it addresses social and human-rights risks and opportunities for investors (47%).

Concerns most often mentioned by respondents were as follows:

- 83% of respondents said that they had at least one concern about a social taxonomy;
- increasing administrative burden was the concern most frequently identified (chosen by 58% of respondents);
- interference with national legislation and the autonomy of social partners was the second most frequently identified concern (chosen by 45% of respondents).

Other results were as follows:

- 53% voted in favour of addressing both activities and entities in a social taxonomy;
- 39% voted against including sustainability-linked pay in a social taxonomy;
- 35% voted in favour of sustainability-linked pay in a social taxonomy;
- 40% voted for model 1 (social and environmental aspects kept more separate from each other);
- 31% voted for model 2 (social and environmental aspects more closely integrated).

1.3.2. Response to the feedback

In response to the public feedback, and especially to the concerns about increased administrative burden, the Subgroup on Social Taxonomy made efforts to align the structure of a suggested social taxonomy more closely to the existing environmental taxonomy. These efforts also addressed the repeatedly expressed view in the plenary that the social taxonomy should align its structure with the environmental taxonomy and with other legislative projects like the proposed CSRD.

Alignment with the environmental taxonomy and other legislative projects

The Subgroup aligned the draft social taxonomy with the environmental taxonomy and other legislative projects mainly by collapsing the previous ‘horizontal dimension’ and ‘vertical dimension’ into a single structure. This single structure contained three objectives: ‘decent work including value-chain workers’, ‘adequate living standards and wellbeing for end-users’ and ‘inclusive and sustainable communities and societies’. The differences between ‘horizontal’ and ‘vertical’ have now been made more clear by creating different types of substantial contribution (i.e. types of substantial contribution that refine and add detail to the headline objectives). Process-related criteria have now been framed as reducing negative impact on workers, consumers and societies. In doing this, the criteria for what constitutes a substantial contribution to process-related activities (the old ‘horizontal’ dimension) have become much clearer. Firstly, it must be made obvious for which sectors these objectives are most relevant (sectors with high need for training, with low wages etc). Secondly, objectives must be linked to activities for which investments are made which can be counted (investment in training or living wages but not in freedom of association). Thirdly, these investments must go beyond ‘business as usual’ risk-mitigation processes and go demonstrably beyond any applicable legislative requirements. As a consequence, the examples for “avoiding and addressing harm” criteria are much more concrete and show a high level of ambition. One example of ‘avoiding and addressing harm’ would be the training of workers when specifically directed to certain vulnerable groups to improve their employability.

Reporting and administrative burden

Companies that substantially contribute to social sustainability, and that want to attract social investors investing, need to report on their fulfilment of the criteria that have been developed. However, by aligning the structure of the social taxonomy to the structure considered by EFRAG, we have made a first step towards avoiding double reporting structures and unnecessary additional administrative costs.

Concerns on national legislation

The concern about creating criteria for social activities in an environment of differing social regulation is valid and cannot be completely dismissed. However, taking the environmental taxonomy as a role model, there are solutions to this concern. The two solutions which could be adopted in a social taxonomy are set out in the bullet points below.

- One solution is to consider basic criteria of national legislation as a minimum and any further degree of going beyond these basic criteria as qualifying as a substantial contribution. This is already the case for buildings in the climate-mitigation objective of the environmental taxonomy and could be adopted for social housing.
- Another solution is to refer to standards that have been acknowledged by all European countries and globally, such as the UNGPs.

Neither this report nor its specific contents represent recommendations of the Platform on Sustainable Finance. This document is not an official Commission document nor does it set out an official Commission position. Nothing in this document commits the Commission nor does it preclude any policy outcomes.

1.4. Legislative context

The work done by the Subgroup on Social Taxonomy takes place in the context of the EU's existing framework for sustainable finance¹³. The following regulations and legislative initiatives represent the regulatory landscape to which a social taxonomy would finally belong:

1. the EU taxonomy - a classification system for green (and possibly in future social) activities laid down in the Taxonomy Regulation;
2. the proposed CSRD, which will replace the Non-financial Reporting Directive (NFRD) and introduce mandatory, EU sustainability-reporting standards;
3. the SFDR¹⁴;
4. the SCG initiative being drawn up by the Commission.

1.4.1. The EU Taxonomy Regulation

The EU Taxonomy Regulation creates the world's first-ever 'green list' – a classification system for sustainable economic activities. Article 8 of the Taxonomy Regulation puts obligations at entity level for: (i) large firms already subject to the NFRD – and in the future the proposed CSRD – to disclose their level of alignment to the taxonomy; and (ii) financial market participants such as asset managers and pension providers to report the proportion of their managed investments that are aligned to the taxonomy¹⁵.

Financial market participants are also subject to the following additional disclosure obligations at product level:

- **products that have sustainable investment as their objective** (SFDR Article 9 products) must disclose the percentage of the fund that is taxonomy-aligned (Article 5 of the Taxonomy Regulation);
- **products with environmental or social characteristics** (SFDR Article 8 products) must disclose the percentage of the fund that is taxonomy-aligned.

1.4.2. The NFRD and the CSRD

The NFRD lays down the rules for disclosing non-financial information by certain large companies. The NFRD currently applies to large public-interest companies with more than

¹³ In particular, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, Strategy for Financing the Transition to a Sustainable Economy, COM/2021/390 final, 6.7.2021.

¹⁴ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019.

¹⁵ 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, OJ L 198, 22.6.2020.

500 employees, including listed companies, banks, insurance companies and other companies designated by national authorities as public-interest entities.

Under the NFRD, large companies must publish information on: (i) the environment; (ii) social matters and the treatment of employees; (iii) respect for human rights; (iv) anti-corruption and the fight against bribery; and (v) diversity on company boards (in age, gender, educational background, and professional background).

The proposed CSRD, adopted by the Commission on 21 April 2021, and currently being negotiated by the co-legislators would amend the existing reporting requirements of the NFRD. As currently proposed, the CSRD would in particular: (i) extend the reporting requirements to all large companies and all companies listed on regulated markets; (ii) require the audit (assurance) of reported information; (iii) introduce more detailed reporting requirements; and (iv) require reporting according to mandatory EU sustainability-reporting standards.

The proposed CSRD will require companies to publish both: information necessary to understand how sustainability matters affect them; and information necessary to understand the impact these companies have on people and the environment ('double materiality'). Draft sustainability-reporting standards are currently being developed by the EFRAG.

The CSRD requires companies to publish information on the principal adverse impacts connected to the company and its value chain, including its strategy, targets and role of its board. Companies should report qualitative and quantitative information, both forward-looking and retrospective. The information should encompass the company's operations, products, services, business relationships and value chain. Some of this information will be sector specific.

The CSRD requires companies to address the following social topics in the information they provide:

- equal opportunities for all, including: (i) gender equality and equal pay for equal work; (ii) training and skills development; and (iii) employment and inclusion of people with disabilities;
- working conditions, including: (i) secure and adaptable employment; (ii) wages; (iii) social dialogue, collective bargaining and the involvement of workers; (iv) work-life balance; and (v) a healthy, safe and well-adapted work environment;
- respect for human rights, fundamental freedoms, democratic principles and standards set out in: (i) the International Bill of Human Rights and other core UN human rights conventions; (ii) the International Labour Organization's Declaration on Fundamental Principles and Rights at Work and the fundamental conventions of the International Labour Organization (ILO); and (iii) the Charter of Fundamental Rights of the European Union.

The CSRD requires companies to address the following governance factors in the information they provide:

- the role of the company's administrative, management and supervisory bodies (including on sustainability matters), and the composition of these bodies;
- business ethics and corporate culture, including both: (i) anti-corruption and anti-bribery; and (ii) the company's political engagements including its lobbying activities;
- the management and quality of a company's relationships with business partners, including its payment practices;

- the company's internal control and risk-management systems, including in its reporting process¹⁶.

There is clearly an overlap between the topics companies will have to report on under the CSRD and information needed from companies for a suggested social taxonomy. In the future this thematic overlap should lead to an overlap in reporting requirements from these two different initiatives. A first step in this direction has been made by structuring the objectives of the social taxonomy in a similar way as the proposed structure of the CSRD.

Apart from that it must be considered that a social taxonomy just as the environmental taxonomy follows a different aim than a reporting directive. The social taxonomy sets criteria for activities in order to define the substantial contribution this activity makes in the social sphere while the CSRD is a disclosure requirement for entities. This means that just as with the environmental taxonomy, special activity linked information requirements will emerge from a fully developed social taxonomy.

The additional information requirements will especially be needed as a social taxonomy, as it is proposed here, also encompasses the availability and accessibility of social products and services like health care products, social housing or public transport, topics which are not likely to be addressed under the CSRD.

1.4.3. The Sustainable Finance Disclosure Regulation (SFDR)

The SFDR (Regulation(EU) 2019/2088) lays down sustainability-disclosure obligations for financial advisers and manufacturers of financial products. At entity level, the SFDR requires financial-market participants to publish information on the principal adverse impacts (PAIs) of their investment on 'sustainability factors' (i.e. environmental and social aspects). It also requires entities to publish a statement on due-diligence policies with respect to those PAIs. Particular disclosure requirements under the SFDR are for:

- (a) information on the entities' policies for identifying and prioritising sustainability indicators and principal adverse sustainability impacts;
- (b) a description of the principal adverse sustainability impacts and of any actions taken by the entity to address these;
- (c) brief summaries of engagement policies in accordance with Article 3(g) of Directive 2007/36/EC, where applicable;
- (d) a reference to: (i) the entity's compliance with responsible business conduct codes and internationally recognised standards for due diligence and reporting; and (ii) where relevant, the degree of the entity's alignment with the objectives of the Paris Agreement¹⁷.

¹⁶ Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, COM/2021/189 final, 21.4.2021.

¹⁷ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019.

The list of PAIs that are so far known suggest there is an overlap between the topics and information required from financial market participants under the SFDR and information required from financial market participants for a suggested social taxonomy.

1.4.4. The proposal on Corporate Sustainability Due Diligence

The Commission adopted a proposal for a Directive on corporate sustainability due diligence on 23 February 2022. This initiative focuses on the due-diligence duties of a company and its impact on: (i) human rights including workers' rights; (ii) health; (iii) the climate; and (iv) the environment. Its aim is to prevent, mitigate and account for potentially adverse sustainability impact on the basis of the UNGPs and the OECD guidelines.

Companies will have to identify risks – both upstream and downstream – and act on these risks. Information will be required on:

- company policy
- company processes
- company activities
- company findings
- measures taken by the company
- outcomes of these measures.

Due-diligence processes are at the heart of the SCG initiative.

It is obvious that some of the objectives (for example on decent work, end-users, and communities) of a social taxonomy developed in this report can overlap with the objectives of the SCG initiative to improve businesses' respect for human rights. Once the SCG initiative is finalised it must be worked out which role a social taxonomy will play exactly in these areas. However, we can already stress that a taxonomy links its criteria to **activities** while the SCG initiative focuses on **companies**. We can also state that the role of the substantial-contribution criteria is to develop granular criteria on outcomes for rights-holders, setting the bar higher than existing legislation.

On top of this, the objectives of a social taxonomy include ensuring that everyone has access to social products and services needed for an adequate standard of living. This type of significant contribution is unlikely to be covered by the SCG initiative.

Apart from this sustainable-finance legislative framework, this social taxonomy is set up in the context of already existing programmes that set common social objectives. Among these objectives are: (i), the objectives enshrined in the EU Treaties; (ii) the objectives enshrined in the EU Charter of Fundamental Rights; and (iii) the objectives promoted by the European pillar of social rights. These objectives should direct the social taxonomy to align private and public investment to the objective of achieving upward convergence of working and living conditions in Europe.

Within this context, a social taxonomy will respect the limits of the division of powers between the EU and its Member States as outlined in the EU Treaties.

2. Extending the Taxonomy Regulation to social objectives

2.1. The merits of the social dimension

The EU High-Level Expert Group on Sustainable Finance (HLEG) was mandated by the European Commission to advise the financial sector on: (i) sustainability risks; and (ii) opportunities to steer capital towards sustainable investments. The HLEG's 2018 final report gives as much attention to social as to environmental aspects. The report's key recommendations make it clear that sustainable investing means investing in a way that helps achieve both environmental and social objectives¹⁸.

The 2020 report of the Technical Expert Group on Sustainable Finance (TEG), which was set up after the HLEG with the mandate to start working on implementing its recommendations, has elaborated on this idea. This 2020 report said: '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'¹⁹.

In addition to the recommendations of both the HLEG and TEG, the merits of including social objectives in the proposed taxonomy are outlined below.

The recommendations of the sustainable finance expert groups (HLEG and TEG) refer to documents on social rights in the EU, such as the European Social Charter²⁰ and the European pillar of social rights. The latter highlights the priorities of the EU's social agenda in the three areas of: (i) equal opportunities and access to the labour market; (ii) fair working conditions; and (iii) social protection and inclusion²¹.

A taxonomy of this nature should make clear the opportunities for investors to contribute to this European agenda for upward convergence of working conditions and living conditions of

¹⁸ '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.

¹⁹ Taxonomy: Final report of the Technical Expert Group on Sustainable Finance, March 2020, p. 51.

²⁰ <https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=090000168048b059>

²¹ 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

all Europeans. It should also position the EU as a standard setter and frontrunner in implementing global agendas such as the SDGs.

2.1.1. The need and potential for investment in social sustainability

Traditional ways of financing social welfare, such as government spending on stable systems of social security, remain fundamental. However, policymakers also realise that private investments have a role to play. Practically speaking, this means that investors should prevent any social harm by insisting that companies implement systems to ensure human rights are respected. It also means that investors should help to improve the provision of basic goods and services, especially for vulnerable people and groups.

As outlined in the introduction, very large amounts of capital are needed to finance measures for climate-change mitigation and adaptation. However, funding for social needs has been less of a focus. This lack of funding has been further aggravated 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 2020²². And for the first time since its inception, the United Nations Development Programme Index forecast a decline in human development indicators in 2020²³.

In Europe, social bonds were issued to finance the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE). SURE was created to alleviate the consequences of the COVID-19 crisis, and these bonds have proven crucial for containing a surge in unemployment and for maintaining employment, skills, incomes and competitiveness²⁴.

Roughly \$3.3-4.5 trillion a year needs to be mobilised to achieve the objectives of the UN's 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 trillion²⁵.

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 help to lift people out of poverty. Financial inclusion (making credit and deposits available for poor people and micro-enterprises) can help to boost

²² <https://blogs.worldbank.org/opendata/impact-covid-19-global-poverty-under-worsening-growth-and-inequality>.

²³ <https://unsdg.un.org/latest/blog/investing-sdgs-post-covid-world>.

²⁴ https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/eu_sure_social_bond_framework.pdf

²⁵ <https://unsdg.un.org/resources/unlocking-sdg-financing-findings-early-adopters>.

people's income. Research suggests there is less poverty in countries where there is greater access to microfinance²⁶.

2.1.2. The need for investment in a just transition

The transition to a sustainable, net-zero emissions and climate-resilient economy requires crucial changes in many sectors. These sectors include mining; power generation; transport; manufacturing; agriculture; the food system; and forestry. These changes will have affect the lives of workers in these sectors and their communities. The transition will also require land to be used 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 disadvantaged communities. In this sense, the term 'just transition' is best understood as a conceptual framework encompassing the complexities of the transition towards a sustainable, net-zero emissions, and climate-resilient economy. This conceptual framework highlights public-policy needs and aims to maximise the benefits of the transition, while minimising hardship for the workers, consumers and communities affected by it.

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'²⁷.

In the light of these considerations, the Commission has integrated a 'just transition mechanism' into its new European Green Deal investment plan²⁸.

2.1.3. Investors' demand for socially oriented investments

From 2009 to 2017, Europe's compound annual growth rate of capital invested, using a 'best in class', ESG-based approach, rose 20% from \$130 billion to \$580 billion²⁹. 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'³⁰.

There are signs that this growing interest in sustainable investments goes hand in hand with a growing interest in social investments. For example, the number of social bonds issued in 2020 increased to 10 times to what it was before the pandemic, with issuance numbers still

²⁶ 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.

²⁷ <https://www.ituc-csi.org/IMG/pdf/01-Depliant-Transition5.pdf>

²⁸ https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_24

²⁹ European SRI Study 2018: <http://www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study.pdf>, p. 17.

³⁰ [ESG assets may hit \\$53 trillion by 2025, a third of global AUM, Bloomberg Professional Services.](#)

continuing to surge in 2021. The International Capital Market Association (ICMA) defines social bonds as ‘any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance new and/or existing eligible social projects (aimed to address or mitigate a specific social issue and/or to achieve positive social outcomes especially for a target population) and which are aligned with the Social Bond Principles (SBP)’³¹. Bloomberg reports that proceeds from sales of these kinds of bonds rose from about \$20 billion in 2019 to \$147.7 billion in 2020³². Recent data from Moody’s suggest the continuation of this trend in the first quarter of 2021, in which \$90 billion of social bonds were issued³³.

Since 2010, a completely new instrument for socially sustainable investment has been developed to serve the growing market for social investments that have tangible impacts. These ‘social-impact bonds’ (not to be confused with social 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’³⁴. In practice, this means that these bonds link financial returns to social outcomes, such as reducing the 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 investment rises if these social outcomes are achieved and declines if they are not.

Between 2013 and 2016, the number of social-impact bonds contracted each year rose only slightly, before more than doubling in 2017 to 45 and rising again in 2018 to reach a peak of 48 new social impact bonds³⁵.

In addition to 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 their portfolios. New initiatives to cater for these investors have emerged as a result of this growing focus on human rights. For example, Principles for Responsible Investment, an investor association promoting responsible investment, launched a human rights framework for its members in 2020³⁶. Similarly, the Investor Alliance for Human Rights, comprising over 170 institutional investors, now represents a total of over \$5 trillion in assets that are managed across 18 countries³⁷. In the EU and across the world, there is a widely recognised need for better working conditions, dialogue and diversity in the workplace. Investors want to make a positive contribution to redressing the harm done by socially

³¹ ICMA: June 2021 Social Bond Principles Voluntary Process Guidelines for Issuing Social Bonds 2021, p. 2: <https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Social-Bond-Principles-June-2021-140621.pdf>

³² <https://www.bloomberg.com/news/articles/2021-01-11/social-bonds-propel-esg-issuance-to-record-732-billion-in-2020>

³³ https://www.moody.com/research/Moodys-Sustainable-bond-volumes-soar-to-record-231-billion-in--PBC_1283271

³⁴ OECD, *Understanding social impact bonds*, 2016: <https://www.oecd.org/cfe/leed/UnderstandingSIBsLux-WorkingPaper.pdf>.

³⁵ 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

³⁶ [Sustainability issues \(UN Principles for Responsible Investment unpri.org\)](https://www.unpri.org/sustainability-issues)

³⁷ [About the Investor Alliance for Human Rights Investor Alliance for Human Rights \(investorsforhumanrights.org\)](https://www.investorsforhumanrights.org/)

unsustainable practices in this area. This demand of investors is also reflected in topical investor-led human-rights initiatives, for instance on promoting living wages or addressing the human-rights risks associated with tailings from mining³⁸.

Some of these investments are made simply to avoid the specific risks described below. However, for other investors (such as religious investors, value-based banks or charities with social objectives), applying social criteria is an in-built part of their approach to business.

2.1.4. Social and human rights – risks and opportunities for investors

Investors run particular risks if they do not consider the social implications of their investments. For example, 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’. The authority does not consider ESG risk as a separate category of risk but indicates that sustainability risks may potentially have a negative impact on all business areas and investments. ESG risk therefore contributes to:

- reputational risk
- markets risk
- liquidity risk
- credit risk
- regulatory risk
- operational risk
- insurance risk³⁹.

For example, social grievances might translate into reputational risks if a business is associated with tragic events like the collapse of a factory or a fire in a factory with hundreds of deaths, as has happened in Asia in the past.

Due diligence is above all a tool to manage a company’s human rights risks and a due-diligence law is a means to spread this tool to all covered companies. However, from the investors’ perspective, a due-diligence regulation can also be perceived as a tool to make risks more obvious and material. Due-diligence regulation in countries such as Germany, France or the Netherlands means that neglect of human-rights due diligence may lead to

³⁸ See Investor Alliance for Human Rights, the PRI 2020 Human Rights Framework, or the Corporate Human Rights Benchmark.

³⁹ BaFin Guidance Notice, p. 13, [https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/dl_mb_Nachhaltigkeitsrisiken_en.pdf](https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/dl_mb_Nachhaltigkeitsrisiken_en.pdf?jsessionId=B7ED07B3115996DF33F83BAA92B2423A.2_cid502?__blob=publicationFile&v=5);

market and liquidity risks. This is because a violation of this regulation could entail the exclusion of companies from public contracts^{40 41}.

An example of regulatory risks related to social issues is when the US Food and Drug Administration demands better disclosure of the results of drug trials from pharmaceutical companies, threatening to fine them if they fail to comply⁴².

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 in the future, thereby increasing its costs or putting itself at risk of very expensive litigation. This risk has recently increased with the adoption of due-diligence laws in EU Member States and similar legislation being planned at EU level.

Apart from all of the above, companies may experience reputational damage or they may be boycotted, thus losing customers. Supply chains may be disrupted because of strikes or companies may be put at a disadvantage by becoming unattractive employers for highly qualified young people. All of these risks translate into risks for investors.

There are also fundamental economic reasons for making social investments. There is no consensus on the strict relationship between inequality and economic growth. However, there is increasing evidence that a growing gap between rich and poor could impede growth, including by creating political and social instability. This 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 this work of mitigating risks.

This is in line with what European social partners have said. For example, a recent joint position paper by European social partners (including representatives of trade unions and employers) argued that ‘the economy can thrive in dynamic societies, where entrepreneurship is alive, workers are well-educated, highly skilled, and motivated, and where women, immigrants and young workers successfully participate in the labour market in stable jobs’. The position paper went on to say that ‘an open economy thrives in fair societies where public infrastructure and services offer fertile ground for competitive businesses, ensuring development of all regions and stronger cohesion, especially in rural and remote areas, giving access to opportunities and a good quality of life to all, framed by stable and modern

⁴⁰ BaFin: Guidance Notice on Dealing with Sustainability Risks, 2020, p. 13: https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Meldung/2019/meldung_191220_MB_Nachhaltigkeitsrisiken_en.html.

⁴¹ French companies which have not published due diligence in compliance with the law face being excluded from public procurement contracts.

⁴² Regulatory Focus 28 April 2021: <https://www.raps.org/news-and-articles/news-articles/2021/4/fda-threatens-drugmaker-with-fines-for-failing-to>

democratic institutions'⁴³. The social taxonomy can reflect the ambition of European social partners to simultaneously strengthen both the competitive and social environment in which the European economy will develop.

There is also increasing recognition that social conditions are related to positive business outcomes. For example, former OECD Secretary-General (June 2006 to May 2021) Ángel Gurría said the following.

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 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 on⁴⁴.

2.1.5. Need to strengthen the definition and measurement of social investment

The sustainable-finance transition is currently under way, and ESG ratings continue to be shaped by industry expectations. As a result, any analysis of ESG ratings and related outputs underlines the difficulties faced by investors and how fundamentally different these ratings can be depending on the provider of the ratings.

The lack of a clear definition of the essential characteristics of social investments hinders their development and potentially their contribution to solve social problems. A recent study on the divergence of ESG ratings shows, that the categories of human rights and product safety, both social issues, are categories for which the measured deviations in rating results are particularly pronounced. The differences are striking⁴⁵. A global ESG survey by BNP Paribas in 2019 found that 46% of investors surveyed (347 institutional investors were surveyed in total) found the social aspect of ESG to be the most difficult to analyse and embed in their investment strategies⁴⁶. A 2017 study comparing 12 rating-agency approaches to the 'S' in ESG found four main problems in measuring social sustainability:

- social measurement evaluates what is most convenient, not what is most meaningful;
- current approaches to disclosure are not likely to yield the information needed to identify social leaders;
- the lack of consistent standards underpinning the measurement of social sustainability increases costs and creates confusing 'noisiness' across the ESG industry;

⁴³ ETUC, BUSINESS EUROPE, SGI EUROPE SME UNITED: Supplementing GDP as welfare measure: proposed joint list by the European Social Partners, March 2021.

⁴⁴ <https://www.oecd.org/employment/jobs-strategy/>

⁴⁵ 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.

⁴⁶ [BNP Paribas Securities Services ESG Global Survey 2019: trends and key figures - BNP Paribas \(group.bnpparibas\)](#)

- existing measurement does not equip investors to respond to rising demand for socially responsible investing strategies and products⁴⁷.

A social taxonomy has the potential to address these issues and harmonise how social sustainability is 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 environmental taxonomy is to redirect capital flows to necessary investments in climate-change mitigation and adaptation and other environmental goals. By the same token, the purpose of a social taxonomy would be to: (i) direct capital flows to activities that operate with respect for human rights; and (ii) support capital flows to investments that improve living and working conditions, especially for the disadvantaged. The rationale behind the green taxonomy is that sustainable investors need some guidance 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 for investments.

This is not only a concern for institutional investors but also for retail investors. Today there is a wide range of sustainable financial products offered to retail investors who wish to invest in environmentally and/or socially sustainable activities. However, without clear definitions and categorisation of products and independent information there is a lack of guidance for them. Not having the means to buy ESG rating expertise as institutional investors have, they are even more potential victims of social washing. A situation a social taxonomy aims to change.

⁴⁷ [Metrics-Report-final-1.pdf \(squarespace.com\)](#)

2.2. Concerns about a social taxonomy

The previous sections set out a number of arguments for extending the taxonomy to cover social objectives. However, there are also concerns and caveats about extending the taxonomy in this way. The two main concerns are summarised below.

- It might not be possible to define activities as socially sustainable or as socially detrimental (i.e. as violating the DNSH criteria), as this depends on the context. In the social area, context is predominantly set at the national level, including through the industrial relations system.
- Many of the objectives of a social taxonomy would go beyond EU powers (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. A social taxonomy must respect the treaty-based division of powers. This means recognising differences in national labour-market models, such as collective bargaining systems.

A social taxonomy is intended to support investments in activities 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 social objectives. In doing this, a social taxonomy would provide investors with a much-needed instrument for supporting their investment choices.

National regulations vary from country to country, setting different parameters for: (i) preventing detrimental social behaviour by companies; or (ii) demanding social contributions from them. These differences might lead to a social taxonomy favouring 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 as long as this legislation fulfils the fundamental social principles enshrined in the EU social pillar and the European Social Charter.

It is acknowledged that differences in national legislation will probably have a bigger influence on the work of drawing up criteria for a social taxonomy than it did on drawing up criteria for the environmental taxonomy. There are certainly regulatory differences from country to country on topics like nature conservation and protection of species. However, in the social sphere, differences sometimes reach far beyond individual legislation on one topic to the whole structure of how healthcare or wage-setting is organised in countries. Although this might complicate the drawing up of concrete criteria, there are solutions to this problem. Criteria could take national legislation as a starting point (for example, the national definition of social housing or the results of collective bargaining), and build criteria on this basis.

Another way to deal with national differences could be to refer to international standards and guidelines valid in the EU, like the Universal Declaration of Human Rights and the ILO's core labour norms, both of which are valid in all EU countries. The EU social pillar to promote social rights would be the prominent body of rules in the European context for this work. In addition to these standards and guidelines, EU social legislation confers a responsibility on the EU for promoting social rights and social dialogue at all levels. The EU can also take action in the area of social protection (albeit requiring unanimity among Member States). However, more detailed social issues covered by a social taxonomy (such as wages, social dialogue and

social protection) are within the national competencies of Member States. Social dialogue, for example, is designed very differently in Member States. In some Member States, it even plays a key role in determining labour rules.

Apart from this, there might be situations where geographical circumstances might require special attention. For example, the negative impact of mining on communities is much more pronounced in some developing countries than in European countries. Equally, the situation of trade unions and their ability to influence the wage-setting process also differs substantially between countries. When working out concrete criteria it might be necessary to consider these differences.

Another concern is that a social taxonomy could lead to investment being directed only to certain companies, whereas what is actually needed is a wider approach to support companies in their contribution to society and social sustainability. This contribution could include the creation of decent jobs in general.

As explained in more detail below, a social taxonomy acknowledges the social contributions that companies make. However, for a social taxonomy to really work as a tool to direct capital flows towards activities and companies that make substantial social contributions, the criteria must be more specific. The present proposal recommends a broad approach to a social taxonomy. It does this by including social-economic activities like: social housing; healthcare; education; and efforts to reduce negative (and maximise positive) outcomes for the three affected stakeholder groups. These stakeholder groups are workers, end-users and communities.

A social taxonomy will certainly add to the reporting and disclosure requirements already faced by companies under the proposed CSRD, SFDR and the Taxonomy Regulation. This is especially because there are currently only a few standardised social indicators on which companies usually report.

For SMEs in particular, reporting in line with a detailed social taxonomy could impose a disproportionate burden. Ways must therefore be found to ensure that the criteria and indicators selected are meaningful and can be reported on at a reasonable cost.

Multinationals are not without their own challenges 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 commentators are concerned that a social taxonomy would have impacts beyond sustainable investment, in that taxonomy criteria could also be used for deciding on EU funding and subsidies. If this were the intended use of the taxonomy criteria (it is not presently the intention), it would have a stronger and more far-reaching 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 adopted a proposal for a taxonomy regulation and asked the TEG to develop technical screening criteria for that environmental taxonomy. The Commission asked the TEG to begin their work on technical screening criteria by working out criteria for climate-change mitigation and adaptation. This prioritisation was due to the pressing need to mitigate climate change and mobilise more private capital for investments in this area. The basic structure of this environmental taxonomy is a set of performance thresholds (referred to as 'technical screening criteria') for economic activities which: (i) make a substantial contribution to at least 1 of the 6 environmental objectives; and (ii) do not do any significant harm to the other 5 objectives, where relevant. In addition, the environmental taxonomy contains minimum safeguards to guarantee that human rights and governance are also taken into account. It thus provides a classification tool for determining what is an environmentally sustainable activity which helps: (i) asset managers and banks to decide what to invest in; and (ii) end-investors/retail investors to evaluate what degree an environmentally sustainable investment fund or green bond is invested in activities which meet these criteria.

It is recommended that the development of a social taxonomy follow the model of the environmental taxonomy where possible. There are several reasons for this.

In the future, investors will probably be able to choose between investment funds with social objectives, funds with only environmental objectives, or funds with both environmental and social aims. 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, in line with the social taxonomy, or in line with both taxonomies.

Companies that are required to provide data on both environmental and social topics should not be overburdened by having to work with two completely different systems.

The same is true for green and social bonds/loans or project finance. All these instruments would benefit from having to apply a similar classification structure when financing environmental or social objectives.

The environmental taxonomy has gained considerable recognition both within and outside the EU. Keeping the social taxonomy in line with the design of the environmental taxonomy might therefore help with global market acceptance and understanding. It would also support the work of the International Platform on Sustainable Finance, which is currently developing a 'common ground taxonomy' to highlight commonalities between existing taxonomies.

Therefore, as a starting point, a social taxonomy should follow the steps of the environmental taxonomy by: (i) first setting social objectives; (ii) then setting out the substantial contributions that can achieve these objectives; and (iii) finally drawing up 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 whether the social and environmental taxonomies will be combined or will remain separate (see Chapter 9).

3.1.1. Differences between environmental and social taxonomies

There are three key differences, outlined in the bullet points below, between the environmental and social taxonomies. 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 these impacts through carbon capture or ecosystem restoration. However, economic activities tend to have inherent social benefits by creating jobs, providing training, contributing to taxes, bolstering 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. However, if the company improves the accessibility and affordability of certain drugs for certain groups of people, this could be identified as an additional social benefit.
- The foundations of the environmental taxonomy are natural science and international frameworks such as the Paris Agreement. Criteria for the environmental taxonomy were generally developed on 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 CO² reduction requirements, science is not systematically able to play such a role for social factors. And although there is abundant research on social phenomena within social sciences that can influence the development of a social taxonomy, science cannot play the same role here 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 longstanding structured global discussions among stakeholders, thereby gaining authority. This is why, for a social taxonomy, a variety of documents will form the basis for selecting criteria. These documents include: (i) the *OECD Guidelines for Multinational Enterprises*; (ii) the UNGPs; (iii) the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labor Organization on Fundamental Principles and Rights at Work; (iv) the International Bill of Human Rights; (v) the European pillar of social rights; and (vi) the European Social Charter.
- Finally, it might be more difficult – at least initially – to develop quantifiable criteria for a social taxonomy than for an environmental taxonomy. This is because, for environmental topics (and climate-change mitigation in particular), scientific research makes it possible to attach highly relevant quantitative criteria to economic activities. However, social sustainability is at the moment often described in more qualitative terms. However, promising developments are occurring in the field of quantifiable social data. For example, the EU *acquis* in the social fields gives clear policy and legislative references/indicators that measure social impact. More recently, the EU's 'social scoreboard' represents relevant examples and recommendations for

implementing the 20 principles of the European pillar of social rights, and contains a set of indicators of impact. These examples, recommendations and indicators can be used in the EU social taxonomy to measure access to social protection. Another example of the quantifiable measurement of social indicators is the UN Development Programme's annual report on human development. SDG indicators are also quantified, and they could be used for the corporate world by linking the SDG achievement (or lack of achievement) of a given country to its corporate contribution to SDG achievement. This would make it possible to understand and analyse how businesses are helping to achieve the SDGs. There are other quantified social indicators developed by development banks (mostly at project level), ESG rating agencies, and microfinance banks and funds. In the future, these systems will have to be considered and tested.

4. Articulating and setting social objectives

4.1. The objectives

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 ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy
- 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 SDGs
- the UNGPs
- the UN Global Compact
- the OECD guidelines for MNEs.

These documents cover a wide range of social topics that can be brought within the scope of the social taxonomy including:

- labour rights;
- social protection and inclusion;
- non-discrimination;
- the right to health care, housing, education (including professional training) and food;
- assistance in the event of unemployment or self-employment;
- consumer protection;
- peaceful and inclusive societies;
- the fight against corruption and tax evasion.

These documents explicitly cover and/or reference a set of fundamental freedoms and rights that countries have agreed to uphold and enforce to ensure that people and communities live dignified lives. A common distinction between the type of rights included in these documents is that between civil and political rights on the one hand (e.g. the right to vote, the right to freedom of expression, the right to privacy, etc.) and economic, social and cultural rights on the other (the right to fair and just working conditions, the right to health, the right to housing, etc.). Regardless of this distinction, it is widely acknowledged that all these rights are interdependent and indivisible, and that abuses of economic and social rights have implications for civil and political rights and vice versa. For example, restrictions on freedom of association and expression can impair the ability of workers to organise and collectively bargain for better working conditions. The suggested objectives of a social taxonomy have been worked out on the basis of these documents and are therefore by no means “subjective”. It should also be borne in mind that some of these instruments are not prescriptive, but instead

seek to encourage the public and private sectors to: (i) make social rights accessible by all (such as the European pillar of social rights); and (ii) promote the three dimensions of development (such as the SDGs). In this way, these reference documents can set certain standards, achieve common goals, or implement coordinated policies. Because of the interdependence of these rights, it was agreed that the most convincing way to articulate the objectives of a social taxonomy – which should operate at a higher level of generalisation – was by setting out the type of stakeholders that different economic activities can affect. Stakeholders affected by business activities include: (i) an entity’s own workforce (including value-chain workers); (ii) end-users or consumers; and (iii) affected communities (directly or through the value chain). For the sake of simplicity, a future social taxonomy should be centred around these three groups of stakeholders to whose lives and livelihoods economic activities can make a positive contribution.

This approach would align with the recommendation of the EFRAG’s European Lab Project Task Force on preparatory work for developing EU sustainability-reporting standards. In its final report of February 2021, the Task Force suggested that the ‘S’ in ESG (‘environmental, social, governance’) should be defined using a stakeholder-centric approach. (Include reference)

With this stakeholder-centric approach in mind, the topics listed above can be linked to stakeholder groups in the way set out in the table below.

Topic in document	Stakeholder group
Labour rights and working conditions	Workers
Social protection and inclusion	Workers, communities and societies
Non-discrimination	Workers, communities and societies
The right to health care, housing, education (including professional training) and food	End-users, communities and societies
Assistance in the event of unemployment, self-employment, and old age	Workers
Consumer protection including data protection	End-users
Peaceful and inclusive societies	Communities and societies
Fighting corruption and tax evasion	Societies

Based on this allocation of topics to stakeholder groups, we suggest three objectives for a social taxonomy. These three objectives are set out in the sections below (4.1.1 - 4.1.3).

4.1.1. Decent work (including value-chain workers)

This objective focuses on people in their working lives or as workers. The formulation of this objective acknowledges the helpful role of the decent-work agenda spearheaded by the International Labour Organization. The four pillars of the decent-work agenda are: employment creation, social protection, rights at work and social dialogue. This objective would include sub-objectives that emphasise some of these four pillars. Because it also relates to the just transition, this objective would also reflect employment generation for certain groups of people (such as those left unemployed by the closure of polluting industries). The decent-work objective is well expressed in SDG 8 of the UN's 2030 agenda. It is also positively correlated with other SDGs that give shape to the concept of decent work (e.g. SDGs 1, 4, 5, 10, 17, etc.). For example, the European Trade Union Confederation and the International Trade Union Confederation promote an agenda for sustainable development that is centred on SDG 8. At EU level, the European pillar of social rights (and its implementing tools) sets a common and widely agreed definition of quality jobs, which is fully compatible with the UN 2030 agenda. The objective of decent work should, however, not be limited to the European Union. Working conditions in third countries sometimes do not meet the demands of the decent work agenda and are directly linked to the EU market where products made under bad working conditions imported. Therefore it is important to consider working conditions in the supply chain as well.

4.1.2. Adequate living standards and wellbeing for end-users

This objective focuses on people in their role as end-users of certain products and services that either pose heightened health or safety risks or that have the potential to help people to meet basic human needs. The sub-objectives will emphasise aspects related to consumer protection and the realisation of economic and social rights such as the right to health, food, housing and education.

4.1.3. Inclusive and sustainable communities and societies

This objective will emphasise respecting and supporting human rights by paying attention to the impacts of activities on communities and the wider society. It will achieve this by: (i) addressing and avoiding negative impacts; and (ii) making basic economic infrastructure available to certain target groups. This objective focuses on people in their role as members of communities. The sub-objectives under this objective will emphasise issues such as: (i) land rights; (ii) indigenous people's rights; (iii) human-rights defenders; and (iv) improving/maintaining the accessibility and availability of basic economic infrastructure and services like clean electricity and water for certain vulnerable groups or groups in need.

Starting from the above three objectives, we considered the following structural issues for developing a social taxonomy:

- the development of sub-objectives;
- types of substantial contribution and how they will work;
- the special role of DNSH and Minimum Safeguards in a social taxonomy;

- the rationale for selecting sectors;
- linking substantial contribution to capital expenditure (CapEx), operational expenditure (OpEx) or turnover.

In the following sections, these five steps are worked out in more detail. The aim is to set up a basic structure upon which a social taxonomy can be fully developed. In the end, examples will illustrate the suggested path from objectives to detailed criteria.

4.2. The development of sub-objectives

The three objectives on workers, end-users and communities cover a wide range of topics crucial for a social taxonomy. These topics need: (i) different approaches for prioritising sectors; (ii) different substantial contributions; and (iii) different DNSH criteria. Therefore, the development of sub-objectives will be necessary. The two requirements for sub-objectives are that they cover all essential topics of the objective and that they are clearly distinguishable from each other without overlaps. It would also be desirable to be able to select and prioritise sectors for substantial-contribution criteria for each sub-objective. However, this is not a prerequisite. For essential social topics, it will be possible to draw up substantial-contribution criteria, although it will be difficult to prioritise sectors for these topics. In these cases, those sectors relevant for other social topics will be chosen in a similar way to how sectors are chosen for the climate-adaptation taxonomy. Further work is needed on whether and how criteria for substantial contribution can be drawn up for the different sub-objectives. Difficulties related to these questions are further explained in Section 4.3. Care must also be taken that the standard for substantial contribution has an equal level of ambition for all sub-objectives.

Note that an economic activity does not need to make a substantial contribution to all sub-objectives included in an objective in order to qualify as sustainable.

4.2.1. The non-exhaustive proposed list for sub-objectives for the ‘decent work’ objective

1. Promoting decent work

- Strengthening **social dialogue**, promoting freedom of association, and promoting collective bargaining for setting wages and working conditions, especially in situations with low levels of collectively agreed wages. Introducing or maintaining an EU-wide framework agreement – or an otherwise active framework agreement – between the company and workers, where applicable and as appropriate in the national context. This agreement should make specific reference to upholding labour standards along value chains⁴⁸.
- Ensuring pay levels for workers are set in a predictable and transparent way. **Living wages** should be paid that guarantee decent lives to workers and their families, while respecting wider collective bargaining arrangements between social partners and ensuring decent working hours.

⁴⁸ Global framework agreements regulate working conditions across a company’s global operations and are negotiated on a global level between trade unions and multinationals.

- **Ensuring that formal working** relationships avoid precarious working conditions.
- Providing excellent **health and safety** for workers, with high levels of worker representation in formal committees on health and safety that are jointly composed of management and workers.
- Running extensive programmes for skills and **life-long learning**, job transition, and employment generation. These programmes should make special effort to ensure high levels of worker involvement in programme development and in the generation of training opportunities. They should also make a special effort to include certain groups (still to be determined), including women.
- Providing for **social protection** as appropriate in the national context. This should include employee pensions, also funded by employers, and occupational welfare such as good childcare arrangements. Social protection outside the work sphere would be considered in the 'inclusive and sustainable communities and societies' objectives.
- Taking immediate and effective measures to **end forced labour** and exploitation of work, with specific reference to workers with a migration background.
- Taking immediate and **effective measures against child labour** to end child labour.

2. Promoting equality and non-discrimination at work

- Equal **employment opportunities for women** including by helping to end segregation in the labour market through gender-specific professions. Ensure that women and workers from different backgrounds are equally represented at all levels of the company and in all kinds of occupations and positions including senior management. This should have as a specific aim to reduce pay gaps including gender pay gaps. Offering parental leave and other facilities and assets that help to improve the working conditions and career prospects of disadvantaged people. Decent job creation for target populations (unemployed young people, disadvantaged groups).
- Creating jobs for women, both directly and indirectly, including through special measures to attract women into the workforce or to break down gender-segregation in jobs (e.g. childcare facilities, and diversity policies that go beyond mere compliance with existing legislation).
- Ensuring that the pay gap between executives and the average worker is not excessive.
- Ensuring a living income for farmers.

3. Ensuring respect for the **human rights and workers' rights of affected workers in the value chain** by carrying out risk-based due diligence including on the sub-objective areas listed above.

As a general rule, these sub-objectives should ensure that investments that comply with the social taxonomy are aligned to the European pillar of social rights and to the decent-work agenda under the SDG framework.

4.2.2. The non-exhaustive proposed list of sub-objectives for adequate living standards and wellbeing for end-users

- Ensuring **healthy and safe products and services**.

- Designing **products to be durable and repairable** (making spare parts available, ensuring the interoperability of spare parts with those of competitors) and offering services that allow for a smooth multimodal experience (e.g. in transport).
- Providing for cybersecurity and the **protection of personal data and privacy**.
- Engaging in **responsible marketing practices** by providing all relevant and comprehensible information to consumers so that they can make an informed choice. Avoiding directing consumers towards products and services that are not in their interest.
- **Ensuring access to quality healthcare** products and services **including care services**. These products and services should have a high standard of quality and safety, and be easy to access.
- **Improving access to healthy and highly nutritious food** of good quality especially for children.
- **Improving access to good-quality drinking water**.
- **Improving access to good-quality housing**.
- **Improving access to education and lifelong learning**.

4.2.3. The non-exhaustive proposed list of sub-objectives for inclusive and sustainable communities and societies

1. Promoting equality and inclusive growth by:

- improving access for target populations and/or areas to basic economic infrastructure such as transport, telecommunications (including the internet), financial services, and electricity
- Child care and support to children
- Inclusion of people with disabilities
- creating and preserving decent jobs, particularly as part of a just, green and digital transition, for example by retaining and reskilling workers;
- to the extent that is appropriate, preserving employment levels and hiring local workers and supporting local suppliers in targeted areas;
- promoting equality by: (i) addressing recognised gender gaps in communities and society; or (ii) having a transformative impact on gender equality and time savings for women (e.g. design features of mobility projects, access to finance for female entrepreneurs).

2. Supporting sustainable livelihoods and land rights including by doing the following.

- Promoting community-driven development where decision-making processes are decentralised to the community level.
- Avoiding and addressing negative impacts on communities affected by business operations (including but not limited to their: land and livelihoods; health, safety and security; culturally and spiritually sacred sites; and access to basic services, such as water, sanitation, housing and education).
- Carrying out meaningful consultations with affected communities, including on development priorities where relevant. This should aim to ensure continuous

engagement and good-faith negotiation with indigenous peoples to obtain their free, prior and informed consent before undertaking any activities that may affect them.

3. Ensuring respect for the human rights of affected communities by carrying out risk-based due diligence, including as it relates to the above-mentioned sub-objective areas.
 - Implementing the ‘free, prior and informed consent’ process when indigenous people’s groups are affected. Supporting freedom of assembly and expression including the protection of human-rights defenders and civic space by:
 - wherever appropriate, taking action and engaging in collective advocacy, dialogue with states, and multi-stakeholder coalitions on issues relating to human-rights defenders and restrictions on civic freedoms and the rule of law;
 - ensuring that indigenous and customary land rights are upheld when acquiring or using land, including by redesigning business plans or activities to avoid impacts on indigenous or customary land.

Finally, it should be considered that under this proposed social taxonomy it would be possible to make a substantial contribution to several of the objectives and sub-objectives simultaneously. In this case, a bundle of criteria can be applied to a certain activity which relates to several of the objectives. This can be the case if products from certification schemes are considered, such as fair-trade products or metals from certified mines. In these cases, the components of the certification scheme must be scrutinised.

Activities which make a substantial contribution to several social objectives at the same time might also be linked to the social economy, meaning companies which have both social and financial objectives.

All of these sub-objectives have their rightful place in a social taxonomy. However, it will be very challenging to meet DNSH requirements for all of them. When further developing the social taxonomy, this problem of how to meet DNSH requirements should be taken into account and a solution should be found.

All these sub-objectives can be promoted in different ways. To structure these different types of substantial contribution, the environmental taxonomy categorised them into three broad types: (i) reducing environmental pressure; (ii) improving the state of the environment; and (iii) enabling activities. This three-part distinction also makes sense for a social taxonomy and helps to cover the different ways an activity can contribute to social sustainability. In the next section, this proposed three-part distinction for a social taxonomy is explored further.

4.3. Types of substantial contribution

For a social taxonomy, we suggest the types of substantial contribution set out in the table below.

Substantial-contribution type	Explanation
Avoiding and addressing negative impact	Targeting both: (i) high-risk sectors with documented human-rights and labour-rights abuses of relevance to the objective; or (ii) sectors that are less likely to contribute to the objectives of the European social pillar.
Enhancing the inherent positive impacts of: (i) social goods and services; and (ii) basic economic infrastructure	Targeting social goods and services sectors that provide: (i) goods and services for basic human needs; and (ii) basic economic infrastructure of direct relevance to the right to an adequate standard of living. By doing this, help progress towards the SDGs and the objectives of the European social pillar.
Enabling activities	Where economic activities have the potential to enable substantial risk reductions in other sectors*, these activities should also be classified.

*NB: This has been adapted from the definition of 'enabling activities' in the environmental taxonomy which are defined as 'economic activities that, by provision of their products or services, enable a substantial contribution to be made in other activities'.

There are three aspects to the structure set out in the table above. Firstly, activities which address and avoid negative impacts for workers, consumers and/or communities can make a substantial contribution to these objectives (for example, by improving OHS). Secondly, there are activities with inherent social benefits for end-users, communities and societies, which by their very nature contribute to social objectives, such as providing affordable pharmaceuticals to certain groups of people. Thirdly, there are enabling activities for all three objectives, for example, social auditing services which help to reduce negative impacts on value-chain workers. All three of these aspects are crucial for a social taxonomy.

4.3.1. Avoiding and addressing negative impact

Avoiding and addressing negative impacts on workers, end-users and communities is considered to be a vital part of a social taxonomy. 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'. Indeed, respect for human rights by business has the potential to transform the lives of workers, communities and consumers. It can also 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 economic activities, it can bring transformative social improvements for those affected. The centrality and

transformative potential of respect for human rights by business would not adequately be captured by the current inclusion of the UNGPs and the OECD MNE guidelines⁴⁹ in Article 18 alone. It would also not be adequate to treat these topics as mere DNSH elements.

However, care must be taken when defining substantial contribution for avoiding and addressing negative impacts. It must be possible to identify activities which are typically part of minimum standards or 'business as usual' and to exclude these activities. This is to avoid a situation where all/any pro-active risk mitigation is considered a substantial contribution. This will help ensure that the substantial-contribution criteria will reward measures at the economic activity level: (i) that are credible; (ii) that are 'best in class' in terms of the design and implementation of human-rights due diligence or risk-management processes; and (iii) that generate meaningful human-rights outcomes for stakeholders.

Allowing substantial-contribution criteria for 'avoiding and addressing negative impacts' enables the taxonomy to recognise and give weight to the European pillar of social rights as it relates to: (i) equal opportunities and access to the labour market; (ii) fair working conditions and social protection and inclusion; and (iii) the main internationally agreed standards on social sustainability in a business context (namely the UNGPs and the OECD guidelines for MNEs).

Without this type of substantial contribution in a social taxonomy, there would be no criteria to incentivise companies with activities in risk sectors to effectively and comprehensively reduce negative impacts.

This is so because other instruments in the EU sustainability-regulation toolbox are either pure reporting requirements (the CSRD) or laws which sanction certain unacceptable behaviour (such as the EU Regulation on Conflict Minerals). Only the taxonomy will be able to provide incentives for investments. Moreover, only the taxonomy will work out very detailed criteria which are able to pinpoint necessary changes in a company's activities, and by this give very clear guidance to companies and investors.

The alternative scenario of not including this kind of substantial contribution and including only activities with inherent social benefit would result in only a limited 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.

An associated advantage of including more sectors and companies is that it mitigates the potential for asset bubbles associated with a combination of high investor demand and a narrower universe of 'socially sustainable' assets.

4.3.2. Enhancing the positive impact inherent in economic activity

This type of substantial contribution is applied for two objectives: 'adequate living standards and wellbeing for end-users' and 'inclusive and sustainable communities and societies'. The rationale is that certain economic activities are a prerequisite for both adequate living standards and fulfilling economic, social, cultural and human rights. Because of this, these economic activities have inherent social benefits. Economic activities of this sort include

⁴⁹ It should also be noted that the Human Rights Chapter of the OECD MNE Guidelines introduced during the 2011 update draws on – and is aligned with – the United Nations 'protect, respect and remedy' framework and the guiding principles for business and human rights that operationalise that framework.

providing access to housing, healthcare transport, and telecommunications and must be acknowledged in a social taxonomy.

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, safe, and healthy food, water, housing and clothing. The subsequent paragraphs refer to the right to 'the highest attainable standard of physical and mental health' and the 'right to education'⁵⁰. In Europe, the EU's social pillar emphasises in particular the right to healthcare, housing and education. Similarly, the European Social Charter mentions the rights to housing, healthcare and vocational training. Basic human needs are particularly covered in SDGs 1-4, 6 and 8, which emphasise decent work and economic growth. These SDGs contain targets for national economies on decent work; OHS; social protection; inclusive economic growth; and equitable distribution of wealth.

It will be necessary to work out criteria for this type of substantial contribution to target situations where – and groups for whom – basic human needs are not secured or where it might be difficult to meet these needs. Investments must be directed to situations of special needs when financing products and services for basic human needs and basic economic infrastructure. The suggested starting point for developing criteria for the enhancement of positive impact inherent in economic activity for the objective of adequate living standards and wellbeing for end-users is the concept of availability, accessibility, acceptability and quality (AAQ). The aim of these criteria developed using the AAQ concept would be to direct capital flows to situations where goods and services for basic human needs and basic economic infrastructure: (i) are not met; (ii) are not accessible to certain target groups; or (iii) are in danger of not being met in the future (for example, because finance for maintenance is lacking). This means that within the AAQ concept, availability and accessibility will be the source of substantial-contribution criteria.

4.3.3. The concept of availability, accessibility, acceptability and quality (AAQ)

This concept is used as a tool to implement rights included in the International Covenant on Economic, Social and Cultural Rights. It has been used among other things for helping to secure the right to water, food⁵¹ ⁵², and health⁵³. The aim of the AAQ approach is to address all possible obstacles to the fulfilment of social, economic and cultural rights and to find ways to overcome these obstacles. The AAQ approach is an internationally recognised way to

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>.

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

⁵² Danish Institute for Human Rights: The AAQ Manual and the Right to Water – contextualizing indicators 2014, <https://www.humanrights.dk/publications/aaq-manual-right-water-contextualising-indicators>.

⁵³ <https://www.ohchr.org/Documents/Issues/ESCR/Health/RightToHealthWHOFS2.pdf>

implement and test the fulfilment of these rights, and it could be used for this purpose for a social taxonomy.

The four bullet points below explain each of the four components of AAAQ.

1. Availability means that a certain good is available in a sufficient quantity.
2. Accessibility means that a product or service is economically affordable and physically accessible without any discrimination, and that related information about this product or service is also provided.
3. Acceptability means that the provision of goods and services should be ethically and culturally appropriate. This means it should also be respectful of minorities and vulnerable groups, and sensitive to gender and age requirements. Given its dependence on culturally sensitive norms and standards, the concept of acceptability will be more difficult to define than the other three. Current debates on cultural differences need to be taken into account when applying this criterion and it should not necessarily be applied in all circumstances. However, there are examples where acceptability is meaningful, as can be seen in discussions about sustainable investing in agriculture and food systems⁵⁴.
4. Quality means that the good or service is safe and that it meets internationally recognised quality standards that are scientifically approved.

The AAAQ concept is applied to both public and private products and services. When applied in the social taxonomy, this means that public and privately offered products and services with inherent social benefits can qualify for the social taxonomy if they meet the criteria based on the AAAQ concept.

4.3.4. Reducing negative impacts versus enhancing inherent positive impacts – a common distinction in SDG systems

A distinction is often made between two types of substantial contribution: reducing the negative impacts of an economic activity on the one hand, and enhancing the positive impacts inherent in an economic activity on the other hand. This distinction is a feature of many approaches and systems that spell out the implementation of the SDGs in companies. At present, there are no authoritative guidelines on how companies can implement and measure their contribution to achieving the SDGs. Nevertheless, there is some uniformity in existing approaches in that they all take account of a 'contribution through products and services' and a 'contribution through operation and conduct'. For example, this distinction has been made by the SDI Asset Owner Platform⁵⁵.

Similarly, the Global Reporting Initiative's approach to achieving the SDGs in companies distinguishes between two entry points, set out below.

⁵⁴ Available at <https://www.fao.org/3/au866e/au866e.pdf>.

⁵⁵ <https://apg.nl/media/c1vdc522/sdi-taxonomy-and-guidance.pdf>, p. 6.

- a) Entry point A: ‘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’.
- b) Entry point B: ‘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’⁵⁶.

These two entry points are also a feature of other approaches to SDG reporting for companies in the Global Compact⁵⁷, and to a lesser extent the UN’s Principles of Responsible Investment⁵⁸, as well as the rating systems of the two rating agencies, ISS ESG and Sustainalytics⁵⁹.

4.3.5. Enabling activities

The environmental taxonomy acknowledges the role of enabling activities. It defines enabling activities as ‘economic activities that, by provision of their products or services, enable a substantial contribution to be made in other activities. For example, an economic activity that manufactures a component that improves the environmental performance of another activity’⁶⁰. Similarly, a social taxonomy can consider – for each of the three proposed objectives – economic activities that enable improved social performance in other activities. To ensure decent working conditions in a value chain, social audits can be deployed to highlight deficiencies and recommend improvements. It is also possible to: (i) conduct meaningful stakeholder dialogues with communities; (ii) conduct mediation services; or (iii) carry out a complaint mechanism acceptable to all parties. Other services involve carrying out tests to discover harmful substances in consumer products. These kinds of activities enable other activities to reduce negative impacts and are therefore proposed to be part of a social taxonomy. In general, the classification of enabling activities for a social taxonomy is expected to include only a limited number of activities. It will be important to develop technical screening criteria focused on ensuring that these activities meet qualitative criteria.

4.4. DNSH in a social taxonomy

The DNSH criteria in a social taxonomy play a similar role to the one they play in the environmental taxonomy. They ensure that when an activity makes a substantial contribution

⁵⁶ Global Reporting Initiative: Business reporting on SDGs: Integrating the SDG into corporate reporting a practical guide, 2018, p. 7 <https://www.globalreporting.org/public-policy-partnerships/sustainable-development/integrating-sdgs-into-sustainability-reporting/>.

⁵⁷ 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>.

⁵⁸ UNPRI: The SDG investment case, 2017, p22 <https://www.unpri.org/download?ac=5909>.

⁵⁹ 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.

⁶⁰ https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf

to one social objective, it does not harm the other social objectives. In other words, an activity that makes a substantial contribution to the objective on decent work should not harm end-users (i.e. objective 2, See Section 4.1.), communities and societies (i.e. objective 3, see Section 4.1.). For example, an economic activity such as broadband expansion in under-served areas makes a substantial contribution to the objective on inclusive and sustainable communities and societies. However, broadband expansion should not harm the rights of workers building the broadband infrastructure and the living standards and well-being of consumers using the internet services. Similarly, lending activities to under-banked groups make a substantial contribution to the objective of inclusive societies, but must not harm the living standards and wellbeing of the end-users (for example, by using non-transparent and unfair lending practices).

There are three features of the DNSH criteria which require emphasis because they differ from the environmental taxonomy. These features are set out in the paragraphs below.

1. The first feature to emphasise is the need for more granular DNSH criteria at the level of the sub-objectives. Given that the substantial-contribution criteria in a social taxonomy will be developed and assessed at the level of sub-objectives, it would be most logical to also develop DNSH criteria at the level of sub-objectives, taking into the account the practical difficulties this approach entails. This means that an economic activity could be assessed for both substantial contribution and DNSH under the same headline objective. For example, an economic activity that makes a substantial contribution to living wages (thus promoting the decent-work objective) should not: (i) harm equal employment opportunities for women; (ii) undermine collective bargaining processes; or (iii) use child or forced labour in supply chains, etc. (all three of these are sub-objectives under the decent-work objective). Moreover, there might be cases where economic activities assessed for substantial contribution might also need to demonstrate DNSH for the very same sub-objective to which they make the substantial contribution. This should be further explored.
2. The second feature is that the DNSH criteria might also play an important role in some important social topics and sub-objectives for which it might be challenging to draw up substantial-contribution criteria. The reason it could be challenging to draw up substantial-contribution criteria could be either because it would be difficult to meaningfully prioritise sectors or because it is not possible to link turnover or expenditure to these activities.

Examples of topics that we discussed where no sector-selection⁶¹ methodology was found to be meaningful include collective bargaining and workforce-diversity aspects. These topics are considered to be of great importance and further consultation with thematic experts is needed to understand whether and how to integrate these issues in the taxonomy through the development of substantial-contribution criteria. However, if a decision is reached that substantial-contribution criteria cannot be meaningfully drawn up, then the topics could still find a place in the taxonomy through the development of DNSH criteria. In that case, the social taxonomy would follow the example of the climate change-adaptation objective in the environmental taxonomy where DNSH criteria are drawn up for all sectors selected for the climate change-

⁶¹ Sector selection means here the selection of sectors that are especially relevant for the objective, for example, a living wage might be more relevant for agriculture than for IT services or banking'

mitigation objective. In a similar way, all economic activities prioritised for the social taxonomy could be then assessed against these DNSH criteria.

The second case arises where neither turnover nor expenditures can meaningfully be linked to sub-objectives like freedom of association and taxation, both topics closely related to measures at the entity level. In this case, we suggest developing criteria under the minimum-safeguards requirements (see Section 4.4 below). As these topics might not be considered anywhere else in the taxonomy, special care must be taken that they are adequately considered within the minimum safeguards.

3. The third feature is that it is challenging to build a meaningful case for a substantial contribution for objectives like ‘avoiding and addressing’ child labour or forced labour. This is because these issues are generally subject to zero-tolerance in law and are sometimes subject to import bans and exclusion criteria. In these cases, we suggest that experts be consulted to better understand if and how these objectives could be reasonably framed in substantial-contribution criteria.

The above three obstacles to drawing up DNSH criteria must still be explored in further detail. In the meantime, our ambition should be to have DNSH criteria wherever possible, as these are more precise than minimum safeguards. This means that, as a general principle, if a specific DNSH is available and possible it should apply.

4.5. Minimum safeguards

In addition to the DNSH criteria, the EU already recognised the importance of key international standards on social issues by including them as minimum safeguards in the existing Taxonomy Regulation (Article 18). This was deemed necessary when creating a taxonomy that focused on environmental sustainability in order to prevent a situation whereby certain activities are categorised as sustainable even though the entity which carries out these activities violates: (i) fundamental human rights; (ii) workers’ rights; or (iii) principles of good governance like anti-bribery measurements or non-aggressive tax planning.

Article 18 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. Although this task related to Article 18 was originally meant to be developed after the advice on a social taxonomy had been finalised, the two tasks are intertwined and interdependent. For this reason, the Platform has also discussed the implications of Article 18 for the social taxonomy.

When developing a social taxonomy, the absence of detail on how to apply Article 18 poses some problems. Questions that will have to be answered include:

1. whether there will be environmental minimum safeguards in parallel to the social minimum safeguards that will apply to the economic entities included in the social taxonomy;
2. whether there will be social minimum safeguards in a social taxonomy on certain topics for which no substantial-contribution or DNSH criteria can be drawn up;
3. whether there would be generic DNSH criteria, meaning identical DNSH criteria attached to all economic activities in the social taxonomy (and, depending on which of the models in Chapter 9 is finally chosen, to all environmental activities as well).

Given that the Subgroup on Social Taxonomy was asked to first work out a structure for a social taxonomy, and only then give advice on the minimum safeguards, we can only provisionally answer these questions. The three paragraphs below contain our provisional responses to the three questions raised above. A more comprehensive answer will follow once the report on the minimum safeguard is published.

1. If the DNSH criteria of the environmental taxonomy are not valid for the social taxonomy (see model 1 in Chapter 9) there is a need for environmental minimum safeguards to prevent activities from being classified as socially sustainable even though they violate environmental standards. One suggestion is to employ the environmental part of the OECD guidelines as environmental minimum safeguards.
2. As explained in the context of the social taxonomy above, minimum safeguards are of particular importance for certain social topics. These include topics for which it is challenging to work out substantial-contribution criteria because a link to the turnover of – or investment in – an activity can hardly be made. In these cases, we suggest that identical social minimum safeguards apply to the environmental and social taxonomy. This means that the social taxonomy would have not only environmental but also social minimum safeguards (a feature different to the environmental taxonomy due to the fact that important social topics cannot be linked to an activity but to the entity). For these situations Minimum safeguards based on the UNGPs and OECD guidelines in a social taxonomy would ensure that basic social criteria are met.
3. In cases where a topic can be linked to an activity but sector selection ⁶²proves to be difficult, generic DNSH criteria might be applied. These generic DNSH criteria would be linked to an activity not to the entity, but they would have the same wording for all activities identified in the social taxonomy. The advantage would be that activity-linked criteria would be more detailed than minimum safeguards. The role model for this would be the generic DNSH criteria in the climate change-adaptation taxonomy.

As financial market participants have started to apply the Taxonomy Regulation in practice, there are already some examples available of early-stage challenges found in implementing DNSH and minimum safeguards.

Experience shared by financial-market participants highlights the challenges experienced when service providers started to develop taxonomy services. Some of these challenges are based on worrying examples of how the taxonomy is being applied. For example, providers of ESG ratings indicate that compliance with the minimum safeguards meant that one company was not subject to controversies suggesting that it fails to meet human rights standards in their operations.

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 a company proactively aligning with the requirements of the minimum safeguards. Otherwise, a simple check of media reports on

⁶² Sector selection means here the selection of sectors that are especially relevant for the objective, for example, a living wage might be more relevant for agriculture than for IT services or banking'

human-rights violations, which tends to be arbitrary, would suffice to evaluate the human-rights performance of a company.

One way of addressing this problem is by interpreting minimum safeguards as requiring the prioritisation of salient indicators and the development of standardised reporting templates in line with the future CSRD.

In other words, there are indications that the minimum-safeguards clause is currently difficult to implement and that it cannot be relied on to drive large-scale uptake of respect for human rights by businesses. This is a concern because it could undermine sustainable finance in the current taxonomy, but it becomes even more problematic if not addressed when introducing social objectives.

When applying the safeguards requirement it is necessary to address these current suggestions. This will have to be done by following the legislator's intention to avoid a situation where an entity can make a substantial contribution to environmental objectives with one activity, while simultaneously violating social standards as a company as a whole. This includes work on open questions on data and when and how compliance with Article 18 can simply be assumed due to the company being in legal compliance⁶³.

4.6. The rationale for the selection of sectors

Mirroring the environmental taxonomy, a rationale for prioritising sectors for each objective and sub-objective is needed. This section explains how a social taxonomy could include a sector methodology. It describes two things:

- 1) the NACE sector and economic activity-based framework;
- 2) the methodology we suggest for deciding which sectors to consider for social objectives.

4.6.1. NACE codes, sectors and economic activities

Similar to the environmental objectives of the Taxonomy, extending the taxonomy to social objectives will require building on robust classifications. It will also need to be based on a comprehensive overview and prioritisation of economic activities. A sector framework to underpin the social taxonomy is therefore required.

We found it useful to build on the NACE⁶⁴ industrial classification system⁶⁵ to build this sector framework. The NACE system is laid down by EU law⁶⁶, and compatible with international and Member State frameworks. NACE codes cover 21 broad economic sectors, with four levels of

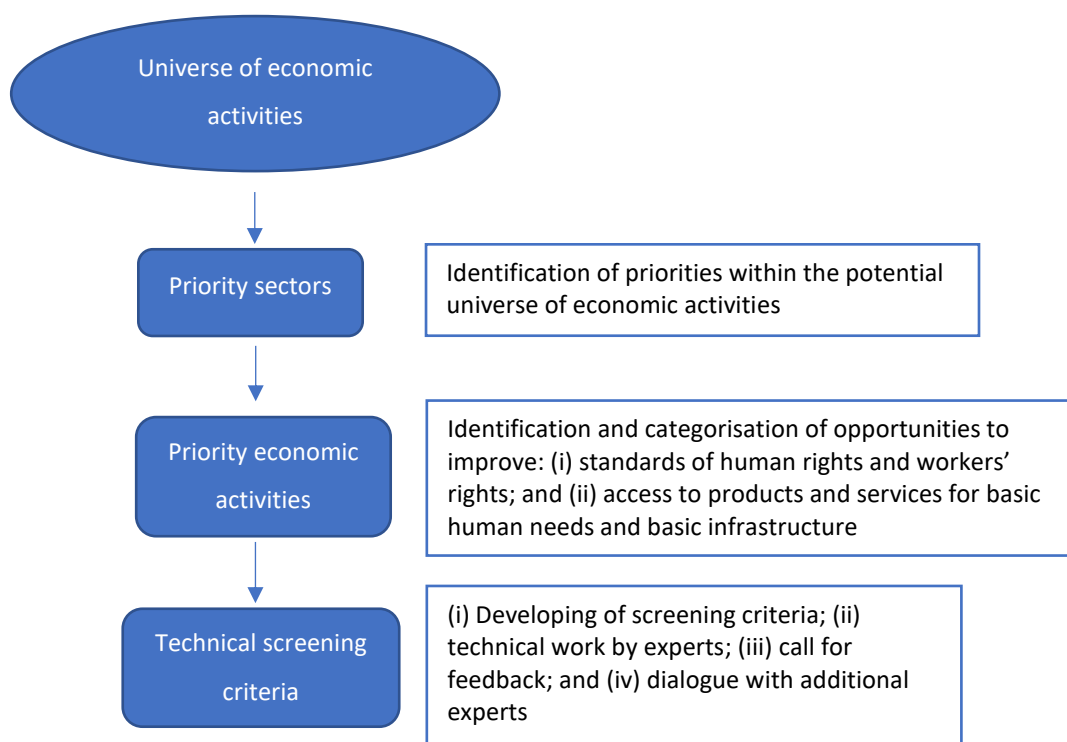
⁶³ United Nations Environment Program Finance Initiative & the European Banking Federation (EBF). 'Testing the application of the EU Taxonomy to core banking products: high level recommendations, 2021, see pp. 34-36, available at [Testing-the-application-of-the-EU-Taxonomy-to-core-banking-products-Final-v2.pdf \(unepfi.org\)](https://unepfi.org/publications/testing-the-application-of-the-eu-taxonomy-to-core-banking-products-final-v2.pdf), last accessed 31.3.2021.

⁶⁴ Nomenclature generale des Activites economiques dans les Communautés europeennes.

⁶⁵ <https://ec.europa.eu/eurostat/web/nace-rev2>

⁶⁶ Regulation (EC) No 1893/2006 of the European Parliament and of the Council of 20 December 2006 establishing the statistical classification of economic activities NACE Revision 2 and amending Council Regulation (EEC) No 3037/90 as well as certain EC Regulations on specific statistical domains, OJ L 393, 30.12.2006.

sub-codes. At the fourth level, 615 classes of economic activity are identified. The NACE system is: (i) comprehensive in its coverage of the real economy; (ii) used by EU institutions such as Eurostat; and (iii) already used by financial institutions, including in response to the incorporation of NACE into the existing taxonomy design. For the social taxonomy, NACE may in some areas need to be supplemented by additional categories, where the current level of granularity within NACE is not sufficient.



4.6.2. Methodology for selecting sectors and activities

In general, there are three ways to select sectors of relevance to the proposed social objectives, each one of which has its own advantages⁶⁷. These three ways are linked to the three types of substantial contribution identified in the table above.

Addressing and avoiding negative impacts

The Platform on Sustainable Finance recognises that businesses across all sectors must address negative impacts on people by respecting human rights including labour rights. Moreover, all sectors have human-rights and labour-rights risks, although these differ across sectors, both in their severity and their likelihood.

For climate-change mitigation in the existing taxonomy, the methodology for selecting activities was based on high-emitting NACE sectors, with additional consideration of enabling sectors. In a similar way, it is proposed that the 'addressing negative impacts' substantial contribution focus on high-risk NACE sectors.

⁶⁷ Note that the decent-work objective likely has only two types of substantial contribution.

There is currently no single authoritative research resource available that covers a wide number of economic sectors and identifies their associated social or human-rights risks. However, there are several organisations, initiatives and resources offering detailed insights and guidance into key social or human-rights risks associated with different sectors. These can help in sector selection and include:

- a) sector-oriented standards and guidance, including relevant ILO reports; OECD sectoral guidelines on responsible business conduct; sector standards set out by the Global Reporting Initiative; or standards developed by international financial institutions, industry and multi-stakeholder initiatives;
- b) sector-oriented benchmarks including the Corporate Human Rights Benchmark; the World Benchmarking Alliance benchmarks; KnowtheChain; the Access to Medicines Index; and Ranking Digital Rights;
- c) the Business and Human Rights Resource Centre’s lawsuits and allegations databases, which cover the human-rights impacts related to more than 20 000 companies.

These sources can give some indication of high-risk sectors from the perspective of negative impacts associated with the sub-objectives. At the same time, the sources indicate that sector risks differ across different social topics or human rights. We therefore suggest selecting economic sectors that are relevant for the ‘reducing negative impacts’ substantial contribution at the sub-objective level. This is a slight change from the approach taken in the environmental taxonomy, where sector selection happens at the objective level (e.g. climate-change mitigation).

The table below contains some examples of high-risk sectors related to decent work and selected sub-objectives.

Social objective: Decent work	
Sub-objective	Sectors of relevance
Living wage	High-risk sectors including sectors with high prevalence of contingent workers and/or workers earning the minimum wage – including in countries where the minimum wage is below a living wage (for example, calculated as below 60% of the median wage)
OHS	High-risk sectors identified on the basis of OHS incident statistics, e.g. including B - MINING AND QUARRYING; C – MANUFACTURING; F – CONSTRUCTION; A - AGRICULTURE, FORESTRY AND FISHING; H - TRANSPORTATION AND STORAGE; and D - ELECTRICITY, GAS, STEAM AND AIR CONDITIONING SUPPLY
Training	<ul style="list-style-type: none"> • Sectors with skills shortages – according to OECD and EU data

	<ul style="list-style-type: none"> • Sectors negatively affected by the green transition or digitalisation with associated risks of layoffs • Sectors with shortages of general skills.
Diversity and inclusion	Relevant in all sectors

As illustrated in the table above, certain sub-objectives lend themselves well to the ‘high-risk sector’ approach. For example, while there can be OHS risks associated with all sectors, it is generally intuitive and acknowledged that such risks are more severe in sectors such as construction (NACE F) than in sectors such as administrative and support services (NACE N). In these cases, we suggest identifying high-risk sectors, including by consulting the sources indicated above as well as sectoral experts with social and human-rights expertise through formalised processes.

However, for some sub-objectives such as diversity and inclusion or social dialogue, it is less evident that a high-risk-sector approach is relevant and feasible. This is because the issue is sector-agnostic in nature, and often relevant across most – if not all – sectors. This is similar to the climate change-adaptation objectives, where the TEG recognised that all sectors must become more climate resilient to achieve adaptation objectives. As a result, associated screening criteria are a set of screening criteria for assets like buildings, which can be applied in any sector which is part of the environmental taxonomy. A similar procedure could be taken up by the social taxonomy by working out generic DNSH criteria for all sectors selected for the different subobjective in the social taxonomy.

In some cases, it will be necessary, within identified priority sectors, to identify priority economic activities. It is proposed that such prioritisation rests on standard criteria for prioritising human rights due diligence efforts i.e. prioritising economic sectors with the highest general severity of risks (where possible based on gravity, scale and irremediably considerations). For this exercise, consulting the above mentioned resources as well as sectoral experts with social and human rights expertise will be central.

For all sectors and activities identified in relation to ‘addressing negative impacts’, the technical screening criteria would focus on improving the social and human-rights performance of the economic activity, including by improving policies and procedures at the entity level. Where the performance of the activity is consistent with the technical screening criteria, its revenues or expenditures may be considered eligible within the social taxonomy.

Enhancing the positive impact inherent in an economic activity

As explained above, this type of substantial contribution is based on 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 safe and healthy food, water, housing and clothing. The subsequent paragraphs of Article 11 refer to the right to ‘the highest attainable standard of physical and mental health’ and the ‘right to education’⁶⁸. The topics of Article 11 of the Universal Declaration of Human

⁶⁸ 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>.

Rights are central elements of the EU Social Pillar which lists housing, health, education and childcare and long term care among its objectives. On the basis of this background, the following sectors are relevant to this objective.

- water, including waste-water management
- food, including the food value chain
- housing
- healthcare, including care work
- education (including vocational training).

In addition to these sectors which directly provide goods and services for basic human needs, there are also other sectors providing basic economic infrastructure (access to essential services in the EU Social Pillar). These sectors have an inherent social benefit because they are a prerequisite for adequate living conditions. The sectors providing basic economic infrastructure are: transport; telecommunications including the internet; financial services; and electricity. Both this selection and the Covenant on Economic, Social and Cultural Rights are supported by SDG 9: industry, innovation and infrastructure; and SDG 16: peaceful and inclusive societies.

Activities in these sectors certainly contribute to adequate living conditions. Nevertheless, it must be ensured that any criteria and indicators drawn up serve the purpose of directing capital flows to where they are needed. Investments in goods and services for basic human needs and basic economic infrastructure already attract capital today, even without being classified as promoting social objectives. Criteria must fulfil the purpose of directing capital to underfinanced activities which at the same time have social benefits. We suggest that these criteria be developed on the basis of the AAAQ concept explained earlier.

For the sectors of 'basic economic infrastructure' the difference between 'business as usual' and 'social merits' can be shown with the example of retail banking. Investments in retail banking can be considered as business-as-usual without having any particular social merit. However, with a suggested social taxonomy, directing investments to microfinance, SME financing, or micro insurance could be classified as a substantial contribution as long as certain DNSH criteria are also fulfilled.

The selection of sectors for 'enabling activities' will follow the sectors relevant for the other two types of substantial contribution. Enabling activities will be those which enable a substantial contribution in those sectors. For example, social audits make it possible to avoid and address negative impacts on decent work.

4.7. The link to CapEx, OpEx and turnover

Up to this point it has been explained how and which social objectives and sub-objectives are proposed (ii) how sectors are selected for these objectives; and (iii) what types of substantial contribution the activities can make to become socially sustainable. There have also been some ideas about what criteria would look like and which role DNSH criteria will play in the structure. In this section, we will finish with proposals for how to link socially sustainable activities with CapEx, OpEx or turnover.

First ideas on linking CapEx, OpEx and turnover to social activities build on the differentiation between ‘reducing negative impacts’ on the one hand and ‘enhancing inherent social benefits’ on the other.

For activities which reduce a negative impact, a company’s investments made to address and avoid their negative impact might count as a social contribution. For example, the expenditure for training as defined in a social taxonomy will count as socially sustainable. The amount of this investment would then be reflected as OpEx.

This might be different if a whole bundle of social criteria is attached to an activity, such as for a fair-trade product or a mineral sourced from a mine with an approved social certificate. In this case, it might be the turnover made with the sale of the product which would be counted as a socially sustainable

However, for activities which are considered social on the basis that they substantially contribute by enhancing their existing inherent social benefit, it will instead be the turnover made from the sale of the respective products and services which will count as social. However, this might differ from case to case depending on how the improved access to a product or service is achieved.

Finally, enabling activities mainly consist of services which make it possible to address and avoid negative impacts. Here it is suggested that the company selling the product or service which enables the other company to address and avoid negative impacts counts the turnover made with these products or services as ‘socially sustainable’.

4.7.1. First ideas about disclosures for a social taxonomy

Equity funds

Percentage of the fund that complies with the Social Taxonomy is given and a breakdown by social objectives

What to disclose:

Depending on type of fund, if the emphasis is on “enhanced products and services with inherent social benefit (supporting adequate living conditions or basic economic infrastructure)” funds would disclose the social taxonomy aligned turnover. Funds with the objective of “avoiding and addressing negative impacts on stakeholders” would rather disclose investments employed to avoid and address negative impacts like ensuring that a living wage is paid.

Fixed income funds with corporate and social bonds

The same rules apply as for equity funds, with the additional requirement for the fund to disclose the percentage of their investments that are invested in social bonds which are aligned with the social taxonomy.

Social bonds

The issuer explains why and how the investments will be aligned with the social Taxonomy, by for example investing in projects which improve living standards for a target group and, after the investment has been made (and periodically), how exactly the proceeds have been, or are being, allocated, and the extent to which they are aligned with the social Taxonomy (% of expenditures allocated to Taxonomy-aligned projects).

Social loan

Loan financiers must follow similar procedures to those for issuers of social bonds. Borrowers of social loans would be obliged to inform lenders on how the loans are used and why the project financed is aligned to the social taxonomy. For example, the loans could be used finance investments in AAAQ healthcare or improved OHS in certain sectors.

5. Examples

The paragraphs above explain the role of the structural elements of objectives, sub-objectives, substantial contribution, DNSH, and the different types of ‘substantial contribution’. In the following sections, these elements are illustrated with examples. These examples do not represent fully worked out criteria of a social taxonomy. Instead they should be considered as sketches to illustrate how the suggested structure would work in practice.

5.1. Objective: Decent work, sub-objective: training

Sector selection, substantial contribution, DNSH

	Rationale for selecting sectors		
Selection of sectors	High-impact NACE codes could be selected via: <ol style="list-style-type: none"> 1) sectors with skills shortages – according to OECD and EU data; 2) sectors negatively affected by the green transition or digitalisation with risks of layoffs and therefore a special need to train certain groups of employees; 3) sectors with general shortages of skills. 		
Type of substantial contribution	Reducing negative impacts for workers		
Substantial contribution	Entity runs extensive programmes for skills and lifelong learning/upskilling/reskilling for workers in situations of vulnerability. There are high levels of worker involvement in developing these programmes (OpEx for training).		
	Decent work	Adequate living standards and wellbeing for end-users	Inclusive communities & societies
DNSH	Workers must be paid at least the national minimum wage, where one is available, or according to negotiations and	n.a.	No discrimination in training offers

	<p>collective bargaining by social parties.</p> <p>ILO core labour standards must be met.</p> <p>There must be adequate OHS.</p>		
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5.2. Objective: Decent work, sub-objective: living wage:

Sector selection, substantial contribution, DNSH

	Rationale for selecting sectors
Selection of sectors	<p>All sectors – in particular sectors with many workers on lower wage.</p> <p>Sector exposed to international competition (e.g. textiles).</p> <p>Sectors exposed to social dumping (e.g. agriculture).</p> <p>Labour-intensive sectors with little added value (e.g. some construction sub-sectors).</p>
Type of substantial contribution	Reducing negative impacts for workers
Substantial contribution	<p>Entity has a time-bound target for paying all workers' wages that: (i) provide for a decent standard of living; (ii) fight in-work poverty; and (iii) are set in a transparent and predictable way according to national practices and respecting the autonomy of the social partners. In particular, genuine collective agreements (signed by independent and representative trade unions) are meant to set wages that: (i) provide for a decent standard of living; (ii) make it possible to satisfy the needs of the workers and their families; and (iii) motivate the workforce to improve their performance and skills. The company or the concerned entity must describe how it determines decent wages through applicable collective agreements in all operations or regions in which it operates. If there are no genuine collective agreements, companies will be obliged to report on how the wages paid to their workers are always above the poverty threshold of the country/region in which they operate, being the poverty threshold defined in SDG 1.</p> <p>The company or the entity must also describe how all workers along the supply value chain are ensured a decent wage – regardless of their working contracts and regardless of whether they are employed by suppliers or subcontractors. Application of</p>

	statutory minimum wages does not fulfil this requirement unless the minimum wage is equal to or above the poverty threshold.		
	Decent work	Adequate living standards and wellbeing for end-users	Inclusive communities & societies
DNSH	Workers must be paid at least the national minimum wage, where one is available, or according to negotiations and collective bargaining by social parties. ILO core labour standards must be met. There must be adequate OHS.	n.a.	Activity does not harm communities, e.g. by polluting drinking water

5.3. Objective: Adequate living standards and wellbeing for end-users, sub-objective: access to housing

Sector selection, substantial contribution, DNSH

	Rationale for selecting sectors
Selection of sectors	Sectors which contribute to reductions in the number of people without adequate, safe, and affordable housing. Building and managing apartments and houses; NACE Code 41.20. Construction of residential and non-residential buildings.
Type of substantial contribution	Enhancing positive impact inherent in economic activity (examples)
Substantial contribution	<u>Improving the availability/accessibility of housing units</u> Percentage of flats available for low income and disadvantaged people. Flats should have at least a x % cheaper rent than average in the region, and access should be by means of a housing permit only. Percentage of m ² assigned through a public waiting list.

	<p><u>Improving accessibility</u></p> <p>Build open spaces designed for social activities; foster access for vulnerable groups; ensure the presence of additional public services; ensure the existence of a social-management project.</p>		
	<p>Adequate living standards and wellbeing for end-users</p>	<p>Decent work</p>	<p>Inclusive and sustainable societies</p>
<p>DNSH</p>	<p><u>Guarantee acceptability</u></p> <p>Housing units/flats must follow the environmental taxonomy for protection of biodiversity and ecosystems</p> <p><u>Guarantee quality</u></p> <p>Housing units/apartments must respect DNSH criteria set for the sector under the environmental taxonomy.</p> <p>There must be security of tenure for vulnerable groups.</p> <p>On process-related criteria, human rights and labour rights must be respected when building the units/apartments.</p>	<p>ILO core labour standards must be met.</p> <p>There must be adequate OHS.</p> <p>The minimum wage must be paid to workers.</p>	<p>No involuntary resettlement, and no pollution of drinking water when building apartments</p>

5.4. Objective: Adequate living standards and wellbeing for end-users, sub-objective: access to healthcare

Sector selection, substantial contribution, DNSH

	Rationale for selecting sectors		
Selection of sectors	<p>Sectors which provide products and services for basic human needs (according to the Universal Declaration of Human Rights accepted by the General Assembly of the UN on 10 December, 1948 (Articles 11 and 25)).</p> <p>Sectors related to the production of goods and services for basic human needs: food, water, housing, healthcare, education (European Social Pillar).</p>		
Type of SC	Enhancing positive impact inherent in economic activity		
Substantial contribution	<p>Improve availability (examples)</p> <p>The health care is available in sufficient quantity to cover people in need</p> <p>Improve accessibility (examples)</p> <p>The drug is affordable and economically sustainable for the countries where it is distributed</p> <p>There is an access strategy for the new medicine, which is developed when it is clinically tested</p> <p>There is a monitoring of the % of the patient group which needs the medicine, and which is reached</p> <p>Number of countries in which the medicine is needed and filled for registration</p>		
	Adequate living standards and wellbeing for end-users	Decent work	Inclusive and sustainable societies and communities
DNSH	<p>Guarantee quality (examples)</p> <p>Meeting internationally accepted standards of quality</p>	<p>ILO core labour standards must be met.</p> <p>There must be adequate OHS.</p> <p>Minimum wage must be paid to workers.</p>	<p>Effluent must not pollute drinking water.</p>

5.5. Objective: Inclusive and sustainable communities, sub-objective: supporting sustainable livelihoods and land rights

Sector selection, substantial contribution, DNSH

	Rationale for selecting sectors		
Selection of sectors	High-impact sectors such as those with a large land footprint or known involvement in impacts on land rights. Examples of these sectors include: agriculture, forestry, fishing, mining, electricity, construction, transportation and storage.		
Type of substantial contribution	Avoiding and addressing negative impacts		
Substantial contribution	<p>Supports local communities via benefit-sharing agreements or contributions to local policy objectives connected to land rights. These local policy objectives include: poverty eradication, food security, sustainable land-use, sustainable fisheries, and sustainable forests.</p> <p>Contribute to rural development.</p> <p>Promote and secure local food-production systems.</p> <p>Improve social and economic sustainable development.</p>		
	Adequate living standards and wellbeing for end-users	Decent work	Inclusive and sustainable societies and communities
DNSH	n.a.	<p>ILO core labour standards must be met.</p> <p>There must be adequate OHS.</p> <p>Minimum wage must be paid to workers.</p>	<p>Respect for human-rights defenders.</p> <p>Access to basic economic infrastructure must not be undermined.</p>

6. 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 according to 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 these 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’⁶⁹.

The understanding of governance for the purpose of this report is the following.

“Corporate governance can be defined as the material obligations of a company towards shareholders, employees, customers, suppliers, creditors, tax, and other supervisory authorities. From this definition, we can infer that corporate governance is a set of relationships framed by corporate by-laws, articles of association, charters, and applicable statutory or other legal rules and principles, between the board of directors, shareholders, and other stakeholders of an organization that outlines the relationship among these groups, sets rules as to how the organization should be managed, as well as its operational framework”⁷⁰.

Understood in this way, the topic of governance has a special role for two reasons.

Firstly, aspects of governance have an impact on both social and environmental topics because governance structures provide a company with the framework for setting guidelines and principles which can benefit social and environmental concerns and prevent risks in both areas.

Secondly, in comparison to environmental and social aspects there is even less of an uncontested common canon on governance topics let alone on sustainable governance topics. Therefore, part of the work is to define which aspects are relevant in the context of a social taxonomy.

A first step to determine this would be to identify topics which are relevant for this report. For this, purely economic and financial governance aspects must be separated from sustainable aspects of governance.

Apart from this, the EU Taxonomy Regulation in its current state already gives some guidance as to which governance aspects should be taken into account in the context of the taxonomy through the minimum safeguards, which refer to the OECD MNE guidelines. From the

⁶⁹ Article 2 (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’.

⁷⁰ <https://www.springerprofessional.de/de/corporate-governance-framework/7373532>

governance perspective, these guidelines address in particular corruption, tax evasion, and fair competition.

6.1. Identification of governance aspects related to environmental or social sustainability

Governance factors typically address purely economic issues like: (i) ownership and shareholders' rights; (ii) the composition, development and evaluation of boards; (iii) financial reporting and disclosure; (iv) qualifications and conflicts of interest of board members; (v) audits; (vi) risk management; (vii) remuneration; and (viii) legal-compliance systems. To consider all these aspects in the context of an environmental and social taxonomy would clearly go beyond the scope of a social taxonomy. Therefore, only the aspects of these topics which are directly related to sustainability matters would be taken up in a social taxonomy. These would include disclosure and transparency on: (i) sustainability objectives and targets; (ii) conflict of interest of board members on sustainability matters; (iii) board and director competencies; (iv) evaluation of sustainability topics; and, optionally (v) remuneration/incentives linked to sustainability targets, etc.

The topics listed in the previous paragraph represent the extension of traditional governance aspects to sustainability topics. But there are also governance topics which have an independent significance for sustainability. These include:

- (i) anti-bribery and anti-corruption measurements
- (ii) responsible lobbying and political engagement
- (iii) non-aggressive and transparent tax planning
- (iv) diversity of board members
- (v) the option of employee representation on supervisory boards.

As part of an environmental and social taxonomy, we would therefore recommend 2 objectives on governance with 7 sub-objectives in total. These 2 objectives are set out below.

1. The first objective is strengthening sustainability aspects of traditional corporate governance with sub-objectives like:
 - sustainability-assessment skills in the highest governance body;
 - transparency on sustainability objectives and targets.
2. The second objective is strengthening corporate-governance aspects that are important for sustainability with sub-objectives like:
 - anti-bribery and anti-corruption measurements;
 - responsible lobbying and political engagement;
 - transparent and non-aggressive tax planning;
 - diversity of board members;
 - the option for employee representation on supervisory boards.

6.2. Strengthening sustainability aspects of traditional corporate-governance topics

6.2.1. Sustainability competencies in the highest governance body

Risk management is a central task of any board of directors. This includes managing the social and environmental risks a company faces (including in its value chain). It also means managing how these risks might impact the business itself, but also how it might affect the business model and competitive positioning of the company. In the sense of the concept of “double materiality” introduced by the SFDR not only risks to the company (outside-in) but also risks caused by the company to the environment, to stakeholders and society at large (inside-out) have to be considered by a company’s board. Therefore, respective competencies have to be present and committees have to be established.

Depending on the nature and size of the company, the kind of skills needed will vary greatly. The best way to ensure that a company’s board members are equipped with the necessary qualifications is to publish a skills matrix stating how many members of the board have sustainability skills relevant for the company.

6.2.2. Transparency on sustainability targets and the incentives to achieve these targets

At European level, the Commission is expected to soon propose a new framework on corporate governance, which will address various aspects of sustainability linked to corporate governance. It may also include sustainability-linked pay.

A recent report found that many European companies already incorporate environmental, social and governance metrics into their executive pay. In a study of 365 issuers from major equity indices in continental Europe and the UK, 68% of companies have at least one ESG metric in their management-incentive plans. Environmental, social and governance issues now sit at the heart of good business practice, and for some companies these issues have become a central strategic pillar. As a result, many companies around the world are linking executive remuneration to sustainability goals – whether they be reducing emissions, customer welfare, or workforce diversity⁷¹. Linking executive pay 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 pay 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 linking pay to sustainability performance 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 pay would not be based on a fixed list of indicators for a

⁷¹<https://www.pwc.co.uk/services/human-resource-services/insights/environmental-social-governance-exec-pay-report.html>.

company or even sector. Instead, it would be based on the companies' own sustainability strategy and key performance indicators. One option would be to link sustainability factors to the structure of long-term incentive plans and the performance measures these plans are tied to, possibly along with 'claw back' or 'malus' measures⁷². Consideration also needs to be given to any unintended consequences of linking ESG to long-term incentive plans⁷³.

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 is a criterion in most ESG ratings, and is also part of engagement strategies and dialogues between investors and companies. Furthermore, the 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 pay, means that companies' autonomy is largely preserved.

6.2.3. Developing criteria on sustainability-linked pay and diversity

Having presented reasons to include diversity and sustainability-linked pay and diversity in a taxonomy, we turn now to the negative effects ('cons') of including these factors in a social taxonomy.

6.2.4. Cons to sustainability-linked remuneration and diversity (expressed concerns)

Expertise on gender diversity and sustainability at board level are undeniably key factors for ensuring sustainability in businesses. However, it might prove difficult to develop criteria for furthering diversity on boards, not least because gathering information on employees' ethnicity or sexual orientation is forbidden by law in some countries.

Disclosing information on board composition and how the board is nominated is a feature of corporate governance legislated for in most Member States. Many of these Member States (e.g. France, Spain, Germany, Italy, etc.) have already set targets and legislation to ensure that diversity is a key component of the boards of listed companies. Moreover, the proposed regulatory technical standards for the SFDR already oblige financial market participants to take into account and disclose the degree of gender diversity among their boards, which means that all financial products would have to report on diversity anyway.

Nevertheless, setting criteria on executive pay may prove to be extraordinarily complex given the variety of long-term and short-term variables and schemes at work in different companies. Setting such criteria could also lead to unintended consequences. The right balance between short-term and long-term compensation and between 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 pay, especially if the targets vary between companies. An alternative approach may be to draw up some rules

⁷² <https://www.icgn.org/integrating-esg-executive-compensation-plans>

⁷³ <https://www.unpri.org/pri-blog/embedding-sustainability-into-executive-pay/4825.article>

around the structure, transparency, and policies for pay applied in a company. Responsible investors already use such rules when deciding whether or not to approve executive pay at annual general meetings.

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

6.3. Governance topics directly linked to sustainability

- Anti-bribery and anti-corruption measurements
- Responsible lobbying and political engagement
- Transparent and non-aggressive tax planning
- Diversity of board members
- The option of employee representation on supervisory boards.

6.3.1. Anti-bribery, anti-corruption, and whistle-blowing

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. Corruption 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 of the rule of law.

Organisations can demonstrate that they are prepared to meet these expectations by setting up appropriate risk-assessment systems. Investors should expect companies to demonstrate their commitment to evaluating the risk of corruption when workers, agents, intermediaries or consultants deal with public officials. Companies should also provide regular anti-corruption training for all relevant workers within the organisation, including procurement and sales staff⁷⁴.

Whistle-blowing is increasingly recognised as an important tool to prevent and detect corruption and other malpractice. By disclosing wrongdoing in an organisation, whistle-blowers can avert harm, protect human rights, help to save lives, and safeguard the rule of law⁷⁵. Whistle-blowers are a valuable resource for companies to mitigate risks. The way an organisation deals with reports of malpractice or corruption can provide a good sense of the effectiveness of different policies and processes, covering issues from financial performance

⁷⁴ <https://investorsforhumanrights.org/issues/corruption>

⁷⁵ https://images.transparencycdn.org/images/2010_1_PP_Whistleblowing_EN.pdf

to environmental and social protections. The crucial role whistle blowers can play in detecting breaches in these areas has been addressed by the EU's Whistle-blowing Directive⁷⁶.

6.3.2. Responsible lobbying and political engagement

When carried out responsibly, lobbying – or rather advocacy – 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.

The OECD argues that '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'⁷⁷.

As part of their lobbying activities, companies also engage with, and contribute to, trade associations and other organisations. These groups lobby indirectly on behalf of these companies without specific disclosure or accountability. The 'revolving door' phenomenon is also widespread, where people move between roles as legislators and regulators.

Responsible practices in lobbying include observing a quiet period where no lobbying takes place during elections, and ensuring transparency over payments to – and collaboration with – politicians or political parties.

Companies should disclose:

- their policies and procedures on direct and indirect lobbying;
- payments for lobbying, including amounts and recipients;
- their involvement with tax-exempt organisations that write and endorse model legislation; and
- governance, decision-making and oversight processes.

Companies are expected by the market, international norms, and stakeholders to demonstrate their adherence to integrity, governance, and responsible business practices⁷⁸.

⁷⁶ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L1937>

⁷⁷ <https://www.oecd.org/governance/lobbying-in-the-21st-century-c6d8eff8-en.htm>

⁷⁸ 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.

6.3.3. Transparent and non-aggressive tax planning

Taxes are significant 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 SDGs⁷⁹.

Taxes are also considered to be crucial to reducing inequality, thus contributing to the objective of economic, social and territorial cohesion provided for in the Treaty on European Union (Articles 174 to 178). The financial services company Kepler Cheuvreux argues that 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 inequality⁸⁰.

The role of taxes as a measure against soaring inequality, especially during a crisis, was highlighted by the *Employment and Social Developments in Europe* report in 2020, which said the following.

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 countries⁸¹.

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

Companies 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, increases in government debt, or shifting of the tax obligation onto other tax payers.

Perceptions of tax avoidance by a company could also undermine tax compliance more broadly, by driving other companies 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 greater inequality within and between countries.

⁷⁹ 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.')

⁸⁰ https://www.longfinance.net/media/documents/Kepler_Cheuvreux_Inequality_2016.pdf p. 53.

⁸¹ *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>

6.3.4. Tax transparency

Public reporting on tax helps to increase transparency. It also promotes trust and credibility in the tax practices of companies and in tax systems. It enables stakeholders to make informed judgements about an organisation's tax position. 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's approach 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 disclosures on management's approach to tax, country-by-country reporting gives insight into the company's tax practices in different jurisdictions. It can also signal to stakeholders about any potential reputational and financial risks in the organisation's tax practices. The EU Commission regulated country by country reporting within the EU in the directive 2016/0107 which will lead to respective disclosures by companies in 2026.

6.3.5. Tax approach

A company's approach to tax sets out how the organisation balances: (i) tax compliance; (ii) business activities; and (iii) expectations of ethical, societal and sustainable development. A tax approach can include the company's tax principles, its attitude to tax planning, the degree of risk it is willing to accept, and its approach to engaging with tax authorities.

Having robust governance, control and risk-management systems in place for tax can be an indication that a company'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 a company is accountable for compliance with the tax strategy, including the degree to which the highest governance body has oversight of tax compliance;
- whether the company 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)⁸²;
- whether the company embraces practices to avoid tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created.

⁸² Organisation for Economic Co-operation and Development (OECD), 'Taxation', OECD Guidelines for Multinational Enterprises, pp. 60-63, 2011.

6.3.6. Diversity of the highest governance body

Non-discrimination and the support of women and minorities in the workforce are addressed in the 'decent work' objective of the social taxonomy. These principles should be extended to the board's composition.

Employee representation on boards

We consider employee representation to be an essential contribution to support social dialogue in a company. Therefore, there should be an option for employees to participate on boards.

6.4. The role of identified governance topics in a taxonomy regulation

Sustainable governance topics, as spelled out above, are dealt with by companies' own rules/procedures and by government regulation. In this respect, governance differs fundamentally from the environmental and social taxonomy, where criteria are developed to classify sustainable activities. Governance can thus be looked at as providing a framework of voluntary and mandatory regulations in which sustainable activities take place. This framework is crucial for two reasons. Firstly, it helps to avoid inconsistencies, such as a company with 100% sustainable activities being involved in severe tax fraud and bribery. Secondly, a good sustainable-governance framework supports a change within companies towards more sustainable activities.

Because governance topics are so strongly linked to the undertaking (entity-level) which carries out the activity, its natural place within the taxonomy framework would be in the minimum safeguards. On the basis of the arguments outlined above, a first suggestion for criteria on governance would be that they should emphasise transparency. Transparency on governance rules applied in a company would show to investors whether a company which carries out sustainable activities has implemented procedures which: (i) support the advancement of these activities; and (ii) prevent reputational sustainability risks. In strong alignment with the work of the EFRAG taskforce, a social taxonomy regulation should include reporting requirements for companies on governance in the manner – and on the topics – outlined above.

7. Metrics of a social taxonomy

7.1. Qualitative and quantitative metrics

Stakeholder-centric technical screening criteria would ultimately include qualitative and quantitative metrics and thresholds that target key business impacts on these stakeholder groups. Qualitative indicators might focus on policies and procedures in place in a company. The social domain is sometimes not as easily quantifiable as the environmental domain, and quantitative metrics are not always meaningful without context or qualitative information. However, quantifiable metrics exist that could assist with the decent-work agenda. These include metrics 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 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, and whether they are in tension with any national laws, etc., as well as whether it will be feasible to develop metrics and set thresholds for these dimensions.

Some data needed for social criteria (for example on staff wages, health and safety) are already at the disposal of companies and official bodies. In addition, the EFRAG taskforce is presently working out non-financial reporting requirements on the three stakeholder groups. A close cooperation will help to identify key data points and find common solutions so as not to unnecessarily increase the reporting burden for companies.

For further consideration 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, such as 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 (for example, the proportion of women on a board is a proxy for board diversity but not for non-discrimination in a company).
- The indicator should be specific enough to relate it to an economic activity.
- The indicator must have a clear direction. For example, when evaluating complaint mechanisms, we should ask the following questions: Is it good if there are many complaints, as this shows that workers trust the complaint mechanism? Or is it good if there are only few complaints, as this might indicate that stakeholders do not find many issues to complain about? This can sometimes be solved by investigation.
- The indicator should be precise so that there is no doubt whether an activity fulfils it or not.
- Indicators should all be at a similar level of detail.

- Indicators should avoid driving perverse incentives or unintended consequences, such as unintendedly driving divestments from SMEs.
- Data should be available at reasonable cost. Differences between larger and smaller companies should be considered. The principle of proportionality should apply.

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

8. Harmful activities to be considered for a social taxonomy

Environmentally harmful activities are those activities which are always significantly harmful for the environment and to which no meaningful improvement can be made. Presently, 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 Agreement⁸³.

If the social taxonomy follows this reasoning, significantly harmful activities could be those which are fundamentally and under all circumstances opposed to social objectives. These are activities for which there are no ways to make less harmful.

The reasoning for declaring activities socially harmful could then be based on two sources. The first source would be internationally agreed conventions, for example, on certain kinds of weapons. The second source would be research on the detrimental social effects of certain activities to identify significantly harmful activities. For example, the generally acknowledged detrimental health effects of tobacco use could be a reason to identify the production and marketing of cigarettes as significantly harmful.

A source for identifying harmful activities could be: (i) the international humanitarian law treaties, including in particular the Geneva Conventions and their additional protocols; and (ii) a series of other conventions and protocols on specific topics. These treaties contain basic principles and rules on the use of weapons and prohibit or restrict the employment of certain weapons. Some of these treaties governing the use of weapons are outlined below.

The Declaration of Saint Petersburg (1868) (covering explosive projectiles weighing less than 400 grams)

The Hague Declaration (1899) (covering bullets that expand or flatten in the human body)

The Hague Regulations (1907) (covering poison and poisoned weapons)

The Geneva Protocol (1925) (on chemical and biological weapons)

Treaty on the Non-Proliferation of Nuclear Weapons (1968)

Convention on the prohibition of biological weapons (1972)

⁸³ 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, OJ L 198, 22.6.2020.

Protocol I to the Convention on Certain Conventional Weapons (1980) (covering weapons that injure by fragments which, in the human body, escape detection by X-rays)

Protocol III to the Convention on Certain Conventional Weapons (1980) (on incendiary weapons)

The Convention on the Prohibition of Chemical Weapons (1993)

Protocol IV to the Convention on Certain Conventional Weapons (1995) (on blinding laser weapons)

Protocol II, as amended to the Convention on Certain Conventional Weapons (1996) (on mines, booby traps and 'other devices')

Convention on the Prohibition of Anti-Personnel Mines (Ottawa Treaty) (1997)

Protocol V (2003) to the Convention on Certain Conventional Weapons (on explosive remnants of war)

Convention on Cluster Munitions (2008)

Treaty on the Prohibition of Nuclear Weapons (2017)

Upcoming treaties for examples on autonomous weapons would have to be considered as well.

It should also be borne in mind that activities which are described as always harmful in one taxonomy (such as coal-fired power generation in the environmental taxonomy) will also be excluded from the other taxonomy.

9. The relationship between the social taxonomy and the environmental taxonomy

9.1 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 a company's social and environmental sustainability, expressed as percentages, even though they are measuring very different things. The sum of this social and environmental sustainability would not be transparent or could even be misleading. This approach would also drastically reduce the number of sustainable activities, as these activities would have to meet both demanding environmental criteria and demanding social criteria. This probably means that this approach is not practicable.

At the other end of the spectrum are two independent taxonomies, one setting out environmentally sustainable activities and the other setting out socially sustainable activities, without any relationship between them. The existing Taxonomy Regulation already rules out this 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 the equality of the social and environmental taxonomies.

Based on these premises, the obvious structure for a looser relationship would be to draw up 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: In this model, the social and the environmental taxonomy are related only by both having minimum safeguards for the respective other part. In this model, governance safeguards and entity-related social safeguards based on the UNGPs and the OECD guidelines for MNEs would be valid for both taxonomies. Basically, the UNGPs and all chapters of the OECD's guidelines for MNEs (except for the chapter on environment) would serve as minimum safeguards for the environmental taxonomy, while the environmental chapter of the OECD's guidelines for MNEs would serve as minimum safeguards for the social taxonomy. The respective social and environmental DNSH 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 for social activities, and their operating expenses for environmental activities.

Model 1:

Objective	Substantial-contribution criteria for	DNSH criteria for	Minimum safeguard (UNGP, OECD)
Climate-change mitigation	Environment	Environment	UNGP OECD without environment
Climate-change 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
Decent work	Social	Social	Governance, environment, entity-related social topics
Adequate standards living and wellbeing for end-users	Social	Social	Governance, environment, entity-related social topics
Inclusive and sustainable communities and societies	Social	Social	Governance, environment, entity-related social topics

Model 1 would have general requirements for social activities and another set of general requirements for environmental activities. A general due-diligence system for environmental and climate protection on the basis of the UNGPs and OECD guidelines for MNEs might suffice to fulfil the minimum safeguards. With this model, activities with a strong environmental or social profile would 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 substantial-contribution and DNSH criteria and undergo only general due diligence on the UNGPs and OECD guidelines for MNEs; but (ii) might have some exposure to human-rights risks. On the other hand, socially sustainable activities would only be required to meet general environmental standards that are less detailed than the DNSH 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 the human-rights criteria 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.

Model 2: The second model under consideration might solve this problem of companies focusing only on meeting whichever criteria are easier, but it may create new problems. In model 2, there is a closer relationship between the social and the environmental. An activity would have to meet either at least one substantial-contribution requirement, whether it be social or environmental. 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 partly replaced by more detailed social DNSH criteria for the environmental taxonomy, while the already existing DNSH criteria in the environmental taxonomy would also be valid for the social taxonomy. 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. In contrast to the existing minimum safeguards, these would address risks in more detail and might be sector-specific in some cases (see below).

Replacing the minimum safeguards by DNSH criteria where advisable looks at first sight like a big change to the system. However, it might not necessarily be such a big change. The role model would be the generic DNSH criteria for climate adaptation in the green taxonomy (see Appendix 2). These DNSH criteria 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.'

However, topics which are closely linked to the entity will still have to be addressed as minimum safeguards. This will be the case for governance topics or other social topics where a link to an activity cannot meaningfully be made.

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: (i) DNSH criteria for the social and environmental objectives; and (ii) common minimum safeguards on governance and specific social topics. Depending on 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	Substantial-contribution criteria for	DNSH criteria (including generic DNSH criteria) for	Minimum safeguards at entity level
Climate mitigation	Environment	Environment and social	Governance, social
Climate adaptation	Environment	Environment and social	Governance, social
Circular economy	Environment	Environment and social	Governance, social
Pollution control	Environment	Environment and social	Governance, social
Water	Environment	Environment and social	Governance, social
Biodiversity	Environment	Environment and social	Governance, social
Decent work	Social	Environment and social	Governance, social
Adequate living standards and wellbeing for end-users	Social	Environment and social	Governance, social
Inclusive and sustainable communities and societies	Social	Environment and social	Governance, social

The two models would probably have slightly different impacts on capital flows. It is to be expected that: (i) investment funds will report separately on their alignment with the green and social taxonomy; and (ii) economic entities will report the respective 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 fewer 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 both social and environmental DNSH criteria. The distinction between 'socially sustainable' and 'environmentally sustainable' would be less pronounced as they would only relate to substantial contributions. In addition, 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 is 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.

It should also be considered that activities which are described as always harmful in the one taxonomy (like coal-fired power generation in the environmental taxonomy) will also be excluded from the other taxonomy.

9.2. Preliminary reflection on possible changes to the Taxonomy Regulation

We suggest that the social taxonomy prescribes the social objectives, and how the substantial contribution and DNSH criteria for those objectives would be set, in ways similar to the recommendations we make in this report. This could be done by articles that would mirror somehow Articles 10-15 of the existing Taxonomy Regulation. As for the environmental taxonomy, the technical screening criteria would be specified in the delegated acts to be adopted by the Commission.

Depending on the overall relationship between the social and environmental taxonomy, more or less substantial changes might be necessary for the DNSH and minimum safeguards, as suggested in Chapter 9.1.

Apart from these suggested changes to the Taxonomy Regulation, we would recommend coordinating: (i) the legislative processes on the social taxonomy, the SFDR, and the CRSD; as well as (ii) the legislative processes on sustainable corporate governance, mandatory human rights, and due diligence. All of these relate to investor and company processes and to reporting on responsible business conduct 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 UNGPs and the OECD guidelines as the principles with which the undertaking and activity must comply, the SFDR (PAI Annex 1) refers to the UN Global Compact (UNGC) and the OECD guidelines.

Similarly, Article 2(17) of the SFDR 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, if 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 DNSH criteria are built, while the mandate of the Subgroup on Social Taxonomy included a wider scope of topics, most notably human rights and the UNGPs.

We make two recommendations. The first is that the sustainable corporate due diligence regulation give guidance on the DNSH criteria. However, because the DNSH criteria are activity-linked while the due-diligence law and the CSRD will be entity-linked there will also be differences. The second recommendation is that the SFDR and CSRD address the reporting requirements for a social taxonomy, including the reporting necessary for the substantial-contribution criteria on for example social products and services . However, this 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 MNEs’ and ‘involvement in violations of the UNGC principles’ (SFDR PAI Annex 1) are open to interpretation and need to be more specific to 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 MNEs; or (ii) grievance/complaint-handling mechanisms to address violations of the UNGC principles or OECD guidelines (SFDR PAI Annex 1).

Apart from legislation on sustainable finance, EU legislation in other areas (like health and consumer protection) will play a role when working out detailed criteria for the respective objectives.

10. Preliminary reflections on impacts

There are still many unanswered questions 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 must 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: (i) be recognised as ‘social’ investments; (ii) provide the necessary data; (iii) intensify efforts on social economic activities; and (iv) 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 options for making social contributions. This will lead to different kinds of impacts.

One impact would be more effective human-rights processes across economies, with measurable positive impacts and real outcomes for workers, consumers and communities throughout the value chain. This would have positive impacts for: trade unions' rights; the payment of living wages; health & safety; safer and more practicable products for consumers; positive impacts for communities; and the creation of decent jobs. At first sight, these all seem rather self-evident and may not be viewed as huge strides towards combating inequality and marginalisation. However, calculations 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 value chain, this would be a significant step towards implementing the SDGs. According to calculations by the organisation Shift, this action alone would improve the lives of 340-450 million people. If we also factor in these workers' 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 SDGs⁸⁴.

In addition, capital might flow to activities which contribute to improving access to products and services that improve standards of living and access to basic economic infrastructure. For example, redirecting capital flows in these areas might help reduce the share of people (currently 19%) living below the poverty threshold and experiencing energy poverty in the EU⁸⁵.

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:

- measuring the number of listed EU companies which have implemented a strategy on living wages throughout their value chain;
- measuring the number of apartments meeting minimum quality standards for people who have the right to live in social housing with a housing permit;
- measuring changes to the prices of certain pharmaceuticals.

⁸⁴ <https://shiftproject.org/resource/the-human-rights-opportunity-in-collaboration-with-wbcsd/living-wages>.

⁸⁵ 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>

11. Next steps

The five next steps for developing a social taxonomy would be to:

- 1 clarify the minimum safeguards according to the scoping note;
- 2 conduct a study on the impacts of a social taxonomy considering different options for application and designs;
- 3 work out a rationale for prioritising objectives and sub-objectives;
- 4 prioritise objectives according to the rationale;
- 5 define substantial-contribution and DNSH criteria for the first objective(s) and sectors.

12. Composition of the Subgroup

All members, observers and sherpas in this group have worked in their personal capacity for this report which does not necessarily reflect the position of their organisations.

Members and Observers of the Platform on Sustainable Finance are listed below. Members of Subgroup 4 on Social Taxonomy are in bold.

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