

DUFAS response to the call for feedback on the Platform on Sustainable Finance's draft report on the social taxonomy

info@dufas.nl
www.dufas.nl

To EU Platform for Sustainable Finance
From DUFAS (the Dutch Fund and Asset Management Association)

Date 6 September 2021
Subject **EU social taxonomy**
Contact details Randy Pattiselanno, manager strategy & regulatory affairs, rp@dufas.nl
Ivan aan den Toorn, policy advisor sustainability a.i., iadt@dufas.nl

DUFAS (the Dutch Fund and Asset Management Association) welcomes the opportunity to respond to the EU Platform for Sustainable Finance call for feedback on the Platform on Sustainable Finance's draft report on the social taxonomy, as published on 12 July 2021.

Executive Summary

DUFAS supports the development of the social taxonomy. Although included in the definition of sustainable investments, we believe social sustainability is currently underrepresented. If the social taxonomy (1) prioritizes practical application and (2) aligns with existing regulations, the EU Sustainable Finance framework would have an actionable way to better align with the concept of ESG.

- **Prioritize usability**

DUFAS believes that the social taxonomy should focus on usability. The environmental taxonomy has shown that prioritizing the development of criteria can lead to challenges in adherence due to data availability when applied in practice. Data is even more challenging for social sustainability. We believe the usability will benefit from first considering data availability, not only with respect to the social taxonomy, but also in view of the environmental taxonomy, SFDR and CSRD. By focusing on (1) which data are available and (2) which social topics are addressed by this data, the criteria and specifics such as the covered activities can be formulated to be actionable and to direct capital where it is needed most to achieve social objectives. In a later stage, other relevant topics can be added for which there currently is not sufficient data. Secondly, the usability also depends on clear definitions and standard setting. We have also learnt from the environmental taxonomy, but more in general the sustainable finance regulations such as SFDR, that clear and well-defined definitions are key for the usability. Furthermore, we suggest a phased approach with sufficient time between adopted proposals and implementation to avoid turmoil in the market. This would ensure a smooth implementation when combined with clear guidance.

Proposal: DUFAS proposes to prioritize usability when creating social taxonomy criteria. This could be achieved by considering data availability before creating criteria and setting clear definitions and standards, not only with respect to the social taxonomy, but also in view of the environmental taxonomy, SFDR and CSRD. A phased approach with clear guidance would also ensure a smooth implementation thereby improving the usability.

- **Align with existing regulations**

Vertical dimension and environmental taxonomy

DUFAS recognizes the two dimensions of the social taxonomy. On one hand the process-related *horizontal dimension* which is mainly based on the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, the ILO Declaration on Fundamental Rights and Principles at Work, the European Pillar of Social Rights and the European Social Charter. On the other hand, *the vertical dimension* which concerns products and services essential for protecting certain economic and social rights.

DUFAS believes that it is crucial to align the social taxonomy to the greatest extent possible with the environmental taxonomy. This is key for the usability. To comply with the environmental taxonomy, our members have already implemented processes for asking taxonomy alignment of investees. We believe the vertical dimension should be integrated in these processes. This is only possible if: (1) the vertical dimension covers the same activities as the environmental taxonomy, (2) the 'do no significant harm' criteria are integrated and (3) if the list of harmful activities is unified. Failure to do so would result in more complexity and a disconnect between the environmental and social taxonomy.

Proposal: DUFAS proposes to align the vertical dimension with the environmental taxonomy. This can be achieved by including the same economic activities, integrating the 'do no significant harm' criteria and creating a unified list of harmful activities.

Horizontal dimension and 'do no significant harm'

We believe integrating the horizontal dimension with existing regulations is more challenging. However, the 'do no significant harm' criteria of the horizontal dimension are similar to the SFDR principal adverse impact indicators. DUFAS believes care should be taken to harmonize the horizontal dimension with the SFDR principal adverse impacts indicators to improve the usability. Regarding alignment with other regulations, we believe reconciling the horizontal dimension with, for example, OECD and national regulations will be hard due to different norms. In addition, the Sustainable Corporate Governance initiative also aims to align with OECD and UN guidelines. We suggest closely monitor how the horizontal dimension works in practice if implemented.

Proposal: DUFAS proposes prioritizing clarity and the avoidance of hurdles to the practical implementation the horizontal dimension. A first step could be to harmonize the horizontal '*do no significant harm*' with the SFDR principal adverse impact requirements.

6 September 2021

DUFAS

RESPONSE TO QUESTIONS:

Merits and concerns

Question 1.1 Which in your view are the main merits of a social taxonomy?

Please select as many answers as you like

- supporting investment in social sustainability and a just transition
- responding to investors' demand for socially orientated investments
- addressing social and human rights risks and opportunities for investors
- strengthening the definition and measurement of social investment
- other
- none

Please specify to what other merit(s) you refer in your answer to question 1.1:

DUFAS supports the development of a social taxonomy. In our view, social sustainability is currently underrepresented. The social taxonomy can be an actionable way to better align the Sustainable Finance framework with the concept of ESG and to provide guidance on social sustainable investments for clients and investees. However, it should be clear defined what the usage will be of social taxonomy. How will the social taxonomy work in in practice?

Question 1.2 Which in your view are the main concerns about a social taxonomy?

Please select as many answers as you like

- interference with national regulations and social partners' autonomy
- increasing administrative burden for companies
- other
- none

Please specify to what other concern(s) you refer in your answer to question 1.2:

Although DUFAS supports the increased attention for social sustainability, our main concern relates to misalignments between the environmental and social taxonomy and with SFDR. We encourage to focus on clarity and avoid duplicating assessments of similar issues and creating confusion on what these indicators mean when determining whether a corporate is sustainable or not.

We also believe reconciling the horizontal dimension with, for example, OECD and national regulations will be one of the main challenges due to differing norms between regulations, and interpreting the norms. The horizontal dimension should focus on clarity. We also suggest closely monitoring how the horizontal dimension works in practice if implemented.

For both the vertical and horizontal dimensions, we also suggest creating clarity how the criteria will relate to activities operated in third countries.

Furthermore, we foresee challenges to creating financial products if the social taxonomy further narrows down the eligible investment opportunities. The relative lack of data requires more thorough implementation and guidance to work in practice.

Finally, timing and implementation are a concern in view of the SFDR and environmental taxonomy. These initiatives have already caused turmoil in the market, because of continuously published changes to new and related legislative initiatives (ESAP, CSRD, Social Corporate Governance, etc.), lack of data at the level of investee companies and financial market participants, and lack of implementation guidance. Therefore, as a general remark we strongly suggest a phased approach with sufficient time between adopted proposals and implementation, and that clear guidance is provided to the market.

Structure of the social taxonomy

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

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

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

Question 2. In your view, are there other objectives that should be considered in vertical or horizontal dimension?

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

Please explain your answer to question 2:

We believe the horizontal dimension should include diversity and equality issues in the workplace in case this is not yet considered under "enabling the creation of inclusive and sustainable communities".

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

Please select as many answers as you like

- A1 - Crop and animal production,
- A1.1 - Growing of non-perennial crops
- A1.2 - Growing of perennial crops
- A1.4 - Animal production
- A3 - Fishing and aquaculture
- C10 - Manufacture of food products
- C10.8.2 - Manufacture of cocoa, chocolate and sugar confectionery C10.8.3 - Processing of tea and coffee
- C10.8.6 - Manufacture of homogenised food preparations and dietetic food C13 - Manufacture of textiles
- C20.1.5 - Manufacture of fertilisers and nitrogen compounds
- C20.2 - Manufacture of pesticides and other agrochemical products
- C21 - Manufacture of basic pharmaceutical products and pharmaceutical preparations
- C23.3 - Manufacture of clay building materials
- C23.5 - Manufacture of cement, lime and plaster

- C25.2.1 - Manufacture of central heating radiators and boilers
- C30.1 - Building of ships and boats
- C30.2 - Manufacture of railway locomotives and rolling stock
- C30.3 - Manufacture of air and spacecraft and related machinery
- C30.9.2 - Manufacture of bicycles and invalid carriages
- C31 - Manufacture of furniture
- C32.2 - Manufacture of musical instruments
- C32.3 - Manufacture of sports goods
- C32.5 - Manufacture of medical and dental instruments and supplies
- D35.1 - Electric power generation, transmission and distribution
- D35.3 - Steam and air conditioning supply
- E - Water supply; sewerage; waste management and remediation activities
- E36 - Water collection, treatment and supply
- E37 - Sewerage
- E38 - Waste collection, treatment and disposal activities; materials recovery
- E38.3 - Materials recovery
- E39 - Remediation activities and other waste management services
- F41 - Construction of buildings
- F42.1 - Construction of roads and railways
- F42.1.2 - Construction of railways and underground railways
- F42.2.2 - Construction of utility projects for electricity and telecommunications
- F43.3 - Building completion and finishing
- G45.2 - Maintenance and repair of motor vehicles
- G46.1.6 - Agents involved in the sale of textiles, clothing, fur, footwear and leather goods
- G46.1.7 - Agents involved in the sale of food, beverages
- G47.5.1 - Retail sale of textiles in specialised stores
- H49.1 - Passenger rail transport, interurban
- H49.2 - Freight rail transport
- H49.3 - Other passenger land transport
- H49.3.1 - Urban and suburban passenger land transport
- H50.1 - Sea and coastal passenger water transport
- H50.3 - Inland passenger water transport
- H51.1 - Passenger air transport
- J58.1 - Publishing of books, periodicals and other publishing activities
- J59.1 - Motion picture, video and television programme activities
- J60 - Programming and broadcasting activities
- K - Financial and insurance activities
- L68.2 - Renting and operating of own or leased real estate
- M71 - Architectural and engineering activities; technical testing and analysis
- M72.1.1 - Research and experimental development on biotechnology
- N77.1.1 - Renting and leasing of cars and light motor vehicles
- N77.2 - Renting and leasing of personal and household goods
- N78.1 - Activities of employment placement agencies
- N78.2 - Temporary employment agency activities
- N78.3 - Other human resources provision
- O84.1.2 - Regulation of the activities of providing health care, education, cultural services and other social services, excluding social security
- O84.2 - Provision of services to the community as a whole
- O84.2.4 - Public order and safety activities
- O84.2.5 - Fire service activities
- O84.3 - Compulsory social security activities
- P85.1 - Pre-primary education
- P85.2 - Primary education

- P85.2.0 - Primary education
- P85.3 - Secondary education
- P85.3.2 - Technical and vocational secondary education
- P85.4.2 - Tertiary education
- Q - Human health and social work activities
- Q86.1 - Hospital activities
- Q86.2 - Medical and dental practice activities
- Q87 - Residential care activities
- Q88 - social work activities without accommodation Q88.9.1 - Child day-care activities
- Q88.9.9 - Other social work activities without accommodation n.e.c. R - Arts, entertainment and recreation
- R93.1.3 - Fitness facilities
- S95 - Repair of computers and personal and household goods
- S96.0.4 - Physical well-being activities
- Other

Please specify to what other activity(ies) you refer in your answer to question 3:

DUFAS believes that as a matter of principle, all activities, including the unticked activities, should be eligible to be covered in the vertical dimension. However, harmonizing the list of activities with the environmental taxonomy would result in the highest usability. We therefore currently selected all the activities that are covered by the environmental taxonomy, but the provided list already does not cover the same activities currently in the environmental taxonomy. By aligning the activities, the vertical dimension of the social taxonomy can benefit from processes put in place to collect taxonomy alignment data from investees. This enhances the practical application of the regulation and avoids creating excess complexity. Needless to say where activities under the environmental taxonomy will be extended, this should be done equally for the social taxonomy.

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

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

Please explain your answer to question 4:

We believe that the horizontal dimension is interesting, especially for 'do no significant harm' criteria. However, reconciling the horizontal dimension with OECD and national regulations is likely challenging due to differences in norms and interpreting the norms. In addition, the Sustainable Corporate Governance initiative also aims to align with OECD and UN guidelines. If the horizontal dimension is included, we encourage a focus on clarity in relation to other regulations.

In addition, we believe that criteria on entity level should align with the SFDR as it also calls for measuring social/human rights adverse impact based on specific indicators. The horizontal dimension appears to have significant overlap with the principal adverse impact indicators of SFDR. If this approach is taken, the taxonomy and SFDR requirements should be fully aligned and harmonized to prevent duplication and confusion among corporates and investors.

Harmful activities

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

Question 5. Based on these assumptions, would you consider certain of the following activities as 'socially harmful'?

Please select as many answers as you like

- A1.1.5 - Growing of tobacco
- B5 - Mining of coal and lignite
- B7 - Mining of metal or iron ores
- B9 - Mining support service activities
- B9.1 - Support activities for petroleum and natural gas extraction
- C10.8.1 - Manufacture of sugar
- C10.8.2 - Manufacture of cocoa, chocolate and sugar confectionery
- C10.8.3 - Processing of tea and coffee
- C11.0.1 - Distilling, rectifying and blending of spirits
- C11.0.2 - Manufacture of wine from grape
- C11.0.5 - Manufacture of beer
- C11.0.7 - Manufacture of soft drinks;
- C12 - Manufacture of tobacco products
- C13 - Manufacture of textiles
- C15.2 - Manufacture of footwear
- C20.2 - Manufacture of pesticides and other agrochemical products
- C25.4 - Manufacture of weapons and ammunition
- C25.4.0 - Manufacture of weapons and ammunition
- C30.4 - Manufacture of military fighting vehicles
- G46.1.6 - Agents involved in the sale of textiles, clothing, fur, footwear and leather goods
- G46.3.5 - Wholesale of tobacco products
- G46.3.6 - Wholesale of sugar and chocolate and sugar confectionery
- G46.4.2 - Wholesale of clothing and footwear
- G47.1.1 - Retail sale tobacco predominating
- N80.1 - Private security activities
- O84.2.2 - Defence activities
- Other

Please specify to what other activity(ies) you refer in your answer to question 5:

DUFAS notes that the opinions on socially harmful vary widely, especially if the list is used to exclude activities from being (social) taxonomy-aligned. For usability, we suggest creating one harmonized list with the environmental taxonomy to reduce the complexity of creating financial products. Two separate lists would also hinder the use of processes put into place to gather taxonomy-related data for the social taxonomy. Furthermore, we suggest that the harmonized list also aligns with the EU climate benchmarks. The EU Paris-aligned benchmarks must, for example, exclude companies involved in the cultivation and production of tobacco.

Governance objectives

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

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

Please explain your answer to question 6:

Yes, we support linking the executive remuneration with environmental and social factors in line with companies' own targets, although opinions on the manner and extent of the impact on executive remunerations in general vary. In our view, the environmental and social factors in line with companies' own targets should be material and underlying the business strategy of the company. Remuneration plans must use quantitative indicators as much as possible, and executives' performance should always be transparent and verifiable.

Question 7. The report envisages governance objectives and analyses a certain number of governance topics. Please select the governance topics which in your view should be covered:

Please select as many answers as you like

- Sustainability competencies in the highest governance body
- Diversity of the highest governance body (gender, skillset, experience, background), including employee participation.
- Transparent and non-aggressive tax planning
- Diversity in senior management (gender, skillset, experience, background) Executive remuneration linked to environmental and social factors in line with companies' own targets
- Anti-bribery and anti-corruption
- Responsible auditing
- Responsible lobbying and political engagement
- Other

Please specify to what other governance topic(s) you refer in your answer to question 7:

DUFAS supports the inclusion of most proposed governance topics, but we believe that 'Sustainability competencies in the highest governance body' may pose challenges depending on the implementation. We believe the tone at the top is important. Having sustainability competencies in the highest governance body indicates that sustainability is strategic topic within a firm. If covered by the taxonomy, the following aspects should be considered: (1) the implementation should not infringe on the right of investors to freely propose members for the highest governance body; (2) there should be clear guidance how sustainability competences should be checked, and which topics should be covered when members are proposed, especially given the broad nature of sustainability.

Models for linking an environmental and a social taxonomy

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

- Model 1: The social and an environmental taxonomy would only be related through social and environmental minimum safeguards with governance safeguards being valid for both. The [UN guiding principles](#) would serve as minimum safeguards for the environmental part, while the environmental part of the [OECD guidelines](#) would serve as environmental minimum safeguards for the social part. The downside would be thin social and environmental criteria in the respective other part of the taxonomy
- Model 2: There would be one taxonomy with a list of social and environmental objectives and DNSH criteria. It would essentially be one system with the same detailed 'do no significant harm' criteria for the social and environmental objectives. The downside would be that there would be fewer activities that would meet both social and environmental 'do no significant harm' criteria

Question 8. Which model for extending the taxonomy to social objectives do you prefer?

- Model 1
 Model 2
 Don't know / no opinion / not applicable

Please explain your answer to question 8:

DUFAS believes there is merit to both models. When viewing model 1, it appears easier to implement as it does not require additional changes to the environmental taxonomy currently in place. However, it is a concern that the interlinkages between E&S objectives and adverse impacts are not fully accounted for. This model will inevitably lead to situations in which companies contributing to environmental objectives do social harm, or whereby companies advancing social objectives do environmental harm. A logical question then follows: what will this do to the overall progress in promoting social and environmental objectives? In addition, having two sets of criteria makes model 1 less friendly to the construction of sustainable financial products. However, this would also encourage considering more thoughtfully which investments to include when constructing financial products.

When viewing model 2, the single system of E&S objectives and adverse impacts avoids the problems of model 1. Having a single set of criteria would also be more friendly to constructing sustainable financial products. However, it is more difficult to implement given the existing taxonomy in place. Under model 2 there may be more room to add more eligible economic activities. Otherwise, in practice, this means that adequate living standards will only have to be considered for economic activities that are eligible under the environmental taxonomy and many relevant sectors and activities will be left out. DUFAS notes that the smaller investment universe is not necessarily viewed as problematic by some members, whereas others view it as a challenge.

Finally, DUFAS again would like to emphasize the importance of aligning the (social) taxonomy with the concepts in SFDR on sustainable investment and adverse impact indicators. There is a risk of duplicating assessments of similar issues and creating confusion on what these indicators mean when determining whether a corporate is sustainable or not. Harmonizing concepts would create clarity and improve the usability of the regulation.

General expectation from the social taxonomy

Question 9. What do you expect from a social taxonomy?

DUFAS expects that the social taxonomy could increase the attention given to social sustainability. However, the social taxonomy should prioritize usability. The environmental taxonomy has shown that prioritizing the development of criteria can lead to challenges in data availability when applied in practice. Data is even more challenging for social sustainability. We believe the usability will benefit from first considering data availability not only with respect to the social taxonomy, but also in view of the environmental taxonomy, SFDR and CSRD. By focusing on what is measurable in practice, the criteria and specifics such as the covered activities can be formulated to direct capital where it is needed most to achieve social objectives.

We also believe it is crucial to align the social taxonomy to the greatest extent possible with the environmental taxonomy. This is key for the usability. To comply with the existing taxonomy, our members have already implemented processes for asking taxonomy alignment of investees. We believe the vertical dimension should be integrated in these processes. This is only possible if: (1) the vertical dimension covers the same activities as the environmental taxonomy, (2) the 'do no significant harm' criteria are integrated and (3) if the list of harmful activities is unified. Failure to do so would result in more complexity and a disconnect between the environmental and social taxonomy.

We believe integrating the horizontal dimension with existing regulations is more challenging. However, the 'do no significant harm' criteria of the horizontal dimension are similar to the SFDR principal adverse impact indicators. DUFAS believes care should be taken to harmonize the horizontal dimension with the SFDR principal adverse impacts indicators to improve the usability. Regarding alignment with other regulations, we believe reconciling the horizontal dimension with, for example, OECD and national regulations will be hard due to different norms. In addition, the Sustainable Corporate Governance initiative also aims to align with OECD and UN guidelines. We suggest closely monitor how the horizontal dimension works in practice if implemented.

More information

Would you like to respond, or should you have any questions? I would be pleased to hear from you. Please feel welcome to e-mail Randy Pattiselanno, DUFAS, manager strategy & regulatory affairs, at rp@dufas.nl.

DUFAS: Dutch Fund and Asset Management Association

Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.