

TRANSITION PRODUCTS, RETAIL INVESTOR PREFERENCES AND THE REFORM OF THE SFDR

Empirical insights from the ClimLabels project on credible product design, investor demand, and policy alignment

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Executive Summary

Why credible transition finance matters now. To deliver the EU Green Deal, restore investor confidence amid product confusion and maintain Europe's market competitiveness, credible transition finance is essential. Anchored in German-funded², EU-relevant evidence, credible transition finance offers a practical route to delivering the Green Deal, rebuilding investor trust and strengthening Europe's sustainable finance leadership. While the Sustainable Finance Disclosure Regulation (SFDR) is under review, evidence from the ClimLabels projects sheds light on both the supply and demand sides. On the supply side, the project analyses how transition products can be credibly designed while remaining financially competitive. On the demand side, it gathers empirical evidence on retail investors' preferences, willingness to pay, and understanding of different SFDR product categories.

Key Findings and Policy Implications

1) Supply-side insights: Transition products – minimum criteria as credible entry points are feasible.

Climate & Company tested the feasibility of transition products through a proof of concept by applying a set of potential transition criteria to 3,320 publicly listed firms. Simulated portfolios based on these criteria achieved competitive returns and volatility patterns compared to benchmarks between 2018-2024. However, stricter thresholds led to less attractive profiles. These results confirm that moderate minimum criteria can effectively serve as entry points, ensuring baseline integrity while preserving diversification and financial competitiveness.

Policy takeaway: Harmonised minimum criteria for transition products should be embedded in the SFDR to enhance comparability and credibility without compromising risk–return performance.

2) Investor heterogeneity – retail investors are highly heterogenous and can act on product distinctions.

In demand-side experiments, we engaged 300 retail investors from across the EU in an incentivised investment task, complemented by a survey of over 2,500 investors and 400 financial advisors. The results: Retail investors are highly diverse in their interest and willingness to pay for sustainable investments. When categories are clearly and consistently explained, investors can understand and act on these distinctions, allocating capital differently across ESG, sustainable, transition, and impact funds.

Policy takeaway: Differentiated SFDR categories are essential to reflect diverse sustainability preferences. Importantly, investors can understand and act on these distinctions once they are clearly explained - an insight that is relevant for both the SFDR and the forthcoming MiFID update.

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3) Exclusion priorities – retail investors prioritise social and governance aspects.

A survey of over 1,000 retail investors was conducted to test which exclusions matter most, with ESG being disaggregated into 18 subcategories. The findings reveal a clear preference hierarchy, with social and governance factors significantly outweighing environmental factors.

Policy takeaway: SFDR product design should reflect the broad consensus on social safeguards.

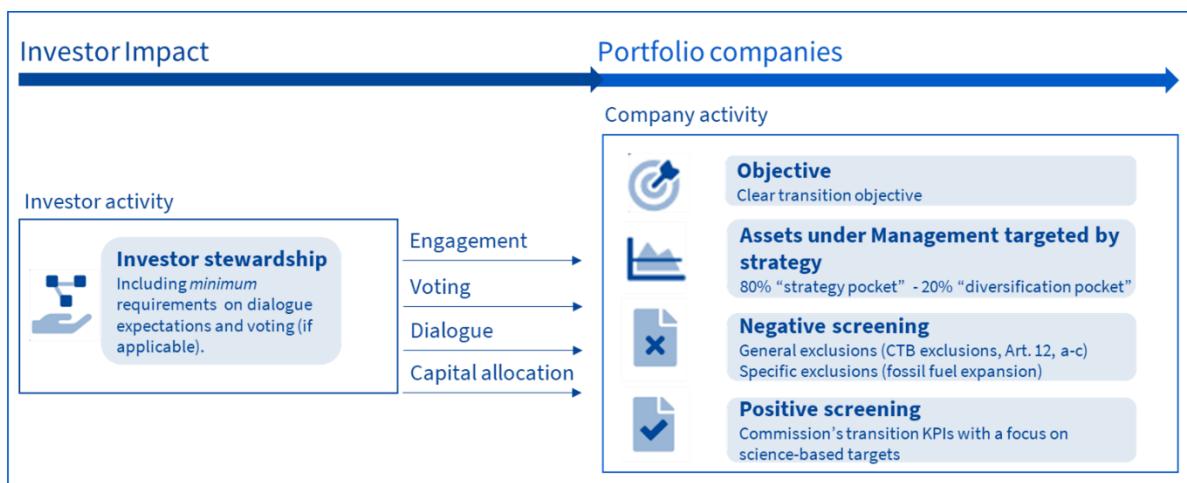
The findings stem from the three-year ClimLabels research project (2022–2025), funded by the German Federal Government, conducted by Climate & Company, SAFE, University of Münster and Ruhr University Bochum.

SUPPLY SIDE – TRANSITION PRODUCTS

How can transition finance products be constructed credibly?

Climate & Company's research focused on the supply side of transition finance, exploring how such products can be designed while remaining aligned with risk–return considerations. To promote transparency, trustworthiness and comparability, C&C aimed to facilitate an evidence-based discussion around the concept of objective minimum criteria, a concept endorsed by numerous other stakeholders in the field, including [AFM](#), [BaFin](#), [FMA](#). In our White Paper *Transition Products: Conceptual Clarity & Implementation Guidance* ([link](#)), we have thoroughly tested this for the transition category, drawing on proposals from French and Dutch authorities, as well as the ESMA guidelines. Based on this analysis and various discussions, we have identified the following core principles for a credible transition category (see also [Figure 1](#)):

Figure 1. Transition Products: Conceptual Framework for Credible Product



Investor stewardship: crucial for realising the contribution potential in public equity markets.

- **Engagement strategy:** Each fund should have a credible sustainability-related engagement strategy that includes: clear and systematic methods for selecting portfolio companies and topics/themes for engagement; clear, and time-bound goals and milestones for each engagement; regular assessment of the achievement of the engagement³.

³ Main Source: Nordic Swan Label criteria ([link](#)). Also the [Eurosif paper](#) or [EU Ecolabel v4](#), Criterion 4 outline core parameters.

- *Dialogue expectations:* The fund manager should engage with at least 5% of the holdings (by number), with a minimum of five companies. For collaborative engagements, this is counted as a “full” engagement if the fund manager acts as a lead investor. If the fund manager actively contributes to the engagement initiative, collaborative engagements may be counted as $\frac{1}{2}$ ⁴.
- *Exercise of voting rights [for equity funds]:* The fund manager should maintain a public voting policy that promotes ESG-related issues. At a minimum, the fund manager should regularly vote at annual general meetings for at least 25% of the fund's holdings (and 70% if a proxy service is used)⁵.

Assets under management targeted by the strategy: To align with the ESMA Fund Naming Guidelines and related initiatives, the portfolio can be divided into two parts: a *strategy pocket* with measurable company-level key performance indicators and a *diversification pocket* applying negative screening criteria only.

Negative screening: application of general exclusions (as defined under CTB, Art. 12, a-c) and climate-specific exclusions focusing on fossil fuel expansion. In practice, these exclusions are non-controversial and do not overly restrict the investable universe. For example, within an EU-extended MSCI All Country World Index (ACWI) universe of 3,320 companies, these combined exclusions reduce market capitalisation by only about 15 percent (see Figure 2 below).

Positive screening: Combine the transition KPIs [outlined by the Commission](#) with a prioritisation of verified science-based targets as a relatively robust criterion. Empirical research has already linked verified SBTs with future GHG emission reductions⁶. A limited share of holdings (up to X%) may lack validated targets or transition plans, provided that these holdings are targeted by an engagement strategy⁷.

High-impact focus: Portfolio composition and engagement strategies should include a meaningful share of companies from high-impact sectors, ensuring that transition finance products contribute where emission reductions matter most.

Proof of Concept: Empirical Testing of Transition Product Design

In order to test the feasibility of this framework, Climate & Company conducted a proof of concept involving a global equity universe, which covered the MSCI ACWI and EU mid-cap companies (a total of 3,320 firms). Successive layers of negative and positive screening were applied to the analysis to simulate how transition-oriented investment products can be constructed in practice.

⁴ Sources: Nordic Swan Label criteria ([link](#)). For comparison, the EU Ecolabel v4 suggested a 10% threshold (Criterion 4, see [link](#)). A [Eurosif paper](#) suggests disclosure on “the number of explicit engagement actions”, [Swiss climate scores](#) reference “Proportion of portfolio currently under active climate engagement”.

⁵ Sources: Nordic Swan Label criteria ([link](#)). For comparison, the French ISR label asks for 70% for non-French companies and 90% for French companies. Also the [Swiss climate scores](#) reference: “Share of votes [...] on climate resolutions voted in a manner consistent with [...] reaching net zero by 2050”

⁶ Gehrke et al (2024). The Role of Sustainable Management Practices in the Transition of Corporates Towards Net-Zero ([link](#))

⁷ This point aligns with the report by the Platform on Sustainable Finance (2024): Categorisation of Products under the SFDR ([link](#))

Figure 2. All Country World Index (ACWI) – EU Percentage by Subsample (n = 3,320)

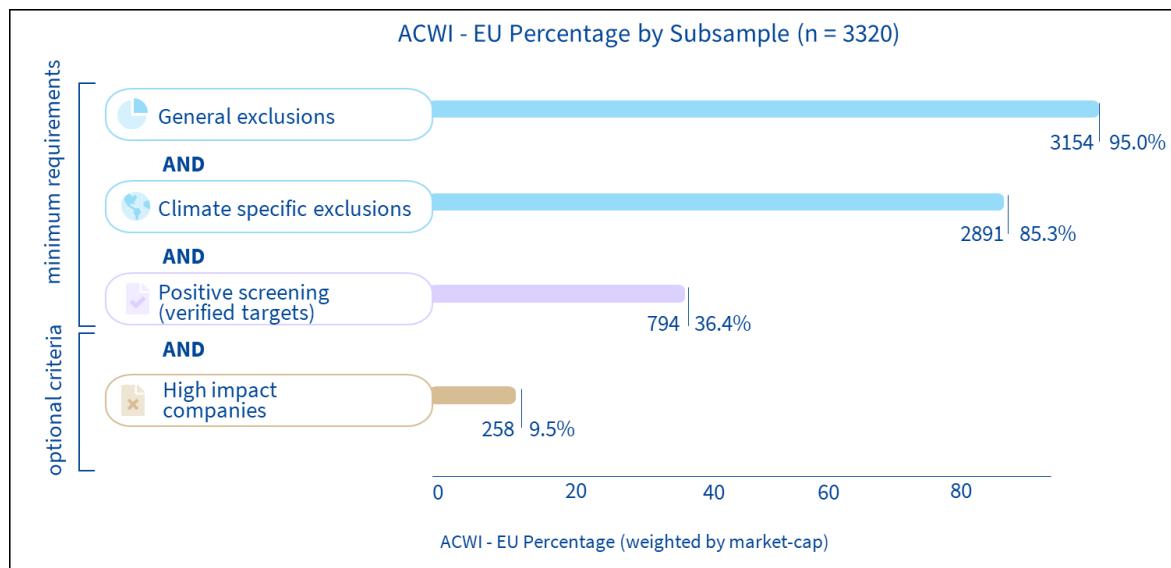
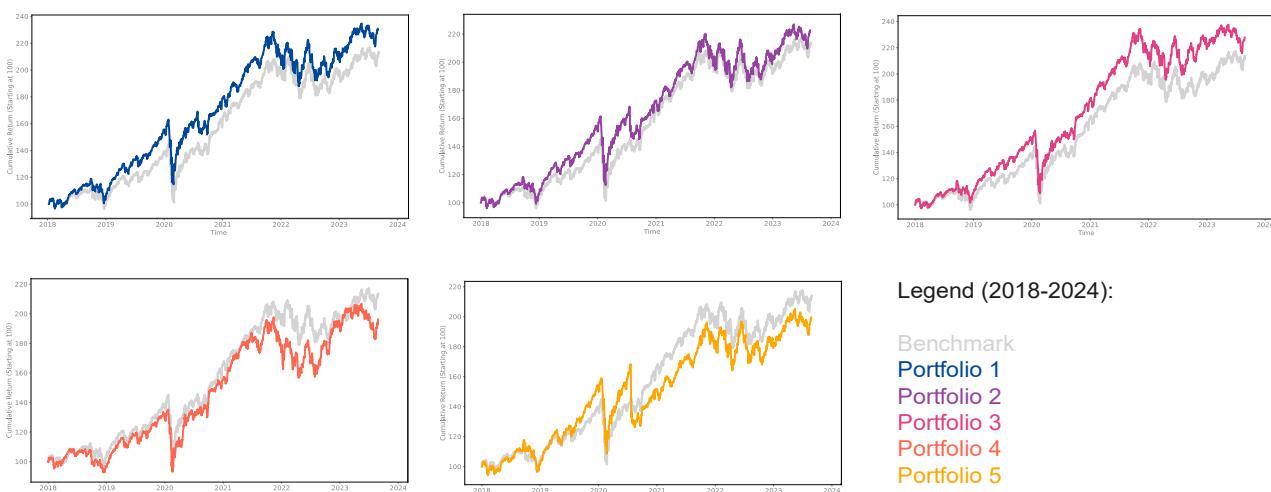


Figure 2 illustrates how the investable universe evolves as successive filters are applied. Starting from general and climate-specific exclusions, around 85 percent of market capitalisation remains - indicating that such exclusions are not overly restrictive for investors. Introducing positive transition criteria on top of it, such as verified science-based targets, reduces the investable share to about 35 percent, reflecting a more focused but still diversified universe that captures firms with credible decarbonisation pathways.

To assess financial feasibility, Figure 3 compares several hypothetical portfolio configurations using different combinations of the proposed criteria. The baseline setup (see Portfolio 1), which combines general and climate-specific exclusions with verified science-based targets, delivers competitive returns and volatility patterns compared to the benchmark over 2018–2024. However, as stricter criteria are added, the portfolios show less attractive return and volatility patterns, highlighting the trade-off between environmental ambition and financial diversification. This reveals a key policy insight: moderate minimum criteria can enhance credibility without compromising performance, but overly restrictive criteria risk shrinking the investable universe to the point where risk-adjusted returns suffer. Properly designed, such criteria can act as entry points - ensuring a baseline contribution to transition goals while allowing investors to pursue more ambitious strategies if desired.

Figure 3. Portfolio Configurations 1–5 – Constructing Transition Portfolios with Varying Stringency of Criteria



The figure shows cumulative returns for five simulated portfolio configurations (2018–2024), each applying increasingly stringent transition-related criteria. Portfolio 1 represents a less restrictive approach, while Portfolio 5 applies the strictest set of transition filters. For the exact portfolio configurations, see our White Paper.

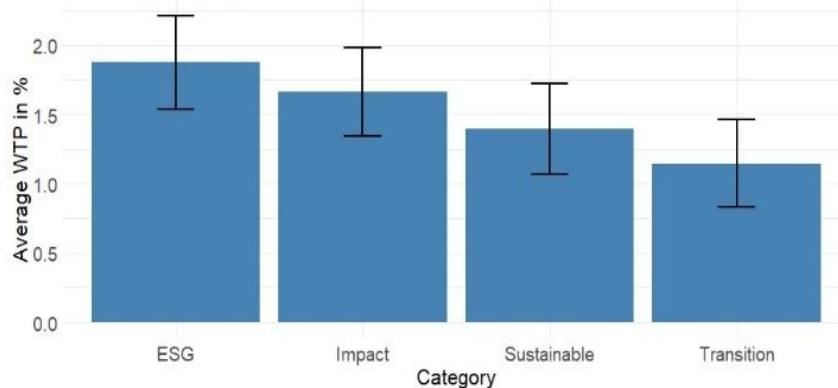
DEMAND – RETAIL INVESTOR PREFERENCES

Retail investors' perception and preferences regarding SFDR categories - Clear evidence that investors are heterogeneous and distinguish between differentiated categories if these are explained

A total of 300 retail investors from across the EU took part in the first experiment⁸. Each participant made four investment decisions involving funds that matched different sustainability categories. This allowed us to measure their willingness to pay (WTP) for these investments compared to a conventional fund. The survey was designed based on the categorisation proposed by the EU Platform on Sustainable Finance, with the addition of an Impact category. Furthermore, we made sure that the category descriptions were easy to understand and did not require a high level of financial sophistication. Figure 4 shows the average WTP for each of the four categories.

Figure 4 – Investors' willingness to pay (WTP) for SFDR Categories

WTP by Category



This figure displays the average fee investors are willing to pay for each investment category in the experiment, along with the corresponding standard errors.

The analysis of retail investors' behaviour reveals three key insights:

1. **Retail investors are highly heterogeneous in their behaviour regarding the different categories:** 20% consistently show a strong interest in sustainable products, expressing a willingness to pay a fee premium of more than 4 percentage points across all categories. Another 20% show no interest in any sustainability funds, regardless of the category. The remaining 60% exhibit differentiated interest across categories.
2. **Most investors differentiate meaningfully between different sustainability categories:** Among the 60% of retail investors showing interest in some but not all categories, we observe large and meaningful differences in the WTP for a sustainable investment. On average, the difference between the highest and lowest measured WTP for an individual amounts to a six percentage-point fee.
3. **There is interest among retail investors for all categories:** On average, the WTP for a sustainable investment is positive for all categories. Overall, traditional ESG investments are most preferred by investors, while transition-focused products receive the least interest on average by retail investors. Nevertheless, a large number of retail investors prefer transition products the most.

⁸ The experiment was conducted with 300 EU retail investors on Prolific in May 2025. Participation was restricted to individuals with prior stock investment experience, and each participant was compensated with £3. Ethical approval was granted by the German Association of Experimental Economic Research. Participants were asked to make four investment choices between a conventional fund and a sustainable fund. Each round, the sustainable fund was described as either an ESG, Sustainable, Transition, or Impact fund. The order was randomized for each participant. The descriptions followed the proposals of the EU Platform on Sustainable Finance; the Impact category was based on Busch et al. (2021). Willingness-to-pay (WTP) was elicited via multiple price lists, allowing for both positive and negative valuations.

Exclusion Criteria – What do retail investors care about?

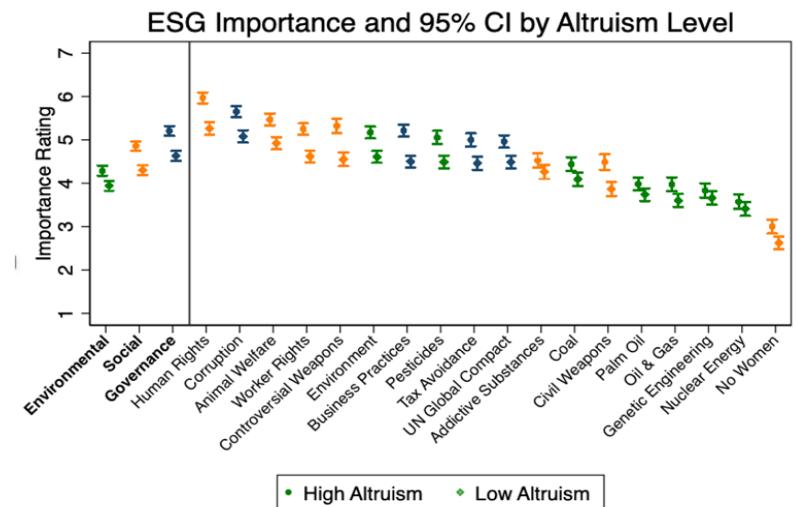
Current EU sustainable finance regulation, including the EU Climate Transition Benchmark (Art. 12, a-c, covering weapons, tobacco, and human rights violations), reflects a regulatory approach to defining exclusion criteria. However, limited evidence exists on whether these criteria align with retail investor preferences. Understanding this alignment is crucial for effective policy design and market adoption of sustainable investment products.

When retail investors state their investment preferences regarding ESG, this typically results in a single bundled response for the combined measure, with a focus on environmental sustainability. In a survey with more than 1,000 retail investors, we disaggregated ESG into 18 subcategories and asked investors to rate the importance of excluding each subcategory from their portfolios. Several key findings emerge from this analysis (for more details, see Fadavi et al., 2025, forthcoming as SAFE White Paper)

First, retail investors prioritise social and governance factors over environmental topics. When asked about the importance of excluding specific subcategories, both social and governance factors rank significantly higher than environmental factors. The five most important categories for exclusion are "Human Rights Violations," "Corruption," "Animal Welfare," "Workers Rights," and "Controversial Weapons." This difference manifests not only in average ratings but also in the distribution of responses. Topics like "Human Rights" and "Corruption" show strong consensus, with the vast majority of investors rating them as highly important. In contrast, environmental subcategories such as "Nuclear Energy," "Oil and Gas," "Genetic Engineering," and "Palm Oil" generate polarized responses, with nearly equal numbers of investors on both ends of the importance spectrum. This heterogeneity in environmental preferences appears to mirror broader societal debates about these technologies and practices.

These findings suggest that separating the "E" component from "S" and "G" in ESG ratings could better serve investor preferences. Social and governance criteria could form a core rating that appeals to the broad consensus among investors, while environmental criteria could be offered as modular add-ons for investors with specific environmental priorities. When asked to identify their single most important exclusion criterion, roughly 30% of investors selected "Human Rights Controversies," followed by approximately 10% each choosing "Animal Welfare" or "Corruption Controversies". Overall, investor preferences partially align with but significantly extend beyond current EU exclusion frameworks.

Figure 5 – Investors' willingness to pay (WTP) for SFDR Categories



The figure shows mean importance ratings (1-7 scale) from retail investors on excluding stocks based on specific ESG subcategories from their investments, by altruism level (high = dots, low = squares). The first three data points show averages for Environmental, Social, and Governance categories, followed by individual subcategories sorted by importance. Error bars show 95% confidence intervals. Social and Governance categories receive the highest average importance ratings, with high-altruism individuals consistently rating exclusion as more important than low-altruism individuals across nearly all ESG subcategories

Second, exclusion preferences correlate strongly with social preferences, particularly altruism. More altruistic individuals consistently assign higher importance to ESG exclusion criteria across all categories. Importantly, the relative ranking of categories remains similar across altruism levels—less altruistic investors simply assign lower absolute importance scores while maintaining the same prioritization. This correlation suggests that granular ESG ratings serve a specific investor segment: those with prosocial preferences who seek to align their investments with their values. While such ratings will not attract all retail investors, they provide a valuable tool for values-based investing for a meaningful subset of the market.

Third, experimental evidence confirms that granular ratings influence actual investment behaviour among altruistic investors. We provided participants with sustainability scores for their current holdings across the subcategories described above and tracked subsequent portfolio changes. On average, investors did not significantly adjust their holdings. However, investors with higher altruism scores systematically reallocated their portfolios toward more sustainable options. This demonstrates that when investors have access to subcategory-level information aligned with their personal priorities, those with specific social preferences actively use this information to adjust their investments. While not all investors respond to such ratings, a significant proportion of the retail market values and acts upon this granular information.