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BAI REPRESENTING ALTERNATIVE INVESTMENTS

CALL FOR EVIDENCE FOR AN IMPACT ASSESSMENT ON THE SUSTAINABLE FINANCE DISCLOSURES REGULATION (SFDR)

Position Paper of the Bundesverband Alternative Investments e.V. (BAI)

Summary of BAI's main petita:

(I) Importance and regulatory treatment of alternative investments/private markets, and especially infrastructure, under the SFDR

- The importance of private maket asset classes such as infrastructure, real estate, private equity and private debt for the transformation and transition of the European economy, their importance in the portfolio of institutional investors and their suitability for impact investing should be recognized and mirrored within the SFDR.
- The regulatory treatment of private markets, especially infrastructure, should be improved and be adequate to the (most illiquid) nature of the assets.
- An own PAI category for infrastructure should be introduced, PAIs should be concentrated on the most important aspects, and in any case, SFDR reporting should be aligned with the CSRD.

(II) Simplifying disclosures and (PAI) Reporting/PAI Statement

- The scope of KPIs should be reduced or, at least, many datapoints should be moved from mandatory PAI category to the additional PAI category.
- BAI advocates for more flexibility and distinction between retail and professional investors regarding regulatory reporting, e.g. exemptions for professional investors (regarding disclosure requirements and formats).
- Alignment of reporting under the SFDR with the (amended) CSRD in the respective versions of Omnibus I and II should be ensured. The scope of KPIs should be reduced to those identified as material under (amended) CSRD/ESRS.
- Methodologies should be consistent between Art. 8 Taxonomy Delegated Act, SFDR PAI Statement and CSRD/ESRS in the respective versions of Omnibus I and II.
- Provide explicit mathematical formulas/guidance for each KPI to reduce ambiguity.
- Require the provision of eligibility ratios and coverage ratios for each PAI alongside with the PAI.

(III) BAI supports the PSF's proposals on fund categories, but advocates their voluntary nature and a focus on simplified, transparent requirements with clear minimum standards aiming for a comprehensible, practibale and trustworthy SFDR regime that enables sustainable innovation and prevents greenwashing.

(IV) BAI opposes to the introduction of a stricter definition of "sustainable investment" and asks for opening clauses similar to Art. 9(3) for decarbonization to cover strategies for transition, transformation or impact.

(V) **Impact Investing should be regnocized within EU's Sustainable Finance framework** to establish a minimum baseline for impact investing by defining key principles and qualifying criteria based on existing standards.

I. General remarks from the perspective of the alternative investments industry

1. (Underestimated) importance of alternative investments/private markets

SMEs are the backbone of the European (and German) economy, accounting for around two thirds of economic output, but also for a correspondingly high proportion of greenhouse gas emissions. The necessary transformation of the economy ("grey to green") requires enormous investments, which should help companies, SMEs, to produce more energy-efficiently, switch their production to non-fossil energy sources and develop new business models. **This requires private capital, for example in the form of private equity and/or private debt.**

Enormous sums are also required for the energy transition, the expansion of wind and solar power plants, hydrogen production and (battery) storage capacities, etc. **An enormous number of BAI members are active in this area and provide such capacities through AIFs with the capital of institutional investors, whether equity-financed or debt-financed (infrastructure equity/infrastructure debt).**

In addition to transport and the manufacturing industry, the building stock and the construction industry are known to be responsible for a high proportion of emissions. Energy-efficient refurbishment of existing buildings, energy efficiency measures, etc. ("brown to green") also require enormous sums of money to improve the energy balance and reduce greenhouse gas emissions. **The capital for this often also comes from AIFs with a focus on real estate/real estate (real estate equity/real estate debt).**

Infrastructure, private equity/private debt and real estate are traditionally the most important asset classes in the field of alternative investments. These are typically illiquid in nature.

2. (Inappropriate) treatment of alternative asset classes/private markets by the SFDR and sustainable finance regulation as a whole

Despite the enormous importance of these asset classes for the transformation/transition and the necessary financing outlined above, sustainable finance regulation rarely suits to the characteristics and specifics of the (illiquid) asset classes, and the challenges are different. **Infrastructure as an asset class, for example, is not mentioned at all in the SFDR**, which the BAI had criticized from the outset (and was only confirmed in the PAI statements; see also hereinafter 3.). The regulation appears to be primarily tailored to typical liquid investments such as equity funds and thus misses important parts of the economy and its financing.

- There is regularly **no ESG data for illiquid assets** that can be acquired from one of the well-known data providers. If the availability and reliability of ESG data is already low, this problem is exacerbated in the case of alternatives. It should be that legislators, regulators and supervisors had always held out the prospect of better data availability through the CSRD and ESAP, for example. The fund industry generally shared this view, but was nevertheless required by the SFDR to report data that portfolio companies were not yet required to report. Accordingly, Omnibus I and II are not necessarily helpful from the SFDR and fund industry perspective. PAI data for alternative investments is based to a large extent on approximations, estimates, etc., which will not and cannot change in the foreseeable future.
- The **nature of illiquid asset classes** is geared towards the long term, which is why the structures are usually **closed-ended funds**. Accordingly, unlike with liquid assets, a portfolio cannot be put together/built up, adjusted or liquidated in a matter of seconds on each trading day. The set-up/rump

up and liquidation phases of closed-ended funds therefore require special regulations, for example with regard to any threshold values (which may only be reached after a three- to five-year set-up phase), the question of the frequency of valuations (there are no price values at the touch of a button), etc. This is outlined using the example of an infrastructure fund:

  - **The asset class is enormously diverse**, which is why any excessive standardization is misguided and a one size fits all approach does not fit.
  - Regulation is a particular challenge because it often negates the **complexity and uniqueness of the asset class** (PAIs must be calculated using the investee companies KPIs, which in practice results in an exercise that makes little sense, for example by having to calculate the gender pay gap ratio of a wind turbine).
  - The regulatory framework does not reflect the **very different development stages of infrastructure projects**, from development to construction to the operating phase and end-of-life management. The regulatory framework generally sets requirements based on reporting dates, for example with regard to threshold values.
  - The **high upfront investments** before returns are generated and the **high capital investments** are not covered either by regulation (the point of time reference is problematic, too).
  - Infrastructure is characterized by a **variety of financing options** (debt, equity, (EU) green bonds, etc.).

- **The structures of alternative asset classes/illiquid asset classes and real assets often differ significantly from traditional/liquid asset classes.** Real estate and infrastructure projects are often held or financed by special purpose vehicles (SPVs) for a variety of reasons. These reasons can be the separation of projects in SPVs, liability shielding for individual projects, but also the better transferability of shares in SPVs compared to transfers of ownership of real assets.

We believe that a certain degree of flexibility in the application of the SFDR would be helpful for (alternative) asset managers to take into account the many different investment strategies and asset classes that alternative asset managers pursue or in which they invest in. Only in this way the intention of the SFDR to reorient capital flows towards sustainable finance in order to finance the transition to a net zero economy can be achieved. **The SFDR should be an enabling regulation and not a regulatory obstacle.**

The BAI has pointed out to the EU Commission and the ESAs on various occasions that the infrastructure asset class in particular, which is so important for transition, transformation and (green) energy production, is not adequately covered by the regulatory framework. The following is a brief outline of the specific challenges and problems, primarily with regard to Principle Adverse Impacts or PAIs.

3. In particular: PAIs and alternative investments

For the BAI and its member companies, PAIs are a core element of sustainability concepts and one of the central instruments for the standardized measurement of negative impacts on the environment and society. They are also important for risk management. **However, the SFDR Delegated Regulation only recognizes three categories of PAIs, each with a number of mandatory and additional PAI KPIs: for Sovereigns & Supranationals, for Real Estate and for Investee Companies. The treatment of infrastructure is not regulated separately, which raises a number of application issues.** Just a brief outline of what is at stake: Do you apply the KPIs for real estate to infrastructure because it is also a real asset? Or the KPIs for investee companies because infrastructure is usually held via SPVs, i.e., companies? **It should be emphasized that both or even more variants are somehow "feasible" in a technical sense; the question is, however, what makes sense in order to meet the objectives of the SFDR.** The SPVs are regularly "shells" with possibly one or two formally appointed directors because this is required by law. Collecting KPIs for these investee companies defeats the purpose of capturing the real and main negative impacts of an investment, because this "shell" has no staff, for example, which is why practically all social PAI indicators are collected and measured without meaning or purpose.

When reviewing of the SFDR, the following points should therefore be considered with regard to the PAIs:

- Alignment of reporting under the SFDR with the (amended) CSRD in the respective versions of Omnibus I and II.

  As outlined at the beginning under 2., the BAI and probably the entire fund and financial sector believe that the cart has been put before the horse. FMPs under the SFDR can basically only report data if it is available or supplied by portfolio companies (the real economy), otherwise it has to be laboriously collected individually or rather estimated (proxies etc.). The BAI is not fundamentally opposed to simplifications in the context of CSRD reporting, but the reporting obligations under the SFDR should also be harmonized for FMPs. **The SFDR review should reflect the new, reduced requirements of the CSRD in terms of scope and data points.**

- Fewer PAIs/Concentrating on the most important aspects

BAI is supporting BaFin's point of view ("Time to make things simpler and more effective"[1]) on concentrating on the most important aspects (i.e., in our view, the Principal Adverse Impacts):

> *"[...]*
> ***Concentrating on the most important aspects***
> *Second, companies should be required to disclose less, but at the same time essential and (more) meaningful information. The principal adverse impact (PAI) statement is a good example. Financial market participants with more than 500 employees must specify in this report how they take account of the negative impacts of their investment decisions on sustainability factors.*
>
> *That is a good thing in principle. But does the report really need to encompass 18 mandatory – and two voluntary – indicators, with six of them addressing the area of greenhouse gas emissions? In this case, less would be more. Six legally mandatory indicators addressing the most important aspects of sustainability would suffice.*
>
> *For example: information on greenhouse gas emissions, biodiversity and respect for human rights. And these indicators, too, should be based on the specific requirements of existing regulatory frameworks such as the Corporate Sustainability Reporting Directive (CSRD) (Directive (EU) 2022/2464)."*

A few meaningful PAIs – primarily related with the climate change – and well-collected PAIs will have more impact than a large number of less or more poorly collected/collectable PAIs. **Against this background, the BAI positioned against the introduction of four additional social PAI KPIs as part of the ESMA consultation on amending the Delegated Regulation on the SFDR in summer 2023.**

[1] Cf. BaFin - Current topics - Time to make things simpler and more effective from 26 August 2024.

II. Disclosures (cf. already I.3. above)

1. Appropriate scope of disclosures

The type, number, form and granularity of the SFDR disclosure requirements have failed and continue to fail to achieve the intended objectives of the SFDR. Private investors tend to be overwhelmed by the existing disclosure requirements and are exposed to a counteracting information overload, while institutional investors in turn do not need templates of the prescribed type and rigidity.

In principle, a small amount of meaningful information would be more effective, especially in the retail sector. In the environmental sector, for example, a few KPIs on CO2 or biodiversity would already be meaningful, while other appropriate (social) KPIs would also be welcome for thematic funds.
This core set of PAIs would be mandatory; significantly more PAIs than before would be voluntary and could be selected and adapted depending on the strategy and asset class. Voluntary does not mean arbitrary, but the (voluntary) PAIs relevant (in the meaning of the really Principle Adverse Impacts) to a fund must always be selected. However, significantly greater flexibility and more leeway would be appropriate.

The current disclosure requirements (especially the PAI statements) are, in their granularity, more suited to institutional investors, who would and could do ESG reporting (or PAI reporting) even without regulatory requirements. But whether they are actually helpful for private investors when making decisions is questionable.

Overall, a stronger focus on the materiality of the KPIs would be desirable. After all, these are key performance indicators or Principal Adverse Impacts. **With regard to the PAIs, synchronization with the materiality provision according to the CSRD/ESRS (in the respective versions of Omnibus I and II) should be introduced in any case: Only PAI indicators that are material under ESRS should be considered material under SFDR.** We therefore advocate, in line with the EU Commission's aim to "streamline and reduce disclosure requirements", homing in on "essential information for investors", for reducing the scope of KPIs to those really used / provided by the industry and / or identified as material under CSRD. Alternatively, if the amount of KPIs should not be changed especially because various market participants already have processes in place to collect those datapoints, at least many datapoints could be removed from mandatory PAI category to the additional category.

At present, most BAI members do not consider PAI reporting at company/entity level in accordance with Art. 4 SFDR to be expedient and the majority are of the opinion that these disclosure requirements should rather be deleted. The focus should be on PAI reporting at product or fund level. Granularity is more important here than consolidation; the portfolio level is more meaningful than the company level.

2. Distinction between retail and professional investors with regard to the scope of disclosures requirements

Although the degree of sustainability of a financial product/fund does not depend on the type of investor, it is generally true that institutional investors have little to no need for regulatory disclosure requirements. On the other hand, institutional investors are far more likely to be in a position to (also) process and evaluate extensive information and, if necessary, integrate it into their own systems/reporting obligations.

It would be appropriate to differentiate between different types of investors (i.e. retail investors vs.

professional investors) and adapt the disclosure requirements accordingly. A fundamental principle of EU financial services regulation is that disclosure requirements should be tailored to the information needs of the (respective) end investors. The distinction between the disclosure requirements for funds open to retail investors and those open only to professional investors (as defined in the AIFMD) is widely recognized in existing EU legislation. This distinction can also be found in the AIFMD and UCITS Directive.

If a fund only has professional investors, it would be more appropriate to take a more flexible approach rather than requiring, for instance, the use of templates that are not always suitable for all asset classes or meet the information needs of professional investors – certainly not in the alternatives sector. The professional investors who invest in our members' funds regularly speak directly with fund managers to discuss the investor's sustainability preferences or objectives in detail to ensure that a fund's strategy is aligned with the investor's objectives. Professional investors often have their own sustainability preferences or objectives and, unlike retail investors, they are able to engage directly with potential or existing fund managers to ensure that the professional investor is investing in products that align with their ESG preferences. We therefore believe that pre-contractual and periodic disclosure requirements for products aimed exclusively at professional investors should be revised, as we do not believe that mandatory templates are required for such products. This would help to reduce the administrative burden and costs and make the information more relevant to the target audience.

In terms of volume, a much greater condensation of information would be helpful for retail investors. This could possibly be done of ESG scales, categories or labels. These are debatable alternatives to the existing templates.

3. Exemptions for professional investors

In cases where the information on the website is only aimed at a professional audience, it would be beneficial if it did not need to be translated into other languages and was only available in English. This would help to reduce the administrative burden and costs and increase relevance for the target audience.

4. Simplifying disclosures (PAI indicators, DNSH criteria)/PAI Statements

- **The collection and calculation of PAI indicators poses considerable problems for our members from the world of alternative investment funds, especially for illiquid asset classes, as described at the beginning in our general remarks. This is particularly the case if data is not available, or if the data is limited, or if a PAI indicator is not relevant for all asset classes. We generally believe that a greater degree of flexibility in the PAI indicators would be helpful to ensure that relevant indicators are reported – they should be Principal Adverse Indicators. It would be helpful if the PAIs were applied on the basis of the materiality of the indicators.** In our view, PAI indicators should only be required to be reported if they are relevant and material to the company's activities. We believe a focus on a few highly meaningful indicators, primarily the climate-related KPIs, would be more important than having a large number of KPIs "somehow" covered.

- **Under all circumstances, consistency and coherence with the CSRD/ESRS (in the respective versions of Omnibus I and II) should be established with regard to the PAI indicators. If a PAI KPI is classified as not material for the purposes of the ESRS, this should also apply without further ado for the purposes of the SFDR. Although this opinion seems to have already been**

accepted by the European authorities, we would like to emphasize this point once again.

- Make sure **methodologies are consistent** between Art. 8 Taxonomy DA, SFDR PAI Statement and CSRD / ESRS. Currently there are inconsistencies such as different valuation basis (regulatory / accounting balance sheet CSRD vs. adjusted market values SFDR), point of time (year end for Taxonomy / CSRD vs. average of at least 4 quarters under SFDR), derivatives treatment (netting for SFDR, gross for Taxonomy and CSRD). We recommend using the year end observation based on the accounting basis used in the financial statement to avoid inconsistencies and unnecessary calculations.

- Provide explicit **mathematical formulas / guidance** for each KPI. Currently, SFDR leaves a lot of room for interpretation (e.g., denominator with / without covered / uncovered assets, treatment of derivatives and cash in the denominator) etc. due to vague, not sufficiently concrete formulas. Explicit formulas are required to reduce ambiguity.

- In terms of **quantitative disclosures**, we note the increasing use of a "coverage" metric that reflects the proportion of a fund's underlying portfolio for data relating to a particular PAI indicator. This approach deserves support. Thus, if data is not available for a particular PAI indicator, asset managers should not be required to disclose that indicator and instead disclose the coverage metric, in line with the SFDR's idea of transparency.

- We therefore require the provision of **eligibility ratios and coverage ratios** for each PAI alongside the PAI. The experience with data collection via EETs and liquid service providers as well as reporting of data gaps in PAI statements shows that the disclosed PAI values are difficult to be used if there is no information about which % was supposed to report (eligibility ratio) and which % did actually report (coverage ratio). Eligibility ratio should be defined as eligible assets / total assets incl. bank deposits and derivatives. Coverage ratio should be defined as covered assets / total assets incl. bank deposits and derivatives.

- With regard to the **type, location and sequence of disclosure obligations**, it should also be the case that these should be harmonized: The same indicators should be disclosed in the same way, in the same order etc. in pre-contractual information, on homepages and in periodic reports. We therefore see potential for improvement, particularly in terms of presentation and standardization. We also see potential for improvement with regard to standardized reporting and the possibility of enabling machine readability or processing with a focus on mandatory indicators in particular. The industry standard European ESG Template (EET) or our own BAI ESG Template offers a good and useful template for this.

III. SFDR Fund Product Categories

1. Need for a fund categorization system (?)

Regarding the (need for a) potential introduction of a fund categorization system, the starting point is that the SFDR is used as a de facto label by parts of the market, as the European Supervisory Authorities and the EU Commission itself have also noted several times. This also shows the need for some sort of categories or label, mostly, but not only by retail investors. The reviewed SFDR should therefore reconcile the basic idea of transparency/disclosures with market practice.

BAI generally supports in this regards the proposals of the Platform on Sustainable Finance (PSF) for the introduction of clear fund categories within the framework of the SFDR. At the same time, the BAI advocates that allocation to these categories should be on a voluntary basis. The main focus of the SFDR should continue to be on transparent but significantly simplified disclosure requirements. The current "charm" of the SFDR with its provisions on Artt. 8 and 9 lies in its great flexibility, which in turn fits in well with the various investment strategies, especially in the alternative investment sector (taking into account all detailed criticism, see before).

Key points of BAI's position:

- **Voluntary** fund categories:
  The introduction of fund categories such as "Sustainable", "Transition" and possibly "ESG Focus" can increase comparability and comprehensibility for investors. However, allocation to these categories should be voluntary in order to do justice to the diversity of investment strategies and asset classes (cf. our introductory remarks with regard to alternative investments under I.) and not create barriers to innovation.
- **Simplified disclosure requirements**:
  Disclosure requirements should be fundamentally streamlined and reduced to a few, clearly understandable and objectively measurable indicators (cf. II.). This facilitates implementation for market participants and makes the information comprehensible for investors.
- Protection against greenwashing:
  Objective minimum criteria must apply to funds that voluntarily assign themselves to a category. This is the only way to strengthen confidence in sustainable products and effectively prevent greenwashing.
- Regulatory coherence:
  SFDR categories and disclosure requirements should be aligned with existing and planned European regulations (e.g., MiFID II, IDD, Taxonomy; CSRD/ESRS; cf. I. and II.) to avoid double regulation and contradictory requirements
- **Focus on transparency**:
  Although we acknowledge that the signaling effect of "labels" is huge, especially in retail sales (examples of this include credit ratings, scorings, scales, TÜV certificates, etc. These also seem to be a need of the industry, especially for retail investors, but in some cases also for institutional investors), BAI continues to see disclosure and transparency as the key instrument for promoting sustainable investments and protecting investors. The introduction of SFDR fund categories must not lead to pure "labeling", but must always be linked to clear disclosure obligations and minimum standards.

In sum, BAI supports the PSF proposals on fund categories, but advocates their voluntary nature and a focus on simplified, transparent disclosure requirements with clear minimum standards. The aim is a comprehensible, practicable and trustworthy SFDR regime that enables innovation and prevents greenwashing.

2. Thresholds to create product categories based on hard/measurable criteria?

Thresholds are problematic, especially for illiquid asset classes with generally closed-end fund structures due to the set-up phase of a fund vehicle. However, illiquid asset classes (primarily real estate/ infrastructure/private equity) are essential, especially for transformation issues ("brown to green", "grey to green"). The need for thresholds is understandable (for instance, a "sustainable" fund category might require a minimum share of truly sustainable, i.e. Taxonomy-aligned investments), but a pragmatic solution should be found for the specifics of closed-ended structures for the investment and divestment phase, whereby thresholds do not have the same significance.

The deal pipeline of an AIF is often not as predictable (blind pool) as one of liquid asset classes, and in some cases opportunistic. Deals are also not equally predictable in terms of time (long due diligences, contract negotiations, complexity, etc.).

We are therefore critical of the introduction of thresholds – at the very least, these would have to be adapted to the specifics and characteristics of illiquid asset classes and their structuring.

IV. „Sustainable investments“, transition and transformation

The current definition of “sustainable investments” in Art. 2(17) SFDR is broad and therefore offers the necessary leeway and flexibility for very different sustainability strategies. Accordingly, a definition that is too detailed contains the risk of inflexibility and rigidity, although we know hat a realistic scenario is “targeted changes and clarifications to the existing disclosures” and that the Commission itself acknowledges a “lack of legal clarity on key terms” as a core problem identified by stakeholders.

In our opinion, it is crucial that the EU Commission retains the flexibility for companies to develop their own approaches to the key concepts of the SFDR. This includes the question of what constitutes a "sustainable investment". The SFDR does not prescribe a specific approach to determine the contribution of an investment to environmental or social objectives. Financial market participants must disclose the methodology they have used in carrying out their assessment of sustainable investments, including how they have determined the contribution of the investments to environmental or social objectives, how the investments do not materially harm any of these lines (DNSH) and how the companies invested in fulfil the requirements of a 'good governance' requirement.

We believe this is the right approach as this general definition of 'sustainable investment' allows for flexibility and is broad enough to cover a wide range of asset classes. Asset managers should be able to set their own targets and disclose their approach in a transparent manner to end investors. This flexibility is particularly helpful for the alternative investment industry as it allows investment managers to develop customized approaches that apply to the asset class in question.

The BAI is therefore opposed to the introduction of a stricter definition of "sustainable investment". Whilst we understand that there is a need for clarification in some areas, introducing a more restrictive definition of "sustainable investment" would likely limit the market and the development of funds. In particular, we believe that the definition of "sustainable investment" should not be defined solely by reference to the EU Taxonomy, as the EU Taxonomy only covers selected economic activities. The broader definition in the SFDR compared to the Taxonomy allows for a variety of strategies, especially sustainable strategies with a social focus.

Having said that, there is nevertheless a rather high level of legal uncertainty with strategies such as transition, transformation financing and impact. However, this could be achieved through opening clauses similar to Art. 9(3) for decarbonization without changing the definition as a whole.

Given the political intention and objective of the SFDR to channel capital into sustainable assets, it seems necessary to us to consider the inclusion of transformation and transition in Article 9 funds, or in new categories, respectively. Particularly in the case of transformation, assets will not have "green" or sustainable characteristics from day one, but will only develop in this direction over time. For real estate funds that focus on development or “brown to green strategies”, it is just as difficult to develop a framework that easily falls under Art. 8, let alone Art. 9, even if at the end of the investment period the entire portfolio may consist of sustainable properties, as it is for a private equity fund that has adopted transformation as its investment strategy.

The EU Commission's Q&As suggest that a transition plan alone is not sufficient for an investment to be considered sustainable. However, transition plans that are credible and verifiable (e.g., by aligning with the Paris Agreement targets or publishing regular progress reports on decarbonization and/or science-based targets) can play an important role in supporting the transformation. It would therefore be helpful if the EU Commission were to recognize in the fundamental revision of the SFDR that transition investments (if, for example, transition investments are supported by credible and verifiable transition plans) can be considered sustainable investments.

The same applies to the requirement of "good governance" in connection with transition assets. The SFDR requires "good governance" to be in place at the time of investment, but it would be helpful to have some flexibility to apply the good governance test after the time of investment. This is important, for example, in fund strategies for distressed debt. The manager of such funds wants to improve good governance in such companies, but this requires a certain amount of time.

V. Recognition of Impact Investing in the EU Sustainable Finance framework and how this could look like

Impact investing is central to achieving policy goals across Europe since the impact lens is essential to understanding and driving change to solve current problems. Impact investing can rely on a long-standing market practice and converging voluntary standards but it lacks recognition in the SFDR framework. Moreover, certain concepts under SFDR (e.g., DNSH for sustainable investments) have led to challenges for impact investors and impact managers. Regulators have difficulties recognizing impact investing as valid sustainable investing strategy due to their difficulties or lack of understanding coupled with their focus on combatting greenwashing practices. At the same time, managers and investors taking first steps into impact investing struggle to identify the right framework which can serve as basis for these first steps.

The initiative aims to establish non-binding guidance (ideally issued / endorsed by the EU Commission) creating a "safe space" for impact investing to grow in Europe, with managers and investors having something to rely on when they reconcile impact investing with their regulatory and fiduciary obligations. By being non-binding, the guidelines are sufficiently flexible to adapt to emerging practices and permit a broad range of possible strategies. At the same time, they are aligned with the EU Commission's simplification agenda since they do not create an additional regulatory burden. In detail, such non-binding guidelines should:

- Establish a joint minimum baseline for impact investing in Europe by defining key principles and qualifying criteria;
- Provide managers and investors with a clear reference framework based on existing standards permitting first steps into impact investing; and
- Support regulators and policymakers in better understanding the fundamentals of impact investing as a global concept.

As Europe strives to balance economic competitiveness with sustainability goals, impact investing stands out as a key mechanism for driving positive change. We therefore petition the EU Commission to recognize impact investing as a concept in a non-binding recommendation to create a "safe space" for the further development of the impact investing market in Europe.

Below is a graphic overview of the principles and criteria that might form the minimum baseline for impact investing in Europe.

Principle	Qualifying criteria
1. Intentionality	1.1. Strategic impact objective 1.2. Impact thesis 1.3. Impact targets
2. Measurability	2.1 Asset contribution 2.2 Investor contribution 2.3 Impact KPIs and measurement process
3. Impact Management	3.1 Asset allocation 3.2 Managing impact performance 3.3 Managing negative impacts 3.4 Engagement
4. Reporting	4.1 Impact reporting

Please find attached our proposal „Why impact investing should be recognized in the EU Sustainable Finance framework and how this could look like – Enabling the impact investing market in the EU and supporting market growth, innovation, and competition" which forms an integral part of this position paper.

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The **Bundesverband Alternative Investments e.V. (BAI)** is the cross-asset and cross-product lobby association for the alternative investment industry in Germany and we consider ourselves as a catalyzer between professional German investors and suppliers of alternative investment products worldwide. The overarching goal is that German institutional and professional investors must be able to diversify their investment with regard to alternatives better and more easily. The BAI is promoting a broad diversification which includes alternative investments as indispensable, in particular in terms of safeguarding long-term retirement pensions and the provision of money for construction, maintenance, and development of public infrastructure and renewable energies.
BAI members are recruited from all areas of the alternative investments' industry, e.g., AIF managers and banks as well as service providers. At present, the BAI counts over 300 national and international member companies and is growing continuously.