September 6th, 2021

Consultation Response to the Draft Report of the Platform on Sustainable Finance on a Social Taxonomy

Additional Considerations

Key Points

The EBF welcomes the work of the EU Platform on Sustainable Finance in developing the Draft Report on the Social Taxonomy.

- From the banks' point of view, the Social Taxonomy should enable the industry to have a **common reference defining socially sustainable activities** and companies' behaviors at the EU level. A social taxonomy would act as a tool to promote socially responsible finance. Ultimately, by better identifying the range of potential socially sustainable use of proceeds, this will encourage deal flow dedicated towards the promotion of those activities driven by well-established "social" characteristics and increase investors' confidence on that market.

- The visibility of the green taxonomy and momentum created should also give more "standing" to the social taxonomy. **Nonetheless, we propose** to first start developing further the vertical dimension of the Social Taxonomy and in a **sequential approach** later on focus on adding the horizontal dimension. This is would be to especially reduce complexity at the beginning of working with the Social Taxonomy.

- The **EU should provide consistency with upcoming legislation,** e.g. on Sustainable Corporate Governance, the CSRD as well as already existing market guidance on the Social Bonds Standard.

- The Social Taxonomy **should not become an all-encompassing ESG taxonomy**. Such a taxonomy would end up classifying any business as social that would have social policies in place for their operations. This would not add any value because this should be business as usual – and should instead focus on the value added through the additionality of social impact in a company's main activities, to be accompanied by a few horizontal considerations. Although important, it should not be the main purpose of the social taxonomy to encourage all companies to comply with basic social safeguard for their own operations. Nonetheless, also a Significant Contribution related to horizontal dimension should be a component of social taxonomy as mentioned above.

- The expectation of the taxonomy is that it would allow banks (and investors) to identify the proportion of the investments that create a high level of social impact. **This social impact can be based on the type of activities (the sector) but also on the beneficiaries that an activity is aiming at.** The definition of social sectors should not

European Banking Federation aisbl

Brussels / Avenue des Arts 56, 1000 Brussels, Belgium / +32 2 508 3711 / info@ebf.eu
Frankfurt / Weißfrauenstraße 12-16, 60311 Frankfurt, Germany
EU Transparency Register / ID number: 4722660838-23

www.ebf.eu

be limited to companies active in providing basic human needs or basic infrastructure, although we recognize that this is the core of it. Activities from manufacturers of products that play an essential a role in the supply chains of basic needs and infrastructure can be considered as social, and specific projects and enterpises may already be linked with labels (please refer to our answer to Question 2).It is also important to keep geographical context in mind when defining social impact.

- We expect a **balanced ambitious and robust framework** that clearly defines what can be considered socially sustainable in doing business, also from the point of view of corporate lenders who want to have a positive social impact. In particular, we expect metrics to apply the ‘do no significant harm’ and ‘substantial contribution’ criteria, as well as concrete examples of thresholds for ‘do no significant harm’ and ‘substantial contribution’ criteria with worker, consumer and community objectives, by activity and at entity level (meaning both at horizontal and vertical level). It is also desirable that the social taxonomy is consistent with current market standards. A social taxonomy should also enable aligned transactions to be included in European re-financing programs, as it is the case for “green taxonomy aligned” financial products.

- We agree with the Platform that **data availability** will constitute an imperative challenge for establishing an effective Social Taxonomy. We see merits in the platform proposing a progressive construction process of this taxonomy that would be closely linked/correlated with the quality and granularity of what companies are able to or required to disclose under CSRD. We note the importance of having material, clearly explained, and defined, and, to the extent possible, quantitative metrics. It is key that the first version of the Social Taxonomy be calibrated to be effective also with current data availability, while working actively to improve data requirements. If the taxonomy ends up being significantly out of sync with current data availability, it risks low adoption, as the cost of generating data and documentation for issuers could outweigh the benefits of the social investment label.

- Whereas the impact of the Green Taxonomy through, for example, CO2 reductions, by default creates global benefits, social impacts can be locally confined, especially the vertical objectives, and to some extent also the horizontal objectives, depending on a company's supply chain. Therefore, it is important that the taxonomy **clearly delineates its geographical focus** (EU vs. global level); in particular reflecting on what impact it aims to create outside the EU. This is particularly relevant as the new EU Strategy for Financing the Transition states that *the EU needs to cooperate globally and work with low- and middle-income countries in their transition.*

- The currently suggested impact indicators proposed are primarily focused on listed EU companies. Further consideration should be given to the applicability of the **Sustainable Development Goal indicators**, which are covered at the beginning of the report. While acknowledging that they were designed for governments and not companies, it can still be argued that there are opportunities to link corporate efforts to the fulfilment of the SDGs on both a national and international level, undertaken by governments. The work of EFRAG in developing a EU Non-Financial Reporting Standard for use with the CSRD should assess their usefulness for corporate measurement and disclosure.

- We would also recommend some caution with regards to any regulatory obligation in terms of mandatory reporting related to the Social Taxonomy. It is not, in our view, relevant to trace the Social Taxonomy framework on the current reporting obligations of the Green Taxonomy, and notably Article 8. As we had wished it to be the case for the Green Taxonomy, the Social Taxonomy should remain a voluntary tool for both financial and non-financial undertakings to guide their positive societal impact - in addition to the mandatory socially-related regulations they are already abiding by. At the moment w**e would strongly oppose for example a "Social Asset Ratio"** on banking and trading books, as there are too many uncertainties at the moment to be considered. In addition, any reporting requirement under the Social Taxonomy should be aligned with the CSRD.

- Nonetheless, in the case that reporting requirements would be introduced upon further definition of the framework, we believe that is important that the **entry into force** of the reporting according to the Social Taxonomy for financial undertakings should take place in the year following that foreseen for non-financial undertakings, in line with the recent Delegated Act of the Green Taxonomy. The current consultative document foresees the entry into force of the "new" reporting in 2023, without distinguishing between financial and non-financial undertakings. This would not be consistent with the extension of the simplified reporting under the Green Taxonomy for financial undertakings to 2023, introduced by the recent Delegated Act. Moreover, the entry into force of the "new" reporting in 2023 - even if only for non-financial undertakings - seems to be too early: time should be given to allow companies to organise themselves appropriately, given the time needed for the full definition of the extended taxonomy.

- The Taxonomy should also articulate a vision for how banks, including as employers, could contribute to upholding human rights standards.

- The requirements concerning "social dialogue" should be more clearly articulated, considering also the national legislations governing the role of the social partners.

Analysis

I. Merits and concerns of a Social Taxonomy

The EBF supports the Platform's analysis of the merits of a social taxonomy, and would like to emphasize the importance of the Taxonomy limiting the risk of "social washing", as well as raising awareness around the fact that all economic activities have a social impact.

Equally, we share the Platform's analysis of the potential concerns stemming from a Social Taxonomy, and would also like to highlight these additional considerations:

Data challenges for financial market participants, due to scarcity of data on social matters, including lack of background information to define what thresholds are consistent. Also, we have concerns regarding complexity and sequencing of implementation for companies covered by the forthcoming CSRD**.**

Data protection issues, for example in the context of financial inclusion. Unintended consequences may be the exclusion of economic activities that don't completely meet social criteria as would be determined by the final Social Taxonomy, despite their potential social benefit – there will be a need to balance theoretical purity with pragmatic improvements, especially in a tool that is underpinned by a lack of (uniform) methodologies and reliable data. It is important to show the effects and impact of economic activities covered by a

Social Taxonomy. The Social Taxonomy must also be subject to high-quality oversight, and be scalable – not a Taxonomy only covering “niche” activities.

Due diligence – horizontal dimension. Lack of harmonized national legislations regarding due diligence duties across European countries, e.g. the institution of a diversity policy may not be a requirement everywhere. It is important to assess whether companies in countries with more developed due diligence frameworks may have a competitive advantage in meeting the requirements of the social taxonomy.

II. Structure of the Social Taxonomy

The EBF is of the opinion that the Social Taxonomy should help to direct more mainstream capital to socially beneficial economic activities, which is the approach adopted by the Platform. We agree with the Platform that it is essential that the Social Taxonomy build on the two dimensions described into the paper: horizontal/vertical.

There are more activities that could fall under both dimensions. Considering the novelty of the Social Taxonomy, it would be important that more guidance and information about these activities be produced, including concrete examples about the application of AAAQ criteria, some of which can be found in the report.

One example are cultural activities,, i.e. libraries, museums, the enhancement of cultural heritage as a sector or activity – which fall into the horizontal dimension with the aim of enabling inclusive and sustainable communities, but also into the vertical dimension as long as the activity is socially inclusive of vulnerable groups, in compliance with AAAQ criteria.

We agree with the Platform that the vertical dimension is more challenging to define, and clarity is necessary in doing so effectively. To this end, we suggest developing and further defining the below mentioned aspects, which may allow the inclusion of activities that otherwise would be out of scope, e.g. certain motorized vehicles for people with disabilities.

We suggest that the Platform provide concrete lists for the below mentioned issues:

“**social activities”** in which companies are active. The list of sectors included in the report is not exhaustive now, and a social contribution could be based on a different aspect from the sector. For example, real estate activities for the construction of social infrastructures or urban redevelopment are currently missing – many companies have activities targeting the most vulnerable in Europe and elsewhere. Most real estate entities build either social housing or constructions to be acquired by first time buyers. Food and hygiene companies develop special product ranges for “bottom of the pyramid” customers in emerging markets. These activities and investments should be considered as in line with the proposed Social Taxonomy. If this is not the case, companies acting in other sectors than those “social by nature” would find it difficult to relate a Social Taxonomy that is leaving their core activities aside, in principle. As such, the geographical context and the nature of the beneficiaries should be taken into account when determining the social impact of an activity.

In addition, facilitating access to green energy, depending on the project’s location, is very often an activity that can be social by nature. This accounts also for infrastructure projects and projects aiming at promoting decent employment in certain jurisdictions - reference can be taken from UNEP-FI Impact Radar. There should thus be the possibility to extend the list of sectors. Our suggestion is to extend the current thinking of the Social Taxonomy and go beyond only basic needs and basic infrastructure and be aligned with SDGs. The Social Taxonomy should rather focus on classifying the mainstream activities of companies that may have a social impact, and just focus on basic needs.

"basic needs" products and services that companies produce. To put an emphasis on the usability of the Social Taxonomy by banks there is a need to define the activities contributing to basic needs very clearly. This would also help companies, as they would need clear definitions to decide whether their products qualify fully or partially "social". For example, what classifies as part of "basic infrastructure activities" – is a "drinking water pump valve" covered or a "transmitting tower amplifier"?

"labels and certifications" that can be used as a proxy to express that certain products can be seen as social. In several sectors, various labels already exist and the Social Taxonomy should make the connection clear. Socially impactful labels and certifications which might be considered can be found for example in the food, minerals and clothing industry e.g. Fairtrade, UTZ, Fairwear, Fair mined metals, ICMM, Aluminium Stewardship Initiative, Responsible Minerals initiative, etc. In the food and clothing industry these are used very often to guarantee a socially-audited supply chain. These certifications and labels can and should be classified in multiple ways, including their objectives such as the impact on workers, consumers, and communities.

"geographical deprived/underserved/disadvantaged areas or target groups" in/for which companies are active; these "postal code zones" or target groups can be based on inequality indexes (GINI), multidimensional poverty indexes (MPI), GDP indexes, income thresholds, LGBT, social rent levels etc. The list of criteria is necessary to make "access to basic needs and basic infrastructure" concrete; companies that provide basic needs and basic infrastructure in these areas are -in principle- social (only that proportion of their turnover). The targeted vulnerable groups, beneficiaries and the geographical context, should allow inclusion of activities as compliant with the Social Taxonomy. This could help to clarify whether job creation can be considered an additional social contribution within the horizontal dimension for strengthening a given local community or if it represents a dimension in itself (beyond the horizontal one) where there are disadvantaged areas or areas with high unemployment, in which employment is created. In all, there should be a due appreciation of how local conditions influence both the horizontal and vertical axes.

"social enterprises" are important actors in the field of sustainability. Lending to Social enterprises (i.e. social impact-oriented SMEs, mutual societies, foundations cooperatives, public benefit/social utility companies, etc.) should be aligned with the Social Taxonomy but further guidance is expected from the Platform as to criteria used for definition of these entities and their related activities.

The **allowance of moratoria** for clients in financial trouble may also be considered further by the Platform, for inclusion in the Social Taxonomy framework.

In our view, **charitable donations or projects** should may not be the primary focus of the Social Taxonomy, because these activities are not covering essential activities in terms of social impact of companies and they usually have too small volumes. **Rather, economic activities linked to the core business should be in the Social Taxonomy focus.** In addition, social projects undertaken, through cross-sectoral partnerships with social organisations such as NGOs or Social Enterprises should be covered by the Social Taxonomy. These activities go beyond the core business of the company and contribute to sustainability of the larger eco-system or supply chain, within and beyond the company's own anchor sector and in a way, constitute a strategic move for these corporates to shift towards more aligned activities.

Nonetheless, while not the primary focus, charitable activities should also be considered within the Social Taxonomy framework.

III. Developing the vertical dimension

In our view, it is too premature to define sectors. First, we would encourage a discussion about the underlying principles. Work that has been done by the UNEP FI and regarding the SDGs should be considered. The Social Taxonomy should follow an inclusive approach. Please refer to the previous question regarding the clear identification of activities that can be covered by the social taxonomy..

A Social Taxonomy should be accompanied by measuring tools and related methodologies to value the aforementioned activities, and the ones that should be further defined. Such evaluation should be centered around two stages, where intentionality and additionality is measured ex ante. Ex ante monitoring should be based on the explenation of SC (based on additonality and AAAQ) and DNSH or minimum requirements. In our view ex post monitoring would be too burdensome for both banks and companies. Any further ex post monitoring can be linked on impacts, but should not be imposed for all other "use of proceed" financing:

- **Intentionality:** a matrix of sectors/ geography/ use of proceeds can be helpful. This would cover the compliance with human rights, the horizontal dimension, according to the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, ILO Declaration on Fundamental Principles and Rights at Work. In addition, the ex ante stage could cover socially-driven economic activities which are either social by nature, as defined through existing frameworks such as the UNEP-FI Impact Radar, the SDGs, or IFC's AIMM, or by context, where the corporate's activity is made social by its geographical scope or its beneficiaries base.

- **Additionality:** independent evaluation of KPIs, validation of additionality, where digitalization could act as a facilitator.

Both dimensions should be added to the SC and DNSH criteria in the vertical dimension. It would also be necessary to work on incentives for companies to undertake social projects as well as for investors to purchase social/sustainability securities or loans.

In the EBF's view, it is important that the Social Taxonomy can be used by banks as an effective tool for social transformation across geographies. For example, this can be done by developing relative instead of absolute income thresholds on social housing.

IV. On the vertical and horizontal dimension structure

The EBF views this is as common practice and necessary. Criteria need to be defined at both levels, activity and entity. The horizontal dimension is transversal to all sectors and represents a must-have, which can be traced back to the level of the economic entity or of the company beyond its economic activity and the business considered. For instance, attention could be paid to the re-skilling initiatives of the company's employees, following technological changes.

ESG investors and ESG rating agencies have always evaluated social policies of companies at the company level, and they will keep doing so because it makes sense: ESG policies at companies are very often defined at the level of the holding company or economic sub-entity and not at the level of individual activities.

The definition of the horizontal should be in compliance with the applicable legal standards for human rights in the relevant jurisdiction. Furthermore, it would be useful to investigate the 'Substantial Contribution' criteria of the horizontal dimension and indicate which projects and initiatives implemented by the company in favor of its stakeholders can be considered an additional social contribution (positive impact), beyond the DNSH criteria.

V. Harmful Activities

In our view it is too premature to define sectors. We would first encourage a discussion about the underlying principles that may define them. We would like criteria to be developed for good decision making, rather than for sector-wide exclusions., In the case where the creation of such an exclusion list would be pursued, due consideration should be given to EU policies and objectives setting high quality standards for certain of the proposed activities. Some would be contributing to citizens' public security and safety, as well as ability of our EU democracies to defend themselves. For other sectors, these policies are also setting high quality standards to ensure EU products' attractiveness. These include but are not limited to : the Common Security and Defence Policy (CSDP), the EU wine legislation, the EU Textiles and clothing legislation; and the EU sugar policy. Due consideration should also be given to comparable legislations outside of the EU on those activities some of which often provide vital revenues to local populations. The Platform should take account of the work done by the UNEP FI regarding the SDGs, in this regard.

VI. Governance objectives

Linking the remuneration of managers to ESG objectives represents a means for the company to orient its strategy towards sustainability, which can be part of the ESG strategy implemented by the company. It should nonetheless be done within strict and well-defined boundaries, in order to be effective.

Including ESG objectives in executive remuneration ensures focus and prioritization of sustainability performance on a corporate level. Furthermore, including ESG objectives in executive remuneration can to some extent safeguard against "sustainability-washing", as it ensures that executives are involved in and actively manage their corporate responsibility and accountability for sustainability performance.

ESG-linked remuneration, if applied well, can incentivize companies to achieve better sustainability performance. However, if the targets are easy to attain/non-core/irrelevant/arbitrary, it doesn't contribute and actually potentially distracts management from effective sustainability efforts. ESG-linked remuneration can only be a criterion when it makes the economic activities of the company (i.e. the products and services that the company produces) more directed towards basic needs or basic infrastructure, as defined under the Taxonomy. Sustainability -linked remuneration should be applied also to indicators of Significant Contribution in horizontal or governance dimension.

In all other cases such governance criteria could be seen as “minimum safeguards” in both a Social and Environmental taxonomy. For example, if a car manufacturers’ management has a target to increase the number of women in senior positions and to close the diversity /gender pay gap, these are indeed very important objectives. Nonetheless, they are not linked to making the core activities of this car company more “social” (in the sense of the vertical dimension). Any company should have such diversity policies in place. To further specify, the EBF’s members have seen car manufacturers issuing social inclusion/diversity bonds for providing car loans to SMEs run by women and minorities; in that case the diversity policy is aiming at creating social impact in the core business of the car company. Of course it is difficult to draw a sharp line between all such cases, and the Social Taxonomy should provide this kind of guidance.

As far as remuneration is concerned, it should be determined whether all companies establishing a link between ESG objectives and remuneration would be compliant with the Social Taxonomy, or whether it would be an additional criterion.

It would be important for the Social Taxonomy to be fully aligned with the provisions of the forthcoming Sustainable Corporate Governance proposal.

In terms of the further governance objectives proposed by the Platform, the EBF generally agrees with the aforementioned governance items but suggest three aspects to be considered when choosing the finally relevant issues for the Social Taxonomy:

- Firstly, items/issues should be **properly accounted for in the companies reporting**. Because if banks do not have this information by companies they can not work with this data. It is thus crucial to ensure alignment of the requirements of the Social Taxonomy with the reporting requirements of the CSRD.

- Secondly, **governance items are important for all companies**, they are useful to identify social lending activities on a banks’ balance sheet or to identify social activities of a company. Only in some “pure” cases, like co-operatives, foundations or public benefit companies the governance makes it possible to see the entire company as social. The Social Taxonomy should not broaden too much on this aspects and distinctions should be made clear: Example: If a coal mining companies is funding their maintenance costs outsourced to SME contractors via social bonds we would see this not as social. The social element in this example could exist when the company has a policy to prioritize contracting SMEs in certain underserved regions.

- Finally, the EBF would note the following concerning "diversity of the highest governing body": while we strongly support that diversity in terms of gender, skillset, experience and background to be included in the governing board, we consider that there is no cohesive standard that defines the parameters of employee participation. The determination of this topic may be more appropriate for the forthcoming proposal on Sustainable Corporate Governance.

VII. Model Preference

Usability and practicality should be guiding factors in the development of the Social Taxonomy. For this reason, the EBF is supportive of Model 1, acknowledging nonetheless that the current level of information and analysis provided needs to be supplemented for a full picture of their respective designs to emerge.

Environmentally sustainable and social activities are of a different nature and serve different objectives. It would be challenging for banks to identify meaningful amounts of environmentally sustainable lending, e.g. according to the Green Taxonomy. Our assumption is that for the time being if credit institutions have to combine social and environmental criteria in one taxonomy there would hardly be any project that could be covered.

In addition, investors prefer to set their own preferences and may tend to look more deeply in either environmental or social issues, depending on the project. Finally, it is important to note, that product certifications or declarations and external product labels are single issued mostly – rarely combining both adequately.

On the other hand, the overall vision for the EU taxonomy should be to guarantee that all taxonomy-compliant investments ensure a fundamental level of sustainability. Differentiating these between environmental and social investments may give raise to inconsistencies.

However, if this leads to only limited financing/investments qualifying, it does not contribute to the purpose of the EU Sustainable Finance Action Plan to direct more private capital towards those activities. If it becomes a niche then it is not a viable business case for credit and investment institutions. And it will not create an incentive for other companies to become EU Taxonomy aligned.

It is to be clarified if the taxonomy could also consider companies that are committed to create a positive social impact (both on the horizontal and/or vertical dimension), but are still in an ‘ongoing phase’ and not yet mature.