



A REALITY CHECK ON ESG

ANALYSIS OF THE SIZE, GROWTH & PENETRATION OF SUSTAINABLE FINANCE ACTIVITY IN GLOBAL MARKETS

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By Christopher Breen, Matilda Hames, and James Thornhill

In partnership with:



> This is our third report that measures the penetration of ESG in different sectors of banking and finance around the world. The report analyses the public commitment of firms to ESG initiatives, and the value of ESG activity in different sectors, in the context of a wider 'anti-ESG' backlash over the past few years. It shows that while ESG in Europe is resilient, the most severe effects of the backlash are being felt in the US and Asia-Pacific.

INTRODUCTION

The state of ESG in banking and finance

In the 20 years since the term 'ESG' was first used to describe a framework to incorporate environmental, social, and governance issues in investing, ESG has grown to become an important part of banking and finance and now covers more than \$30 trillion in assets across banking, asset management, insurance, and pensions.

But today ESG is at a pivotal moment. The new administration in the US has launched a full-frontal assault on the core principles of ESG. Financial services firms appear to be spooked by this 'anti-ESG' politicisation. And regulators in Europe are undertaking a 'simplification' effort to streamline complex sustainable finance regulation and seem to be suggesting that ESG may be conflicting with wider goals on global competitiveness and economic growth.

It would not be unreasonable to think that ESG is in deep trouble. That is why we are publishing this 'reality check' on ESG. It builds on our previous analysis from 2023 that benchmarked ESG in banking and finance. Our new analysis shows that while the public commitment to ESG has declined globally, European firms remain more committed than their peers in other corners of the world. And while the hard value of ESG financial activity is down from its peak in 2021, the overall growth over the past six years is strong and the market has proved surprisingly resilient in the past few years.

That said, the labelled loan market appears to be stagnating, and the sustainable fund market (which has grown exponentially since 2019) is seeing outflows globally. But ESG and sustainable finance remain an important part of the overall financial markets. Europe continues to lead on ESG, providing the region with an important competitive advantage in the capital markets.

This report shows how financial firms are implementing their ESG commitments and outlines what a more 'sustainable' framework for ESG could look like. It offers some directional questions for policymakers and other ESG stakeholders, and asks how can we ensure that the underlying principles behind sustainable finance and ESG remain an important part of the financial industry in the years to come - even if ESG as a standalone sector recedes.

We hope this research provides relevant insights and we are always interested in your thoughts and questions. I would like to thank Matilda Hames and James Thornhill for collecting and analysing much of the data that underpins this report, Maximilian Bierbaum and William Wright for their support and feedback, Dealogic, S&P Global Intelligence, and Morningstar for providing access to their data, and Luxembourg for Finance for once again partnering with New Financial on this important project.

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EXECUTIVE SUMMARY

Here is a short summary of the report:

1. **A challenging environment:** in this report we outline the challenges facing ESG and sustainable finance in the context of a wider 'anti-ESG' backlash over the past few years. Those challenges include political uncertainty; complex regulatory frameworks; and tensions around the financial industry's fiduciary duty.
2. **A decline in commitment:** the public commitment to ESG by financial services firms has declined since we last measured it in 2022. The regions with the greatest declines have been the US (-30%) and APAC (-20%). In Europe, the number of firms committed to at least one ESG initiative has dropped by 4%.
3. **A resilient bond market:** although the labelled bond market is below its 2021 peak in terms of value, it is up from where it was in 2019. The value of labelled ESG bond issuance has increased by more than \$600bn in real terms from 2019 to 2024. In Europe, labelled ESG bond issuance makes up 13% of total European bond activity.
4. **Europe's competitive advantage?** Europe maintains its leadership on ESG and other long-term, non-financial issues. It is the only area of the capital markets where Europe is a global leader. But European policymakers are performing a delicate balancing act in simplifying rules in order to boost economic growth while ensuring that guardrails for Europe's sustainability objectives still exist.
5. **A political problem:** the new US administration has been behind much of the 'anti-ESG' rhetoric in recent months, but even before it took office the share of ESG capital markets activity originating from or taking place in the US was relatively small. ESG will run into problems when it does not play a bigger role in the largest capital markets worldwide.
6. **Too green?** A common criticism of ESG is that it is too much about environmental issues. This can best be seen in the labelled bond market, where nearly two-thirds of labelled financing is green bonds. While 'green' does need more financing (decarbonisation is very capital intensive), the fact that the 'S' and the 'G' receive less attention can undermine a more nuanced understanding of long-term issues.
7. **Not enough 'good':** companies that progress, rather than delay, ESG goals (such as solar farms or social housing providers) receive significantly lower financing on the capital markets than their conventional peers. Only 4% of capital markets activity globally is going towards these 'good' companies. For every dollar that was raised by a 'good' company in 2024, \$24 went toward 'business as usual' companies.
8. **Little engagement:** financial firms, despite their often well-intended commitments to ESG, are not engaging enough with their portfolio members to set carbon emissions targets. Our analysis shows that less than half of the asset management industry is engaging with companies to set targets, while pensions and insurance companies are even further behind.
9. **A silver lining?** While ESG finds itself in a difficult place, the story isn't all bad. The value of the assets of sustainable funds globally is larger than they have ever been, while public commitment to ESG initiatives is still higher than it was than when we first measured it in 2019.
10. **A more 'sustainable' framework:** to ensure that ESG remains an important part of the financial markets, policymakers and other ESG stakeholders need to rethink what a focus on non-financial issues really means. They could rework the concept of fiduciary duty; develop a financial system centred on the longer term; and work on a more nuanced narrative that shows how far ESG has come and what it has achieved.

ESG at a crossroads



ESG considerations have played an increasingly important role in global finance over the past two decades. Today, however, it stands at a crossroads. The environment surrounding ESG has shifted markedly, both in terms of market commitment and political positioning, and the future trajectory of sustainable finance is less certain than it appeared a short while ago.

This report seeks to provide a clear view of where ESG currently stands in financial markets, informed by public commitments, regulatory developments, and trends in real-economy financing. It does so at a time when jurisdictions are taking noticeably different approaches. In the United States, political headwinds have led to a retreat from sustainability-related policies. In the Asia-Pacific region, despite a correction, markets appear to be stabilising and maturing - reflecting a phase of consolidation rather than reduced commitment, with regulatory adoption progressing at a more measured pace. In contrast, the European Union has undertaken a simplification of its regulatory framework, aimed not at reversal, but at recalibration, recognising the need to align sustainability goals more effectively with wider objectives for competitiveness, productivity, and growth.

This report does not seek to provide definitive conclusions. Rather, it offers a foundation for informed discussion - bringing together market data, regulatory context, and institutional perspectives to clarify the state of play. The focus is not only on where ESG stands today, but on the strategic questions that continue to shape its future: what must be preserved, where reform is needed, how ESG can remain relevant and resilient in an evolving financial landscape, and how it can continue to align with the fiduciary duty that financial institutions hold towards their clients.

As the debate around ESG continues to intensify, Europe is well-positioned to set the tone and direction. With deep-rooted policy engagement, significant capital allocation, and a track record of innovation, the region has both the tools and the responsibility to lead the next phase of sustainable finance. Having spent a lot of time over the past months travelling to different parts of the world, I can confirm that other regions remain not only committed to achieving a more sustainable economy, but also expect Europe to continue to show leadership. Ensuring that leadership is sustained, and matched by credibility and effectiveness, will require pragmatism, clarity, and commitment.

This publication is intended as a contribution to that process. As the conversation evolves, it is important not to lose sight of the long-term principles that underpin both sustainability and sustainable finance. We remain committed to continuing to monitor developments in this space in the years ahead. Our thanks go to the team at New Financial for their continued collaboration and thoughtful analysis.

Tom Théobald

Chief Executive Officer
Luxembourg for Finance

THE CHALLENGES FACING ESG FINANCE (I)

Why is it time for a reality check on the state of ESG?

ESG is facing challenges, criticisms, and opportunities. ESG and sustainable finance have become an important part of the capital markets, but there is now a lot of noise around the relevance of ESG today, and around how (and if) the financial services industry should use the framework in the future. Before we zoom in on the change in the levels of commitment to ESG by market participants and the development of the 'hard value' of ESG finance, here are 10 broad challenges and trends that have emerged in ESG and sustainable finance over the past few years:

1. **A politicised acronym:** from an 'anti-DEI' discourse (mainly fuelled by the new US administration) to policies that pause or even reverse decarbonisation initiatives, ESG has become for some in both business and policy a bit of a bogeyman. The politicisation of ESG risks investors turning away from it, leads to less predictability with rules and attitudes changing rapidly, and can cause global fragmentation between different regions. While less than 5% of our sample of firms leaving ESG initiatives publicly admitted that this was due to the now politicised state of ESG, we assume that the political debate around it has had an impact on many more firms, making it more difficult for them to use the framework.
2. **Overburdensome and inconsistent regulation:** one of the main problems that has emerged around ESG and sustainable finance is a complicated and overburdensome regulatory regime. The series of regulations and rules that were designed to prevent greenwashing and incentivise sustainable investment are now weighing down on the private sector. In trying to tackle this now complicated regime, policymakers are taking different approaches. The EU is trying to streamline and simplify rules through its omnibus package; the US government has stopped defending its climate disclosure rule in the courts and is even developing 'anti-DEI' regulations; and regulators in the Asia-Pacific region are deferring to the standards set by the International Sustainability Standards Board (ISSB). ESG might soon have a simpler but globally more fragmented framework which in turn generates its own challenges. Much of the growth in renewables, workforce initiatives, and improvements to governance have occurred under the auspices of the 'old' regime. If this 'new' regime only covers a much smaller sub-section of the economy, then there's a risk that the growth we have seen over the past years could stall or even decline.
3. **A question of fiduciary duty:** a significant concern for the financial industry is that by considering and addressing non-financial matters in their investment decisions, it is potentially conflicting with its fiduciary duty to generate the highest returns for its clients. This conflict is based on two assumptions: that investing that incorporates ESG principles does not generate as good a return as 'regular' investing; and that even if ESG investing did generate higher returns, it would be irrelevant because factoring in non-financial matters is not material to financial returns. Part of this problem is related to how some policymakers view the role of the financial industry when it comes to long-term public policy goals. Much of the financial industry views itself as enablers, rather than drivers, of sustainable finance. Governments or regulators that shift the burden on financial institutions to generate significant capital flows to finance these goals will continue to be disappointed if the current understanding of fiduciary duty remains.
4. **A question of economic growth:** for Europe, in particular, ESG and sustainable finance are a major part of its competitiveness agenda. Decarbonisation is one of the EU's three 'core areas for action' in its competitiveness strategy, and the transition to net zero features alongside competitiveness when it comes to boosting innovation and growth. At the same time, European policymakers are performing a delicate balancing act in simplifying regulation to boost growth (see: FCA and PRA, the two main financial regulators in the UK, dropping their initially planned rules for diversity and inclusion in financial services firms) while ensuring that guardrails for long-term principles and the incorporation of non-financial matters in investment decisions still exist. In Europe, the main challenge for ESG then is and will be balancing ESG and sustainability with competitiveness and economic growth.

THE CHALLENGES FACING ESG FINANCE (II)

5. **The unbundling of ESG:** in the last few years, the financial industry has started to view each strain of ESG as a separate stream of work, with a tendency to 'unbundle' the acronym and consider issues more around physical risk. The problem that comes with this unbundling is that one of the strains ends up getting more attention than the other. The strain that has received the most attention historically has been the 'E' in ESG, and it's uncertain whether the unbundling will lead to the 'S' and 'G' getting more attention or simply being forgotten altogether. If, in this unbundling process, the focus is simply on the 'E', then there's a risk that policies to address environmental risk will disregard issues around governance, or around the workplace and the wider society.
6. **A problem of short-termism:** when ESG activity stagnates or declines there's an impulse to blame financial firms for not choosing the 'long-term' (and therefore the 'good'). This impulse assumes that financial firms exist to advance certain long-term policy goals such as the transition to net zero or digital inclusion, while financial firms see themselves more as enablers rather than drivers of ESG priorities. The problem with ESG then is that its long-term goals are not well integrated into the short-term nature of the financial markets. And even when there is integration, such as in the case of labelled bonds or sustainable funds, it can be the case that these instruments are just mirroring capital flows in the larger capital market ecosystem rather than encouraging investment into sustainable companies and projects.
7. **Sustainability vs. transition:** the emergence of 'transition' finance has created confusion about what makes a company 'sustainable'. In a more general understanding of 'sustainability', a company can manage its own internal risks to ensure that it can persist through changes in the economic, regulatory, and geopolitical environment. In the 'transition' understanding of 'sustainability', a company can only be 'sustainable' if it outlines how and when it will achieve certain objectives. In the 'transition' understanding, financial firms play a much more active role toward ensuring that their portfolios achieve certain objectives. In the general understanding, financial firms focus more on engagement rather than tying their specific financing to certain society-wide goals.
8. **A shift in priorities:** developments in recent years have brought unique challenges to the world that have forced many governments and firms to put ESG on the backburner. From the Russian invasion of Ukraine to an energy and cost-of-living crisis that has further strained governments' fiscal constraints, ESG and sustainable finance have either been relegated to a lower priority or have been discussed as a means toward addressing typically non-ESG related issues such as defence. A danger then has emerged that ESG is being viewed as a means of policy, rather than as a long-term investment principle.
9. **A lack of supply:** while much of the conversation around ESG's problems has been focused on the demand (or lack of it) for sustainable products and companies, less attention is being paid to problems around supply. The problem of supply is particularly salient for companies that fall within the 'S' or 'G' category: it is much easier to find and invest in a major company with a good DEI policy than an actual social enterprise (such as a housing association) that aims to advance an ESG initiative. And there is no clear taxonomy around what a good 'G' company or project is.
10. **The true meaning of 'ESG':** driving the politicisation of ESG and the increasing confusion around sustainable finance regulation is a question around purpose. If the purpose of sustainability is to ensure that companies manage their ESG risks well, then any company could be a 'good' ESG company. But if the purpose of ESG is to finance companies that explicitly advance ESG goals, such as a social enterprise that addresses food insecurity, then only a select group of companies can be considered 'good'. Resolving the contradiction between these two different ideas of ESG will be key to its success and will ensure that sustainable finance remains an important part of the capital markets.

HOW HAS THE PUBLIC COMMITMENT TO ESG CHANGED?

A shift in commitment

The public commitment (or signing up) to ESG initiatives by financial firms across the world has decreased in recent years. This decline has been driven by companies in APAC and the US, while Europe and the rest of the world remain relatively committed.

To measure the public commitment to ESG, we cross-checked a sample of the largest financial firms in the world with the list of signatories to various ESG initiatives (such as the Net Zero Asset Owner Alliance or UNPRI) and analysed how many firms are signed up to at least one initiative.

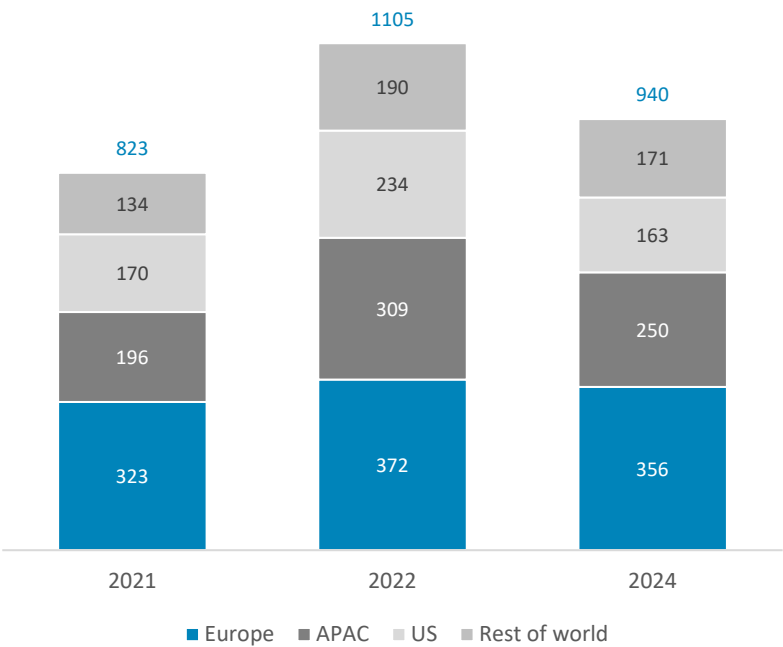
The number of publicly committed companies has decreased in every region that we look at, but the size of the fall differs from region to region. Fig. I i) shows that from 2022 to 2024, there was a 14% (165 companies) decline globally in the number of financial firms committed to at least one ESG initiative. More than 40% of that decline can be explained by US firms leaving these initiatives, while more than a third was driven by firms from the APAC region.

Europe has maintained the highest and most consistent levels of commitment. Fig. I ii) highlights the disparity between Europe and global trends, with more than three quarters of European financial firms still committed to at least one ESG initiative. Given Europe's strengths in ESG and the importance of sustainability to the continent's competitiveness objectives it is promising to see these consistent levels of commitment.

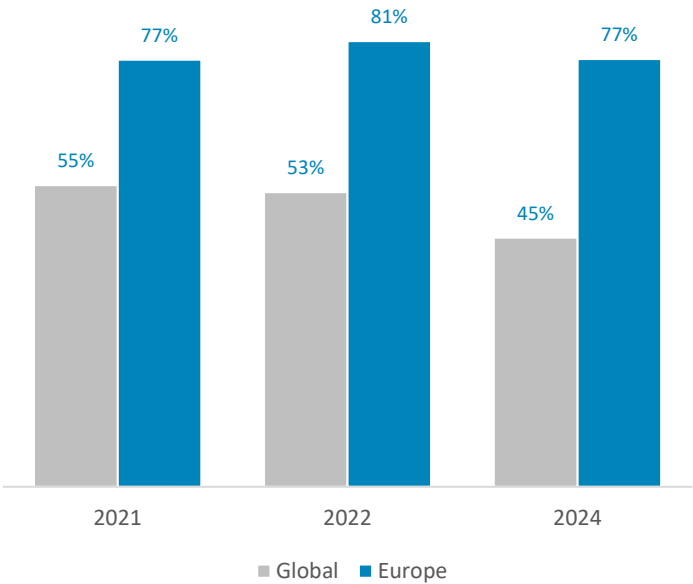
There are different ways to view this shift in commitment. One view is that financial firms have outgrown these initiatives and are now advancing ESG goals on their own. Another view is that the politicisation of ESG - along with global fragmentation in the approach toward sustainability - has made firms less willing to publicly commit to sustainability.

Fig. I What does the public commitment to ESG look like?

i) The change in the number of major financial institutions (from asset management, insurance, pensions, and banking) signed up to at least one ESG initiative, by region (from 2021 to 2024)*



ii) The share of major financial institutions, for Europe and globally, that are signed up to at least one ESG initiative (from 2021 to 2024)



Source: New Financial analysis of signatory data from various initiatives
* Europe includes EU, the UK, Norway, Iceland, and Switzerland

HOW HAS THE HARD VALUE OF ESG FINANCE CHANGED?

A nuanced picture

Despite a sharp decline in activity in 2022, the hard value of ESG financial activity in the capital markets has proved surprisingly resilient since then.

We measure the hard value of ESG activity in two ways: by analysing the total value of labelled issuance across the debt and the equity capital markets in real terms, and by calculating the share of the overall capital markets financing that we can clearly identify as ESG activity.

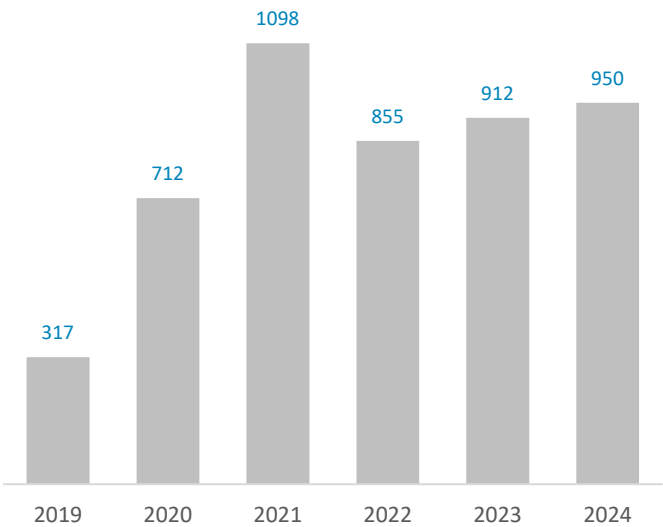
In terms of the value of bond issuance, labelled ESG activity has nearly tripled since 2019 in real terms. Fig.2 i) shows that over the last six years, nearly \$5 trillion has been raised in the labelled bond market. The big change since the peak in 2021 is that the growth trajectory has slowed - but the overall value of ESG labelled bond issuance has (perhaps surprisingly) grown in each of the past two years.

The penetration of ESG financing in capital markets has declined across most sectors since 2022. Fig.2 ii) shows how globally, labelled ESG bond issuance experienced a minor decline in the last two years. Even European labelled ESG bond issuance has experienced a decline in terms of all bond issuance. The only region and sector that saw a small uptick in penetration was European investment funds, which saw a one percentage point increase by value.

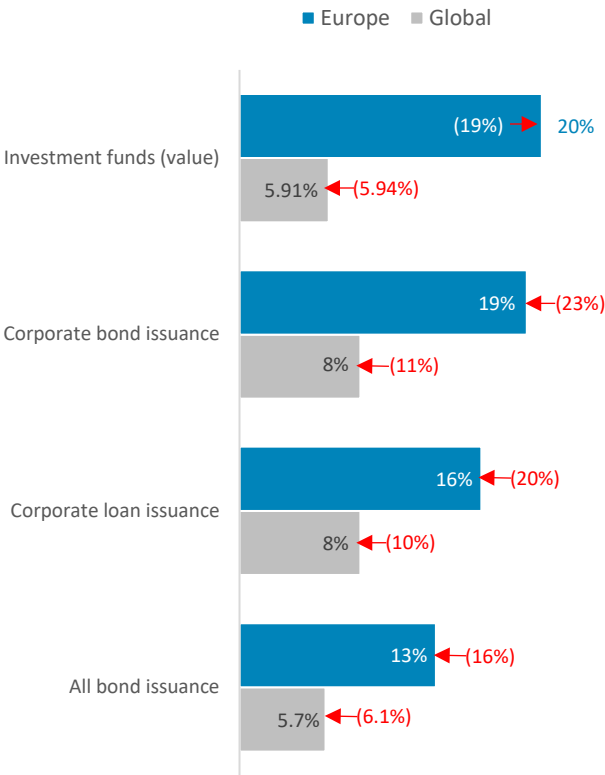
While the decline in penetration is concerning, the labelled bond market is proving resilient. This is despite the loud 'anti-ESG' backlash and financial firms pulling back from their public commitments to ESG initiatives. There is still a lot of room to grow for ESG, but sustainable finance is significantly above where it was even six years ago.

Fig.2 What is the hard value of ESG activity?

i) The value of global ESG labelled bond issuance from 2019 to 2024 (in real terms, \$bn) - includes corporate and government bonds



ii) The share of ESG labelled capital markets activity in Europe and worldwide in different areas of activity (with the change from 2022 to 2024 in red lines)



Source: New Financial analysis of Dealogic and Morningstar data

HOW HAVE ESG COMMITMENTS BEEN IMPLEMENTED?

Commitment versus reality

Once a financial firm commits to a particular ESG initiative or cause, it needs to follow through with implementation. The degree to which financial firms are implementing their commitments, though, is minimal at best.

We are measuring this implementation in two ways: by analysing the level of capital markets financing that is going to 'good' companies (which we define as companies that advance, rather than delay, long-term ESG aligned goals such as community enterprises), and by checking how financial firms are engaging with their portfolio members on ESG issues.

Since 2022, the share of financing in the capital markets that is going toward 'good' has decreased. Fig.3 i) shows that even during its peak in 2022, a large majority of capital flows financed 'business as usual' activities of firms. In 2024, more than 96% of global corporate capital markets activity by value financed 'business as usual'. In other words, for every dollar that was invested in a 'good' company, \$24 were not.

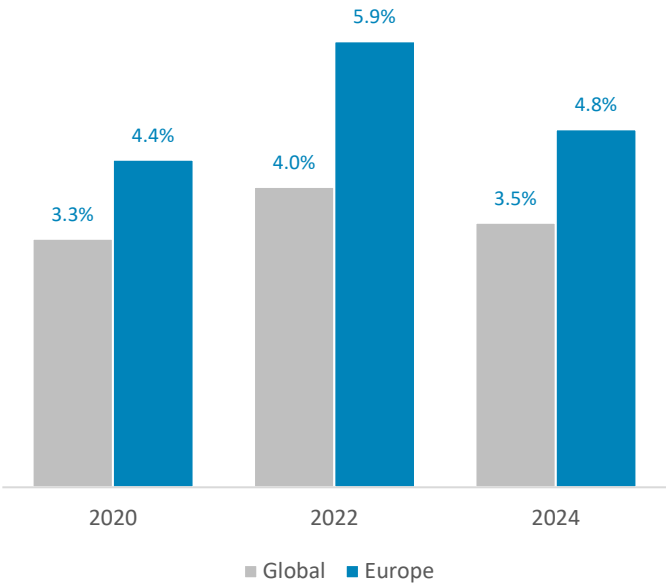
When financial firms still finance 'bad' companies, another way for them to implement their ESG commitments is to engage with portfolio firms to, for example, set ESG targets, track ESG KPIs, or help develop transition plans.

Fig.3 ii) shows that the level of engagement in 2024 differs among sectors. While only little more than a fifth of insurance firms globally have engagement plans for their portfolios, more than 40% of all asset managers in our sample have such plans.

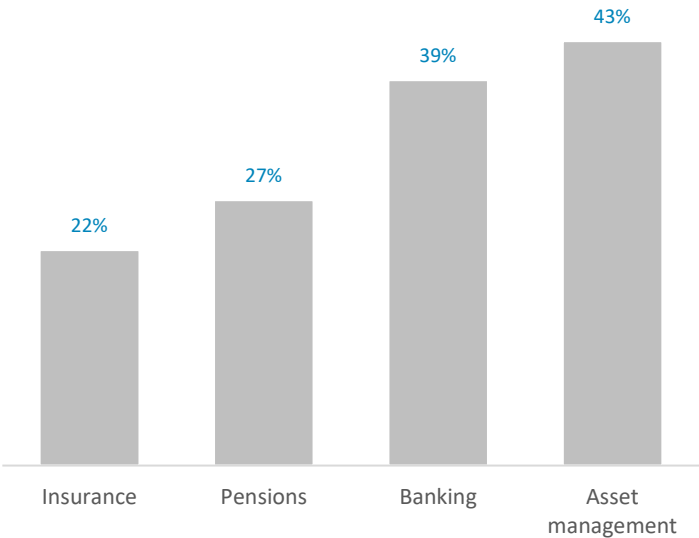
If divestment is not an option for financial firms, engagement is the way to go to implement their ESG commitments. But we do not see them engage at the levels that they could or should engage.

Fig.3 How are ESG commitments being implemented?

i) Total financing of 'good' companies* as a percentage of total corporate capital markets financing by value, broken down by Europe and global (every other year, from 2020 to 2024)



ii) The share of the world's largest financial firms across APAC, Europe, and US that engage with portfolio members to set decarbonisation targets (in 2024, based on a sample of around 200 asset management, banking, insurance, and pension firms)



Source: New Financial analysis of Dealogic data; analysis of company annual reports and sustainability reports

* A 'good' company is one that advances the goals of ESG (such as a renewable energy company or a social enterprise); a 'bad' company delays the progress of ESG goals (e.g., carbon intensive companies such as oil and gas)

WHAT DOES THE FUTURE OF ESG LOOK LIKE?

Quo vadis, ESG?

Just because ESG and sustainable finance are facing problems doesn't mean that policy makers and financial firms should give up on sustainability. If anything, the backlash has provided an opportunity to rethink what ESG means in a constantly evolving global economy. Later in this report, we outline some principles for a new and more 'sustainable' ESG framework to ensure that sustainable finance remains an important part of the financial markets. Below, we summarise briefly what these principles are:

1. **Less is more:** for too long, the financial industry has pointed to overburdensome and complex regulation as a barrier to sustainable finance. ESG policymakers and regulators need to understand that if a sustainable finance market is going to work, there need to be clear and simple rules for investors and institutions who want to invest in ESG. That doesn't mean that regulators should throw out everything that they have worked so hard on developing over the years. Rather, it means that they should make the rules as clear as possible, and work with the financial industry in developing the best possible regime.
2. **The potential of private markets:** private markets have emerged as an important source of financing for various parts of the economy. Given that public markets as they stand today are too focused on the short-term, there's an opportunity for private markets (which are usually more long-term focused) to channel capital to 'good' ESG projects. Private and public markets can also work in tandem, with venture capital firms investing in high-growth, sustainable companies and preparing them for a listing on a public exchange. Private markets can (and, perhaps, should) play an important part in growing the supply of investable sustainable companies.
3. **Explaining the trade-offs:** ESG, like any other investment principle, will have its trade-offs. This is difficult to accept for some, but it's important to acknowledge if ESG practitioners want to maintain the place of sustainability in the financial markets. There will always be a trade-off between using a traditional investing principle and sustainable investing principles. It's the responsibility of pension schemes, insurance companies, and other asset owners and managers in particular to explain these trade offs to their clients and allow for real choice in how investment decisions are made.
4. **System-wide reform:** policymakers can and should not expect financial firms to be major tools of policy. Financial firms, as enablers, do not have the ability to shape the contours of the financial markets, nor should they be expected to channel capital to ESG-specific projects without the right guardrails. One of these new guardrails could include a new definition of fiduciary duty that focuses not just on financial returns but also on issues around long-term sustainability. Another guardrail could be adjusting the way that firms carry out their regular reporting cycles, as now, the focus is mainly on quarterly returns around specific financial matters.
5. **A competitive advantage for Europe:** Europe has proven itself to be the world-leader in sustainable finance, but there's a risk that it will backtrack on its accomplishments. The omnibus package is a noble effort to simplify complex regulation, but if Europe really wants to achieve its dual imperative of 'decarbonisation and competitiveness', then it will need to double down on sustainability and ESG. Given that the US is abandoning its commitment to not just 'green' but also DEI and corporate governance, and the Asia-Pacific is not yet at the level where it could be in terms of sustainable finance, then Europe can and should take the lead. Otherwise, those behind the backlash will seize the narrative and ESG will find itself in even more dire straits.

A MORE DETAILED ANALYSIS

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The commitment to ESG

The starting point for measuring the penetration of ESG in banking and finance is to measure the public commitment to ESG by market participants around the world in different sectors. This section analyses the public commitment to ESG in selected sectors of the industry by looking at the number of initiatives and signatories in each sector and the distribution of signatories by region.

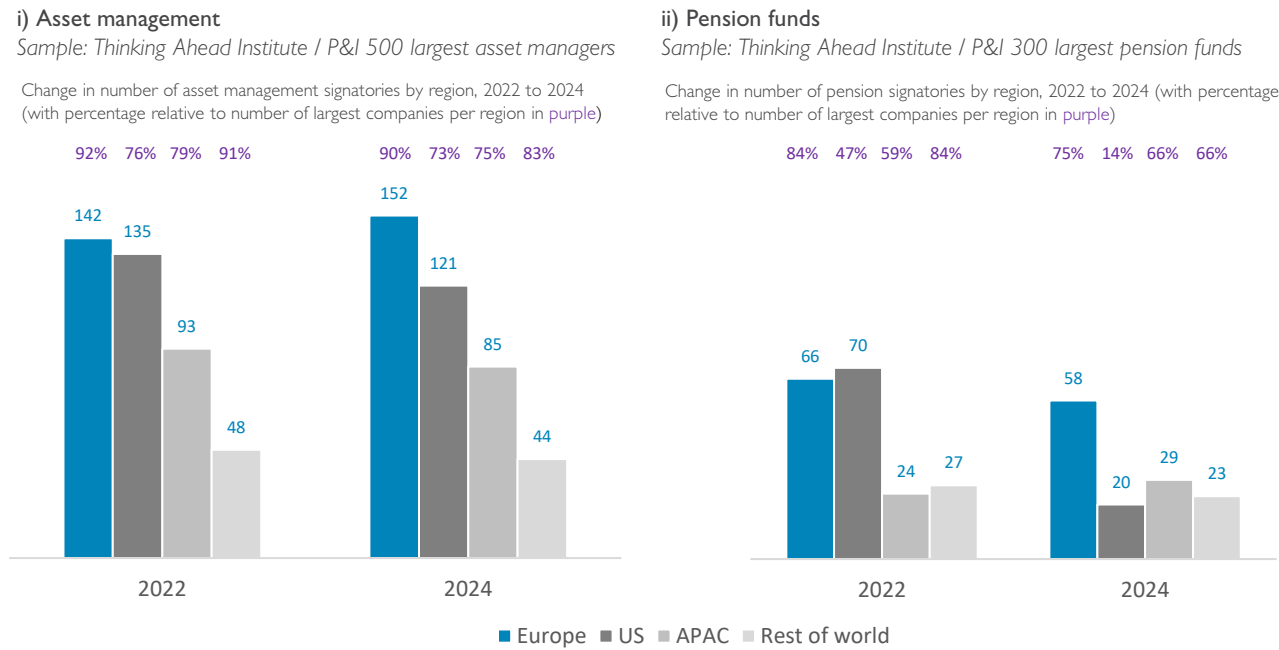
In this section, we also provide a ‘reality check’ on the commitment to ESG given the recent examples of major financial firms withdrawing from ESG initiatives. We outline what this decline in commitment looks like and the potential reasons behind it.

Later in the report, we analyse how firms follow through on and implement the commitments they made when they joined these ESG initiatives.

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Fig.4 Where are signatories to ESG initiatives located and how has the distribution changed?

The regional distribution of signatories to sector-relevant ESG initiatives in 2024



Source: New Financial analysis of initiatives signatory lists & lists of largest firms in the world.

To measure the commitment to ESG by market participants, we look at 30 different initiatives around the world related to banking and finance. Signing up to a particular initiative is almost cost-free, so it is the least you might expect of a large firm. Not signing up to any initiative can be seen as evidence that a firm may not be committed to ESG.

Asset managers: of the 500 largest asset managers in the world, 402 are signed up to at least one of 15 sector-relevant ESG initiatives. While this decrease from 419 ESG-committed asset managers in 2022 is a concerning development, it is perhaps a smaller drop than one would think after all the recent noise around large US asset managers leaving these initiatives. Of the 402, a little more than half are signed up to two or more initiatives, with the UN Principles for Responsible Investment (UNPRI) initiative responsible for nearly 90% of the commitments by firms signed up to only one initiative.

Fig.4 i) shows how the number of signatories has changed per region. The number of European asset management signatories has increased by nearly a tenth (although the percent of European asset managers signed up to at least one initiative has decreased by 2 percentage points), while the number of US asset managers signed up to at least one initiative has decreased by more than a tenth. Relative to other sectors of the financial industry, asset managers remain relatively committed to ESG initiatives and principles.

Pension funds: less than a half of the world's 300 largest pension funds are signed up to at least one of 16 pensions relevant ESG initiatives, with the overall number of signatories declining from 187 in 2022 to 130 in 2024. Fig.4 ii) highlights the significant drop in US pension schemes' commitments to ESG, with nearly three quarters of US signatories in 2022 having left initiatives by 2024, with the share of US pension funds signed up to at least one initiative decreasing from nearly half to a little more than a tenth.

SECTOR ANALYSIS: BANKING AND INSURANCE

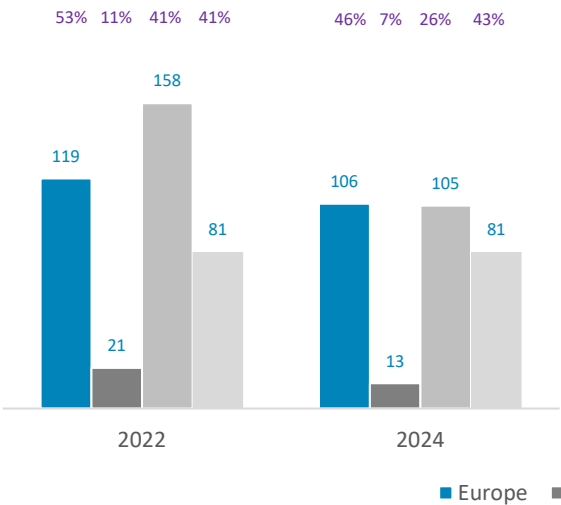
Fig.5 Where are signatories to ESG initiatives located and how has the distribution changed?

The regional distribution of signatories to sector-relevant ESG initiatives in 2024

i) Banking

Sample: The Banker (2022) / S&P Global Market Intelligence (2024)
1,000 largest banks

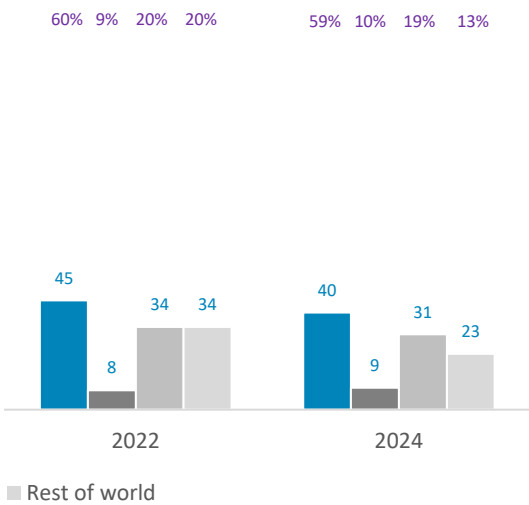
Change in number of banking signatories by region, 2022 to 2024 (with percentage relative to number of largest companies per region in purple)



ii) Insurance

Sample: S&P Global Market Intelligence, 500 largest insurers

Change in number of insurance signatories by region, 2022 to 2024 (with percentage relative to number of largest companies per region in purple)



Source: New Financial analysis of initiatives signatory lists & lists of largest firms in the world.

Banking: of the 1,000 largest banks in the world, 305 are signed up to at least one of 16 sector-relevant ESG initiatives. This is a noticeable drop from the 379 recorded for 2022 and indicates that the banking sector is experiencing a more rapid decrease in the commitment to ESG than, for example, the asset management industry.

Fig.5 i) shows that the most significant drop in banking signatories occurred in APAC. Europe experienced a smaller decline. In the US, which did not have high levels of banking signatories to begin with, a drop of eight signatories is equal to more than one-third of signatories in 2022 leaving these initiatives. Still, the analysis puts the recent focus on the US ‘anti-ESG’ backlash into perspective. While the rhetoric and news coverage around ESG has ramped up recently, the public commitment to long-term, non-financial matters by the US banking sectors had already been relatively low (with the percentage of US banks signed up to at least one initiative for 2022 being only 11%).

Insurance: the insurance sector is overall less committed to the principles of ESG than other sectors. Only around a fifth of the world’s 500 largest insurers are signed up to one or more of the 15 relevant ESG initiatives. It is troubling to see that the number of insurance firms that are signed up to at least one initiative has decreased from 122 to 103 in 2024. One effect of this lack of commitment has been the collapse of the Net Zero Insurance Alliance (NZIA) in April 2024, which closed after the exit of a few major insurance firms. Given the importance of insurers as asset owners and their business models that are deeply entwined with ESG issues, such as when it comes to climate change and the effect of extreme weather risks on offering affordable coverage, it is concerning to see this trend.

Fig.5 ii) shows that there has not been much of a change in the ranking of regions in terms of insurance signatories. Europe saw a minor decline both in terms of number and percentage, while the US actually experienced a small uptick.

UNDERSTANDING THE CHANGE IN PUBLIC COMMITMENT

A noticeable decline

The commitment to ESG has been experiencing some headwinds. While the degree in the decline of the commitment to ESG varies, in all four major sectors of the financial markets fewer firms are committed to ESG initiatives today than there were in 2022.

The change in public commitment has not been uniform across the financial industry. Fig.6 i) shows that the number of ESG committed asset managers decreased by four percentage points but remains at a high level. The sector that experienced the greatest decline was the pension sector, mainly driven by US pension schemes withdrawing from initiatives.

The other sectors, such as banking and insurance, never had high levels of commitment, although it is worrying to see that both still have experienced declines given their importance in financing corporates that require more upfront capital flows (banks) and as asset owners (insurers).

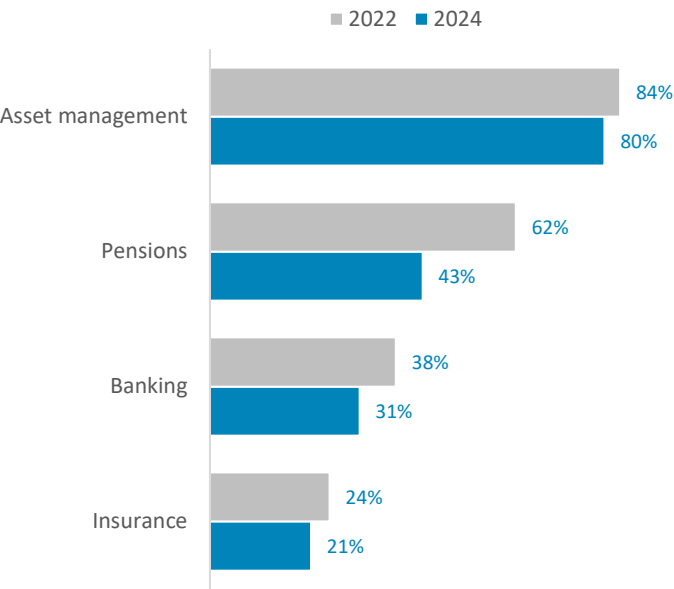
Fig.6 ii) shows why companies are leaving ESG initiatives. Based on a sample of 29 firms that have left an ESG initiative, the most stated reason was that firms wanted to 'continue [their] sustainability journey independently'. The second most stated reason was a 'compromised business approach' which essentially means that there was a conflict between a firm's fiduciary duty and its sustainability goals.

Interestingly, only 4% of the sample identified 'politicised ESG' as a reason for leaving an initiative. It would make sense that a firm would not say outright that politicisation is driving them away from ESG, but the fact that any firm is using this as a reason shows just how toxic some of the discourse around ESG and sustainable finance has become.

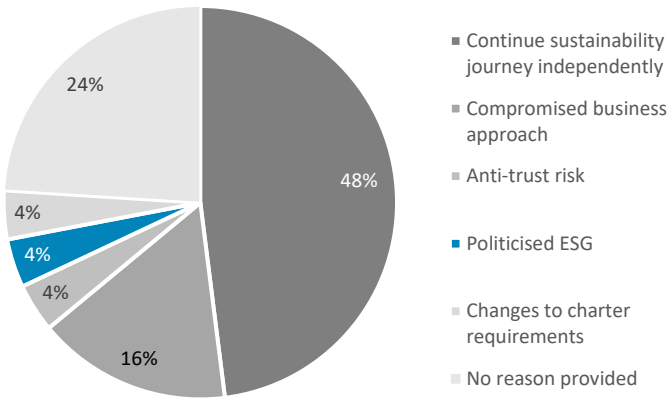
While nothing is stopping firms from incorporating long-term, non-financial issues into their business activities even when they are not signed up to an ESG initiative, the decline in the public commitment could suggest that financial firms across the world will place less emphasis on ESG now and in the future.

Fig.6 How has the public commitment changed?

i) The change in the share of the largest firms per sector, in terms of number of companies, that are committed to at least one ESG initiative (2022 compared to 2024)



ii) The stated reasons behind a sample of financial firms (n=29) that have departed from an ESG initiative (in 2024)



Source: New Financial analysis of signatory data from various ESG initiatives; analysis of company statements and annual reports

The hard value of ESG activity

The second step for measuring the penetration of ESG in banking and finance is to analyse those areas of the banking and finance industry that have clearly designated ESG activity. In this section we measure the value and growth in designated ESG activity, the share of ESG out of total capital markets activity within Europe and worldwide, and the distribution of ESG activity by region.

In the final section of this chapter we also explore why labelled ESG finance has changed the way it has. We show the drivers of the latest changes in ESG finance, with a focus on region and type of issuance, and outline where we think ESG finance is heading.

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ANALYSIS: ESG BONDS

Highs and lows

The labelled ESG bond market has grown significantly since 2019. The primary driver of this growth has been Europe, with the region making up nearly half of the total amount of labelled ESG bond finance raised over the last six years.

The labelled ESG bond market (including bonds issued by corporates, financials, governments, and supranational bodies) has nearly tripled in size over the last six years, with nearly \$5 trillion raised during that time. Fig.7 i) shows that in 2021, the annual (!) value of labelled ESG bond issuance reached more than \$1 trillion in real terms based on the rate of inflation since 2019.

While Europe has been behind much of the growth in the value of labelled ESG bond issuance, APAC has been responsible for more than a quarter of financing, while the US has been behind about a fifth.

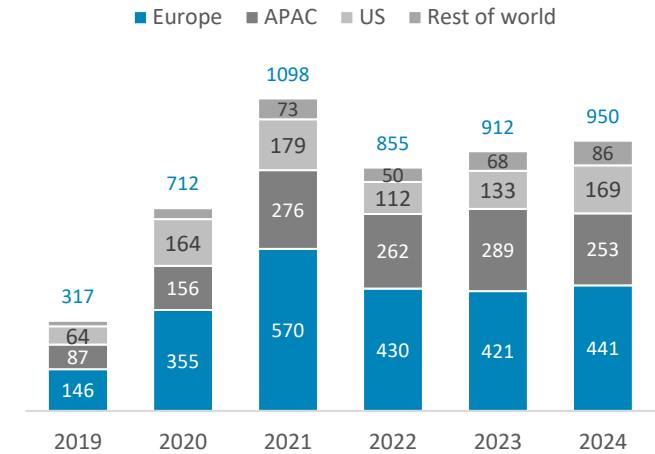
The penetration (or the share of overall capital market activity) of ESG finance is much higher in Europe than it is globally. Fig.7 ii) shows that in 2024 6% of global bond market activity was ESG but in Europe it was 13% of overall bond issuance. While Europe's bond markets are much more 'ESG' than the rest of the world, the penetration of ESG in bond issuance has decreased over the last few years and dropped from a peak at 16% in 2022.

Still, Europe has maintained its leading share of overall labelled ESG bond issuance. Fig.7 iii) zooms in on the EU and shows that despite making up only 15% of overall bond market issuance, the bloc makes up nearly 40% of labelled ESG bond issuance. APAC is also punching above its weight, while the US is nowhere where it could (and perhaps should) be in terms of both value and distribution.

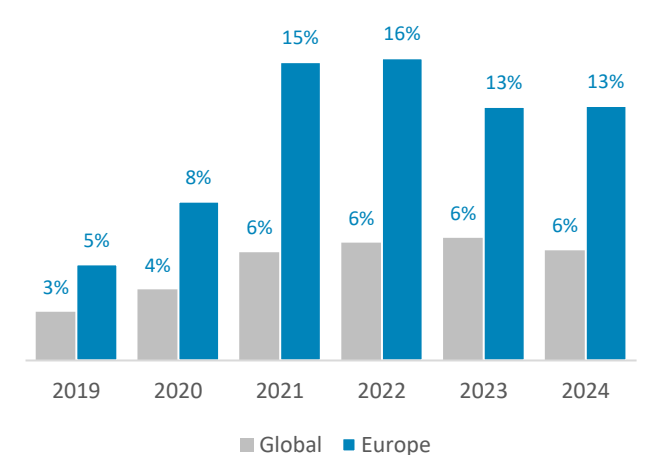
If the US made up the same share of labelled ESG bond issuance as its share of the overall market, there could be an additional \$320 billion in sustainable bonds. Raising that amount would raise global penetration of ESG to more than 12% (nearly the same penetration as in Europe) and would bring much needed financing to social enterprises such as employment training or housing organisations.

Fig.7 How has ESG bond issuance changed?

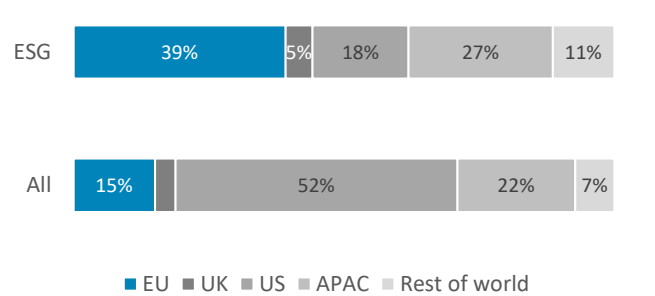
i) The growth in ESG debt capital markets issuance (excl. loans) in Europe and the rest of the world, \$bn (in real terms)



ii) The penetration of ESG debt issuance (excl. loans) in global and European debt capital markets



iii) The distribution of ESG debt capital markets issuance (excl. loans) and total debt capital markets issuance (excl. loans) across regions in 2024



Source: New Financial analysis of Dealogic data
Note: DCM issuance includes medium-term notes, asset-backed securities, all bonds, covered bonds, preferred shares, and mortgage-backed securities

ANALYSIS: ESG CORPORATE BONDS

Europe is taking the lead

Over the last six years, the labelled ESG corporate bond market has more than doubled in terms of value. European issuance has nearly tripled, with the value of issuance in 2024 even above the breakout year of 2021 in real terms.

Labelled ESG corporate bonds are an important subset of overall bonds. Given that non-financial corporates are an important stakeholder in any drive to achieve long-term goals (for example, much of the world’s decarbonisation efforts will involve turning a carbon-intensive company into a carbon-neutral one), the level of labelled ESG corporate bond financing is a good indicator of where corporates are heading on that journey.

The trend for the ESG corporate bond market has been overall up. Fig.8 i) shows that much of that increase in the corporate bond market has been driven by Europe, with the region being responsible for more than half of the growth. APAC has been responsible for a third, whereas the US has actually seen its value of labelled ESG corporate bond issuance decrease from 2019. The US is the only region in our sample that has seen such a decline - a concerning development given the size of the US corporate bond market.

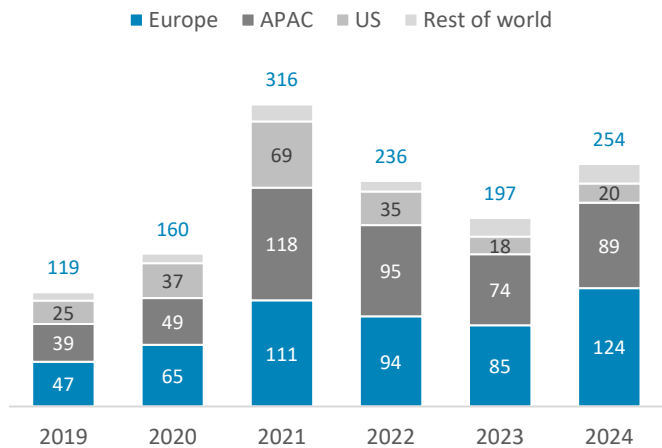
Europe has maintained relatively high levels of ESG penetration in the corporate bond market. Fig.8 ii) shows that in 2024, Europe’s corporate bond market was more than twice as ‘sustainable’ as the global corporate bond market. Both European and global penetration has declined since peaking in 2022.

Europe continues to make up a large share of labelled ESG corporate bond issuance too. In 2024, the EU alone made up nearly 40% of global labelled ESG corporate bond issuance. On the flipside, the US share of ESG corporate bond issuance was much smaller than its share of all corporate bond issues.

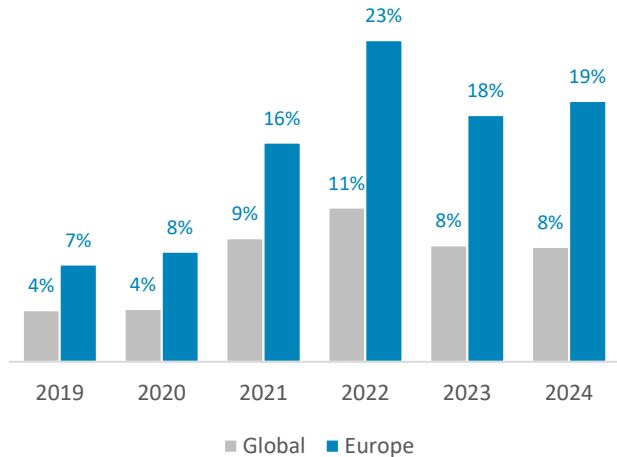
While it is good that Europe is leading the way in corporate bond issuance, APAC and particularly the US need to play their part to increase the overall volume of issuance.

Fig.8 How has ESG corporate bond issuance changed?

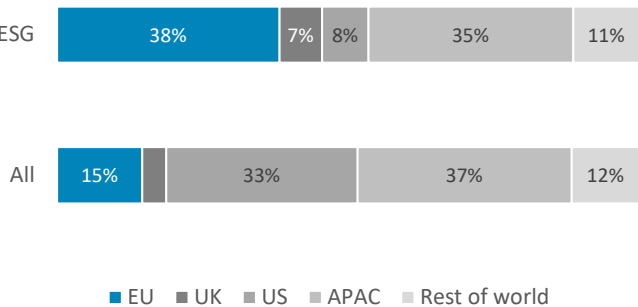
i) The growth in ESG corporate bond issuance in Europe and the rest of the world, \$bn (in real terms)



ii) The penetration of ESG corporate bond issuance in global and European corporate bond markets



iii) The distribution of ESG corporate bond issuance and total corporate bond issuance across regions in 2024



Source: New Financial analysis of Dealogic data

ANALYSIS: ESG CORPORATE LOANS

A lagging market

The labelled ESG loan market has been showing signs of decline since 2021. Most worryingly is a significant decrease in penetration for not just the global average, but for Europe in particular.

The main way to measure the size of the labelled ESG loan market is by looking at the issuance of SLLP (Sustainability Linked Loan Principles) loans that tie financial terms to the achievement of certain, usually ESG-related, KPIs. Fig.9 i) shows that the value of SLLP loans exploded from 2020 to 2021, driven mainly by increases in the European and US markets. But from 2021 to 2024, European labelled loan issuance has decreased again by 40% in terms of value. The US has also seen a decline of nearly a half, whereas APAC has seen an increase of around \$18 billion from the breakout year of 2021.

The analysis of the penetration of ESG corporate loan issuance in Fig.9 ii) makes this sharp decline even more visible. From 2020 to 2021, European and global penetration increased dramatically - with labelled ESG loans making up a quarter of European loan issuance in 2021.

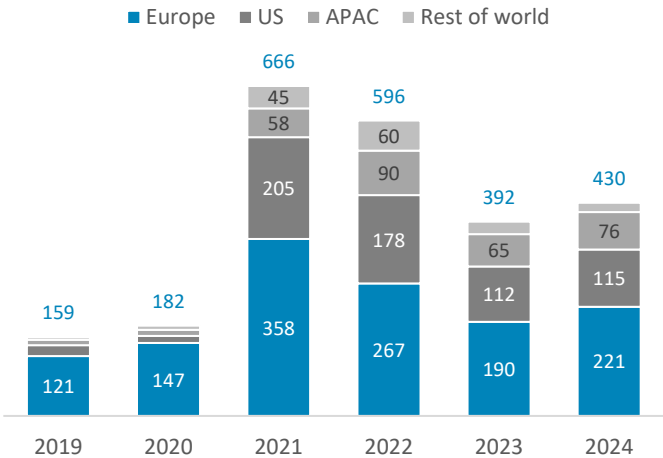
By 2024, European penetration had decreased to 16% and global penetration had gone to less than a tenth. There was a small uptick in penetration in Europe from 2023 to 2024 though.

It is interesting to see how the regional distribution in the labelled loan market is more balanced than in the bond markets. Fig.9 iii) shows that the US, in 2024, made up more than a quarter of labelled ESG loan issuance in terms of value. APAC as well made up a significant share, contributing nearly a fifth, although as in bonds, the EU still dominates - making up more than 40% of issuance in terms of value.

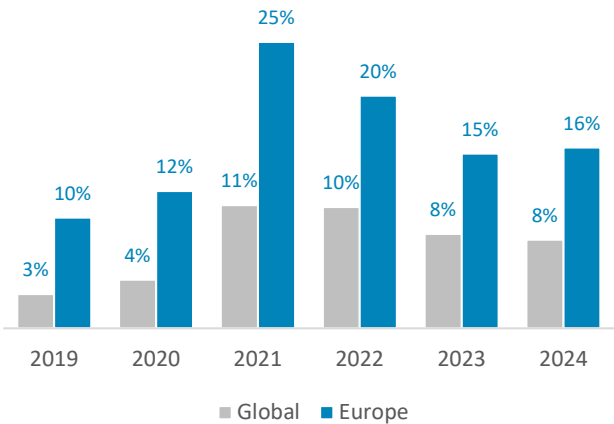
Where the labelled ESG loan market is heading next will be critical for ESG's future. Much of the problems with the loan market could be solved by developing a better labelling framework (as the one that exists for green bonds).

Fig.9 How has ESG loan issuance changed?

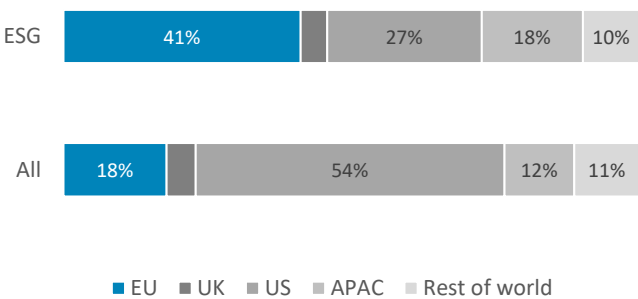
i) The growth in ESG corporate loan issuance in Europe and the rest of the world, \$bn (in real terms)



ii) The penetration of ESG corporate loan issuance in global and European corporate loan markets



iii) The distribution of ESG corporate loan capital markets issuance and total corporate loan capital markets issuance across regions in 2024



Source: New Financial analysis of Dealogic data

ANALYSIS: ESG INVESTMENT FUNDS

A sizeable presence

While sustainable funds have a more indirect role to play in channelling capital to long-term, non-financial issues, they are an important indicator of ESG capital markets activity. Since 2019, sustainable funds have grown into a more than \$3 trillion industry - but there are signs of it running out of steam.

Sustainable investment funds, as defined by Morningstar, are investment funds that ‘incorporate environmental, social, and governance criteria into their selection and portfolio management process.’ In recent years, sustainable funds have been the target of ‘greenwashing’ claims, although recent regulations put forward by the EU and other jurisdictions have sought to address those criticisms.

Fig.10 i) shows that from 2019 to 2024, the value of assets in sustainable investment funds has doubled from \$1.5 trillion to over \$3 trillion. Europe dominates the sustainable funds market and makes up nearly 85% of the global value in sustainable funds. The US takes a distant second place (with assets of more than \$300 billion in 2024) ahead of APAC.

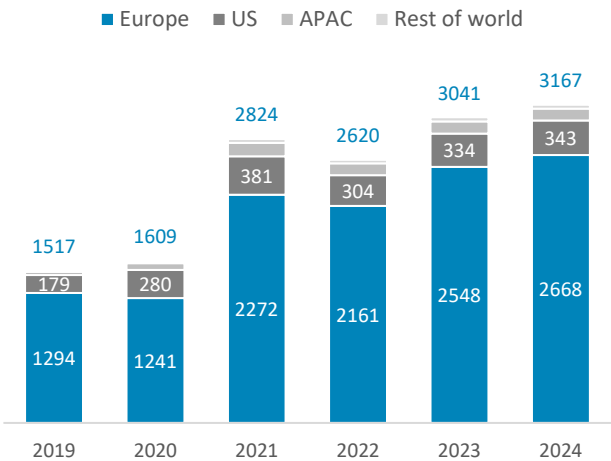
In the last year, though, the sustainable funds market has begun to show signs of stagnation and even decline. In Europe, after years of steady growth, for the first time the penetration of ESG investment funds in the European fund market overall has stagnated in 2024. On a global level, this stagnation has been happening for a few years now.

In terms of regional distribution (as seen in Fig.10 iii), perhaps unsurprisingly, Europe makes up the absolute majority, with the EU and UK combined making up more than three-quarters of the global sustainable funds market in terms of value. The US, despite making up more than half of the global investment funds market overall, only makes up around a tenth of the sustainable funds market.

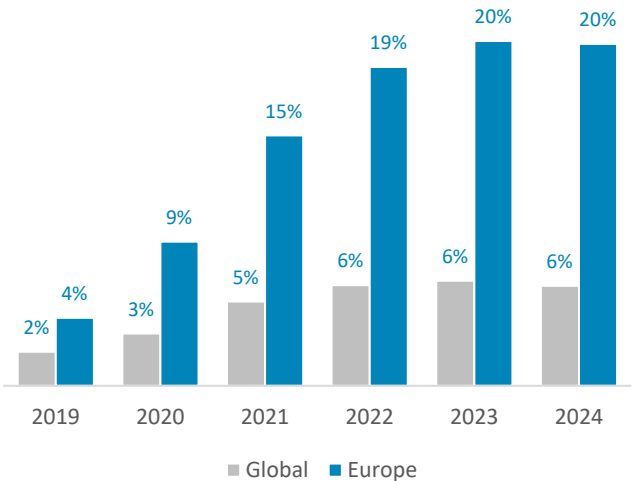
The state of the sustainable funds market offers a glimpse into where investors feel comfortable putting their money. European sustainable funds have been the most appealing, but there is vast potential for US and Asia-Pacific funds to bring more capital into ESG.

Fig.10 How have ESG investment funds changed?

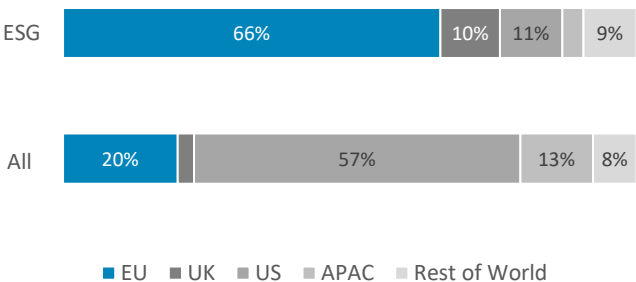
i) The growth in the value of assets of ESG investment funds in Europe and the rest of the world, \$bn (in real terms)



ii) The penetration of ESG investment funds in global and European investment fund markets



iii) The distribution of the value of ESG investment funds and all investment funds across regions in 2024



Source: New Financial analysis of Morningstar Direct data

UNDERSTANDING ESG CAPITAL MARKETS ACTIVITY (I)

A global imbalance

The two markets that have showed signs of worrying trends in our analysis are the sustainable funds and labelled loan markets. The sustainable funds market is seeing record outflows, while the labelled loan market (while larger than it has been in 2019) is stagnating.

Relative to each region's economy, the labelled loan market is not much larger now than it was in 2019. Fig. I I i) shows the size of each region's labelled loan market in terms of the value of issuance relative to GDP. From 2019 to 2021, the European labelled loan market nearly tripled in size. The US market nearly grew ten-fold, while APAC's market doubled.

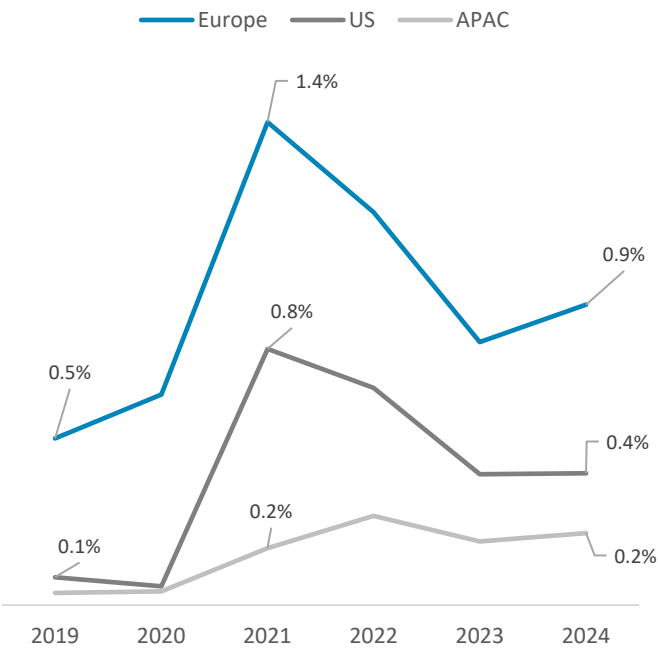
By 2024, the size of Europe's labelled loan market was less than two-times larger than it was in 2019 (relative to GDP). The US market was now 'only' four times larger, and APAC's market had barely budged since 2021. This 'decline' can be explained by suspicion's around SLLP's effectiveness (particularly given that SLLP's are less about impact and more about achieving certain key performance metrics).

The sustainable funds market has seen record outflows recently. Fig. I I ii) shows that in 2020 and 2021, there were net-inflows into sustainable funds in the EU, US, and the APAC. Those inflows peaked in 2021, a year marked by the lingering COVID pandemic when there was a global retreat from vanilla investment funds into more sustainable funds. That same year, there was an explosion in interest for ESG issues - particularly around climate, with an increasingly vast array of sustainable fund products available to investors.

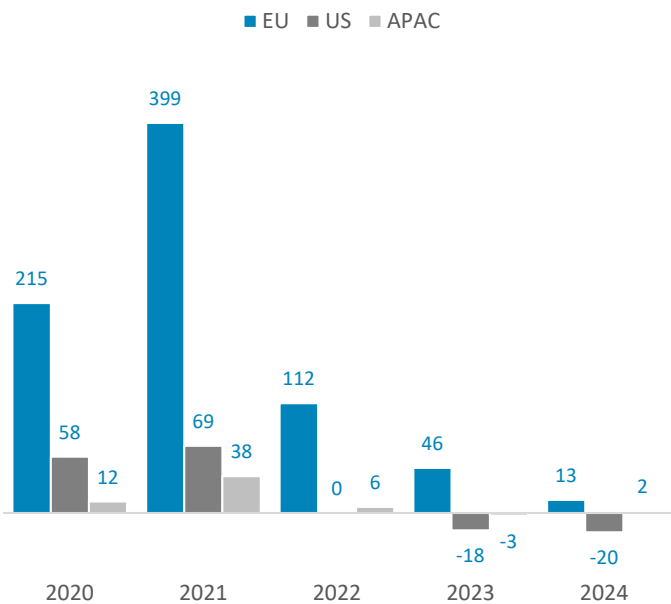
Since 2022, there has been a dramatic decline in net-flows into sustainable funds. The decline in flows into sustainable funds has been more dramatic than changes across other asset classes. Some of sustainable funds' outflows, then, could be explained by two trends: stricter rules around what is considered a 'sustainable' fund and the 'anti-ESG' backlash. While stricter rules aren't necessarily a bad thing (a better labelling regime sows further trust around sustainability), the backlash and its ensuing politicisation could undermine the industry.

Fig. I I How has ESG finance changed?

i) The change in the size of the labelled loan market per region, from 2019 to 2024 (with size = value of issuance relative to GDP)



ii) Net flows in and out of sustainable funds for the EU, US, and APAC (2020 to 2024, in \$bn, real terms)



Source: New Financial analysis of data from Dealogic, IMF, and Morningstar Direct

UNDERSTANDING ESG CAPITAL MARKETS ACTIVITY (II)

All about the ‘E’?

One of the problems with measuring the hard value of ESG capital markets activity is that a lot of it that is measurable is focused on environmental issues, such as labelled ‘green’ finance. The ‘S’ gets a lot less attention, and it is virtually impossible to measure the ‘G’ (as one would expect that governance plays an important part in any kind of financing).

There is a real-life reason for why ‘green’ is overrepresented in ESG and sustainable finance capital markets activity: green activities, like renewable energy, require higher upfront levels of capital than for example more social oriented companies such as those providing care and social housing.

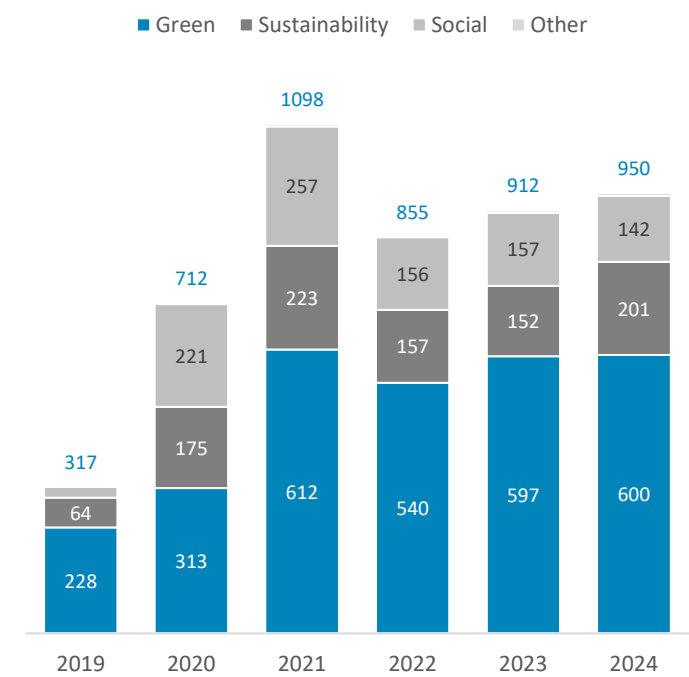
Fig. I.2 i) shows just how much of overall bond financing is identifiably ‘green’. From 2019 to 2024, labelled green bonds made up around two-thirds of all labelled ESG bond issuance. Labelled social bonds only made up around a fifth. Green bond issuance, while having declined since their peak in 2021, continues to stay at relatively high levels (around \$600bn per year). The value of social bond issuance has declined by almost 45% since 2021.

The corporate bond market is dominated by green bonds too. Fig. I.2 ii) shows that green bonds have been the main way for firms to raise ESG finance. In 2024, green bonds made up more than four-fifths of labelled corporate bond issuance in terms of value. Social bonds only made up around 5%.

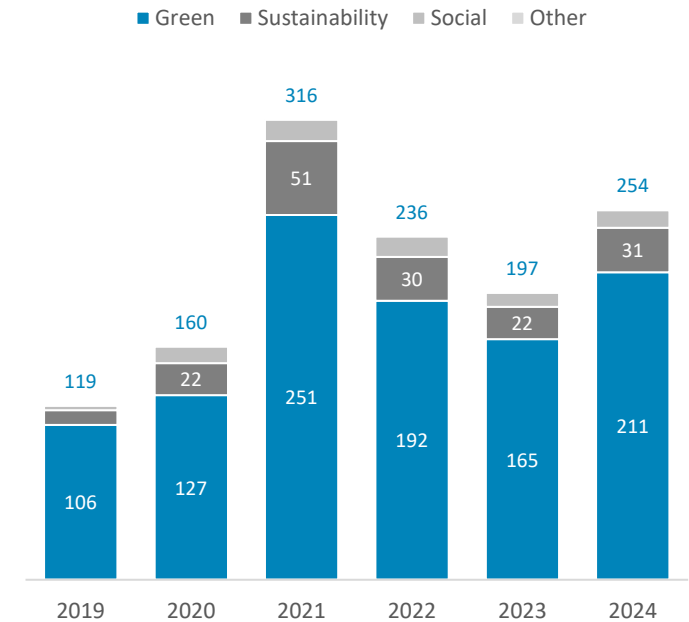
We think there are a few reasons for why green bonds have captured so much of the ESG bond markets: First, green projects are very capital intensive. Second, the most well-known ‘ESG taxonomy’ (the EU green taxonomy) is focused mostly on net zero activities, while there is no real ‘social’ taxonomy that outlines what projects are socially sustainable or not. Third, another reason may have to do with the effects of the ESG backlash which has focused a lot on ‘woke’ diversity and inclusion initiatives which one could expect to see covered primarily by social bonds. Finally, there is a noticeable letter missing from any data on ESG capital markets activity - the ‘G’ - which is practically impossible to measure.

Fig. I.2 How has the type of bond issuance changed?

i) The breakdown of overall ESG bond issuance from 2019 to 2024 broken down by type of issuance, \$bn (in real terms)



ii) The breakdown of corporate ESG bond issuance from 2019 to 2024 broken down by type of issuance, \$bn (in real terms)



Source: New Financial analysis of Dealogic data

The implementation of ESG

The third step to measure the penetration of ESG in banking and finance is to analyse whether firms are walking the walk and not just talking the talk. This section looks at the climate engagement strategies of finance firms and measures capital markets activity by 'good' and 'bad' companies.

We also analyse how firms are addressing 'transition finance', an increasingly important part of ESG activity and climate finance, along with how pension funds are addressing financed emissions.

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Still ‘business as usual’

Committing to an ESG initiative is one thing, implementing those commitments is another. If financial firms are not implementing the changes needed to make progress on sustainability goals, then ESG will continue to be exposed to criticism.

Measuring implementation is not as easy as tallying commitment or hard value. There is not as much public data around how firms are implementing their commitments, and it is rare to hear from a financial firm how exactly they engage with a portfolio company to set e.g. decarbonisation targets. We track progress by measuring the level of financing going toward ‘good’ companies, and by assessing what companies are saying in their corporate strategies.

A ‘good’ company is one that progresses ESG goals (such as the transition to net zero). A ‘bad’ company is one that delays them (such as an oil and gas firm). Fig.13 i) shows that in 2024, only 3% of capital markets activity globally by value went to ‘good’ companies, but 19% went towards ‘bad’. For every dollar that financed a good company, six dollars financed ‘bad’ activities.

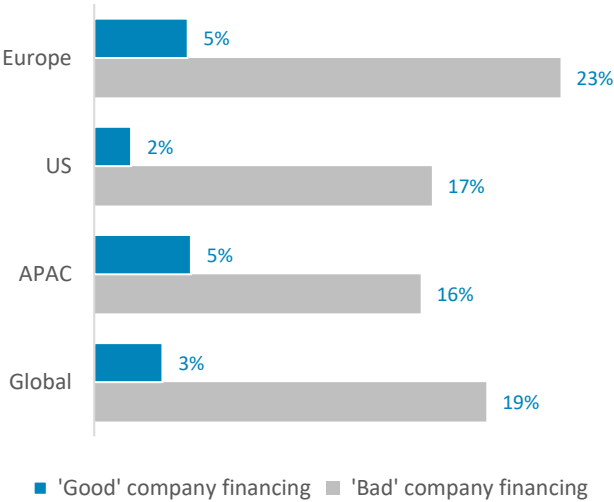
Europe and APAC have higher levels of ‘good’ financing than the global average, but Europe also has the highest levels of ‘bad’ financing. This can be attributed to the heavy industries that Europe is still based on such as manufacturing and automobiles.

Financial firms can also implement their commitments by engaging with companies around transition finance and planning. The idea of ‘transition’ has emerged as an important concept in recent years and focuses on turning hard-to-abate sectors into ones that are more environmentally friendly.

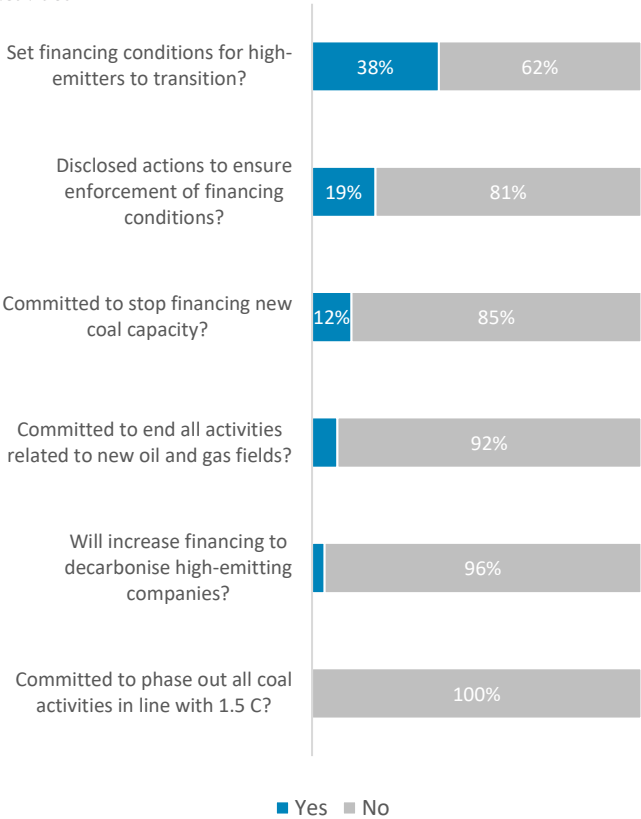
Fig.13 ii) shows that of a small sample of major banks, nearly 40% set financing conditions for high-emitters to transition. That is significant - but should be put in the context that only 4% say that they ‘will increase financing to decarbonise high-emitting companies’. Given that transition finance is about delivering transition capital to carbon-intensive sectors, the relatively low levels of engagement are concerning.

Fig.13 How are firms financing decarbonisation?

i) Financing of ‘good’ and ‘bad’ companies in the capital markets (as a share of total capital markets activity, in 2024)



ii) The share of banks (n=26) that are carrying out transition-related activities



Source: New Financial analysis of data from Dealogic and the Transition Pathway Initiative

Different levels of engagement

Engaging with portfolio companies is a critical way for financial firms to make the economy more sustainable. Engagement is also a particularly important method for firms that do not want to divest from a company, while still trying to meet their sustainability goals.

European financial firms seem to be the most active in engaging with their portfolio companies to set decarbonisation targets. Fig. I 4 i) shows that more than two-thirds of European asset managers outline strategies in their annual reports to engage with portfolio companies around target setting. For asset management firms in the rest of the world, that number is only around one-third. The sector that seems the least active in engaging with portfolio members is the pensions industry. Even in Europe, the share of pension schemes that have outlined engagement strategies is only around 40%.

That does not necessarily mean that pensions are not implementing their commitments. Fig. I 4 ii) shows how pension schemes (and other asset owners) that are signed up to the Net Zero Asset Owner Alliance (NZAOA) are addressing the carbon emissions from their portfolio. When a pension sets a sub-portfolio target for a particular part of its portfolio, it is tailored for a particular asset class such as equities or bonds.

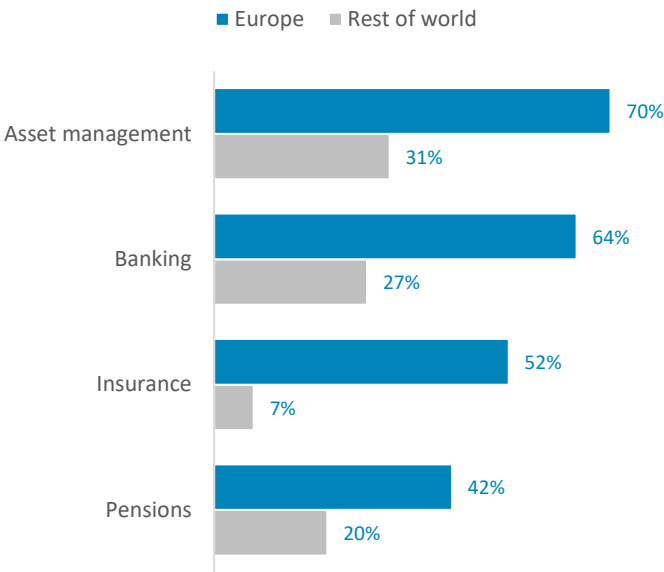
An example could be a pension scheme setting a specific carbon emissions target for its bond holdings. Given that companies that issue bonds might have a higher (or lower) average carbon emissions profile than for other asset classes, this allows the pension scheme to be more strategic in its engagement.

According to the NZAOA, since 2021, the assets under management of asset owners (including pensions) that are covered by sub-portfolio targets have nearly tripled. More than \$4 trillion in assets are covered by specific decarbonisation targets today.

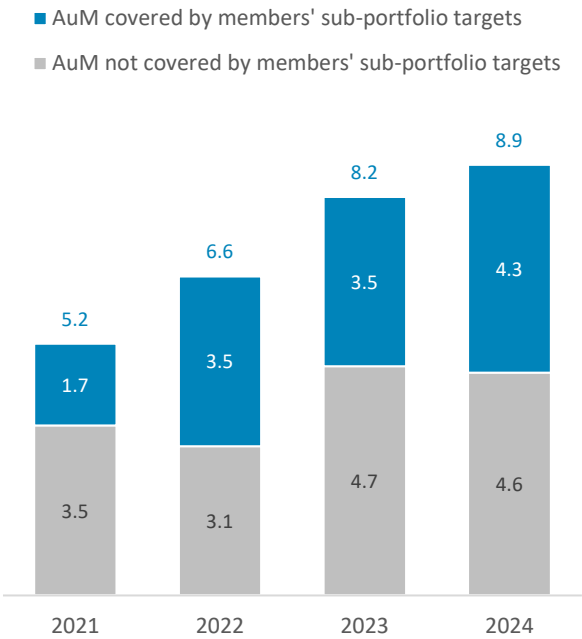
Engaging with portfolio members is an important way for financial firms to deliver on ESG goals. For this kind of engagement to go even further, policymakers and other ESG stakeholders will need to think through how the system could focus more on the longer term.

Fig. I 4 How are firms engaging with their portfolio?

i) The share of the largest 50 companies in asset management, banking, and pensions broken down by Europe and rest of world (APAC and US) that engage with portfolio companies around setting carbon emissions targets



ii) Assets under management (AuM) of Net Zero Asset Owners Alliance members covered by sub-portfolio net zero targets (\$tn, in real terms)



Source: New Financial analysis of disclosures by the largest firms in the world; Net Zero Asset Owner Alliance

The future of ESG

In this final section, we outline what a future, more 'sustainable' framework for ESG and sustainable finance could look like. We also provide some points for further discussion, with questions that we think policymakers and other ESG stakeholders could ask themselves.

Developing a future framework	27-28
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A more 'sustainable' framework for ESG

In this report, we have outlined the challenges facing ESG; analyse how the public commitment, the hard value of ESG capital markets activity, and the implementation of ESG commitments have changed over the last few years; and offered a glimpse into where ESG might be heading. In the section below, we outline what some principles for a future and more 'sustainable' framework for ESG could look like to ensure that ESG and sustainable finance remain an important part of the financial markets.

1. **Less is more:** given the complex state of ESG and sustainable finance regulation, simplifying and streamlining regulation could provide the financial industry with the clarity that it desperately needs. The EU's omnibus packages are a good first step toward addressing this complexity in regulation, but more can and should be done on a global level. It is promising to see the development of the ISSB standards from the IFRS Foundation which aim to provide a global baseline for sustainability disclosures and reporting. Regulators (at the global, regional, and national level) should build off the ISSB's efforts and develop an interoperable framework for directing sustainable capital flows that is simple and consistent.

Realistically, governments cannot expect financial firms - which consider themselves enablers of sustainable finance, not drivers - to deliver the kind of change that is needed to push ESG forward on their own. Instead, policymakers should consider the framework in which the financial industry operates (including important principles such as fiduciary duty); understand what facilitates, rather than discourages, investment that incorporates ESG considerations; and work with other governments to ensure that ESG and sustainable capital flows are global.

2. **The potential of private markets:** in recent years, private markets have emerged as a potential and powerful alternative for companies - including sustainable companies - to access capital. One of the benefits of private markets is that they offer a much longer-term investment and reporting horizon than the public markets. Private markets are also usually geared toward illiquid assets such as real estate, transport, and infrastructure - all sectors that are critical for ESG and long-term issues (particularly when it comes areas such as climate transition and mitigation, or housing). An expansion of ESG principles to cover the private markets could give it a real boost.

This would not mean that public markets would not have their place. If anything, public markets provide sustainable companies with the opportunity to generate a more public profile and access financing from a wider range of investors. Public markets and private markets can work in tandem, with the latter delivering early stage and venture capital investment to companies that could then list, and grow, on the equity and debt markets. In the EU, for example, venture capital firms and private debt funds are driving investment in life sciences and biotech - with early-stage investors already mobilising financing to innovators in diagnostics and drug development. After growing these companies, these firms can exit with an initial public offering on the public markets, expanding the potential supply of 'good' companies in which to invest.

3. **Explaining the trade-offs:** while the backlash to ESG and sustainable finance has been heavy handed at times, there is a point to be made that ESG and the traditional sense of fiduciary duty do and can conflict. But that does not mean that profit and immediate returns should always be prioritised over long-term, sustainable investments. Rather, it means that asset managers and pensions could try a bit harder to explain to their clients just what benefit an investment strategy that also considers longer term, non financial issues could bring.

DEVELOPING A FUTURE FRAMEWORK (II)

Pension funds and other asset owners have a unique role in explaining these potential 'trade-offs', given that they are one of the main ways that the wider public interacts with the financial markets. The traditional way of meeting its fiduciary duty would be for a pension provider to say, 'we are investing in this oil and gas company because it will generate a significant return over the next five years'. But why can it not say, 'we are going to invest in low-carbon enterprises because it will lead to much lower energy costs for you over the next five to ten years'? Both cases have their benefits and costs, but it would be useful for the provider to balance these two examples and provide their clients with a choice. By explaining the trade-offs, the pension provider can solve the problem of the manager having more information than the client; and give their client a real choice in how they want to invest for the future.

4. **System-wide reform:** as it stands now, financial markets are geared more to the short-term than they are to the long-term. This makes sense, given that markets function best when they are as liquid as possible. But given ESG and sustainable finance are about the long-term, it is essential that the system as a whole - not just financial firms - starts to think more longer term. The burden here must not be placed on financial firms alone: they are just enabling the financial flows that are being driven by this short-termism. Rather, governments and policymakers - from market regulators to politicians - need to think about what incentives are baked into the system. This process would involve rethinking the role of quarterly reporting; expanding and evolving the definition of fiduciary duty; and developing a pipeline of 'good' or 'ESG-friendly' companies into which investors can put their money in. It would also involve more nationwide efforts, such as national transition planning and signalling to the market such as through targeted government investment where capital could (and maybe should) flow.
5. **A competitive advantage for Europe:** Europe has established itself as *the* place for sustainable investment. It leads the way in terms of sustainable investment funds; makes up a significant part of the debt capital markets in terms of labelled issuance; and has constructed a sustainability regulatory regime that is much more embedded and widespread than regimes in other regions throughout the world. What Europe should not do is to lose sight of and backtrack on these advantages. To quote former ECB president Mario Draghi's report on Europe's competitiveness: 'The EU is a world leader in clean technologies...yet it is not guaranteed that Europe will seize this opportunity.'

For Europe to seize the opportunity of decarbonisation, sustainability, and ESG principles more widely, it will need to ensure that it does not abandon its principles in its simplification drive. As the ECB recently recommended in its review of the omnibus package, the availability of 'harmonised' and 'standardised' disclosures ensures that a sustainable finance market can work properly. Europe's sustainable finance market has thrived precisely because of innovative regulations such as the Corporate Sustainability Reporting Directive or the EU's taxonomy for sustainable activities. If Europe surrenders its advantage in these areas, it might lose out in its wider competitiveness goals too and lose ground to economies that neither prioritise nor lead on ESG and sustainable finance.

By being a leader in ESG and sustainable finance, Europe can shape the discourse around sustainability; draw innovative companies to its shores while boosting growth in the economy; and put ESG on a more 'sustainable' path.

Questions for ESG stakeholders

The main takeaway from this report is that ESG is facing challenges and criticisms but also opportunities. In this final section, we propose some questions that we think ESG stakeholders in governments, regulators, and in the industry could ask themselves to help start a wider discussion around the future of ESG and sustainable finance:

1. **What is fiduciary duty?** What duty does a financial firm have to its clients? What are the benefits of thinking 'holistically' versus a narrower understanding of fiduciary duty? What role could regulators and governments play in rethinking fiduciary duty, and what measures can they take to ensure that fiduciary duty and ESG or sustainable finance do not conflict?
2. **Long-term thinking:** how can the financial system - and the economy as a whole - be constructed on more long-term, rather than short-term, lines? What is driving short-termism in the financial markets? What are the benefits of short-term, quarterly reporting versus long-term, multi-year reporting?
3. **The opportunity for Europe:** how can Europe use its strengths in ESG and sustainable finance as a competitive advantage? How can Europe ensure that it does not backtrack on its success, and how can regulators in the EU balance their competitiveness agenda with their decarbonisation agenda?
4. **Building out supply:** how can governments, policymakers, and financial firms work together to help build out a supply of investable, 'good' companies? What measures are needed to make sure that 'good' companies can easily access financing on both private and public markets? What are the barriers in place that are reducing the supply of 'good' and increasing the supply of 'bad'?
5. **Rethinking the acronym:** ESG, for better or worse, has become the three-letter representation of sustainable finance. What are the costs of bundling together these three different concepts? And what are the costs of unbundling the strains? Is there room for ESG being centred more around physical risk rather than abstract financial concerns?
6. **What about private markets?** In recent years, private markets have become an important source of financing not just for 'good' ESG companies but for the economy as a whole. How can ESG and sustainable finance maximise the potential of private markets? Can private markets provide that long-term oriented system that public markets do not provide?
7. **Simplification versus deregulation:** how can regulators balance the need for simplification while still maintaining guardrails for a functioning sustainable finance market? How can regulators in Europe, APAC, the US, and other regions learn from each other based on best practice? And what role can a global standard, such as the ISSB, play in providing a floor - rather than a ceiling - for ESG regulation?
8. **Dealing with the backlash:** how should the financial sector and other ESG stakeholders address the backlash occurring against ESG and sustainable finance? What tools do policymakers need to best explain the value of ESG and sustainable finance?
9. **Explaining the trade-offs:** there will always be a trade-off between long and short term thinking. How can financial firms - particularly asset owners - best explain these trade-offs to their clients?
10. **Sustainable finance is finance:** how do we ensure that ESG and sustainable finance remain an important part of the financial sector? And how can we bring new momentum to sustainability?

NEW FINANCIAL

Rethinking capital markets

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Here is a selection of some of our recent reports that discuss ESG and sustainable finance:

[What is the problem with ESG?](#)

[Searching for growth: the future of EU capital markets](#)

[A reality check on green finance](#)

[A renewed vision for EU capital markets](#)

[EU capital markets: a new call to action](#)

[Benchmarking ESG in banking and finance](#)