

Is ESG losing its lustre?

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Cite this paper as: Prof. Prantik Ray (2025) Is ESG losing its lustre? *Advances in Consumer Research*, 2 (4), 2536-2544

<b>KEYWORDS</b> <i>ESG investing, Sustainable finance, Greenwashing</i>	<b>ABSTRACT</b> Environmental, Social, and Governance (ESG) investing has emerged as a dominant force in sustainable finance, reshaping corporate behavior, investment strategies, and regulatory frameworks worldwide. Initially viewed as a transformative approach to aligning financial performance with societal and environmental goals, ESG witnessed exponential growth between 2015 and 2022. However, recent years have seen growing skepticism and challenges surrounding its effectiveness, standardization, and credibility. This article critically examines the evolution of ESG—from its roots in Corporate Social Responsibility (CSR) and Socially Responsible Investing (SRI) to its overlap with the more outcomes-focused domain of impact investing. It explores the rise of ESG investing, the proliferation of ESG-linked financial instruments, and the global regulatory frameworks that have propelled its adoption. At the same time, it highlights mounting concerns over greenwashing, inconsistent ESG ratings, lack of universal disclosure standards, and the politicization of ESG, especially in markets like the United States. The article argues that while ESG is undergoing a period of reputational and structural scrutiny, it is not in terminal decline. Instead, ESG is entering a phase of transformation—“ESG 2.0”—characterized by regulatory integration, enhanced measurement tools, and closer alignment with financial materiality and long-term risk management. As investors, regulators, and corporations adapt to this changing landscape, the future of ESG will depend on its ability to deliver transparency, accountability, and demonstrable impact in a politically polarized and economically uncertain world..
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1. WHAT IS ESG?

Environmental, Social, and Governance (ESG) has emerged as a critical framework in modern business and investment strategies, reshaping corporate practices and financial decision- making.

ESG refers to a set of criteria used to evaluate a company's performance and impact across three key areas: *environmental responsibility, social accountability, and corporate governance*.

**Environmental responsibility** assesses a company’s impact on the environment and its sustainability efforts, focusing on how businesses manage environmental risks and reduce their ecological footprint. This includes climate change mitigation through carbon footprint reduction, net-zero goals, and renewable energy adoption, as well as resource efficiency in sustainable water, energy, and raw material usage. Companies are also evaluated on pollution and waste management, emissions control, plastic usage, and circular economy practices. Biodiversity conservation efforts, sustainable land use, and adherence to environmental regulations such as TCFD and CDP also fall under this category. Examples include Tesla’s prioritization of renewable energy and electric vehicles to reduce carbon emissions, Unilever’s sustainable sourcing of palm oil to prevent deforestation, and companies reducing single-use plastics through circular economy models.

**Social accountability** focuses on a company's relationships with employees, customers, communities, and stakeholders. It examines whether businesses operate ethically, promote diversity, and contribute to societal well-being. This includes diversity, equity, and inclusion (DEI) initiatives such as fair hiring practices, gender diversity, and workplace inclusivity, along with labor rights, fair wages, and employee safety. Companies are also evaluated on human rights protections in their supply chains, customer engagement, ethical product sourcing, data privacy, and corporate social responsibility (CSR) initiatives. Starbucks, for instance, promotes inclusive hiring practices and supports coffee farmers through fair trade initiatives, Patagonia ensures fair wages and ethical labor practices in its supply chain, and Apple prioritizes data privacy and responsible material sourcing like cobalt.

Corporate governance examines a company’s internal structures, leadership, and ethical decision-making processes to ensure transparency, accountability, and stakeholder trust. It includes board diversity and independence, executive compensation.



and incentives, ethical business practices such as anti-corruption policies and whistleblower protections, shareholder rights and engagement, and regulatory compliance. Examples include Microsoft maintaining independent board oversight and strong cybersecurity governance, JPMorgan Chase adopting robust compliance measures to prevent financial misconduct, and Nestlé enhancing supply chain transparency through disclosures

The concept's roots can be traced back to the social upheavals of the 1960s and 1970s, which raised awareness about environmental issues and social movements. However, the term "ESG" itself was first coined in 2004 in a United Nations Global Compact report<sup>1</sup>.

### Importance of ESG in sustainable finance

ESG has become integral to sustainable finance practices, driving the transformation of both the economy and society towards more responsible development. It plays a crucial role in addressing global challenges such as climate change, social inequality, and corporate scandals. The importance of ESG in sustainable finance is evident in several ways:

**Risk management:** ESG considerations help identify and mitigate environmental, social, and governance-related risks that can impact financial performance.

**Performance enhancement:** Studies have shown that companies with strong ESG profiles often demonstrate better operational performance and higher profitability.

**Investor demand:** There is a growing demand from investors for sustainable assets and ESG-aligned investment opportunities.

**Regulatory pressure:** Increasing regulatory focus on ESG disclosure and compliance is pushing companies to adopt sustainable practices.

ESG is important because it influences financial performance, risk mitigation, and long-term value creation for investors while helping companies enhance their reputation, attract talent, and improve regulatory compliance.

### The Initial Promise and Rise of ESG Investing

The rise of Environmental, Social, and Governance (ESG) investing has been remarkable, with a significant increase in funds allocated to sustainable investments over the past few decades. Between 2018 and 2020, global assets under management (AUM) in ESG investments surged from \$4.5 trillion to nearly \$40.5 trillion, marking almost a tenfold increase (Global Sustainable Investment Alliance [GSIA], 2021). Moreover, from 1995 to 2020, ESG-focused investments grew nearly 25-fold, from \$639 billion to over \$16.6 trillion in the United States alone (Forum for Sustainable and Responsible Investment [US SIF], 2021).

This exponential growth highlights the initial promise of ESG investing, which is built on the following key factors:

**Financial Performance:** ESG investments have demonstrated strong financial resilience, particularly during market downturns. Studies show that ESG funds tend to outperform traditional investments, especially during periods of economic distress. For example, a 2020 Morningstar analysis found that 72% of ESG funds outperformed their non-ESG counterparts during the COVID-19 market crash (Hale, 2020). Furthermore,

a meta-analysis of over 1,000 studies by NYU Stern School of Business found that 59% of ESG investments showed improved financial performance, while only 14% showed negative performance impacts (Whelan et al., 2021).

**Long-Term Value Creation:** Investors increasingly recognize ESG factors as key indicators of long-term financial sustainability and risk management. A study by BlackRock (2021) found that companies with higher ESG scores experienced 3% lower costs of capital and 10% lower stock price volatility compared to their lower ESG-rated peers. Additionally, ESG leaders tend to achieve 15% higher return on equity (ROE) over a five-year period compared to their industry peers (MSCI, 2022).

**Alignment with Global Goals:** ESG investing aligns with international sustainability frameworks such as the United Nations Sustainable Development Goals (SDGs) and the Paris Agreement on Climate Change. Over 80% of institutional investors now integrate ESG factors into their investment decisions to contribute to global sustainability initiatives (Principles for Responsible Investment [PRI], 2022). Additionally, the European Union's Sustainable Finance Disclosure Regulation (SFDR) and the U.S. SEC's proposed climate disclosure rules are further accelerating ESG adoption (European Commission, 2021; U.S. Securities and Exchange Commission [SEC], 2022).

**Addressing Stakeholder Concerns:** Growing stakeholder demand for responsible corporate practices is a major driver of ESG investing. A 2022 PwC survey revealed that 79% of investors believe companies should prioritize ESG factors alongside financial performance (PwC, 2022). Moreover, millennial and Gen Z investors—who are projected to inherit \$68 trillion in wealth by 2030—are twice as likely to invest in ESG-aligned portfolios (Morgan Stanley, 2021).

As ESG continues to evolve, it is expected to play an even more significant role in shaping a sustainable, equitable, and prosperous future for businesses and society. Global ESG assets are projected to reach \$53 trillion by 2025, accounting for over one-third of total assets under management (Bloomberg Intelligence, 2021). However, challenges such as greenwashing



concerns, inconsistent ESG metrics, and regulatory uncertainties need to be addressed to maintain investor confidence and maximize the impact of ESG investing.

### **Historical background: From CSR to ESG to Impact Investing**

The evolution of responsible investing can be traced back centuries, but its modern development has occurred in several distinct phases. The concept of aligning business with ethical and social concerns began with early moral philosophers like John Wesley and Adam Smith, who connected ethics with economics (Sparkes, 2002). Over time, this idea evolved into Corporate Social Responsibility (CSR), Socially Responsible Investing (SRI), ESG, and eventually Impact Investing.

#### **Corporate Social Responsibility (CSR): The 1980s Onward**

The CSR movement emerged in the 1980s as companies began acknowledging their responsibilities beyond profit generation (Carroll, 1999). Businesses started incorporating social and environmental concerns into their operations, often as part of voluntary initiatives rather than regulatory compliance.

Key developments include Carroll's CSR Pyramid (1991), which outlined four levels of corporate responsibility: economic, legal, ethical, and philanthropic (Carroll, 1999). The United Nations Global Compact (2000) encouraged businesses to adopt principles related to human rights, labor, environment, and anti-corruption (UNGC, 2000). Large corporations began publishing sustainability reports, detailing their environmental and social impact.

Example: Ben & Jerry's and The Body Shop were early adopters of CSR, focusing on ethical sourcing, fair trade, and social justice initiatives.

#### **Socially Responsible Investing (SRI): The 1960s to 1980s**

SRI emerged in the 1960s and 1970s, initially focusing on excluding certain industries from investment portfolios based on moral or ethical considerations (Schueth, 2003).

Key developments include opposition to investments in industries such as tobacco, weapons, and gambling. The anti-apartheid divestment campaign in the 1980s led to major institutional investors withdrawing capital from companies operating in South Africa, pressuring the country to end apartheid (Richardson, 2009). Ethical mutual funds gained traction in the 1990s, screening investments based on social and environmental criteria.

Example: CalPERS and other pension funds divested from companies operating in apartheid South Africa, leading to global sanctions and contributing to the fall of apartheid.

#### **ESG Framework: From 2004 Onward**

The term ESG (Environmental, Social, and Governance) was first coined in 2004 in the report *"Who Cares Wins,"* published by the United Nations Global Compact (UNGC, 2004). ESG marked a shift from exclusionary approaches to a comprehensive evaluation of sustainability factors.

Key developments include the UN Principles for Responsible Investment (PRI) (2006), which encouraged institutional investors to integrate ESG factors (PRI, 2006). The 2008 financial crisis highlighted the importance of governance and risk management in corporate sustainability (Eccles et al., 2020). Regulatory frameworks such as the EU Taxonomy (2020) and SFDR (2021) introduced ESG disclosure requirements (European Commission, 2021), while the SEC's proposed climate disclosure rules (2022) reinforced ESG integration in financial reporting (SEC, 2022).

Example: BlackRock's 2020 Letter emphasized that climate risk is investment risk, signaling the financial industry's shift toward ESG-aligned portfolios (Fink, 2020).

#### **Impact Investing: The 2000s to Present**

Impact investing emerged in the early 2000s as an approach that seeks to generate measurable social and environmental impact alongside financial returns (Bugg-Levine & Emerson, 2011). Unlike SRI and ESG, which focus on risk mitigation, impact investing actively drives positive change in areas like renewable energy, affordable housing, and microfinance.

Key developments include the Rockefeller Foundation formally introducing the term *impact investing* in 2007 (Bugg-Levine & Emerson, 2011). The Global Impact Investing Network (GIIN) (2013) established impact measurement frameworks (GIIN, 2013). The market for green, social, and sustainability bonds surpassed \$3 trillion by 2023 (Climate Bonds Initiative, 2023).

Example: Acumen Fund and LeapFrog Investments finance enterprises that address poverty, healthcare, and climate action while delivering strong financial returns.

The journey from CSR to ESG to Impact Investing reflects a shift from voluntary corporate responsibility to financial market integration. Today, ESG investing has become a mainstream strategy, influencing trillions of dollars in global assets. While CSR and SRI laid the ethical foundation, ESG investing quantifies sustainability factors, and impact investing aims for tangible, measurable social change. As the world faces climate change, social inequality, and governance challenges, the



next phase of sustainable finance will likely focus on regulatory enforcement, standardization of ESG metrics, and deeper impact measurement.

### **Regulatory and Policy Frameworks Driving ESG Adoption**

The institutionalization of ESG investing has been significantly influenced by global regulatory and policy frameworks. These frameworks ensure transparency, accountability, and the integration of sustainability in financial markets, encouraging businesses and investors to align their strategies with long-term ESG considerations.

United Nations Principles for Responsible Investment (UNPRI) (2005)

The UNPRI, launched in 2005 and formally established in 2006, is a global initiative that promotes responsible investment practices. It encourages institutional investors to integrate ESG factors into their financial decisions. Today, over 5,000 signatories, representing \$121 trillion in assets, have committed to these principles (UNPRI, 2023). Investors following UNPRI pledge to incorporate ESG factors into investment analysis, be active owners, and report on their ESG progress. Leading global funds, such as Norway's Pension Fund and Japan's Government Pension Investment Fund (GPIF), have adopted UNPRI principles, significantly influencing sustainable investing worldwide.

### **Paris Agreement (2015)**

Adopted in 2015, the Paris Agreement is a legally binding international treaty on climate change that aims to limit global warming to 1.5°C above pre-industrial levels (UNFCCC, 2015). Countries that have signed the agreement commit to reducing carbon emissions through Nationally Determined Contributions (NDCs) and mobilizing \$100 billion annually for climate financing. The Paris Agreement has influenced ESG-focused financial regulations worldwide, leading to the introduction of climate risk disclosures, net-zero targets, and green finance policies. The European Union's Green Deal is one such policy framework aligned with the Paris Agreement, setting stricter carbon reporting and sustainability targets for corporations.

### **EU Sustainable Finance Disclosure Regulation (SFDR) (2021)**

The EU Sustainable Finance Disclosure Regulation (SFDR) was introduced in 2021 to improve transparency in sustainable investing (European Commission, 2021). It classifies financial products into three categories based on their sustainability focus: Article 6 (non-ESG funds), Article 8 (ESG-promoting funds), and Article 9 (impact-driven funds). SFDR aims to curb greenwashing and ensure that investors have clear and reliable information about ESG investments. Since its implementation, over \$4 trillion in assets have been classified under Article 8 and 9, reflecting a strong market shift toward sustainability-focused funds.

### **India's Business Responsibility and Sustainability Report (BRSR) (2021)**

The Business Responsibility and Sustainability Report (BRSR) was mandated by the Securities and Exchange Board of India (SEBI) in 2021, requiring the top 1,000 listed companies to disclose ESG-related data (SEBI, 2021). It replaces the previous Business Responsibility Report (BRR) with a more comprehensive framework, aligning with global sustainability standards such as the Global Reporting Initiative (GRI) and Task Force on Climate-related Financial Disclosures (TCFD). Companies must report on key ESG parameters, including carbon emissions, waste management, workforce diversity, and governance structures. Leading Indian corporations like Infosys, Reliance, and Tata Group have strengthened their sustainability disclosures to comply with the BRSR framework, making India a growing player in ESG reporting.

### **Growth of ESG funds and sustainable finance instruments**

The ESG investing landscape has experienced remarkable growth:

**ESG Funds:** Assets under management in global sustainable funds have grown from USD 639 billion in 1995 to over USD 2.7 trillion in 2021. Projections suggest this could reach USD 30 trillion by 2030 (Bloomberg Intelligence, 2021).

**Green Bonds:** The outstanding amount of euro area green bonds has increased sevenfold since 2015 (European Central Bank, 2022).

**Sustainability-Linked Loans:** These instruments link interest rates to improvements in sustainability performance, providing a direct financial incentive for ESG improvements (Loan Market Association, 2022).

**Social Bonds:** These raise funds for projects with positive social outcomes, complementing green bonds in the sustainable finance ecosystem (International Capital Market Association, 2021).

## **2. KEY PLAYERS: GOVERNMENTS, INVESTORS, RATING AGENCIES, AND CORPORATIONS**

### **The ESG ecosystem involves a diverse range of stakeholders:**

**Governments:** Through policy-making and regulation, governments play a crucial role in setting the framework for ESG adoption. For example, India's BRSR mandate has significantly influenced corporate sustainability reporting (SEBI, 2021).



**Investors:** Institutional investors, such as pension funds and asset managers, have been instrumental in driving ESG adoption. As of 2021, ESG funds represented about 7% of the total global mutual funds and ETFs (Morningstar, 2022).

**Rating Agencies:** Organizations like MSCI provide ESG ratings, aiming to assess the long-term resilience of companies to ESG issues (MSCI, 2022).

**Corporations:** Companies are increasingly integrating ESG factors into their core business strategies, driven by investor demand and regulatory pressure (McKinsey & Company, 2022).

**International Organizations:** The United Nations, through initiatives like the UNPRI and the Sustainable Development Goals, has played a pivotal role in shaping the global ESG agenda (United Nations, 2022).

**Financial Institutions:** Banks and other financial institutions are developing ESG- focused products and incorporating ESG considerations into their lending and investment decisions (Bank for International Settlements, 2021).

As of 2025, the ESG landscape continues to evolve rapidly. The growth in ESG investing reflects a broader shift towards sustainable and responsible business practices. However, challenges remain, including the need for standardized reporting frameworks, concerns about greenwashing, and the ongoing debate about the relationship between ESG performance and financial returns. Despite these challenges, the trend towards ESG integration in investment decision-making appears set to continue, driven by increasing awareness of global sustainability challenges and the potential for ESG factors to impact long-term financial performance.

The effectiveness of Environmental, Social, and Governance (ESG) investing has faced numerous challenges in recent years. This comprehensive analysis explores the key issues undermining ESG's efficacy and investor confidence.

### **Greenwashing Concerns**

Greenwashing, the practice of making misleading or false claims about the environmental benefits of a product, service, or company, has emerged as a significant threat to the credibility of ESG investing.

Cases of misrepresentation and misleading ESG claims

Numerous instances of greenwashing have come to light, eroding trust in ESG claims. For example, in 2024, the Securities and Exchange Commission (SEC) adopted rules to enhance climate-related disclosures for investors, aiming to improve transparency and consistency in climate-related reporting<sup>3</sup>. This regulatory action was partly in response to the growing concerns about misrepresentation in ESG claims.

### **Impact of greenwashing on investor trust**

The prevalence of greenwashing has significantly impacted investor confidence in ESG investments. According to a recent study, two-thirds of private investors express concerns about

greenwashing, while 61% are not convinced by ESG claims from funds<sup>2</sup>. This lack of trust has led to ESG fund outflows and undermined investment firms' broader sustainability credentials and objectives<sup>5</sup>.

### **Regulatory and Standardization Issues**

The absence of universally accepted ESG reporting frameworks and the divergence in ESG rating methodologies have created significant challenges for investors and companies alike.

Lack of universal ESG reporting frameworks

Despite efforts to standardize ESG reporting, the landscape remains fragmented. Various frameworks and standards exist, including the Corporate Sustainability Reporting Directive (CSRD), International Sustainability Standards Board (ISSB), Sustainability Accounting Standards Board (SASB), and Global Reporting Initiative (GRI)<sup>3</sup>. This diversity in reporting standards makes it difficult for investors to compare ESG performance across companies and sectors.

### **Divergence in ESG rating methodologies**

The lack of standardization extends to ESG rating methodologies. Major rating agencies such as MSCI, S&P, and Sustainalytics employ different approaches to assess ESG performance, leading to inconsistent ratings for the same company<sup>1</sup>. This divergence creates confusion for investors and undermines the credibility of ESG ratings as a reliable indicator of sustainability performance.

### **Financial Performance vs. ESG Metrics**

The relationship between ESG performance and financial returns remains a subject of debate among investors and researchers.

### **Does ESG lead to superior or inferior financial returns?**

Research on the link between ESG and financial performance has yielded mixed results. Some studies suggest that companies with strong ESG profiles demonstrate better operational performance and higher profitability<sup>1</sup>. However, other research





indicates that the relationship between ESG and financial performance is not straightforward and may vary depending on factors such as industry, region, and time horizon<sup>1</sup>.

#### Conflicts between fiduciary duties and ESG commitments

Asset managers face challenges in balancing their fiduciary duties to maximize returns with their ESG commitments. The absence of clear regulatory guidance on how to integrate ESG factors into investment decisions while fulfilling fiduciary responsibilities has created uncertainty for many investors<sup>8</sup>.

#### Short-termism vs. Long-term Impact

The tension between short-term financial performance and long-term ESG impact presents a significant challenge for investors and companies.

#### Investor impatience and demand for quick returns

Many investors continue to prioritize short-term financial performance over long-term sustainability goals. This focus on immediate returns can discourage companies from making necessary investments in ESG initiatives that may not yield immediate financial benefits<sup>1</sup>.

#### Balancing ESG-driven impact with financial materiality

Companies and investors struggle to strike a balance between pursuing ESG objectives and maintaining financial performance. Research has shown that focusing on material ESG issues can lead to improved stock performance, while addressing immaterial ESG issues may not yield significant financial benefits<sup>1</sup>. This highlights the need for a more nuanced approach to ESG integration that considers both impact and financial materiality. In conclusion, while ESG investing has gained significant traction in recent years, it faces numerous challenges that threaten its effectiveness and credibility. Addressing these issues will require concerted efforts from regulators, investors, and companies to improve standardization, enhance transparency, and develop more sophisticated approaches to integrating ESG factors into investment decision-making. As the field continues to evolve, ongoing research and dialogue will be crucial in refining ESG practices and ensuring their long-term viability as a tool for promoting sustainable and responsible business practices

The ESG landscape in 2025 is characterized by significant challenges and declining interest, driven by political opposition, corporate skepticism, and shifting investor priorities.

Political opposition to ESG has intensified, particularly in the United States following Donald Trump's 2024 victory. There has been a renewed push against "woke capitalism," with Republican-led states introducing and passing anti-ESG legislation<sup>[5]</sup>. This political backlash has created a divided global landscape, with Europe and Asia continuing to advance ambitious sustainability plans<sup>[5]</sup>.

Corporate leaders are increasingly skeptical of ESG initiatives. A PwC survey of US corporate boards revealed deep-rooted political polarization surrounding ESG issues<sup>[1]</sup>. Some corporations have aligned with Republican positions, often adopting rhetoric that dismisses climate change and other ESG concerns as part of a broader "anti-woke" agenda<sup>[1]</sup>.

ESG funds have experienced significant outflows and performance concerns. Investors pulled

\$4.7 billion from US sustainable funds in the second quarter of 2024, marking the seventh consecutive quarter of outflows<sup>[9]</sup>. The percentage of investors prioritizing ESG dropped from 53% in 2023 to 48% in 2024<sup>[9]</sup>.

The backlash against ESG has led to a shift in investor priorities and the emergence of "anti-ESG" funds. Some investors are reevaluating their positions due to the increasing politicization and regulatory scrutiny of ESG investing<sup>[3]</sup>. At least seven states have taken anti-ESG stances,

presenting them as 'anti-boycott' measures aimed at preventing state entities from investing in companies boycotting the fossil fuel industry<sup>[3]</sup>.

Despite these challenges, some experts argue that ESG investing is not just about improving environmental credentials but also about managing long-term risks<sup>[4]</sup>. As the debate continues, the future of ESG in 2025 remains uncertain, with the potential for further polarization and regulatory changes shaping the investment landscape.

#### Transition from ESG to Impact Investing

The sustainable finance landscape has evolved from traditional ESG investing towards impact investing, which focuses on measurable positive outcomes rather than just avoiding harm. Impact investing seeks investments that generate quantifiable, positive social or environmental impacts alongside financial returns<sup>1</sup>. This shift represents a more proactive approach to addressing global challenges, moving beyond risk mitigation to actively driving positive change<sup>1</sup>. Key differences between ESG and impact investing include:

Objectives: Impact investing focuses on achieving measurable positive outcomes, while ESG emphasizes incorporating sustainability factors into decision-making<sup>4</sup>.



Measurement: Impact investing requires quantifiable reporting of social or environmental impacts, whereas ESG evaluates a company's overall sustainability performance<sup>4</sup>.

## **ESG 2.0: Moving Towards Regulation & Standardization**

The ESG landscape is rapidly evolving towards increased regulation and standardization:

European Sustainability Reporting Standards (ESRS): Approved in July 2023, these standards unify ESG reporting guidelines across the EU<sup>2</sup>.

International Sustainability Standards Board (ISSB): Global adoption of ISSB standards is expected to drive consistent sustainability reporting across jurisdictions by 2025<sup>5</sup>.

California regulations: The Voluntary Carbon Market Disclosures Act (AB 1305) and SB 253 on GHG disclosure are set to take effect in 2025<sup>5</sup>.

EU Omnibus simplification package: This initiative aims to align various EU sustainability directives, streamlining compliance requirements<sup>5</sup>.

## **Integration with Financial Risk Management**

ESG factors are increasingly integrated into financial risk assessments:

Credit ratings: Major credit rating agencies now consider material ESG factors in their credit risk assessments<sup>3</sup>

ESG scores: Some credit rating agencies provide separate ESG scores to communicate the impact of these factors on credit ratings<sup>3</sup>.

Climate risk stress testing: Central banks and regulators are incorporating climate risk into financial stability assessments<sup>6</sup>.

The future of ESG in sustainable finance is poised for significant changes and evolution by 2025, with several key trends emerging:

## **Evolution of ESG Framework**

ESG is likely to evolve rather than completely rebrand, with a focus on more standardized and regulated approaches:

The transition from ESG to impact investing is gaining momentum, emphasizing measurable sustainability outcomes over ESG scores<sup>1</sup>.

There's a shift towards "ESG 2.0," moving towards increased regulation and standardization<sup>4</sup>.

### **Role of Key Stakeholders**

Governments, central banks, and institutional investors are playing crucial roles in shaping the future of ESG:

Central banks are incorporating climate risk into financial stability assessments<sup>3</sup>.

Institutional investors are increasingly integrating ESG criteria into their decision-making processes<sup>1</sup>.

### **Mandatory ESG Disclosures**

The transition from voluntary to mandatory ESG disclosures is well underway:

By 2025, the first reports under the EU's Corporate Sustainability Reporting Directive (CSRD) will be submitted, setting new benchmarks for ESG reporting<sup>4</sup>.

The UK has enacted mandatory ESG disclosure laws, affecting large companies and financial institutions<sup>2</sup>.

In India, SEBI has mandated ESG disclosures for the top 1,000 listed companies from FY 2022-23<sup>8</sup>.

### **Integration with Financial Regulations**

ESG is becoming increasingly integrated with financial regulations:

The Basel Committee on Banking Supervision is considering the implications of climate-related financial risks on Pillars 1 and 3 of its Basel Framework<sup>6</sup>.

The International Sustainability Standards Board (ISSB) is developing global baseline standards for sustainability disclosures<sup>6</sup>.

## **ESG-Linked Financial Instruments**

### **ESG-linked financial instruments are gaining prominence:**

Green bonds and sustainability-linked loans continue to be popular ways to raise funds for environmental projects<sup>4</sup>.

Transition finance, including sustainability-linked bonds, is emerging as a cornerstone of sustainable finance, particularly for industries striving to align with climate goals<sup>1</sup>.



In conclusion, the future of ESG in sustainable finance is characterized by increased standardization, regulation, and integration with existing financial frameworks. The shift towards mandatory disclosures and the evolution of ESG-linked financial instruments suggest a more mature and sophisticated approach to sustainable finance by 2025

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