



The

Climate Finance Review

Addressing the Perceived ESG Pullback – Fact or Fiction?

**Building
tomorrow**

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About Climate Finance Advisors

A boutique advisory firm in sustainable finance, impact investing, and environmental finance.

Combining academic expertise with industry experience to deliver efficient outcomes with creativity and integrity.

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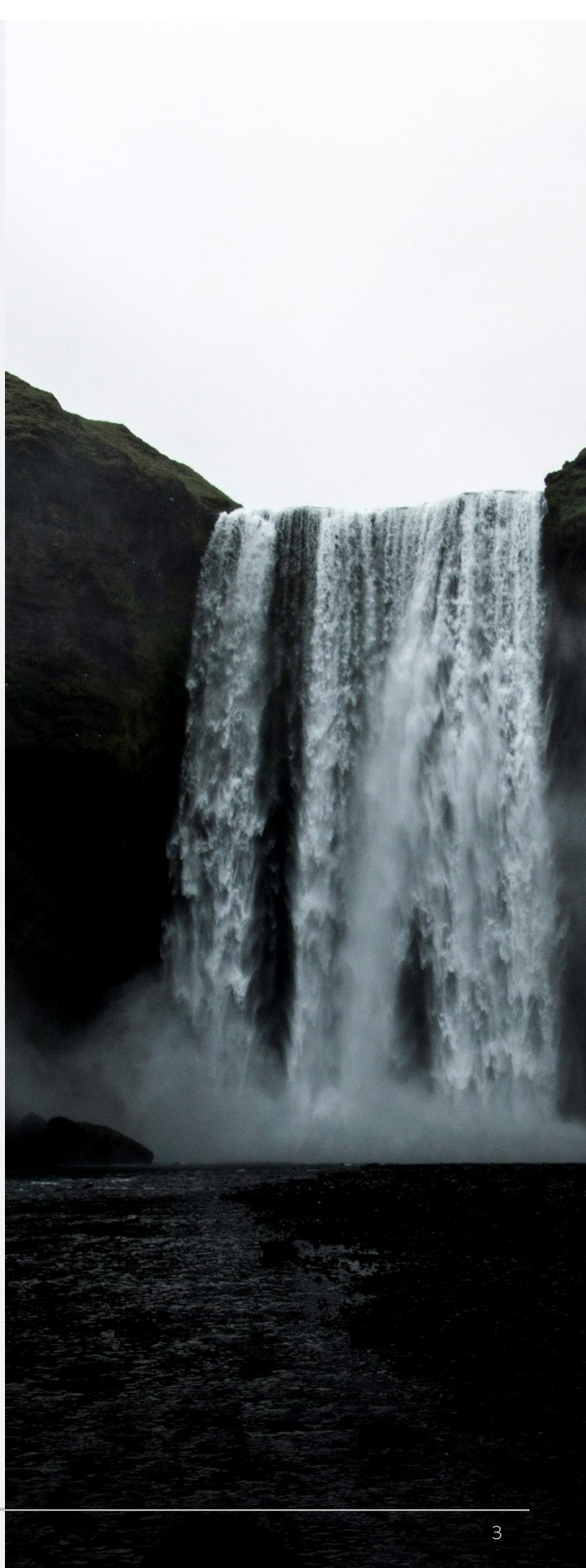
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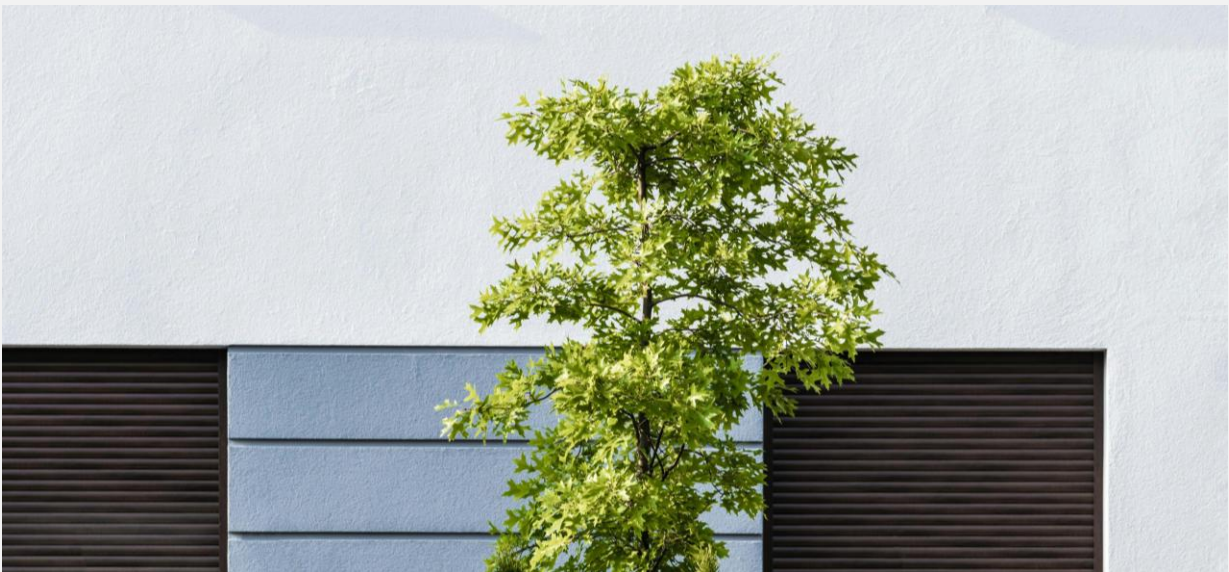
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The Times are Changing

Looking back on the last five years, a lot has changed. 2019 marked a pivotal year in climate action – ‘the year the world woke up to climate change’ as described by the EBRD. Following the release of the [IPCC special report on global warming of 1.5°C](#) one specific catchphrase sent echoes across the world: ‘only 12 years to save the planet’. Back then, only 16% of global GDP was covered by net zero targets, today that number is closer to 90%. It was also the year that Swedish climate activist Greta Thunberg, the inspiration for the climate strike movement, was nominated for her first of two Nobel Peace Prizes and named *Time* Person of the Year. **It was the year that sparked a half decade of the most ambitious climate progress that humankind has ever achieved.** In the following years, sustainable investing assets would explode hitting record levels (over USD\$35 trillion), scores of companies would rush to make climate commitments including nearly 10,000 companies with approved Science Based Targets (SBTi), and corporate sustainability, it seemed, was gaining the traction it desperately needed.

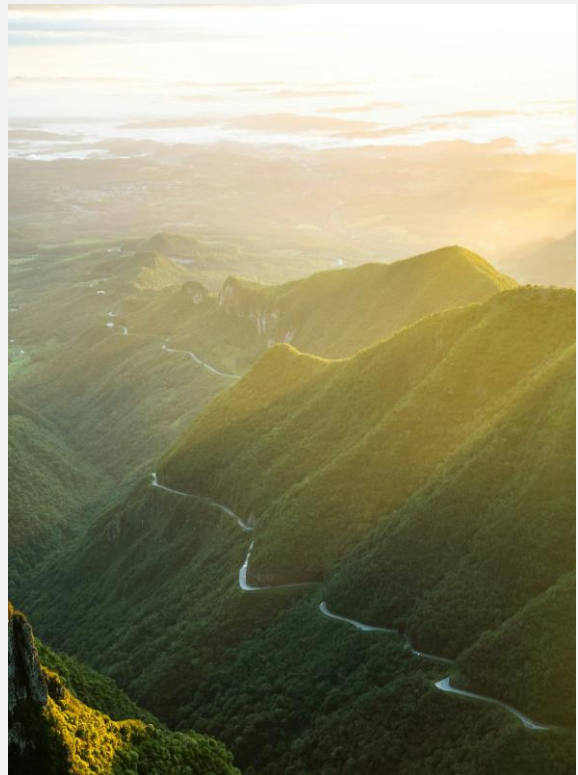


Five years later, the headlines kicking off 2025 paint a much different picture. Politically, the last few years have [seen hundreds of legislative attempts](#) to limit ESG, particularly across the US, including [one in Florida](#) that “prohibited financial institutions and banks from considering non-financial factors in making investing choices and from enacting ‘social credit scores’”. Asset managers were being put between a rock and a hard place: on one hand, sustainability funds have proliferated widely as the result of a mutual understanding between the asset owner (including retail investors and the general public) and the asset manager on the importance of directing capital towards climate solutions. On the other, in order to continue operating in one of the largest economies in the world, they were being asked to walk back from this belief.

The Pullback

One interim solution seemed to be exiting organized initiatives that allowed asset managers around the world to commit to a single set of standards for greening their portfolios. This would allow for greater flexibility in their approach. Notably Blackrock recently exited the Net Zero Asset Managers (NZAM) initiative leading the organization to [suspend its activities](#) including tracking signatory implementation and reporting as well as removing the commitment statement and list of NZAM signatories from its website and related case studies until further review. Although the news seems bleak, it's important to contextualize the real impact – based on a preliminary assessment global AUM committed to net zero fell from an approximate ~50% of global assets to ~40% post BlackRock exit. In the grand scheme of things, a small (though not insignificant) movement. Similar pressure has been applied to the banking sector with several financial institutions pulling out of the UN-backed Net Zero Banking Alliance (NZBA). Despite this retreat, major Canadian banks remain committed to a cumulative goal of directing ~CAD\$ 2 trillion to sustainable finance by 2030 as well as upholding their net zero targets. Further, 142 central banks (including the Bank of Canada) remain members of the Network for Greening the Financial System (NGFS) demonstrating ongoing commitment to managing the impacts of climate risks within the global financial sector.

Despite the headlines grabbing attention of recent high-profile withdrawals, there still remains a significant amount of assets pursuing decarbonization commitments. To further contextualize these implications and their potential to alter the landscape of supply and demand through technical effects on securities valuation, it should be noted the marginal carbon abatement in portfolio and on balance sheets is a paltry 2.0% - 4.5% per annum depending on baseline emissions, to achieve a 1.5°C trajectory.



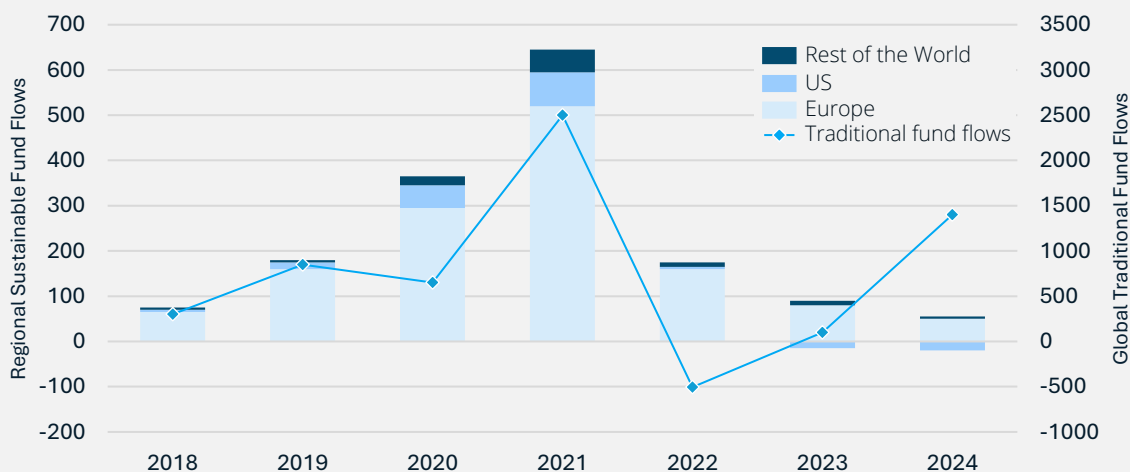
This edition of The Climate Finance Review aims to explore the effects on the value of securities through technical (supply-demand) and fundamental factors to assist asset owners with their outlook.

Review of Global Landscape

Global Sustainable Investing Assets, By the Numbers

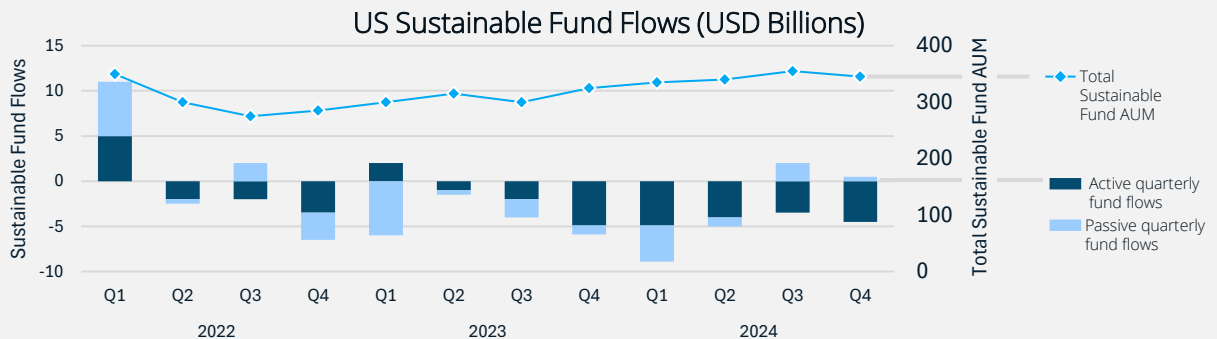
We believe in the power of data to uncover trends and themes less obvious at first glance. In order to peak into the state of affairs, we reviewed 1) the [Global Sustainable Investment Review 2022](#), a biennial publication by the Global Sustainable Investment Alliance (GSIA) which includes a snapshot of sustainable investing assets based on the regional and national reports from GSIA members and 2) Morningstar Sustainalytics' [Global Sustainable Fund Flows: Q4 2024 in Review](#), a quarterly publication which reports a global sustainable fund universe, encompassing open-end funds and exchange-traded funds that focus on sustainability, impact, or environmental, social, and governance factors. Both of these reports enable a comparative analysis of three jurisdictions: US, Canada, and Europe.


Annual Global Sustainable Fund Flows by Region (USD Billion)



Globally, sustainable fund flows peaked in 2021 (bar chart) mirroring the broader market (bright blue line) and remained net positive in 2022, 2023 and 2024. Interestingly, in 2022 sustainable fund flows registered a ~USD\$200 billion gain while the broader market posted net outflows of USD\$500 billion. This is not an isolated phenomenon. Several studies have begun to emerge citing greater stability in sustainable assets vs traditional ones in times of volatility. [One such study](#) concluded that green bond portfolios experienced lower net sales (and therefore drawdowns) during the COVID-19 shock than equivalent conventional bond portfolios. [Other studies](#) have shown, over the same time period, that sustainable equity funds outperformed traditional equity funds. This pronounced 'buy and hold' strategy has proven beneficial for the overall sustainable investing market.

US Fund Flows Retreating



 While global sustainable funds have had net inflows every quarter since Q1 2022, the US has seen net outflows in 10 of the last 12, even as total global sustainable AUM hit an all time high in 2024. Further, after a sharp decline in Q3 2023, the US lagged the rest of the world in sustainable fund launches in 2024, which have been significantly outpaced by fund closures. The impacts of these outflows is demonstrated by total sustainable fund AUM dropping for the first time in Q4 2024 since Q2 2023. There are several contributing factors to this localized pullback:

1 Politicization of ESG

In 2023 alone, lawmakers in 47 states proposed [anti-ESG legislation](#). [Indiana](#) now prohibits state pension money from investing in ESG assets. [Alabama](#) prohibits government contracts with companies that boycott certain industries such as fossil fuels or companies based on ESG criteria. Further, twenty-one state Attorneys General warned asset managers that net-zero commitments might be in violation of their fiduciary duty to clients and compliance with antitrust laws. These, among other examples, have led to a politicization of ESG. What is viewed by some as an important metric for financial risk and/or a moral imperative, is conversely framed by others as a “woke” (pejorative) ideology that has no place in investment. Many of the financial institutions who have recently pulled out of global climate coalitions point to [political pressure](#) and [anxiety](#) as the main factor.

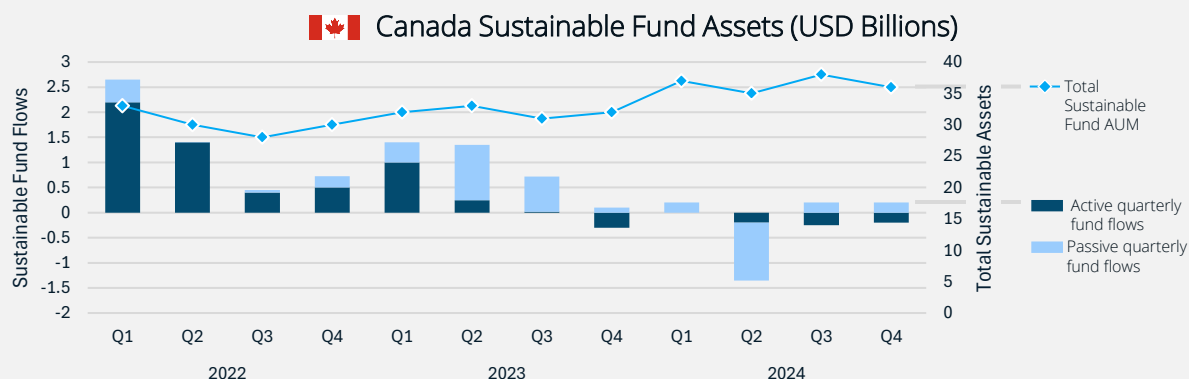
2 Greenhushing

Pursuant to the issue of politicization, an interesting compromise made by some, is the dropping of the term ‘ESG’ entirely while continuing to pursue the same goals associated with it (read: greenhushing). Larry Fink, Chairman and CEO of BlackRock, [commented](#) that “[he doesn’t] use the word ESG anymore, because it’s been entirely weaponized” before going on to establish that the firm would continue to talk to portfolio companies about decarbonization, corporate governance, and social issues. This strategy calls into question the efficacy, rigor, and accountability of firms with sustainability goals while skewing public perception.

3 To Label or not to Label

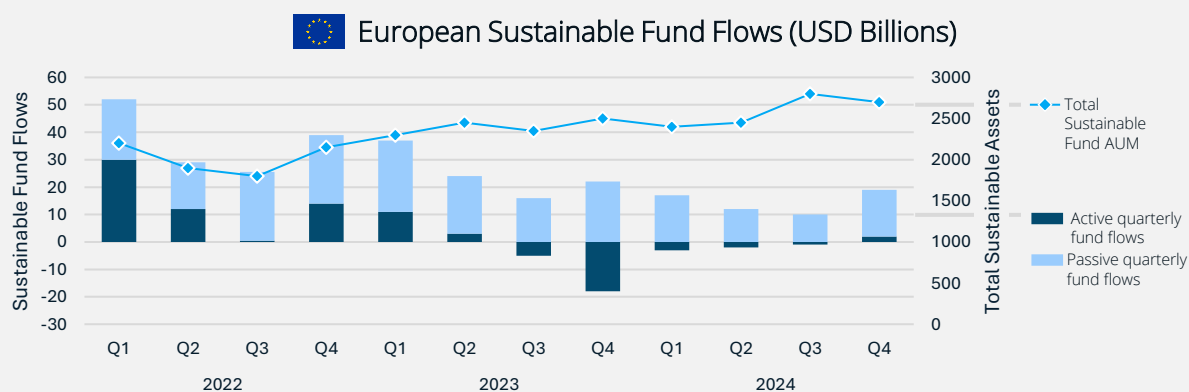
Regulators have frequently changed the requirements for labelling funds as sustainable, changing methodologies and skewing results. The [SEC rule change](#) which came into effect in December 2023 now requires sustainable and ESG funds to prove that 80% of assets are aligned to the focus suggested by the fund name. Given the rigidity of the regulation, many have dropped ESG-related nomenclature all together to avoid fines and reduce the administrative burden of proof.

Growth Continues Elsewhere



Cumulative Sustainable AUM Growing Despite Quarterly Volatility

Total sustainable fund AUM posted two-year highs in 2024, with total AUM at the end of 2024 was 16% higher YoY. This cumulative growth remains strong despite declines in quarterly inflows over the last 6 quarters. New sustainable fund launches were considerably lower in 2024 than in previous years as institutions take a 'wait and see' approach expecting the release of the long anticipated Canadian sustainable finance taxonomy, as well as the results of the upcoming federal election. Fixed income saw consistent inflows in 2024, demonstrating similar resilience seen in other markets within the asset class.



Europe Continues to Prop-up Sustainable AUM Demonstrating High Demand

European markets led the charge with USD\$18.5 billion in inflows in Q4 2024, essentially single handedly driving net global flows of USD\$16.0 billion – representing an 84% market share – reflecting its pivotal role in the global sustainable investing landscape. Sustainable equities saw a sevenfold growth in Q4 2024 vs Q3 2024, far outpacing the 75% growth in traditional equity markets. Fixed income saw slight outflows of 7% QoQ, proving more resilient than traditional fixed income outflows of 9% QoQ. However, 2024 saw lower overall flows than previous years, down significantly from record highs of USD\$527 billion in inflows in 2021. This is as the result of mixed performance, greenwashing concerns, political and regulatory uncertainty and changes, and spillover from the anti-ESG sentiment in the US.

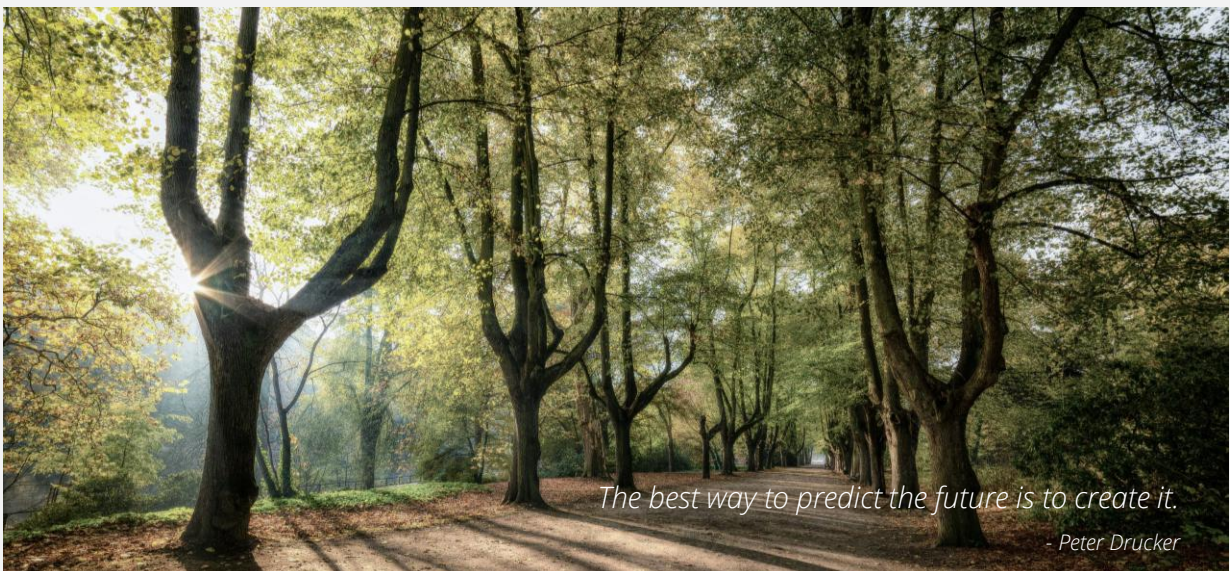
Sources of Optimism

Investors Continue to Mobilize Capital

- **90% of global GDP** covered by net zero targets
- **~USD\$65 trillion** in net zero committed assets remains
- **~USD\$1 trillion** in global green social sustainability bond issuance in 2024
- **61% of asset owners** in North America said ESG has become more material in the last 5 years
- **~8 in 10 asset owners and managers** expect sustainable AUM to rise in the next 2 years
- **77% of retail investors** are interested in sustainable investing with **54%** planning to increase their ESG allocations

Philanthropy Stepping up to the Plate

In a recent [press release](#), “Michael R. Bloomberg... announced that Bloomberg Philanthropies and other U.S. climate funders will ensure the United States meets its global climate obligations following the federal government’s intent to withdraw from the Paris Agreement for the second time. This includes covering the funding gap left by the United States to UN Climate Change (UNFCCC) and upholding the country’s reporting commitments.” He further noted “Bloomberg Philanthropies has made significant investments in empowering local leaders, providing businesses with the data to track emissions while driving economic growth, and building coalitions across public and private sectors. Now, philanthropy’s role in driving local, state, and private sector action is more crucial than ever—and we’re committed to leading the way.”

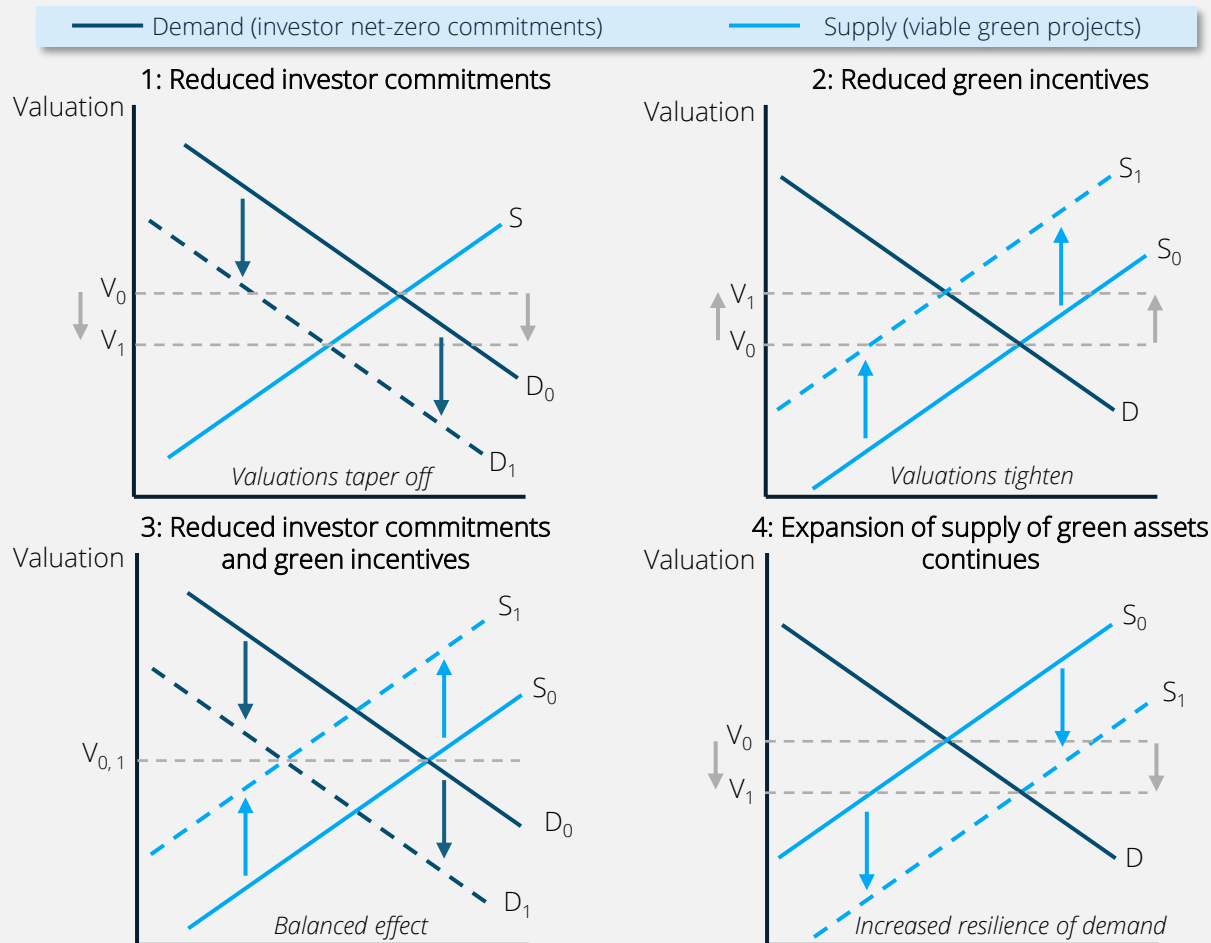


Protocol for Managers (I)

Anticipating Scenarios






In order to look forward, it is helpful to think about the movement of both the 1) demand for green assets (through investor net zero commitments) and 2) supply of green assets (through the manufacturing of green projects).

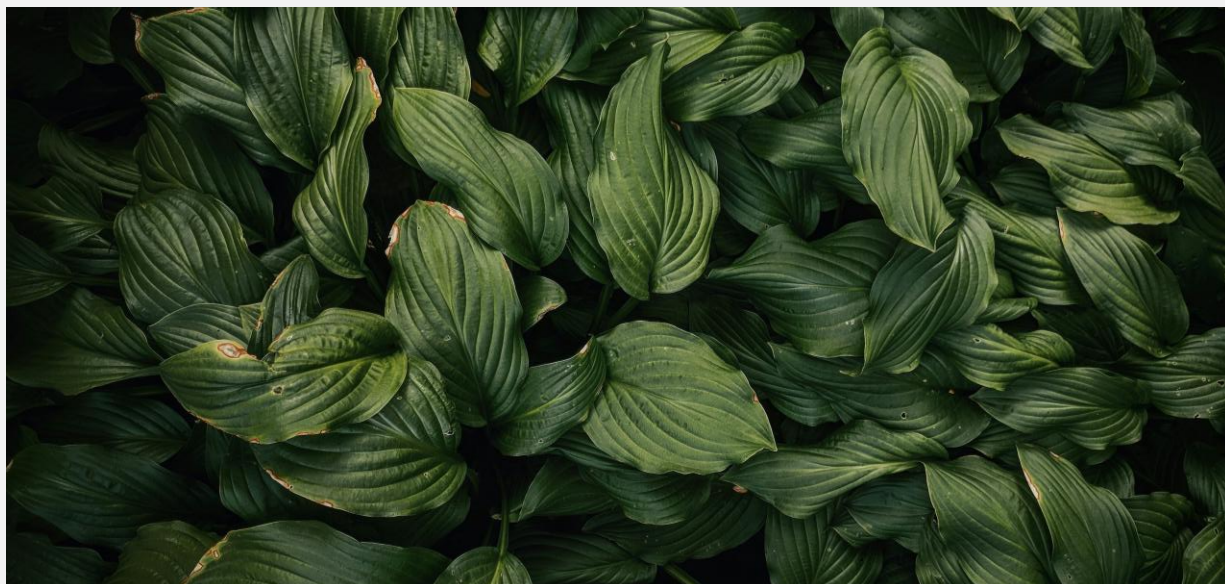
Take **scenario 1** where the demand for green assets tapers off due to the exiting of climate change commitments, holding all else constant we should see smaller order books and less pricing tension. In **scenario 2**, where the expected removal of green incentives causes a slowing in the manufacturing of green assets (reduction in supply), we would see a tightening of valuations. However, in **scenario 3** where we see both a reduction in demand and supply, than the effects on valuations would be more subdued. In **scenario 4**, should supply continue to increase and demand remains stagnant, tactical buying opportunities could emerge as a result. In this scenario, we assume that the business fundamentals of renewable energy and clean technology solutions continue to improve through decreasing cost curves, improving prototype stages of technologies and their ability to commercialize.



Protocol for Managers (II)

Hedging for Downside Risk

Hedging Technique	Rationale
 Diversification	Allocating capital across sector, geography, and asset class to reduce exposure to overall portfolio risk.
 In-Depth Due Diligence	Performing in-depth due diligence enables investors to better understand and avoid the climate risk associated with their investments.
 Derivatives	Derivative instruments can enable investors to alter the climate risk characteristics of the portfolio to mitigate uncompensated risk and to increase exposure to high conviction opportunities.
 Structured Products	Applying financial engineering can enable investors to achieve a more tailored and granular risk-reward profile (Blended finance, social impact bond, impact investing, etc.)
 Insurance	Can explore insurance products through explicit coverage of nature-based assets or embedded into instruments such as catastrophe bonds.



Resilience in Adversity

Closing the Climate Finance Gap

[Annual climate finance requirements](#) are projected to rise to \$9 trillion by 2030, which is now only 5 years away. Between 2031 and 2050, this number exceeds \$10 trillion per annum across both mitigation and adaptation activities. Yet, only \$1.26 trillion was invested in each of 2021 and 2022. This climate finance gap leaves investors exposed and generally uncompensated for the systemic risks presented by climate change.

Climate change challenges traditional financial risk models in many ways given the uncertainty of the timing, magnitude, and frequency of events, along with the interconnected and irreversible nature of global tipping points. **Those managers who are able to both hedge their own portfolios while contributing to broader real-world emissions reduction** (financing of climate tech VCs, contributing to research and development of climate solutions, unlocking capital through innovation like blended finance) **create the kind of resilience needed to generate returns while reducing overall climate risk in the system.**

Todd Cort, a professor at the Yale School of Management who specializes in sustainable investing, framed this argument - "Behind the curtain there will be substantially more effort by investors to understand environmental and social risk," he said. "That will continue to grow, and I actually don't care too much if we continue to call it ESG [or not]." ↘





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