The EU Platform on Sustainable Finance's Final Report on Minimum Safeguards

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The European Commission's Platform on Sustainable Finance, an expert group established to assist with the development of the European Union's sustainable finance policies, recently published its Final Report on Minimum Safeguards under the EU Taxonomy Regulation (the "Report"). The Report sets out the checks for firms to determine whether their investee companies have in place "minimum safeguards" in relation to human rights, as well as other business practices. Whilst the concept of Minimum Safeguards broadly encompasses human rights, the Report construes that topic very broadly, covering, in a company, concerns relating to employment rights, legal compliance and best business practices. Also, whilst the checks described in the Report form part of the process for qualifying an investment under the Taxonomy Regulation as taxonomy aligned, the practical impact of the Report is likely to be wider—the Report's standards are general criteria for due diligence on human rights and best business practices, and there is significant overlap between the concept of "Minimum Safeguards" and "good governance" in the definition of sustainable investment[1] and the Do No Significant Harm test (the "DNSH") for funds classified under Article 8 and 9 of the EU Sustainable Finance Disclosure Regulation (the "SFDR").

The Concept of "Minimum Safeguards" in the Taxonomy Regulation

The Taxonomy Regulation provides the EU criteria for an activity to be classified as "environmentally sustainable". This principally involves application of the Taxonomy technical screening criteria. However, one criterion that applies for the taxonomy alignment test is that the activity is carried out in accordance with the "Minimum Safeguards" laid down in Article 18 of the Taxonomy Regulation, with Article 18 defining Minimum Safeguards "as procedures implemented by an undertaking that is carrying out an economic activity referring to the standards in the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental

[1] Article 2(17) of Sustainable Finance Disclosure Regulation

Principles and Rights at Work and the International Bill of Rights". As the Report says, the purpose of Article 18 of the Taxonomy Regulation is to prevent green investments from being labelled and regarded as "sustainable" when they involve negative impacts on human rights and labour rights, corrupt practices, or are linked to non-compliance with the letter or spirit of tax laws or anti-competitive practices.

The Report identifies the four substantive topics arising from the standards as human rights, bribery, taxation and fair competition. Human rights include employees' rights to equal opportunities, privacy, and health and safety standards; the rights of workers in supply chains, particularly in countries with low human rights standards; and consumers' rights, such as privacy.

Criteria to Comply with the Minimum Safeguards

The Report recommends criteria for a firm to check for an investee company to comply with the Minimum Safeguards, regardless of whether such company is public or private or established in the European Union or outside the European Union. There is presently no consistency in the market for checking Minimum Safeguards, with relevant data often lacking, particularly with non-EU companies. Some firms use externally sourced data (known as "controversy screening") and make various assumptions.

The Report states that what is in fact required to ensure compliance with the OECD Guidelines and UN Guiding Principles (referred to in Article 18 as "procedures implemented by an undertaking"), are systems in place by companies—such as internal policies, supplier due diligence and management reporting and training—to comply with all elements of the requirements, and evidence of outcomes from those systems—such as corrective action taken against suppliers. Whilst controversy screening indicates possible risks or gaps in a company's processes, the Report notes that a lack of reported "incidents" at a company is not sufficient to conclude that the company has adequate human rights due diligence in place.

CSDDD—Compliance with the CSDDD a Proxy for Compliance with the Minimum Safeguards

Some, but by no means all, aspects of the Minimum Safeguards are already mandatory under EU law. A significant development in regard to mandatory consideration of human (and environmental) rights risks is the forthcoming EU Directive on Corporate

Sustainability Due Diligence (the "CSDDD"), which will require companies in scope[2] to conduct human rights and environmental due diligence, and identify and prevent adverse human rights and environmental impacts, on their own operations and supply and distribution chains. When the CSDDD is in force (but not before), the Report confirms that compliance by a company with the CSDDD will be a proxy for compliance with the Minimum Safeguards under Article 18.

CSRD – the Basis of the Minimum Safeguard Tests

The separate forthcoming EU Corporate Sustainability Reporting Directive (the "CSRD") will require larger EU companies[3] to disclose on elements of their human rights due diligence, and for that disclosure to be audited. The EU Financial Reporting Advisory Group recently released draft European Sustainability Reporting Standards ("ESRS") which build out, in extensive detail, the proposed reporting standards envisaged by the CSRD, and the Report refers to these standards in defining the types of checks envisaged under the Minimum Safeguards test. In practice, this means that companies in scope of the CSRD will provide the necessary information for investors to check Minimum Safeguards in the manner envisaged in the Report.

As above, the CSDDD will require companies to have in place human rights and environmental due diligence procedures, and compliance with the CSDDD (in the form currently proposed) will mean alignment by the company with the Minimum Safeguards. By contrast, the CSRD requires a larger group of companies to disclose their approach to human rights risks in their operations. The Report acknowledges that non-EU companies and smaller EU companies will be out of scope of the CSDDD and CSRD, but as a principle does not propose to hold non-EU companies to lower standards, noting that the UN and OECD frameworks are international.

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[2] The CSDD will apply to companies based in the European Union with more than 500 employees and a net worldwide turnover of more than EUR 150 million in the last financial year, with lower thresholds for companies in sectors regarded as higher risk for sustainability (such as textile manufacture or mining). Non-EU companies with turnover of more than EUR 150 million generated in the European Union are also in scope (with lower thresholds for companies in high risk sectors).

[3] The CSRD will cover "large" companies (which are those meeting two of the three criteria: balance sheet of EUR 20m, turnover of EUR 40m or 250 average number of employees); any listed company (excluding micro-enterprises), and large or listed insurance undertakings or credit institutions.

Different Scales of Checks Depending on Whether a Company Is in Scope of the CSRD or an SME

Under the headings of human rights, corruption, taxation and fair competition, the Report recommends criteria for checking compliance with the Minimum Safeguards, with different scales of checks required, depending on whether the company is in scope of the CSRD or a small to medium sized enterprise ("SME"). The checks proposed are essentially:

- Whether the company has established adequate human rights due diligence processes, anti-corruption processes, tax risk management processes and promotion of employee awareness of the importance of competition law compliance. Investors may find some external data available for these checks, but will largely need to do their own assessments. As mentioned above, the Report proposes checking human rights processes and measures by reference to the Reporting Standards being developed under the CSRD.[4,5]

- Whether there is evidence that the company did not adequately implement human rights due diligence, through the company or senior management finally found[6] to be in breach of labour law or human rights, or through processes initiated by OECD "National Contact Points"[7] or the Business and Human Rights Resource Centre. If a company has been found to have committed a human rights breach, it will need to show that it has provided remedies and made definite improvements in its processes.

Smaller companies[8] are not considered compliant if the company has not established human rights due diligence proportionate to its size and risks, or if the company has been found in breach of human rights, labour rights or consumer rights.

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4 For instance, due diligence questions in relation to anti-bribery include information about: (i) the company's systems to track, investigate, and respond to allegations or incidents relating to corruption; (ii) any anti-corruption training programmes; (iii) how the company shares its anti-corruption policy with its value chain and business partners; and (iv) any corruption incidents (sanctions, allegations and investigations) that came to its attention during a specified reporting period.

5 For instance, due diligence questions in relation to fair competition include information about: (i) the company's approach to cultivate and promote competition risk awareness within the organisation, including processes, training, and management controls and (ii) any incidents of anti-competitive behaviour (such as legal actions or being named for violation of competition law) during a specified reporting period.

6 There is some lack of clarity as to the scope of "finally found to be breach of labour law or human rights", which appears to include civil litigation as well as criminal convictions.

7 "National contact points" for Responsible Business Conduct are non-judicial grievance mechanisms for persons affected by breaches of the OECD Guidelines.

8 Defined as small-to-medium sized enterprises (SMEs), as businesses with up to 250 employees.

Relevance to Firms Subject to SFDR

Whilst the Report is focused on the standard required to check Minimum Safeguards under the Taxonomy Regulation, it will also impact firms that wish to qualify their investments as “sustainable investments” under the SFDR but outside the Taxonomy Regulation. The sustainable investment test under the SFDR requires a firm to ensure that investments do not significantly harm any social objective. The social factors of the principal adverse impact (“PAI”) indicators form the basis of this test. As noted above, Article 18(2) of the Taxonomy Regulation requires firms, when checking for Minimum Safeguards, also to adhere to the principle of DNSH under the SFDR. The PAI social factors include “Violations of UN Global Compact Principles and OECD Guidelines” and “Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact Principles and OECD Guidelines”. Thus, the material that the Report proposes for checking compliance with the UN Global Compact Principles and the OECD Guidelines is a standard that firms could use under the DNSH test. Similarly, the Article 8 and Article 9 pre-contractual disclosure templates include the question “How are the sustainable investments aligned with the OECD Guidelines and UN Guiding Principles”, and the Report provides a basis for answering this question.

In terms of the broader “good governance” test under the SFDR, which firms are required to apply to companies invested by funds qualified under the Article 8 of SFDR, good governance is referred to in the SFDR as including, “in particular, sound management structures, employee relations, remuneration of staff and tax compliance”. Whilst the Report does not explicitly make a link between this concept and the Minimum Safeguards, it does create a set of standards which a firm could use for this test, noting that the final Guidelines on Minimum Safeguards will generally raise the bar for checking good governance standards.

Private Equity Feedback

From a private equity perspective, the Report sets a very high bar, with a binary “comply/does not comply” approach that depends on companies having extensive processes in place. The Report refers to “due diligence” as the main focus for checking compliance with the Minimum Safeguards, whilst in practice firms may wish to take the approach of pursuing higher standards of governance with a portfolio company in a period after acquisition. There is also no current clarity on the treatment of investments made prior to the Report applying.

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