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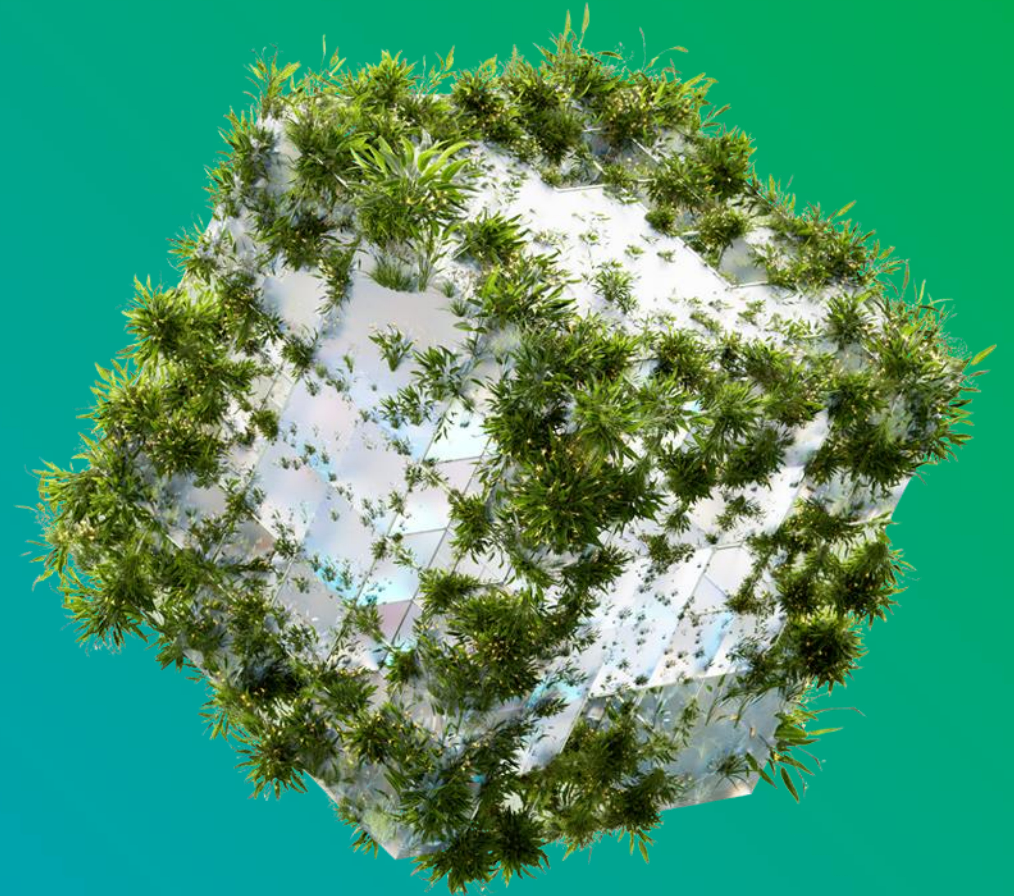
2025 Sustainable Investment Global Update



An overview of global SI regulations, insights from COP16 & COP29, and key trends and outlook on sustainable finance.

A business of Marsh McLennan

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Executive Summary

Regulatory Update

Regulators focused on enhancing transparency, accountability, and sustainability in financial and corporate sectors.

In 2024, significant strides continued to be made globally towards enhanced integration of sustainability considerations. In **Asia**, **Hong Kong** has launched a roadmap for sustainability disclosures, mandating publicly accountable entities to adopt ISSB Standards. **China** has enacted a new Energy Law prioritizing renewable energy. **Japan** is emphasizing non-financial factors in investments with new "Asset Owner Principles." **Singapore** has expanded its taxonomy to enhance interoperability with China and the EU. **Korea** is updating its carbon neutrality framework and has passed climate-related financial disclosure legislation.

Australia is rolling out mandatory climate disclosures for large companies and contributing $50 million for climate change loss and damage. **New Zealand** is developing a sustainable finance strategy to boost capital flow for sustainable opportunities.

Over the year, the **European Union** updated its sustainable finance framework by introducing new regulations, amending existing ones, and reviewing regulations like the SFDR, with the first phase of the Corporate Sustainability Reporting Directive (CSRD) reports set for release for larger entities. The **UK** is consulting on mandatory climate transition plans, revising the Stewardship Code, and introduced anti-greenwashing rules.

Canada is enhancing its sustainability framework by introducing guidelines for pension plans to incorporate ESG considerations, developing a voluntary taxonomy for green investments, and mandating climate-related disclosures for large companies. In the **US**, the US Securities and Exchange Commission (SEC) climate disclosure rule is final, however pending implementation.

In the near future, climate and sustainability policies are likely to continue diverging across different regions such as the EU and US as these issues receive increased attention in a politically polarized environment.

COP Reflections

COP29 focused on mobilizing finance, with an agreement to finance climate action through $300 billion per year commitment and carving a path towards a global carbon market. COP16 set ambitious goals for biodiversity conservation and introduced transition plans.

Our key takeaways for investors include:

1. Launch of the Cali fund which aims to share the benefits derived from using **digital sequence information (DSI)** from genetic resources.
2. TNFD published its draft guidance on **nature transition planning** for corporates and financial institutions
3. Launch of a **New Collective Quantified Goal on Climate Finance (NCQG)**
4. Operationalizing **Carbon Markets** under Article 6

At COP29 and COP16, Marsh McLennan specialists shared research and participated in sessions on the latest trends and innovative solutions in climate resilience and nature, empowering attendees with insights to make a tangible impact within and outside an organization on sustainability issues.

The Year Ahead: 2025

Despite the challenges faced in 2024, many investors remain committed to sustainability goals. With significant events like COP30 and ongoing innovations, 2025 holds the potential for practical solutions from both public and private sectors to foster a resilient global economy.

Key Themes for Investors to consider in 2025:

- **AI Revolution**: Artificial intelligence is rapidly becoming essential in the energy sector, enhancing the production, consumption, and distribution of energy, and making complex systems like electricity networks more secure, efficient, and sustainable.
- **Climate Adaptation**: Addressing growing physical risks and finding adaptation solutions is critical to achieving a successful transition. Enhancing risk management of infrastructure and real estate assets, and opportunities in emerging technologies supporting climate adaptation are both areas for investors to explore further.
- **Climate Finance in Emerging Markets**: As the world grapples with the urgent need to address climate change, the spotlight on climate finance in emerging markets continues to grow. The transition to a low-carbon global economy is not just a necessity; it is an opportunity for private investment to play a transformative role in driving sustainable development.
- **Nature**: An exciting investment opportunity which is starting to scale is in what is known as "the circular bioeconomy". This model focuses on reducing waste, enhancing resource efficiency, and promoting the regeneration of natural systems.
- **Social Factors in ESG**: Asset owners are increasingly recognizing the importance of social factors in investment strategies, acknowledging their impact on long-term financial performance. While environmental and governance issues have traditionally dominated the ESG conversation, there is a growing emphasis on social factors like labor rights, human rights, and diversity.
- **The Trump Effect**: In light of President Trump's return to the White House, it is expected sustainable investing will face policy headwinds in the US. We discuss areas which will impact investors the most.

Regulatory Updates

Global Overview

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Regulatory Updates

Asia

China and Hong Kong

- In December, the Hong Kong government launched the roadmap on sustainability disclosures in Hong Kong, which sets out the approach to require publicly accountable entities (PAEs) to adopt the ISSB Standards. It will first be mandatory for listed PAEs that are Main Board and/or Large Cap issuers starting 1 January 2025, before applying to other listed PAEs under a proportionate approach beginning 1 January 2028. Also, financial regulators will require financial institutions carrying a significant weight (non-listed PAEs such as banks and insurance companies) to apply the Standards no later than 2028.
- In November, the National People's Congress approved the new Energy Law of the People's Republic of China, effective 1 January 2025. The law states that China will prioritize renewable energy development, while encouraging a rational, clean, and efficient use of fossil fuels.

Japan

- In June, the Japanese Government published "Grand Design and Action Plan for a New Form of Capitalism" including the plan on "Reform of asset ownership". This plan clarified that consideration of non-financial factors, including impact, when making investments, doesn't violate fiduciary duty, and also stated that representative public pension funds will complete the signing of PRI by the end of this year, aiming to strengthen sustainable investment initiatives and spread the trend to the entire market.
- The Japanese government published the "Asset Owner Principles" in August as a set of common principles for asset owners' investment, governance, and risk management. The principles include a focus on stewardship activities, with a supplementary principle referring to sustainable investment.

Singapore

- Published in November, the Multi-Jurisdiction Common Ground Taxonomy (M-CGT) expands on the bilateral EU-China CGT to include the Singapore-Asia Taxonomy, thereby enhancing the interoperability of taxonomies in China, the EU and Singapore.

South Korea

- In August, the South Korean Constitutional Court ruled that the 2021 "Framework Act on Carbon Neutrality and Green Growth for Coping with Climate Crisis" is unconstitutional. The insufficiency of the Framework stems from its lack of legally binding targets for reductions beyond 2030, which "shifts an excessive burden to the future". The Court has mandated that the Framework and associated targets be updated by February 2026.

Regulatory Updates

Australia & New Zealand

Australia

In early September, the mandatory climate related financial disclosures legislation was passed

- The framework for Australia's first climate-related financial disclosure regime, was passed by Parliament on 9 September 2024 and received royal assent on 17 September 2024. The legislation comes into effect starting 1 January 2025.
- The Bill seeks to introduce mandatory climate-related disclosures for large companies and financial institutions (notably Asset Owners with more than $5Bn in FUM) in Australia, aligning with international IFRS standards.
- The reporting requirements will be phased in over three years for three groups of entities, categorized by size. The first group (large firms) starts reporting for the financial year starting on or after January 1, 2025, while the second and third groups start on July 1, 2026, and July 1, 2027, respectively.
- It will be mandatory for these firms to report:
  - Material climate-related financial risks and opportunities faced by the entity;
  - Scope 1, 2 and 3* GHG emissions and any associated reduction targets;
  - any information about governance of, strategy of or risk management by the entity in relation to these risks, opportunities, metrics and targets; and
  - an assessment of the entity's resilience to climate-related changes using scenario analysis. This Scenario analysis will need to include a 1.5C and >2.5C scenario at a minimum

Australia contributes $50 million for loss and damage from climate change:

- The Fund announced by Chris Bowen (Minister of Climate Change & Co-Chair of the NCQG) at COP29, will assist developing countries respond to extreme weather and slow onset climate events, addressing the economic and non-economic impacts of climate change.
- Support for loss and damage is a priority for Pacific countries, who face an existential threat from climate change.

State of Climate Report 2024:

- The recent State of Climate Report was provided by the Commonwealth Scientific and Industrial Research Organisation (CSIRO). Where on land, Australia has warmed by an average of 1.51°C since 1910, Australia's oceans have heated up by 1.08°C on average since 1900.

Updates to the Safeguard Mechanism:

- The safeguard mechanism is an emissions reduction policy where large emitters are required to reduce their emissions in line with legislated limits (or baselines) to support Australia's net zero target
- This was largely focused on existing industrial, mining or manufacturing facilities, but has now branched out to more sectors (incl. agriculture), which must evidence a declining emissions trajectory as of June 2025.

Progress continues for the Australian Sustainable Finance Taxonomy:

- ASFI is committed to delivering a six-sector sustainable finance taxonomy for climate change mitigation. ASFI expects to make the initial taxonomy available for use by firms, investors and regulators on a voluntary basis from mid-2025.

New Zealand

Progress continues for development of Aotearoa New Zealand's Sustainable Finance Taxonomy

- Minister of Climate Change Hon. Simon Watts announced at the RIAA Conference in Auckland in September 2024 that Centre for Sustainable Finance is partnering with the Government on its sustainable finance strategy for Aotearoa New Zealand.
- The strategy will provide clarity on the Government's priorities to increase the flow of domestic and international capital for sustainable and transition opportunities. Sustainable finance can help Aotearoa New Zealand to:
  - Reduce greenhouse gas emissions to maintain our access to international markets
  - Seize new growth and productivity opportunities
  - Responsibly manage our natural resources
  - Build a resilient economy that can adapt to future shocks

External Reporting Board (XRB) announces differential climate-related reporting and approves proposed amendments to the climate and assurance standards

- XRB announced plans to consult on Aotearoa New Zealand Climate Standards (NZ CS), focusing on differential climate-related reporting in 2025.
- Differential reporting would allow climate standards to vary based on entity characteristics or size, as per Section 19C of the Financial Reporting Act 2013. The XRB plans to review this approach to ensure it meets the needs of climate reporting entities (CREs).
- In 2025, the XRB will consult on using Section 19C to issue new or amended standards for different CRE classes. The consultation will address appropriate categories, tier size thresholds, and the balance of costs and benefits for disclosure requirements, aiming for international alignment.
- In November 2024, following an earlier October consultation, the XRB approved three out of the four proposed amendments to the climate and assurance standards. The amendments will apply from 1 January 2024, so will be applicable for reporting periods that begin on or after that date.

*There is a modified liability for Scope 3 emissions, scenario analysis and transition plans for the first 3 years of reporting.

Regulatory Updates

Canada

CAPSA Pension Plan Risk Management Guidelines

- The Canadian Association of Pension Supervisory Authorities (CAPSA) released its new guideline No. 10 for Risk Management for Plan Administrators, which is applicable to all pension plans. Environmental, Social, Governance (ESG) issues are listed as a specific topic for risk consideration.
- Importantly, the guideline describes using ESG information to provide financial insight as "consistent with an administrator's fiduciary duty" and that "ignoring or failing to consider ESG information that might materially affect the fund's financial risk-return profile could be a breach of fiduciary duty." The guideline adds climate change is considered to pose urgent and material systemic risks to the financial system.
- The guideline outlines key principles and expectations that pension plan administrators should consider from ESG materiality, implementation, governance, risk identification, investment decision-making and disclosure aspects.
- Canada's regulator for federally regulated pension plans -- the Office of the Superintendent of Financial Institutions (OSFI) -- said it expects plan administrators to follow the CAPSA Risk Management Guideline.

Canadian Taxonomy and Mandatory Climate-related Disclosures

- The Canadian government will develop a voluntary sustainable development taxonomy to define green and transition investments that is consistent with the goal of reaching net-zero emissions by 2050 and limiting global temperature rise to 1.5 degrees above pre-industrial levels.
- A taxonomy covering two to three priority sectors for the Canadian economy will be published within 12 months, which would help companies and investors mobilize capital towards green categories and support transition activities.
- The Canadian government also announced plans to mandate climate-related financial disclosures for large, federally incorporated private companies, as it commits to expanding climate-related financial disclosures, which already covers federal crown corporations and federally regulated financial institutions. As of 2024, OSFI already requires federally regulated banks, insurance companies, and trust and loan companies to publish climate disclosures.

Greenwashing Regulation

- The Competition Bureau, an independent law enforcement agency, added new provisions to the Competition Act in June 2024 requiring businesses to have testing or substantiation to support certain environmental claims to prevent greenwashing. Violations may lead to significant financial penalties.
- The Competition Bureau's definition of environmental claims is broad. It notes one of the bigger trends in complaints involves claims about environmental improvements that the business will accomplish in the future, such as claims about being carbon neutral by a certain date, without a credible plan to deliver on the claim. The regulation could capture asset owners and asset manager claims, however further clarification is expected.

Canada's First Sustainability Disclosure Standards

- The Canadian Sustainability Standards Board (CSSB) issued Canada inaugural sustainability disclosure standards in December after an extensive public consultation, a significant step in increasing transparency and consistency in sustainability reporting by Canadian organizations. The standards are voluntary unless mandated by regulators or governments.
- The CSSB's standards are aligned with global baseline standards of the International Sustainability Standards Board (ISSB) but modified for the Canadian context including giving companies more time to prepare for scope 3 GHG emissions reporting.
- The Canadian Securities Administrators (CSA) has expressed interest in making the CSSB standard mandatory. They are working on developing a revised climate-related disclosure rule and plan to seek public feedback before implementing any changes to their rules.

Regulatory Updates

Europe

Corporate Sustainability Reporting Directive (CSRD) reports due in 2025

- On July 31, 2023, the European Commission published the European Sustainability Reporting Standards (ESRS), the criteria for implementing the recently adopted CSRD. Large public-interest companies (with over 500 employees) that are already subject to the existing Non-Financial Reporting Directive (NFRD) have their reports due in 2025. In the coming years, the CSRD is expected to significantly improve the quality and quantity of sustainability-related information available to investors and will, when fully implemented, be a reporting requirement for approximately 50,000 entities in Europe and beyond.

The European Green Bonds Regulation, a new standard

- Starting December 21, 2024, issuers can issue European green bonds under a new voluntary standard introduced by the EU, aiming to set a clear gold standard for green bonds and to fully integrate with the SFDR, particularly concerning how issuers of green bonds report their alignment with the Taxonomy Regulation.
- Under this standard, issuers must provide clear disclosures about what qualifies a bond as "green," with assessments by independent external reviewers before and after issuance, enhancing transparency for investors. Moreover, for the first time, firms providing external reviews will be supervised at the EU level by ESMA. It is also worth noting that European green bonds will not only be suitable for entities whose activities are already sustainable. On the contrary, European green bonds can support those issuers that are still working to transition toward becoming greener.

New guidelines on funds' names using ESG or sustainability-related terms

- Following the public statement of 14 December 2023, ESMA published in May 2024 the final report containing Guidelines on funds' names using ESG or sustainability-related terms, to ensure greater integrity in the labelling and marketing of sustainable investment funds.
- The new guidelines require sustainable funds to allocate at least 80% of their assets to ESG objectives, introduce "Transition Funds" for companies moving toward greener practices, and impose stricter restrictions on asset managers using ESG terms, with non-compliant funds risking the loss of their ESG designation, among other things.

Amendments to the EU Taxonomy Regulation

- The EU Taxonomy Regulation, a key element of sustainable finance in Europe, was updated to enhance its technical screening criteria. The revisions include extended coverage of economic activities, providing clearer alignment criteria for previously underrepresented sectors like agriculture, water management, and circular economy initiatives. Additionally, the updates extend but simplify disclosure rules from January 2024, offering companies and investors streamlined reporting requirements that reduce complexity while maintaining transparency.

EU Investing for Transition Benchmarks (ITBs)

- EU Platform on Sustainable Finance has published a report introducing Investing for Transition Benchmarks (ITBs). The new framework outlines two benchmarks – ITB and ITBex - designed to integrate the EU Taxonomy into investors' existing strategies. The benchmarks build upon the foundation of the EU Paris-Aligned and Climate Transition Benchmarks (PAB and CTB) by incorporating a decarbonisation objective. Additionally, ITBs introduce an objective on the greening of CapEx, enhancing transparency in transition financing. Further refinement of the methodology for regulatory development is expected in the coming year.

SFDR under Review

- As of the end of 2024, the European Commission continues its review of the Sustainable Finance Disclosure Regulation (SFDR) 2019/2088, which was initiated in September 2023. The implementation of the SFDR follows a phased approach aligned with other sustainable finance regulations.

Key regulatory reference dates

- **January 1, 2024**: Financial institutions began reporting their alignment with the same climate objectives under the Taxonomy Regulation.
- **From January 2025 Onwards:** Financial institutions will be required to disclose KPIs related to additional environmental objectives, including sustainable water use, circular economy transition, pollution prevention, and biodiversity protection.
- **Mid-2025 SFDR Level 1 Review**: A review of SFDR is expected around mid-2025 to refine disclosure obligations based on stakeholder feedback and regulatory developments.
- **2026 to 2027:** Large companies not previously subject to the NFRD will start reporting under the ESRS Set 1. Listed SMEs and small, non-complex financial institutions can begin optional reporting under the ESRS for Listed SMEs, with mandatory reporting starting in 2029.
- **End of 2025 Transition Periods**: Key transitional provisions under the Benchmark Regulation (BMR) and SFDR will conclude, particularly regarding existing funds and third-country benchmarks.

Possible consolidation of sustainability regulations

- The European Commission is planning to merge three key sustainability frameworks—Corporate Sustainability Due Diligence Directive (CSDDD), Corporate Sustainability Reporting Directive (CSRD), and Taxonomy Regulation—through omnibus legislation. This aims to streamline reporting and reduce bureaucratic overlap without changing substantive requirements. However, this consolidation could lead to significant revisions during the legislative process, as both the European Parliament and Council can propose amendments.
- The technical complexity of merging these frameworks, due to their different legal forms and scopes, presents additional challenges, including the potential oversimplification of the regulations.

Regulatory Updates

United Kingdom

Climate transition plans consultation

- The Transition Plan Taskforce (TPT) was a UK initiative set up in 2022 that aims to create a global standard for climate transition plans. The TPT's framework provides detailed guidance on how entities can disclose their transition plan. The TPT has also published sector guidance to help preparers interpret the Disclosure Framework. The International Financial Reporting Standards (IFRS) Foundation assumed responsibility for the TPT Disclosure Framework during 2024 as part of ISSB work to streamline and consolidate frameworks and standards for disclosures about transition plans.
- Currently, Climate Transition Plans can be produced on a voluntary basis. As announced in the UK Chancellor's Mansion House speech, the UK Government will be consulting in the first half of 2025 on how best to take forward the Labour Government's manifesto commitment to make climate transition plans mandatory for UK-regulated financial institutions and FTSE 100 companies.

UK Stewardship Code' proposed revisions

- The Financial Reporting Council (FRC) launched a consultation on its proposed revisions to the UK Stewardship Code in November 2024, with a response deadline by 19 February 2025.
- The proposed revisions to the UK Stewardship Code focus on re-defining stewardship, streamlining and changing the reporting requirements, and introducing dedicated Principles for proxy advisors and investment consultants. The updates aim to streamline reporting and provide clearer guidance for implementation, while ensuring the Code remains relevant and aligned with the evolving standards and market needs.
- The FRC plans to publish the updated UK Stewardship Code in late 2025, with implementation and the first reporting cycle expected in 2026.

Sustainability Disclosure Requirements (SDR) coming into force

- The Financial Conduct Authority (FCA) introduced an anti-greenwashing rule with effect from May 31, 2024 for all FCA-regulated firms to ensure that any sustainability-related claims are fair, clear, and not misleading. As of July 31, 2024, UK asset managers could begin using new sustainability labels for UK domiciled funds—such as 'Improvers,' 'Focus,' 'Impact,' and 'Mixed Goals – subject to compliance with the Policy Statement PS23/16. These labels aim to help consumers make informed investment decisions by clearly indicating the sustainability objectives of financial products and to improve the trust and transparency of sustainable investment products.
- The naming and marketing requirement, originally set to take effect on December 2 2024, restrict the use of specific sustainability-related terms in product names and marketing materials unless the products meet certain criteria. However, the FCA extended the compliance deadline to April 2025, acknowledging that firms required additional time to align with the new standards.
- The FCA had confirmed that 30 funds had applied for an SDR label at the December 2, 2024 deadline.

Regulation of ESG Ratings Providers

- On November 14, 2024, the UK government confirmed plans to regulate ESG ratings providers by bringing them under the supervision of the Financial Conduct Authority (FCA). Draft legislation was also released, with technical comments invited by January 14, 2025.
- The government intends to introduce finalized legislation to Parliament in early 2025, officially bringing ESG ratings providers within the UK's regulatory perimeter.
- Entities offering ESG ratings influencing investment decisions will require FCA authorization, encompassing both domestic and international providers engaging with UK users. This is expected to enable investors make more informed decisions based on clearer and more reliable ESG assessments.

UK Green Taxonomy Consultation

- In 2024, the UK government initiated steps to develop a UK-specific Green Taxonomy, distinct from the EU framework, to better align with national sustainability goals.
- A consultation was launched on November 14, 2024, seeking views on the value and design of a UK Green Taxonomy, aiming to support sustainable investment and mitigate greenwashing. The consultation is open until February 6, 2025, inviting feedback from stakeholders on the proposed framework and its implementation. The consultation addresses the scope, structure, and potential use cases of the UK Green Taxonomy, considering lessons from the EU's experience and seeking to ensure interoperability with international standards.

UK Biodiversity Net Gain regulations came into force Feb 2024

- The UK's Biodiversity Net Gain legislation mandates that developers leave natural habitats in a measurably better state after development, requiring a minimum 10% improvement compared to the pre-development state, which can be achieved on-site or by purchasing biodiversity units from off-site projects.

Regulatory Updates

United States

Federal-Level Highlights

ESG Considerations in ERISA Plans

- The House Education and Workforce Committee passed bills aimed at restricting environmental, social and governance considerations in ERISA-governed retirement plans in September 2024.[1]

SEC Climate Disclosure Rules

- On April 4, 2024, the Securities and Exchange Commission (SEC) issued an Order to stay its climate rule, which was published in the Federal Register on March 28, 2024.[2]

A U.S. Federal Court of Appeals suspended the Fearless Fund venture firm's gender diversity grant program

- The subsequent settlement ended the grant program, which included a gender diversity requirement.[3]

The Fed issued principles for climate-related financial risk management for large banks[4]

- The Fed issued a high-level framework for management of exposures to climate-related financial risks for institutions with at least $100 billion in assets. The principles address: governance; policies, procedures, and limits; strategic planning; risk management; data, risk measurement, and reporting; and scenario analysis.
- The principles are intended to be neutral, and neither prohibit or require large financial institutions to provide banking services to customers of any specific class or type.

State-Level Highlights

California

- The new California Climate Disclosure Law signed on September 27, 2024, amends the Climate Corporate Data Accountability Act (SB 253) regarding regulatory timelines and reporting scope.[5]

Texas

- The State of Texas challenged the DOL ESG rule and must now present their claims in a lower court after the Fifth Circuit Court of Appeals remanded the case, citing the recent Supreme Court ruling in Loper Bright Enterprises v. Raimondo, which limits the interpretive authority of federal agencies and the application of the Chevron deference doctrine. This remand instructs the Texas federal district court to reevaluate the case.[6]

Montana

- Montana's Supreme Court upheld a lower state court's ruling that the state constitution guarantees the constitutional right to a clean and healthful environment in Montana an opinion published on December 18, 2024.[7] Litigation is anticipated in other states with similar language in the state constitution.

[1]Source: https://www.pionline.com/washington/house-passes-anti-esg-package-bills; [2]Source: https://www.sec.gov/files/rules/other/2024/33-11280.pdf; [3]Source: https://media.ca11.uscourts.gov/opinions/pub/files/202313138.pdf

[4]Source: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231024b.htm; [5]Source https://ww2.arb.ca.gov/sites/default/files/2024-12/ClimateDisclosureQs_Dec2024.pdf; [6]Source: https://aboutblaw.com/beUE; [7]Source:https://climatecasechart.com/wp-content/uploads/case-documents/2024/20241218_docket-DA-23-0575_opinion.pdf

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Regulatory commentary is for illustrative purposes only and is not intended as a comprehensive guide to legal and regulatory impact or policy positions. As of 12/15/2024.

COP16 & COP29

Reflections

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COP16 – UN Convention on Biological Diversity

Reflections

Image courtesy of COP16 Colombia

In October 2024, government and private sector representatives from around the world met in Cali, Colombia, for the United Nations' Convention on Biological Diversity Conference — COP16 — to discuss the impacts on nature and biodiversity and agree on actions to address them.

The theme of COP16 was "Peace with Nature", intended to call on Parties to collectively commit to achieving 23 targets for 2030 laid out in the Kunming-Montreal Global Biodiversity Framework (KMGBF), adopted at the previous meeting of the Convention's 196 Parties in Montreal in 2022.

We note the progress made on these goals and our insights on the next page.

COP16 – Convention on Biological Diversity

Mercer's key takeaways for investors

At COP16, delegates reviewed progress on the Kunming-Montreal Global Biodiversity Framework (KMGBF) since its adoption at COP 15 in 2022. Acknowledging progress, COP 16 emphasized the need to accelerate action. To date, 119 out of 196 countries have submitted national biodiversity targets aligned with the KMGBF, and 44 countries have submitted National Biodiversity Strategy and Action Plans (NBSAPs). While the meeting lost quorum before all agenda items were addressed (due to logistical issues), the conference did make progress on agreements around expanded role for indigenous peoples and local communities in biodiversity protection and on the operationalization of a new global mechanism to share benefits from digital genetic information.

The Cali Fund

- At COP 16, delegates advanced the operationalization of a multilateral mechanism, including a global fund, to share benefits from the use of digital sequence information (DSI) on genetic resources more fairly and equitably.
- The decision outlines how industries like pharmaceuticals and biotechnology should share benefits with developing countries and Indigenous Peoples. Large companies benefiting from DSI are expected to contribute to "the Cali Fund" based on 1% profits or 0.01% revenues.
- The fund will largely benefit developing countries, supporting the implementation of the KMGBF according to their priorities. At least 50% of the funding will address the needs of Indigenous Peoples and local communities, including women and youth, through government or direct payments.
- This mechanism is expected to raise USD 1 billion annually and is aimed to bridge the biodiversity finance gap and enhance equity and justice in biodiversity-based innovation.
- At rescheduled COP16 meetings in Rome in 2025, the Parties will resume discussions to approve a new "Strategy for Resource Mobilization" aiming to secure $200 billion annually by 2030 from various sources to support global biodiversity initiatives. Another goal is to redirect $500 billion per year in subsidies that harm biodiversity by 2030. The outcomes from this agreement are expected to create opportunities for private finance to explore and create more investments in nature related solutions supported by government incentives and policies.

TNFD and Nature Action 100 launch initiatives

- Recurring discussions at COP16 highlighted the need for companies and financial institutions to measure and report their biodiversity-related risks and impacts, serving as a catalyst for action in this area. At COP16, the number of companies publicly committing to adopt the Taskforce on Nature-related Financial Disclosures (TNFD) recommendations exceeded 500.
- In Cali, the TNFD published its draft guidance on nature transition planning for corporates and financial institutions. The draft is open for consultation until 1 Feb 2025 with final guidance expected sometime in 2025.
- The European Union is already incorporating biodiversity considerations into key regulations, such as the Corporate Sustainability Reporting Directive. It is likely that other regulators will implement more stringent rules, especially for sectors with significant impacts on nature. Furthermore, Target 15 of the KMGBF states adoption of policy measure encouraging corporates to regularly monitor and disclose their nature impacts.
- Nature Action 100, the first global investor-led initiative focused on addressing nature and biodiversity loss, announced its inaugural benchmark assessments at COP16. The assessments measure corporate progress against the initiative's Investor Expectations for Companies. The initial results indicate that most of the 100 companies involved are in the early stages of addressing their nature-related impacts and dependencies.
- Improved transparency through disclosures and assessments will be invaluable for investors in accelerating both climate and nature action across regions and sectors.

The bureau of the Conference of the Parties to the Convention on Biological Diversity agreed to hold resumed sessions for COP 16 to address agenda items left unresolved in Cali. The meetings will take place at the headquarters of the Food and Agriculture Organization of the United Nations in Rome, Italy in February 2025. The resumed meetings will focus on a new framework for monitoring countries' progress on tackling nature loss and establishing a new global biodiversity fund under the COP. COP17 will be held in Armenia in 2026.

COP29 – UN Climate Change Conference

Reflections

Image courtesy of UNFCC

COP29, the 29th UN Climate Change Conference, took place in Baku, Azerbaijan, from November 11th to 22nd, 2024.

COP29, dubbed as the "Finance COP" aimed to accelerate global climate action and mobilize the necessary financial resources to support developing countries in their climate mitigation and adaptation efforts.

Key goals of COP29 were to secure a new, significantly higher level of climate finance involving setting a new goal for developed countries to provide financial assistance to developing nations. The second goal was to mobilize finance to increase both public and private investments in climate action, such as renewable energy, adaptation measures, and reducing greenhouse gas emissions.

We note the progress made on these goals and our insights on the next page.

COP29 – UN Climate Change Conference

Mercer's key takeaways for investors

COP29 highlighted disagreements among developing countries, with different Parties requesting varying levels of financial support. While there was consensus on launching global carbon markets, with trading anticipated to begin in 2025, there was limited emphasis on enhancing mitigation efforts. Some progress was made on global adaptation initiatives, which received more attention than at previous COPs, although many important decisions regarding adaptation indicators, implementation of global stocktake outcomes and Loss and Damage (L&D) were postponed.

New Collective Quantified Goal on Climate Finance

- The New Collective Quantified Goal (NCQG) on climate finance was announced at COP29. It aims to enhance the financial support provided to developing countries in their efforts to combat climate change and adapt to its impacts.
- Developed countries have committed to providing at least $300 billion annually by 2035 through various sources, including bilateral and multilateral agreements. The agreement also encourages parties to aim for at least a total of $1.3 trillion by 2025, primarily from private financing. However, this falls short of the trillions needed by poor and vulnerable nations to build climate resiliency into their economies.
- There is widespread skepticism about whether wealthy nations will fulfill their promise, especially with previously missed commitments and a rise of fiscal and political constraints across the developed world, including inflation and rising populism. Moreover, the goal does not build on COP28 commitments to reduce and transition away from fossil fuels.
- While the agreement lacked in defining any actionable mechanisms to finance the target, the text did mention the importance of private capital to close funding gaps, presenting an opportunity for private capital allocators to explore market-based mechanisms to help support the objectives of the agreements through various financial instruments and private-public partnerships.
- Additionally, ten large Multilateral Development Banks (MDBs) announced plans to boost climate finance and introduced a new capital market mechanism to attract private investment. Collectively, MDBs aim to increase their annual financing for low- and middle-income countries to USD 120 billion, with a goal to mobilize USD 65 billion from the private sector.

Operationalizing Carbon Markets under Article 6

- COP29 marked a significant milestone with the agreement on a package of rules under Article 6 of the Paris Agreement. While Article 6.2 focuses on voluntary bilateral or multilateral agreements between countries to trade emissions reductions, Article 6.4 aims to create a centralized global carbon credit market, set to be called the Paris Agreement Crediting Mechanism (PCAM), for countries and companies. A global carbon market can be a major catalyst for climate action and funding for emerging markets.
- The main criticism of voluntary carbon markets has been the lack of uniform standards and the integrity of carbon credits. Article 6.4 seeks to address these issues as a key feature of PCAM is its centralized governance by the UN Supervisory Body, which will oversee the entire process and establish rules for regulatory stability and standards.
- In the short term, the Article 6.4 mechanism is expected to operate alongside voluntary carbon markets. As confidence grows and policymakers support the acceptance of Article 6 credits in compliance markets, there may be a shift in demand towards the Article 6.4 mechanism, driven by Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) and organizations with net-zero targets. Investors are expected to participate by investing in projects that generate carbon credits for trading under PCAM.
- While voluntary carbon markets have gained momentum through the Article 6 agreements, uncertainty will persist until robust standards are implemented to restore market trust and policymakers create further incentives for international cooperation to support climate finance.

Looking forward to COP30 in Brazil in November 2025, discussions are likely to center around the outcomes of the Global Stocktake and furthering the commitment to transition away fossil fuels and the Loss & Damage fund. The distinction between climate and nature agendas will continue to blur, especially considering Brazil's role in protecting the Amazon rainforest.

Marsh McLennan at COP16 & COP29

Rodrigo Suarez, Marsh Climate & Sustainability Advisory Leader for Latin America (pictured at COP16) attended COP16 in Cali to represent Marsh McLennan. In collaboration with the TNFD, he presented on the crucial role of the insurance sector in protecting biodiversity and how to better integrate biodiversity analysis into risk assessment. He engaged in conversations around advances in technology and metrics, particularly around integrating localized datasets with other data sources across supply chains, portfolios, and geographies remains a major challenge.

Rodrigo also noted the importance of discussions around the interconnectedness of biodiversity and climate change, with the Global South being particularly vulnerable. Financial institutions and insurance can play a large role in supporting mitigation efforts and building adaptation solutions.

A summary of Rodrigo's takeaways can be accessed here.

At COP29, Marsh McLennan specialists participated in sessions on the latest trends and innovative solutions in climate resilience, empowering attendees with insights.

Amy Barnes, Marsh (far left) and Cara Williams, Mercer(second from left) discussed the important role that large corporates play in advancing climate adaptation during Wednesday November 13th panel session in the Resilience Hub at COP29.

Furthermore, Mercer's "Transition Today" paper, published ahead of COP29, highlighted the importance of aligning investments by undertaking attribution analysis with scope 3 emissions to make real world change.

To read more perspectives from our experts from COP29, please visit our Climate Hub.

The Year Ahead – 2025 Trends

Overview

Despite the challenges faced in 2024, many investors remain committed to sustainability goals. With significant events like COP30 and ongoing innovations, 2025 holds the potential for practical solutions from both public and private sectors to foster a resilient global economy. In this section, we discuss issues and themes that will be top of mind for investors to consider:

- **AI Revolution**: Artificial intelligence is rapidly becoming essential in the energy sector, enhancing the production, consumption, and distribution of energy, and making complex systems like electricity networks more secure, efficient, and sustainable.
- **Climate Adaptation**: Addressing growing physical risks and finding adaptation solutions is critical to achieving a successful transition. Enhancing risk management of infrastructure and real estate assets, and opportunities in emerging technologies supporting climate adaptation are both areas for investors to explore further.
- **Climate Finance in Emerging Markets**: As the world grapples with the urgent need to address climate change, the spotlight on climate finance in emerging markets continues to grow. The transition to a low-carbon global economy is not just a necessity; it is an opportunity for private investment to play a transformative role in driving sustainable development.
- **Nature**: An exciting investment opportunity which is starting to scale is in what is known as "the circular bioeconomy". This model focuses on reducing waste, enhancing resource efficiency, and promoting the regeneration of natural systems.
- **Social Factors in ESG**: Asset owners are increasingly recognizing the importance of social factors in investment strategies, acknowledging their impact on long-term financial performance. While environmental and governance issues have traditionally dominated the ESG conversation, there is a growing emphasis on social factors like labor rights, human rights, and diversity.
- **The Trump Effect**: In light of President Trump's return to the White House, it is expected sustainable investing will face policy headwinds in the US. We discuss areas which will impact investors the most.

As we move into 2025, several factors are at play across politics, societies, and economies. As long-term investors, it is important to remember that the shift towards a more sustainable economy is a global trend that is broad-reaching, surpassing any one sector or country. It is expected to continue reshaping the global economy in the coming months and years.

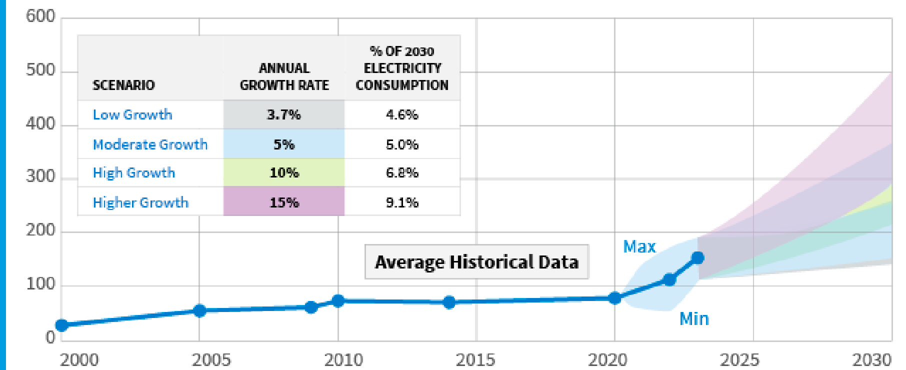
AI revolution – The impact of AI on the energy transition

Trends & Outlook

Artificial intelligence (AI) is rapidly becoming a crucial technology with transformative potential for the energy sector. It is being used to enhance the production, consumption, and distribution of energy. Making complex systems like electricity networks more secure, efficient, and sustainable. However, the expansion of AI and the digital economy necessitates large data centers that consume electricity. Although their current energy use is relatively small globally, it has been increasing rapidly and is expected to continue growing. For investors, understanding the implications of the AI revolution is crucial for comprehending the future of energy transition and innovation.

AI's rise is a significant energy trend, requiring substantial electricity, particularly for large data centers that can consume as much electricity as 100,000 households. In 2022, data centers accounted for about 1% of global electricity demand, excluding data networks and cryptocurrency mining. In major economies like China, the EU, the UK, and the US, they represent 2-4% of electricity demand. Data centers are expected to see a sharp rise in electricity consumption, as much as 160% by 2030, due to major investments by tech companies and AI start-ups. This growth challenges decarbonization goals as greenhouse gas (GHG) emissions from datacentres continue to rise, with Scope 2[1] emissions increasing by 48% from 2021 to 2023. The large energy consumption also creates considerable strain on local grids, especially in areas with concentrated data centers. Due to such concerns, data center operators are turning to low-emission renewable energy sources, which are often the quickest and most cost-effective options to meet their energy demands. Large operators like Microsoft and Google are also investing in clean energy technologies like small modular reactors (SMRs) and long-duration energy storage to secure additional energy in the long term. This growing demand for energy is also leading to accelerated investments in upgrading and digitalizing power grid infrastructure which is essential to supplying demand, improving the resilience of power supply, and enabling the energy transition.

AI is also driving innovation in various sectors. AI deployment in the energy sector can optimize complex systems like electricity networks and accelerate innovation in energy technologies, such as developing efficient batteries for EVs and hydrogen production catalysts. For example, AI is being used to discover high-performing materials by analyzing vast data sets, such as the research conducted in the US which evaluated 32.5 million potential new solid-state electrolytes for lithium-based batteries, identifying 23 with desirable characteristics. However, large challenges remain for AI technologies to become fully optimal with data availability being a major hurdle. Current datasets are incomplete and cover only a limited range of materials and reactions. Further, regulations such as the EU AI Act and data protection laws, as well as UN's recently adopted resolution on regulating AI, could potentially limit the supply of data and increase costs.



Sources: EPRI and William Blair, as of May 2024. Projections of potential electricity consumption by U.S. data centers from 2023 to 2030. Percentage of 2030 electricity consumption projections assume that all other (non-data center) load increases at 1% annually.

Contributor:
Lovey Sidhu | Montreal
Sustainable Investment Specialist

Source: IEA, Artificial Intelligence – Topics – IEA
1: Scope 2 emissions are indirect emissions derived from purchased energy

Climate adaptation – Growing physical risks & finding adaptation solutions

Trends & Outlook

With Earth's average temperatures surpassing the Paris Agreement threshold of 1.5°C above pre-industrial levels in 2024, it is clear climate mitigation efforts to reduce greenhouse gas emissions have not moved at sufficient pace or scale to limit warming. The world is now in a position of having to adapt to a changing climate and develop resilience to further changes. It's no longer a case of mitigation or adaptation, rather both are necessary now. While mitigation efforts continue, with incidence of climate-related physical events, including extreme weather events such as wildfires and flooding, increasing in both frequency and intensity, it is clear the impact of climate-related physical events will become increasingly important for investors to consider from a risk management and portfolio resilience perspective. There are also opportunities for investors to support new emerging technologies related to adaptation and resilience.

Given the nature of their business, insurers have been considering the impacts of climate-related hazards for longer than most. There is opportunity for investors to apply learnings and approaches from the insurance industry, including modelling of climate-related physical risks, particularly for real asset portfolios. We believe that climate scenario analysis currently used by investors can be enhanced by taking a more granular and asset level approach to the consideration of physical risks in portfolios. We are looking at improving how we integrate climate-related physical risks into both our scenario and portfolio modelling, using geolocation and asset specific risk modelling, particularly for higher risk areas, to enhance existing top-down economic scenario analysis. Businesses are also reviewing how resilient they are to climate change, including considering resilience of critical infrastructure, supply chain impacts, and impacts on health and wellbeing of employees. We believe many of the areas identified in the Marsh Adaptation Framework are relevant to investors.

Climate adaptation is typically perceived in cost terms, with an estimated two thirds of adaptation financing provided by the public sector. Innovative approaches to unlocking private sector capital for adaption are emerging, including through blended finance and insurance-linked instruments[1]. Opportunities that investors can support as the world adapts to being more climate resilient include:

- **Early warning systems (EWS)** – technologies designed to detect early signs of extreme weather or other physical events enabling early/ pre-emptive action to support disaster risk reduction, such as AI, drone, satellite or remote sensor technologies designed to detect, for example, early signs of forest fires. Early warning has been proven to reduce the impact of disasters and save lives.
- **Building and infrastructure adaptation** – both in terms of construction materials and building design and use, for example, flood defences and ventilation systems.
- **Water management** – water and climate change are inextricably linked, opportunities include water saving solutions, flood management to prevent pollution and rainwater recycling.
- **Agriculture and food security** – particularly vulnerable to climate change, transformative agriculture considerations include shifting geographic locations of particular crops and livestock, more resilient crop varieties and irrigation systems.
- **Ecosystem conservation and restoration** – natural flood defences, such as coastal mangroves.

Source: Marsh Adaptation Framework

As expected, many of these opportunities are interconnected with our other areas of research focus, including EM transition, fair transition, health and vulnerability of people to climate-related hazards, nature, the future of food and use cases for AI. As highlighted in our Transition Today approach, investors, alongside governments, policy makers and business, will increasingly need to consider Adaptation and Resilience as a core element of their transition strategy.

Contributor:
Kate Brett | Edinburgh
Sustainable Investment Intellectual Capital Leader

[1] UNEP Adaptation Gap Report 2024: Come hell and high water

Spotlight on climate finance in emerging markets

Trends & Outlook

As the world grapples with the urgent need to address climate change, the spotlight on climate finance in emerging markets continues to grow. The transition to a low-carbon global economy is not just a necessity; it is an opportunity for private investment to play a transformative role in driving sustainable development. This page explores the current landscape of climate finance, the challenges faced, and the potential for private capital to catalyze meaningful change in emerging markets.

The Need for Climate Finance

Mercer's "Transition Today" paper, published ahead of COP28, highlighted the importance of a fair carbon budget in realising a sustainable transition. This concept involves equitably allocating the global carbon budget taking into account regional and sectoral considerations. This mindset is foundational to identifying the required finance flows to facilitate a real-world transition aligned with the goals of the Paris Agreement. Article 2 of the Paris Agreement explicitly calls for making finance flows consistent with pathways toward low greenhouse gas emissions and climate-resilient development. However, the reality is stark. Climate finance flows have not been sufficient in either volume or alignment to date. Developed nations, for instance, were two years late in meeting their $100 billion p.a. commitment established at COP16 in Cancun. In 2022, of the estimated $115.9 billion in climate finance mobilized, $21.9 billion came from private finance. This highlights a significant gap in public and private investment that must be addressed to meet global climate targets and avoid the climate impacts that are expected to have indiscriminate negative impacts on portfolio returns.

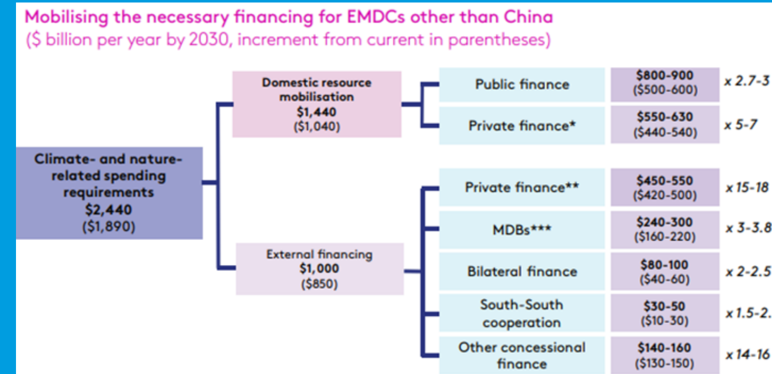
The Role of Private Investment

The recent COP29 summit, dubbed the "climate finance COP," underscored the urgent need for a New Collective Quantified Goal (NCQG) on climate finance to replace the previous $100 billion p.a. commitment to 2025. The Independent High-Level Expert Group (IHLEG) on Climate Finance reported that developing countries, excluding China, would require $1 trillion p.a. in external climate finance by 2030, escalating to $1.3 trillion by 2035. Crucially, they found that half of this funding must come from the private sector (with bilateral or multilateral public finance providing the other half). Heading into COP29, the G77 group of over 130 nations called for developed countries to commit $500 billion in bilateral and multilateral public finance by 2030 to galvanize private investment. The final COP29 text set a goal of at least $300 billion p.a. by 2035 for climate action in developing countries, emphasizing that this funding should come from a diverse array of sources, both public and private.

Bridging the Investment Gap

The COP29 outcome did acknowledge the full scale of developing countries' needs but provided few details on how to achieve it. The newly announced "Baku to Belém Roadmap to $1.3 trillion" initiative aims to provide a framework for addressing these challenges, with a report expected at COP30 in Belém, Brazil. This roadmap will be crucial for guiding the private investment community in aligning their strategies with the climate finance needs of emerging markets. Climate finance in Emerging Markets has been, and remains, a key topic of interest for Mercer, seeking to characterise current supply and demand dynamics and barriers to greater institutional investment. Analysis carried out by Mercer over 2024 builds the strategic case for private market allocations in emerging markets. Our analysis demonstrates that such allocations can offer significant diversification benefits, even before considering the ESG and impact co-benefits. This is particularly relevant for unconstrained investors seeking to enhance their portfolios while contributing to sustainable development. On the supply side, Mercer is proud to have recently partnered with British International Investment (BII), the UK's Development Finance Institution and impact investor. Mercer, in partnership with BII, is actively identifying asset manager proposals that leverage £50 million of concessional capital from a Mobilisation Facility set up within BII. This initiative aims to bridge the gap between the risk appetite and return thresholds of private investors, who often favour more developed markets.

The path to achieving climate finance goals in emerging markets remains a challenge, but it also presents a unique opportunity for private investors to generate a diversified set of returns alongside impact. We anticipate increased collaboration between the public and private sectors over 2025 to realise the commitments made at COP29 and in the run up to COP30.



Contributor:
Jonathan Cross | London
Senior SI Consultant

Notes: *Includes household savings. **A significant proportion of this private finance would be directly and indirectly catalysed by MDBs, other development finance institutions and bilateral finance. ***Includes multilateral climate funds
Source: Independent High-Level Expert Group on Climate Finance report, 2024

Nature – What is the circular bioeconomy?

Trends & Outlook

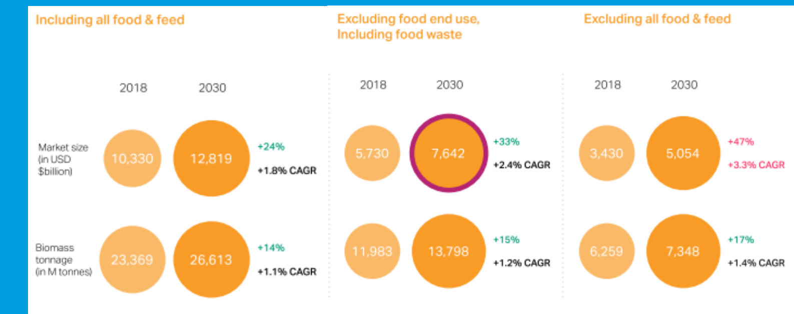
An exciting investment opportunity which is starting to scale is "the circular bioeconomy". This represents a transformative approach to economic development that emphasizes sustainability by using regenerative natural inputs and waste products to create value. This model focuses on reducing waste, enhancing resource efficiency, and promoting the regeneration of natural systems. Investment opportunities are often within the venture capital space focusing on growth-stage companies bringing natural products to market that can have a transformative impact across multiple sectors including industrials, chemicals, pharmaceuticals, fashion, agriculture, forestry, waste management, and renewable energy.

Investing in the circular bioeconomy may present an interesting growth opportunity for several reasons:

1. **Growing Demand for Sustainable Solutions**: As consumers and businesses increasingly prioritize sustainability, there is a rising demand for products and services that minimize environmental impact, and often these products command a price premium leading to enhanced profits to innovators in this space. Bio-based products are expected to experience significant growth, estimated to reach approximately USD 7.7 trillion by 2030. As shown in the figure, this growth is particularly notable in non-food sectors such as products and energy, with an anticipated annual growth rate of 3.3% from 2018 to 2030, culminating in USD 5.5 trillion by 2030. The increased use of biomaterials in industries like pharmaceuticals, textiles, building materials, and packaging is driving this expansion.
2. **Regulatory tailwinds**: Governments and standards setters worldwide are implementing policies and incentives to promote sustainable practices and reduce carbon emissions. These include the mandatory reporting of scope 3 emissions under IFRS ISSB (a global sustainable accounting standard) as well as the EU Taxonomy that encourages financing towards circular and renewable production processes. This regulatory environment can enhance the profitability of circular bioeconomy investments.
3. **Resource Efficiency**: By focusing on waste reduction and resource recovery, businesses in the circular bioeconomy can lower operational costs and improve margins. Efficient use of resources can lead to higher profitability and resilience against market fluctuations.
4. **Innovation and Technology**: The circular bioeconomy encourages innovation in processes and products, leading to repurposing of production processes and value chains towards adopting renewable, regenerative and often more cost-efficient approaches. These bioeconomy innovations are becoming increasingly cost competitive with non-regenerative process and as their costs continue to fall will start to replace non renewable inputs across multiple sectors.
5. **Long-term Viability**: As the global economy shifts towards sustainability, investments in the circular bioeconomy are likely to be more resilient in the long term. Companies that adopt circular practices are better positioned to adapt to changing market conditions and consumer preferences.

Overall, the circular bioeconomy may present investors with a compelling investment opportunity that aligns financial returns with positive environmental and social impacts, making it an attractive option for forward-thinking investors.

Circular bioeconomy growth opportunity



Note, the second set excludes food but includes food waste.
Source: World Business Council for Sustainable Development report, European Commission; Oxford Economics; BCG analysis

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Sustainable Investment Leader, Europe

The ‘S’ of ESG – Continued focus on social factors

Trends & Outlook

Asset owners are increasingly recognizing the importance of social factors like labor rights, human rights and social risks to supply chains in investment strategies, acknowledging their impact on long-term financial performance. While environmental and governance issues have traditionally dominated the ESG conversation, there is a growing emphasis on social factors including privacy and data, health and access to skilled workforces in a changing industries. The investment community is also increasingly recognizing Indigenous perspectives and rights, driven by stakeholder pressure, regulatory developments, and a desire to align investments with social responsibility and ethical values.

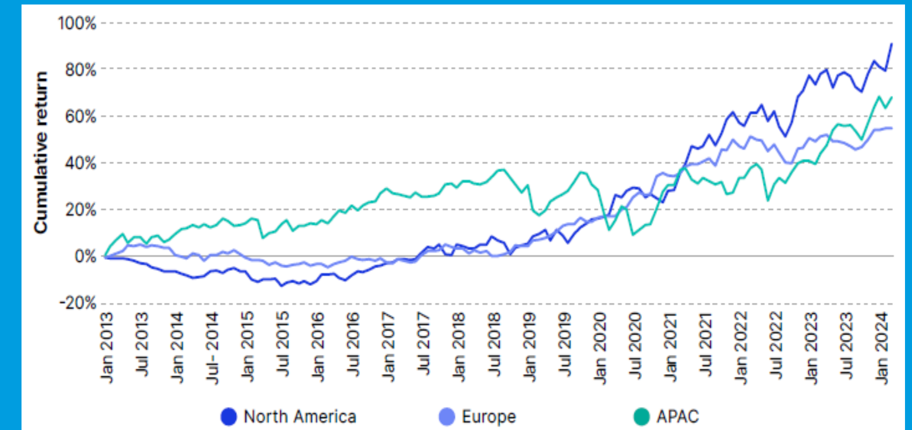
Some examples evident over the past year include:

- The Committee on Workers’ Capital, a global network of over 700 labor activists and asset owner board members, launched a statement in 2024 outlining the priorities for workers' capital, focusing on asset manager accountability, private market investments, and the stewardship of labor rights, setting the stage for a framework for their asset owner members, representing unions and workers’ capital.
- Encampments at universities globally became increasingly prevalent in 2024 as students and faculty advocated for action on human rights and challenged the role of investment in global conflict.
- In Canada, the prominence of Indigenous perspectives in sustainability standards reflects a growing recognition of the importance of integrating Indigenous knowledge and rights into responsible and sustainable investment approaches.

As asset owners pay more attention to social factors, they are beginning to incorporate these considerations into their investment governance, processes for due diligence, monitoring and manager engagement, and investment decision-making frameworks. This trend is evident in the increasing number of asset owners who are evolving their sustainable and responsible investment policies to intentionally address specific social factors or adopting measurement frameworks and guidelines that emphasize social impact, such as the Sustainable Development Goals (SDGs). By focusing on social factors, asset owners aim to mitigate risks associated with reputational damage but also risks to asset values that can arise from neglecting human rights and social issues, such as impacts in supply chains, talent acquisition, workforce retention, and the health and wellness of employees, customers, and communities. Furthermore, some asset owners recognize that companies with strong social practices often exhibit better employee satisfaction, customer loyalty, and community relations, which can ultimately lead to enhanced financial performance. Leading sustainable and responsible investors recognize the intersection of social factors noted above with environmental and governance issues such as climate change and corporate governance.

The landscape continues to be complex, and in many cases, the expectations placed upon institutional investors to achieve both their financial objectives and as well as address social factors remain high.

Performance of highest- vs. lowest-rated MSCI ESG Rating social-pillar quintiles by region, equally weighted



Source: MSCI, Sustainability and Climate Trends to Watch for 2025

Analysis by MSCI found that companies with the highest scores on the overall social assessment in MSCI ESG Ratings outperformed their lowest-scoring peers across major regions over the past 11 years. This trend was consistent in North America, Asia Pacific, and Europe, when adjusted for size and sector. Although not all regions experienced this positive performance trend in every time period, the gap between the best and worst performers was evident globally over the past 11 years.

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US politics – What another Trump term could mean for sustainable finance

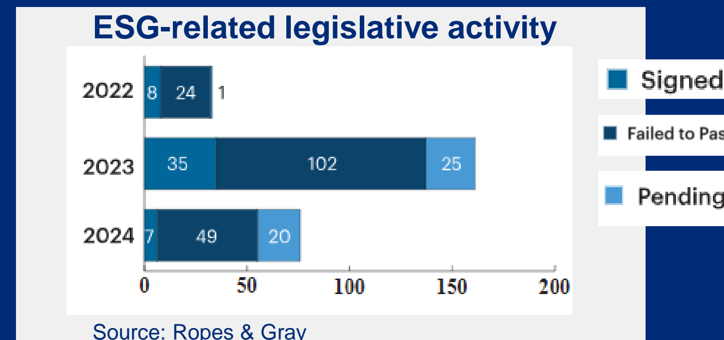
Trends & Outlook

With President Trump's return to the White House, it is anticipated that sustainable investing in the US will encounter policy challenges, similar to those during President Trump's first term when over 100 environmental regulations were rolled back, including those related to ERISA plans and proxy voting. This could impact investment flows in sustainability funds and increase uncertainty for sustainable investing as a whole. The following areas will be top of mind for the sustainable finance industry as the administration takes control of the oval office:

- **The IRA**: The 2022 Inflation Reduction Act (IRA) is the largest climate change legislation in U.S. history, allocating nearly $370 billion for initiatives like tax credits for efficient appliances, new battery plants, and renewable energy subsidies. It has spurred a boom in construction and manufacturing, particularly for solar panels, and created hundreds of thousands of new jobs. As of 2024, more than three quarters of announced clean energy investments are in Republican districts. While President Trump has signed an executive order to pause funding for some IRA programs, the IRA is well entrenched in the US economy (with over $200 billion in investments underway) and Congress controls the spending as well as any changes to rollback the IRA would require passing of another act by Congress. This may present challenges when repealing some of the IRA funds and lawmakers may not want resources removed from projects already underway in their districts.
- **Anti-ESG litigation** The rise in anti-ESG legislation can be partly attributed to a response to the 2022 U.S. Department of Labor's (DoL) rule allowing ESG factors in private retirement plans and rise in divestment from fossil fuels. As shown in the chart below, by mid-2024, there has been a notable decrease in ESG-related legislative activity, with only half the number of bills proposed and a quarter enacted compared to 2023. A significant increase in 'anti-ESG' litigation at the state level is not expected, as many supportive ESG policies have already faced courtroom challenges regarding their enforceability. However, ESG may now receive more national attention in the US Congress and the White House, especially with the appeal on the DoL's ESG rule still pending in the Northern District of Texas. The outcome of the case could play a critical role in predicting future litigation in this space. The President may also choose to revoke the Rule at the federal-level.
- **The change in SEC leadership**: A Trump-appointed SEC leadership is expected to have implications for sustainability- related rules, for instance influencing whether the SEC's Climate Disclosure rule is implemented and overhaul the rules around ESG shareholder proposals to restrict the types of ESG-related resolutions put forward by shareholders. Further, the finalization and future adoption of SEC's draft ESG fund labeling rules to prevent greenwashing remains unclear under the new administration.
- **The Paris Agreement**: Similar to his first term, President Trump has signed an executive order to withdraw from the Paris Agreement, which will take a year to implement. The US withdrawal could impact international climate negotiations and postpone collective actions to combat climate change, impacting commitments to limit adverse impacts of climate change especially in emerging markets which rely on funding from developed markets like the US. This may hinder progress towards the Paris Agreement's goal of limiting the average temperature rise to 2°C, and it is estimated by Carbon Brief that another Trump term could potentially result in an additional 4 billion tonnes of CO_2e emissions by 2030 relative to a continued Biden administration.

The recent Palisades and Eaton wildfires and Hurricane Helene and Milton are raising awareness of the need for increased climate change resilience, as climate change and related risks are increasingly influencing the frequency and severity of natural catastrophe perils and losses. Munich Re estimates that global economic losses from natural catastrophes in 2024 reached $320 billion, with insured losses at $140 billion, leaving a protection gap of 56%. Both the economic and insured losses significantly exceeded the inflation-adjusted averages of the past 10 and 30 years, with the United States accounting for the largest proportion of global losses in 2024.

Globally, with China continuing to rapidly invest in green infrastructure and electric vehicles, along with supportive sustainability policies in most developed markets and increasingly in emerging markets, we anticipate that the certain markets will continue to see the economic impacts of sustainability shifts to a low-carbon economy and the potential implications of an increased focus on climate resilience. This is evidenced by record global investments in energy transition and advancements in electrification, water infrastructure, and grid technology.



Source: Ropes & Gray

Contributor:
Lovey Sidhu | Montreal
Sustainable Investment Specialist

Mercer Intellectual Capital

Summaries of key research papers

5

Mercer Intellectual Capital – Sustainable Investment

Click on the graphics to access our content!

Our research in recent years

Find more ESG insights from **Mercer** on [MercerInsight Community]

Consultants should pinpoint key ESG topics for their clients and consistently share sustainability-related research from Strategic Research. This approach can facilitate discussions, showcase Mercer's expertise and capabilities, and strengthen client relationships through better understanding of their needs.

Mercer's Investment Philosophy

Updated over 2024

We understand that every investor has unique objectives. That's why we offer a range of proprietary tools, a breadth of expertise, global scale and decades of experience to help you achieve your specific goals. We believe that an effective investment strategy requires clear thinking. The investment philosophy, which imbeds sustainability principles, outlined below serves as the foundation of our approach to help drive client success.

Client objectives: Investment success hinges on clearly defined investment goals. An investor's true risk lies in not being able to meet their primary objective. Aligning governance processes is essential for driving investment performance

Strong governance: Robust and high-quality governance processes are fundamental to achieving successful investment outcomes. Strong governance becomes even more essential during periods of stress. Establishing clear accountability for results promotes disciplined decision-making and risk-taking. **Effective stewardship plays a crucial role in improving investment outcomes.**

Rewarded risk: Asset allocation is the most important factor influencing risk and return outcomes. While risk and return are related, the relationship can vary over time. Understanding how risks interact is critical to making informed investment choices. Investors should focus on the risks that matter most to their specific circumstances. **Integrating financially material sustainability, transition and socio-economic risks into investment decision-making can potentially enhance portfolio resilience.**

Maximize value: Strategic asset allocation serves as the primary driver of value creation. Active management can be employed when the expected return benefits justify the associated risks and fees. For long-term investors, private markets can offer certain advantages over public markets. Dynamic asset allocation can add value to investment strategies. **Investing to solve long-term systemic issues may provide opportunities to improve risk-adjusted returns.**

Further details on the Philosophy can be found here.

Transition Today – A progress update

Research Paper Summary

Building on the 2023 Transition Today paper, Mercer launched an update to the research ahead of COP29. In this paper, we explore three investor-led approaches to portfolio transition and assess how institutional investors are approaching climate policy and investing for a net-zero economy:

1. **Decarbonization of investments**: we examine how investors might go beyond simple portfolio emissions reduction targets to evaluate emissions changes through attribution analysis, as well as the importance of including scope 3 emissions within strategic decision-making to align portfolios with real world transition objectives by incorporating broader, systemic risks.
2. **Climate transition alignment**: we provide examples of stock level and portfolio-wide approaches to alignment and how investors can build resilient allocations using tools such as Analytics on Climate Transition (ACT).
3. **Climate solutions investment**: we look at common approaches to setting objectives in support of climate transition, directing investment to funds that may benefit as economies transition to more sustainable means of production.

In this two-part paper, we initially assess the market environment for climate transition investing before exploring the various approaches that investors are taking in their climate strategies. Overall, we find that asset owners globally remain committed to pursuing the ultimate and unifying objective of halting and reversing global temperature increases.

Swing state – Investment themes and opportunities in 2025 and beyond

Summary

The global economy has faced significant shocks, including the Covid-19 pandemic, conflicts in Ukraine and the Middle East, inflation, and the rapid adoption of generative AI. These events have challenged traditional portfolio strategies, particularly diversification.

Our annual ‘Themes and Opportunities’ report titled "Swing State," highlights several dynamic factors affecting the investment landscape:

Market concentration is at a high.

Interest rates are decreasing as inflation is controlled.

Government debt in developed economies is strained, with potential increases under a new U.S. administration.

Emissions are rising despite cleaner technologies due to increased energy demand.

The report categorizes key themes and opportunities for the next five years and beyond into:

- **Regime Changes**: Enduring shifts in conditions.
- **Super-cycles**: Positions in economic and socioeconomic cycles.
- **Megatrends**: Long-term transitions reshaping the world.

Please click the image on the right to view the **full report**.

Awards

Environmental Finance

Investment consultant of the year and Thought Leadership: Mercer Sustainable Investment

Fourth time in a row, Mercer's Sustainable Investment team won the 'Investment consultant of the year', awarded by Environmental Finance. The SI team also won an award for global thought leadership for it's COP28 Transition Today paper.

We are thrilled to receive these awards and to be acknowledged for our ongoing leadership in sustainable investment. We continue to innovate, influence, and integrate our sustainable investment expertise throughout our broader business to enhance outcomes for our clients worldwide.

Fund of the year and Impact measurement and metrics - multi-asset/other: Global Impact Strategy

In 2024, the Global Impact Strategy was awarded the Fund of the year by Environmental Finance second time in a row. It is a global fund covering a broad spectrum of private market asset classes. The fund positively contributed to environmental and social outcomes.

Manager Research Update

Sustainability trends

Mercer Manager Research

Sustainability Trends

Performance of Sustainability Equity Funds

Performance of sustainable equities was mixed in 2024. The top performing sustainability funds were those exposed to companies committed to technology solutions. 2024 showed another strong year for communication services and info tech, particularly companies exposed to artificial intelligence (AI) which continued to boom as a theme. Sustainability funds with value exposure, or solutions companies typically in underperforming sectors such as Materials and Industrials, as we see for many environmental funds, are expected to underperform.

Clean Energy companies struggled to perform for another year as seen by the Global Alternative Energy index (-32%) and the S&P Global Clean Energy index (-26%). Strategies with exposure to the water theme will also have underperformed as the MSCI Global Sustainable Water (-11%) and S&P Global Water (-9%) also lagged the MSCI ACWI index (+18%) for 2024. The performance of broad environment indices such as the FTSE Environment Opportunities All Share Index only slightly lagged the broad market posting +17%. This somewhat highlights that while investing in niche themes like clean energy and water were out of favour, allocation to the broader environment and climate themes were more successful in 2024.

Broad sustainability index performance was mixed, either in line (i.e. FTSE4Good Global (+18%)) or lagging (Dow Jones Sustainability World (+12%)) the broad market. Strategies targeting sustainability or impact themes typically have less sector concentration and allocate across sectors and themes. That being said, some overweight allocation to certain sectors will have impacted performance. The health care sector underperformed significantly, leading to the underperformance of some sustainable and impact strategies. However, those with overweight allocations to info tech and financial were able to mitigate some underperformance.

We observe that the low carbon / ex-fossil fuel versions of the MSCI ACWI index outperformed the broad benchmark, as did various climate change indexes. Due to the optimization approach, these indices tend to display overweight allocation to low carbon emitting sectors or sectors containing more companies committed to decarbonization (info tech, consumer discretionary, and communication services) which outperformed in 2024.

Broadening the opportunity set

In 2023, we published a paper, providing an expanded definition of transition (Transition today – Portfolio decisions and actions). We are seeing investors beginning to spend more time considering broader risks such as physical damages, resilience, and adaptation finance. There also continues to be momentum around nature and biodiversity, as such, the lens around environmental issues continues to broaden. These interrelated risks are leading investors to take a broader and more holistic approach to transition that focuses on objectives beyond just carbon reduction targets (which is where most of the efforts have been to date) to consider mitigation and adaptation solutions that address physical risks. These investors are also recognizing not only that natural capital is critical to address climate change, but also that opportunities around the circular economy can be an important solution to many of these challenges and are seeking to integrate these concepts into investment decisions.

There are ideas in the listed space that capture elements of mitigation, adaptation, transition and biodiversity in a diversified environmental strategy. Within listed equities, there is a broader range of sustainability strategies to meet portfolio construction needs across diversified styles and sector allocation. An increasing opportunity set of investment solution with value style tilts are emerging as asset owners look for balanced style exposures within equities.

In private markets and real assets there are emerging opportunities where investors are looking beyond the traditional investments, that focus on these broader expanded transition themes. From energy storage, charging infrastructure, and grid modernization to ideas in natural capital and biodiversity with new product launches taking place.

Regulation and policy impact

In the year 2024, the market saw more scrutiny towards sustainable investing directed towards asset managers. We saw managers withdrawing from the Climate Action 100+ (CA100+) initiative for example – many due to an obligation not to engage in activism in accordance with the US as well as being subject to anti-trust and competitive laws.

Regulation for anti-greenwashing, has led to some managers changing their sustainable strategy name, particularly in light of new UK SDR regulation announced in 2024 but also for EU SFDR implemented. Some managers have attributed strategy name change to support their products being viewed in competition with mainstream equity funds.

Performance figures are for the 2024 calendar year ending 31 December 2024

Mercer Manager Research

Regional Index Performance

Benchmark	1 year (%)	3 years (% p.a.)	5 years (% p.a.)
MSCI ACWI	18.0%	5.9%	10.6%
MSCI World	19.2%	6.9%	11.7%
MSCI Emerging Markets	8.1%	-1.5%	2.1%
MSCI EAFE	4.3%	2.2%	5.2%
MSCI North America	24.5%	8.4%	14.3%

MSCI ACWI Factors

Benchmark	1 year (%)	3 years (% p.a.)	5 years (% p.a.)
MSCI ACWI Small Cap	8.2%	1.2%	7.2%
MSCI ACWI Value	11.6%	5.4%	7.2%
MSCI ACWI Quality	19.5%	6.8%	13.3%
MSCI ACWI Momentum	32.3%	6.2%	11.5%
MSCI ACWI Minimum Volatility	12.0%	3.1%	5.3%
MSCI ACWI High Dividend Yield	8.3%	3.7%	5.7%
MSCI ACWI Growth	24.5%	5.9%	13.3%

MSCI ACWI Sectors

Benchmark	1 year (%)	3 years (% p.a.)	5 years (% p.a.)
MSCI ACWI: Consumer Discretionary	20.7%	2.3%	9.9%
MSCI ACWI: Consumer Staples	4.7%	0.5%	4.3%
MSCI ACWI: Communication Services	31.9%	5.6%	10.1%
MSCI ACWI: Energy	2.9%	13.6%	7.8%
MSCI ACWI: Financials	25.1%	9.7%	9.9%
MSCI ACWI: Health Care	1.5%	-0.1%	6.3%
MSCI ACWI: Industrials	12.8%	6.5%	9.5%
MSCI ACWI: Information Technology	31.9%	11.4%	20.8%
MSCI ACWI: Materials	-7.7%	-2.6%	5.3%
MSCI ACWI: Real Estate	3.1%	-5.0%	0.0%
MSCI ACWI: Utilities	12.7%	3.2%	5.0%

Specialist Sustainability Indices

Benchmark	1 year (%)	3 years (% p.a.)	5 years (% p.a.)
FTSE4Good Global (FTSE4Good Developed)	17.9%	7.1%	11.8%
Dow Jones Sustainability World	11.9%	5.2%	10.2%
MSCI ACWI ESG Leaders	17.4%	5.3%	10.5%
MSCI Global Sustainable Water	1.5%	2.6%	11.2%
S&P Global Water	5.5%	-1.4%	8.1%
MSCI Global Alternative Energy	-32.3%	-22.0%	-4.0%
S&P Global Clean Energy	-25.5%	-17.3%	1.0%
MSCI Global Energy Efficiency	8.5%	-9.0%	23.9%
FTSE ET100	14.7%	0.7%	17.6%
FTSE Environmental Opportunities All Share Index	16.8%	4.2%	13.8%
FTSE ET50	13.3%	-0.3%	15.8%
MSCI ACWI LOW CARBON LEADERS	18.4%	5.9%	10.6%
MSCI ACWI Low Carbon Target	19.7%	6.1%	10.7%
MSCI ACWI ex Fossil Fuels	18.9%	5.6%	10.7%
FTSE Developed Paris Aligned (PAB) Index	18.7%	-	-
MSCI World Climate Paris Aligned Index	18.6%	5.6%	11.3%
S&P Developed Ex-Korea LargeMidCap NZ 2050 PAB ESG Index	21.4%	-	-
FTSE Developed Climate Transition (CTB) Index	18.6%	-	-
MSCI World Climate Change	25.5%	8.6%	13.9%
S&P Developed Ex-Korea LargeMidCap NZ 2050 CTB ESG Index	20.4%	6.3%	12.5%

Performance figures are as at calendar year ending 31 December 2024

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