Caspar Snijders

Portfolio Manager Equities

Dear Ruud,

Last year, there was a lot of focus on the EU taxonomy, a framework that imposes uniform reporting requirements on companies when it comes to a company's impact on the environment. The fact that the implementation by companies is slow to take shape, does not alter the fact that standardisation is a big step in the right direction: for investors it means more transparency, rendering 'green-washing' more difficult. Another contributing factor is the fact that fund houses must meet certain guidelines before they can label a fund as sustainable.

However, the framework focuses exclusively on environmental aspects (the E in ESG), but this is only one component of sustainable investing. The EU has recognised this and started developing the "Social Taxonomy". The current (environmental) taxonomy will serve as a blueprint for the development of a taxonomy related to social aspects of sustainability. The combination of these two taxonomies should ultimately lead to a unified and holistic approach and reporting by companies as well as asset and fund managers.

The choice to introduce the "Green Taxonomy" first was because the impact of production and products and services on the environment can be more easily substantiated in a scientific sense. The environmental impacts on businesses and the additional policy development such as a carbon tax, directly show the materiality of this issue. This makes it easier to measure environmental aspects.

Social aspects are not so much present in the products and services, but rather in the production processes of companies. The EU also recognises this: only products and services of property companies and pharmaceutical companies are examples of sectors where social impact can be generated. For property companies, for example, this is the construction of low-cost flats so that less privileged people also have access to property, and in pharmaceutical companies this includes access to medicines for that same group. It is doubtful whether this will create substantial opportunities for investors. Quite often, this range of products and services depresses the margins of companies and will not therefore lead directly to an investment opportunity.

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The social taxonomy can be of interest to investors, however, in terms of its emphasis on conducting due diligence within the value chain. With explicit checks within the value chain on, for example, fair pay and safety measures, the social taxonomy can ensure that companies can protect themselves from reputational risk and financial consequences should suppliers not be all that particular about safety or other stakeholders' interests.

One example of this is Rio Tinto, where the CEO and two top officials had to resign because Rio Tinto destroyed an Aboriginal cave in the Juukan Gorge. When this news broke, the impact on the stock market value was around 10%.

For investors, the social taxonomy relating to actual investment opportunities is still fairly limited. For instance, it assesses how a company addresses social issues and compares this to the sector. For IT companies, the emphasis will be on retaining knowledge and skills among employees. Companies operating in emerging countries or in nature conservation areas will have to ensure adequate consultation with (and recognition of) community rights.

There should also be more reporting on social aspects and outcomes. This will have an impact on a company's overall rating, often expressed in ESG scores. Having policies alone is not enough.

To me, it looks more like the taxonomy is what you might call a "licence to operate."

Is that also how you see it? Or is the social taxonomy adding value for investors in other areas?

Regards, Caspar

Ruud Hadders

Responsible Investment Officer

Hi Caspar,

As with previous crises, inequality in the world has increased as a result of the COVID-19 pandemic. According to the ILO, the pandemic has resulted in a $ 3.7 trillion loss of income for the global workforce, equivalent to 255 million full-time jobs lost.

The pandemic has also exposed inequalities within countries, particularly affecting the low-skilled, ethnic minorities and young adults. Also, the pandemic has clearly demonstrated that many of the essential services we rely on are run by individuals with weak forms of worker protection. The European Commission's announcement to introduce a social taxonomy as well, which will define what is expected of companies in how they treat both their employees and the society in which they operate, has therefore become even more important.

Increasingly, investors are monitoring how companies they invest in ensure basic rights for the society, such as protecting human rights and preventing child labour.

However, as well as this ethical baseline and meeting legal requirements, it is important to raise workers' living standards in real terms. On the one hand because this is how companies and investors will comply with international treaties and guidelines such as the UN Guiding Principles on Business and Human Rights (UNGPs) and, on the other hand, because they face less financial risk this way, since the likelihood of protests and staff turnover is reduced. Employee satisfaction and health are also improved when, for example, a living wage is paid or employees have access to good healthcare. This promotes productivity and resilience within the chain.

In contrast to information about how companies deal with the environment, there is still limited reporting on this social impact. Because there is no standardised way to make this impact transparent, the announcement to expand the taxonomy to include social themes is indeed a step in the right direction.

"There is still a lot to be crystallised before investors can use the social taxonomy to drive improvements in social impact."

The announcement has nevertheless already raised a few eyebrows, though. For example, on behalf of Dutch investors, Eumedion has asked the Commission how to deal with the link between social and other sustainability factors, for example when addressing climate issues is accompanied in practice by a negative social impact - or vice versa.

In addition, as with the green taxonomy, the question is how "hard" the European Commission's indicators will be for actually differentiating among companies whose social impact is positive. Finally, the question arises of how to deal with cultural differences between countries in which companies operate.

Thus, there is still a lot to be crystallised before investors can use the social taxonomy to drive improvements in social impact. This makes it all the more important for investors to identify the social impact of each company. Although traditionally we often look at the negative impact that undesirable social behaviour can have on the valuation of a company, there will increasingly also be companies that are able to distinguish themselves in a positive way and thus, for example, tap into new markets and win the 'war on talent' in terms of a human resource policy.

It is interesting to follow closely the roll-out of the social taxonomy, but also to make an active contribution to it.

Translating these developments and data into customer service is therefore high on my agenda!

Regards, Ruud

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