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TOWARDS AN EU IMPACT INVESTING FRAMEWORK

The current EU regulatory landscape may hinder effective impact investing by prioritising disclosure of sustainability risks over measurable, positive impact. The authors of the study propose five fine-tuned amendments to bolster EU financial regulation and amplify its reach beyond the EU.

BACKGROUND AND STUDY RATIONALE



Impact investing in context

Amid shifting geopolitical priorities and the United Nations' Sustainable Development Goals 2030 deadline looming on the horizon, impact investing has emerged as an alternative approach to sustainable development. This output-oriented investment strategy aims to address complex global challenges and to **generate intentional, measurable and positive social and environmental outcomes alongside financial returns.**

Though still relatively niche, the market size for impact investing has grown. By 2024, impact investing assets under management (AUM) reached US\$1.571 worldwide, up 21% per year since 2019¹. Asset and fund managers held 27% of total impact assets². Given that Europe accounts for 45% of impact investors and 54% of [MB2.1] impact assets³, determining the effectiveness and reach of EU financial regulation governing impact investing becomes highly relevant.

RESEARCH QUESTION AND METHODOLOGY



Examining the EU regulatory landscape

Does current EU financial regulation provide the **relevant regulatory framework for demonstrable, measurable and positive impact investment?** To address this question, the authors examined EU legal sources that are central to the EU Sustainable Finance Framework (EUSFF), including:

- ☒ The Sustainable Finance Disclosure Regulation (SFDR)
- ☒ The proposal for a revised Sustainable Finance Disclosure Regulation (SFDR 2.0)
- ☒ The Taxonomy Regulation (TR)
- ☒ The Directive of Alternative Investment Fund Managers (AIFMD)
- ☒ The Corporate Sustainability Reporting Directive (CSRD)
- ☒ The European Securities and Markets Authority (ESMA) Guidelines on funds' names using environment, social or governance or sustainability-related terms

The analysis consisted in a qualitative examination of these sources, drawing from regulatory frameworks in the United Kingdom and Switzerland.

¹ ALFI - European Sustainable Investment Funds Study 2024

² Sizing the Impact Investing Market 2024 - The GIIN

³ Sizing the Impact Investing Market 2024 - The GIIN



Regulatory hurdles to impact investing

Critical examination of EU financial regulation revealed that both the EUSFF and EU asset management law (through the AIFMD) represent regulatory barriers to impact investing. **The regulatory landscape is predominantly input-oriented and focuses on risk mitigation.** Its emphasis lies in the disclosure of anticipated sustainability risks – that is, financial risks caused by environmental and social dimensions – and the avoidance of anticipated adverse impacts. There is an implicit assumption that compliant investments, considered “sustainable activities” from a regulatory standpoint, will yield positive outcomes and impact.

However, **limited mechanisms are in place to measure, monitor and evaluate actual outcomes** during and after an investment period, leaving investors and fund managers with costly and burdensome compliance requirements rather than providing them with the tools to demonstrate measurable positive impact, with the following consequences:

→ Limited positive impact

Current EU legislation favours investments in industries that already have high sustainability standards, while making it harder to fund decarbonisation projects in carbon-intensive sectors, which could nonetheless have a larger positive impact overall. This, together with a lack of clarity on what constitutes a “transition” activity, carries an inherent greenwashing risk.

→ Weak global influence

The high compliance cost and the lack of demonstrable positive impact dissuade non-EU investors and policymakers, while encouraging unsustainable activities to be relocated outside of the EU.

A five-step approach to strengthening EU financial regulation

Five fine-tuned steps simplifying current EU financial regulation could shift its approach from input-based to output-oriented and pave the way towards a simpler, more effective framework:

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- 1 **Recognise the potential of positive impacts in the EUSFF**, not merely adverse impacts: This would allow the inclusion of emerging industries and markets where data needed for compliance may be limited and/or where negative externalities cannot be entirely excluded, but with a real opportunity to generate positive impact.
- 2 **Address “do no significant harm” (DNSH) barriers**: Mirroring Swiss and British jurisdictions, DNSH could be reinterpreted as “no factor is worse off than before” in the absence of counterfactual evidence, filling gaps with publicly available data.
- 3 **Simplify impact reporting**: Currently, impact reporting is highly fragmented. Bundling reporting requirements into sectoral legislation (under that AIFMD) would reduce compliance costs, strengthen legal discipline and address greenwashing risks.
- 4 **Introduce proportionate AIFMD thresholds for smaller impact funds**: Revising the AIFMD thresholds would ease regulatory burden without increasing systemic risk by exempting smaller funds from the strict requirements applicable for loan origination.
- 5 **Revise rules on fund names**: Instead of introducing a new impact investing sub-category as proposed in the SFDR 2.0, a revision of the rules on fund names could provide greater legal clarity. Funds using “impact” should be required to embed positive impact objectives in their investment policy, implement robust measurement methods and undergo independent verification during the fund lifecycle.

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