

ESMA TRV Risk Analysis

Sustainable Finance

# Emerging trends in transition fund strategies



#### ESMA Report on Trends, Risks and Vulnerabilities Risk Analysis

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# Emerging trends in transition fund strategies

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## Summary

New investment strategies have emerged that support an economy-wide climate transition and companies in transition. As the European Commission (EC) plans to review the Sustainable Finance Disclosure Regulation (SFDR), EU regulators have called for the creation of a transition product category<sup>2</sup>, where the focus is on investments in economic activities, assets or portfolios not yet sustainable but aiming to become sustainable over time. To understand emerging patterns in how actively managed investment funds define and implement climate transition investment strategies, we reviewed fund portfolio data and pre-contractual disclosures.

Our main findings include:

- Transition funds primarily define their ambition in terms of portfolio-level performance or exposure, which they sometimes complement with an ambition to foster real-economy outcomes. Most funds also translate their ambition into measurable, time-bound targets.
  - Positive screening of assets is informed by asset-level forward-looking data, in line with the EC definition<sup>3</sup> of transition investments, which refers to investments in activities expected to become aligned with the EU Taxonomy, and investments in companies or activities with credible transition plans or science-based targets.
  - Positive screening appears to rely on the use of ESG ratings, but the role of those ratings is not always clear, due to limited disclosures by fund managers on the products used or the underlying data and methodologies.
  - To set targets and monitor progress towards transition funds ambition, the metrics most often used relate to portfolio emissions and activity exposure.
  - Data shows that transition funds have distinctive portfolio composition features compared with other environmental and ESG funds. They focus on equity instruments from energy-intensive sectors and show greater exposure to companies with science-based targets or involved in climate solutions.
  - These characteristics suggest a more targeted and forward-looking investment approach, consistent with their widespread reliance on engagement with investees.
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<sup>1</sup> This article was authored by Guilain CALS, Dajana JATA, Julien MAZZACURATI and Federico PIAZZA.

<sup>2</sup> [Joint ESAs Opinion on SFDR](#).

<sup>3</sup> [Commission Recommendation \(EU\) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy](#).

## Introduction

With the mainstreaming and maturing of sustainable investing in Europe since 2020 new investment strategies have emerged. Some of these strategies specifically aim to support an economy-wide climate transition and companies in transition, as opposed to sectors and companies that are already predominantly engaged in “green” or low-emission activities.<sup>4</sup>

Outreach to industry participants and other stakeholders<sup>5</sup> suggests that actively managed investment funds with climate transition strategies (hereafter referred to as ‘transition funds’) generally rely on three main levers: positive screening, negative screening and engagement.<sup>6</sup> Positive screening of investments is usually based on an assessment of transition-readiness or exposure to certain activities (e.g. climate solutions or enabling activities). Assessing transition-readiness usually involves considering current emissions as well as forward-looking data regarding emission reduction targets, transition plans and ‘green’ capital expenditures (CapEx). Negative screening is done typically through exclusions tied to certain sectors or climate performance criteria. Engagement involves influencing companies’ ambition, plans and actions, via board nomination, dialogue with management, filing of shareholders resolutions or exercising voting rights, and escalation measures.<sup>7</sup>

Through these three levers, fund managers typically seek to align portfolio composition with climate-related objectives set at portfolio level. Beyond portfolio level objectives, managers may

also seek to achieve real economy outcome,<sup>8</sup> based on positive screening and engagement, thereby addressing concerns about ‘paper decarbonisation’.<sup>9</sup>

The EU regulatory framework already provides some tools for transition minded investors. EU Climate Benchmarks support portfolio level transition, especially for passively managed funds. Certain features of the EU sustainable finance framework help companies communicate their transition financing needs to investors. This is for instance the case of the EU Taxonomy, notably through disclosures about CapEx alignment, as well as the disclosures laid down in the current European Sustainability Reporting Standards (ESRS) as regard transition plans.<sup>10</sup>

Additionally, the EC published a recommendation to the market in 2023, including a definition of transition investments.<sup>11</sup> To harmonise naming practices and address concerns about greenwashing risks in the funds industry, ESMA issued Guidelines on ESG- and sustainability-related terms in funds names. The Guidelines require that funds using transition-related terms in their names apply exclusions and ensure that at least 80% of their investments are aligned with their sustainability characteristics or sustainable objectives and invest in assets that are on a clear and measurable path toward the transition.<sup>12</sup>

Yet, additional improvements would help to make sure the framework most effectively supports the financing of the climate transition.<sup>13</sup> Among such possible changes, the ESAs have called for the introduction of a classification system and the creation of a transition category for financial products under SFDR.<sup>14</sup> As the EC has

<sup>4</sup> MSCI (2024) and Goldman Sachs (2023).

<sup>5</sup> Between May and July 2025, ESMA convened a series of three workshops on transition finance, with a view to support ESMA and NCAs’ staff exposed to transition finance questions in their supervision or regulation work and to foster supervisory convergence in this nascent area. The workshops channelled insights from market participants and other stakeholders, regarding their current practices and experience.

<sup>6</sup> Climate & Company et al. (2024).

<sup>7</sup> CFA Institute et al. (2023). Such engagement activities may be implemented individually or as part of collective initiatives.

<sup>8</sup> In this analysis, real-economy outcome refers to measurable changes in environmental or social performance of specific assets (for instance, a reduction in the GHG emissions of an investee company), in contrast to a reduction of financed emissions through the transfer of ownership of carbon-intensive assets.

<sup>9</sup> Where funds achieve reduced “financed” emissions over time which does not represent actual emissions reduction by investees. By running attribution analyses, industry participants can track emission reductions driven by investees’ action versus reductions driven by portfolio reallocation or other factors, thereby assessing the extent to which real-economy outcome was achieved.

<sup>10</sup> See ESRS E1-1, and the related disclosure requirements and application requirements, laid down in Commission Delegated Regulation (EU) 2023/2772 as regards sustainability reporting standards. These are currently being reviewed.

<sup>11</sup> Transition investments are defined as including investments in Taxonomy-aligned economic activities, investments in undertakings or economic activities with a credible transition plan, and investments in undertakings or economic activities with credible science-based targets. See Commission Recommendation (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy.

<sup>12</sup> [ESMA Guidelines on funds’ names using ESG or sustainability-related terms](#). While the focus of this article is on climate transition, the Guidelines also cover funds that defined their investment strategies considering the transition to other environmental or social goals.

<sup>13</sup> [ESMA Opinion on the Sustainable Finance Framework](#)

<sup>14</sup> [Joint ESAs Opinion on SFDR](#). As further laid out in the JC Opinion, such a “category is expected to support investments that will help deliver on the ‘Fit for 55’ package, the EU commitment of climate neutrality by 2050 and the objective of limiting global warming to 1.5 degrees. The category could support progress towards other

announced it would soon review SFDR, this fact finding exercise aims to identify emerging patterns in how investment fund managers define and implement climate transition investment strategies, with a focus on actively managed funds, where the asset manager plays a direct role in investment choices.<sup>15</sup> Findings presented below are based on a detailed review of a sample of pre-contractual disclosures and the assessment of portfolio data.

## Methodology and sample

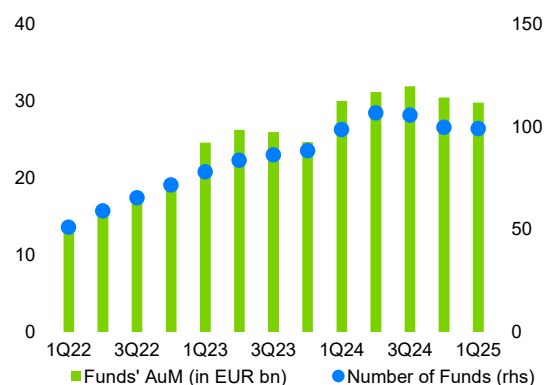
### Identification of transition funds

To identify transition funds, we implement a string-based textual analysis of fund names, applying the methodology developed in Amzallag et al. (2023). This approach involves scanning fund names for ESG-related expressions using a predefined list of words. Once the initial set of funds is established, we further refine the sample by isolating those funds that specifically include references to “transition” or climate transition-related terminology in their names.<sup>16</sup>

Applying this methodology to Morningstar’s universe of EU-domiciled investment funds<sup>17</sup> allows us to identify 220 transition funds that we assume to be representative of the transition funds market segment.<sup>18</sup> From this initial pool, we exclude funds passively tracking climate benchmarks (i.e. funds tracking EU climate benchmarks), as the objective of the analysis is to gain insights into the strategies of actively managed funds. This leaves us with a sample of 121 distinct actively managed transition funds. As of December 2024, these funds collectively managed approximately EUR 30 bn in assets under management (AuM), representing about 5% in AuM terms (up from around 2% as of January 2022) of the broader universe of 1,400

non-index funds using environmental-related words in their name (Chart 1).

Chart 1  
Number and assets of transition funds  
Transition fund segment grows



Note: Number of actively managed transition funds (RHS) and their AuM (EUR bn). Figures reflect funds with transition-related terms in their names in each quarter; the sample may vary as funds name might change over time.  
Sources: ESMA, Morningstar

### Pre-contractual disclosure review

To assess how transition funds articulate their sustainability ambition and investment strategies, we carry out a manual screening of SFDR pre-contractual disclosures for a sub-sample of the largest 42 actively managed funds. These funds are selected based on size, representing approximately 90% of the total AuM and around 30% of the total number of funds in our broader sample (see next page).<sup>19</sup> Each fund’s pre-contractual documentation is reviewed using a standardised question-based framework capturing transition-related data points about their transition-related ambition and investment strategy.

We aim to see how transition-related ambition is defined by fund managers and whether they are (1) related to portfolio exposure or to real-economy outcome and (2) translated into measurable, time-bound targets. We also assess to what extent investment strategies rely on the

environmental objectives, and if feasible also social objective.” This paper, however, focuses on transition investment strategies supporting the climate transition, recognising that the policy framework offers greater clarity for transition strategies focused on climate objectives and that market practices associated with climate objectives are more mature.

<sup>15</sup> Passive funds can also count as transition funds, based on the 2023 EC Recommendation which defines portfolios tracking EU Climate Benchmarks as transition investments. Such funds’ portfolios reflect the minimum standards applicable to EU Climate Benchmarks and defined in Commission Delegated Regulation (EU) 2020/1818.

<sup>16</sup> This second step builds on the criteria outlined in ESMA’s Guidelines on fund names using ESG or sustainability-related

terms. Transition-related terms encompass any terms derived from the word ‘transition’ (e.g. ‘transitioning’, ‘transitional’, etc.) and terms derived from ‘improve’, ‘progress’, ‘evolution’, ‘transformation’, ‘net-zero’, ‘decarbonisation’, ‘Paris-aligned’, etc. in all EU languages.

<sup>17</sup> The initial Morningstar sample comprised approximately 28,000 funds domiciled in Europe, 86% of which are UCITS funds.

<sup>18</sup> However, some funds with climate transition strategies may decide not to use transition-related terms in their names.

<sup>19</sup> This sub-sample comprises 25 funds disclosing under SFDR Article 8 and 17 disclosing under Article 9, as of April 2025.

use of asset-level forward-looking data and ESG ratings and scores for their approach to positive screening, as well as on engagement activities to deliver on transition-related ambition. Last, the exercise aims to identify which metrics are most used to set targets and to monitor progress.

### Portfolio analysis

To understand how transition funds invest, we conduct a portfolio-based analysis comparing the investment profiles of actively managed transition funds to those of other actively managed funds with other environmental or ESG words in their name.

The analysis uses monthly portfolio holdings data from Morningstar for both the 121 actively managed transition funds and a comparison group of roughly 1,400 funds using other environmental-related terms in their names and 3,500 funds using other ESG words in their names (identified using the same methodology but different keywords, all actively managed).

We structure our analysis using a fund-month level panel dataset and group funds into three different cohorts ('transition', 'E funds' and 'ESG funds'). For the assessment, our approach relies on a combination of descriptive statistics and regression model.<sup>20</sup>

To capture how transition funds differ from their peers, we examine different variables:

- **Energy intensity:** Percent share of portfolio invested in companies classified within Morningstar's *industrials* and *basic materials* sectors. These energy-intensive sectors are central to the transition given their share of economic activity globally and high emission intensity.<sup>21</sup>

- **SBTi:** Percent share of portfolio allocated to companies that have committed to or have approved targets under the Science-Based Targets initiative (SBTi).<sup>22</sup>
- **Climate action:** Percent share of portfolio invested in companies pursuing clean energy, emissions reduction, or climate adaptation strategies (Morningstar definition).

## Main findings

### Transition strategies

To effectively inform investment decisions, managers of transition funds set and disclose the ambition of the funds (i.e. in line with SFDR disclosure requirements, their sustainability characteristics or sustainable investment objectives), the investment strategy the funds will follow to deliver on their ambition, and the metrics used to monitor progress.<sup>23</sup>

To better understand how this is implemented in practice, we first examine how fund managers frame their transition ambition and to what extent the ambition is translated into measurable, time-bound targets. On that basis, we then analyse how investment strategies are designed to deliver on funds ambition, focusing on positive screening and engagement. Finally, we examine the set of metrics used to monitor progress towards the funds transition ambition.

### Transition ambition and target-setting

We first review fund disclosures to examine whether funds define their ambition in terms of portfolio-level performance (such as reduced portfolio financed emissions, minimum or increased exposure to green activities, average

<sup>20</sup> To do this, we estimate the following regression model:

$$\%Share_{i,t} = \beta_0 + \beta_1 \cdot Transition_i + \sum \beta_n \cdot Control_{i,t} + \delta_t + \varepsilon_{i,t}$$

where  $\%Share_{i,t}$  is the share of fund portfolio  $i$  in month  $t$  invested in one of the variables described further down,  $Transition_i$  is a binary variable equal to 1 for transition funds and 0 otherwise,  $Control_{i,t}$  includes time-varying fund-level controls (size, flows, asset allocation, annual returns, sector allocation, regional exposures, and country of domicile), and  $\delta_t$  captures time-fixed effects to control for market-wide factors or shocks affecting all funds in a given month. Standard errors are clustered at the fund level to account for serial correlation and heteroskedasticity in the residuals across time for each fund.

<sup>21</sup> 'Basic Materials' includes companies that manufacture chemicals, building materials and paper products. 'Industrials' includes companies that manufacture machinery and industrial products,

aerospace and defense firms, and transportation and logistics companies.

In the analysis we also tested the share of energy sector, separately and in combination with basic materials and industrials. The results were non-conclusive compared with ESG funds and showed that transition funds are relatively less invested in energy firms compared with other E funds – possibly reflecting the large and growing share of renewable energy supply in Europe.

<sup>22</sup> The SBTi is a non-governmental organisation that validates the greenhouse gas emissions reduction targets voluntarily submitted by companies in line with the Corporate Net Zero Standard. For further details on SBTi, see <https://sciencebasedtargets.org>. The Corporate Net Zero Standard is meant to provide a framework to set climate targets aligned with climate science. This is not a framework to demonstrate the completeness or credibility of transition plans.

<sup>23</sup> Busch et al. (2024a and 2024b).

portfolio ESG scores, etc.) or in terms of real economy outcome (such as actual emission reductions by investees).

The review shows that all transition funds primarily define their ambition in terms of portfolio exposure. This is sometimes complemented with the ambition to foster a real economy outcome (43%). None of the reviewed funds set their ambition solely in terms of a real economy outcome. Actual emission reductions by an investee can be driven by multiple factors many of which are outside fund managers' control (e.g. climate policy, changes in consumer preferences or behaviour, technological change, supply chain decarbonisation). In that context, engagement efforts can help move the needle in the right direction but cannot guarantee a positive outcome.<sup>24</sup> In addition, assessing the transition readiness of investees *ex ante* requires managers to build new expertise and data analysis capabilities, while dealing with high uncertainties and persisting data gaps. For those reasons, it appears risky for them to make promises about real economy outcomes. This dual approach (for instance set the ambition both in terms of financed emissions and investees' emissions) may reflect managers' efforts to address concerns about 'paper decarbonisation', while mitigating this risk of overpromising.

Based on the pre-contractual disclosures reviewed, it appears that most funds (62%) set their ambition in dynamic terms, aiming for a change over time, whether it is in terms of financed emissions, exposures to transition-related activities, or investees' own performance. On the other hand, 29% of funds set their ambition in non-dynamic terms, either because (1) they commit to a minimum share of AuM to be invested in certain types of assets or activities or (2) they commit to outperforming a specific benchmark in relation to a sustainability metric. For almost 10% of the funds, it was not clear whether the ambition is dynamic or not.

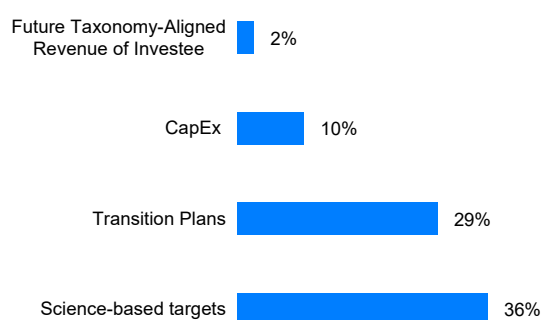
Going one step further, the review seeks to understand how a broad ambition can typically be translated into measurable, time bound targets using specific metrics. It appears that most funds (67%) translate their ambition into measurable targets. One common approach is to commit to a

7% year-on-year reduction of portfolio emissions, in line with the decarbonisation trajectory required from EU Climate Benchmarks (19% of funds in the sample). Finally, leaving aside funds whose objective is defined in static terms, most of the reviewed funds (69%) disclose a specific time horizon. Time horizons considered range from year-on-year trajectories to mid- and long-term targets up to 2050 – with 2030 or 2040 milestones sometimes disclosed. This variability in target setting practices may reflect diverging investors' expectations and managers' approaches. However, where the ambition is set in dynamic terms with no specific timeframe, this might raise concern whether the commitment is clear and about the fund's manager accountability.

### Positive screening

Positive screening at the asset selection stage appears to be a key lever for managers of transition funds. Depending on the type of target the managers have set, various criteria may be used in screening the assets. The analysis focused on the use of asset-level, forward-looking data – covering key features of climate mitigation transition plans (i.e. targets, CapEx, Taxonomy-aligned revenues) and transition plans themselves (Chart 2).

Chart 2  
Forward-looking data for positive screening  
A focus on SBTs, transition plans



Note: Share of EU transition funds mentioning the use of asset-level forward-looking data in their pre-contractual disclosures, based on a sample of 42 funds as of April 2025. 19% of the funds in the sample refer to more than one of the data points listed above.  
Sources: ESMA

Whether the ambition is set in terms of portfolio-level decarbonisation or real economy outcome, the use of asset-level, forward-looking data appears widespread. Indeed, 64% of funds

<sup>24</sup> AFM (2025).

explicitly mention the use of forward-looking data as criteria for positive screening, in their pre-contractual disclosures. Science based targets (SBTs) and transition plans are the two most common criteria, while CapEx and future Taxonomy-aligned revenue are used to a more limited extent. Forward-looking data is key to assessing the transition readiness of investees and inform views on the expected decarbonisation trajectory of the portfolio. This also reflects the alignment of some managers, with the definition of transition investments provided by the EC in its 2023 Recommendation. Where increasing the exposure to certain climate solutions is a key element of the strategies of transition funds, one would expect CapEx and future Taxonomy-aligned revenues to be key criteria for positive screening.

Funds that include SBTs as a criterion show higher portfolio exposure to companies with targets validated by the SBTi (50% average portfolio share vs. 42% for funds not mentioning SBTs), suggesting some degree of alignment between transition claims and portfolio investments.

In addition to asset-level data, transition fund managers commonly mention the use of ESG ratings and scores as part of their asset selection process. 81% of funds use internal ESG ratings and scores, and 48% incorporate external ones, either standalone or in combination. ESG ratings and scores developed internally are often described in broad, qualitative terms. For instance, several funds refer to Net Zero Investment Framework (NZIF) categories, but the level of details provided on the underlying data and methodology used to classify assets across those transition readiness categories does not allow for a direct comparison of the funds' approaches. Interestingly, a small subset of funds mention internal ratings, developed with a view to rate assets' transition readiness in terms of temperature alignment.<sup>25</sup> Where external ratings and scores are mentioned, few funds (18%) disclose the exact products they use and in most

cases the rating products mentioned do not appear to rate transition readiness.<sup>26</sup>

## Engagement

Engagement with investees (including investee companies, infrastructure fund managers, real estate asset managers, etc.) is another key lever for transition funds to achieve their objectives. Engagement is capacity intensive because it requires prior knowledge of an investee's business model and climate impact, and of how the sustainability transition affects the investee. Based on outreach to stakeholders and desk research, engagement typically involves targeting specific changes with defined milestones and success is measured with reference to these targets and milestones. It also includes escalation measures, potentially leading to the reduction of an equity position or even exclusion, where the expected change did not happen within a given timeframe.

Almost all funds reviewed (88%) mention engagement as part of their investment strategies in pre-contractual disclosures. Engagement activities are expected to focus on fostering emission reductions and adoption of SBTs and transition plans at investee level, within a specific timeframe that is in line with the ambition of the fund. Some managers may be able to provide advice on how to set credible, realistic targets and plans. Additional information is frequently made publicly available by fund managers on (1) engagement policies at entity level (via website disclosures) and (2) engagement activities taken at product level (via periodic reports). Recent analyses help identify some of the potential drivers of success for engagement efforts, such as focusing on a limited number of investees and themes, laying out credible threats of escalation where the desired actions are not implemented, and the coordination of action across investors.<sup>27</sup>

## Metrics used to monitor progress

Monitoring progress towards a fund's ambition (and any measurable target it has set) is

<sup>25</sup> These ratings refer to temperature alignment and seek to estimate the global warming outcome implied by investees projected GHG trajectory (combining historical emissions data with data about emission reductions targets and their credibility).

<sup>26</sup> Most products mentioned by fund managers (MSCI ESG Scores, MSCI Environmental Controversy scores, Sustainalytics Risk

Ratings) primarily assess a company's exposure to financially material ESG risks and its management of those risks.

<sup>27</sup> AFM (2025), Dimson et al. (2023). Focusing on a limited number of investees and themes allows to build deeper expertise and a stronger case for the proposed transition-related actions.

important to ensure accountability of the managers.<sup>28</sup> Given the variability in language and metrics used, we created a categorisation to bring consistency and clarity into the analysis (Table 1).

Table 1

## Fund disclosures on metrics

## Typology of transition-related metrics

| Category                            | Illustrative metrics                                                               |
|-------------------------------------|------------------------------------------------------------------------------------|
| A. Portfolio emissions              | Weighted Average Carbon Intensity, Absolute greenhouse gas (GHG) emissions         |
| B. Activity exposure                | Share of AuM invested in activities classified as green / enabling / in transition |
| C. Asset-level forward-looking data | Share of AuM with SBTs or transition plans, Minimum level of green CapEx           |
| D. Asset-level ratings and scores   | Share of AuM with minimum transition-readiness scoring (e.g. NZIF category).       |

## E. Counter-factuals Avoided GHG emissions

Note: Some of the metrics listed closely relate to Principal Adverse Impact (PAI) indicators under [SFDR DR Annex I](#). For instance, portfolio emissions metrics relate to PAI indicators 1 to 3 and 15, covering Scope 1 and 2 GHG emissions, carbon footprint, and GHG intensity of investee companies. With regard to activity exposure metrics, PAI indicator 4 on exposure to fossil fuels is somewhat relevant although it focuses on harmful activities rather than green ones. In addition, SFDR DR Annex I identifies as additional adverse impact indicator the share of investments in investee companies without carbon emission reduction initiatives, which relates to SBTs and transition plans adoption.

As shown in Chart 3, the most used metrics are about portfolio emissions (76%) and activity-based exposure (55%). Both can serve to monitor progress in terms of portfolio-level performance, based on various metrics. The widespread use of portfolio emission metrics reflects the prevalence of portfolio-level decarbonisation objectives in transition strategies. While the achievement of real economy change at investee-level can contribute to improved portfolio-level performance, an attribution analysis is necessary to disentangle the effect of investee-level change from other factors, such as reallocation of capital.

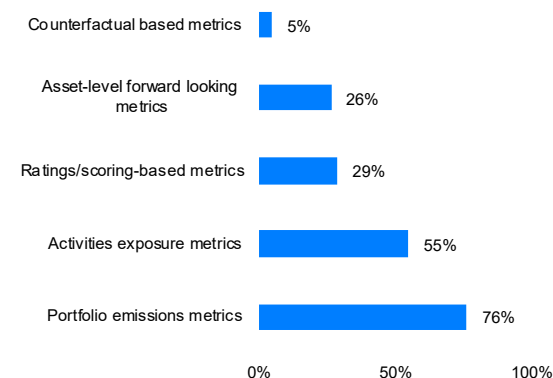
The use of metrics related to asset-level ESG ratings and scores (29%) or asset-level forward-looking data (26%) is more limited in relation to target setting and progress monitoring. This information helps measure transition readiness at asset-level and provide a tool to improve the likelihood that real economy decarbonisation is achieved for a given portfolio. The reliance on asset-level, forward-looking data appears to

confirm that some fund managers have adopted practices in line with the definition of transition investments provided by the EC in its Recommendation of 2023.

Chart 3

## Share of metric type used by funds

## Portfolio emissions most popular metrics



Note: This analysis is based on the review of a sub-sample of 42 funds. Metric types reflect the underlying indicators used by funds to set targets: portfolio emissions (e.g. GHG emissions or carbon intensity), activities exposure (e.g. green or enabling investments), forward-looking alignment (e.g. science-based targets or CapEx thresholds), ESG ratings-based thresholds (e.g. NZIF categorisation), and counterfactuals (e.g. avoided emissions).  
Sources: ESMA

Forward-looking data and ESG ratings can be used by fund managers to identify transition leaders. However, ratings methodology and criteria relevant for forward-looking data should depend on the sector of the investee companies. Activity based metrics and ESG ratings and scores can be used to positively screen for climate solution leaders. Climate solutions are products and services developed to tackle climate change specific issues and may include a broad range of activities (including e.g. carbon capture technologies, data products, innovative adaptation solutions, etc.).

## Portfolio composition analysis

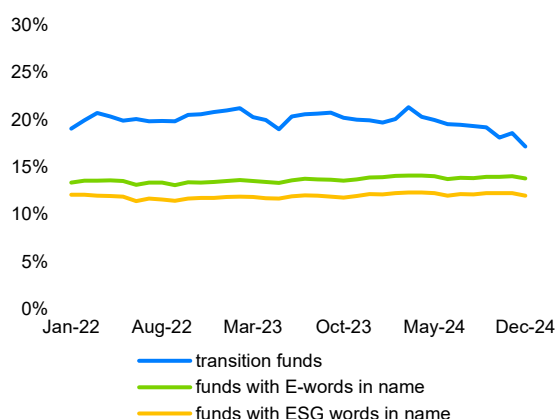
The evidence gathered from fund disclosures helps assess whether the investment allocations of transition funds align with their stated objectives, screening criteria, and engagement practices, and whether they differ from broader categories of funds featuring 'E' or 'ESG' terms in their names. In this respect, we observe that transition funds invest a higher share of their portfolios in energy intensive sectors (basic materials and industrials) – on average five to ten percentage points more compared to funds with ESG language in their name (Chart 4), and four

<sup>28</sup> We did not review indicators used in some cases to track progress regarding the means deployed by fund managers (e.g. the share of investees that are "engaged" by the managers).

percentage points more when controlling for other factors. (see Annex for the regression table). The higher allocation suggests a more targeted approach toward sectors critical for decarbonisation and where transition strategies are most needed. It is also consistent with the emphasis on forward-looking indicators, which are more relevant in high emission, hard to abate sectors.

Chart 4

#### Portfolio share of energy-intensive assets Focus on hard to abate sectors

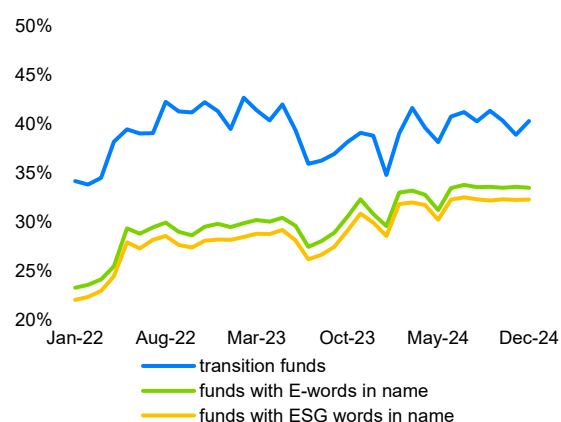


Note: Average monthly relative exposure to energy-intensive assets  
Sources: ESMA, Morningstar

Confirming the relative focus on climate solutions, the portfolio analysis shows that transition funds indeed allocate 5 to 6 percentage points more of their portfolios to companies identified by Morningstar as contributing to climate action, compared with other E/ESG-named funds. This includes firms involved in clean energy, emissions mitigation, and climate adaptation (Chart 5). This suggests that positive screening strategies focused on identifying climate solution leaders are more reflected in actual capital allocation.

Chart 5

#### Portfolio share of climate solution firms Investments in climate solution leaders

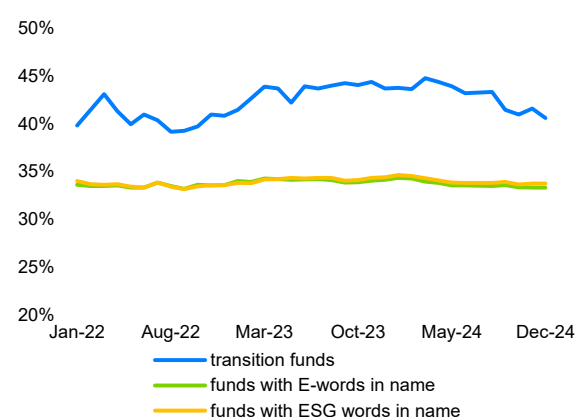


Note: Average monthly relative exposure to climate action-aligned assets  
Sources: ESMA, Morningstar

Transition funds also show higher alignment with SBT frameworks, investing on average, 3 percentage points more in companies with SBTs compared to other funds using E/ESG funds in their names (Chart 6). This confirms a slightly higher emphasis on investments in firms with climate transition plans that are considered credible and verifiable by certain sources and indicates that transition funds may be more forward-looking in their investment approach.

Chart 6

#### Portfolio share of science-based targets Transition funds seek reduction targets



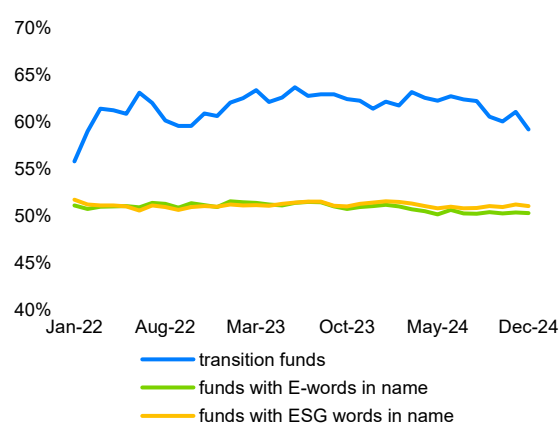
Note: Average monthly relative exposure to assets with science-based targets  
Sources: ESMA, SBTi, Morningstar

Finally, transition funds invest between 60% to 65% of their portfolio in equity instruments, compared with around 50% for other E/ESG-named funds (Chart 7). Conversely, transition funds tend to be less invested than ESG and E

funds in green bonds, despite the role these instruments can play in the financing of credible transition plans and green CapEx.

This higher equity exposure is partly explained by the composition of the sample: approximately 55% of transition funds in the dataset are classified as equity funds by Morningstar, compared with 47% for both funds with E- and ESG-related words. Nonetheless, the tilt towards equities is notable given that equity holdings typically offer greater opportunities for active ownership and engagement. As outlined in the previous section, engagement is a central pillar of many transition strategies, with fund managers aiming to influence investee behaviour. The portfolio tilt toward equities therefore appears consistent with the engagement-based approach disclosed by most transition funds.

Chart 7  
Portfolio share of equity instruments  
Transition funds invest more in equity



Note: Average monthly relative exposure to equity  
Sources: ESMA, SBTi, Morningstar

## Conclusions

While the transition funds segment is emerging and practices are still evolving, our analysis outlines a few key trends in transition fund investment strategies and metrics.

The review of pre-contractual disclosures shows that transition funds primarily define their ambition in terms of portfolio-level performance or exposure, which they sometimes complement with an ambition to foster real-economy outcomes. Most funds also translate their ambition into measurable, time-bound targets.

Positive screening of assets is informed by asset-level forward-looking data and generally reflects alignment with the EC definition of transition investments (e.g. including references to investments in activities expected to become aligned with the EU Taxonomy, and investments in companies or activities with credible transition plans or SBTs). Positive screening also appears to rely on the use of ESG ratings and scores, but the role of these ratings in transition strategies is not always clear, due to limited disclosures by fund managers on the products used or the underlying data and methodologies. Portfolio data confirms that managers allocate relatively higher fundings towards companies that disclose forward-looking data (i.e. SBTs) or demonstrate being involved in climate solutions.

To set targets and monitor progress towards transition funds ambition, the metrics most often used by fund managers measure portfolio emissions and activity exposure. In contrast, less than a third of funds use metrics informed by asset-level ESG ratings or asset-level forward-looking data.

Finally, the analysis of data on fund portfolio holdings shows that transition funds have distinctive portfolio composition features compared with other environmental and ESG funds. Especially their focus on equity instruments from energy-intensive sectors which is consistent with the fact that they almost unanimously claim to rely on engagement.

The findings of this analysis may help inform supervisory expectations about how fund managers define and implement their climate transition investment strategies. Despite persistent data challenges and uncertainties with respect to forward-looking data, fund managers have a responsibility to provide fair, clear and not misleading information to their clients. This research offers a factual basis that could also support the EC's broader thinking around the development of a potential transition products category in the context of the SFDR review. In particular, the observed use of asset-level, forward-looking data and sectoral focus on hard-to-abate industries may contribute to shaping a clearer understanding of how transition objectives are defined and operationalised by fund managers in practice.

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# Annex

Table A

## Full regression results

|                           | Climate Action Aligned Assets |                      | Energy Intensive Assets |                   | SBTi Assets          |                      |
|---------------------------|-------------------------------|----------------------|-------------------------|-------------------|----------------------|----------------------|
|                           | vs. ESG Funds                 | vs. E Funds          | vs. ESG Funds           | vs. E Funds       | vs. ESG Funds        | vs. E Funds          |
| Transition Funds          | 0.0566***<br>(0.015)          | 0.0521***<br>(0.016) | 0.0403***<br>(0.013)    | 0.0165<br>(0.014) | 0.0289***<br>(0.008) | 0.0335***<br>(0.011) |
| <b>Control Variables</b>  |                               |                      |                         |                   |                      |                      |
| Fund Size                 | 0.012***<br>(0.003)           | 0.013***<br>(0.004)  | 0.001<br>(0.002)        | 0.000<br>(0.003)  | -0.002<br>(0.001)    | -0.002<br>(0.002)    |
| Fund Flows                | 0.003<br>(0.002)              | 0.004<br>(0.003)     | 0.001<br>(0.002)        | 0.001<br>(0.002)  | 0.000<br>(0.001)     | 0.001<br>(0.001)     |
| Return                    | 0.001<br>(0.000)              | 0.001<br>(0.001)     | 0.000<br>(0.000)        | 0.000<br>(0.000)  | 0.000<br>(0.000)     | 0.000<br>(0.000)     |
| Equity Share              | -0.007***<br>(0.002)          | -0.007***<br>(0.002) | 0.003*<br>(0.002)       | 0.002<br>(0.002)  | 0.002<br>(0.001)     | 0.002<br>(0.001)     |
| Fund Domicile Dummies     | Y                             | Y                    | Y                       | Y                 | Y                    | Y                    |
| Fund Type dummies         | Y                             | Y                    | Y                       | Y                 | Y                    | Y                    |
| Sector shares of assets   | Y                             | Y                    | Y                       | Y                 | Y                    | Y                    |
| Regional shares of assets | Y                             | Y                    | Y                       | Y                 | Y                    | Y                    |
| Time Fixed Effects        | Y                             | Y                    | Y                       | Y                 | Y                    | Y                    |

Note: Estimated coefficients and standard errors from an OLS panel regression evaluating the relationship between transition fund classification and asset exposures. The dependent variable denotes the monthly portfolio share of fund *i* invested in a given asset category. The main independent variable, *Transition fund*, is a binary indicator equal to 1 for transition-labelled funds. Control variables include time-varying fund-level characteristics: fund size (as logarithm of fund size), monthly flows (as % of fund size), annual return, equity share, regional exposures, sector allocations, and country of domicile. Time fixed effects are included to control for month-specific shocks. Observations are at the fund-month level. Standard errors are clustered at the fund level so to account for serial correlation and heteroskedasticity. For robustness, alternative specifications have been estimated, including a beta regression model and specifications with alternative sets of dummy variables for fund categories. \*\*\*, \*\*, and \* indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

