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Categories of Sustainability-related Financial Products

A Proposal in the Context of the SFDR- Review

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1. Introduction

The European Union has committed itself to ambitious climate and environmental objectives, including a 55% reduction in greenhouse gas emissions by 2030 compared to 1990 levels. Achieving these targets requires a substantial increase in investment—estimated at approximately EUR 1.53 trillion annually (European Commission, 2024a). A significant portion of this investment is expected to come from private capital markets. To support this shift, the EU’s sustainable finance regulatory framework is designed to steer capital flows towards sustainability-related investments (European Commission, 2018; Platform on Sustainable Finance, 2024a). The Sustainable Finance Disclosure Regulation (SFDR) is a cornerstone helping to achieve this goal, creating transparency around sustainability-related information about financial products, financial market participants and financial advisors (European Commission, 2020a).

In a recent consultation, which is part of an ongoing SFDR review, investors criticised the SFDR for failing to effectively direct capital towards sustainable or transitional investments, (European Commission, 2024b). One criticism is that the SFDR fails to provide a clear definition of impact and impact investments and does not incorporate the notion of investor contribution. This omission leads to at least two issues. First, having a clear understanding of impact, impact investments and investor contribution is crucial to effectively channelling capital towards sustainability goals, as these investments are best designed to create positive social or environmental real-world outcomes. In the absence of product categories that include impact investments, retail investors lack the necessary clarity to direct their investments where they can have the greatest impact. Second, the lack of definition increases the risk of green- or impact-washing in financial markets. The European Securities and Markets Authority (ESMA) has warned that the term “impact” is particularly vulnerable to being misused, noting that “there are currently no rules in the EU sustainable finance framework for the use of terms such as ‘impact’, ‘impact investing’, or other impact-related terms” (ESMA, 2023, p. 20).¹

In parallel with the SFDR review, the new European Commission has launched a strategy establishing „competitiveness as one of the EU’s overarching principles for action“ (European Commission, 2025a, p. 3). The European Commission plans to implement several legislative changes, aiming to increase innovation, support decarbonisation and competitiveness, and reduce excessive dependencies while increasing security (European Commission, 2025a). As part of this agenda, the European Commission published so-called “omnibus” legislations, proposing far-reaching changes to several key regulations of the EU Sustainable Finance framework like the Corporate Sustainability Reporting Directive (CSRD), the Corporate Sustainability Due Diligence Directive (CSDDD), and the EU Taxonomy with the goal of reducing regulatory burden (European Commission, 2025b, 2025c). This changed focus does

¹While the ESMA guidelines on fund names using ESG or sustainability-related terms (ESMA guidelines) introduce rules regarding funds with the term “impact” in their name, they do not provide a definition of impact. When specifying the types of investments these products make, the guidelines refer to the Global Impact Investing Networks’ (GIIN) definition of impact investments (ESMA, 2024b). While this is a good starting point, this high-level definition does not provide sufficient detail to develop sustainability-related financial product categories.

not alter the need to introduce clear product categories with a clear definition of impact and impact investments in SFDR to reorient capital and to realize the EU Commission's political goals with regard to environmental and social objectives. On the contrary, the European Commission continues to emphasize the importance of a sustainable economy, including decarbonisation, the circular use of materials and the importance of a sustainable EU agriculture and food production (European Commission, 2025a). In addition, creating the right conditions for channelling private capital to investments in innovative companies and future-oriented growth sectors is a central aspect of the competitiveness agenda. European start-ups, for example, are diagnosed as having "less access to venture capital and other forms of risk capital than their US peers" (European Commission, 2025a, p. 4). This is why the proposed classification scheme for sustainability-related financial products is intended to guide capital towards products with the highest ambition in terms of impact.

2. Concepts

The intention of the SFDR was to create transparency about the sustainability-related characteristics of financial products to help investors in their decision-making. Originally, the SFDR also set out to enable investors to differentiate between the “various degrees of ambition” (European Commission, 2020a, p. 5) of sustainability-related products by introducing the distinction between Article 8 and Article 9 products. However, the SFDR did not fulfil this goal. Articles 8 and 9 do not provide a clear product categorisation or minimum criteria to be able to differentiate the ambition levels of different sustainability-related financial products. This paper takes up this task and develops categories of sustainability-related financial products, learning from experiences and discussions around the SFDR.

82% of respondents to the SFDR consultation agreed that some of its key concepts, like sustainable investments as defined in article 2(17), “are not sufficiently clear” (European Commission, 2024b, p. 5). To avoid this problem, terms and concepts need to be clearly defined, building upon existing EU sustainable finance regulation to increase consistency and interoperability. Therefore, we use existing terms in EU sustainable finance regulation, namely, impacts, risks and opportunities, as defined in the European Sustainability Reporting Standards (ESRS). See the glossary for an overview. Where no legally defined concepts are available, we refer to market consensus.

2.1. Impacts, Risks and Opportunities (IROs)

According to the ESRS, risks are “sustainability-related risks with negative financial effects arising from environmental, social or governance matters that may negatively affect the undertaking's financial position, financial performance, cash flows, access to finance or cost of capital in the short, medium or long term” (ESRS, 2023, p. 276). Opportunities are defined as “sustainability-related opportunities with positive financial effects” (ESRS, 2023, p. 273). Consequently, risks and opportunities are those uncertain environmental, social or governance events or conditions that can have negative or positive financial effects and that are material from a financial perspective. In the rest of the paper, we use the terms ESG risks and opportunities to describe these concepts.

The ESRS also introduce a legal definition of impacts as

“The effect the undertaking has or could have on the environment and people, including effects on their human rights, connected with its own operations and upstream and downstream value chain, including through its products and services, as well as through its business relationships. The impacts can be actual or potential, negative or positive, intended or unintended, and reversible or irreversible. They can arise over the short-, medium-, or long-term. Impacts indicate the undertaking's contribution, negative or positive, to sustainable development.” (European Commission, 2023b, p. 269).

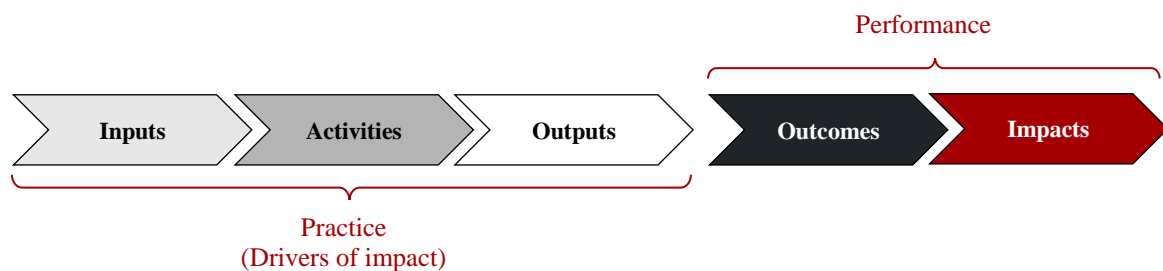
While useful, this definition does not differentiate between the impact created by investees or assets (company impact) and that generated by asset owners or managers (investor impact). Kölbel et al. (2020) clarify this distinction, defining company impact as the “change that a company's activities achieve in a social or environmental parameter,” and investor impact as the “change that investor activity achieves in company impact” (p. 3). Investors can positively influence a company's impact by allocating capital in ways that help the company maintain or

improve its social or environmental performance – for example, by offering funding at favourable terms or in meaningful amounts. In addition, investors can actively engage with companies to encourage improvements in their social or environmental performance. In practice, “investor contribution” is regularly used instead of investor impact. We use the Impact Management Platform’s (IMP) definition of investor contribution as “The contribution that the investor makes to enable enterprises (or intermediary investment managers) to achieve impact.” (IMP, 2024a).

2.2. Impact Pathway

A central element of impact investing that is currently missing in SFDR is the impact pathway—also known as theory of change (ToC) or impact thesis (Busch et al., 2025; IMP, 2024a). Since the SFDR and other EU sustainable finance regulations like the ESRS do not provide a legal definition of this concept, we refer to the IMP’s understanding of an impact pathway.² From this perspective, an impact pathway outlines the sequence of steps required to generate impact, progressing from inputs and activities to outputs, outcomes, and ultimately, impacts (see Figure 1; for definitions of all terms see the glossary).

Figure 1: The Impact Pathway



Source: IMP (2024b)

This understanding of how companies or financial market participants turn inputs into impacts is essential for clearly defining impact investments. One key insight of the impact pathway is the differentiation between practice and performance. Organisations have a large degree of influence over their own practices, i.e. which inputs they use, which activities they implement, and which outputs they produce. However, they have varying amounts of influence on outcomes and their changes—which reflect social or environmental performance—as these are often influenced by external factors beyond the company or investor’s control. The differing influence over practices versus performance is essential when defining key characteristics of impact investments (see section 3.4).

2.3. Outcome

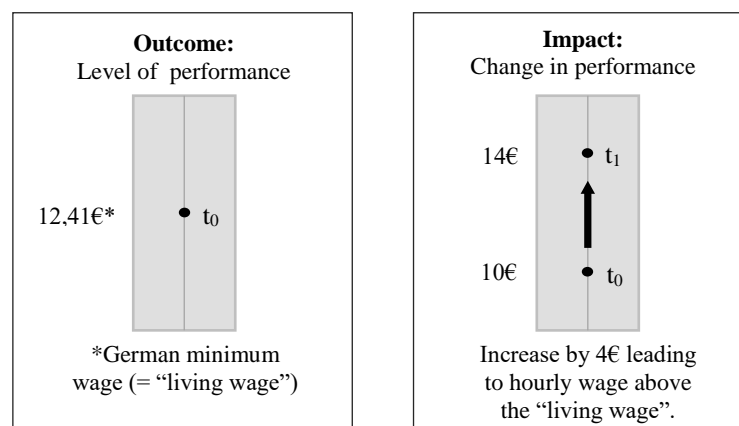
The impact pathway shows that the term “outcome” is of central importance to impact investments. Differentiating impact from outcome also helps distinguishing different types of positive contribution (see next section), increasing the clarity of the proposed categorisation

² The IMP is a collaboration between major providers of sustainability standards and guidance, whose goal is to mainstream the practice of impact management (IMP, 2023a). Partners in this collaboration include, among others, the Organisation for Economic Cooperation and Development (OECD), the United Nations Environmental Program Finance Initiative (UNEP FI), the International Finance Corporation (IFC), the United Nations Development Program (UNDP), the Global Reporting Initiative (GRI), the Capitals Coalition, and the Global Impact Investing Network (GIIN).

scheme. The term “outcome” is used but not explicitly defined in the ESRS (European Commission, 2023b).³ Since neither the SFDR nor the ESRS provide a legal definition of the term, we again refer to the IMP’s definition in order to be in line with global standards for impact management and measurement. The IMP defines outcomes as “the level of well-being experienced by people or condition of the natural environment that results from the actions of the organisation, as well as from external factors” (IMP, 2024a). To implement impact investments with the necessary clarity, it is important to be explicit about the difference between outcome and impact. Figure 2 shows that this understanding of outcomes refers to a *level of well-being* or *the state of nature* at a specific point in time, while impacts refer to *changes in outcomes* caused by specific activities (of investees or investors, i.e. company or investor impact).

A second understanding of outcomes described by the IMP defines an outcome as „a change or event resulting from organisations’ activities and outputs, providing a causal link between the activities/outputs and their impact(s) on people and/or the natural environment” (IMP, 2024a). From this perspective, outcomes and impacts are very close in meaning, both referring to changes on people or the natural environment caused by inputs, activities or outputs. To be in line with the ESRS’s definition of impact provided in Chapter 2.2. and to clearly differentiate impacts from outcomes, this paper uses the understanding of outcomes as *levels of well-being* caused by inputs, activities or outputs, instead of *changes* caused by inputs, activities or outputs.

Figure 2: Difference between outcome and impact (example hourly wage)



Source: adopted from Busch & Pruessner (2023), IMP (2024e) and Pruessner et al. 2024

³ For instance, the ESRS mention outcomes in the application requirements of ESRS 1, when outlining how to evaluate the usefulness of metrics for inclusion in entity-specific disclosures: “a) its chosen performance metrics provide insight into: [...] how effective its practices are in reducing negative outcomes and/or increasing positive outcomes for people and the environment (for impacts);” (European Commission, 2023b, p. 24)

2.4. Contribution

Both the SFDR and the EU Taxonomy use the term “contribution”. The EU Taxonomy defines concrete criteria determining which economic activities qualify as environmentally sustainable. One of the necessary criteria is that they need to *contribute substantially* to specific environmental objectives also defined in the EU Taxonomy (European Commission, 2020c). Consequently, the EU Taxonomy is very detailed in defining what criteria economic activities need to fulfil to be considered as contributing substantially. The EU Taxonomy is thus very detailed in defining what criteria economic activities need to fulfil to be considered as contributing substantially. It focusses on the positive contribution of companies to environmental sustainability goals, i.e. company impact. At a closer look, the EU taxonomy includes different types of substantial contribution:⁴

1. Substantial contribution through activities that are already sustainable
2. Substantial contribution through transitioning activities

Figure 3 shows how economic activities that are already sustainable contribute to sustainability goals. In this example, building solar or wind parks contributes to climate change mitigation, since it leads to a higher share of renewable energy in the energy mix and a lower level of CO₂e-emissions. Consequently, the resulting level of CO₂e-concentration in the atmosphere is lower compared to a situation where the share of fossil fuel-based energy production is higher. In this example, the economic activity itself is already sustainable and the positive company impact is created at the level of the overall energy system by increasing the share of sustainable energy production in the overall energy mix.

Figure 3: Example of positive contribution through sustainable activities

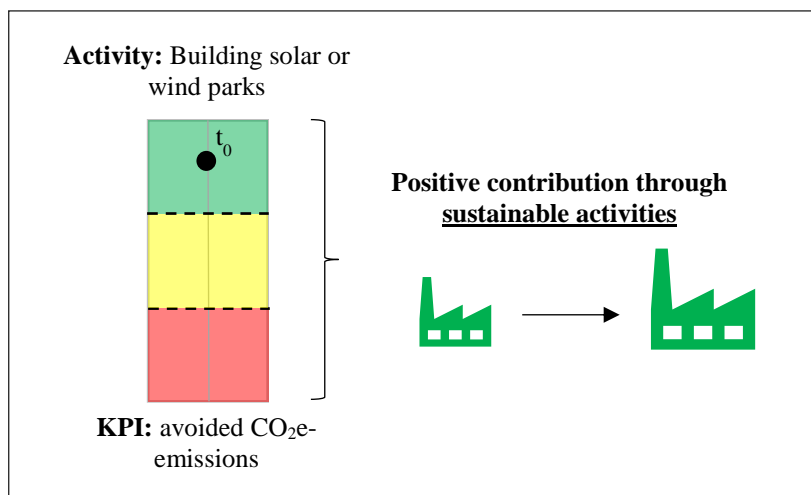
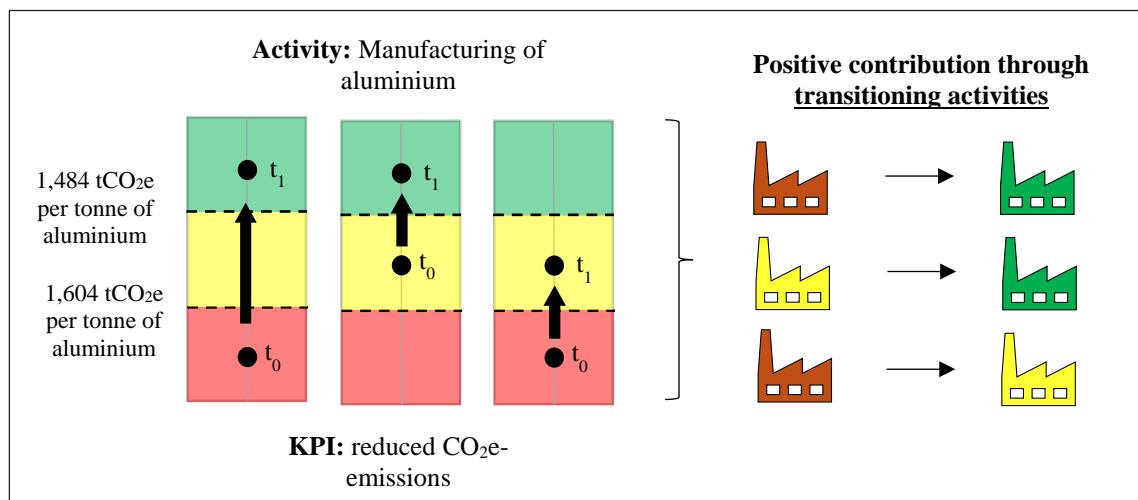


Figure 4 shows how currently unsustainable economic activities contribute to sustainability goals by transitioning towards sustainable levels of environmental or social performance. In this example, manufacturing aluminium leads to unsustainable levels of CO₂e-emissions at the point of investment (t_0). Over time, the aluminium manufacturer starts sourcing its energy for the production from renewable energy sources, decreasing the CO₂e-emissions per tonne of

⁴ The EU Taxonomy also includes activities that enable substantial contributions to environmental goals.

aluminium produced. At t_1 , the resulting CO₂e-emissions per tonne of aluminium produced have transitioned beyond the substantial contribution threshold defined by the EU Taxonomy for aluminium production. In this example, the positive company impact is created by transitioning from unsustainable to sustainable environmental performance levels at the asset or company level, i.e. reducing CO₂e-emissions. A positive contribution through transitioning activities can also be achieved by transforming intermediate performance into sustainable performance (yellow to green) or harmful performance to intermediate performance (red to yellow).

Figure 4: Positive contribution through transitioning activities



Differentiating between these two types of positive contribution also helps specify how SFDR defines positive contribution. As part of its definition of sustainable investments, the SFDR's understanding of positive contribution is vague compared to the EU Taxonomy.⁵ In Section 4, we propose adopting the two types of positive contribution exemplified above as an important foundation to specify the SFDR's concept of sustainable investments.

⁵ In their questions and answers, the EU Commission states that „The definition of sustainable investment set out in Article 2, point (17), SFDR does not prescribe any specific approach to determine the contribution of an investment to environmental or social objectives“ (ESMA, 2023, p. 7)

3. Sustainability-Related Investor Preferences

We build upon the investor preferences described by the EU Platform on Sustainable Finance and adopt them in order to provide a clear basis for product categories. We differentiate between the following preferences:

1. **Invest with ESG focus:** Investing in products that improve risk-adjusted returns by measuring and managing ESG risks and opportunities.
2. **Invest sustainable:** “Investing in products that direct investments towards assets, activities, or economic actors that are already sustainable. These products do not invest in any significantly harmful asset or activity” (PSF, 2024b, p. 13).
3. **Invest in transition:** “Investing in products that primarily or exclusively invest in assets, activities, or economic actors becoming more sustainable (invest in transition). These products support economic actors transforming or upgrading their activities or assets, such as companies with significant Taxonomy CapEx alignment” (PSF, 2024b, p. 13).
4. **Invest and achieve investor impact:** Investing in products that not only focus on sustainable or transition investments but also help as an investor to achieve or maintain sustainable levels of social or environmental performance of their investees (investor contribution/impact).⁶

The second and third investor preferences are from the EU Platform on Sustainable Finance’s proposal for SFDR product categories. The first investor preference, “invest in ESG”, is also part of the Platform’s proposal. The Platform does, however, not clearly differentiate this preference, stating that products suited for these ESG preferences “may also include or even focus on activities or assets that are already environmentally or socially sustainable, provided they offer sufficient safeguards” (PSF, 2024b, p. 13). Since this understanding makes it difficult to differentiate the preference of “investing sustainable” from the preference to “invest in ESG”, our proposal does not adopt it. Instead, we propose that the preference to “invest in ESG” should be clearly restricted to the goal of investing in products that improve risk-adjusted returns by measuring and managing ESG risks and opportunities. See section 4.1. for a clear definition of ESG investments that follows this understanding.

The Platform also describes the importance for investors to differentiate company impact and investor contribution:

“it is crucial that investors understand that by simply buying a product which is investing in secondary markets, the contribution or causation to transformation of investees [...] is indirect and might be limited. This limitation may also be relevant when investing in assets that are already sustainable” (PSF, 2024b, p. 13-14).

We agree with this assessment and, therefore, propose the fourth type of investor preference “invest and achieve investor impact”. This preference differs from “invest sustainable” and “invest in transition” in that it requires a positive investor contribution of the financial product itself, going beyond only buying positive impact (i.e. investing in sustainable or transition investments). Investors can positively influence a company’s impact by allocating capital in

⁶ Products qualifying for the preference to “invest sustainable” or “invest in transition” also invest in assets or companies that contribute positively to sustainability objectives. They do not, however, aim for or measure their investor contribution. This is a key difference to products falling into the preference of “invest with impact” (see section 4 for details).

ways that help the company maintain or improve its social or environmental performance – for example, by offering funding at favourable terms or in meaningful amounts. In addition, investors can actively engage with companies to encourage improvements in their social or environmental performance. Including this investor preference helps identify a higher ambition level compared to the other preferences, since it is an additional challenge for financial market participants to provide convincing claims of investor contribution. It also helps to prevent impact-washing, since both investors and financial product providers have an explicit and more transparent understanding of the expected product characteristics.

4. Sustainability-Related Investments

As the basis for clear categories of sustainability-related financial products, this section defines four types of sustainability-related investments these products can implement, based on the sustainability-related investor preferences discussed above:

1. ESG investments
 2. Sustainable investments
 3. Transition investments
 4. Impact-generating investments
- } Impact-aligned investments

Differentiating these types of sustainability-related investments is important to be able to state what impact investments are, and what impact investments are not. The goal is to encompass all types of sustainability-related investments to provide the necessary transparency to investors interested in these types of investments. This approach also prevents the current problem of a large share of the fund market being classified as SFDR Article 8, without a clear idea about what this means in terms of product strategy and investment process.

4.1. ESG Investments

The acronym ESG, short for environmental, social and governance factors, has been used in many different contexts with different meanings. The UN PRI provides a concrete definition of ESG factors (see glossary), which we will adapt in this paper. In the widely adopted definitions of responsible investment approaches, ESG integration is one core strategy (GSIA et al., 2023). From this perspective, ESG integration is the “ongoing consideration of ESG factors within an investment analysis and decision-making process with the aim to *improve risk-adjusted returns*” (GSIA et al., 2023, p. 8, emphasis added by author). In addition, many of the most widely used ESG-scores from large rating providers analyse how issuers manage ESG risks and opportunities (MSCI, 2025; Sustainalytics, 2025). Consequently, many practitioners of sustainability-related investments use “ESG” to refer to those investment approaches or scores that focus on managing and measuring ESG risks and opportunities.

Building on this understanding, *ESG investments are investments made with the intention to improve risk-adjusted returns by measuring and managing ESG risks and/or opportunities*. This definition provides a clear understanding of ESG investments, preventing the currently ambiguous and multifaceted usage in the market. ESG investments can be considered the least ambitious category of sustainability-related investments, since managing ESG risks is already part of regulatory obligations, for example in the EU context, where UCITs and AIF funds are required to include ESG risks in their due diligence processes (European Commission, 2025d, 2025e).

4.2. Sustainable Investments

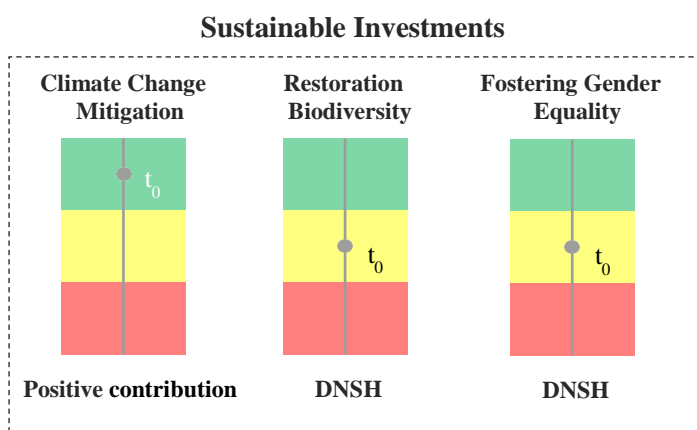
Sustainable investments are defined in the SFDR article 2(17) as investments in economic activities that (1) contribute to an environmental or social objective, (2) do not significantly harm (DNSH) any of these objectives, (3) provided that investee companies follow good governance practices (see glossary).

We propose to specify the first aspect of SFDR's concept of sustainable investments, referring only to those economic activities that contribute positively *by already being sustainable*, e.g. building solar or wind parks (see Figure 5 and section 2.4. for an illustration and explanation of this type of positive contribution).⁷ This specification provides manufacturers of financial products with clearer guidance on how to assess the positive contribution of sustainable investments in practice. It also supports investors' decision-making, since it provides greater clarity in financial product disclosures (see section 4). The DNSH-principle and the good governance criterion remain unchanged compared to the current SFDR approach (see Figure 5)

4.3. Transition Investments

In its current form, the SFDR does not include a definition of transition investments. The EU Commission provided a proposal for a definition in a communication, but this proposal only refers to environmental issues and does not tackle the topic of do-no-significant-harm (EU Commission, 2023c). We, therefore, propose to integrate a concrete definition of transition investments into the SFDR, following the logic of defining sustainable investments. As an illustrative example, transition investments could be defined as investments in economic activities that (1) contribute to (an) environmental or social objective(s) by transitioning towards sustainable levels of social or environmental performance, (2) do not significantly harm (DNSH) any objectives that are not the target of the transition, (3) provided that investee companies follow good governance practices (see Figure 6 for an illustration).⁸ This type of definition is in line with the EU Commission's definition of transition investments. It also goes beyond the Commission's understanding by including the DNSH principle and broadening the scope to include social transitions. A clear definition of transition investments in SFDR provides asset managers with clearer guidance on how to assess the positive contribution of transition investments in practice and is consistent with the existing EU Sustainable Finance Framework, especially with the EU Taxonomy's approach to include transitional activities. It also supports investors' decision-making, since it provides greater clarity in financial product disclosures (see section 4).

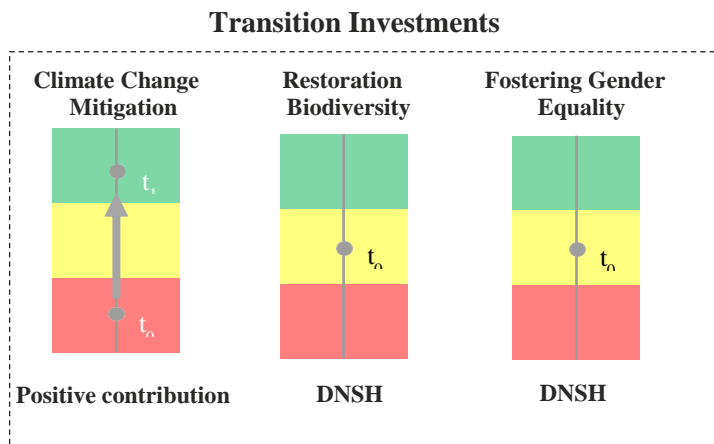
Figure 5: Specified definition of sustainable investments



⁷ This would also include economic activities enabling other economic activities to have a positive contribution, as for example defined in the EU Taxonomy.

⁸ This would also include economic activities enabling other economic activities to have a positive contribution, as for example defined in the EU Taxonomy.

Figure 6: Definition of transition investments



4.4. The Missing Link: Impact-generating Investments and Investor Contribution

A key question in current discussions about sustainability-related financial product categories is how to integrate impact investments into the categorisation scheme. Following the sustainability-related investor preferences defined above, investors need to be able to identify products to “invest with impact”. The Global Impact Investing Network (GIIN) developed one of the most widely cited definitions of impact investments as investments made with the intention to generate positive, measurable social or environmental impact alongside a financial return (GIIN, 2025). This definition, however, is missing the concept of investor contribution. Consequently, it has been specified by academics and practitioners (Busch et al., 2021, Kölbel et al., 2020, Pruessner et al., 2024), especially regarding the differentiation between company impact and investor impact/contribution. An overview of existing definitions from practitioners across Europe shows that most definitions refer to five characteristics (Pruessner et al., 2024):

1. Intentionality
2. Impact measurement and management (IMM)
3. Positive company (or asset) impact
4. Positive investor contribution
5. Financial return

The first two criteria of intentionality and IMM are important to make transparent how an investor measures outcomes and impacts, especially when using output measures as a proxy for outcomes and impacts that are beyond its direct control. Positive company impact can be realised through either transition or sustainable investments as described above (see sections 2.4, 4.2 and 4.3). As stated above regarding the preference to “invest with impact” it is important to enable investors to distinguish products that have positive investor contribution from those that do not. Since the potential to contribute positively as an investor differs strongly for example across asset classes and public and private markets, we propose to differentiate between impact-generating investments, which fulfil all of the five criteria above, and impact-aligned investments, which fulfil all of the criteria except for providing evidence of positive investor contribution (see Table 1).

Table 1: Characteristics of impact-aligned and impact-generating investments

No.	Impact-aligned investments	Impact-generating investments
1	Intentionality	Intentionality
2	Impact management and measurement (IMM)	Impact management and measurement (IMM)
3	Positive company/asset impact	Positive company/asset impact
4	-	Positive investor impact
5	Financial return	Financial return

Source: adopted from Busch et al. (2021) and Pruessner et al. (2024)

It is important to clarify that impact-generating investment can have positive company impact, i.e. contribute positively to sustainability goals, by making sustainable investments, transition investments, or both. Sustainable and transition investments refer to the positive impact of economic activities and, therefore, only to the asset level or the level of company impact (impact-aligned).⁹ Impact-generating investments go beyond that by including the investor level in terms of investor contribution. This differentiation is very important to clearly establish how impact-generating investments go beyond sustainable and transition investments enabling investors to identify products for “investing with impact”. Based on these insights from both academia and practitioners, we propose including a definition of impact investments in the SFDR based on these five criteria.

⁹ Sustainable and transition investments are usually implemented with a concrete intention and measurement and management process. This is why they can be qualified as „impact-aligned“, fulfilling the criteria in Table 1.

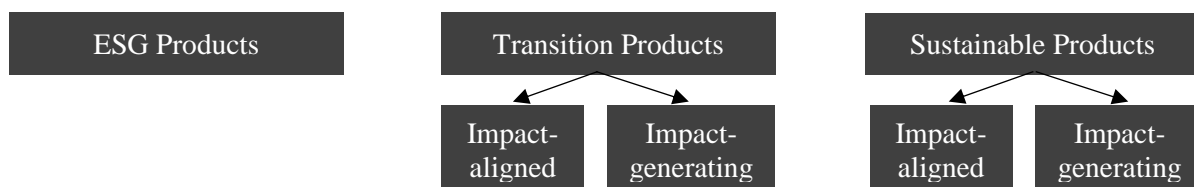
5. A new Classification Scheme for Sustainability-related Products

Sustainability-related categories for financial products should at least serve two purposes:

1. The categories should enable investors to match their investment preferences with concrete financial products.
2. The categories should provide financial market participants with clear expectations regarding the concrete characteristics needed to fall into one of the categories.

This section therefore proposes three product categories based on the sustainability-related investor preferences and investments defined in sections 3 and 4 and following the Platform's proposal, namely (1) ESG products, (2) transition products, and (3) sustainable products (see Figure 7. For the concrete criteria see Table 2). The categories are built to align with the different investor preferences and can be distinguished based on their objective, their binding minimum criteria for the investment process, the KPIs used to measure sustainability-related performance at the asset or company level, and their ability to provide convincing evidence of investor contribution. These characteristics are meant to serve as minimum requirements that need to be fulfilled to fall into one of the categories. The proposed categories also go beyond the Platform's proposal in systematically integrating impact-aligned and impact-generating investments as a possible dimension of sustainable and transition products

Figure 7: Overview of product categories



5.1. ESG Products

ESG products have the objective of making ESG investments, i.e., investments made with the intention of improving risk-adjusted returns by measuring and managing ESG risks and/or opportunities. Products in this category are therefore well suited to meeting the preference of investors to invest in ESG. To be able to implement their objective, ESG products need to conduct a financial materiality analysis to determine the financially material ESG factors of their investments. In practice, this is often part of internal or external ESG scores, which usually include an assessment of the ESG risk exposure of analysed issuers.

For minimum exclusions, ESG products should implement the Climate Transition Benchmark (CTB) exclusions as a minimum requirement.¹⁰ These minimum exclusions need to be binding

¹⁰ These exclusions refer to companies involved in any activities related to controversial weapons, companies involved in the cultivation and production of tobacco, and companies in violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises (European Commission, 2020b, p. 23). The Platform also proposes the CTB exclusions for their ESG Collection category, though with some adjustments, namely to exclude companies that violate the United Nations Guiding Principles on Business and Human Rights (UNGPs) instead of those violating the UNGC principles. Based on our definition of ESG products, excluding issuers violating the UNGC principles

for 100% of the investments in the portfolio, excluding liquidity and hedging. Financial market participants are, however, free to add any other exclusions of activities whose ESG risks are deemed too high based on their analyses of financially material ESG factors. We also propose that ESG products are not required to perform a DNSH assessment, since their goal is not to contribute positively to sustainability objectives. ESG products can of course implement DNSH assessments, but they are not required to do so to qualify as ESG products. Regarding their positive screening, at least 80% of investments need to be ESG investments, following the thresholds introduced by the ESMA guidelines. To implement ESG investments, ESG products need to measure the ESG risks and/or opportunities of their investments, using KPIs of those ESG risks and/or opportunities deemed financially material. This could be CO₂e-emissions, social or environmental controversies posing reputation risks, or ESG scores focusing on ESG risks or opportunities. For products to qualify as ESG products, these KPIs need to be binding selection criteria in the investment process.

5.2. Transition Products

Transition products have the objective of making transition investments, i.e. investments in economic activities that contribute to an environmental or social objective(s) by transitioning towards sustainable levels of social or environmental performance. They are impact-aligned in the sense that making transition investments does not entail achieving an investor contribution. Products falling into this category are, therefore, well-suited to meet the preference of investors to invest in transition. To be able to implement their objective, transition products need to conduct a double materiality analysis to determine not only the financially material ESG factors of their investments, but also the most material negative impacts of their portfolio that need to transition towards sustainability.¹¹ In practice, transition products often refer to the climate dimension of transition, measured based on CO₂e-emissions and assessment frameworks like the Science-Based Targets Initiative. Another approach is to use SDG ratings, for example provided by many ESG research agencies, to assess issuers' negative and positive contributions to the SDGs.

For minimum exclusions, transition products should implement the CTB exclusions as a minimum requirement, following the ESMA guidelines. These minimum exclusions need to be binding for 100% of the investments in the portfolio, excluding liquidity and hedging. We also propose that transition products are required to perform a DNSH assessment, since their goal is to contribute positively to sustainability objectives through transition, which should not entail harming other sustainability objectives. One way to implement the DNSH assessment is to use the existing principal adverse impact (PAI) indicators as currently practiced under the SFDR

fits well as a minimum exclusion, since the UNGC includes both social and environmental controversies that could pose significant reputational risks. Referring to the UNGP would ignore environmental controversies, which is why we propose to keep the violations of UNGC principles as an exclusion criterion for ESG products. Requiring CTB exclusions as a minimum requirement of ESG products is, however, in conflict with the ESMA guidelines on funds' names using ESG or sustainability-related terms (ESMA guidelines). According to these guidelines, "ESG" qualifies as an environmental-related term, meaning that funds with ESG in their name need to implement the exclusions of Paris-aligned Benchmarks (PAB). Since the ESMA guidelines refer to the existing SFDR wording of "environmental or social characteristics", they also inherit the corresponding ambiguities. We suspect that an update of SFDR as level 1 regulation would also lead to an update of these guidelines in order to provide the necessary clarity and consistency.

¹¹ This assessment can follow the process described in the ESRS.

by article 9 products. The DNSH assessment should include those PAIs deemed most material following the double materiality assessment. Regarding their positive screening, at least 80% of investments need to be transition investments, following the thresholds introduced by the ESMA guidelines. For transition products, this would mean investing in issuers that are not yet sustainable — i.e., not yet Paris-aligned or not yet contributing positively to an SDG, but that are on a credible pathway towards achieving these sustainable levels of performance. To implement transition investments, transition products need to use concrete KPIs as binding selection criteria to measure the positive contribution of their investments. In its recommendation on transition finance, the EU Commission proposed several ways to measure transition, e.g. taxonomy-aligned activities (transitional economic activities or economic activities becoming aligned in 5-10 years), credible transition plans or credible science-based targets (European Commission, 2023). Several sustainability research agencies also provide SDG-scores or transition-scores, which are another option. To make the thresholds more comparable, financial market participants should use the activity-based approach to measure transition investments where relevant.

5.3. Sustainable Products

Sustainable products have the objective of making sustainable investments, i.e. investments in economic activities that contribute positively by already being sustainable. They are impact-aligned in the sense that making sustainable investments does not entail achieving an investor contribution. Products falling into this category are, therefore, well-suited to meet the preference of investors to invest sustainably. To be able to implement their objective, sustainable products need to conduct a double materiality analysis to determine not only the financially material ESG factors of their investments, but also the most material negative and positive impacts of their portfolio. In practice, sustainable products can refer to concrete social or environmental indicators, such as CO₂e-emissions, assessment frameworks like the Science-Based Targets Initiative, or SDG ratings, to assess issuers' negative and positive contributions to sustainability objectives.

For minimum exclusions, transition products should implement the Paris-aligned Benchmark (PAB) exclusions as a minimum requirement, following the ESMA guidelines. These minimum exclusions need to be binding for 100% of the investments in the portfolio, excluding liquidity and hedging. We also propose keeping the requirement that sustainable products need to perform a DNSH assessment, since their goal is to contribute positively to sustainability objectives, which should not entail harming other sustainability objectives. One way to implement the DNSH assessment is to use the existing principal adverse impact (PAI) indicators as currently practiced under the SFDR by article 9 products. The DNSH assessment should include those PAIs deemed most material following the double materiality assessment. Regarding their positive screening, at least 80% of investments need to be sustainable investments, following the thresholds introduced by the ESMA guidelines. To implement sustainable investments, sustainable products need to use the KPIs mentioned above as binding selection criteria (SBTi, SDG-Scores, etc.) to measure the positive contribution of their investments. For sustainable products, this would mean investing in issuers whose economic activities are already sustainable (i.e. Paris-aligned, or contributing positively to an SDG), thereby contributing to achieve sustainability objectives. To make the thresholds more

comparable, financial market participants should use the activity-based approach to measure sustainable investments.

Table 2: Classification of sustainability-related investment products

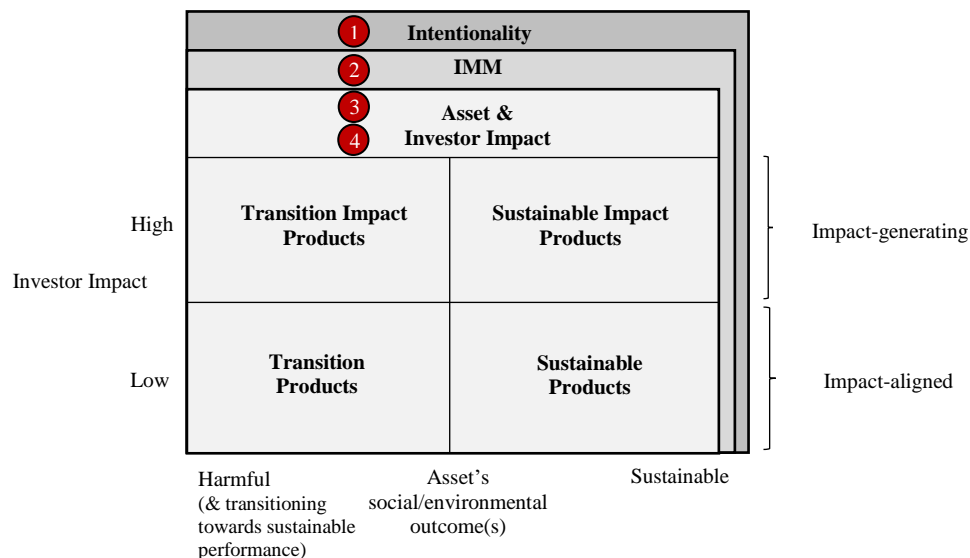
Dimension		ESG Products	Transition products		Sustainable Products	
			Impact-aligned	Impact-generating	Impact-aligned	Impact-generating
Investor Preference		Invest in ESG	Invest in transition	Invest with impact	Invest sustainable	Invest with impact
Product Objective		ESG investments	Transition investments	Impact-generating investments with focus on transition	Sustainable investments	Impact-generating investments with focus on sustainable activities
Materiality assessment		Financial materiality	Double materiality		Double materiality	
Minimum criteria investment process	Minimum exclusions	100% CTB-exclusions	100% CTB exclusions		100% PAB exclusions	
	DNSH	X	✓		✓	
	Positive screening	80% ESG investments	80% transition investments	80% Impact-generating investments	80% sustainable investments	80% Impact-generating investments
KPIs Asset level		1. KPIs measuring exposure to ESG risks and opportunities 2. ESG-scores measuring exposure and management of ESG risks and opportunities	KPIs measuring positive contribution via social or environmental transition of assets, e.g.: 1. Transition-KPIs proposed by EU Commission, 2. Transition scores 3. SDG ratings		KPIs measuring positive contribution via already sustainable activities, e.g.: 1. Taxonomy-aligned activities (Revenues) 2. SDG ratings	
Investor Contribution		X	X	✓	X	✓

5.4. Impact-generating transition and sustainable products

The product categorisation we propose follows the Platform’s call to “develop a common understanding on impact investing in the EU sustainable finance framework and [...] determine how to integrate it in the categorisation scheme” (PSF, 2024b, p. 5). We propose that sustainable and transition products can either be impact-aligned or impact-generating products (see Table 1).

Impact-generating transition or sustainable products have the objective of making impact-generating investments. Impact-generating investments go beyond transition and sustainable investments in three ways: (1) a clear intention of the investor to create a positive impact, (2) an impact measurement and management system (IMM) and (3) a contribution of the investor to this positive company impact (investor contribution).¹² Products falling into these categories are, therefore, well-suited to meeting the preference of investors to invest and achieve investor impact. To be able to implement their objective, impact-generating transition or sustainable products need to conduct a double materiality analysis to determine not only the financially material ESG factors of their investments, but also the most material negative and positive impacts of their portfolio. In practice, they can refer to concrete social or environmental indicators like CO₂e-emissions, assessment frameworks like the Science-Based Targets Initiative, or SDG ratings, to assess issuers’ negative and positive contributions to sustainability objectives. All other characteristics are identical to impact-aligned transition and sustainable products. For an overview of less technical labels of impact-aligned and impact-generating sustainable and transition products, see Figure 8.

Figure 8: Labels for transition and sustainable products depending on the impact dimension



Source: adopted from Busch et al. (2021) and Pruessner et al. (2024)

¹² There are some approaches for measuring investor contribution, e.g. the Impact Potential Assessment Framework (IPAF) (Sustainable Finance Observatory, 2023) or the investor contribution due diligence templates developed by Impact Frontiers (Impact Frontiers, 2023).

5.5. Overlap Between Sustainability-related Investments and Product Categories

To have clear product categories, we need to be clear about the relationships between the different sustainability-related investments and how this influences the reporting of portfolio-level thresholds. The different types of sustainability-related investments proposed above are not mutually exclusive but can overlap (see Figures 9-11). ESG investments can overlap with transition or sustainable investments. In practice, most sustainability-related financial products integrate ESG risks and opportunities into their investment processes. For example, many financial market participants use an ESG-score measuring ESG risks and opportunities as one selection criterion for issuers. They can then use a concrete selection threshold (often between 0-100) to define which issuers qualify for an investment from an ESG risks and opportunities perspective. In addition, they can look at issuers from a sustainable or transition perspective, analysing whether the issuers, besides being good ESG investments, also contribute positively to sustainability goals. This is often implemented using SDG scores that measure positive contribution based on an issuer's revenue. In that sense, *one issuer can qualify as both an ESG investment and a sustainable or transition investment*. This is why Figure 9 shows high percentages for both ESG and sustainable or transition investments for ESG product 2, with these investments collectively being greater than 100%.

In contrast, sustainable and transition investments cannot overlap. Given a concrete sustainability objective, an economic activity can either contribute positively to that objective or not. Aggregated on the issuer level, for example, the CO₂e-emissions of a company cannot be Paris-aligned (sustainable) and, at the same time, transition towards becoming Paris-aligned. Given *different* sustainable objectives, the same issuer can be both a sustainable and a transition investment. For example, one issuer can have Paris-aligned CO₂e-emissions and qualify as a sustainable investment given the objective of climate change mitigation of an investment fund. The same issuer can also have high negative impacts on biodiversity, making it a possible transition investment for the objective of restoring biodiversity of another investment fund. This is why the double materiality assessment is essential to determine the most relevant positive and negative company impacts and the respective sustainability objectives of the issuers in the portfolio in order to be able to determine the most relevant sustainability objective(s) to focus on.

The relationship between impact-generating investments and sustainable and transition investments is not mutually exclusive (as is the case for ESG investments). One issuer classified as a sustainable or transition investment can, at the same time, be classified as an impact-generating investment, if the additional criteria are fulfilled (intentionality, investor contribution). Figure 10 shows a transition product that makes 80% transition investments, e.g. a public equity fund investing in issuers with credible climate transition plans and verified science-based targets. For 20% of these transition investments, the product implements a systematic engagement strategy, with the aim of pushing issuers to get verified science-based targets or to implement their transition plan, while measuring and managing progress and success, fulfilling the criteria for impact-generating investments. Therefore, the financial product classifies these 20% of all transition investments as impact-generating (the rest being impact-aligned). The transition *impact* product, on the other hand, is a real estate fund that

invests in existing properties with the strategy of improving their energy-efficiency and exchanging fossil fuel-based heating systems with renewable energy-based heating systems. Since the fund has direct control over the invested assets and brings in its expertise and capital to improve the climate performance of the portfolio, it classifies all 80% of the transition investments as impact-generating investments. Consequently, the fund can be classified as a transition *impact* fund since it fulfils the 80% threshold of impact-generating investments. The same logic applies to sustainable products and sustainable impact products (see Figure 11). In this way, impact-generating investments and transition or sustainable investments are not mutually exclusive. While transition and sustainable investments look at the positive contribution of economic activities to sustainability goals (i.e. company impact) an investor can go beyond that by making impact-generating investments, i.e. implementing a theory of change (intentionality), an impact measurement and management system, and contributing as an investor.

Figure 9: ESG product with different shares of sustainability-related investments

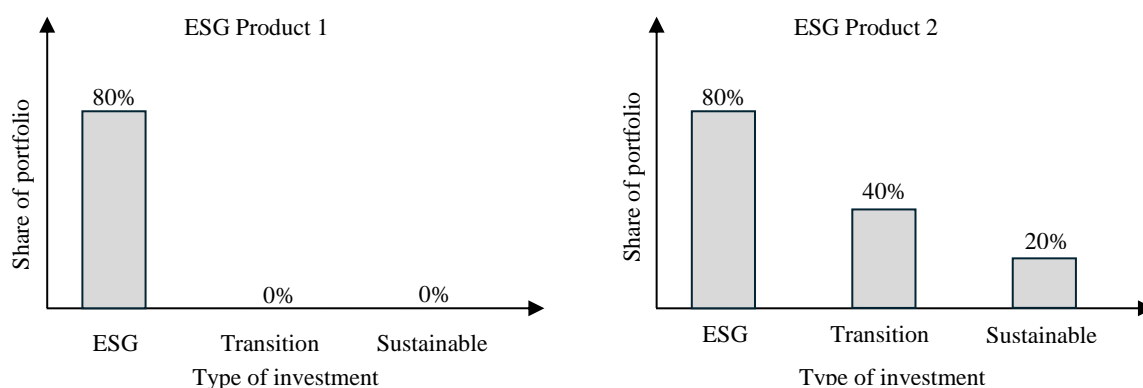


Figure 10: Difference between transition products and transition impact products

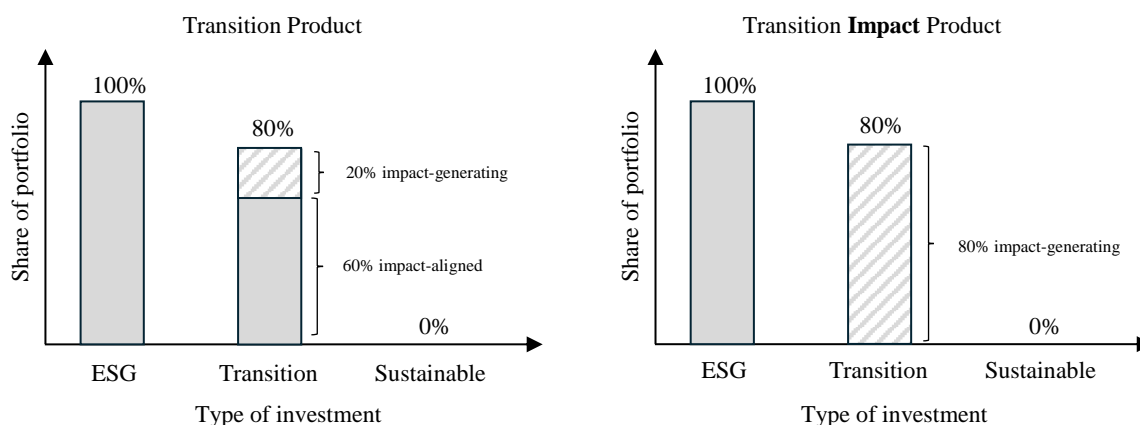
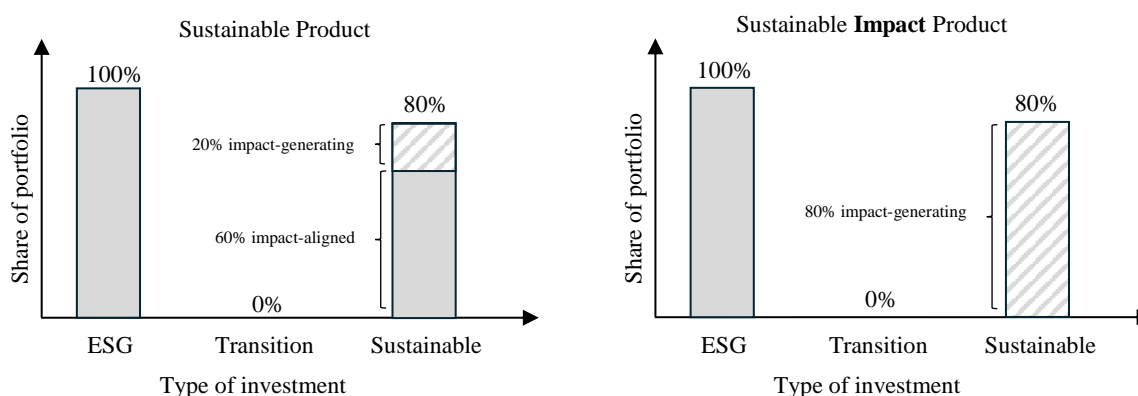
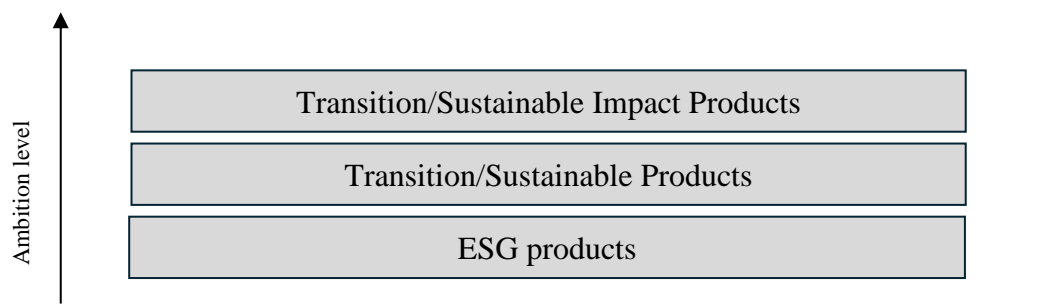


Figure 11: Difference between sustainable products and sustainable impact products



Consequently, one financial product can fulfil the criteria of several sustainability-related financial product categories at the same time. For example, the public equity transition fund or the transition impact real estate fund described above can also be classified as ESG products. To ensure clarity in the categorisation of financial products, we propose assigning each product to the category corresponding to the highest ambition level for which it meets the defined criteria (see Figure 12). For instance, if a product meets only the criteria for ESG products, it should be classified accordingly. If it fulfils the criteria for both ESG and transition products, it should be categorized as a transition product. Similarly, if it qualifies under ESG, transition, and transition impact product criteria, it should be classified as a transition impact product. The same logic applies to products spanning the ESG, sustainable, and sustainable impact categories.

Figure 12: Ambition level of sustainability-related financial product categories



While this proposal introduces clearer criteria for defining the 80% threshold at the portfolio level, it does not resolve the fundamental issue of limited comparability between different approaches to measuring ESG, sustainable, transition, or impact-oriented investments. In public markets, for example, financial market participants frequently rely on ESG data providers, each using its own methodologies, scores, and sustainability ratings. Because these methodologies and resulting assessments vary significantly, portfolio-level thresholds based on them are often not comparable. One research provider illustrated this variability by showing that the share of sustainable investments in the same index can range from 13% to 84%, depending on the definition and measurement approach used (ISS ESG, 2023). While we recommend using an activity-based approach to assess the share of sustainable investments — aiming to increase

comparability — this does not address the broader issue of divergent methodologies and outcomes across ESG providers.

Resolving this challenge goes beyond what product categorization under the SFDR can achieve and would require regulatory intervention to harmonize these differences. The current EU regulation on ESG ratings is a first step towards greater transparency regarding existing methodologies (European Commission, 2024c). However, it does not introduce common standards for ESG rating methodologies. As long as such standards are lacking, investors will need to evaluate the differences in methodologies themselves to fully understand the criteria used for sustainability-related issuer selection.

6. Recommended Reporting Requirements

Regarding reporting requirements, we follow the proposals of the EU Platform on Sustainable Finance (Platform on Sustainable Finance, 2024b) with some adjustments and specifications. We agree that sustainability-related financial products should disclose binding KPIs in pre-contractual and periodic disclosures. They should also disclose the name of the category they fall into, as long as the minimum requirements are fulfilled. This will help match investor preferences to concrete products. We propose the following specifications compared to the Platform's proposal regarding reporting requirements:

Precontractual disclosures:

1. ESG products should report the outcomes of their financial materiality assessment, specifying which risks and opportunities are considered most material and consequently addressed in the investment process.
2. Sustainable and transition products, as well as sustainable impact and transition impact products should report the outcomes of their double materiality assessment, specifying which impacts, risks and opportunities are most material and consequently addressed in the investment process. Based on the most material impacts, these products should specify which sustainability goal(s) they seek to contribute to through transition investments, sustainable investments, or impact-generating investments.
3. Sustainability-related products should report the share of sustainability-related investments they aim for (share of ESG-, transition-, sustainable-, and/or impact-generating investments).
4. Sustainability-related products should clearly state which reported KPIs are binding in the selection process and which are not. This should include clear information about which KPIs are used to measure each type of sustainability-related investment.
5. Sustainable and transition products should disclose their definition of sustainable and transition investments, including the thresholds used to differentiate sustainable from unsustainable performance.
6. Sustainable impact and transition impact products should disclose their engagement strategy, if applicable, including the concrete impact-related engagement objectives.
7. Sustainable impact and transition impact products should disclose their theory of change and their IMM processes.

Periodic disclosures:

1. Sustainability-related products should report the actual share of sustainability-related investments they achieved in the reporting period (ESG-, transition-, sustainable-, and impact-generating investments).
2. Sustainability-related products should report the performance of the KPIs that are binding in the selection process.
3. Sustainable impact and transition impact products should disclose the current results of their sustainability-related engagement strategy, if applicable, including concrete engagement examples.

Sustainable and transition impact products should disclose the results of monitoring their theory of change — specifically, whether impact targets have been achieved. Where targets have not

been met, periodic disclosures should provide an explanation and outline concrete actions planned to improve performance.

Glossary

Environmental factors	Issues relating to the quality and functioning of the natural environment and natural systems, identified or assessed in responsible investment processes. (UN PRI, 2024)
Social factors	Issues relating to the rights, well-being and interests of people and communities, identified or assessed in responsible investment processes. (UN PRI, 2024)
Governance factors	Issues relating to the governance of companies and other investee entities, identified or assessed in responsible investment processes. (UN PRI, 2024)
Sustainable investments	“‘sustainable investment’ means an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or 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, provided that 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.” (European Commission, 2020a, p. 8)
Environmentally sustainable investments	“For the purposes of establishing the degree to which an investment is environmentally sustainable, an economic activity shall qualify as environmentally sustainable where that economic activity: (a) contributes substantially to one or more of the environmental objectives set out in Article 9 in accordance with Articles 10 to 16; (b) does not significantly harm any of the environmental objectives set out in Article 9 in accordance with Article 17; (c) is carried out in compliance with the minimum safeguards laid down in Article 18; and (d) complies with technical screening criteria that have been established by the Commission in accordance with Article 10 (3), 11(3), 12(2), 13(2), 14(2) or 15(2).” (European Commission, 2020c, p. 27)
Sustainability-related opportunities:	“Uncertain environmental, social or governance events or conditions that, if they occur, could cause a potential material positive effect on the undertaking's business model , or strategy on its capability to achieve its goals and targets and to create value, and therefore may influence its decisions and those of its business relationship partners with regard to sustainability matters . Like any other opportunity , sustainability-related opportunities are measured as a combination of an impact's magnitude and the probability of occurrence.” (European Commission, 2023b, p. 280)
Sustainability-related risks	“Uncertain environmental, social or governance events or conditions that, if they occur, could cause a potential material negative effect on the undertaking's business model or strategy and on its capability to achieve its goals and targets and to create value, and therefore may influence its decisions and those of its business relationships with regard to

	sustainability matters. Like any other risks , sustainability-related risks are the combination of an impact’s magnitude and the probability of occurrence.” (European Commission, 2023b, p. 280)
Supply chain impacts	Impact associated with an organisation’s inputs, and where and how these are sourced (IMP, 2024d)
Operational impacts	Impacts associated with an organisation’s production process (IMP, 2024d)
Product impacts	Impacts associated with an organisation’s products/services and their usage (IMP, 2024d)
Materiality	“A sustainability matter is material if it meets the definition of impact materiality , financial materiality , or both.” (European Commission, 2023b, p. 272)
Financial materiality	“A sustainability matter is material from a financial perspective if it generates risks or opportunities that affect (or could reasonably be expected to affect) the undertaking’s financial position, financial performance, cash flows, access to finance or cost of capital over the short, medium or long term.” (European Commission, 2023b, p. 272)
Impact materiality	“A sustainability matter is material from an impact perspective when it pertains to the undertaking’s material actual or potential, positive or negative impacts on people or the environment over the short-, medium- and long-term. A material sustainability matter from an impact perspective includes impacts connected with the undertaking’s own operations and upstream and downstream value chain , including through its products and services, as well as through its business relationships .” (European Commission, 2023b, p. 270)
Input	“The resources and relationships that organisations draw upon for their business activities, as well as the contextual elements that define their business activities” (IMP, 2024a).
Activities	“Everything that organisations do, including operations, the procurement of inputs, the sale and provision of products and/or services, as well as any supporting activities“ (IMP, 2024a)
Output	“The direct result of organisations’ activities, including their products, services and any by-products.“ (IMP, 2024a).
Outcome	<p>Usage in this paper:</p> <p>“The level of well-being experienced by people or condition of the natural environment that results from the actions of the organisation, as well as from external factors“ (IMP, 2024a)</p> <p>Additional meaning:</p> <p>“A <i>change</i> or <i>event</i> resulting from organisations’ activities and outputs, providing a causal link between the activities/outputs and their impact(s) on people and/or the natural environment“ (IMP, 2024a)</p>
Impact	<p>ESRS:</p> <p>“The effect the undertaking has or could have on the environment and people, including effects on their human rights, connected with its own operations and upstream and downstream value chain, including through its products and services, as well as through its business relationships. The impacts can be actual or potential, negative or positive, intended or unintended, and reversible or irreversible. They can arise over the short-, medium-, or long-term. Impacts indicate the undertaking’s contribution,</p>

	<p>negative or positive, to sustainable development.” (European Commission, 2023b, p. 269)</p> <p>IMP: “The effect(s) of organisations’ actions on people and the natural environment.” (IMP, 2024a)</p>
Impact pathway	<p>“The sequence that links organisations’ actions with their effects on people and the natural environment.” (IMP, 2024a)</p>
Investor contribution	<p>“The contribution that the investor makes to enable enterprises (or intermediary investment managers) to achieve impact.” (IMP, 2024a)</p>
Stewardship	<p>“The use of influence by investors to protect and enhance overall long-term value, including the value of common economic, social and environmental assets, on which returns and client and beneficiary interests depend.” (PRI, 2024)</p>

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